March 23, 2009

Bezeq The Israel Telecommunication Corp. Ltd.

Annual Report for 2008

Chapter A - **Description of Corporation’s Operations**

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

Chapter C - **Financial Statements**

Chapter D - **Additional Details About the Corporation**

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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Chapter B – Directors' Report on the State of the Corporation's Affairs

Chapter C – Annual Financial Statements

Chapter D – Additional Details About the Corporation

Chapter A – Description of Corporation's Operations

In this report, which contains a description of the Corporation's business operations as at December 31, 2008, the Company has included forward-looking information, as defined in the Securities Law 5728-1968 (the Securities Law). Such information includes forecasts, targets, appraisals and assessments which apply to future events or matters the realization of which is not certain and is not under the Corporation's control. Forward-looking information in this report will usually be identified specifically, or by employing statements such as "the Company expects", "the Company assesses", "it is the Company's intention", and similar statements.

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

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

Bezeq The Israel Telecommunication Corporation Limited (the Company or Bezeq) along with the subsidiaries that it owns in whole or in part, whose financial statements are consolidated with the Company's, shall be jointly referred to in this periodic report as the Group or the Bezeq Group.

1. Description of General Development of Group Operations

1.1 Group Activity and Description of its Business Development

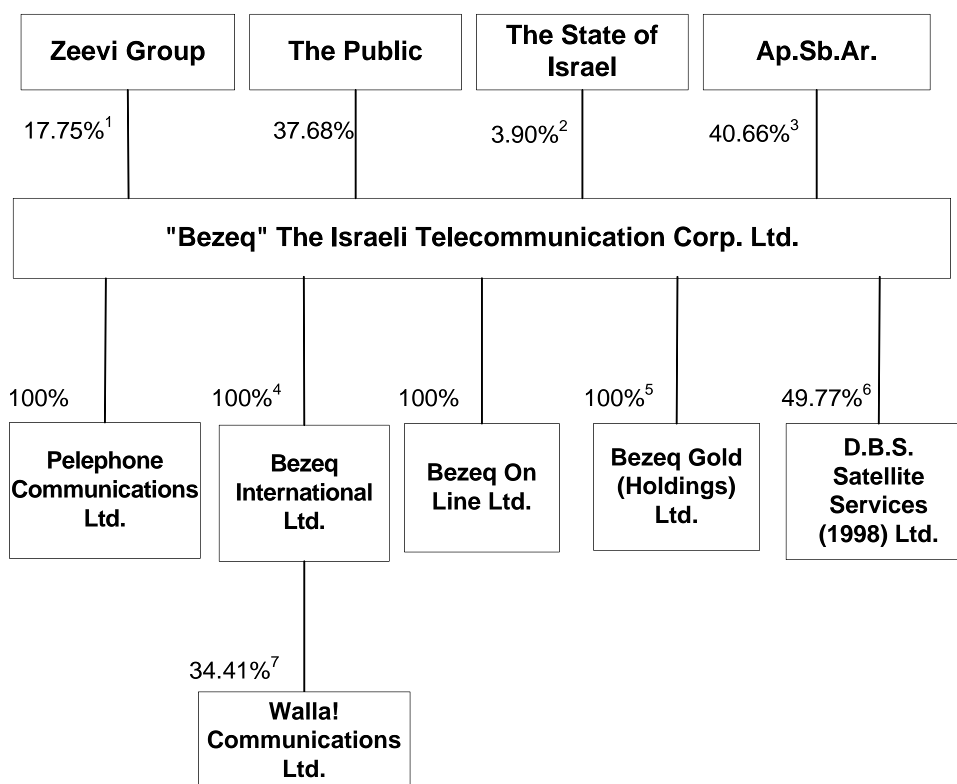
1.1.1 As at the date of this periodic report, the Bezeq Group is the principal provider of communications services in Israel. The Bezeq Group implements and provides a broad range of telecommunications operations and services, including domestic fixed-line, cellular and international communication services,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

1.1.2 The telecommunications sector is developing rapidly in global markets and in Israel. The telecommunications sector is affected by changes in technology, in relation to both the business structure of the industry and the applicable regulations.

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

1.1.4 Since October 11, 2005, the controlling shareholder of the Company is Ap. Sb. Ar. Holdings Ltd. (Ap. Sb. Ar.) which holds 40.66% of the shares in the Company (38.62% in full dilution) on March 23, 2009 after exercising an option to purchase 10.66% of the Company's shares held by the State (see section 1.3.1 below).

The following chart describes the structure of shareholdings of the Company, and the Company's shareholdings in its principal subsidiaries and affiliates, as at March 22, 2009.



The holdings in the diagram above are correct as at the date of publication of this periodic report. As set out in section 2.9.6 below, the State issued the Company's employees with 122,697,648 options, exercisable for 122,697,648 of the Company's shares held by the State. Under an employee option plan (apart from members of senior management), the Company allotted 78,151,368 options, exercisable into 78,151,368 of the Company's shares,[7] and as part of an options plan for senior managers and employees of the Group – 59,550,000 options (net, less expired options) exercisable into 59,550,000 of the Company's shares.

The following are details of the rates of holdings of the Company under full dilution, assuming exercise of all of the options allocated to the Group's employees and managers as at December 31, 2008 and March 23, 2009 .

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[1] Of this, 17.63% are held by Zeevi Communications Holdings Ltd., to which a receiver has been appointed, with authority to exercise the rights flowing from the shares in accordance with the ruling and approval of the Court. 0.12% of the Company's shares are held by D.E. Dirot Elite Ltd.

[2] For the option granted to Ap. Sb. Ar. to purchase up to approximately 10.66% of the State's shares, see section 1.3 below; for the options to employees for the State's shares in the Company, see section 2.9.6.1 below.

[3] The shareholders in Ap. Sb. Ar. are 1. SCG Israel Ventures LLC (capital 45%, voting 40.5%), controlled by private companies controlled by Haim Saban; 2. Purple Green Project and Investment Co. Ltd. together with Yellow Green Financing and Investment Ltd. (jointly: capital 45%, voting 40.5%), indirectly wholly owned (100%) by corporations in the Apax Europe VI Fund, managed by Apax Europe Managers Ltd. 3. Arkin Communications Ltd. (capital 10%, voting 19%), which is wholly owned (100%) by Moshe Arkin.

[4] A company whose only activity is to hold series 5 debentures of the Company (see section 2.13.7 and 2.17.1 below)

[5] As of the date of publication, the Company has option warrants which afford it the right to increase its holdings in DBS to approximately 58.36% (see section 1.1.5(A) below.

[6] 34.25% as at December 31, 2008 and 32.42% in full dilution

[7] Of this amount, 59,574 options were allotted to two employee-directors.

Shareholders	Percentage of holdings		
	As at December 31, 2008	As at March 23, 2009	Fully diluted
Ap. Sb. Ar.	40.66%	40.66%	38.62%
State of Israel	4.38%	3.90%	0.96%
Zeevi Group	17.75%	17.75%	16.86%
The Public	37.21%	37.68%	43.56%

1.1.5 Mergers and acquisitions

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

On August 2, 2006, the Company and DBS submitted merger notices to the Antitrust Commissioner regarding the exercise of options for DBS's shares by the Company, which, if exercised, will increase the Company's holdings in DBS from 49.8% to 58%. On December 31, 2006, the Antitrust Commission gave notice of the Antitrust Commissioner's objection to the merger and on May 15, 2007, the Company appealed the decision.

On February 3, 2009, the Antitrust Tribunal approved the merger under terms that are subject to approval by the Company within three months. The Antitrust Authority and Eurocom DBS Ltd. (a shareholder in DBS) appealed the Tribunal's ruling. In addition, after the Antitrust Authority's request to delay implementation of the ruling was denied by the Antitrust Tribunal and an additional request to delay implementation was filed with the Supreme Court, the parties reached an agreement, at the request of the Supreme Court, which received the effect of a ruling, whereby at this stage, implementation of the merger would be delayed. A hearing of the appeals was set for the first week of June 2009.

For additional details regarding the Company's investment in DBS, see also Note 33 to the Company's financial statements for the year ended December 31, 2008, included in this periodic report.

1.1.6 Disposals

Satellite communication operations

On March 26, 2008, the Company signed an agreement with RRsat Global Communications Network Ltd., a company registered in Israel whose shares are traded on the NASDAQ in the USA. The agreement was for the sale of the Company's satellite communications operations (Inmarsat and Bezeq Sat) and assets relating to such operations, including the satellite communications site at the Ella Valley. Under the agreement, the operations are to be sold in consideration for the total NIS equivalent of US $15 million plus VAT, subject to price adjustments. Completion of the transaction was subject, inter alia, to regulatory approvals and on November 4, 2008, the transaction was completed after the fulfillment of all the conditions required for its completion, including the receipt of the regulatory approvals. The Company recorded a capital gain of approximately NIS 50 million for this transaction (gross, before tax) in its financial statements for the year ended December 31, 2008.

1.2 Areas of Operation

The Group has four principal areas of operation. These four areas of operation are reported as business segments in the Company's consolidated financial statements (see also Note 28 to the Company's financial statements for the year ended December 31, 2008, included in this periodic report).

1.2.1 Domestic fixed-line communications

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

1.2.2 Cellular Radio Telephone (MRT)

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

and systems. These operations are performed by Pelephone Communications Ltd. (Pelephone).

1.2.3 International communications, internet services and NEP

International communications services, internet access (ISP) services, and NEP services. These operations are carried out by Bezeq International Ltd. (Bezeq International). Bezeq International also holds 34.25% (32.42% fully diluted)[8] of Walla! Communications Ltd., an Israeli company whose shares are listed on the Tel Aviv Stock Exchange and which provides internet and portal services (see section 4.14 below).

1.2.4 Multi-channel television

Multi-channel digital television broadcasts to subscribers over satellite (DBS) and provision of value-added services to subscribers. This operation is carried out by DBS Satellite Services (1998) Ltd. (DBS).

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

1.3 Investments in Equity and Share Transactions

1.3.1 In 2005, the State of Israel completed proceedings for the sale of its control core of the Company to Ap. Sb. Ar. In this context, the State sold to Ap. Sb. Ar., by way of private sale, 30% of the share capital of the Company (held in trust by Romema Investment Company Ltd.), and granted Ap. Sb. Ar. options to purchase an additional 10.66% of the share capital of the Company.

On September 25, 2008, Ab. Sb. Ar. acquired 277,697,862 ordinary shares of the Company from the State by fully exercising these options. The consideration for the option exercise is NIS 1.08 billion. Per Ap. Sb. Ar's request, ownership of the acquired shares is registered in the name of the trust company (Romema Trust Ltd.). As a result of the exercise of options, Ap. Sb. Ar's holding in the Company increased to 40.66% (38.62% fully diluted) and the State's holding declined as a result to 4.95% (0.96% fully diluted). From that date onwards, the State ceased to be an interested party in the Company by virtue of its holdings.

Note that Ap. Sb. Ar. has undertaken to the Company that during the four years following the date of execution of the new collective agreement of December 5, 2006 (see sections 2.9.1 and 17.4(F) below), Ap. Sb. Ar. will not purchase shares in the Company that will result in a holding for Ap. Sb. Ar. of more than 90% of the share capital of the Company, and shall not respond to a full sale offer. This undertaking is noted in the collective agreement signed on December 5, 2006 (see section 2.9.1 below).

1.3.2 Employee option plans

As at the date of publication of this periodic report, there are three option plans for shares of the Company:

A. An employee option plan of 2005, in which employees of the Company were offered up to 122,697,648 options for shares of the Company held by the State of Israel.

B. An employee option plan of 2007, in which the Company allotted 78,151,368 options for shares of the Company to its employees.

C. An options plan for managers and senior employees of the Group, of November 2007, for the allotment of up to 65,000,000 options for shares of the Company to senior managers and employees of the Company and its affiliates (the general meeting approved the issue of the options under this plan on January 31, 2008). Of this sum, as at the date of this periodic report, 59,550,000 options were allotted (net, less options that vested).

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

[8] See footnote 6 above.

1.4 Payment of Dividends

1.4.1 Pursuant to a resolution of the board of directors on March 1, 2006, resolutions regarding the distribution of dividends are to be passed specifically in accordance with the Company's financial results, financial state and the other relevant circumstances and data.

1.4.2 Below are details of distributions made by the Company in 2007-2008 and up to the date of publication of this periodic report

Date of distribution	Type of distribution	Total distributed amount (NIS millions)	Distributed amount per share (NIS)
January 9, 2007	Cash dividend	300	0.1151612
February 26, 2007	Cash dividend[9]	1800	0.6909668
October 15, 2007	Cash dividend	760	0.2917415
April 28, 2008	Cash dividend	679	0.260648
October 29, 2008	Cash dividend	835	0.3205318

In addition, on March 23, 2009 the Board of Directors of the Company resolved to recommend to the general meeting of shareholders of the Company to distribute a cash dividend to shareholders in the amount of NIS 792 million.

1.4.3 **Distribution of a cash dividend not in accordance with the earnings test**

On December 28, 2006, the general meeting of the Company's shareholders approved the recommendation of the board of directors of the Company to distribute a cash dividend of NIS 1,800,000,030 (amounting to NIS 0.6909668 per share), as a distribution which does not comply with the earnings test. The court approved the distribution on February 4, 2007, and the distribution was made on February 26, 2007.

1.4.4 It is noted that under the agreement between the State and Ap. Sb. Ar. for the sale of the controlling interest in the Company, Ap. Sb. Ar. undertook, inter alia, to operate by virtue of its holdings in a way that it would not make a distribution from the Company's accumulated retained earnings on December 31, 2000 (it was clarified that this would not prevent the distribution of earnings generated after December 31, 2000 in accordance with the Companies Law, 5759-1999).

[9] Distribution of a cash dividend not in accordance with the earnings test. See section 1.4.4 below.

1.5 Financial Information Regarding Areas of Group Operations

1.5.1 2008

	Domestic fixed-line communications	Cellular	International communications, internet services and NEP	Multi-channel television	Other	Adjustments to consolidated *	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Total revenue:							
From externals	5,179	4,448	1,243	1,506	31		12,407
From other areas of operations in the group	319	265	63	7	44	(698)*	
Total	5,498	4,713	1,306	1,513	75	(698)	12,407
Total attributed costs							
Costs not constituting revenues in another area of operation	3,743	3,614	928	1,222	73	10	9,590
Costs constituting revenue from other areas of operation	280	166	136	114	2	(698)*	
Total	4,023	3,780	1,064	1,336	75	(688)	9,590
Operating profit	1,475	933	242	177	-	10	2,817
Total identifiable assets as at December 31, 2008	7,325	4,641	947	1,129	51	(181)*	13,912
Minority percentage in the segment					28.19%		

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

1.5.2 **2007**

	Domestic fixed-line communications	Cellular	International communications, internet services and NEP	Multi-channel television	Other	Adjustments to consolidated *	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Total revenue:							
From externals	5,373	4,380	1,226	1,403	18	-	12,400
From other areas of operations in the group	340	304	78	12	46	(780)	-
Total	5,713	4,684	1,304	1,415	64	(780)	12,400
Total attributed costs							
Costs not constituting revenues in another area of operation	4,102	3,711	960	1,228	63		10,064
Costs constituting revenue from other areas of operation	332	168	140	139	1	(780)	
Total	4,434	3,879	1,100	1,367	64	(780)	10,064
Operating profit	1,319**	805	204	48	-		2,376**
Total identifiable assets as at December 31, 2007	7,756**	4,290	837*	1,097	59	(229)**	13,810 **
Minority percentage in the segment					17.5%		

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

** Reclassified

1.5.3 2006

	Domestic fixed-line communications	Cellular	International communications, internet services and NEP	Multi-channel television	Other	Adjustments to consolidated *	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Total revenue:							
From externals	5,514	4,141	1,219	1,339	19		12,232
From other areas of operations in the group	285	337	82	23	37	(764)	-
Total	5,799	4,478	1,301	1,362	56	(764)	12,232
Total attributed costs							
Costs not constituting revenues in another area of operation	4,670**	3,625	1,090	1,209	54		10,648**
Costs constituting revenue from other areas of operation	364	161	92	145	2	(764)	
Total	5,034**	3,786	1,182	1,354	56	(764)	10,648**
Operating profit	765**	692	119	8			1,584**
Total identifiable assets as at December 31, 2006	9,837	3,717	784**	1,008	47	(214)**	15,179**
Minority percentage in the segment							

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

** Reclassified

1.5.4 Principal results and operational data

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

	2008	2007	Q4 2008	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q2 2007	Q1 2007
Revenue	5,498	5,713	1,348	1,388	1,354	1,408	1,453	1,425	1,393	1,442
Operating profit	1,475	1,319*	257	422	428	368	380*	327	243	369
Depreciation and amortization	852	941	209	214	211	218	232	236	236	237
EBITDA	2,327	2,260*	466	636	639	586	612*	563	479	606
Investment in property, plant & equipment and intangible assets	616	504	170	156	132	158	141	149	101	113
Proceeds from sale of property, plant & equipment	117	153	20	12	25	60	23	16	96	18
Number of active subscriber lines at end of period	2,615	2,761	2,615	2,645	2,681	2,711	2,761	2,767	2,778	2,798
Average monthly revenue per line (NIS) (1)	83	87	82	85	82	84	86	86	86	89
No. of outgoing minutes (in millions) (2)	13,439	14,869	3,154	3,428	3,346	3,511	3,653	3,760	3,654	3,802
No. of incoming minutes (in millions) (3)	6,691	6,411	1,648	1,719	1,651	1,673	1,661	1,651	1,553	1,545
No. of ADSL subscribers at end of period (in thousands)	1,005	963	1,005	994	982	970	963	942	924	912
Average monthly revenue per ADSL user (NIS) (4)	67	64	67	68	66	68	69	64	62	62

* Reclassified

(1) Not including revenue from data transmission and communication services, internet services, services to communication operators, contract work and other revenue. In this section, there were minor adjustments in the prior quarters due to retroactive classifications and changes in revenue.

(2) Outgoing minutes were updated retroactively to exclude the number of direct dial internet calls and calls of Bezeq's operational lines.

(3) Incoming minutes were updated retroactively to include the number of international calls.

(4) The average monthly income for ADSL subscribers was updated retroactively to include revenue from equipment.

B. Pelephone

(NIS millions except where stated otherwise)

	2008	2007	Q4 2008	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q2 2007	Q1 2007
Revenue	4,713	4,684	1,138	1,214	1,188	1,173	1,182	1,203	1,152	1,147
Operating profit	933	805	159	293	266	215	133	219	240	213
Depreciation and amortization	523	478	135	129	130	129	125	121	115	117
EBITDA	1,456	1,283	294	422	396	344	258	340	355	330
Net profit	682	585	128	211	180	163	104	154	173	154
Cash flow from current operations *	1,277	1,228	298	379	344	256	245	387	241	355
Investment in property, plant & equipment and intangible assets	798	381	163	350	182	103	120	81	117	63
Proceeds from sale of property, plant & equipment	3	5	1	-	1	1	3	-	-	2
No. of subscribers at end of period (in thousands)	2,649	2,622	2,649	2,698	2,636	2,595	2,622	2,560	2,513	2,478
Average monthly minutes of use (MOU) per subscriber	352	354	335	359	358	355	358	363	350	344
Average monthly revenue per ADSL subscriber (NIS)	126	131	122	129	128	126	130	135	129	132
No. of subscribers at end of period (in thousands)	1,151	749	1,151	1,068	977	867	749	607	471	358
Revenue from value added services and content, of revenues from cellular services (%)	16.3%	12.7%	18.4%	16.2%	15.5%	15.0%	13.6%	12.8%	12.5%	12.0%

* From the fourth quarter of 2008, interest and dividends received were reclassified from cash flow from operating activities to investment activities. The data was adjusted retroactively.

C. <u>Bezeq International</u>

(NIS millions except where stated otherwise)

	2008	2007	Q4 2008	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q2 2007	Q1 2007
Revenue	1,306	1,304	337	329	326	314	334	326	321	323
Operating profit	242	204	65	59	63	55	45	54	54	51
Depreciation and amortization	80	87	20	20	20	20	21	21	22	23
EBITDA	322	291	85	79	83	75	66	75	76	74
Net profit	178	153	46	44	47	41	38	39	39	37
Cash flow from operating activities *	163	93	72	32	51	8	30	33	32	(2)
Investment in property, plant & equipment and intangible assets	118	104	26	33	31	28	36	29	18	21
Proceeds from sale of property, plant & equipment	1	4	1	-	-	-	2	2	-	-

From the fourth quarter of 2008, interest and dividends received were reclassified from cash flow from operating activities to investment activities. The data was adjusted retroactively.

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

D. DBS

(NIS millions except where stated otherwise)

	2008	2007	Q4 2008	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q2 2007	Q1 2007
Revenue	1,513	1,415	377	375	380	381	347	360	354	354
Operating profit	177	56	56	52	43	26	4	(4)	31	25
Depreciation and amortization	250	273	66	59	60	65	70	66	69	68
EBITDA	427	329	122	111	103	91	74	62	100	93
Net profit (loss)	(265)	(118)	(18)	(82)	(99)	(66)	(75)	70	(65)	(48)
Cash flow from operating activities	347	250	134	97	32	84	76	56	25	93
Investment in property, plant & equipment and intangible assets *	238	255	63	56	40	79	81	84	45	45
Proceeds from sale of property, plant & equipment	-	-	-	-	-	-	-	-	-	-
No. of ADSL subscribers at end of period (in thousands)	560	549	560	556	551	549	549	545	543	542
Average monthly revenue per subscriber (NIS)	228	217	225	226	230	231	212	220	218	218

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

1.6 Forecast for the Group

As the challenges facing the global economic environment have translated into a slowdown in the Israeli economy, Bezeq is monitoring the potential impacts on its business on an ongoing basis. Despite this challenging economic backdrop, in 2009 we aim to maintain EBITDA, operating cash flows and gross capital expenditures close to those of full year 2008 performance levels. This forecast is underpinned by the strength of Bezeq's comprehensive consumer and business communications offerings, a strict focus on improving operating efficiencies and strong operating cash flows. With specific regards to gross capital expenditures, 2009 will reflect continuing investment in Pelephone's HSPA network investment, which was successfully launched with national coverage at the end of January 2009, and the modular deployment of Bezeq's Next Generation Network (NGN), expanding its coverage to reach a meaningful part of Israeli households during 2010.

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

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

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

The Israeli communications market is characterized by a high level of concentration and a complex structure of cross-ownerships which are a fertile ground for the setting up of a number of communications groups operating on the basis of marketing cooperation between a number of companies and/or joint holdings for the supply of inclusive communications services, while using the marketing and operating advantages that such a structure permits. Given the regulatory limitations imposed at present upon the Group in the context of generation of cooperation between all of the companies in the Group, the Group is having difficulty providing an appropriate response to threats stemming from the increasing competition on the part of the other communications groups.

Global economic crisis

In the last quarter of 2008, the global economic crisis has sent global markets into a recession and credit crunch. It is expected that the impact of the process will continue to be felt in 2009 and possibly even later, and there will be a transition from growth to recession. The local market is also expected to experience a significant slump together with a deterioration in business operations and central economic parameters. The Company estimates that the crisis could have an adverse effect on its operations, however at this stage, it is unable to asses the impact of the crisis on the Group's operations. The Group is closely following the economic situation and the changes in its performance so that it will be able to provide a timely and optimum response to changes.

This information contains forward looking statements, based on the Company's assessments. The actual results may differ materially from these assessments if there is a change in any of the factors taken into account in these assessments.

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

2.1 General Information on the Area of Operations

2.1.1 Structure of area of operations and changes therein

The Company has a general license for the provision of domestic fixed-line communication services. The Company's services include telephony, broadband internet access (ADSL), home networks, transmission, information and data communication, IP-VPN, remote access, and maintenance and development of infrastructure. Other operations include the establishment and operation of broadcast facilities for radio and television transmissions, laying and maintenance of television cables, sale of terminal equipment, billing and collection services and other services to other communications operators, and IP Centrex. The telecommunications sector is developing rapidly in global markets and in Israel. The sector is affected by changes in technology, in relation to both the business structure of the industry and the applicable regulations.

2.1.2 Statutory restrictions and special constraints

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

The tariffs for the Company's main activities are subject to strict regulation under various provisions of the law. The tariffs are updated and change from time to time in regulations, inter alia, according to recommendations of the Committee for the Regulation of Bezeq's Tariffs. The tariffs were recently amended on June 1, 2008. The Company's interconnect tariffs were reduced as of June 11, 2008 (see section 2.16.1).

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

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

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

See section 1.5.4(A) above.

2.1.4 Developments in the market and in customer attributes

In recent years, competition between fixed-line and cellular telephony has intensified. In the past, almost all calls were made between two fixed lines, however today, in the Company's assessment, more than two-thirds of calls are made over cellular networks. The number of cellular subscribers has grown and reached approximately 9.1 million subscribers (according to data published by the cellular companies), while there has been a decline in the number of households and businesses holding a fixed line as well as a decline in the number of lines per customer. Furthermore, there has been an ongoing average decline in the Company's regulated and unregulated tariffs (see section 2.16.1 below). For a description of the development of competition in domestic fixed-line communications, see section 2.6 below.

2.1.5 Technological changes that materially impact the area of operation

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

In recent years, bandwidths to the customer home or business have been increasing, allowing penetration of applications required for high-volume data streaming at a fast rate as well as voice services for regular phone calls over the internet and/or IP networks. For a description of competition through the provision of telephony over the Company's broadband network (VoB), see section 2.6.1 below. Given this trend, the Company is adapting its infrastructures to allow it to provide its customers with significant bandwidths. For a description of the new generation network (NGN), see sections 2.6.7 and 2.7.2.

B. The increase in the number and capacity of cellular networks, along with technological enhancements, enable cellular service providers to compete with the Company's services more effectively in comparison to existing technologies.

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

D. Technological developments may enable other operators to build networks that provide services similar to those offered by the Company, at lower cost. Furthermore, as a result of the advances in technology on the one hand, and the aging technology implemented in the Company's systems, which may be difficult for suppliers to support, on the other hand, it may be necessary to switch to other technologies or to improve the existing systems.

2.1.6 Critical success factors in area of operations and changes therein

A. Regulatory decisions.

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

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

D. Technological and marketing innovation.

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

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

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

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

I. Maintaining brand values and adjusting them to the changing competitive environment.

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

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

network (inter alia due to regulatory decisions) by competing communications operators or operators intending to compete with the Company.

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

The main exit barriers are attributable to the following: the obligation of the Company, as stipulated in its license, to provide services at a defined quality of service on a universal basis; its being subject to the emergency regulations and the provisions of the Communications Order based on section 4(D) of the Communications Law; the obligation to some of its employees as part of collective agreements; long-term agreements with infrastructure providers; large investments requiring a long time to return on investment; and an obligation to repay long-term loans taken to finance the investments.

2.1.8 Substitutes and changes in products in the sector

In recent years, cellular communication services have largely become an alternative to services offered by the Company, in telephony as well as data communications.

There is also a growing trend of streaming voice over the internet or over public and private IP-based networks, using dedicated software provided free of charge or at a discounted price by companies in Israel and abroad. Furthermore, the internet enables email applications and instant messaging, which to a certain extent are also alternatives to telephone calls.

In the area of data transfer and communication services, technological advances enable the provision of new high-speed services at low prices.

2.1.9 Competitive environment and changes therein

The data transfer and communications sector, particularly at high band rates, was opened to competition at the end of 2000.

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

In the field of telephony, HOT Telecom, a partnership of the cable companies (HOT or HOT Telecom) started to provide services on a commercial basis on November 25, 2004. A number of companies were also given special general licenses for the provision of domestic fixed-line communications services, without an obligation provide services to everyone. Additionally, the Company views cellular telephony services as an alternative to the telephony services it provides.

Competition in the sector is dependent on a variety of factors, including provision of licenses to other domestic operators; possible changes to conditions of the licenses of the Company and the subsidiaries, and conditions of the licenses of their competitors; mergers and joint ventures between companies in competition with companies in the Group; financing universal service; the new services that the Company is permitted to offer; tariff policy and the level of flexibility available to the Company in offering service packages, including with subsidiaries.,

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

2.2 Products and Services

2.2.1 The Company provides a wide range of communications services to business and private customers. The main services offered by the Company include telephony, associated and value-added services, internet access, data transfer and communications over a wide range of infrastructures for businesses and other communication operators.

2.2.2 Telephony

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

Furthermore, the Company provides number services for businesses that enable incoming calls from anywhere through a single short speed dial (asterisk plus four digits), and via the 1-700, 1-800 area codes. These area codes enable business customers to determine whether the company or the customer will pay for the call. On April 7, 2008, the Ministry of Communications published a draft amendment to the license and service file of the toll free service (1-800). The significance of the amendment is, inter alia, that the Company's 1-800 subscribers will pay the cellular companies a much higher tariff for calls made to them from the cellular network. On May 6, 2008, the Company submitted its comments on this amendment to the Ministry of Communications. On November 26, 2008 the Ministry of Communications received a revised draft incorporating some of the Company's comments, including a more moderate increase paid by the 1-800 subscriber to the cellular operator. On December 17, 2008, the Company submitted its response to this draft.

The Company currently operates approximately 12,500 public telephones around the country that are operated by prepaid cards (Telecard), billing a Bezeqcard or calling collect. In 2005, draft regulations were compiled, designed to ease the obligation of deployment of public telephones, however the draft was not approved by the Knesset Economics Committee, which resolved that the Ministry of Communications should submit a revised draft. As at the date of publication of this periodic report, the Company is not aware as to whether an amended bill has been submitted by the Ministry of Communications, however to the best of its knowledge, the Ministry of Communications intends to start working anew in this regard.

Under the amendments to the license, commencing February 8, 2007, the Company is required to provide, itself or through another entity acting on its behalf, a telephone number information service for all subscribers of a fixed-line or cellular operator, with the exception of unlisted numbers, for the public and without payment via the internet and for its subscribers at a reasonable price through a service center. Since February 8, 2007, the Company has operated a unified service center, by a network code set by the Ministry of Communications (1344), including for the cellular operators and for HOT. This is in addition to the Company's 144 service.

Following the Company’s application filed for the sake of caution, on August 12, 2008, the Antitrust Commissioner granted the Company an exemption from obtaining the approval of the Antitrust Tribunal for a restrictive agreement to operate a telephone and online information service shared by all companies holding a domestic operator or cellular license. The exemption was granted under conditions and for three years.

The Company’s telephony services are among the main services provided by the Company, and in recent years they have been on a downward trend, in terms of both use and revenues. This is mainly due to the telephony services offered by competing domestic communications operators and alternative services provided by the cellular companies, since use of cellular phones is, to a great extent, an alternative to making a call on a fixed-line phone.

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

2.2.3 <u>Internet access services</u>

These services enable access to the internet and are in principle high speed internet services using ADSL technology

At the end of 2008, the Company had approximately 1,005,000 ADSL subscribers (compared to approximately 963,000 subscribers at the end of 2007), amounting to approximately 60% of the broadband internet market in Israel (based on items in the Israeli media regarding the number of subscribers who are not subscribers of the Company). For changes in the number of the Company’s ADSL subscribers and average monthly revenue per ADSL subscriber, see section 1.5.4(A) above.

The high speed internet market is one of the markets that has shown the most growth in recent years, and this growth is reflected in the Company’s business. As hundreds of thousands of customers have subscribed to high speed internet services over the past five years, this service has become one of the Company’s main operations and a major channel for its investments in technology, marketing, advertising and customer acquisition.

The high speed internet market is also marked by fierce competition against HOT, which offers high speed internet services over cable.

The Company's service portfolio regarding high-speed access service via ISP has been amended so as to enable broadband access to internet service providers (ADSL) without such supply being conditional upon the purchase of a basic telephone subscription (ADSL only). Payment for the ADSL-only service is prescribed by the Company, in accordance with section 17 of the Communications Law. According to the Ministry's decision, the Company started to supply the service on May 15, 2008.

2.2.4 Transmission and data communication services

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

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

The Company offers transmission services, including high speed services, to its business customers and communication operators over a variety of protocols (see section 2.6.3 below).

2.2.5 Other services

A. Services to communication operators

The Company provides services to other communication operators, including cellular, international, NEP and domestic operators, cable broadcasting licensees, ISPs, and Palestinian Authority communication providers.

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

B. Broadcasting services

The Company operates and maintains radio networks operated, inter alia, by the Israel Broadcasting Authority, television transmitters of Channel 1, Educational Television, Channel 2 and regional radio stations. The Company is only responsible for operation and maintenance of the transmitters for distribution of radio and television broadcasts and not for the content of the broadcasts. In this regard see also section 2.15.1 above.

C. Contract work

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

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

D. IP Centrex

The IP Centrex service is a virtual private exchange service.

E. Data Center

At the beginning of 2008, the Company launched its Data Center project, which enables provision of a total solution for customers, including in aspects of backup and survivability of services.

2.3 Revenue and Profitability of Products and Services

The following table provides data on the breakdown of the Company's revenues by the main products and services in its area of activity, which represent 10% or more of the Company's revenues (in NIS million and as a percentage of total revenues) over the past two years:

	2008		2007		2006	
	NIS millions	% of revenue	NIS millions	% of revenue	NIS millions	% of revenue
Telephony	3,572	65%	3,905	68%	4,148	72%
Internet	790	14%	712	13%	608	10%
Data transmission and communications	811	15%	754	13%	711	12%
Other services	325	6%	342	6%	332	6%
Total	5,498	100%	5,713	100%	5,799	100%

For updates of the information about the distribution of the Company's revenue by products and services, see Note 32 (G) to the Company's financial statements for the year ended December 31, 2008.

2.4 Customers

2.4.1 The Company is not dependent on any single customer or on a limited number of customers, which if lost would significantly affect the area of activity.

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

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

2.5 Marketing, Distribution and Service

2.5.1 The Company has marketing, sales and service systems for the private and business sectors, which include customer managers for the business sector, joint sales and service centers (including the 199 center) located throughout the country, technical support centers for private and business customers and 17 points of sale and service (the Bezeq Store network) around the country.

2.5.2 The Company markets its services mainly through advertising in the mass media and telesales centers, customer representatives and through a system of independent marketers including ISPs, DBS, sales centers working on an outsourcing model, D2D and resale systems that operate points of sale in shopping centers.

2.6 Competition

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

The Minister of Communications adopted the conclusions of the Gronau Committee for formulating detailed recommendations concerning the policy and rules of competition in the communication sector in Israel.

On March 12, 2008, the Gronau Committee published its report. The Committee was appointed by the Minister of Communications to formulate detailed recommendations regarding policy and rules of competition in the field of communications in Israel. On August 13, 2008, the Minister of Communications announced his decision to adopt the conclusions of the committee, subject to a number of changes and emphases, and they will become the policy guiding the Ministry in the years

to come. The Minister's decision increases the level of regulatory clarity to some extent. The main assumptions are described below.

Structural changes in the fixed-line sector

Recommendations of the Gronau Committee

1. To act to develop the wholesale market in the fixed-line sector, centered around the sub-loop unbundling obligation. In this context, the owners of universal infrastructure are required to sell services wholesale and lease access segments to competitors. For reasons of technological applicability, at this stage the local loop unbundling obligation will only apply to the Company.
2. Within 15 months of the date of adoption of the recommendation by the Minister of Communications, the regulating body will publish maximum tariffs for bitstream access and resale services in the wholesale market and the conditions for provision of such services. Such tariffs and conditions are to be determined subsequent to hearing the positions of the entities operating in the segment.
3. To issue a permit to the Company's subsidiaries to supply subsidized bundled service packages,[10] which include Bezeq Fixed-Line telephony and broadband services and IPTV, after implementation of the arrangement set out in section 1 above. On that date, the subsidiaries of the Company shall also be entitled to receive special licenses for the supply of domestic operator services that are not VOB.
4. The structural separation in the Company is to remain so long as there are only two companies with nationally deployed fixed line infrastructure. Likewise, if the Minister of Communications finds, within a reasonable time of implementation of the local loop unbundling (LLU) arrangement (no longer than two years), that the Company's actions are preventing expansion of competition in the domestic communications market, the recommendation is that he will exercise his powers under section 4(D2)(3) of the Communications Law regarding structural separation between operation of the infrastructure and operation of services at the Company.

The decision of the Minister of Communications

The Ministry of Communications will start to prepare the regulatory and pricing infrastructure required in the wholesale market, including LLU arrangements. However, to encourage the Company to realize the arrangements of the wholesale market as soon as possible, the Company will be permitted to present the Ministry with a commercial agreement for the supply of wholesale services with a communication operator, which is not a subsidiary of the Company.

The Minister agrees with the Committee in respect of the importance of upgrading fixed-line communication infrastructure. Therefore, if the Minister believes that there should be incentives for the Company, which will advance universal and rapid deployment of the NGN, he will act accordingly.

Tariff flexibility for Bezeq – alternative service packages

Recommendations of the Gronau Committee

So long as the Bezeq Group's market share is greater than 60%, supervision of the Company's tariffs shall continue in the format of fixing binding tariffs (fix). Various restrictions (as set out in the recommendations) shall be set with respect to approval of alternative tariff bundles for the Company. With respect to supervised tariffs – up until the middle of 2009, cost-based tariffs will be prescribed for call completion on the fixed-line network. With respect to non-supervised tariffs, loyalty discounts will be prohibited so long as the Company is a monopoly. PRI lines – if there is no significant change in market share, the prices of these will come under supervision.

The decision of the Minister of Communications

To improve the process for approving alternative service packages and provide a higher level of certainty for the Company, the Minister decided to change the system for approving alternative payment packages, such that the Company will not be required to wait for the explicit approval of both Ministers, and will be able to offer the package 45 days after submitting a detailed application to the Ministry of Communications, unless the Minister of Communications or the Minister of Finance informs the Company of their objection to the application. Note that the Minister adopted the recommendations of the Committee because as long as the Group’s market share is more than 60%, supervision of the Company’s tariffs will continue in the format of fixed prices and in the matter

[10] For which there is no obligation that any service included can also be purchased separately under the same terms as in the bundle.

of the alternative payment packages – the maximum discount allowed will be higher as long as the Group's market share in fixed-line telephony is smaller (it will be 15% provided that the market share is higher than 85%; 25% when the market share is between 75% and 85%; and 40% when the market share is between 60% and 75%). Note that according to the recommendation, the alternative payment package will only be approved if it is feasible for at least 30% of the subscribers consuming the services offered in the package.

Competition in the mobile sector

Recommendations of the Gronau Committee

It is necessary to accelerate the regulation processes required for the entry of mobile virtual network operators (MVNO), to accelerate the WiMAX tender in order to strengthen competition in the mobile sector and additionally, during 2009, to check the cost of call completion on mobile networks and to amend the tariff accordingly.

The decision of the Minister of Communications

The Minister instructed the Director General of the Ministry of Communications to work towards advancing the licensing policy for MVNO. On January 5, 2009, the Ministry of Communications scheduled a hearing for a license to provide cellular services involved in using the cellular system of another operator and the terms and reservations in the submission of the application. In this regard, see also section 3.7.2 below.

Multi-channel television – basic channel package

Recommendations of the Gronau Committee

Setting up of a narrow basic channel package, including 5-10 channels (open channels and channels of special social or cultural value), with the possibility that the regulating body might determine the price of the package.

The decision of the Minister of Communications

The Minister decided to conduct a more comprehensive examination of all aspects of broadcasting. Therefore, he announced that in the near future, it is his intention to appoint a committee to provide recommendations regarding policy and terms of competition in the multi-channel and commercial television sector. Note that the Minister of Communications appointed an inter-ministerial committee to regulate commercial television broadcasts and on October 12, 2008, the committee scheduled a hearing. In this regard, see also section 5.1.3.3 below.

Structural separation in the HOT Group

Recommendations of the Gronau Committee

Enforcement of structural separation between HOT Broadcasts and HOT Telecom in the framework of their licenses, in accordance with the existing format in place in the Company

The decision of the Minister of Communications

The Ministry will work to ensure that companies in the HOT Group comply with the rules of structural separation established in their licenses, with the exception of the option available to the companies to market service packages that include services offered by the companies on a regular basis, as is currently permitted by their licenses, contrary to the committee's decision, according to which the rules of structural separation should be enforced in the format applicable to the company. In this regard see also section 2.6.1 above.

The guidelines for structural separation should allow the implementation of the recommendations regarding the wholesale market in general, and its prices in particular.

International call sector – entrance of players controlled by cellular companies to the international calls market

Recommendations of the Gronau Committee

The committee recommends that international call tariffs via mobile telephones will be prescribed by the international calling company, and that company will make payments to the cellular company at the tariff determined in the Interconnect Regulations for call completion on mobile networks. Furthermore, new players controlled by the cellular companies shall be permitted entry into the international call sector.

The decision of the Minister of Communications

The Minister is of the opinion that the recommendations of the Committee regarding setting fees for outgoing international calls using a mobile network in the framework of the interconnect regulations should be advanced.

General

Additional committee recommendations adopted by the Minister of Communications – Consumer issues

The OECD recommendations are guidelines for addressing consumer issues. It shall be prohibited to change fixed tariffs in a contract with customers during the contract term, the term of contracts shall be limited to 18-24 months and the prevention of transfer due to the tying of purchase of a handset to purchase of services will be removed.

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

At this stage, the Company is unable to assess the precise impact on its business results and those of its subsidiaries.

See also updates to sections 3.7, 4.1.2 and 5.1.3.2 below.

2.6.1 Telephony

Competition with HOT, which received a general license for the provision of domestic fixed-line services including telephony, is increasing, and is expressed, *inter alia,* in offers by HOT which combine broadband internet, telephony and cable television, aimed mainly at households. In addition, HOT markets telephony services to business customers.

The Company petitioned the High Court of Justice against the Minister of Communications, in an application for immediate enforcement of HOT's obligations and commitments under its license, concerning structural separation. The petition was amended so as to include the Company's reservations against amendment of HOT's license enabling it to market a basket of services including HOT Telecom services and broadcast services provided by HOT's broadcast company. On January 7, 2009, proximate to the court hearing, the Ministry of Communications scheduled a hearing for the Company and HOT to amend HOT's general license, including reservations regarding structural separation. In the hearing on January 8, 2009, the court ruled that since there might be a decision to amend HOT's license in the near future, there is no point in hearing the petition. The State attorney will file updated notice within 4.5 months from the hearing. HOT and the Company will be given the opportunity to respond. Once all the notices are filed, the court will decide whether to continue with the petition.

On December 2, 2007, implementation of the number portability program commenced. Number portability increased the level of competition in domestic operator sector. In this regard, see also section 2.6.6(A) below.

As of September 2004, the Minister was entitled to issue special general licenses for the provision of domestic fixed-line telecommunications services, including telephony, with no obligation to provide universal service or minimal geographical deployment. To the best of the Company's knowledge, such licenses were granted, inter alia, to GlobeCall Limited Partnership (which was merged with Barak and NetVision), Cellcom Fixed-Line Communications Services Limited Partnership, 012 Telecom Ltd. and Partner Fixed-Line Communication Solutions (trial license). The operators which received such licenses provide services in accordance with their licenses. Two subsidiaries, Bezeq International Ltd. and Pelephone Communications Ltd. applied for these licenses. On February 8, 2009, a corporation wholly-owned by Bezeq International received a special general license to provide VOD service (see sections 3.7.4 and 4.1.2.2 below).

According to the announcement of the Ministry of Communications on March 9, 2009, in November 2008, the market share was 82.3% in the residential sector and 88.1% in the business sector. Additionally, commencing from November 2008, the Ministry of Communications also measured the market share using a new format recommended by the Gronau Committee – separate measuring for regular lines and for traffic lines. In accordance with the new measuring system, the Company's market share based on normative income is 80.7% for regular lines and 84.4% for traffic lines.

On February 1, 2009, the Ministry of Communications scheduled a hearing to consider ordering the Company to stop using the conventional tariffs system in PRI service, regarding the price determined by the Company in the price list and the special marketing offers in relation to service. In addition, the Ministry of Communications dismissed the Company's application for an alternative basket of payments for PRI traffic.

VoB service policy[11]

Pursuant to a policy paper published by the Ministry of Communications on January 31, 2007, the Company and its subsidiaries shall be entitled to supply VoB services only after the Company's market share in the field of domestic fixed-line telephony in any particular customer sector (business or private) falls below 85%. With respect to calculation of market share, see section 2.16.2 below. On August 12, 2008, the Company applied to the Ministry and requested, for the sake of good order, to make an addition to the Services Addendum to the Company's license for broadband telephone service, if it reaches a market share of 85%. It is noted that according to the Ministry of Communications' announcement on August 25, 2008, the Company's market share has dropped to below 85% in terms of normative revenue, as at June 2008, in the fixed-line telephony sector (private sector)(see the announcement of the Ministry of Communications in respect of the market share in November 2008). As stated above, on February 8, 2009, a wholly-owned company of Bezeq International received a special general license to provide service.

Regarding the call completion tariff in the network of a VoB operator, it was determined that it will be the same as the payment for call completion in a public telecommunications network of a fixed-line domestic operator (in other words, the same as the payment which the Company receives for completing a call in its network), for two years from the effective date. No later than by the end of two years, the Ministry will re-examine the arrangement, noting, inter alia, the actual development of competition in the field.

According to the policy document, the Company will also not receive additional payment from a VoB operator who uses its network, beyond the payment made by the end user for the broadband access service.

The regulation for the provision of a private organizational network in IP technology for transferring calls will be similar to that for NEP services. In this context, the policy document notes that the Ministry of Communications intends to adapt the NEP service licensing policy for a body that is one legal entity even if not in continuous premises, and to consider expanding the use of the IP/VPN service to intra-organizational telephony.

Implementation of these provisions could harm the Company and its ability to compete in a way that cannot be assessed by the Company. Implementation of ADSL only (see section 2.2.3 above) could increase the attractiveness of VoB services offered by the competitor.

For the positions of the subsidiaries Pelephone, Bezeq International and DBS in this regard, see (respectively) sections 3.7.4, 4.1.5 and 5.6.5(G) below.

2.6.2 Broadband internet access

In the broadband internet sector, competition has been keen since the cable partnerships (now HOT) began competing with the Company in this sector in March 2000. On March 5, 2008, the Ministry's decision was handed down regarding requiring the Company to provide broadband access to internet service providers without a telephone line (see also section 2.2.3 above).

HOT has access to a cable and fiber-optic infrastructure over significant parts of Israel and a relatively high penetration rate into homes in those areas. The cable network underwent a major upgrade recently and is currently a digital broadband network. A wide range of advanced communications services and advanced interactive applications can be provided over this network. This network is currently the main universal alternative for competition against the Company in the private sector.

In 2008, the cellular companies deepened their broadband operations on cellular infrastructure in the private sector as well as in the business sector.

2.6.3 Data transmission and communications

[11] Voice over Broadband

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

Cellcom has set up an independent backbone to connect its switches, which it uses for both its own purposes (instead of transmission which in the past was provided by the Company) and for competition against the Company in the data transmission and communications market.

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

2.6.4 Competition from cellular companies

The penetration rates of cellular technology in Israel are among the highest in the western world. The Company's opinion, which is not accepted by the Ministry of Communications or the Antitrust Commissioner, is that the penetration rate, combined with airtime tariffs which are low in international terms, have made cellular phones a product which is largely interchangeable with telephone lines. Over the past two years, there has been steady erosion, albeit at varying rates, in the number of voice minutes over the Company's network, as a result of a slowdown in the pace of growth of the cellular companies. There has also been an increase rise in calls from the networks of fixed-line domestic operators to the cellular networks. The Company believes that increasing interchangeability between fixed-line and cellular telephones is one of the reasons for the growing rate at which telephone lines are being removed, to the extent that approximately 16% of Israeli households today do not have a fixed line (compared to approximately 5% in 1996).

Cellcom is operating in the domestic communications market, and to the best of the Company's knowledge, Cellcom has deployed a fiber-optic infrastructure reaching, inter alia, industrial and commercial sites, office buildings and business centers. This infrastructure is used by Cellcom to connect business customers to its installations in order to provide communications services as an alternative to the services the Company is currently providing to some of these customers. Entry into the domestic fixed-line telecommunications market has enabled Cellcom to offer its customers a complete line of solutions, including domestic telephony, and data and cellular communications, while using its own infrastructure and sales system.

Partner Fixed-Line Communication Solutions has also been granted a license for providing domestic fixed-line services and it has recently launched fixed-line telephony services with VoB technology and ISP services.

2.6.5 VoB service policy [12]

In July 2007, an amendment to the Communications Law was passed, entitling additional content providers other than HOT to provide content upon subscriber demand over a broadband-managed access network, using IP technology. The significance of this amendment, according to the restrictions set out in it is, inter alia, that the Company's subsidiaries (apart from DBS) will not be allowed to supply that service.

In this regard, see also sections 5.4 and 5.6.5 below and section 1.1.5 above.

2.6.6 Additional factors that may affect competition

A. Numbering and number portability

On December 2, 2007, the number portability plan began to be implemented, enabling a transfer of customers between the various communication operators without changing their telephone numbers, and the petitions to the High Court of Justice filed by the cellular companies and by the Company were withdrawn by the consent of all of the parties, whilst reserving their rights.

Number portability increases competition and the strength of such competition, as well as customer awareness of the market.

Note that on May 24, 2007, the Company received a notice from the Director General of the Ministry of Communications stating that he was considering imposing financial sanctions on the Company under Chapter (G)1 of the Communications Law, 5742-1982, due to alleged breach of the duty to provide number portability as of September 1, 2006.

[12] Video On Demand (VOD) services

The Company, Pelephone and Bezeq International responded to the notices of the Ministry of Communications. On November 20, 2008, the Ministry asked the Company (and the other relevant licensees) for information about the dates of actual implementation number portability. According to the Ministry, the request was made to formulate its position on the question of the Company's compliance. According to information available to the Ministry, the Company did not provide number portability on September 1, 2006, under the provisions of the law and the number portability plan. On January 5, 2009, the Company submitted its position and the information to the Ministry.

On September 1, 2008, the numbering plan was amended such that in respect of the entitlement to number portability, a subscriber would be deemed to include an NEP licensee with allocated telephone numbers paying for use of these numbers, and the end user will not be entitled to port such a number. Nonetheless, the Ministry noted in an accompanying document that it intends to examine regulating the relationship between the end user and the NEP license holders, in whose name the telephone numbers are registered, so that the number portability regulation will also be applicable to the end users.

On May 4, 2008, the Company received an Administrative Directive from the Ministry of Communications to the effect that a customer which has been allotted a speed dial business number (asterisk plus four digits) may port such a number.

B. Other potential competing infrastructures

In addition to HOT's cable and fiber-optic network and Cellcom and Partner's fiber-optic infrastructures, there are a number of fiber-optic networks in Israel today, most of which are owned by State-owned companies or government agencies. These include Israel Electric Corporation, Israel Railways, Mekorot, the Oil Infrastructure Company and the Cross-Israel Highway Company. At this stage, there is no use of the aforesaid infrastructure in competition with the Company. Some municipalities are also attempting to create an alternative to the laying of pipelines by communications licenses, via the infrastructure held by such municipalities.

On March 1, 2009, the Ministry issued a policy for allocating frequencies for wireless broadband access networks. The Ministry decided that the Company and HOT Telecom would not be permitted to participate in a tender for the allocation of 3.5 GHz frequencies. Under the policy, allocation of access network frequencies will only be carried out according to the tender. In this context, significant weight will be given to the projected contribution of the offerer to improve consumer welfare and increase competition. This will be reflected in frequencies allocated for domestic operator services and for including characteristics in the framework of the weighting formula, for example, scope and rate of network deployment, including in remote or sparsely-populated areas, bandwidth and service quality for the subscriber. Regarding the preferences in the 3.5 GHz range, the Ministry ascribes great importance on providing preference in allocating access frequencies for operators interested in supplying universal broadband service nationwide, and therefore will prefer a new domestic operator to a special domestic operator. For 3.7 GHz frequencies, the Ministry decided that participation in the tender will be open to all domestic operators, including the Company, to allow service on these frequencies for the supply of broadband services in remote areas and as a complementary means. For allocation in the 2.5GHz range for cellular operators, see section 3.7.5 below. Parallel to the determination of the general policy, there were negotiations between the Company and the Ministry of Communication with respect to the allocation of alternative frequencies for the Company in return for vacating frequencies that the Company currently uses to provide services to the radio systems subscribers, as required by the Ministry of Communications (see section 2.16.8 below). On March 1, 2009, the Ministry notified the Company that it had decided to allocate an alternative 5MHz bandwidth in frequencies between 3.6 GHz and 3.8 GHz (the 3.7 frequency range). This alternative frequency is not included in the frequencies in the policy, and the Company is permitted to participate in this tender, so that it can be allocated 3.7 GHz frequencies.

C. Technological developments

The development of competition in the market, which harms market segments, rests, inter alia, on frequent technological developments and breakthroughs in the various communication sectors. Technological progress is expected to enable competing companies to introduce technology quickly at a relatively low cost, which will enable

supply of telephony and data communications services over private and public IP networks, as well as via advance cellular infrastructure. At the same time. the main traditional barrier to the entry of competitors into the sector – access infrastructure connecting the subscriber to the communication network of a competing operator – is becoming less significant. The rapid growth in the number of cellular and broadband internet subscribers, improved quality of sound and increasing bandwidth enabling alternative technologies have an adverse effect on the number of calls passing through the Company's network, causing a decline in its revenue from telephony services and moderating the growth potential in its revenue from advanced internet and data communication applications.

2.6.7 The Company's preparations and methods for coping with the growing competition

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

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

B. The Company worked to introduce broadband (high-speed) internet services using ADSL technology and is working to increase the number of customers it has in this area. The Company provides a secured business access service, which provides secure connectivity of branches and enables employees to connect from their homes to their organization’s network. It also launched an ADSL-based service for business customers and high-speed data communications services for business customers and communications providers.

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

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

E. The Company will implement a new billing system for business and private customers.

F. The Company is working to heighten awareness of the use of fixed-line telephony and to promote the use of other services which increase telephone use, such as numbering services, voice mail, marketing of digital cordless phones, telephone information services and other value-added services.

G. The Company is adjusting expenditures with the goal of focusing investments in fixed assets in growth activities and reducing operating costs. The Company has a policy of selective investments, effective utilization of existing resources and reducing the prices of the equipment and services it purchases. The Company has also changed the mix of its investments: less emphasis on investments for maintenance of existing items and greater emphasis on development of growing services (such as ADSL and IPVPN), and the integration of advanced information systems for achieving its marketing and business-related goals. Notwithstanding the foregoing, the Company's ability to make adjustments in its expenses in the short and medium term is limited due to its cost structure, which mainly comprises rigid short- and medium-term costs. These costs consist mainly of depreciation expenses and expenses related to salary and benefits. Furthermore, the Company has other operating costs such as infrastructure maintenance and leasing as well as maintenance of buildings, which are also rigid short-term costs.

H. In continuation of the Company’s examination of its integration into the process faced by other communications companies around the world, regarding the deployment of uniform infrastructure for transmission of voice communications services, high-speed internet services and content, leisure and entertainment applications, the Company’s board of directors approved the entry into specific content and implementation of the next generation network (NGN) (the Project). In this context, the board of directors approved detailed planning of the project, setting-up of two areas as operational pilots and the purchase of soft switches. The project will be implemented in modules with Company assessments on a regular basis, and after each stage of implementation it will reconsider the viability of continuing the project, looking at all the variables that could influence its viability and therefore the need to revise the project outline. The

content, pace of performance and the amounts to be invested in the project, will be determined each year in the framework of the annual budget of the Company. Accordingly, the work plan for 2009 was approved and the Company expects that it will expand the network coverage to a significant number of households in Israel in 2010. See also section 2.7.2 below and Note 9 (G) to the Company's financial statements for the year ended December 31, 2008.

I. In 2008, the Company continued to assimilate the new brand that it launched towards the end of 2007.

J. For a description of how the Company intends to cope with the impact of the global economic crisis, see section 1.7 above.

2.6.8 Positive and negative factors affecting the Company's competitive status

Positive factors

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

B. Presence in most businesses and households

C. Strong capital structure and positive cash flow

D. Expansive service infrastructure and various customer interfaces

E. Professional, experienced and skilled staff

F. Strong, well-known brand

Negative factors

Regulation

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

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

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

B. Lack of tariff flexibility

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

C. Obligation of structural separation

Under its license, the Company is required to maintain full structural separation, in the form set out in the license, between itself and those subsidiaries and affiliated companies that are specified in the license. There is also a separation between the Company's operations and those of Pelephone due to the conditions of the merger approved by the Antitrust Commissioner and the ruling of the Antitrust Tribunal regarding the merger of the Company and DBS under terms referring to structural separation between the two companies (see section 1.1.5 above). At this stage, the format restrictions that apply to the Company do not apply in practice to the other organizations operating in the communications market, and thus put the Company in an inferior position.

D. Universal service obligation

The Company is under an obligation to provide services to the entire public in Israel (universal service), and as a rule, the Company is in compliance with this obligation. This obligation is not imposed on the special local operator licensees, which can offer

their services to the Company's profit-bearing customers (particularly business customers), which represent a significant source of revenue for the Company.

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

E. Accessibility deficit

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

F. Amendment to the Consumer Protection Law regarding a fixed transaction (see section 2.16.9 below)

Labor relations

Labor relations in the Company make flexibility of its operations and its ability to deal with competition more difficult (see also section 2.20(D) below).

2.7 Property, Plant and Equipment

2.7.1 The Company's fixed assets primarily include: domestic telecommunications infrastructure, exchanges, various networks, real estate (property and buildings), computer systems, vehicles and office equipment.

2.7.2 Domestic fixed-line telecommunications infrastructure

This infrastructure is comprised of five principal components deployed throughout the country.

A. Exchanges

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

B. Transmission network

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

C. Data communications networks

Networks for the provision of data communications services at various speeds.

D. Access network

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

E. Terminal equipment

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

NGN

The requirements for communication services in Israel, as in the entire world, includes a requirement for increasing bandwidths and an advanced IP platform. In order to provide a response to these needs, the Company has started to gradually establish, commencing in late 2008, a new generation network (NGN) based on the core of the IP network and bringing fiber optic infrastructure to street switching cabinets (the topology of the network is referred to as fiber to the curb – FTTC). With this network, it is possible to supply broadband technology up to 50 Mbit/s in the download channel and innovative added-value

services. In addition, the NGN will allow the Company to make the network more efficient. The project for establishing the new network will be implemented gradually, with the pace of the deployment being tested annually. In this respect, see section 2.6.7, above, and Note 9 (G) to the financial statements for the year ended December 31, 2008.

The information in this section contains forward-looking information, based on the Company's assessments. Actual results might be substantially different from these assessments, taking into account the changes that might occur in technology and in the communication market.

2.7.3 Computing

The Company's IT system supports four central areas:

A. Marketing and customer management

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

B. Information systems for engineering infrastructures of the telecommunications networks

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

C. Information systems for management of Company resources

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

D. Cross-organization systems

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

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

2.7.4 Real estate

A. General

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

As at the date of publication of this periodic report, the Company has freehold or leasehold title or the right to lease approximately 425 real estate assets around the country. The total area over which the Company has full title or capitalized long-term lease rights (including joint long-term lease rights as set out below), amounts to approximately 1,185,000 sq m of land, of which approximately 355,000 sq m is built up. Six of these properties are in Judea and Samaria, covering lots of approximately 7,000 sq m and built up areas of approximately 500 sq m.

In addition, the Company has a right to land of approximately 7 hectares at Sakia (near Messubim Junction), for the purposes of storage and offices. The Company

received a draft contract for a planning permit for this land from the Israel Lands Administration (ILA) and submitted its reservations regarding the contract to the ILA.

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

In addition to these 425 properties, as at the date of publication of this periodic report the Company holds some 70 properties in Israeli settlements in Judea and Samaria, in a total area of approximately 9,600 sq m of land, on which about 1,700 sq m is built up. No written arrangement of the contractual rights in these properties exists, but in the Company's opinion, this does not constitute a significant problem.

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

As at the date of publication of this periodic report, the Company leases about 150 land assets, with a total area of 60,000 sq m, of which 55,000 sq m are built-up, from various lessors.

The Company has easements (rights of way, etc.) over other real estate (to erect transmitters and deploy cables). The Company also has about 330 concentration rooms at its disposal (rooms for cables and installations for the purpose of neighborhood communications), with a total area of approximately 4,400 sq m, most of which are not regulated by written arrangements of rights with the owners (such as: the Israel Lands Administration, settling organizations, entrepreneurs of projects on which the properties are situated, and cooperative house committees).

B Registration

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

C. Property settlement

On March 10, 2004, the settlement signed by the Company, the Israel Lands Administration (the ILA) and the State (the settlement agreement) was given the force of a judgment after a drawn out dispute over most of the real estate assets transferred to the Company under the real estate transfer agreement which was executed when the Company began its commercial operations. The settlement provided that the assets that remain in the Company's possession have the status of a capitalized lease. The settlement agreement also provides that 17 properties specified in the agreement will be returned to the State through the ILA on various dates (by 2010) and in accordance with the terms stipulated in the agreement.

As at the date of publication of this periodic report, the Company has returned 14 properties to the ILA. Three additional properties will be returned to the ILA after the Company receives substitute properties, in accordance with the settlement agreement.

D. Sale of real estate assets

During 2006-2008, the Company sold 21 assets (in full or in part), amounting to approximately $82.7 million. Out of this amount, in 2008, the Company sold three real estate assets in a total area of approximately 40,480 sq m in land and approximately 6,541sq m built-up area, for a total sum of $ 22 million.

Further to the renewed examination by management of the Company with respect to the sale of its real estate assets, the board of directors approved the continued sale of inactive real estate assets and/or assets that can be relatively easily vacated, without incurring significant expenses, in accordance with lists presented to it from time to time. Likewise, the board of directors approved a detailed working procedure with respect to the sale of the Company's real estate assets, and a procedure for

approving such transactions. The NGN should allow the Company to improve the efficiency of its network structure and the sell some of the real estate assets that will be vacated following migration to the new network.

From the second half of 2008, the real estate market in Israel experienced a slowdown, which led to a slump in the sale of the Company's real estate assets.

2.8 Intangible Assets

2.8.1 The Company's general license

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

2.8.2 Trademarks

The Company uses trademarks that reflect its products and services.

As of the date of this periodic report, the Company has approximately 130 trademarks registered in its name or in the process of being registered at the Registrar of Patents and Trademarks. The main trade marks are:

Bezeq – Company name

B – Company logo

The main trademarks are advertised in the various media outlets such as the press, radio, television, billboards and mailings.

The investment in advertising the trademarks is intended to increase the level of public exposure and awareness of the trademarks to create differentiation which will have an effect on customer purchasing decisions and preferences.

2.9 Human Resources

2.9.1 Organizational structure and employees according to organization structure

In 2006 and 2007, the Company worked in coordination with the workers' union to bring about a change in the Company's organizational structure, with the aim of making the Company compatible with the competitive market in which it operates, by focusing on the customer and achieving operational and procedural efficiency.

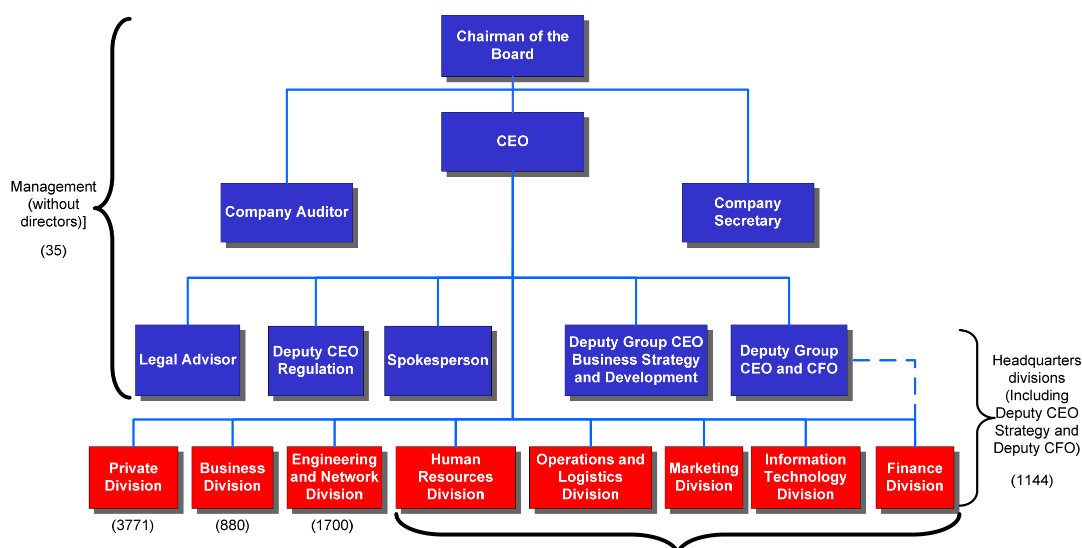
On December 5, 2006, a special collective agreement was signed between the Company and the workers' union and the New General Trade Union, setting out the employment relationships at the Company following transfer of control of the Company from the State of Israel to Ap. Sb. Ar. Holdings Ltd. The main points of the agreement are set out in section 2.17.4 below.

The new collective agreement provides, inter alia, that a total organizational change would be made in the Company based, inter alia, on a transition from a geographical structure to a functional structure, which would be implemented gradually over two years.

In addition, the collective agreement provides mechanisms for the payment of annual incentives (bonuses) in accordance with criteria prescribed by management.

In May 2008, the amendment to the new collective labor agreement was completed, concerning bringing forward completion of the implementation of the organizational structure and bringing forward the retirement dates and changing the mix of those scheduled to retire under the new collective agreement by the end of 2008.

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



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

2.9.2 Personnel according to employment framework

Description of employment framework	Number of employees	
	As at December 31, 2008	As at December 31, 2007
Senior managers excluded from application of the Company's collective bargaining agreements. Their terms of employment are set in personal agreements.	63	87
Permanent employees employed through collective agreements.	3,320	3,315
Employees employed through personal contracts that are not part of the collective agreements.	600	695
Employees employed under detailed agreements under collective agreement conditions (rank rating contracts).	183	341
Employees engaged in defined activities, which in the past were staffed by workers from employment agencies. The conditions of employment of employees in this category were recently updated in the special collective agreement of December 5, 2006 (Generation 2000 Employees)	0	55
Employees employed under the special collective agreement of December 5, 2006, on an hourly basis	2,241	2,192
Employees employed under the special collective agreement of December 5, 2006, on a monthly basis	1,123	926
Other	0	3
Total	**7,530**	**7,614**

Note: 1. In the matter of tenured employees employed under collective agreements: in 2008, 97 employees retired under this agreement (another employee was

transferred to the group of senior managers) and the increase is due to the transfer of 103 employees from other agreement frameworks to this framework.

2. Former Generation 2000 employees are included under the hourly collective agreement as are employees under the former temporary hourly agreement and new employees recruited for hourly employment. Former Generation 2000 employees who were hired to perform jobs that are monthly by nature are included under the monthly collective agreement, as are employees under former total salary contracts and new employees recruited for monthly employment.

Note that all 975 employees who were supposed to terminate their employment at the Company between 2006-2008 under early retirement tracks or increased severance pay tracks, under the collective agreement of December 5, 2006 (see section 2.17.4(f) below), have retired from the Company.

During 2008, the number of employees of the Company fell from 7,614 employees on December 31, 2007, to 7,530 employees on December 31, 2008 (a net reduction of 84 employees) as a result of retirements from the Company (in parallel with the recruitment of employees required, such as sales representatives).

In the fourth quarter of 2008, the Company's board of directors resolved to approve the resignation of 245 employees during the course of 2009, at a cost of NIS 177 million, in accordance with the terms of the collective agreement of December 2006.

2.9.3 Hiring and retirement of employees from January 1, 2008 through December 31, 2008

Employment framework	Intake	Retirement
Senior managers	2	27
Permanent employees	0	97
Employees under other employment arrangements	1,402	1,364
Total	**1,404**	**1,488**

Note that between January 1, 2009 and February 28, 2009 a further 72 permanent employees retired from the Company.

2.9.4 Company's investment in further study, training of employees and higher education

The Company conducts internal training sessions given by professional experts who are Company employees and at times, with the assistance of external organizations, in all its areas of activity. Total work days allotted to training of all employees in 2008 – approximately 31,000 days, or an average of 3.5 training days per employee. This training activity includes professional training in technology, sales, management, service and others.

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

Total investments by the Company in the above activities in 2008 amounted to approximately NIS 3.7 million, over and above the cost of work days of employees with respect to training and study days.

2.9.5 Nature of employment agreements at the Company

Labor relations at the Company are regulated, in addition to labor laws, by the collective agreements between the Company, the representatives of Company employees and the New General Federation of Labor (the Histadrut) and personal contracts. Additionally, expansion orders to certain general collective agreements apply to Company employees. These include agreements on cost-of-living allowance.

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

2.9.6 Employee remuneration schemes

2.9.6.1 Employee option plan of 2005

On November 15, 2005, the Company published an outline of an offer of the State's shares to employees of the Company. The offer is for up to 122,697,648 options, exercisable for up to 122,697,648 shares of the Company held by the State of Israel and constituting approximately 4.71% of the shares in the Company, exercisable in three equal portions after approximately two years, three years and four years following the date of allotment. As of January 1, 2008, the employees are entitled to exercise the first installment of the plan and as of November 15, 2008, the employees are entitled to exercise the second installment of the plan. In this regard, see also Note 26 to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

2.9.6.2 Employee option plan of 2007

On February 22, 2007, the board of directors of the Company approved an employee option scheme and on the same date, the Company published an outline with respect to the scheme. Under the scheme, the Company shall issue its employees with options exercisable for shares at 3% of the issued share capital of the Company, at an exercise price (adjusted for each kind of distribution etc.), of 50% of the last closing price of the share prior to the date of issue, (apart from senior management staff), for no consideration, in accordance with criteria prescribed in the collective agreement of December 5, 2006.

Accordingly, on March 25, 2007, the Company allotted 78,091,794 options (out of a total sum of 78,151,368 options[14]) to employees, exercisable for 78,091,794 ordinary shares of the Company of NIS 1.00 par value each at an exercise price of NIS 3.201 per share, linked to the CPI for February 2007 (adjustments for all kinds of distributions etc. shall apply to the exercise price). The options shall be blocked for a period of two years as of the date of their issue, and shall be exercisable over three years from the end of the blockage period.

The total value of the benefit to the employees under this scheme, according to the opinion of an external economic adviser, and based on the price of the Company's share as at February 18, 2007, is approximately NIS 170 million. However, the recording of the expenses for this scheme for accounting purposes cannot take into account the effect of the obstruction arrangements in the options, and therefore, the Company has recorded the sum of approximately NIS 287 million as a salary expense in its financial statements (see Note 26 to the financial statements of the Company for the year ended December 31, 2008, which are included in this periodic report).

2.9.6.3 Options plan for senior managers and employees of the group, of November 2007

On November 20, 2007, the board of directors of the Company resolved to adopt an options plan for managers, and senior employees in the Company and/or affiliates, allocating 65,000,000 non-negotiable options exercisable for up to 65,000,000 shares of the Company and comprising approximately 2.5% of the issued share capital of the Company, and at full dilution, approximately 2.36% of the share capital. The option warrants will vest in three equal annual portions. The vesting dates of each installment shall fall at the end of each of the first year, the second year and the third year after the date of grant, accordingly. The exercise price of each option is NIS 5.50, reflecting a discount of approximately 16.8% compared with the closing price of the Company's shares on the Tel Aviv Stock Exchange on January 31, 2008, the date of approval by the general meeting. The allocation under the plan shall be under the capital gain track, with a trustee as set out in section 102(b)(2) of the Income Tax Ordinance [New

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

Version], 5721-1961.The option plan and allocation of all of the options under it were approved by the general meeting of the Company on January 31, 2008, in accordance with the articles of association of the Company.

On December 25, 2007, the Company published an outline of an allocation of options from the plan in accordance with the Securities (Details of Outline of Offer of Securities to Employees) Regulations, 5760-2000, setting out the conditions of the plan, inter alia, and a report of private placement under the Securities (Private Placement of Securities in a Listed Company) Regulations, 5760-2000.

Accordingly, as at the date of publication of this periodic report, 59,550,000 options exercisable for up to 59,550,000 shares have been offered (less options that have expired) under the option plan, including to the CEO of the Company and the chairman of the board.

According to the resolution of the board of directors on June 26, 2008, the exercise price for each option allocated from this date onwards will be the same as the average closing price of the Company's share on the stock exchange in the 30 days' trading prior to the date of the board resolution to grant the options.[15] In addition, the options allocated to the chairman of the board will vest in 12 equal quarterly installments.

In this regard, see also Note 26 to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

2.9.7 <u>Company officers and senior executives</u>

As of the date of this periodic report, the Company has 16 directors[16] and 14 senior executives.

The two external directors acting on the board of directors of the Company receive remuneration in accordance with the Companies (Rules Regarding Remuneration and Expenses of an External Director) Regulations, 5760-2000. The other directors of the Company do not receive any remuneration or salary for their office as directors. On April 17, 2008, the board of directors of the Company, after receiving the approvals of the compensation and audit committees of the board of directors, approved the conditions of employment of the chairman of the board of directors as set out in the immediate report of the Company published on April 18, 2008. The conditions of employment of the chairman of the board of directors were approved by the general meeting of the Company's shareholders on June 1, 2008 and on September 28, 2008.

For the management agreement between a management company owned by the shareholders of Ap. Sb. Ar., see section 2.17.5 below and Note 29(D) to the Company's financial statements for the year ended December 31, 2008, included in this periodic report.

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

For 2008, payment of grants to members of senior management and the chairman of the board of directors was approved in the total sum of approximately NIS 8.9 million.

2.10 Raw Materials and Suppliers, Purchase of Equipment and Suppliers

2.10.1 The main raw materials used by the Company are: exchanges, copper cable, fiber-optic cables, transmission equipment, data communications systems and equipment, servers, routers and XDSL routers. The Company purchases most of the equipment required for its communications infrastructures from Israeli companies connected with communications equipment manufacturers from around the world. The Company purchases hardware and software from a number of main suppliers. Most of the equipment purchased for data communications, switching, transmission and radio systems was unique equipment, and it

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

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

has only been possible, over the years, to receive support services from the manufacturer (in this regard see also section 2.10.3 below).

2.10.2 The table below includes details of the rate of the Company's acquisitions from the main suppliers in 2008 and the type of agreement:

Main products	Main supplier	Form of agreement	Percentage of purchases out of the total purchases in the operating sector
Leased vehicles	Supplier A	Framework and orders agreement	6.8%

2.10.3 In the Company's opinion, it is dependent on the Alcatel Group, which is represented in Israel by Alcatel Telecom Israel Ltd., for public switching equipment. For collection systems for business customers, the Company is dependent on Amdocs Software Systems and for transmission, on ECI.

As for the Company's relationship with the Nortel Group, which is represented in Israel by Nortel Israel (Sales and Marketing) Ltd., the Company and Nortel have an upgrade and maintenance agreement for switches manufactured by Nortel, which was in force until the end of 2007. Prior to termination of the term of the agreement, a comprehensive examination was performed at the Company and it was found that in view of the Company's experience in operating Nortel switches, the low probability (based on past experience) of faults that the Company is unable to solve by itself, and the very high costs involved in renewing the agreement, it would be more correct not to renew the contract under the proposed conditions. As a result, the Company's dependence on Nortel dropped. For further information see section 3.1.3 below.

2.11 Working Capital

2.11.1 The cash and cash equivalents component and short-term investments in working capital are generally significant and designed to allow the Company flexibility in its activities.

2.11.2 The inventory purchased by the Company is for the most part intended for investment in fixed assets. The Company's inventory policy strives to maintain an inventory sufficient for the Company's needs for average consumption from time to time, with flexibility for special cases according to the nature of the consumption and price of the item. Orders from suppliers are made taking into consideration past demand and forecasts for the future.

2.11.3 The following table presents data on supplier and customer credit in 2008:

	Average scope of credit in NIS millions	Average days credit
Customers	996	EOM + 16
Suppliers	328	EOM + 30

2.12 Investments

For information on investments in subsidiaries, see Note 33 to the financial statements for the year ended December 31, 2008, which are included in this periodic report. See also sections 3 and 4 in Chapter D of this periodic report.

2.13 Financing

2.13.1 <u>**Average interest rate on loans**</u>

As at 31 December 2008, the Company is not financed by any short-term credit (less than one year).

Distribution of the loans:

Source of financing	Type of currency or linkage	Average interest rates
Non-banking sources	Index-linked shekels	4.31%

2.13.2 Credit limits

A. With respect to limitations on Company loans – see Note 13 to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

B. Bank of Israel restrictions regarding sole debtor and group of debtors

The Bank of Israel directives include restrictions on liabilities of a single borrower and of a group of borrowers towards the banks. These provisions may, from time to time, affect the ability of some banking institutions to issue additional credit to the Company. As the Company does not have data and exact information regarding the restrictions on individual borrowers that apply to the banks, and given the fact that the Company cannot quantify the number of debentures issued by the Company and held by the banks, the Company is not able to estimate when and at what level of debt, if at all, these restrictions will impact on the Company's ability to secure credit.

2.13.3 Credit received during the reporting period

Commencing from June 2008, the Company takes out on-call loans, usually in amounts that are not significant. As at the date of this report, the Company has no such loans.

2.13.4 Credit received after December 31, 2008

On March 12, 2009, the Company raised bank credit amounting to NIS 400 million. The credit was provided in the form of shekel loans (unlinked) for a period of three or four years at average interest (including commissions) of prime + 0.97% (at the date of the loan – 3.22%).

2.13.5 Variable interest

As at December 31, 2008, the Company had no variable interest loans. For the variable interest bank loan raised on March 13, 2009, see section 2.13.4 above.

2.13.6 Credit rating

The Company is rated by four credit rating agencies. The following are details of the rating given by each of the rating companies as at the date of publication of this periodic report (including latest rating updates):

Rating agency	Rank	Changes in rating	Type of credit rated
Standard & Poors Maalot	AA +	August 25, 2008: The Company's debt rating was raised from AA to AA+ with a stable forecast. The raised rating is based primarily on the Group's improved performance and operational effectiveness, the stability of the Company's managerial structure and the changes to the structure of the business risks as a result of the change in the mix of the Group's revenue. October 13, 2008: The validity of this rating was confirmed, and this, inter alia, following examination of the anticipated impact of the exercise of the purchase option (10.66%) executed by Ap.Sb.Ar. (see section 1.3.1)	All debentures series

Rating agency	Rank	Changes in rating	Type of credit rated
Midroog	Aa1	May 21, 2008: Return of the Company's rating outlook from negative to stable in view of the improvement in the Company's financial results, and the continued presentation of a strong financial profile, compensation for erosion in the fixed line communications segment via operations in the other segments and very low rates of financing despite the distribution of all of the net profit as dividend, after the transfer of the control core of the Company.	Debenture series 4 and 5
Standard & Poors	BBB+	August 12, 2008: Change in the Company's rating outlook from negative to stable, on the basis of its re-examination of its operating performance and the leverage within the company. The Company's rating relies, inter alia, on its leadership as the national communications operator, its operational efficiency, the range of services it offers in the communications market and its adequate financial profile. October 7, 2008: The validity of this rating was confirmed, following examination of the exercise of the purchase option (10.66%) executed by Ap.Sb.Ar. (see section 1.3.1)	The rating is for the Company
Moody`s	Baa1	November 24, 2008 – rating left at Baa1(stable)	The rating is for the Company

2.13.7 Estimate of fundraising in the coming year (2009) and sources of financing

The Company will repay some of its loans during 2009. If necessary, the Company will raise additional debt in 2009. The financing options open to the Company are: raising debt by the sale of series 5 debentures held by a wholly-owned subsidiary, Bezeq Gold (Holdings) Ltd., raising debt by new loans from banking corporations and/or by raising debt or capital on the capital market.

The Company estimates that it could raise from time to time short-term loans from banks and/or other credit suppliers to bridge any gaps in the cash flows, from time to time.

For the bank loan raised on March 12, 2009, see section 2.13.4 above.

2.13.8 Liens and guarantees

For information regarding the Company's liens and guarantees, see Notes 13 and 19 to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

2.14 Taxation

For information regarding taxation, see Note 8 to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

2.15 Environmental Quality

2.15.1 The Non-Ionized Radiation Law, 5766-2006 (the Law)

The Law regulates the handling of sources of electromagnetic radiation (Radiation Source), their erection, operation and supervision. The Law provides, inter alia, that the erection and operation of a radiation source will require a permit; imposes penal provisions and severe provisions with respect to liability of officers; imposes recording and reporting obligations on a permit-holder and grants the Commissioner for Radiation supervisory powers,

including with respect to the conditions of the permit, cancellation of the permit and removal of the Radiation Source. Note that the Company's installations, such as broadcast installations or wireless communication installations, are included under the definition of Radiation Source.

The Company obtained operating permits from the Commissioner for Non-Ionized Radiation at the Ministry of the Environment (the Commissioner), all in accordance with the Law for the communication facilities and broadcasting sites it operates.

Note that the Commissioner may require building permits as a condition of the continued validity of the operating permits for communications facilities (including broadcast facilities) granted by him. See also section 2.16.11 below.

The Company has work procedures for the set-up, operation and measurement of non-ionized radiation sources, and an appropriate compliance procedure which was approved by the board of directors of the Company.

New regulations regarding non-ionized radiation which were published on January 19, 2009 prescribe payment of fees for the filing of an application for a radiation source permit. Following approval of the regulations, the Company is expected to be required to pay fees in a non-substantial sum, which will be payable over a number of years. These regulations also prescribe criminal liability for failure to prepare measurements and report the measurements in accordance with the provisions of the regulations.

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

2.15.3 For claims filed regarding alleged radiation from the Hillel broadcasting station – see Note 17(A)(5) to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

2.16 Restrictions on and Supervision of Operations

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

2.16.1 Regulation of Company tariffs

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

A. The tariffs for the Company's supervised services, stipulated in these regulations are updated using a linkage formula, less an efficiency coefficient, as set forth in the regulations and based on the recommendations of public committees for the review of the Company's tariffs.

On March 20, 2008, a letter was received from the Ministry of Communications under which the next update of tariffs on June 1, 2008 will be based on the existing tariff outline prescribed by the Gronau Committee in 2003, in accordance with the formula set out in the Communications (Telecommunications and Broadcasts) (Calculation and Linkage of Payments for Telecommunications Services) (Amendment) Regulations, 5767-2007. According to the letter, after and to the effect that the Gronau Committee's recommendations regarding policy and rules of competition in the communications market are adopted, the path will be laid for the work of a commission to prescribe new tariff arrangements for the coming years. On June 1, 2008, the Company's tariffs were reduced in accordance with a formula fixed in the Calculation Regulations, at the average rate of approximately 2%, except for the fixed fee for a telephone line that was updated in accordance with the increase in the CPI (3.4%). The interconnect tariffs currently paid to domestic operators by licensees were reduced by an average of approximately 2%, effective June 11, 2008. From January 1, 2009, the interconnect charges for call completion are calculated by one-second segments instead of by 12-second segments. With respect to the update of the Company's tariffs, see also the update regarding publication of the recommendations of the Gronau Committee and their adoption by the Ministry of Communications in 2006 above.

In view of the fact that the Gronau settlement ended in 2008, after an extension of one year, the issue of tariff updates, and including the efficiency coefficient, is under discussion with the Ministry of Communications.

B. Pursuant to section 15(A) of the Communications Law, if tariffs are stipulated for the supervised services under the above section 15, the Minister may, with the consent of the Minister of Finance, approve the request made by the Licensee for an alternative payment basket for a package of services.

C. Under Section 17 of the Communications Law, "a Licensee may request a reasonable payment for a telecommunications service for which no payment is stipulated in Section 15." For these types of services provided by the Company (including broadband internet access service and business access) the Company sets tariffs and informs the Ministry of Communications of them in accordance with its general license For additional provisions of the general license regarding tariffs, see section 2.16.2 (C) below.

2.16.2 <u>The Company's general license</u>

<u>The Minister's policy paper</u>

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

Volume discounts - Once a competing domestic operator begins providing commercial telephony services, the Ministry will permit the Company to grant volume discounts of no more than 10% of the payment stipulated for the service, under Section 15 of the Communications Law. Such size discounts will be determined by way of an alternative basket of payments according to Section 15(A) of the Law. The discount shall not apply to the services for which discounts higher than 10% are set today in the regulations. Note that on May 24, 2006, an additional payments package (in force as of June 1, 2006) was approved by the Ministers of Communications and Finance, which allows the Company to give volume discounts of up to 10%.

Basket of services - Once the market share of the Company in domestic fixed-line telephony in a particular customer segment (business or private) falls below 85%, the Company's license will be amended so as to enable it to submit an application for the Minister's approval to market a basket of services in that customer segment, which includes telecommunications services provided by the Company and by a subsidiary, including broadcasts. The Minister's approval to market a basket of services will be granted on the status of competition in the area of telecommunications or broadcasts. The Minister's approval to market a basket of services will be granted, *inter alia, on* the basis of the following: (1) The existence of a group of services in a similar format, sold by a competitor as a package; (2) the Company and the subsidiary allowing customers to purchase any service included in the basket of services separately on identical terms to those offered in the basket; (3) that the basket of services be offered to customers on an equal and non-discriminatory basis. If even before the Company's fixed-line telephony market share falls below 85%, a material deterioration occurs in the competitive status of a subsidiary of the Company, stemming from marketing a package of services that includes, among other things, telephony by a competitor, the Minister will consider amending the Company's license as stated above.

In the Company's opinion, the conditions that will enable it to sell joint service bundles with its subsidiaries as set out above, harm the efficacy of such bundles.

On July 3, 2008, the Company received a draft amendment of the Company's license and the licenses of it subsidiary companies Pelephone, Bezeq International and D.B.S. regarding the marketing of joint service packages. On July 27, 2008, the Company submitted its position to the Ministry of Communications, stating that the amendment of the licenses represents an intensification of regulation in comparison to the policy document of the Minister of Communications dated March 31, 2004, which is supposed to reflect relief for the Company, and it would be appropriate to allow a model for marketing of joint packages of services that represents relief for the Company now that its market share has decreased to 85% or less, together with ministerial supervision using more moderate measures than those proposed in the draft amendment to the license. On January 22, 2009, draft amendments to the general licenses of the Company and its subsidiaries were submitted to the companies and published on the Ministry's website. The amendments addressed the approval for marketing of the joint packages. On February 8, 2009, the Company submitted its position, stating that the Company's material remarks were not

reflected in the draft, without explanation. The Company requested material amendments to the first draft amendment, including in respect of the required approvals and the obligation for unbundled package components. Regarding the positions of the subsidiary companies on this matter, see sections 3.18.3.1, 4.1.2 and 5.6.5, below.

According to the announcement of the Ministry of Communications on August 25, 2008, as at June 2008, the Company's market share has declined in the fixed-line telephony sector (private sector) to below 85% in terms of normative revenue. In addition, in accordance with the notice of the Ministry of Communications on March 9, 2009, commencing from November 2008, the market share is 82.3% in the residential sector and 88.1% in the business sector. For further information relating to this matter also see section 2.6.1 above.

Main points of the general license

A. Scope of license and obligation to provide service to all (universal service obligation)

The Company is required to supply basic services, ancillary and other services as set forth in the appendix to the license; the term of the license is not limited in time; the license anchors the Minister's existing powers under the Law, to modify, revoke and suspend the license; the Company is required to supply its services to all persons (the universal service obligation), on equal and nondiscriminatory basis with respect to each class of service, regardless of the location or the unique cost.

B. Rules of structural separation

The Company must establish a structural separation between it and a subsidiary, the definition of which, for this purpose, includes Pelephone, Bezeq International, DBS, Bezeq On-line, and BezeqCall Communications, and GoldNet which have, in the meantime, been merged into Bezeq International. The Minister has the authority to expand the application of the rules of structural separation to an affiliated company,[17] if it has been established that there is a real fear of injury to competition or to the public. Full separation is required between the managements of the various companies, including with respect to the business system, the finance system and the marketing system; full separation of assets; prohibition against employing the Company's employees at a subsidiary, and employees of a subsidiary at the Company (as at the date of publication of this periodic report, a small number of employees remain who were loaned, in the past, from Bezeq to Bezeq International and BezeqCall, due to an arrangement in the Company's previous general license and following the merger with Pelephone, Bezeq International now bears the costs of employment of these people); prohibition against the transfer of commercial information to a subsidiary (the definition of "commercial information" having been expanded to include commercial information regarding the Company as well). No employee of the Company may be appointed a director of a subsidiary, if, within the scope of his duties in the Company, he has access to "commercial information" concerning a competitor, the use of which by the subsidiary could damage competition between it and the competitor. This limitation on appointment does not apply to the chairman of the board of directors of the Company.

The Company must set rules and procedures to preserve the confidentiality of commercial information on licensees competing with the Company's subsidiary, and it is prohibited from transferring said information to the subsidiary. The Company has set such rules.

It is noted that on March 9, 2009, the Company received a letter from the Director General of the Ministry of Communications announcing that he is considering imposing monetary sanctions on the Company under section 37(B)(4) of the Communications Law, in the amount of NIS 15.024 million, for alleged violation of the provisions of the Company's general license regarding structural separation. The Company was given the opportunity to present its claims to the Director General of the Ministry of Communications by April 8, 2009 and is studying the contents of the letter.

C. Tariffs

Should the Director General (according to the license: the Director General of the Ministry of Communications or a person authorized by the Minister with respect to

[17] Parent company, subsidiary, interested party, affiliated company, related company or partner

licenses in general or with respect to this license in particular, as a rule or for a specific issue) announce that the Minister intends to set a tariff for a new service in accordance with Section 15 of the Communications Law, the Company shall not begin provision of the service before a tariff has been specified, unless the Minister so permits. The Company shall not charge a discriminatory price.

The Company shall provide service or a package of services, in respect of which no tariff is stipulated under Sections 15 or 15(A) of the Law, at a reasonable price, and shall offer them to any person so requesting, without discrimination, at a uniform tariff.

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

On April 14, 2008, the Company’s license was amended such that it is permitted to require a subscriber to pay by stop order or credit card, with the exception of a private subscriber who does not have a bank account.

D. Investments in other fields and restrictions on cooperation

A provision has been added allowing the Company to invest in any calendar year up to 25% of its annual earnings (not including the income of companies linked to the Company) in activity not designated for provision of the Company's services. The Minister is also entitled to authorize this percentage to be exceeded.

The Company's agreements for performance of services through another licensee requires the Director's approval and contractual arrangements for performance of telecommunications services or telecommunications operations in conjunction with another licensee or broadcasting licensee requires the Minister's approval.

The Company shall not conduct any activity and shall not be party to any agreement, arrangement or understanding which is designed or which might limit or harm competition in the field of telecommunications. The Minister may direct the Company on the steps to be taken in order to prevent harm to competition in the field of telecommunications or broadcasting.

E. Numbering and number portability

It has been prescribed that the Company is to operate in accordance with the numbering plan and with the provisions regarding activation of number portability. For the numbering plan and number portability, see section 2.6.6(A) above.

F. Operation of company networks and service levels

The Company must maintain and operate the network and provide its services 365 days a year, around the clock, including at times of emergency, in a regular and proper manner, commensurate with technical requirements and service quality. The Company is also bound to work towards improving its services. The Company’s general license includes an appendix regarding the “level of service for subscribers”, which is to be amended after the Company provides the Ministry with data. The Company provided the Ministry with a proposal to amend the Appendix, adjusting it to the current state of affairs and the licenses of other carriers, but this amendment has not yet been made.

G. Interconnections and use

Infrastructure services - the Company will supply such services to another licensee such that it will be required to meet the requirements of its license, under reasonable and non-discriminatory conditions, avoiding preference in favor of a licensee that is an affiliated company. New provisions have been made regarding provision of essential information which another licensee may need in order to receive service from the Company, and in order to supply services so as to enable it to meet the service level requirements imposed upon it and so as not to discriminate between recipients of the Company’s services and the other licensee’s customers.

Interconnectivity - new provisions were included which are essentially designed to enable the implementation of interconnectivity between the Company's network and that of another public network. Similar provisions exist with respect to providing the option of use to another licensee.

H. Security arrangements

Provisions were included for operation of the network in times of emergency. The Company is to set up and operate its network in a manner which will prevent its collapse at the time of emergencies and enable a reduction of activity in certain sectors.

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

The Company shall appoint a security director and fully comply with the security instructions contained in the appendix to the license (Israeli requirements, security clearance for the appointment of certain officers, nondisclosure of classified information, including to a shareholder, if the revelation contradicts the security provisions, board meetings discussing security issues, guarding secrecy, protecting systems and limiting reporting or publication pertaining to the provision of classified service to the security forces).

I. Warranty and insurance

Detailed provisions have been added regarding the obligation to insure the Company's liability.

J. Control and reporting

Wide-ranging reporting duties have been imposed on the Company, such as filing the reports specified in the license and on-demand reports on various matters.

The Director has also been granted authority to enter facilities and offices used by the Company, and to inspect and copy documents and demand information and reports from the Company.

K. Miscellaneous matters

The general license includes cross-ownership restrictions.

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

Under the amendment to the license, the Company is to prepare a draft contract it intends to offer to subscribers, and shall submit such to the director for review, upon the demand of the latter. The Director shall have the authority to order changes. The Company is in the ongoing process of preparing this contract.

The Company must provide a bank guarantee to secure performance of the license conditions and indemnify the State for any damage that may be incurred by it following the breach thereof, such guarantee to be in an amount equal to US$10 million. The Company has furnished the guarantee as required. The Minister may forfeit the guarantee or part thereof under the conditions set out in the license (note that the Ministry of Communications has in the past exercised this power with respect to the Company. In this regard, see also Note 19(A) to the Company's financial statements for the period ended December 31, 2008, which are included in this periodic report).

Under the provisions of the Law, the Minister of Communications has the authority, at any time, to revoke, limit or suspend a license, if, for among other reasons, performance of telecommunications activity or provision of telecommunications services by a Licensee do not conform with the standard and at a proper level of similar activity or service, in accordance with the rules stipulated in the Law, or if the Licensee is in material breach of the terms of the license. The Director General of the Ministry of Communications is authorized to impose a monetary sanction on breach of any of the terms of the license. For the increase of the sum of the sanctions, see section 2.16.13 below.

On October 28, 2008, the Ministry of Communications approved the Company's cessation of the services relating to the satellite communications operations and its general license, and the fourth addendum to the Telecommunications Order (Telecommunications and Broadcasts) (Determination of Essential Service Provided by Bezeq The Israel Telecommunication Corp., Limited), 5757-1997 was amended accordingly (see section 1.1.6 above).

2.16.3 Royalties

The Communications Law stipulates that Licensees for the provision of telecommunications services shall pay royalties to the State of Israel on its revenues from the provisions of telecommunications services at a rate to be determined by the Minister of Communications and the Minister of Finance and approved by the Knesset Finance Committee. The rate of royalties stipulated in the Law is 11%, but the provisions allow other rates to be stipulated.

The Telecommunications (Royalties) Regulations, 5761-2001 (the Royalties Regulations), expanded the revenue base on which royalties must be paid, while at the same time gradually reducing the rates. Under the regulations, any party that received a general telecommunications license for the provision of fixed-line domestic services (including the Company), international telecommunications services and cellular services must pay royalties on revenues (without VAT) from the subscriber services in the Schedule to the regulations, including revenues from these services in Judea, Samaria and the Gaza Strip (except for areas in the Palestinian Territory) and including revenues from the provision of these services to the security forces under Section 13 of the Law. On August 31, 2006, an amendment of the Royalties Regulations was published regulating the reduction of the royalty rate for all royalty-owing licensees, commencing on January 1, 2006, by a rate of 0.5% per annum, up to a rate of payment of royalties of 1% per annum as of 2010. The royalty rate in 2008 was 2% compared to 2.5% in 2007.

The Company filed a petition at the High Court of Justice a number of years ago regarding special licenses for data communication services. The court ruled that the State is required to amend the Royalties Regulations, such that a domestic operator's revenue generating by data transmission services, data network management and P2P lines, at high speed and with specific connections, when one of the parties is a corporation, will be exempt from payment of royalties, effective from January 1, 2004. The draft amendment of the Royalties Regulations, which included other amendments, such as the obligation to pay royalties for revenue deriving from telecommunication services, instead of the current version that requires payment of royalties for revenue from providing telecommunication services, was submitted to the Finance Committee of the Knesset on December 31, 2007 and was not approved by the committee. The Company reminded the Ministry of Communications of the State's commitment to amend the regulations to include this exemption, according to the undertaking before the High Court of Justice, without making this amendment contingent on other amendments to the Royalties Regulations.

2.16.4 Authority with respect to real estate

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

Amendment No. 25 of the Law, of 2001, distinguished between land owned by the State, the Development Authority, the Jewish National Fund, a local authority or corporation established by law and which was owned by one of them, and a road (public land) and other land (private land). With respect to public land, the Company and any person authorized by it, may enter and perform work on the land, provided that approval for deployment of the network has been granted by the local planning and building committee. The local committee must decide on a request to approve such a plan within 60 days of it being filed, and in the absence of a decision, the plan will be deemed to have been approved. In most cases, it is necessary to give the occupier 21 days' advance notice and the latter may appeal to the Court.

Under the provisions of the regulations for operation and maintenance, if the Company is of the opinion that providing telecommunication service to an applicant requires installation of a Bezeq transmitter or switch on the premises of the applicant (or in shared premises or property), the Company is permitted to ask the applicant, as a prerequisite for providing the required service, to allocate a suitable place on the premises for installation of the

equipment, for the sole use of the Company, and it may use the equipment to provide service to other customers.

Deployment of a network on private land requires the consent of the landowner, the long-term lessee or protected tenant, depending on the circumstances. In a condominium, the consent of a majority of the apartment owners is required. Notwithstanding the above, the Law contains provisions regarding the deployment of a network in a condominium at the request of an apartment-owner, even in the absence of the consent of a majority of the apartment-owners, while providing powers to the condominium committee and the Condominium Inspector.

2.16.5 Immunities

The Minister of Communications granted the Company certain immunities as listed in Chapter 9 of the Communications Law, pursuant to his authority to grant immunity to a general license holder. A licensee granted immunities according to the aforesaid (an Immune Licensee), its employees and all persons acting on its behalf shall not bear liability in tort, with the exception of the following:

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

(2) Damage arising out of an intentional act or gross negligence of the immune licensee, its employees or persons acting on its behalf

Additionally, an immune licensee, its employees and all persons acting on its behalf shall not bear liability for damage caused by:

(1) Non-provision, delay, restriction or discontinuance of telecommunications services and accessory services as arises out of an intentional act of the Immune Licensee insofar as such act is necessary for the performance of a telecommunication operation or the provision of a telecommunications service

(2) An error in providing a telecommunications service or a telecommunications message or an omission therefrom, failure to transmit a telecommunications message or delay in transmission thereof, delivery of a telecommunications message to an incorrect address or erroneous recording in a subscriber directory or other publication of the holder of immunity, unless done with grievous negligence.

Under Section 13 of the law which relates to the provision of telecommunications services to the security forces, a licensee or any of its employees shall bear no criminal or civil liability for any act committed in the performance of a direction to be given according to said section, except in circumstances in which the State employee bore liability for the act. Under the Civil Wrongs Ordinance, in any action other than negligence, a public servant will have a defense if the act was within the lawful field of their authority or was committed by him in good faith and he understands that he was acting within the scope of his lawful authority.

On May 18, 2008, the Ministry of Communications applied to communication licensees, stating that the Ministry of Communications is of the opinion that following the adoption of the Civil Wrongs Ordinance Amendment (No. 10) Law, 5765-2005, under which the restrictions of the State's liability in tort were reduced, there might be grounds to consider reducing the existing immunity arrangement granted to general licensees and special general licensees The licensees were requested to submit their positions to the Ministry of Communications by June 18, 2008. On July 31, 2008, the Company submitted its position to the Ministry of Communications stating that the Amendment 10 does not change any of the arrangements regarding liability for torts to an extent that justifies reducing the existing immunity arrangement and assigning responsibility to the communications companies. Additionally, expansion of responsibility means placing a heavy burden on communications companies, including the Company, because of the potential extent of the indirect damages and the dimensions of the possible suits.

2.16.6 Regulations and rules under the Communications Law

As at the date of this periodic report, regulations in three main additional areas apply to the Company: (1) the termination, delay or restriction of a telecommunications operation or service; (2) installation, operation and maintenance; (3) methods of inspecting the acts of the Licensee; in addition to which the Company, with the Minister's approval, sets rules regarding the Company's services to subscribers.

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

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

The Company may, with the consent of the Minister, terminate, disconnect or limit the provision of a telecommunications service if the service becomes outdated on technological grounds, or if the service is abused in such a way as to cause tangible financial harm to the public or a part of it, or to the Licensee. Pursuant to the regulations regarding methods of supervision of the acts of a Licensee, the Minister of Communications appointed a manager (an employee of the Ministry) authorized, *inter alia*, to ensure adherence to the provisions of the Communications Law, the regulations and license, for the classes of telecommunications services and conditions thereof, quality of such services and level of maintenance.

In addition, provisions exist regarding reporting, according to which every Licensee must file periodic reports and reports of special events. Rules regarding the Company's services contain provisions relating, *inter alia*, to the issue of bills to subscribers, charging in installments, an appeal committee for complaints regarding charges, and the publication of an entry in the subscriber directory.

The Company acts to locate debtors and to collect debts from its customers. In cases where debts are not paid, legal action is usually taken through external lawyers.

According to the regulations, the Company may disconnect a line if the bill in respect thereof is not paid within 21 days of the payment date prescribed in the bill, and discontinue the service if prior written notice thereof has been given.

On February 6, 2008, draft regulations regarding the set-up of an ‘exceptions committee’ with the purpose of examining requests by Bezeq or Hot for an exemption or delay in providing or installing services (as the case may be) and to make recommendations to the Minister of Communications regarding the grant of such exemption or delay or otherwise, were provided to the Company and Hot for comment. The Company has provided the Ministry with its responses.

2.16.7 <u>Antitrust laws</u>

A. On June 27, 1995, the Antitrust Commissioner (the Commissioner) declared the Company to be a monopoly in the following areas: basic telephone services, provision of communication infrastructure services, unlimited bi-directional international telephone services (including service for incoming calls) and transfer and transmission broadcasting services to the public.

   The Commissioner's declaration of the Company as a monopoly constitutes *prima facie* evidence of the terms thereof in any legal proceeding, including criminal proceedings. Therefore, a plaintiff - being a person or consumer organization - who seeks to sue the Company either by a personal civil action or class action will be excused from proving the fact that the Company is a monopoly, to the extent this proof is relevant for its claim, in reliance on the Commissioner's declaration, and the Company will have to discharge the burden of proof in rebutting the contents of the Commissioner's declaration in this respect.

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

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

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

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

C. On August 26, 2004, the Commissioner approved the merger between Pelephone and the Company (following the acquisition of Shamrock's share of Pelephone by the Company) under conditions that limit certain joint operations and transfer of commercial information as defined in these conditions.

D. On December 24, 2007, the Antitrust Commissioner issued a ruling by virtue of his powers under section 43(A)(5) of the Antitrust Law, stating that Bezeq had abused its status in the market in contravention of the provisions of section 29A of the Law in failing to respond as required and on time to steps taken by its employees during the course of a labor dispute relating to the operations of other communications carriers, and in not being prepared, according to the ruling, to immediately apply to the Labor Court with respect to the disconnection of its network from that of HOT. Note that Bezeq filed its application for an injunction to the Labor Court in the afternoon of May 18, 2006, the day following the date of the fault in HOT's network (May 17, 2006 in the afternoon).

The ruling further states that pursuant to section 43(e) of the Antitrust Law, the ruling itself will be prima facie evidence of the prescription in it in any legal proceedings, and that pursuant to section 43(f) of the Law, the Commissioner's exercise of power under section 43, or lack thereof, shall not constitute any obstacle to trying any person who violates the provisions of the law.

On March 16, 2008, the Company appealed the decision of the Commissioner. With respect to this matter and to the matter of the class action regarding the issue, see Notes 17(A)(11) and 17(C)(1) to the financial statements of the Company for the year ended December 31, 2008, included in this periodic report.

E. On October 18, 2007, the Company gave the Antitrust Authority data and documents at the Authority's request regarding the alleged provision of information to a subsidiary.

F. For the Commissioner's objection to the merger of the Company and DBS, see section 1.1.5 above.

G. The Company has adopted an internal compliance policy (the Policy) containing internal reporting and internal procedures which essentially ensures that the activity of the Company and its employees is carried out in accordance with the provisions of the Antitrust Law, 5748-1988 (the Antitrust Law). The Policy includes a general explanation regarding the Antitrust Law, guidelines for the Company's and its employees' conduct so as not to breach the provisions of the Antitrust Law. Under the Policy, the Company's internal compliance officer issues, from time to time, general and specific directives on various issues (such as pricing, relations with subsidiaries, contacts with customers and the like). The internal compliance officer's directives bind all of the Company's employees and managers.

2.16.8 The Wireless Telegraphy Ordinance

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

For a number of years, the Government has been dealing with a shortage of radio frequencies for public use in Israel (among other reasons, due to the allocation of a large number of frequencies for security purposes), by limiting the number of licenses granted for the use of frequencies on the one hand, and increasing the fees payable for allocation of a frequency in the lower range, on the other. On October 25, 2007, the Ministry of Communications notified the Company that it is considering ordering it to cease using neighborhood radio and rural radio systems and the frequencies allocated to it for the purposes for which they are being used, inter alia, in order to provide its services in areas where an infrastructure of telephone lines does not exist. On December 25, 2007, the Company submitted its response in which it clarified that the Ministry must allocate alternative frequencies and that the Ministry's requirement would create difficulties for the

Company and requires extensive deployment and operations that would entail significant expenses. Furthermore, the Company noted that it would be required, within of two years, to transfer subscribers from the existing systems to new systems and demanded that the State bear the costs of migration from systems that the Company would be required to evacuate. Since then, the Company has been negotiating with the Ministry of Communications with respect to the allocation of alternative frequencies for those frequencies that the Company is required to vacate.

The Company and the Ministry of Communications have a number of differences of opinion regarding fees which the Company claims it does not owe and therefore has not paid. Following a clarification with the Ministry regarding these disputes, most of them have been settled. The main sum remaining in dispute relates to fees in Judea, Samaria and Gaza, and amounts, as at December 31, 2008, to approximately NIS 59 million.

For an update on WiMAX, see section 2.6.6(B) above.

2.16.9 <u>Legislation amendments</u>

In April 2008, the Knesset approved an amendment to the Consumer Protection Law regarding fixed transactions (the Amendment). Under the Amendment, dealers will be required to inform consumers of the date of termination of a fixed transaction prior to termination of such, and of the conditions that will apply after the date of termination. In addition, dealers will be required to obtain the positive consent of the consumer to continue with the contract beyond the fixed period. If positive consent is not obtained, the consumer will be disconnected from the service to which the fixed transaction applied, apart from basic telephone services as defined in the Communications Law (voice services). This amendment came into force on January 10, 2009. The Ministry of Communications also held a hearing for the Company regarding the amendment to the Company's license and those of other licensees in this regard, proposed by the Ministry of Communications. In this context, the Ministry of Communications announced on October 29, 2008 that with regard to the secondary hearing with respect to setting a uniform tariff for the commitment period, the Ministry decided to amend only the licenses of general licensees for providing cellular services in a way that will obligate a uniform tariff as aforesaid. This amendment came into effect on December 31, 2008. Furthermore, the Knesset approved an amendment to the Consumer Protection Law regarding disconnection from ongoing services (effective October 2008) allowing a private subscriber to disconnect from ongoing service by using mail, electronic mail or telephone. In addition, the Knesset approved the amendment to the Consumer Protection Law (effective September 2008) which imposes, in certain circumstances, fines if a technician is late and an amendment to the Communications Laws regarding junk mail (effective November 2008), according to which, among other provisions, as a general rule, a subscriber's explicit permission is required to receive advertising by way of electronic mail, facsimile, automatic dialing systems and SMS.

2.16.10 <u>Security arrangements</u>

In addition to the special provisions that apply to the Company in the field of security by virtue of the general license (see section 2.16.2H above), special provisions also apply to it under the Communications (Telecommunications and Broadcasts) (Prescription of Essential Service Provided by Bezeq, The Israel Telecommunications Corp. Ltd.) Order 5757-1977.

2.16.11 <u>Establishment of communications installations</u>

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

B. <u>NOP 36A</u>

(1) Part I of NOP 36, dealing with building permits for small and micro-broadcasting installations, was approved by the Government on May 2, 2002.

From time to time, the need arises to add broadcasting installations, which require the obtaining of building permits under NOP 36A. As at the date of the publication of this periodic report, the Company is dealing with the production of

building permits for 18 small broadcasting facilities and is involved in legal proceedings for another seven broadcasting facilities.

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

The draft amendment of NOP 36A of January 2008 also prescribes different licensing tracks according to the location and safety range to the public of an installation, where an obligation to deposit deeds of indemnity for compensation under section 197 of the Planning & Building Law, in various indemnity sums (depending on the track) is set for each track.

(3) Given the provisions of the Planning and Building Law, 5725-1965 and the provisions of the Communications Law, the Company believes that the obligation to be issued building permits for micro-broadcasting installations, which are "wireless access facilities" do not apply to it under said laws.

With respect to wireless access installations, there are a number of initiatives to cancel the exemption from a building permit. If the Company is required to provide an affidavit of an exemption from a building permit as set out in section 2.15.1 and/or if the exemption from a building permit is given, this might have substantial adverse implications which the Company is unable to estimate at this stage. For the implications on the subsidiary Pelephone, see section 3.18.3.3 below.

C. NOP 36(B)

As set out in paragraph (b) above, under the January 2008 draft, the licensing process for broadcast installations previously classified as large, which have a smaller safety range than 12 meters, shall come within NOP 36A, the current draft of which does not include transitional provisions enabling an abridged licensing procedure.

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

Note that the Company's broadcast installations were mostly set up many years ago (prior to January 31, 1984), some of them by authorities of the State.

The January 2008 draft also proposes including a provision requiring that an applicant for a permit from a local committee to give a deed of indemnity regarding compensation under section 197 of the Planning & Building Law, should a ruling be made against the local authority for all of the installations contained in NOP 36(B), including broadcast installations erected prior to January 31, 1984, which were exempt from the indemnification obligation under previous drafts of NOP 36(B). The Company has submitted its objection to the inclusion of this provision in NOP 36(B).

D. General

On April 17, 2008, the Company submitted its reservations concerning the proposed draft of National Outline Plan for Communications – NOP/36(A) Small Broadcasting Installations, and NOP/36(B) Large Broadcasting Installations. In brief, the reservations are that the plans as proposed, and in particular as they relate to

changing the definitions of large and small broadcasting installations, create practical difficulties which could prevent the Company from granting the public some of the varied services it provides and is obligated by law to provide.

E. With respect to radiation permits for communications and broadcasting installations, see section 2.15 above.

The information in this section 2.16.11 includes forward-looking information, based on the Company's assessments. Actual results might be substantially different from these assessments.

F. NOP 56 – Communication facilities in the Administrated Territories

On July 29, 2008, the Company received notice that in June 2008, NOP 56 which regulates the establishment and licensing of communications facilities in the Administrated Territories, took effect. The plan includes transition directives for facilities established prior to 1984 and for existing facilities.

The plan includes a requirement for a communication license and approval from the Commissioner of State Property in the Civil Administration. The Company disagrees with the amounts required by these officers as a condition for issuing the approvals. The Company is examining the financial requirements in the context of wider discussion, and as of the reporting date, it is unable to assess the expected implications.

2.16.12 On February 4, 2008, an amendment was published to the Second Television and Radio Authority Law, 5750-1990 under which the Second Television and Radio Authority would set up and operate a digital terrestrial television (DTT) broadcast array backed up by a digital satellite array for the transmission of the television broadcasts of television franchisees freely to the entire Israeli public, and nationally (see also section 5.1.3.3 below) so that such distribution would be effected no later than December 1, 2008. The technological change involved in the transition from analog services to digital services in the area of television might harm the Company's revenues however, at this stage, the Company is unable to assess the aggregate harm that will be caused as a result of closing the analog networks and setting up the digital network.

2.17 Substantial Agreements

The following is a summarized description of the substantial agreements that are not part of the Company's ordinary course of business, and that were signed and/or were in force during the period of this periodic report:

2.17.1 Agreements relating to debentures

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

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

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

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

An addendum to the deed of trust for the debentures in this series relates to the issue of an additional 1,500,000,000 debentures which were issued by the Company to Bezeq Zahav Holdings under the same conditions and listed for trade on the stock exchange (subject to lock-up restrictions).

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

2.17.2 Real estate

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

An agreement between the State and the Company, under which the Company was conferred the State's rights in assets which the Ministry of Communications used for providing telecommunication services, and the Company assumes the rights of the State with respect to those assets and the obligations and liabilities with respect to these rights immediately prior to implementation of the Agreement. Moreover, under that Agreement, the State's rights, powers, obligations and duties according to the agreements, contracts and transactions that were in force with respect to telecommunications services immediately prior to implementation of the Agreement, were transferred to the Company.

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

See Section 2.7.4(C) above.

C. Agreement between the Company and the Israel Postal Authority

An agreement dated June 30, 2004 between the Company and the Israel Postal Authority to define and arrange the rights of the Company and the Postal Authority to their joint assets. The agreement listed the joint assets and defined the share each party has in them. It was determined that each of the parties shall have exclusive rights to their share, except with regard to rights in joint assets, building rights or rights that have been explicitly clarified elsewhere. With regard to a number of additional assets, the party with exclusive rights to them, in whole, will be one party that was so determined.

2.17.3 Agreements with DBS and its other shareholders

A. A founders' agreement of December 4, 1998, between the Company, Eurocom Communications Ltd. (whose holdings were subsequently transferred to Eurocom DBS Ltd.), Lidan Business Enterprises Ltd. (whose holdings in DBS were subsequently transferred to Lidan Business Enterprises (10994) Ltd.), and Gilat Communications Ltd. (which transferred its holdings in DBS to Gilat DBS Ltd.), governing the incorporation and management of DBS and the relationship of its shareholder

B. An agreement dated December 30, 1998 between the shareholders of DBS and DBS, stipulated the establishment of an executive committee and its authorities.

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

D. An agreement dated December 30, 2002, as amended on August 6, 2003, between DBS shareholders and DBS determines preference for shareholder loans given as of July 10, 2002 over the loans made prior to that date. The agreement prescribed that these loans would bear CPI linkage differentials and annual linked compound interest at a rate of 5.5%, while the loans extended as of April 27, 2003 will bear CPI linkage differentials and annual linked compound interest of 11%. Likewise, the agreement set up a mechanism for the issue of shares or options for shares to shareholders who invest in DBS so that their holdings in DBS will be equivalent to their adjusted investment in it. The agreement also determined information rights as determined for its shareholders who are interested parties (for the Company's actions to exercise the options issued to it, see section 1.1.5 above).

In this matter also see section 5.16.7 below.

2.17.4 Labor agreements

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

The agreement provided a full and autonomous arrangement regarding the pension insurance of Company employees. The agreement applies to all transferred employees (who were transferred from the Ministry of Communications to the Company), to all of the members of the cumulative pension fund employed by the Company on the date of execution of the pension agreement and to all of the permanent and temporary employees of the Company, with the exception of special employee groups (students, employees under personal contracts or employees under some other alternative arrangement).

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

For information in this regard and regarding early retirement, see Note 16 to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

C. Agreement to anchor rights of September 4, 2000 between the Company, the Histadrut and the Workers Organization

A special collective agreement between the Company, the Histadrut and the Workers Committee, inter alia regarding anchoring the rights of the transferred employees. This agreement was intended to anchor the rights of the transferred employees to the pension rights to which they were entitled by virtue of their being former public servants, under the Company's pension agreement, adopted by the Company under its pension agreement. According to this agreement, these rights became personal rights which could not be cancelled, other than by waiver of personal rights under law (in other words, by personal waiver by the employee himself or herself).

In this regard see also section 2.9.5 above.

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

Following an amendment in July 2000 to the Employment of Employees by Human Resources Contractors (Amendment) Law, 5760-2000, a special collective bargaining agreement was signed between the Company, the Histadrut and the Workers Committee on January 11, 2001 to recruit new employees and stipulate their salary conditions. The agreement applies to new employees and to employees who were previously employed at the Company via human resources companies, in positions listed in the appendix to the agreement (customer service representatives at call centers, administrative workers, typists, warehouse employees, secretaries, mail sorters and distributors etc., administrative employees such as porters, drivers and forklift operators, and others). Under the special collective agreement of December 5, 2006, it was agreed that the Generation 2000 agreement would not apply to such employees as had been recruited into the Company since July 1, 2006. It was also agreed to insert non-substantial amendments into the conditions of employment of employees recruited for employment under the Generation 2000 agreement.

E. Agreement of April 17, 2005 with alternative entity in lieu of the Makefet Fund with respect to early retirement arrangements for employees of the Company

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

In addition, on June 28, 2005, an agreement was entered into between Harel Insurance Company Ltd. ("Harel") and the Company (the "June 2005 Agreement"). The contract regulates payment of pensions for early retirement and provisions for old-age and survivor pensions deriving from legislative amendments under the Israeli Economy (Recovery Program) Law for employees who retired from the Company from

the end of 2003 / beginning of 2004 and/or who will retire from the Company in accordance with the special collective agreement for retirement of September 2000 as amended on March 18, 2004 and April 17, 2005. Following execution of the agreement with Harel, the special collective agreement between the Company, employee representatives and the General Trade Union as aforesaid was amended on the same date (June 28, 2005).

On February 14, 2008, Harel and the Company signed an amendment to the June 2005 agreement, the main points of which were: (1) The June 2005 agreement would also apply to employees of the Company who resign from their employment at the Company prior to December 31, 2013 under the early pension track, in accordance with an option granted to the Company in the special collective agreement of December 5, 2006, if and to the extent that the Company chooses to exercise such option. (2) Reduction of the consideration paid by the Company to Harel for every retiree insured under the June 2005 agreement and policies have not been issued by Harel on the date of execution of the amendment to the June 2005 agreement.

In this regard, see Note 16(G) to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

Special collective agreement dated December 5, 2006

A collective agreement was signed between the Company and the workers' organization and the New General Trade Union, setting out the employment relationships at the Company following transfer of control of the Company from the State of Israel to Ap. Sb. Ar. Holdings Ltd., and prescribing a new organizational structure for the Company (see section 2.9.1 above).

Under the agreement, all agreements, arrangements and procedures existing in the Company prior to execution of the agreement, including the mechanism of linkage of salaries to the public sector, shall continue to apply to permanent, senior employees of the Company only, to whom the agreement applies, subject to amendments made expressly in the agreement. Existing and new temporary employees shall be employed on the basis of monthly / hourly salary agreements that are based on a market salary model according to their businesses, with a high level of administrative flexibility.

The agreement also provides that in 2006-2008, 975 permanent employees shall retire from the Company under early pension schemes or increased severance pay schemes. The Company shall also be entitled, at its discretion, to terminate the employment of a further 1225 permanent employees (245 permanent employees during any one or more of the years 2009-2013). The retirement conditions to be offered to the retirees shall be identical, for the most part, to the retirement conditions employed at the Company at present.

The agreement shall be valid from the date of execution of through December 31, 2011. The Company has an option to extend the agreement for two more years through December 31, 2013. The retirement chapter of the Agreement shall, in any event, expire on December 31, 2013.

For the amendment of the agreement see section 2.9.1.

2.17.5 Management agreement

On March 23, 2006, the general meeting of the shareholders of the Company approved entry by the Company into an agreement with a company which is to be owned and controlled by the shareholders of Ap. Sb. Ar. under which the Company shall be given ongoing management and consultancy services, including via directors who may act from time to time in the Company and/or its subsidiaries, all in return for $1.2 million each year. The term of the contract is from October 11, 2005 (the date of completion of acquisition of 30% of the shares of the Company by Ap. Sb. Ar.) and until December 31, 2008, unless one of the parties gives notice to the other of its desire to terminate the contract by way of prior notice of three months in advance. On July 29, 2007, a management agreement was executed between the Company and a corporation owned and controlled by the shareholders of Ap. Sab. Ar. Holdings Ltd. This agreement is in force as of October 11, 2005.

2.18 Legal Proceedings

For information on legal proceedings see Notes 15, 16 and 17 to the financial statements for the year ending December 31, 2008, included in this periodic report, and section 1.1.5 above.

2.19 Business Objectives and Strategy

2.19.1 Forward-looking information

It is only natural that a review of Company strategy involves expectations regarding future developments with respect to customer behavior and needs, adoption rate of new services, technological advances, regulatory policy, marketing strategy employed by competitors, and the effectiveness of the Company's marketing strategy.

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

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

2.19.2 Summary of strategy and future plans

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

Vision and objectives

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

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

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

B. Reducing the decline in revenues from core services;

C. Generating new sources of revenue;

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

To implement the strategy and achieve said goals and objectives, the Company uses and will continue to use the following:

Business customers

A. Offering variety in its basket of products and services

B. Providing a comprehensive solution based on the needs of the customer, while using a policy that dictates a commitment to quality and availability of service

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

D. Offering a variety of value-added services

Private customers

A. Continuing to penetrate broadband and improving infrastructures to increase bandwidth

B. Providing differential pricing tracks

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

Network

In order to achieve its strategic goals, the Company is using its best endeavors to improve its existing network and to make it comply with its commercial goals, inter alia by laying optical fibers and making investments in the network core. See also sections 2.6.7 and 2.7.2 above for a description of the NGN.

2.19.3 Development trends in Company activities

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

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

C. The Company is examining the technological viability of distributing digital contents over the Company's network and infrastructure.

D. The Company launched fixed-line and wireless home network services that enable multiple computers to connect simultaneously to the internet from a number of computers.

E. The Company has launched a variety of billing tracks for telephony services along with its basic tariff structure to increase the use of its services.

2.19.4 Main projects in the planning or execution stage

The main projects executed by the Company include deployment of the NGN based on the outline for 2009 as approved by the board of directors, as well as the expansion of capacity for the Company's networks with the aim of providing its business customers with high speed data transmission and communication services. Additionally, the Company is developing and assimilating advanced computing systems, including CRM and network engineering management and management of orders and supply of services.

2.20 Risk Factors

A. Increasing competition

Competition in the field of domestic fixed line communications is increasing. Furthermore, the Company views the cellular telephony market as a market which, to a large extent, is an alternative to the fixed-line domestic telephony market.

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

The number portability that was commenced on December 2, 2007 (see section 2.6.6(A) above) contributes to increase competition in the industry.

Likewise, the possibility of providing telephony services over the Company's and HOT's broadband infrastructure (VoB) could also contribute to increased competition.

Organization of the provisions of the policy in the spirit of the recommendations of the Gronau Committee, as adopted by the Minister of Communications could result in accelerated competition in the Company's sector of operations.

B. Government supervision and regulation

The Company is subject to government supervision and regulation that, among other matters, relate to licensing for activity, determining permitted areas of activity, determining tariffs, operation, competition, payment of royalties, obligation to provide universal service, ability to hold its shares, relationships between the Company and its subsidiaries and prohibition to terminate or restrict its services (which may force the Company to provide services even when

not economically feasible or when it goes against its interests). This supervision and regulation at times lead to State intervention, which the Company believes adversely affects is business operations.

C. Regulation of tariffs

The Company's tariffs for services are subject to State regulation. These tariffs are stipulated in regulations, and regulations also stipulate a formula for linking them to the changes in the Consumer Price Index, less an amount for depreciation. The practical implications of this system is real erosion in the tariffs of the Company. Some of the Company's tariffs are subject to the Supervision of Prices for Commodities and Services Law. For the uncertainty regarding the continued update arrangement of the Company's supervised tariffs, see section 2.16.1 above. Additionally, regarding the reference of the Gronau Committee to flexible tariffs, see section 2.6 above.

D. Difficulties in labor relations and human resources

As a part of the preparations to cope with the increasing competition in the field, the Company must continue to formulate additional plans for organizational changes and make a further reduction in the number of personnel. The implementation of these plans has involved and is expected to involve, coordination with the employees and substantial costs, including the cost of compensation for early retirement, over and above the costs which are stipulated in existing agreements. The implementation processes of these plans have in the past caused and may cause in the future unrest in labor relations and hurt the Company's regular business.

E. Restrictions on relations between the Company and companies in the Bezeq Group

The Company's general license obligates it to ensure that its relationship with its principal subsidiaries in the Bezeq Group does not cause them to be preferred over their competitors. Under the general license, separation is required between the respective managements of the Company and said companies, and separation is also required in the financial and marketing systems, as well as assets and employees, which causes high administration overheads. The Company is also not allowed, at this stage, to offer joint service bundles with the aforesaid companies. In view of the entry of communication companies into direct competition with the Company in most of its sectors of operation based on the supply of a package of services to the customer, whether directly or through cooperation, there is a greater risk that this factor will affect the Company's operations. Nonetheless, with regard to the matter of the permit to provide non-divisible services packages, see section 2.6 above (adoption of Gronau Commission recommendations).

The Antitrust Authority's objection to the merger between the Company and DBS so that the Company's holdings of DBS will increase from 49.8% to 58% (see section 1.1.5(A) above) harms the Company's ability to realize its holdings of DBS.

F. Legal proceedings

The Company is a party to legal proceedings, including class-action claims, which may cause it to have to pay significant sums, most of which cannot be estimated. Therefore provisions have not been made in the Company's financial statements and in those of companies in the Group.

Class-action claims can reach large amounts, as virtually all residents of the country are consumers of the Company's services, and a claim that relates to minor injury to a single consumer may become a significant case for the Company if it is recognized as a class action that applies to all consumers or a significant portion of consumers. Additionally, as the Company provides communications infrastructures as well as billing and collection services to other Licensees, parties initiating legal action against said Licensees in other class action cases may even try to involve Company as a party to these proceedings.

For a description of the legal proceedings, see section 2.18 above, which refers, inter alia, to Note 17 to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

G. Exposure to exchange rate fluctuations and inflation

The Company assesses exposure to changes in exchange rates and inflation by the surplus or deficit of assets against liabilities based on the type of linkage. The Company's exposure to changes in currency exchange rates against the shekel is low. The Company's exposure to inflation changes is high and therefore the Company takes the required steps to cover part of the inflation exposure.

H. **Electromagnetic radiation and licensing of broadcast installations**

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

The Company is working to obtain permits to build and operate its various broadcasting installations, however, the difficulties it faces in this activity, including difficulties related to the change in policy maintained by the various relevant organizations and amendments to statutes and standards, may negatively impact on the infrastructure of the said installations and on the regularity of provision of services using them. The Company's third-party liability policy does not currently cover electromagnetic radiation.

I. **Frequent technological changes**

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

J. **Global economic crisis**

In the last quarter of 2008, the global economic crisis has sent global markets into a recession and credit crunch. It is expected that the impact of the process will continue to be felt in 2009 and possibly even later, and it is possible that there will be a transition from growth to recession. The local market is also expected to experience a significant slump together with deterioration in business operations and central economic parameters. The Company estimates that the crisis could have an adverse effect on its operations, inter alia, as a result of the damage to the Company's revenue and difficulty in selling its real estate assets.

This information contains forward looking statements, based on the Company's assessments. The actual results may differ materially from these assessments if there is a change in any of the factors taken into account in these assessments.

Summary of risk factors

	Effect of risk factor on Company activity		
	Major	**Moderate**	**Minor**
Macro risks			
Exposure to exchange rate fluctuations and inflation			X
Sector risks			
Increasing competition	X		
Government supervision and regulation	X		
Regulation of tariffs	X		
Electromagnetic radiation and licensing of broadcast installations		X	
Frequent technological changes		X	
Company-specific risks			
Exposure in legal proceedings		X	
Difficulties in labor relations		X	
Restrictions on relations between the Company and companies in the Bezeq Group	X		
Global economic crisis		X	

3. Mobile Radio Telephone – Pelephone Communications Ltd. (Pelephone)

3.1 General Information on Area of Operations

3.1.1 Pelephone's field of activity

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

As of August 2004, Pelephone is wholly owned by Bezeq.

3.1.2 Legislative and secondary legislation restrictions applicable to Pelephone

3.1.2.1 General license

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

3.1.2.2 Tariff control

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

3.1.2.3 Royalties

Under its license and under the Telecommunications (Royalties) Regulations 5761-2001, Pelephone pays the State of Israel royalties out of its revenues which bear royalties due to the provision of telecommunications services (see section 3.18.3.2 below).

3.1.2.4 Environmental matters

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

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

The following are financial and quantitative data regarding Pelephone's scope of operations and profits for 2007-2008:

	2008	2007
Revenue (NIS millions)	4,713	4,684
Operating profit (EBIT) (NIS millions)	933	805
Operating profit before depreciation and amortization (EBITDA) (NIS millions)	1,456	1,283
Number of subscribers at end of period[18] (in thousands)	2,649	2,622
Average minutes of use (MOU)[19] per subscriber per month	352	354
Average monthly revenue per subscriber (NIS) (ARPU)[20]	126	131

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

3.1.4 Market development and changes in customer attributes

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

3.1.5 Technological changes affecting the Company's field of activity

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

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

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

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

3.1.5.2 In 2004, Pelephone launched 3G services by means of CDMA 2000 EVDO technology which connects up to CDMA 2000 1XRTT technology that is deployed throughout the country. The EVDO network was deployed in urban areas during 2004-2006 (for details see section 3.9 below). 3G services enable streaming of data, including video, at higher speeds and enables Pelephone to offer its customers a wide range of added value services (for details see section 3.2.1 below).

3.1.5.3 On November 1, 2007 the general shareholders' meeting of Pelephone adopted Pelephone board of directors' resolution from September 2007 regarding establishment of a network using HSPA/UMTS technology at a total investment of NIS 1 billion. This cost includes the cost to the network supplier, establishment of

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

[19] MOU (Minutes of Use) – average monthly minute use per subscriber. This index is calculated in accordance with an annual average of the sum total of outgoing and incoming minutes each month, divided by the average number of subscribers during that month.

[20] ARPU (Average Revenue Per User). This index is calculated by averaging the division of total revenue from cellular services and repairs each month by the average number of active subscribers in that month.

the new sites required to operate in the new frequency range, conversion of existing sites and services to HSPA/UMTS and unfreezing the right to implement frequencies. Ericsson was chosen as the system supplier. The new network began operating during January 2009 (see section 3.9.1 below). The establishment of the new network enables Pelephone to provide services requiring quicker transmission of information, which permits, inter alia, expansion of the variety of terminal equipment and roaming services. In 2008, the principal investment was made in the network and the rest of the investment will be spread out over the next three years.

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

3.1.6 Critical success factors in area of operations and changes therein

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

- National deployment of a high-quality, advanced MRT network, ongoing maintenance of the network at a high level and significant investments, on an ongoing basis, in cellular infrastructure, for the purpose of improving high-quality coverage around the country, which is a basic condition for the provision of Pelephone's services, and in order to provide customers with the most advanced services, via the most advanced technological infrastructure.
- Expansion of the variety of terminal equipment to leading suppliers.
- Provision of high-quality call services and advanced added value services.
- National deployment of service and sale centers which enable high quality customer support and service which allows the Company to successfully deal with a competitive market.
- Professional, high-quality, human resources.
- Marketing strategy for establishing and reinforcing the brand name.

3.1.7 Main entry and exit barriers

The principal barriers to entry to the area of operations are:

- The need for a MRT license, the allocation of frequencies, and operations being subject to the regulatory supervision that applies to the market (see section 3.18 below).
- The need for significant financial resources for making serious investments in infrastructures, which are affected by frequent technological changes, and the importance of providing a response to the needs of the market.
- The difficulty involved in setting up radio sites due to regulatory restrictions and public objections.

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

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

- Long-term agreements with infrastructure suppliers and property owners with whom Pelephone has entered into lease agreements.
- Large investments which require long periods to recoup the investment.
- The obligation to provide services to customers in accordance with conditions prescribed in the license.

3.1.8 Substitutes for Pelephone products

Domestic fixed-line telephone services provided by the domestic operators under the licenses granted to them may constitute a substitute for some of the services provided by Pelephone.

Telephony services based on VOIP/VOB technology might constitute a substitute for cellular services.

3.1.9 Competitive environment and changes therein

Until the end of 1994, Pelephone was Israel's sole cellular company (until the end of 1993 – by virtue of Bezeq's license and on its behalf[21]). In May 1994, Cellcom Israel Ltd posted the successful bid in an invitation to tender for a second operator for MRT service (the Second Operator or Cellcom**).** In February 1998**,** a third operator was selected by invitation to tender – namely Partner Communications Ltd. (the Third Operator or Partner). As of February 2001, MIRS Communications Ltd., (MIRS**)** has been operating as an additional cellular operator. After the entry of the second operator, and later, the third operator, into the cellular market, fierce competition developed among the carriers (primarily between the three main carriers). This competition resulted in market saturation expressed in the diminution of the number of subscribers joining the Company, an increase in the transfer of customers between the cellular companies and an erosion in the prices collected by Pelephone from its customers for services rendered by it. Recently, Cellcom and Partner have entered the ISP (Internet Service Provider), domestic operator, and VOB (Voice Over Broadband) fields, and market bundle packages (see section 3.7 below). In addition, the Ministry of Communications recently granted trial licenses for VOC (voice over cellular) service users, which enables voice calls on the HSPA/UMTS network's data channel.

3.2 Products and Services

3.2.1 Services

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

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

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

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

Pelephone offers its customers added value services using third generation technology, including, inter alia, viewing its various television channels such as: music, sports, news and a variety of entertainment channels, the ability to film and transfer video files, GPS cellular services, AGPS based Navigator services, and a high-speed Netstick cellular modem.

At present, some 1.2 million subscribers have handsets which enable use of third generation services. As part of the third generation services, Pelephone offers its customers internet access from laptops using a cellular modem.

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

At the end of March, 2002 the Ministry of Communications published a public hearing document concerning policy to regulate commercial telephone services via a public telecommunications network. Commercial telephone services include voice and visual data services, entertainment, matchmaking, etc, which are provided to subscribers through terminal equipment connected to the network. It is important to note that the commercial telephone services field constitutes a source of revenue in Pelephone's content world, as well as that of the rest of the cellular operators. In proposed regulation, the regulator would like to change the commercial telephone services regulations in a way which may damage Pelephone's revenues in this field. The Ministry of Communications asked all the relevant authorities operating in the commercial telephone field to respond to the aforementioned hearing by May 29, 2008. Pelephone submitted its viewpoint on the matter according to which, inter alia, it asked the Ministry of Communications to hold frontal meetings on the subject of the hearing prior to making decision. During August, 2008, the Ministry of Communications called frontal meetings on the subject with all of the cellular operators and some of the content providers. During the aforementioned meetings, Pelephone presented its opinion on the subject to the Ministry's representatives. The Ministry has not yet set final policy on the subject.

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

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

With the launching of the HSPA/UMTS network, Pelephone enables its customers with HSPA/UMTS technology handsets to travel around the world with the personal handset and even provides these customers extensive roaming coverage in 207 countries, thanks to agreements with Vodafone, Holland. The agreement also allows roaming coverage for third generation services, video calls and internet access abroad, in countries where these services exist.

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

3.2.2 Products

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

Recently, Pelephone has also begun providing its customers with modems and laptops, which allow surfing the web through the Pelephone network.

3.3 Revenue and Profitability of Products and Services

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

	2008	2007
	NIS millions	NIS millions
Revenue from cellular services, sale of terminal equipment and terminal equipment services	4,713	4,684
Percentage of gross profit	32%	29%

In 2006, 2007 and 2008, revenues from added value services amounted to 11%, 13% and 16% respectively of revenues from cellular communications (payments for call minutes, fixed subscription fees, added value services and roaming services).

3.4 New Products

In 2008 Pelephone continued to improve and expand its range of added value services and to increase the number of subscribers who use these services, including internet packages using a cellular modem (Netstick).

3.5 Customers

As at the end of 2008, Pelephone had 2.649 million subscribers. Approximately 65% of Pelephone's subscribers are private customers and 35% of Pelephone's subscribers are business customers.

3.6 Marketing, Distribution and Service

Pelephone's distribution system is based on 43 service and sales centers including laboratories spread around the country, which deal in service and sales to customers, treatment of malfunctions or provision of a substitute handset while sending the malfunctioning handset for repair, installation of handsets and customer retention. The distribution system is strengthened with stores and stands spread over 115 points of sale (some of which are operated by Pelephone employees, and others of which are operated by authorized sellers). In addition, there are various sellers that operate a door to door system, and service and sales representatives for the business sector.

Pelephone's subscriber service system includes 12 designated telephone call centers which provide information, service on various matters and in three languages, technical support, data regarding customer billing, added value services, sales and general information.

In September 2008, Pelephone signed a memorandum of understanding with Superpharm, which has until now operated as a Partner distributor, following which Pelephone's distribution network will be extended significantly.

3.7 Competition

3.7.1 Pelephone faces fierce competition from the other cellular operators: Partner, Cellcom and MIRS. This competition brought about an increase in the size of the market, the addition of new subscribers and an erosion of prices. This competition even strengthened as a result of the entry of number portability into force (see section 3.7.3 below) and will even deteriorate upon implementation of the Ministry of Communications' policy concerning MVNO/VOC (see section 3.7.2).

To the best of Pelephone's knowledge from the data published by each of the cellular companies in Israel, as at the end of 2008, there are approximately 9.1 million cellular subscribers in Israel: Pelephone has approximately 2.6 million subscribers, Cellcom reported approximately 3.2 million subscribers, Partner reported approximately 2.9 million subscribers and Mirs, approximately 0.4 million subscribers[22].

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[22] This data relates to active subscribers as reported by the cellular companies in Israel.

For the recommendations of the Gronau Committee and their adoption by the Ministry of Communications, see section 2.6 above.

During the Government's deliberations on the Budget Law for 2009, additional Governmental decisions were made concerning the communications industry in general and the cellular industry in particular, inter alia, following the Gronau Commission's recommendations:

1. The roaming cellular tariffs will be examined by an interministerial Government team. The team will submit its recommendations concerning the possibilities of reducing the roaming tariffs by the end of 2008. In addition, the Ministry of Communications, in cooperation with other relevant Government ministries, will act to apply the European regulation in the roaming tariff field by February 28, 2009. In November, the Ministry of Communications approached the cellular operators and requested extensive and detailed data concerning roaming tariffs. At present, no decisions have been made in this matter.

2. An inter-ministerial team, in cooperation with the Ministry of Communications and the Ministry of Finance, will examine the option of reducing the interconnection tariffs. The team was to be established by September 15, 2008 and will submit its recommendations by March 31, 2009.

3. The Ministry of Communications will examine the option of allocating frequencies to establish an additional communications network by a new operator which will enter the communications market. The examination must be completed by the end of 2008. As at the date of this report, no decision has been taken on the subject.

3.7.2 <u>Mobile Virtual Network Operator – MVNO:</u>

In the framework of the deliberations on the Government's budget for 2008, the Government decided that the Ministry of Communications would prepare to grant MVNO licenses as from December 31, 2007 to anyone who is interested. If such a MVNO license is granted and the owner of such a license holds negotiations with the cellular operators that after 6-9 months do not end successfully and it is proven that the reason is the anti-competitive behavior of the cellular operators, the Minister of Communications shall then consider interfering in the matter of the MVNO entering the market in accordance with the powers granted to him by law.

In September 2008, as part of the government deliberations regarding the Budget and Economic Arrangement Laws for 2009, the Government decided to determine that the Minister of Communications will complete all the procedures required for granting MVNO licenses by April 1, 2009.

On January 5, 2009, the Ministry of Communications published a public hearing in which he requested response to his proposed draft license as the format for granting a MVNO license, as well as the key regulation rules of the Communications Law which the Minister intends setting in order to regulate the conditions and issues for granting MVNO licenses in accordance with the policy proposed by the Ministry in this matter. Pelephone submitted its response to this hearing.

3.7.3 <u>Number portability</u>

On March 22, 2005, the joint Finance and Economics Committee of the Knesset approved an amendment to the Communications (Telecommunications and Broadcasts) Law, 5742-1982 to the effect that the Minister of Communications is to prepare a numbering plan regarding number portability with respect to a general licensee for provision of MRT services and a licensee for domestic fixed-line communications services, and is to instruct them regarding the implementation and activation of it by September 1, 2006. According to the amendment, the licensee is required to provide number portability for any subscriber who may request same, free of charge to the subscriber or from any licensee.

Due to the short time schedules provided for the preparations, the cellular operators did not meet the date provided in the Communications Law. Nonetheless, the regulator decided to not postpone the date for implementing the portability plan beyond September 1, 2006. Following this decision, both Pelephone (together with the other cellular companies) and Bezeq filed petitions in the High Court of Justice for a decree nisi against the Government of Israel and the Minister of Communications.

On May 24, 2007 Pelephone received notice from the Ministry of Communications stating that it was considering imposing a monetary sanction on Pelephone for alleged breach of the obligation to provide number portability as of September 1, 2006. The notice also stated that December 1, 2007 is a reasonable date by which the relevant licensees are required to amend the alleged breach.

In 2007 Pelephone continued to prepare for implementation of the number portability plan and towards December 1, 2007, the date the Ministry of Communications determined to be the reasonable and final date for implementation of the plan, it completed its preparations, including all the necessary tests. In November 2007, after consulting with the Minister of Communications and the CEOs of the communications companies regarding readiness for number portability and the final date of beginning implementation of the plan, Pelephone expressed a position by which the date of implementation should not be postponed beyond December 1, 2007, since Pelephone is prepared and ready to begin the process. At the end of the aforementioned meeting the Minister of Communications decided not to change the implementation date (December 1, 2007).

The number portability process began as scheduled. Pelephone and the other cellular companies that filed the petition requested from the High Court of Justice that it dismiss the petition. As a result of this request the petition was dismissed. As at the date of this report, Pelephone has not been requested to pay any penalties in respect of postponement of the implementation date.

The “Number Portability Program” intensified the already fierce competition between the operators. Such competition gave rise to an increase in marketing campaigns, benefits granted to customers and an erosion of prices.

3.7.4 <u>Domestic operator license</u>

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

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

In the last quarter of 2006, the Ministry of Communications held a renewed hearing on the matter of final formulation of its policy regarding licensing of the supply of telephony services using broadband access (VOB). On February 1, 2007, the Ministry published its final policy document on VOB in which it prescribed that Bezeq and the companies in the Bezeq Group (including Pelephone) shall be entitled to take part in this industry in the business and private sectors only once Bezeq’s market share of the domestic fixed-line telephony industry falls to below a threshold of 85% in each of the sectors separately. Pelephone objects to this policy and is of the opinion that it should be treated as an independent body, due also to the existence of the restrictions imposed upon it regarding joint marketing and the sale of joint bundles with Bezeq. Pelephone expressed its opinion during the hearing before the Ministry of Communications and before the committee headed by Prof. Gronau for examining the policy and rules of competition in the communications industry in Israel.

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

3.7.5 WiMAX technology

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

Following the hearing of September 2007, the Ministry of Communications published a secondary hearing in July 2008 on its policy in the matter of allocating frequencies, inter alia, in the 2.5 MHZ range. This frequency range is intended for WiMAX technology in mobile telephony as well as fourth generation cellular technology. According to the proposed policy, the aforementioned frequencies will be allocated in two separate tenders: The first will take place by the end of 2008, in the framework of which frequencies will be allocated in first preference to a new operator and in second preference to Mirs (in order to establish a WiMAX network). The second tender will be held starting from mid 2011, after clearing additional frequencies in the aforementioned frequency range, and the other cellular operators will also be able to participate in this tender. Pelephone has submitted its response to the aforementioned policy document in which it has expressed its opposition to the preference to Mirs in the first tender and has demanded governmental responsibility to clearing additional frequencies towards the second tender in order to ensure a natural fourth generation development track in the cellular technology.

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

3.7.6 Positive and negative factors affecting Pelephone's competitive position

Positive factors

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

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

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

D. An extensive distribution system specializing in the provision of solutions appropriate to each type of customer, high-quality human resources, and expanding it by adding the SuperPharm chain.

E. Strong capital structure and positive cash flow.

Negative factors

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

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

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

D. The cost of operating two networks is high.

3.8 Seasonality

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

3.9 Property, Plant and Equipment

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

3.9.1 Infrastructure

Pelephone presently operates three fundamental communications networks:

A Digital technology using CDMA2000 1XRTT. The advantages of this technology are the ability to provide advanced services, greater capacity for talk calls and data for a given quantity of frequencies and data communications at a speed of up to 144KB per second.

B Digital technology using the EVDO method – see section 3.9.1 below.

C. Digital technology using the HSPA/UMTS method. The advantages of this technology, inter alia, is in supporting download speeds of up to 14.4 Mbps and upload speeds of up to 5.7 Mbps.

It should be noted that the actual surfing speed depends on a number of factors, including place, momentary load in the network, transmission support, the internet network performance and the laptop and terminal equipment compatibility.

EVDO/CDMA200 1XRTT network

As at the date of publication of the report, Pelephone's MRT infrastructure (CDMA) is based primarily on 8 digital switches manufactured by Nortel, connected to approximately 1,540 radio sites (cells), in a countrywide spread. Each radio site incorporates an antenna for reception and transmission and a computerized control system, and covers a certain geographic area. The cells are connected to base station controls (BSC) that are hooked up to the switches. The switches are connected to one another and to all the other telecommunications operators (Bezeq, Partner, Cellcom, MIRS, HOT, and international operators).

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

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

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

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

As of 2004, the Pelephone Board of Directors began upgrading the CDMA2000 1XRTT network to EVDO technology by means of the addition of a special–purpose carrier for data communications in the urban areas of Israel. This technology enables communication between the network and the terminal equipment at rates of up to 2,400 KSS (downlink) and between the terminal equipment and the network at rate of up to 144 KSS (uplink). The EVDO equipment is manufactured by Nortel. Parallel to setting up the network, a

portal was set up for video services enabling customers to view live broadcast channels, to download music clips, entertainment, news, etc. This portal is the key service using EVDO technology.

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

The HSPA/UMTS network

On November 1, 2007 the general shareholders' meeting of Pelephone adopted the resolution of Pelephone's Board of Directors from September 2007 regarding establishment of a network using HSPA/UMTS technology at a total investment of NIS 1 billion. This amount includes the cost of the network supplier, of constructing the new sites required in order to operate in the range of the new frequency, and of converting existing sites and services to HSPA/UMTS and unfreezing the right to implement frequencies. Ericsson was chosen as the supplier of the system. The new network is based on two network centers that will be connected to the existing sites and the new sites that are in the process of acquisition/licensing and construction. The sites operating on CDMA technology were converted in order to adapt them to the new frequency and be added the new radio equipment. The network enables higher transfer speeds of information from the subscriber to the network and from the network to the subscriber using HSDPA and HSUPA technology. The establishment of the new network enables Pelephone to provide services requiring the rapid transmission of information, may partly solve the problem of wireless disturbances (see section 3.24.2.5 below) and enables use of standard terminal equipment supporting HSPA/UMTS technology which enables the diversification of terminal equipment and the expansion of roaming services. In 2008, Pelephone invested NIS 616 million in establishing a HSPA/UMTS network. The rest of the investment is expected to be spread over the next three years.

3.9.2 Premises used by Pelephone

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

3.9.2.1 The land which Pelephone uses for installation of radio and switching sites, as set out in section 3.9.1, are spread out around the country, and are leased for various periods (in many cases, for 5 years plus an option to extend the agreement for another 5 years). For site licensing, see section 3.18.3.3 below.

3.9.2.2 Pelephone leases some of the sites from the Israel Lands Administration (ILA). Pelephone has an agreement for payments due to the ILA for the period up to December 31, 2008.

3.9.2.3 In January 2009, Pelephone filed a claim for declaratory relief and mandatory injunctions at the Petach Tikva District Court.

The claim referred to the ILA's demand, which was send by email to Pelephone, for payment of a cumulative amount of over NIS 200 million for a five year period, for continuation of its "consent" to the presence and setting up of new cellular antennas on ILA land. In the claim, Pelephone alleges that the ILA is not permitted to charge Pelephone for setting up broadcasting equipment; the demand is excessive; and the ILA is abusing its monopolistic power and acting in bad faith. Pelephone's consultants estimate that the company has sound claims against the ILA. However, as the procedure is in the initial stages, and the ILA has yet to submit its respond to the claim, it is not possible to assess the chances of this claim.

3.9.2.4 Pelephone's head offices have been in Givatayim since 1997, and cover a total area of 17,000 sq m. In 2006, Pelephone signed an agreement to extend the lease term until December 31, 2010 and is in the advanced stages of negotiations with the owners of the property to extend the lease until 2011.

3.9.2.5 For the purpose of service and sale operations, Pelephone leases 77 service and sale centers spread out around the country.

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

3.10 Intangible Assets

3.10.1 MRT license

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

3.10.2 Frequency usage right

Pelephone uses frequencies in the 850 MHz range granted pursuant to its license. Pelephone uses these frequencies mainly for CDMA2000 / 1XRTT / EVDO /UTMS technology. In addition, in 2008, Pelephone submitted an application to the Ministry of Communications to exercise its right to for the allocation of frequencies in the 2100 MHz range. To execute this right, Pelephone is required to pay an additional sum of approximately NIS 181 million for license fees and retroactive frequency fees from the day on which it won a tender for these frequencies to the date of exercise of the right to receive them. In September 2008, Pelephone paid this amount for receipt of the frequencies from the Ministry of Communication.

In January 2009, the Ministry of Communications granted approval for Pelephone to return to the 5MHz frequency range, known as TDD, from the aforementioned band of frequencies.

3.10.3 Trademarks

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

3.10.4 Customer base

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

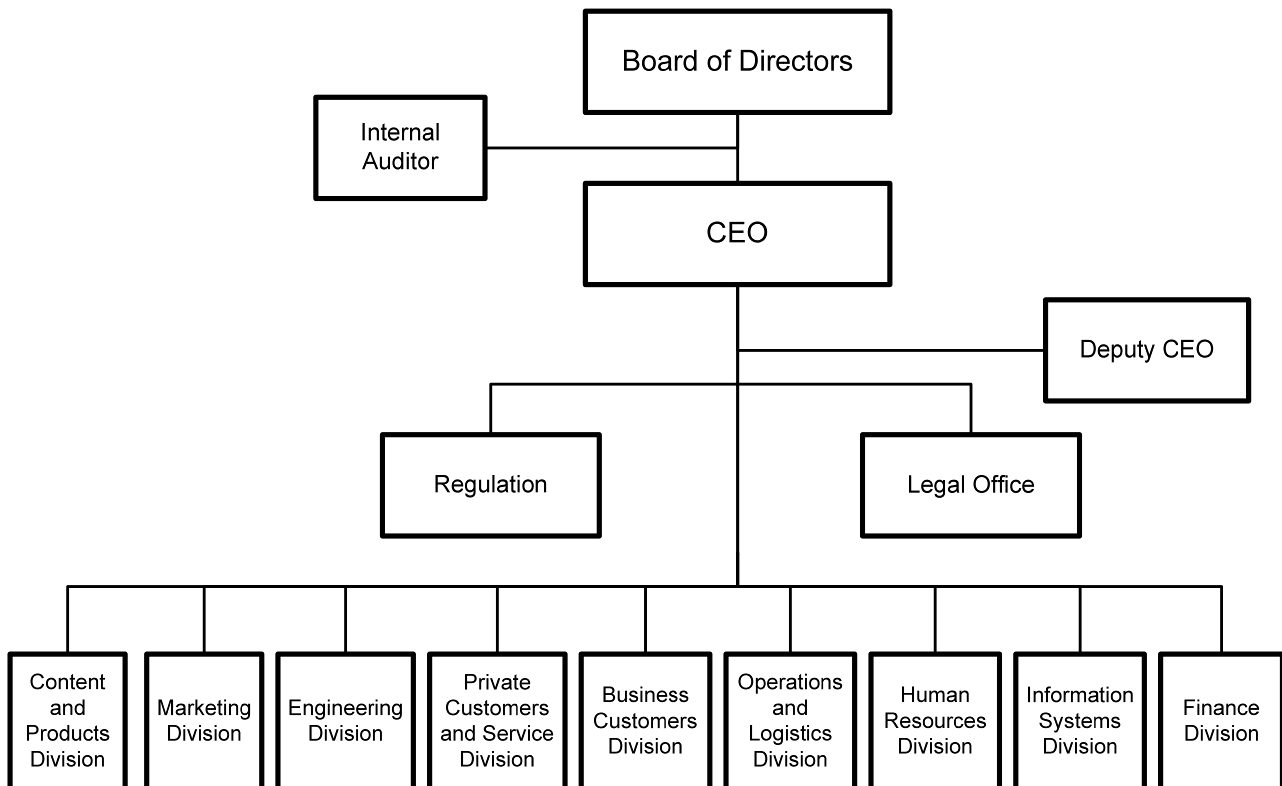
3.10.5 Software, computer systems and databases

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

3.11 Human Resources

3.11.1 Organizational structure

Pelephone's organizational structure:



3.11.2 Employees

The table below describes the number of employees[23] at Pelephone in accordance with its organizational structure:

Division	Number of employees	
	December 12, 2008	December 12, 2007
Headquarters and management	310	295
Content marketing and products division	92	102
Customer service and private sector division	2,453	2,971
Business division	499	534
Operations and logistics division	222	292
Engineering and information systems division	624	617
Total	**4,200**	**4,811**

3.11.3 Changes in the number of employees during 2008

At the end of 2008, Pelephone's human resources stand at approximately 4,200 employees, compared with approximately 4,811 at the end of 2007. The decrease is mainly

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

in the service and sales divisions that were strengthened towards the implementation of number portability.

3.11.4 Instruction and training

Pelephone invests resources in professional training in accordance with the type of employee and occupation. Most training courses take place in service, primarily in the service division. Pelephone's total expenses in 2008 and 2007 in respect of instruction and training amount to NIS 8.5 million and NIS 10.4 million, respectively. There is a high churn rate for sales and service representatives and telephone call center employees, which requires constant investment in new employees.

3.11.5 Employee and manager reward schemes

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

For the options plan for senior officers see Note 26 to the Company's financial statements for the year ended December 31, 2008 included in this annual report.

3.11.6 Employment contracts

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

3.12 Products and Suppliers

3.12.1 Terminal equipment suppliers

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

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

If a contract with a particular terminal equipment supplier is discontinued, Pelephone may increase the quantity purchased from other terminal equipment suppliers or procure terminal equipment from a new terminal equipment supplier. If the replacement of a supplier is required, as aforementioned, the replacement shall not be immediate, and shall be subject to a special preparatory period for purchasing spare parts and accessories, including the repair capacity for all kinds of malfunctions, to enable the provision of service to customers as agreed. Replacement of a supplier involves the addition of exceptional costs due to the need to purchase equipment a period of re-organizing affairs with the replacement suppliers.

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

In preparation for migration to HSPA/UMTS technology, Pelephone had expanded the range of equipment it offers to customers and the number of its terminal equipment suppliers.

3.12.2 Value added service suppliers

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

3.12.3 Infrastructure suppliers

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

Due to the financial difficulties of the Nortel Group internationally, in 2009, the management of the corporation made a decision that all companies in the Group would apply, at the same time, to the courts in the countries in which they are domiciled, for legal protection against their creditors and to freeze the proceedings against them by declaring them as bankrupt. As part of the process, an urgent application was filed at the Tel Aviv District Court for an order to suspend proceedings for Israeli companies of the Nortel Group, serving as a local branch of the Nortel Group in Israel.

3.13 Working Capital

3.13.1 Stock policy

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

The period over which inventory is held is derives from Pelephone's service policy and its sales requirements. The requirements require holding an inventory for a period of 3 – 5 inventory months, depending on the type of inventory. As at the end of 2008, the inventory level stands at approximately NIS 124 million.

3.13.2 Returns policy for terminal equipment purchased

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

Pelephone's policy, as at the date of this report, enables its customers to return equipment purchased shortly after the transaction, according to its judgment and subject to the law, in accordance with the agreement with customers and the conditions thereof, provided that no use has been made of either the product or its accessories.

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

3.13.3 Company policy with respect to product warranty

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

3.13.4 Policy governing credit to customers

Credit in handset sale transactions – Pelephone enables most of its customers purchasing a mobile telephone to pay in up to 36 equal installments. In the past,. Pelephone's policy was to discount part of the transactions that are paid by credit card installments with discount companies. In 2007, Pelephone stopped discounting credit card vouchers.

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

As at 2008, total average customer credit less doubtful debts amounts to NIS 1.530 billion.

3.13.5 Credit from suppliers

Pelephone receives credit from its suppliers for periods ranging from 30 days to 90 days. As at 2008, total average credit from suppliers and service providers amounts to NIS 579 million.

3.14 Investment in Investees and in a Partnership

Pelephone has no active investments in investees and partnerships.

3.15 Financing

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

The average interest rate in 2008 for Pelephone loans:

	Long-term loans (Including current maturities)
Banking sources: CPI-linked – NIS	4.65
Non-banking sources: CPI-linked – NIS	4.64

3.15.2 **<u>Restrictions</u>**

3.15.2.1 Undertakings towards banks

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

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

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

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

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

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

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

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

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

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

3.15.2.2 Immediate repayment of the loan

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

3.15.3 Issue of debentures

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

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

As at December 31, 2008, Pelephone is in compliance with its commitments to the banks and to the debenture holders.

In 2008, there were no new long-term loans and loans and debentures were repaid in the amount of NIS 270 million.

For additional details regarding the composition of the loans and debentures, the conditions thereof and the date of repayment thereof during the report period, see Note 13 of the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

3.15.4 Credit facilities

As at December 31, 2008, Pelephone has bank credit of NIS 356 million.

3.15.5 Guarantees and charges

See Note 13 to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

3.15.6 Credit rating

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

The ratings published from the time of the placements and up to the reporting date remained unchanged.

On October 28, 2008, Maalot announced validation of the unchanged rating of Pelephone's debentures (AA minus), notwithstanding the crisis in the credit market. See the description of macro-economic risk factors in section 3.24.1 below.

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

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

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

3.16 Taxation

See Note 8 to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

3.17 Environmental Quality

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

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

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

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

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

The law includes a punitive section by which, inter alia, the construction or operation of a radiation source in contravention of the provisions of the permit and the construction or

operation of a radiation source without a permit, after having been warned in writing by the commissioner, are strict liability offenses, in respect of which the punishment for the entity is double the penalty provided in Section 61(a)(4) of the Penal Law , 5737-1977.

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

The law also indirectly amends the Planning and Building Law, 5725-1965 and provides that a building permit to a cellular broadcasting facility is contingent on the deposit of a deed of indemnity in respect of claims for compensation pursuant to section 197 of the Planning and Building Law, 5725-1965, providing that such a demand is in accordance with the instructions of the national council. Regarding this matter see section 3.18.3.3 below.

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

On July 17, 2008, a petition was filed at the High Court of Justice requesting an order nisi against the Minister for Environmental Protection, the Minister of Communications and others because of an alleged failure to reach an agreement on the wording of regulations by virtue of sections 25(A)(2) and 25(A)(5) of the Radiation Law, 5766-2006, despite the obligation stated in the law to issue the regulations by January 1, 2007. An application for an interim injunction was dismissed. The petition is yet to be heard. The regulations are yet to be issued.

3.17.2 Anticipated costs and investments

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

3.18 Restrictions on and regulation of Pelephone's operation

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

3.18.1 Statutory restrictions

3.18.1.1 Communications Law and licensing obligation thereunder

The Communications (Telecommunications and Broadcasts) Law 5742-1982 stipulates, inter alia, that that telecommunication activity and telecommunication services, including MRT, are subject to a license from the Minister of Communications (in this chapter: the Minister). Pelephone holds a general license for the provision of MRT services. The Minister is empowered to modify the terms of the license, to add thereto or to detract therefrom, while taking into consideration, inter alia, government telecommunications policy, considerations of public interest, suitability of the license holder to provide the services, the contribution of the license to competition in the telecommunications sector and to the level of service therein. Moreover, the Minister is empowered to annul, restrict or suspend a license in a number of situations (see Section 3.18.3.1 below).

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

3.18.1.2 The Wireless Telegraph Ordinance

The Wireless Telegraph Ordinance (New Version), 5732-1972 (the Telegraph Ordinance) regulates the use of electromagnetic spectrum, and applies, *inter alia,*

to the Company's use of radio frequencies, as part of its infrastructure. Under the Telegraph Ordinance, the establishment and operation of a system using radio frequencies requires a license, and the use of radio frequencies requires designation and allocation of a suitable frequency. The Telegraph Ordinance imposes license fees and fees for designation and allocation of frequencies.

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

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

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

3.18.1.4 The Consumer Protection Law

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

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

3.18.2 Controlled tariffs

Payments for interconnection:

The Telecommunications (Interconnect Fees) Regulations 5760-2000 (the Regulations) prescribe limitations regarding payments to be made or to be received from a domestic operator or another MRT operator under the regulations. In December 2004, the regulations were amended as follows:

A. For the purpose of interconnection payments received from a domestic operator or from another MRT operator for completion of one traffic minute on an MRT network, the current tariff for call completion is to be scaled down gradually to NIS 0.22 in accordance with the following outline (tariffs do not include VAT):

1. As of March 1, 2005, the current tariff of NIS 0.45 per traffic minute was reduced to a maximum of NIS 0.32.
2. As of March 1, 2006, the tariff was reduced to a maximum of NIS 0.29.
3. As of March 1, 2007, the tariff was reduced to a maximum of NIS 0.26.
4. As of March 1, 2007, the tariff was reduced to a maximum of NIS 0.22.

B. With regard to payments to be made by Bezeq International, as an international licensee, for the completion of traffic on a cellular network, the present tariff of NIS 0.25 for call completion was reduced from March 1, 2008 to a maximum of NIS 0.22.

C. With respect to payments received from another MRT operator for transfer of short messages (SMS) over an MRT network, the tariff was reduced in two stages so that

as of March 1, 2005, the maximum tariff for all SMS messages was set at NIS 0.05 and as of March 1, 2006, this tariff was reduced to a maximum of NIS 0.025.

D. The tariffs set forth in sections A-C above will be updated once a year, commencing March 1, 2006, in accordance with the percentage of the change in the CPI.

E. To calculate payment to an MRT network for airtime and call completion, as of January 1, 2009, the charge will be made in accordance with segments of one second (unlike the current charging system which enables charging per segments of up to 12 seconds). Consequently, as of January 1, 2009, the payments payable by the MRT operator for interconnect services to a domestic operator's network will also be revised.

The following table itemizes tariff development:

	Domestic interconnect	International interconnect	
Date	**(per minute tariff)**	**(per minute tariff)**	**SMS**
From May 2004	45.0		28.5
From March 2005	32.0		5.0
From March 2006	29.69	25.57	2.56
From March 2007	26.59		
From March 2008	23.27	23.27	2.64

Note: The tariffs are presented in agorot and do not include VAT. The tariffs as of March 2009 are adjusted for the CPI known in January 2009.

3.18.3 License and site licensing

3.18.3.1 Pelephone's license

The general license for the provision of MRT services granted to Pelephone on February 7, 1996 was for a period of 10 years commencing January 1, 1994, with an option of extending it for additional periods of six years each, under the conditions set forth in the license, consisting primarily of compliance with statutory conditions. Following the tender in which Pelephone was allotted third generation frequencies, the license was extended to be valid for 20 years as of September 9, 2002. For the arrangement with the State regarding the right to use frequencies, see Note 18 (H) to the financial statements of the Company for the year ended December 31, 2008 that are included in this periodic report.

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

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

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

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

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

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

E. The licensee shall refrain from awarding preference in the provision of infrastructure services to a licensee being a company with an interest [24] over another licensee, whether for the payment for the service, whether in the conditions of the service, whether in its availability or otherwise.

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

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

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

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

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

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

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

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

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

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

A. In August 2006, the Ministry of Communications wrote to the cellular companies asking for a response to its intention to amend the companies' license regarding removal of the connection between an MRT terminal handset purchase transaction and the giving of benefits. Pelephone expressed its objection to this license amendment and submitted an economic opinion together with its objection. In November 2007 the Ministry of Communications published an alternative hearing on the same matter, by which any connection between prices of terminal equipment and airtime, as proposed by the MRT providers, should be cancelled. For example, in accordance with the present hearing it will not be possible to offer plans that include a credit for payments in respect of terminal equipment when a certain use threshold is reached in terms of airtime (debit-credit plans). It is noted that most of Pelphone's present plans are of this type. Pelephone has expressed its objection to this change. The Ministry of Communications has not yet made a decision on the matter.

B. In April 2007, the Ministry of Communications published its decision regarding amendment of the license with respect to changing the mechanism used for identifying users of erotic services as adults. In accordance with the amendment, the denial of access to erotic services will be removed by submitting a written request together with a photocopy of an identifying document or by physically appearing before a service representative. The amendment that was supposed to come into effect on May 25, 2007 has been delayed for the time being according to a temporary injunction issued by the Supreme Court, until the request for the temporary injunction and the petition is heard by a panel of three judges. The temporary injunction was awarded in the framework of a private petition to the High Court of Justice against the aforementioned amendment that was filed in May. The petition includes a request for a temporary injunction suspending the coming into effect of the amendment.

C. In June 2008, the Ministry of Communications scheduled a hearing regarding proper disclosure for telephone bills. During this hearing, a number of changes in the structure of the bills were proposed

   The hearing was based on the recommendations of the Subcommittee of the Knesset Economics Committee and recommendations of the professional committee of the Ministry of Communications regarding the structure of the invoice, which completed its work in 2008.

   Pelephone submitted its position to the Ministry of Communications. Implementation of the recommendations as proposed will require Pelephone to make appropriate operational arrangements.

   In February 2009, the Ministry of Communications published its final decision on this matter in the context of the new appendix for MRT licenses. The appendix stipulates the changes required in the structure of the customer invoice. Additionally, the Ministry published a hearing for the amendment of Pelephone's license, including the date for implementation of the changes in the invoices (September 1, 2009). Pelephone intends to apply for a postponement of the final implementation date.

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

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

operators may lower the preset prices during the commitment period. Pelephone applies the amendment from December 31, 2008.

F. In September 2008, the Ministry of Communications published an amendment to the cellular operator's licenses regarding the following matters:

1. Termination of service to a dormant subscriber – under this amendment, the operator is entitled to terminate service to a subscriber who does not use the cellular service for 2 months. Termination will be possible after the operator notifies the subscriber of its intention to terminate the service, in the format set forth in the license amendment. A subscriber requesting continuation of the service despite being a dormant subscriber will not be disconnected by the operator. The operator may only send a second notice of disconnection to the subscriber (the second notice) after the additional 12 months from the date of the first notice, provided the subscriber meets the definition of a dormant subscriber for the entire additional 12-month period. In the second notice, the operator is entitled to notify subscribers that if they remain dormant for another 12 months, the operator will be permitted to disconnect the subscriber finally, without further notice.

2. Blocking end equipment in the event of loss / theft – according to this amendment, the cellular operators are obligated to maintain a joint store of end devices which were reported lost or stolen and ensure that these devices are blocked from any use immediately upon receipt of the loss / theft report This amendment is effective from January 31, 2009.

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

H. According to the policy document of the Ministry of Communications from 2004, Bezeq will be permitted to market joint packages of services with its subsidiaries when its market share for fixed telephony services drops to 85%. In 2008, Bezeq's market share dropped below 85%. Accordingly, the Ministry of Communications recently announced a hearing including the proposed amendments to Pelephone's license.

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

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

1. Approval in principle from the Minister of Communications, contingent on the availability of similar packages in the market.

2. Individual approval of the joint package, contingent on the submission of an individual application to the Ministry of Communications.

Pelephone is preparing its response to this hearing.

3.18.3.2 Royalties

Pursuant to the Telecommunications (Royalties) Regulations, 5761-2001 and its license, Pelephone pays royalties to the State of Israel out of its revenues subject to royalties from the provision of telecommunications services, *inter alia* less revenues and expenses in accordance with the guidelines in the Royalties Regulations. In 2006, these royalties were 3% of its revenues subject to royalties. Under the Regulations, the rate of royalties is to be reduced by 0.5% to 1% from 2010 and onwards, so that in 2007, Pelephone will pay royalties at the rate of 2.5%, in 2008 - 2%, in 2009 - 1.5% and from 2010 onwards - 1%. In this regard, see also reference to a lawsuit filed by the State of Israel against Pelephone with respect to non-payment of royalties in Note 17 to the Company's financial statements for the year ended 2008, included in this periodic report.

3.18.3.3 Site licensing

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

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

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

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

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

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

C. Approval of the Israel Defence Forces.

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

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

update, Pelephone has deposited 234 deeds of indemnity with various local councils, in accordance with the law.

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

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

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

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

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

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

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

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

Pelephone, similar to other MRT operators in Israel, is liable to be required to dismantle broadcasting sites for which the necessary approvals and permits have not been obtained in accordance with the dates prescribed by law. If it is legally

required that sites in a given geographic area be simultaneously demolished, service in that area is liable to deteriorate until substitute broadcasting sites can be built.

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

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

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

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

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

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

The Attorney General’s opinion in this respect is described below.

Pelephone disagreed with the district court’s ruling and on June 10, 2008, it filed a request for permission to appeal to the Supreme Court In the context of the request for permission to appeal the Attorney General stated, inter alia, that the exemption in section 26 (C) of the law also applies to wireless access devices.

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

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

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

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

continued application of the exemption for cellular devices, the purpose of developing an updated position regarding a worthy justification for the exemption for cellular telephone devices, by the end of 2008. The committee has yet to submit its opinion.

Pelephone uses access devices to provide coverage and capacity to highly populated areas. Reducing or preventing use of the access devices track in a given geographical area may have an adverse effect on service in that area until substitute broadcasting sites can be built. If it is legally required that sites in a given geographic area be simultaneously demolished, service in that area is liable to deteriorate until substitute broadcasting sites can be built. As at the date of this report, Pelephone operates 396 wireless access devices.

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

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

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

It is hereby clarified that Pelephone continues to construct wireless access devices. The rejection of Pelephone's position by the courts, in whole or in part, will have an adverse impact on the possibility of deploying sites, pace of deployment, and so forth. Termination of the operation of access devices will also damage service in the areas where these devices operate.

3.18.4 Antitrust

The document setting out the terms of the merger between Pelephone and Bezeq includes various restrictions as to cooperation between the companies. In 2006, Pelephone applied to the Antitrust Commissioner to cancel the conditions of the merger with Bezeq or to provide relief for such conditions so as to enable cooperation between Pelephone and Bezeq. Pelephone has not yet received a response from the Antitrust Authority.

3.18.5 Standards

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

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

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

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

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

3.19 Substantial Agreements

For undertakings to banks, see section 3.15.2 above.

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

3.20 Joint Venture Agreements

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

For roaming agreements, see section 3.2.1 above.

For a memorandum of understanding with the Super-Pharm chain, see section 3.6 above.

3.21 Legal Proceedings

For legal proceedings, see Note 17 to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

3.22 Goals and Business Strategy

Pelephone's principal strategic goals are:

1. To increase revenue and improve profitability
2. To maintain leadership in third generation
3. To increase its market share in the long term

To achieve its goals, Pelephone operates on a number of principal levels:

1. Increasing customer satisfaction

   Pelephone acts to increase customer satisfaction and strengthen customer loyalty to Pelephone's services. These actions are reflected in improvement of the service system, offers to upgrade terminal equipment, and benefits for Pelephone customers under a marketing package reinforcing the Pelephone-customer relationship. Pelephone uses an advanced measurement system to monitor customer satisfaction, so that it may learn from it and constantly make improvements.

2. Third generation leadership

   Pelephone has set itself the goal of being a third generation leader. In 2008, Pelephone continued to maintain its leadership in this area and it presently has the largest number of subscribers with third generation handsets compared to its competitors. This leadership is reflected in increased revenue from 3G services and by the number of subscribers joining such services.

3. Managing migration of customers to HSPA/UMTS

   To lever the new technology to improve customer satisfaction and maximize revenue, Pelephone acts to prioritize migration of customers from CDMA to HSPA/UMTS.

4. Continued investment in infrastructure

   Pelephone acts constantly to improve cellular service so that it can offer its customers the most advanced services, high speed access, high reception quality and full national deployment. The above information contains forward-looking information, which is based on Pelephone's assessments taking into account past experience, surveys regarding the state of the sector in which Pelephone operates, and its own future plans. Actual results might be substantially different from the assessments set out above, if there is any change in any of the factors taken into account in making these assessments. For risk factors, see section 3.24 below.

3.23 Outlook for Development in 2009

In 2009, a number of negative and positive factors are expected to affect Pelephone's activities, the main ones being:

3.23.1 Launching of the HSPA/MTS network

1. Launching of the HSPA/UMTS network allows Pelephone to expand the range of terminal equipment available to its customers, with popular brands such as Nokia and Sony Ericsson, which will contribute to the application to other target populations.
2. Launching the HSPA/UMTS network will allow Pelephone to expand roaming services and accordingly, increase revenue from this sector.

3.23.2 Third generation services

Pelephone expects that during 2009, it will increase the number of customers using 3G and the range of such services, resulting in continued increase its revenue in this sector.

3.23.3 Innovative value added services

In 2008, Pelephone is expected to continue to improve its existing services and to widen its range of advanced value added services, which will help improve brand perception and increase revenue from existing customers.

3.23.4 Regulation

In 2009, Pelephone expects revenue to be adversely affected by regulation of policy, license amendments, consumer legislation and various administration provisions that are expected to come into effect during the year, including the transition to charging by second, the ban on price increases in a fixed transaction and the introduction of MVNO. See section 3.18.3.1 above.

The above information contains forward-looking information, which is based on Pelephone's assessments taking into account past experience, surveys regarding the state of the sector in which Pelephone operates, and its own future plans. Actual results might be substantially different from the assessments set out above, if there is any change in any of the factors taken into account in making these assessments. For risk factors, see section 3.24 below.

3.23.5 Recession – an economic recession in Israel might bring about a reduction in private consumption in general and consumption of cellular services in particular, some of which are considered luxuries. See section 3.24.1.1 below.

3.24 Risk Factors

The Israeli market in which Pelephone operates is stable by nature, however, there are risk factors deriving from the macro-economic environment, the unique qualities of the sector in which Pelephone operates, and risk factors that are unique to the Company.

3.24.1 Macro-economic risks

3.24.1.1 In 2008, the crisis in the credit market has sent global markets into a recession and credit crunch. It is expected that the impact of the process will continue to be felt in 2009 and possibly even later, and it is possible that there will be a transition from growth to recession. The local market is also expected to experience a significant slump together with a deterioration in business operations and central economic parameters, which could have an adverse effect on its operations in 2009.

The possible effect of changes in the economic environment include the following:

1. A slowdown in the acquisition of new subscribers, abandonment of existing subscribers
2. A decline in revenue as a result of the decline in use, erosion of tariffs and reduction in the number of users in other services
3. Changes to the exchange rate which will impact the profitability of the sale of end equipment and financing costs
4. Collapse of suppliers

This information contains forward-looking statements, based on Pelephone's assessments. Actual results may differ materially from these assessments if there is a change in any of the factors taken into account in these assessments.

3.24.1.2 Exposure to fluctuations in exchange rates, interest rates and inflation – Pelephone is exposed to risks caused by fluctuations in exchange rates, since most purchases of terminal equipment, accessories, spare parts and infrastructure are in US dollars, while Pelephone's income is in NIS. Erosion of the shekel as against the dollar might have an adverse effect on Pelephone's profits if sale prices cannot be adjusted in the short term. Accordingly, Pelephone invests a considerable share of its cash balances in deposits that are exposed to changes in real yields as a result of inflation rate fluctuations. Pelephone's CPI-linked loans and debentures bear fixed interest and therefore fluctuations in the interest rate will affect their fair value but not their book value.

3.24.2 Sector risks

3.24.2.1 Investments in infrastructure and technological changes – The cellular market in Israel and other countries is characterized by material capital investments in the deployment of infrastructure and in subscriber equipment. The frequent technological changes in infrastructure and terminal equipment and the fierce competition in various market segments impose a heavy financial burden on the companies operating in the market, requiring them to update their infrastructure technology from time to time or to introduce new devices into the market at heavy cost.

3.24.2.2 Customer credit – Pelephone's sales to its customers are mostly credit-based. Some of this credit is secured using credit insurance which includes policyholder's deductibles, and some is secured by sureties provided by customers. The other part of this credit, which is not covered by either insurance or sureties, is exposed to risk. Due to the wide distribution of its customers, Pelephone assesses that there is a low risk of substantial harm to its business results.

3.24.2.3 Regulatory developments – In the area of Pelephone's operations, there is a trend to legislate and impose standards on issues such as the environment, increased competition, tariffs, product liability and the methods used for repairing products. These regulations might, inter alia, make it much more difficult to construct cellular sites, impairing network quality, and increase the costs of services and marketing. Due to the strong competition, it might not be possible to

roll those costs in full onto consumers, which could erode profits in the sector. Furthermore, regulatory intervention and the uncertainty it entails may have an adverse effect on the Pelephone's ability to plan its business conduct.

3.24.2.4 Competition – The cellular market in Israel is characterized by a high degree of saturation and strong competition, and is exposed to influences due to technological and regulatory developments.

3.24.2.5 Electromagnetic radiation – Pelephone operates hundreds of transmission facilities and sells terminal equipment that emits electromagnetic radiation (see section 3.17 above). Pelephone is taking steps to ensure that the levels of radiation emitted by these transmission facilities and terminal equipment do not exceed the levels of radiation permitted in the directives of the Ministry of Environment Protection (levels adopted in accordance with international standards). Even though Pelephone acts according to the directives of the Ministry of Environment, if health risks are found to exist or if the transmission sites or terminal equipment are found to emit more radiation than that allowed in radiation standards, which constitutes a risk to health, the effect could be negative following a reduction in the use of Pelephone's services, difficulty in renting sites, claims for physical and property damages of substantial amounts and attempts to exercise the deeds of indemnity that were deposited with the planning authorities with respect to section 197 of the Planning and Building Law. Pelephone's third-party liability policy does not currently cover electromagnetic radiation.

3.24.2.6 Site licensing – The establishment and operation of cellular antennas are subject to building permits from the various planning and building committees, a process that involves, inter alia, a number of approvals from State entities and regulatory bodies. For details of the difficulties encountered by Pelephone in the establishment and licensing of sites, see section 3.18.3.3 above. These difficulties may impair the quality of the existing network and even more the deployment of the new network.

3.24.3 Pelephone's risk factors:

3.24.3.1 Terminal equipment quality – Pelephone might be exposed to losses in the event of malfunctions in the terminal equipment that it sells, including indirect damages that could result from such malfunctions.

3.24.3.2 Property risks and liabilities – Pelephone is exposed to various property risks and liabilities. Pelephone employs the services of an expert external insurance consultant in this field. Pelephone has insurance policies which cover the usual risks to which Pelephone is exposed within the limits of the conditions of such policies, such as various forms of property insurance and liability insurance, loss of profits, third party liability insurance and officers' insurance.

3.24.3.3 Serious malfunctions in information systems – Pelephone's information systems are networked throughout the country through designated communications lines and through the internet. Pelephone's business is highly dependent upon these systems. Wide-scale malicious harm or malfunction might adversely affect Pelephone's business and results.

3.24.3.4 Serious malfunctions in the communications network – Pelephone's communications network is deployed around the country through network core sites and antenna sites. Pelephone's business is totally dependent upon these systems. Wide scale malicious harm or malfunction might adversely affect Pelephone's business and results.

3.24.3.5 Damage by natural or other disasters, war, damage to the switching farm and/or servers used by Pelephone for its core activities could have an adverse effect on Pelephone's business and its results.

3.24.3.6 Legal proceedings – Pelephone is party to legal proceedings, including class actions, which are liable to result in its being charged for material amounts that cannot presently be estimated and generally no provision has been made in Pelephone's financial statements for these proceedings. Class actions may reach high amounts, since approximately one third of the residents of Israel are Pelephone consumers, and a claim relating to a small amount of damage to a single consumer may grow into a material claim against Pelephone if certified as

a class action applicable to all or a large proportion of those consumers for legal proceedings to which Pelephone is a party.

3.24.3.7 Pelephone uses two frequency ranges: 850 MHz and 2100 MHz. These frequencies are exposed to interruptions and could impair service quality of networks operated by Pelephone. The factors that could cause interruption include the fact that the 850 MHz frequency is also used for cable television broadcasts, television stations broadcasting in the Middle East (mainly in Cyprus) on the same frequency causing interruption in the Pelephone's EVDO/XRTT1 network. In addition, in view of the peace treaty with Jordan, Pelephone is precluded from using part of the frequency range that is suitable for the CDMA network, which is used by Jordan operators. In addition, development of digital multi-channel television broadcasts could aggravate the disturbances in this network.

The following are the risk factors as described above, and their effect in the opinion of management, on the results of its business:

Effect of risk factor on all of Pelephone's activity			
Risk factors	**Major**	**Moderate**	**Minor**
Macro-economic risk factors			
Economic recession		X	
Exposure to changes in the exchange rates, interest rates and inflation		X	
Sector risk			
Investments in infrastructure and technological changes	X		
Customer credit			X
Regulatory developments	X		
Competition	X		
Electromagnetic radiation*			
Site licensing	X		
Pelephone's risk factors:			
Quality of terminal equipment		X	
Property risks and liabilities			X
Serious malfunctions in information systems	X		
Serious malfunctions in the communications network	X		
Legal proceedings		X	
Restrictions applicable to frequencies and disturbance in use of frequency range		X	

* Pelephone is unable to assess the effect of this risk factor on its operations.

4. International communications and internet services – Bezeq International Ltd. (Bezeq International)

4.1 General

4.1.1 Structure and changes to area of operations

Bezeq International, a wholly-owned Bezeq subsidiary, supplies direct dialing telephone services to 240 destinations all over the world. Bezeq International's telephone services, similar to services of other international operators competing in the market, are primarily based on the Company's domestic network and on the cellular network for connecting the subscriber to the international exchange.

In addition to international call services (Voice Services), Bezeq International supplies data communication services (Data Services), ISP (Internet Services), value added services, telephony routing services between foreign international communication operators and server and web hosting services (Hosting Services). Bezeq International also supplies integration services offering business customers comprehensive communication solutions, including data services, web and server hosting, and maintenance services and technical support for networks (Integration Services). Since its full merger with BezeqCall Communications Ltd. (BezeqCall) on February 11, 2007, (the date of the full merger), the Company also supplies NEP services, including data communications infrastructure services, passive infrastructure installation services and low voltage systems, sale of exchange systems including IP telephony communications systems, and installation and maintenance services for these systems. Bezeq International's data communication services include P2P lines, frame relay, virtual, ATM, ISDN, private networks, video conferencing facilities and IP services.

4.1.2 Legislative and statutory restrictions applicable to Bezeq International

The communications market in Israel is primarily regulated by the Communications (Telecommunications and Broadcasts) Law, 5742-1982 (the Communications Law). See section 4.17 below.

4.1.2.1 General license

Bezeq International operates in compliance with a general license for supply of voice, data and internet services (in this chapter: the License), which is valid until 2022. The provisions of the license regulate, inter alia, the method for determining tariffs charged by Bezeq International for its services, their update and collecting the payments for these services.

On July 11, 2007, the Ministerial Committee approved an amendment to the Communications (Telecommunications and Broadcasts) Law, 5742-1982, which is parallel to the Limitation of Access to Adult Internet Sites Bill, 5766-2006, of Knesset Member Amnon Cohen, and submitted it to the Economic Committee of the Knesset. The bill, which was discussed by the Economic Committee, proposes restricting access to sites that contain pornographic content, gambling, or violence, inter alia by imposing an obligation on internet service providers, including Bezeq International, to activate mechanisms that oversee access to such sites. Due to the many questions raised in the Committee relating to the constitutionality of the amendment, as well as to the technical aspects involved in its implementation, the Committee requested that the Ministry of Communications present it with information before it makes any decision in this regard. At this stage, before completion of the hearing in the Economic Committee of the Knesset, it is not possible to assess the implications of this law, if and when it is passed, on the commercial operations of Bezeq International.

4.1.2.2 Special general domestic operator license

On February 8, 2009, the Minister of Communications granted a special general license for the supply of domestic communication services to BIP Communication Solutions (S.R), a company owned by the Bezeq International.

Granting the license was made possible in view of the VoB policy document, which states, inter alia, that Bezeq International can receive a VoB license once the Company's share of the domestic telephony market falls below 85%.

The license allows Bezeq International to deliver domestic telephony services over broadband (VoB) to private customers only. However, once Bezeq's market share of the business sector falls below 85%, the Bezeq International can also provide these services to business customers.

4.1.2.3 Royalties

Under its license and the Telecommunications (Royalties) Regulations 5761-2001, Bezeq International pays the State of Israel royalties of 3.5% per year, out of most of its revenue from the supply of international call services and P2P lines, less permitted expenses and with the exception of revenue from customers determined in these regulations.

In the past, Bezeq International carried out an examination, which uncovered that the calculation method for royalties due by Bezeq International is incorrect and that it paid excessive royalties in previous years. Accordingly, Bezeq International updated payment of the royalties it transferred. On the publication date of the periodic report, there is a dispute between Bezeq International and the Ministry of Communications in respect of this update.

In the matter of the percentage of the royalties, in August 2006 the Ministry of Communications and the Ministry of Finances approved the Telecommunications (Royalties) (Amendment) Regulations 5766-2006 so that the royalty rate was reduced from 3.5% to 3%, as of January 2006. The amendment also determined that the royalty rate would be gradually reduced, so that in 2007, the rate would be 2.5%, in 2008 it would be 2%, in 2009 it would be 1.5%, and from 1 January 2010 it would be 1%. In this regard see also section 2.16.3 above.

4.1.2.4 NEP license

On December 31, 2006, the Ministry of Communications approved the transfer of BezeqCall's NEP license to Bezeq International. As of the date of the full merger, Bezeq International has been providing NEP services under this license.

4.1.2.5 Gronau Committee report

For recommendations of the Gronau Committee and their adoption by the Minister of Communications, see section 2.6 above.

Bezeq International estimates that the Minister's decision will not have an effect on the company's business operation in the near future and in any event, it is unable, at this stage, to estimate the possible long-term effect. The Minister determined that implementation of the changes in the company's field of operations requires the completion of a lengthy procedure to prepare regulatory infrastructure, the nature of which is uncertain at this stage, as well as the creation of new market arrangements on this infrastructure, and it is uncertain if or when they will materialize.

4.1.2.6 Amendment to the general license – sale of service bundles

On July 3, 2008, Bezeq International received a letter from the Director General of the Ministry of Communications, regarding an amendment to the general license for the sale of service bundles, which includes the services of Bezeq International and Bezeq. The letter included draft amendments to the general licenses of Bezeq International and Bezeq. In its response to this letter and in the framework of the hearing held at the Ministry of Communications on July 20, 2008, Bezeq International informed the Ministry of Communications that it objects to the amendment of its general license, in the proposed wording, because on the one hand, this amendment will not ease the restrictions imposed on Bezeq International and Bezeq for the sale of joint service bundles, and on the other hand, the proposed amendment will have an adverse effect on its current situation and discriminates against the company in comparison to the competitors. In the course of this hearing, further amendments were made to the draft amendments to the licenses of Bezeq International and the Bezeq, and again, this was not to the satisfaction of Bezeq International. On February 11,

2009, another hearing was held with the Director General of the Ministry of Communications. In this hearing, Bezeq International was assured that the Ministry of Communications would consider cancelling or updating the proposed amendment, to avoid discriminating against Bezeq International opposite the competitors.

4.1.3 Main entry and exit barriers

4.1.3.1 The main entry barrier in the international call market is the requirement of a license under the Communications Law and investments in infrastructure, which are affected by frequent technological changes. However, change in the licensing policy, as set forth below, and expansion of the use of VoIP technology in this field, significantly reduces the effect of these barriers.

4.1.3.2 The main entry barrier into the data and internet services market stems from investments in infrastructure (international capacity, access to the internet network and broad service network).

4.1.3.3 The main exit barriers for these markets stem from long-term agreements with infrastructure suppliers and from investments that require a long periods of time to provide returns. Furthermore, Bezeq International is committed to providing service to its customers during the period of their contract .

4.1.4 Substitutes for Bezeq International products

Some service providers in the international call market do not have a license (illegal operators) and therefore do not adhere to the restrictions imposed on Bezeq International by virtue of the license and the provisions of the law. Furthermore, use of VoIP technology enables transfer of international calls over the internet, for other users of this technology, as well as for TDM network users, through the use of software products and services of communication providers abroad. The attractive costs of using these services lead to a steady growth in the number of users, and as a result – a decline in the revenue of Bezeq International.

4.1.5 Structure of competition and changes in the sector

4.1.5.1 In the first year of its operation, from June 1996 to July 1997, Bezeq International was the exclusive provider of international telephony services in Israel. In July 1997, two other international operators entered the market: Barak I.T.C. (1995) – International Telecommunications Services Company Ltd. and 012 Golden Lines Ltd. This led to a sharp fall in the prices of international calls and extensive growth in the capacity of the market. In April 2004, the Communications (Telecommunications and Broadcasts) (Procedures and Conditions for the Receipt of a General License for International Telecommunications Services) Regulations 5764-2004, came into effect. On the publication date of this report, the Ministry of Communications has granted general licenses to provide international telecommunications services to three more operators: Internet Gold-Golden Lines Ltd. (Internet Gold), NetVision Ltd. and Xfone Communication Ltd., all of which commenced operations by the end of 2004. The expansion of competition led to an additional fall in the prices of international calls, although, unlike 1997 when competition began, the volume of international traffic did not undergo a significant increase, since prior to the expansion of competition, call prices did not constitute a factor preventing the public from using the service. The expansion of competition had an adverse effect on the results of Bezeq International's operation and on its financial condition.

4.1.5.2 In 2007, Barak merged with NetVision, forming NetVision 013 Barak and Internet Gold merged with Golden Lines, forming 012 Smile.

4.1.5.3 In September 2008, Partner Communications Ltd. (Partner) announced its intention to offer internet and IP-based content and telephony services, and as such will compete in Bezeq International's markets. Partner chose to soft launch internet, VoB and content services in the fourth quarter of 2008 and started to offer these products to the public on January 1, 2009. Bezeq International is adjusting its work plans accordingly.

4.1.5.4 As at the date of the periodic report, licenses for providing internet services have been granted to some 70 companies, among them five of the aforementioned international operator licensees.

4.2 Products and Services

Below are details of the principal products and services provided by Bezeq International.

4.2.1 Voice services

In the voice services sector, Bezeq International provides international direct dialing (IDD) services to business and private customers; toll-free number services for business customers overseas; telephone card services enabling prepaid and postpaid dialing, mainly from overseas to Israel, for business and private customers; and the 1809 service for dialing from Israel to other countries by dialing 1809.

4.2.2 Internet services

In the internet services sector, Bezeq International provides internet access services for private and business customers, including terminal equipment and support, with an emphasis on broadband internet based on ADSL or cable infrastructures; hosting services – site storage and server services in a designated installation for business and private customers, including value-added services (such as monitoring and control); information security services, services securing customers' internet and LAN connections using the required terminal equipment or software, including monitoring; data services with international data communication IP solutions for business customers, including global deployment if necessary; and wireless (WIFI) access – fast wireless access solutions for private and business customers, including in various public locations (hotspots).

4.2.3 International data services

Supply of international data communication solutions for business customers, includes customized global deployment.

The customer is able to choose from a range of advanced data communication methods:

- DIA is a reliable and scalable P2P public IP platform manufactured by BT Infonet. The service allows global internet access (ISP) through one internet provider, and is designed as an optimum solution for the current requirements in business VPN connectivity.
- iWorks is a global offnet internet service that complements DIA, supplied as a one-stop-shop service through Bezeq International. The service provides full connectivity to public internet, through local providers in each country.
- IP VPN secure service enables transfer of multiple applications on a consolidated network, including data applications, real time and mission critical.
- Bezeq International supplies a range of private P2P services through optic cables running from Israel to Europe, for which the company has long-term leasing rights.

4.2.4 PBX services

Following the merger with BezeqCall, Bezeq International markets and maintains communication systems in the Israeli market, exchanges, telephony networks and IP communications. As part of the service contracts, Bezeq International supplies direct maintenance of a range of exchange manufacturers. The services are given to gateways, exchanges and network end points (NEP) designated for use with both internal and external lines.

4.2.5 Integration services

In the third quarter of 2005, Bezeq International set up an integration and new business division that focuses on data, server and web hosting, and total integration solutions for businesses.

4.2.6 In the NEP services sector, Bezeq International provides sale, installation, and maintenance of exchange systems, installation and maintenance of data communication infrastructure, installation and maintenance services for passive infrastructure and low-voltage systems, with emphasis on integrative solutions tailored to business and institutional customers on their premises.

4.3 Revenue

Bezeq International's revenue (in NIS millions):

	2008	2007	2006
Total revenue	1,306	1,304	1,021
Gross profit (%)	40%	34%	35%

4.4 New Products

4.4.1 In January 2009, Bezeq International launched its new server farm, which is the most advanced in Israel. The server farm, which is in addition to the company's existing server farms (IDC), is expected to host thousands of servers. Establishment of the server farm is part of Bezeq International's strategy to strengthen its position in the corporate sector, and in particular, among small and medium business that prefer outsourcing their IT management. The new server farm is a green farm, based on energy-saving infrastructure. The server farm uses Bezeq International's advantages as a leading internet provider in Israel and is connected directly to the backbone of the company in Big 10 connection. This allows customers to benefit from maximum flexibility in their broadband management and from a wide range of advanced services, including server hosting and management, virtual services and a range of managed services such as backup, information security, firewalls, tracking, statistical construction, international traffic, burstable bandwidth and FTP services.

Principal new products launched in 2008:

4.4.2 **SIM 014**: an international SIM for dialing from cellular handsets when abroad, with the benefit of saving tens of percent compared to special offers for calls from abroad offered by the cellular companies. SIM 014 services are carried out through automatic callback and also provide the following services:

- Voice mail
- SMS
- SIM 014 online support

4.4.3 **Eset**: a security package installed on the customer's PC, supplying comprehensive security including antivirus, anti-spam, spyware and firewall. Eset also provides offline protection and is updated automatically.

4.4.4 **iKeeper version 6:** screening of websites with inappropriate content classified by content – gambling, porn, sport, chat and email. The new version (from December 22, 2008) includes shopping, violence, social networks, blogs and forums.

4.4.5 **@my:** a service allowing customers to select a unique email suffix to replace the regular suffix

4.4.6 **Safeweb:** a network service that screens inappropriate content and sites. The services screens content and websites whenever the customer is online and is not dependent on the customer's screening settings.

4.4.7 **Juniper SSG:** a series of unified threat management products providing a comprehensive protection solution for customers on the organizational gateway level

4.4.8 **Check Point UTM-1 270 / 570 / 3070:** a series of unified threat management products providing comprehensive protection for customers on the organizational gateway level

4.4.9 **Check Point Power 1:** a series of high performance hardware-based network firewalls

4.4.10 From the date of the full merger, Bezeq International absorbed all the products and services that BezeqCall sold and supplied at that time. For further details, see the update in section 4.2 above - Products and ervices.

4.5 Marketing, distribution and service

4.5.1 The marketing department coordinates all the operations for a number of permanent suppliers, among them advertising companies representing Bezeq International, which are used by Bezeq International to remain in contact with the advertising media (television,

internet, radio and the daily national press), production and post-production companies (this changes depending on the requirements of each campaign), design and printing companies, and sales promotion and PR companies. Bezeq International believes that the loss of contact with any of its permanent advertising or marketing suppliers will have no significant effect on its marketing and distribution channels.

4.5.2 Bezeq International operates sales channels for the private market, as follows:

4.5.2.1 Recruitment center for internet and incoming voice call services providing solutions for demand, and recruitment center for internet and outgoing voice calls based on various files.

4.5.2.2 Retention center for internet and incoming voice call services providing solutions for customers wishing to leave Bezeq International and retention center for internet and outgoing voice call services which handles existing customers proactively.

4.5.2.3 National direct sales setup conducting door-to-door operations, operating points of sale and managing customers.

4.5.2.4 Distribution channel setup including external centers and field systems for resellers and dealers.

4.5.3 Bezeq International operates sales channels for the corporate market, as follows:

4.5.3.1 New customer recruitment center – for SMB customers under the ingoing and outgoing call model, using files.

4.5.3.2 Increased existing customer volume center – for SMB customers under the ingoing and outgoing call model, using files.

4.5.3.3 Customer retention center, which handles the heaviest customers in the SMB sector, retains them and increases revenues from them. This center also acts as a second line regarding customer retention matters.

4.5.3.4 National direct sales setup conducting door-to-door operations, operating distributors and recruiting SMB customers.

4.5.3.5 Telemeeting center for setting and coordinating meetings with potential SMB and SME customers.

4.5.3.6 SME sector, which coordinates customer managers who recruit and manage medium-sized customers on an ongoing basis.

4.5.3.7 ENT sector, which coordinates customer managers who recruit and manage strategic customers on an ongoing basis.

4.6 Competition

The main characteristic of market competition in 2008 was the entry of new players into ISP and VoB, following the market consolidation in 2007, which included the mergers of Barak - NetVision, Golden Lines – Internet Gold, and on the other hand, the merger of Bezeq International with BezeqCall. The competition is characterized by eroding tariffs.

4.6.1 <u>Voice services</u>

4.6.1.1 At the end of 2008 there were four competitors operating in the market: 014 Bezeq International, NetVision 013 Barak, 012 Smile and 018 Xfone. In Bezeq International's estimation, its market share in the outgoing calls sector is 36%.

4.6.1.2 General characteristics of competition in 2008

4.6.1.2.1 About 50% of households make international calls at least once a month.

4.6.1.2.2 The various sectors are extremely important (emphasis on immigrants originating from the former USSR) and marketing operations are designed accordingly.

4.6.1.2.3 The product is a commodity.

4.6.1.2.4 The market is a price market.

4.6.1.2.5 There is low consumer involvement due to the low costs.

4.6.1.2.6 Fierce competition and penetration of VoIP technology increase competition for customers.

4.6.2 Internet services

There are a number of competitors in this market, including Bezeq International, 013 NetVision, 012 Smile, Partner (as described in section 4.1.5.3) and two minor niche players. In Bezeq International's estimation, its market share in the internet service sector is 36%.

4.6.2.1 General characteristics of competition in 2008

4.6.2.1.1 Some 73% of Israeli households are connected to the internet and 95% of these have broadband connections.

4.6.2.1.2 There are two alternatives for customers in the market: ADSL, the leading Bezeq infrastructure, and HOT infrastructure.

4.6.2.1.3 HOT frequently cooperates with Bezeq International's direct competitors. HOT acts to restrict Bezeq International's internet operations.

4.6.2.2 Main developments in 2008

4.6.2.2.1 Continued slow-down in the growth rate of high-speed internet compared with previous years.

4.6.2.2.2 Launch of high speed services by infrastructure companies (M 4, 7, 8, 10, 12).

4.6.2.2.3 Continued migration of customers to higher speeds.

4.6.2.2.4 Purchase of value added services.

4.6.2.2.5 Continued importance of price for the customer. At the same time, and in view of the market saturation, emphasis is placed on strengthening customer loyalty.

4.6.2.2.6 Strengthening sales of bundles and triple play in the market, meaning infrastructure suppliers influence market behavior.

4.6.2.2.7 In 2009, Bezeq's ADSL network will be upgraded to NGN, with national deployment and high speed access of up to 50 MB.

4.6.3 Solutions for the business sector – Bezeq International Business

Characteristics of the business sector in 2008

From the aspect of customer orientation and with the aim of increasing revenues from business customers, Bezeq International continues to supply integration services to businesses, providing full solutions in areas such as system, networking, IT, hosting, voice, data, ISP and wireless.

There is a full solution model for the customer, without relying on external suppliers, and the customer has one contact person with responsibility for the process (one supplier, one responsibility).

With the introduction of integration solutions, Bezeq International is facing new competitors in this field, such as Binat, Taldor, and IBM.

The other companies that are in competition with Bezeq International, and which, as well as the Bezeq Group fall into two main communications groups, are also trying to reinforce this field and competition is expected from that direction as well.

4.6.4 NEP services

The traditional field of telephone exchanges is characterized by a large number of competitors and by fierce competition, which has given rise to an erosion of service prices. The most prominent competitors are Tadiran, Eurocom, GlobeCall and Tel-Yad.

The data communications and IP telephony sector is characterized by the entry of new players – IT companies – into the world of voice. These are companies such as Binat, Teldor, Netcom, and IBM, which are substantially different from traditional NEP companies

and are on a higher technological level. Telecommunication companies are also conglomerating and new operators, are entering the market, with the intention of providing customers with total communications solutions, such as telephony, transmission, data communications, internet, and information security.

4.7 Seasonality

In general, the revenues and profitability of Bezeq International are affected in a minor way by the seasons and holidays. There are seasonal fluctuations in the following services:

4.7.1 Voice services for the business sector – decrease in August and during the Passover / Tabernacle holidays

4.7.2 Voice services for the private sector – increase in the summer months and towards the end of the Gregorian year.

4.7.3 Internet services – best results usually achieved in the fourth quarter

4.7.4 Internet services for the business sector – a decrease in the summer months owing to the closure of educational institutions (customers in this sector are not billed for the internet services to which they subscribe during the summer vacation).

4.8 Property, plant and equipment

4.8.1 In the past, Bezeq International referred to international communications infrastructure (underwater cables and international switches) which Bezeq International leases (mainly from Mediterranean Nautilus Limited) as property, plant and equipment. Upon adoption of IFRS, the rights of Bezeq International in international infrastructure can no longer be regarded as property, plant and equipment. For reference to Bezeq International's contract with the infrastructure supplier Mediterranean Nautilus, see section 4.11.5 below.

4.8.2 Towards the end of 2004, Bezeq International signed an agreement with Veraz, to purchase SoftSwitch switches, which, during the course of 2005, replaced the Alcatel S-12 voice switches (at this stage, these switches are still being used as a non-substantial component in Bezeq International's voice service systems). These switches are used to route Bezeq International's voice traffic. The value-added services, including dialing cards, are based on an intelligent network (IN), which was also replaced in 2005 as part of the upgrade of its voice setup.

Bezeq International's technological infrastructures, which support voice, data and internet setups, are deployed in four sites to provide services with high survivability. In 2005, Bezeq International set up another site in London, England to supply advanced services to its customers.

Bezeq International has a long-term lease of the two main structures in which it is based, for average periods of 6 years.

4.8.3 On November 14, 2006, Bezeq International signed an agreement with Avnet Choshen Building and Investment Company Ltd. to lease approximately 7,000 sq m for eight years and four months, from April 2007 to July 2015, with an option to extend the lease term for two years each time, up to an additional eight years.

4.9 Intangible assets

4.9.1 License to provide Bezeq International services

Bezeq International operates within the framework of a general license for the provision of international telecommunications services, under the Communication Law, which anchors the right of Bezeq International to provide internet services. The license constitutes the basis for Bezeq International's operations.

4.9.2 Acquisition of Gil A.R. Telecom Systems

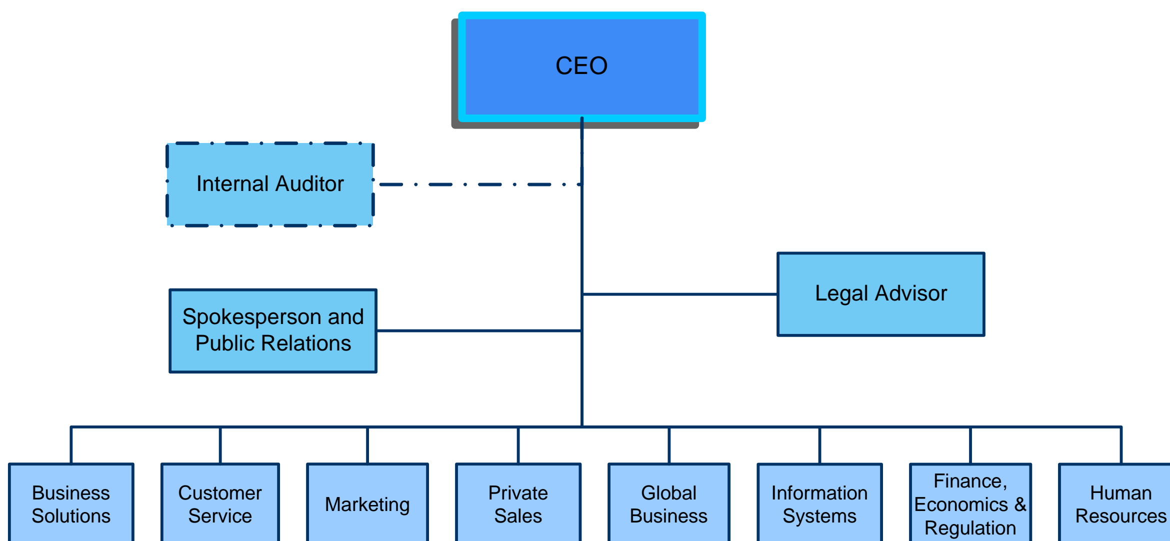
On March 23, 2008, Bezeq International signed an agreement with Gil A.R. Telecom Systems (Gil A.R.). Under this agreement, Bezeq International purchased from Gil A.R. all sales, rental and service operations of Avaya Office telecommunication and exchange products.

4.10 Human resources

4.10.1 The number of persons employed by Bezeq International (employees of the company, employees of human resource firms and outsourcing) is 2,325, of which 900 are permanent employees.

4.10.2 **Organizational structure**

Below is the organizational structure of Bezeq International:



4.10.3 Bezeq International has a number of employee groups whose wage structure includes a component of performance-linked commissions and incentives. These groups include sales employees, telephone sales representatives, and telephone service and support representatives.

4.10.4 Employees have a leasing arrangement enabling employees to receive vehicles at a fixed cost in accordance with the terms of an agreement between Bezeq International and a leasing company. Employees also have an arrangement for pension and health insurance that is fully subsidized by the company.

4.10.5 Bezeq International invests resources in professional training in accordance with the type of employee and the field in which he or she operates, such as technological training and qualification, manager development courses and more.

4.10.6 All of Bezeq International's employees have standard personal contracts based on their professions and positions.

4.11 Suppliers

4.11.1 In February 2005, Bezeq International signed an agreement with SigValue to purchase an intelligent network system, the cost of which is not material. Bezeq International is dependent on this supplier for some of its services based on the intelligent network.

4.11.2 Bezeq International has an agreement with Tadiran Information Systems Ltd. (which was acquired by IBM) which is implemented by IBM Global Services (Israel) Ltd. (IBM) for the maintenance and development of service absorption and pricing and billing systems. Bezeq International is dependent on this service from IBM.

4.11.3 In 2004, Bezeq International set up a contact center (a system integrating switchboard, collaborative system comprising computer, switchboard and interactive voice response). This setup is used by Bezeq International's service, support and sales centers, and is based on Avaya technology. Bezeq International has an agreement with IBM for ongoing support and maintenance.

4.11.4 Bezeq International has financial relations with some 100 foreign operators in approximately 240 destinations worldwide. The substantial foreign operators in terms of

size and cost of traffic passing through these operators include British Telecom, Rostelecom, Paltel, and AT&T.

4.11.5 Bezeq International is dependent upon international communications infrastructure provider Mediterranean Nautilus Limited, which supplies it with most of the international communications infrastructure that it requires through a seabed cable running from Israel to Europe. From there onwards, Bezeq International uses other infrastructure for connecting to the rest of the world.

4.11.6 All of the rights and obligations of BezeqCall under joint venture, marketing and sale agreements to which BezeqCall has been a party, were transferred to Bezeq International, giving it the right to market and supply installation, support and maintenance for equipment sold as part of NEP services. The most significant agreements are with LG, Nortel, Cisco, and Tadiran.

4.12 Working Capital

Bezeq International's cash item includes bank deposits for immediate withdrawal as well as fixed-term deposits on which there are no usage restrictions and whose repayment date, on their investment date, does not exceed three months.

4.13 Credit Policies

4.13.1 <u>Credit to customers</u>

4.13.1.1 Most of Bezeq International's customers have credit terms of EOM + 45.

4.13.1.2 Equipment sold to internet customers is usually billed in 24 installments.

As part of the NEP services, Bezeq International makes sales to its customers through payments in many installments. In this way, Bezeq International gives its customers credit, which they repay in installments. To reduce the exposure which might derive from long-term credit to its customers, Bezeq International checks their financial resilience, sets ceilings for the maximum credit available to customers and registers a charge over the equipment sold, pending full repayment of the credit.

4.13.2 Credit from suppliers

Bezeq International receives credit from its suppliers for 30 to 120 days (usually 90 days).

4.14 Investments

4.14.1 On December 31, 2008, Bezeq International held 34.25% (32.42% after full dilution as at December 31, 2008) of the share capital of Walla! Communications Ltd. (Walla). Walla is an Israeli company whose shares are listed on the Tel Aviv Stock Exchange. Walla provides internet services and is an internet portal provider.

Walla ended 2006 with a net profit of approximately NIS 15.1 million and 2007 with a net profit of approximately NIS 17.4 million.

For additional details regarding Bezeq International's investment in Walla, see Note 12 to the company's financial statements for the year ended 31 December 2008, which are included in this periodic report.

4.14.2 B-Zone Partnership: On October 23, 2006, Bezeq International entered into an agreement with 2+ (Two Plus) Wireless Solutions Ltd. (2+) for the establishment of a general partnership called B-Zone (the Partnership). Each party holds 50% of the partnership. The purpose of the partnership is to set up, support and manage wireless browsing networks in public areas, enabling high-speed internet connection and collecting payment from the end-user for internet access (the Area of Operations). Under the agreement, each of the partners transferred its operations in the partners' area of operations to the partnership, effective from the date of commencement of the partnership's operations. After the partnership was set up, it signed an agreement with 2+ to provide outsourcing services for the partnership, whereby 2+ attends to the day-to-day operation and management of the partnership.

4.14.3 On December 21, 2006, Bezeq International signed an agreement with DSNR Communications Ltd. for the establishment of a joint company, under which Bezecom Ltd. was established in January 2007 (Bezecom). Bezecom was set up as part of the expansion

of Bezeq International's global operations, together with the DSNR Group, which specializes in online marketing. The purpose of Bezecom is to provide communication services to end-users worldwide, inter alia through a unique communications solution to provide telephony services.

4.15 Financing

4.15.1 As of the date of the periodic report, the Company has no liabilities to banks and is not using its approved credit line.

4.15.2 The source of Bezeq International's finance in the past two years has been a positive cash flow from current operations.

4.15.3 Bank guarantees: Pursuant to the requirements of the Ministry of Communications, Bezeq International provided a bank guarantee of NIS 9.4 million and NIS 1.4 million to fulfill all of the conditions of the license to provide international communication services. As at the balance sheet date, Bezeq International has provided additional bank guarantees of approximately NIS 20.1 million.

4.16 Taxation

See Note 8 to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

4.17 Restrictions and Supervision of Operations

4.17.1 Legislative restrictions

The Communications (Telecommunications and Broadcasts) Law, 5742-1982 and the general license to provide international telecommunications services:

Under the Communications Law, implementation of telecommunications operations and provision of telecommunications services, including international telecommunications services and internet access services, require a license from the Minister of Communications. The Minister is authorized to amend the terms of the license, add to them or detract from them, while taking into consideration, inter alia, the government's telecommunications policy, interests of the public, compliance of the licensee to provision of services, contribution of the license to competition in the telecommunications industry, and the level of service therein.

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

A recently introduced amendment to the provisions of the Communications Law permits the Minister of Communications to prescribe telecommunications services that do not require a license. Pursuant to his declarations, the Ministry of Communications intends to exempt the supply of internet access services.

In view of these provisions of the Communications Law, all Bezeq International's telecommunications services are provided by virtue of the provisions of the licenses granted to it and pursuant to the terms therein, as set forth in Section 4.1.2 above.

4.17.2 Payment for interconnection

The Telecommunications (Interconnect Fees) Regulations, 5760-2000 (the Regulations) regulate the payments made to the domestic operator or the cellular operator.

With regard to payments to be made by Bezeq International, as an international licensee, for the completion of traffic on a cellular network, on March 1, 2008, the present tariff of NIS 0.25 for completion of a call was reduced to a maximum tariff of NIS 0.22.

These tariffs are updated once a year, in accordance with the percentage of the change in the CPI.

4.17.3 Royalties

For payment of royalties, see sections 2.16.3 and 4.1.2.3 above.

4.17.4 Standards

Bezeq International holds ISO 9001:2000 certification for quality management systems and ISO 7799 certification for information security management systems issued by the Israel Standards Institute.

4.18 Joint venture agreements

In June 2003, Bezeq International signed an agreement with Infonet Corporation (Infonet) for the distribution of Infonet's data communications services. Infonet is a network connecting many sites worldwide and provides for the efficient transfer of data between these sites. In December 2003, Bezeq International and Kardan Communications Ltd. signed an agreement for the acquisition of the operation of Infonet Israel Ltd., the Israeli representative of Infonet which provides international data communication and IP services on the Infonet network in Israel. The customer files were transferred to Bezeq International, which received the equipment and rights to provide Infonet services in Israel, and it provides technical support to all Infonet's global customers requiring services in Israel. This acquisition process enables Bezeq International to serve as a franchisee and strategic partner of Infonet in Israel and provide its customers with an expanded deployment of global communication networks and access to a wider range of advanced, high-quality communication services.

In the first quarter of 2005, Infonet was acquired by BT, resulting in reorganization under which the infrastructure used by the companies to provide their services to Israel was unified. At this stage, neither the acquisition nor the restructuring have had any affect on the running of Bezeq International's business, nor on its sale of Infonet products.

4.19 Legal Proceedings

4.19.1 In January 2005, a claim for NIS 10 million was filed in the District Court in Tel Aviv against Bezeq International, two other international operators, and another company, alleging that a patent for a prepaid telephone system had been infringed by persons alleging that they are the inventors and owners of this patent. In the statement of claim, the plaintiffs demand payment of the full revenues deriving from infringement of the patent plus reasonable royalties and punitive compensation.

In April 2005, Alcatel took over management of the defense in this case, on behalf of Bezeq International, for one of the systems which are the subject of the claim (supplied by Tadiran Communications Ltd.). Against another supplier of systems the subject of the claim - SigValue Technologies Ltd. (SigValue), the Company submitted notice to a third party.

The option of a settlement is being examined.

4.19.2 On November 2, 2008, a claim and application for certification as a class action was filed against the Company at the Tel Aviv District Court, alleging that the Company charged customers using the SIM-014 service with VAT, contrary to the publications and explanations that the price paid for the service includes VAT.

4.19.3 On December 31, 2008, a claim and application for certification as a class action was filed against Bezeq International at the Tel Aviv District Court, in respect of alleged unlawful connection to Bezeq International's Call for a Shekel service. The applicant is demanding a refund for the amounts charged by Bezeq International for this service, on behalf of all customers who were included in the programs specified in the claim, without their explicit consent, in a cumulative amount of NIS 15.834 million plus VAT.

4.19.4 Further to the provisions of the update to section 2.6.6(A) above, on May 27, 2007, Bezeq International received a letter from the Director General of the Ministry of Communications, giving notice to Bezeq International that he intended to impose a financial sanction upon it in the sum of NIS 2,031,750 for failure to implement and operate the number portability plan, commencing on September 1, 2006.

In its response, Bezeq International claimed that as holder of a general license for the provision of international telecommunications services, it does not allocate numbers to its customers and therefore, in any event, is not part of number portability, which is effected by domestic and cellular operators. Additionally, Bezeq International has implemented number portability faultlessly, and that it should be deemed as prepared for number portability, in accordance with the provisions of the law and on the date set out in such provisions

Bezeq International repeated its position in its response to the Director of Supervision and Compliance at the Ministry of Communications, on November 20, 2008, who asked for information about Bezeq International's actual preparation for the implementation of the portability plan.

4.19.5 For additional legal proceedings, see Note 17 to the Company's financial statements for the year ended 31 December 2008, which are included in this periodic report.

4.20 Goals, Business Strategy and Expected Development

4.20.1 As part of the preparations for 2008, Bezeq International set itself a number of key goals outlining the nature of its operations and reflecting the strategy which it adopted during the year.

4.20.1.1 To retain global leadership in ISP.

4.20.1.2 To create loyalty by improving customer satisfaction and experience for Bezeq International customers.

4.20.1.3 To continue to attract excellent employees.

4.20.1.4 To improve effectiveness and efficiency of cross-organizational work processes.

4.20.1.5 To time investments as a tool for retaining the stability and growth of Bezeq International.

4.20.2 **Bezeq International's goals for 2009**

4.20.2.1 To leverage changes in the market and continue quantitative and perceptual leadership.

4.20.2.2 To expand the range of telecommunication services and solutions.

4.20.2.3 To create differentiation and adapt the service experience to customer requirements.

4.20.2.4 To empower and develop the company's human resources.

4.20.3 2008 was characterized by continued growth and increases in Bezeq International's revenues and operating profits.

4.20.4 Bezeq International's revenues and operating profits continued to grow in 2008. In 2008, Bezeq International increased the range of communications solutions that it provides to its commercial customers. Bezeq International views this field as having growth potential and plans to further establish its status in this sector.

4.20.5 In 2008, Bezeq International improved its market position in all the areas of its operations.

4.20.6 In 2008, Bezeq International continued to invest in its customer service system, which provides service and technical support to its business and private customers.

4.20.7 The above statements contain forward-looking information that is not certain and may not materialize, in full in part. The forward-looking information is based on information that Bezeq International currently has as at the date of publication of this report, and contains assessments made by Bezeq International, its work assumptions or intentions, as at the date of publication of this report. The actual results could be significantly different from the results that are estimated or implied from this information.

The forecast of Bezeq International's management is based on forecasts related to the continued recovery in the Israeli market, continued penetration of broadband technology and continued growth in the number of internet users. The above forecast may not materialize at all or may materialize in part only, owing to a slump in the Israeli economy which will reduce purchasing power in Israel, regulatory changes liable to harm the ability of Bezeq International to provide solutions to existing or changing market requirements, and all the other risk factors listed below.

4.21 Risk Factors

A. Changes in exchange rates

The main currency used by Bezeq International is the new Israeli shekel, which is also its reporting currency. There is a special risk in the nature of Bezeq International's international

transactions: most of its operations (sales) derive from customers in Israel. In addition, Bezeq International provides its services to customers all over the world and collects payments from them in foreign currency, mostly the US dollar. On the other hand, Bezeq International consumes services from suppliers outside Israel and pays for these services in foreign currency, mostly the US dollar. The changes in the exchanges rates of the currencies in which Bezeq International operates opposite the Israeli shekel expose the company to exchange rate differences on the gap created, which could have an adverse effect on its cash flow as well as on its profitability by increasing finance expenses. To protect itself against currency exposure, Bezeq International enters into hedging transactions and purchases other financial instruments.

B. Competition

For the effect of the competition on Bezeq International's businesses, see section 4.6. above.

C. Investments in infrastructures, technological changes and dependence on suppliers

See Section 4.11.

D. Government supervision and regulation

For the application of the provisions of the law and licensing policy and their effect on Bezeq International, see sections 4.1.2 and 4.1.3.1 above.

E. Legal proceedings

Bezeq International is a party to legal proceedings, including class actions, which could result in its being required to pay substantial sums. A provision has been made in Bezeq International's financial statements for the proceedings, which, according to the assessment of the company's legal counsel, could require the use of Bezeq International's financial resources. For legal proceedings to which Bezeq International is a party, see section 4.19 above.

F. Global economic crisis

In the present quarter, the global economic crisis has sent global markets into a recession and credit crunch. It is expected that this will continue in 2009 and possibly even later, and there will be a transition from growth to recession. The local market is also expected to experience a significant slump, together with a deterioration in business operations and central economic parameters. Management believes that these events could affect the operations and business results of Bezeq International, however the company cannot, at this stage, estimate the extent of the impact on its business results. Bezeq International is adjusting its work plans accordingly.

This information contains forward-looking statements, based on the assessments of the company. The actual results may differ materially from these assessments if there is a change in any of the factors taken into account in these assessments.

Summary of risk factors

	Effect of risk factor on Bezeq International's operation		
	Major	**Moderate**	**Minor**
Macro risks			
Exposure to changes in the currency exchange rate			X
Sector risks			
Increasing competition		X	
Investments in infrastructure and technological changes		X	
Government supervision and regulation	X		
Special risks for Bezeq International			
Exposure in legal proceedings		X	
Dependence on suppliers			X

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

5.1 General Information on the Area of Operations

DBS, known also by its trade name YES, provides multi-channel satellite broadcast services to subscribers. DBS was founded on December 2, 1998, and has been providing this service since July 2000.

This service enables the provision of multi-channel encoded digital television broadcasts and value-added services to subscribers who receive the broadcast at home via a small antenna dish from which broadcasts are transmitted to a domestic decoder in the subscriber's home and connected to the television set.

Most of DBS's income derives from subscription fees and additional payments made by viewers.

As at December 31, 2008, DBS had 559,613 subscribers.

DBS is the only company currently operating in the satellite multi-channel television broadcasting sector, even though neither the law nor the license awarded to it grant it exclusivity.

5.1.1 Structure of area of operations and changes therein

The area of broadcasts is regulated and operations in the area are effected with various broadcast licenses. The heavy regulation of the field of broadcasting includes the obligation to receive a license, the obligation to operate in accordance with the relevant provisions of the Communications Law, the provisions of the various licenses and the conditions thereof, and constant supervision of the Ministry of Communications and the Cable and Satellite Broadcast Council (the Council).

Multi-channel television broadcasts have been offered in Israel since the mid-1990s by companies supplying cable television broadcasts. These companies operated first under regional franchises under exclusivity conditions which were granted to them, and since 2002 they have operated by virtue of long-term broadcast licenses which replaced the franchises. In November 1999, these companies were declared to have a monopoly, under the Antitrust Law, 5748-1988, in the field of multi-channel television broadcasts in the regional franchises in which they operated at the time. As of the end of 2003, the cable corporations have worked jointly in several areas of operations under the brand name HOT. In December 2006, the cable corporations merged into a single merged cable company, HOT Cable Communications Systems Ltd., which supplies cable television services to all of the subscribers of the cable corporations that were merged into it (the Cable Company). The cable company holds all of the rights in a limited partnership which owns the cable network infrastructure, including the terminal equipment and broadcast centers, and which, to the best of DBS's knowledge, provides communications services, internet access and telephony services

For the all-in-one services package offered to subscribers, which includes, in addition to the multi-channel television services, infrastructure for internet access (high speed broadband) as well as fixed-line telephony services (the package, which includes these three services, is also known as Triple Play), see section 5.1.8 below.

For proposed advanced television services with added features, including VOD, PVR and HD, see sections 5.1.4 and 5.2 below.

For streaming of video content over the internet, see section 5.1.4 below.

In February 2009, the Finance Ministry published a tender for the establishment and operation of terrestrial distribution system for digital radio broadcasts (see section 5.1.3.1 below). DBS estimates that said distribution system may in the future also serve as infrastructure for providing television services to mobile end devices which will compete with the services provided by DBS.

5.1.2 Statutory restrictions and special constraints

The Communications Law requires that a broadcasting license be obtained in order to transmit satellite television broadcasts to the public. In January 1999 DBS received the above-mentioned broadcasting license under the provisions of the law and pursuant to the

Telecommunications (Proceedings and Conditions for the Grant of a Satellite Broadcasting License) Regulations 5758-1998 (the Broadcast License).

The Broadcast License granted to DBS is valid until 2014. At the end of that period, the Broadcast License shall be renewable for additional periods of six years each, subject to the conditions of the license.

For additional licenses granted to DBS, see Section 5.8.1 below.

Operations in the field of broadcasting and other fields of communications are subject to licensing, supervision and the policy decisions of the Ministry of Communications, in aspects defined in the Law and the communications licenses (which relate, mainly, to matters relating to competition, consumers, and technical and engineering aspects). In recent years, due to the process of closer connections between the field of broadcasting and other fields of communications, and particularly due to the operations of cable companies and entities related to it in the field of telephony and internet, the field of broadcasts is substantially influenced by the policy and supervision of the Ministry of Communications in various areas that relate to or touch the field of broadcasting.

DBS's and the cable company's broadcasting operations are also under the constant supervision of the Council. The Council sets policy and makes rules regarding the content of broadcasts, the duty regarding original Israeli productions, the division of content into genres, broadcasting ethics, consumer protection and other matters in the area of broadcasting policy. The Council is also responsible for enforcing the various statutes relating to the field of broadcasting, for approving the channels that DBS wishes to broadcast, or to cease broadcasting, and is also authorized to amend the broadcast licenses of DBS and the cable company under the conditions set out therein.

The Council has authority in the field of consumer protection, so that the setting of price lists, updating of price lists and offers to customers require its consent or the giving of prior notice (on the issue of DBS's activities being subject to legislation and to the supervision of the Ministry of Communications and the Council, see also section 5.15 below).

Changes may be made to the identity and nature of the persons supervising the operations of the players in the field of licensing and supervision of the field of broadcasting (including DBS's operations), at the initiative of the government.

In 2005, the government resolved to consolidate the Council's activities with those of the Second Television and Radio Authority and the Public Broadcast Regulation Administration into a unified commercial broadcasting authority. This decision was anchored in a government bill, but to the best of DBS's knowledge, the bill has not been discussed. In addition, to the best of DBS's knowledge, in the past, the government examined setting up a communications authority which would replace the Ministry of Communications and the authorities described in section 5.1.1 above, and which would have all of the powers of such authorities, despite the abovementioned delay.

5.1.3 Market developments in the area of operations

In recent years, a number of trends have arisen in the broadcasting industry, which have affected competition in it:

5.1.3.1 Pursuant to an amendment to the Second Television and Radio Authority Law, 5750-1990 of February 2008, the Second Television and Radio Authority is required to set up a system whereby the television channels of the Israel Broadcasting Authority (Channel 1 and Channel 33), the commercial television channels (Channel 2 and Channel 10) and the Knesset Channel (Channel 99) would be distributed to the public freely, nationwide, via a terrestrial transmission service using digital technology, backed-up by a digital satellite system (known as DTT). This distribution system will be a partial substitute for DBS's transmissions which, in DBS's assessment, is likely to cause substantial harm to its revenues. In January 2008, a private member's bill was submitted to the effect that the DTT system will also include the transmission of two special channels broadcast as at the date of this report (a Russian language channel – Channel 9 – and the Music 24 Channel), and the Educational Television channel. Increasing or varying the number of channels distributed via the distribution system is expected, in DBS's assessment, to increase the extent to which the system will substitute for DBS's services, and therefore, might bring about an increase in the harm caused to DBS's revenues.

The private bill on the matter of the inclusion of the two special channels and the Educational Television channel in the DTT was passed in its preliminary reading in the Knesset. Several private bills were also submitted on the subject of including additional channels to the bundle of channels designated for broadcasting via the DTT system and to the best of DBS' knowledge they are in the initial stages of legislation.

To the best of DBS's knowledge, the Second Authority for Television has chosen the winner of the tender that it published for the supply of broadcasting equipment which will serve for the establishment of the distribution system. According to a Second Authority announcement, the distribution system is expected to commence operating in the third quarter of 2009.

5.1.3.2 In August 2008, the Government decided, inter alia, that the Communications Law will be amended as such that as of March 1, 2011 DBS and the cable companies will be obligated to allow any subscriber to connect to a basic package including Channel 1, Channel 33, Channel 2, Channel 10 and the Knesset Channel (in this section - the Basic Package) against payment for the connection to the broadcasting center, which will be calculated on the basis of subscriber connection costs plus reasonable profit; to allow any subscriber to purchase any other broadcast whereby the tariff for the acquisition of several broadcasts shall not be set in a manner that will be conditional as aforesaid; to set a price that will be paid by the owners of the channels in the basic package to the cable companies and to DBS for transferring their broadcasts and this on the basis of usage cost plus reasonable profit; DBS and the cable companies will be entitled to broadcast commercials as of April 1, 2010 when the Commission will establish rules with respect to maximum broadcast time for the various types of channels for a period of three years, which will enable the gradual broadcast of commercials; an order will be legislated with respect to the broadcast of joint channels in the format set forth in section 6(20)1 of the Law, which will expire. In addition, the Government decided to instruct the Commission to examine cancellation of the restrictions applicable to the special license holders for cable broadcasts that do not exist for DBS and the cable companies and the establishment of an inter-ministerial committee headed by a representative of the Ministry of Communications to examine the method of arrangements in the commercial television broadcast sector.

In October 2008, the Government published the Settlements in the State Economy (Legislative Amendments for Achieving Budget Goals and Economic Policies for Fiscal Year 2009) Bill 5768-2008, in order to anchor the aforesaid principles of the Government decision in legislature.

In DBS's estimation, requiring it to offer a basic services package might harm its revenues.

5.1.3.3 For the recommendations of the Gronau Committee and their adoption by the Minister of Communications, see section 2.6 above. As described in that section, on August 13, 2008, the Minister published his decision to adopt the Gronau Commission's recommendations (subject to a few changes and conditions. Nonetheless, the Minister decided that since the Commission focused on Bezeq's area of operations and analysis of the broadcasting sector was not discussed in full, a commission will be set up to formulate recommendations and policy with respect to rules of competition in the multi-channel and commercial television sector. To date, this commission has not yet been established.

5.1.3.4 In November 2008 the Council resolved to institute a new policy with respect to multi-channel television sports broadcasts from June 2009. According to the decision, content protection for the basic sports channel (Channel 5) and Channel 5+ broadcasts and restrictions were imposed on live broadcasts on the pay-for sports channels. DBS estimates that the foresaid decision is liable to harm DBS revenue from its pay-for sports channels.

5.1.3.5 In September 2008, the Council announced a hearing with respect to granting of special license to broadcast a movie and series channel on DBS and the cable companies. According to the hearing, the Council is considering that the actual granting of the aforesaid license and its terms and conditions, whatever they may

be, will limit the ownership of the licensee to a number of special licenses and obligating holders of more than one special license to invest in original productions. DBS objected to the actual hearing regarding the granting of new licenses before the issue of transmission fees to be paid by the special license holders is settled. Furthermore, DBS submitted its responses to the hearing, according to which the granting of special broadcast licenses for movie and series channels should not be permitted or the restriction regarding the maximum number of licenses granted to a single organization should be changed. DBS also requested to equate the license holders' obligation to pay royalties, as aforesaid, to its own commitments and to obligate an organization holding more than one license with a higher obligation to produce original productions than that imposed on DBS.

5.1.3.6 In September 2008, in accordance with the government's decision noted in section 5.1.3.2, an inter-ministerial committee headed by the Ministry of Communications CEO was set up to examine the method for settling the commercial television broadcasts area of operations, including changing the current franchise system, pursuant to the Second Television and Radio Authority Law, 5750-1990, to a licensing system (the Second Authority and the Second Authority Law) for the licensing regime. In March 2009, the committee's recommendations were sent to the Minister of Communications. The recommendations stipulated, inter alia, that as of 2012: (1) the franchise regime based on the Second Authority be changed to a licensing regime for key channel broadcasts; (2) the DTT system be expanded so as to also enable transfer of any key licensed broadcast; (3) commercials be permitted for license holders for multi-channel broadcasts; (4) license holders for multi-channel broadcasts be obligated that the narrow package offers include the basic package (as defined in section 5.1.3.2 above) and broadcasts of a new license holder for key channel broadcasts. Furthermore, the narrow package will include the special licensed broadcasts for cable broadcasts and licensed broadcasts for special channels subject to the payment of transfer fees by the license holders; (5) license holders for multi-channel broadcasts will be exempt from payment of royalties to the State. The Commission also recommended the establishment of a national communications network which will unite the activities of the Broadcasting Corporation and the Second Authority. If the Commission's recommendations will be adopted, they are liable on the one hand to lead to a reduction in DBS expenses due to the payment of royalties and an increase in its revenue as a result of the permit to broadcast commercials and on the other to harm its revenue due to the obligation to offer a narrow package and as a result of the expansion of the DTT system. As at the dater of this periodic report, the Minister of Communication's decision with respect to adopting the Commission's recommendations has not yet been published. Furthermore, the recommendations require legislative amendments and their application therefore depends on the formulation of legislation and the wording of the legislation that will be formulated, if at all.

5.1.3.7 In respect of the Company's appeal of the Antitrust Commissioner's decision to dismiss the application submitted by the Company and DBS for approval of the merger between the two companies by increasing the Company's holdings in DBS to 58.4%, see section 1.1.5 above. If the Company provides notice of its agreement to the foregoing merger conditions, this will have impact on the broadcasting market.

5.1.4 <u>Technological changes that materially impact the area of operation</u>

5.1.4.1 Technological developments and changes which have taken place in the field of digital broadcasting enable the provision of personal television services, which include bi-directional services that enable reciprocal communications between the individual subscriber and the service provider, and immediate provision of the service individually selected by the subscriber. The principal service in this field at present (even in Israel) is the provision of television services upon the immediate demand of subscribers, also known as Video on Demand (VOD services) As at the date of this report, VOD services are only provided by the cable company and this has a substantial effect on competition in the field of broadcasting (in this regard, see section 5.6.5 below.

5.1.4.2 Around the world, transfer services of video content over broadband have developed, whether in closed / managed systems or over the public internet, and these are known as IPTV (Internet Protocol Television). These services and abilities enable the consumer to watch video content (either by transferring content to all users or by transferring individually upon demand), the content sometimes being viewed via a personal computer and at other times via the television. In Israel, this service has not yet been developed in a closed network, and broadband infrastructure owners might act to launch such services in the future, and entry of another service provider into this field might adversely affect the players in the field of broadcasts. However, as at the date of this report, video content is being transferred over the internet (in both local sites designed for Israeli audiences and foreign sites, and via file sharing software), and the development of this trend might substantially affect the field of broadcasts, which is currently based on special infrastructure, and might enable the supply of varied video content without needing a special infrastructure system For DBS's option to use the internet to transfer video content to its subscribers see section 5.4 below.

5.1.5 Critical success factors in area of operations and changes therein

DBS regards the following factors as critical to the success of its operations:

5.1.5.1 Differentiation, innovation and originality in the content, branding and packaging of its broadcasts compared with the broadcasting content of its competitor, the cable company. These factors are reflected in the purchase and production of content, which includes current movies, documentary programs and many series containing unique and innovative characteristics, as well as in the production and purchase of original Israeli programming. For such purpose, ongoing investment is required in the area of production and purchase of the content of broadcasts supplied to DBS customers.

5.1.5.2 The ability to offer subscribers personal television services, and in particular, VOD services and PVR machines (see section 5.6.5(F) below).

5.1.5.3 The ability to offer a bundle of communications services including television services and other services such as telephone services and internet services (see section 5.6.5(G) below).

5.1.5.4 Differentiation at the customer service level provided to DBS subscribers, which constitutes a material success factor in DBS's ability to retain customers in a competitive market.

5.1.6 Main entry and exit barriers for the area of operations

5.1.6.1 The main entry barriers into the area of operations are: (a) the need for appropriate licenses under the Communications Law; (b) the immense investments required to be made by carriers in the area of operations, including for the purpose of setting up appropriate infrastructure and purchasing and producing content; (c) the limited size of the broadcast market which reduces the size advantage characteristic of the broadcast field around the world; (d) saturation of the broadcast market.

Recently, some of these entry barriers started to wear away as a result of regulatory changes (such as DTT – see section 5.1.3.1 above) and as a result of technological developments enabling the transfer of content over alternative infrastructure (such as IPTV – see section 5.1.4.2 above).

5.1.6.2 The principal exit barriers are: (a) the regulatory barrier – termination of operations under the broadcast license depends on a decision of the Minister of Communications to cancel the license prior to the end of the license term, under the conditions set out in the license, including arrangements for ensuring the continuation of broadcasts and services and reduction of harm to subscribers. The licensee is required to continue providing the services under the broadcast license until the date prescribed by the Minister or until completion of such arrangements as the Minister may instruct, whichever is the later; (b) long-term contracts with important suppliers.

5.1.7 Substitutes and changes in products in the sector

With respect to multi-channel television broadcasts, the following principal services can be classified as substitute products:

5.1.7.1 The variety of territorial channels and other channels broadcast for free to the Israeli public. These channels include Channel 1 (belonging to the Israel Broadcasting Authority), Channel 2, the third commercial Channel (Israel Channel 10), the Knesset channel. In addition, many foreign channels that can be received in Israel via relatively inexpensive end equipment are another substitute product to DBS's services.

5.1.7.2 The DTT system, see section 5.1.3.1 above, when it is established, will become an alternative service to multi-channel broadcasts.

5.1.7.3 Access to video content via broadband infrastructure, including the internet (see section 5.1.4.2 above).

5.1.7.4 Partner Ltd, a cellular operator in Israel, recently launched a new venture which is in principle its entry to the internet access sector (ISP service), the VoIP service sector and the content and broadcasts (particularly VOD) sector. The content services are at this stage provided via the PC and are expected later on to also be provided via the television screen with the aid of end equipment which will also allow reception of the DTT channels.

To the best of DBS knowledge, Cellcom Israel Ltd, a cellular operator in Israel, is also considering launching a venture that will include the transfer of video content.

DBS estimates that content services via the television screen, as aforesaid, provided by the cellular companies or either of them, will become a substitute service to the multi-channel television market.

In recent months, DBS applied to the Ministry of Communications and the Council several times demanding the cessation of all aforesaid actions taken by the cellular companies prior to the matter being examined by the Ministry and until equal opportunity policies with respect to all multi-channel television broadcasts are set, in a way that will also obligate the cellular companies to obtain broadcasting licenses and to comply with their terms and conditions, and if necessary, to amend the Law for this purpose. The Minister of Communications and the Council Chair have not yet responded to the fundamental issue of these requests with the exception of a notice to DBS that it has requested clarifications from the cellular companies with respect to their activities in the broadcasting area of operation.

5.1.7.5 DVD libraries

5.1.8 Competitive environment and changes therein

The concentrated and complex ownership structure in the areas of content, communications and infrastructure in Israel is likely to cause groups throughout the chain of production, packaging and supply of content to move into positions of control. The cable company which, together with the corporations related to it, has a broad deployment of advanced broadband infrastructure, markets and sells a package of services including multi-channel television services, high-speed internet infrastructure, and fixed-line telephony. Sale of a service package containing the above three kinds of communications services (known as triple play) whilst DBS, which does not have the infrastructure for providing telephony and high-speed internet access services, and is prevented from offering such a package together with the Company (see section 5.6.4.2 below) does not offer a similar package, is a principal component differentiating the offer to potential subscribers.

5.2 Products and Services

DBS's broadcasts provide its subscribers with a wide variety of channels: Around 160 different video channels (of which 30 are pay per view channels) and another 20 radio channels, 30 music channels and 20 information channels (including portals), and interactive services.

The broadcasts include a basic package which each subscriber is required to purchase as well as additional channels chosen by the subscriber, whether as a package or whether as a single channel, based on plans defined from time to time by DBS, with the approval of the Council and pursuant to the terms of the broadcasting license.

The main channel packages marketed by DBS in addition to the basic package are the movie package, the entertainment package, the children's package, the music package and the sport package and the science and nature package. These channel packages appeal to different target populations depending on their viewing habits and preferences.

As part of its operations, DBS also allows its subscribers to purchase movies and programs on a pay-per-view basis, from a list of movies and programs which is updated from time to time.

DBS is looking into the possibility of obtaining approval to launch VOD services (see section 5.6.5F below).

DBS markets decoders, called personal video recorders, with the capacity to record content broadcast on the various channels on a hard disk, known by the brand name yesMax (PVR Decoders). The PVR decoders interface with the DBS electronic broadcasts and enable receipt of special services, including booking recordings in advance, recording series and pausing live broadcasts. The PVR decoders also enable viewing of the content stored in the decoder memory and which are updated from time to time by DBS. Marketing of PVR decoders among DBS subscribers constitutes, in DBS's estimation, a partial solution for the lack of VOD services.

At the end of 2007, high definition television (HDTV) broadcasts, which can be received through special decoders, were launched in Israel. These broadcasts which, as at the date of this report, are provided for a limited number of channels, allow superior quality viewing. DBS estimates that although, at the date of this report, this service is relatively limited, the development of this service may have significant impact on the broadcasting area of operations.

Content viewing on a website – in August 2007, DBS launched a content site on the internet in cooperation with Walla! Communications Ltd., which allows viewing of various forms of content

5.3 Revenue and Profitability of Products and Services

Following is a table containing a breakdown of DBS’s revenue (in NIS millions):

	2008	2007
Revenue	1,513	1,415
Gross profit	422	298

5.4 New Products

VOD services – subsequent to a legislative amendment in 2007, DBS is permitted to launch broadcasts via broadband infrastructure providing service quality similar to digital broadcasts (Managed Network), however such launch is subject to obtaining an appropriate license and reaching a commercial and technological agreement with the owner of the infrastructure (the Company). To the best of DBS’s knowledge, launching this to all of its subscribers will also involve an upgrade of the Company’s infrastructure.

At present, DBS is working on launching VOD services over the internet (the non-managed network). This method is limited regarding the type of decoders through which the service may be received and with respect to the availability of services due to restrictions connected to the broadband internet infrastructure required.

5.5 Marketing and Distribution

Marketing of DBS services is by way of publication in the various media. DBS’s sales operations are carried out via three main distribution channels:

5.5.1 Field sales people working to recruit subscribers.

5.5.2 Service Call centers that receive telephone enquiries from customers wishing to receive DBS services or additional services, as well as telemarketing campaigns to potential subscribers.

5.5.3 External resellers under contract with DBS. DBS is somewhat dependent on an external reseller who works to recruit subscribers among one of DBS's target groups.

The distribution channels, except for the external resellers, are operated by DBS employees.

5.6 Competition

5.6.1 Competitors in the broadcasting market

DBS is in principal direct competition, as set out in section 5.1.1 above, with the cable company.

DBS estimates its share of the multi-channel television market as at December 31, 2008, to the best of its knowledge, at around 38% of total subscribers.

5.6.2 Broadcasting characteristics of the competitors

DBS's competitor is the cable company. For the operations of the cable company see section 5.1.1 above.

DBS transmits its broadcasts using only a digital method, by means of tiering at various price levels, while the cable company transmits its broadcasts to most of its subscribers using a digital broadcasting method and the above-mentioned tiering, while for the remainder they use an analog broadcasting method, which allows for lower-quality viewing, does not enable display of an electronic broadcast timetable and requires purchase of a uniform channel package without the option of choosing broadcast segments (for further implications of this difference, see section 5.6.4 below).

5.6.3 Characteristics of the current competition

After DBS achieved high rates of growth in subscribers during the first years of its operations, inter alia due to temporary regulatory concessions given to it and a considerable technological gap, together with high churn rates amongst subscribers of the cable company, in 2007 and 2008 there was a relatively slow increment in the number of DBS subscribers, as set out below.

	2008	2007
Increase in number of subscribers	10,400	9,694
Rate of growth	1.9%	1.8%

At present, competition in the field of broadcasts is focused on broadcast content, on the proposed channel packages, on the price of channels and packages, on the field of service, and on the offer of additional services, including VOD services that are provided by the cable company, PVR decoders and HD broadcasts. Competition is also characterized by offers of other communications services as part of the service package (see section 5.6.5G below).

5.6.4 Positive and negative factors regarding the competition

5.6.4.1 DBS management estimates that DBS has competitive edges, the principal ones being:

A. DBS makes use of advanced digital technology, which contributes to picture and sound quality; enables a fast and convenient user interface for subscribers when watching broadcasts; enables translation of the broadcast content into foreign languages and the additional of dubbing into other languages (such as into Russian) at the subscriber's election (in most of the Company's home channels); and enables the user to choose a language interface from four options (Hebrew, English, Arabic and Russian). In addition, DBS transmits wide screen broadcasts in a variety of channels which allows subscribers to watch broadcasts in wide screen format (which is similar to the format used in cinemas) on television sets. DBS broadcasts a number of channels using sound technology known as Dolby Digital (which is only supported by some of the decoders). DBS markets HD services (see section 5.2 above).

B. DBS's broadcasts are transmitted via satellite, and therefore the broadcasts can also be received in remote or isolated areas where there is no access to cable infrastructure. The infrastructure available to DBS also enables transmission of the content outside to the borders of the State of Israel. As of the date of this report, DBS dos not broadcast outside of the borders of the State.

C. The quality and variety of content broadcast by DBS to its subscribers.

D. The level, quality and availability of DBS's customer service system, both telephone service and technical service.

E. Accessibility and fast installation of equipment for receiving DBS broadcasts for customers living in buildings that are not connected to multi-channel television infrastructure in remote or isolated areas.

5.6.4.2 However, DBS's competitive operations suffer from inferiority or from factors that adversely affect it, in a number of areas, the main ones being:

A. Inferiority of infrastructure with respect to the option of offering 'personal television' services such as VOD (see section 5.6.5F below).

B. Some of the cable company's customers are customers of analog cable systems (see section 5.6.2 above). Insofar as such customers wish to switch to the digital system, the cable company has much greater access to them. The analog broadcasting system allows its subscribers to receive lower-cost broadcasts without using a digital decoder.

C. The directives issued by the administration of the Ministry of Communications, relating to the bi-directional transfer of subscribers between DBS and the cable company and use of the infrastructure installed in the homes of subscribers, require 36 hours' notice before disconnection of an existing subscriber of the cable company (and vice versa in the case of disconnection of an existing DBS subscriber). The cable company can exploit this time frame to make special offers to existing subscribers about to leave it for DBS, in order to retain their custom. In addition, where the internal wiring infrastructure is owned by the cable company, the administrative orders stipulate that payment must be made thereof (and vice versa). However, as at the date of this report, neither the cable company nor DBS is in full compliance with the administrative order. For this and the hearing being conducted by the Ministry of Communications with respect to internal wiring see section 5.15.3 below.

D. DBS has infrastructure inferiority which does not permit it to transmit telephone and internet services over its infrastructure, as opposed to the cable company whose infrastructure enables the provision of such services. This inferiority is even greater given the regulatory restrictions imposed on DBS and on the Company, which restrict DBS's ability to offer telephony services using the Company's infrastructure, and the lack of any realistic ability to market the telephony services of the cable companies. For information regarding the hearing on the matter of the restrictions on offering services together with the Company's services, see section 5.6.5G below.

E. Regulatory restrictions of structural separation, including restrictions in the field of joint marketing of products and services, between the Company and its subsidiaries and certain affiliates, including DBS, restrict DBS's operations. So long as these restrictions remain in force, and at the same time, there are no other similar restrictions on the cable company (and corporations related to it in the field of telephony and internet) harm DBS's ability to offer a bundle of services at a competitive price. In addition, existing regulatory restrictions are applicable to the Company with respect injection of funds into DBS. Since the Company is a shareholder of DBS, DBS is subject to the restriction on obtaining a license to supply telephony services itself over broadband internet (VOB), whilst telephony services are offered to subscribers of the cable company. For information regarding the hearing on the matter of the restrictions on offering services together with the Company's services, see section 5.6.5G below.

F. DBS has significant expenses involved in leasing space segments, which are necessary for the purpose of providing DBS's broadcasts.

G. DBS views the development of the capacity to transmit video content via the internet, including IPTV services in Israel as being a factor that might adversely affect its competitive standing in the broadcast field, including as a result of the entry of additional competitors into the field of multi-channel broadcasts.

5.6.5 <u>Principal methods for coping with competition</u>

The following are the main methods used by DBS to deal with competition in the field of broadcasts:

A. Content – DBS acts to purchase, produce and broadcast high-quality, innovative and varied content, creating differentiation of its content;

B. Branding – cultivation, promotion and differentiation of the YES brand;

C. Service – DBS emphasized its customer service and technical service systems;

D. Technology – continuing investments in technological capabilities and quality of DBS's broadcasts; emphasizing technological innovation;

E. PVR decoders – since DBS views the supply of "personal" television broadcasts as an integral part of the services provided by those operating in the broadcasting market in this modern era, and a significant component of the total bundle of services offered to subscribers. At the beginning of 2005, DBS launched PVR decoders under the brand name yesMax. In 2007, DBS significantly increased the rate of penetration of PVR decoders among its subscribers. To the best of DBS's knowledge, the cable company also sells PVR decoders to its subscribers, .although at significantly lower penetration rates. The cable company recently announced that it intends launching PVR services vial the cable network and without the need for a special decoder.

F. VOD – while the cable company commenced providing VOD services to its subscribers at the beginning of 2005, as at the date of this report, DBS has not yet launched such services. DBS is looking into the possibility of obtaining approval to launch VOD services (see section 5.4 below).

G. Services bundle – as set out in section 5.1.8 above, a trend has developed in the field of broadcasts of offering a bundle of communications services as a marketing measure to recruit customers and to retain them, and there is an increasing demand on the part of consumers and potential consumers to receive a total bundle of services enabling them to receive multi-channel television services, high-speed internet connection infrastructure services and fixed line telephony services from one source at lower prices than the prices paid for purchase of each of these services separately.

Until April 2008, DBS, together with the Company, marketed a service package including DBS broadcasts and infrastructure to connect to high-speed internet services. As of April 2008, DBS ceased marketing said service package to its subscribers and began marketing the Company's special offers for infrastructure to connect to high-speed internet service, so that the subscribers' service contract for the said infrastructure is with the Company only.

Due to regulatory restrictions imposed upon the Company with respect to structural separation between it and its subsidiaries and certain related companies, including DBS, contrary to the cable company, which sells its subscribers a triple bundle of services, under which it can also reduce the prices for the bundle of services, DBS is unable to offer a similar bundle at a competitive price.

Letters from the Ministry of Communications to DBS show that the Ministry of Communications is of the opinion that DBS is not permitted to market the Company's telephony services, and this is contrary to DBS's view.

In July 2008, the Communications Ministry informed DBS that it was considering amending the Company's license and as a supplementary amendment, also amending DBS's license so as to enable offering a service package based on the following principles:

1. The services package will be divisible – so that it will be possible to acquire any of the services offered in the service package separately at the price at which it is offered in the services package.
2. Services packages not offered by the cable company may not be offered.
3. Approval to market a services package will be granted on the basis of DBS's prior application to the Communications Ministry.
4. The provisions refer to services offered by DBS together with any of the Company's services.

In reply to the letter dated July 2008, DBS objects to the proposed amendment to its license. Furthermore, DBS claims in its response that granting the option to market a divisible services market does not provide a real solution for the services basket offered by the competition and that the amendment should be applicable only on the Company's telephony services and not on other services, such as internet infrastructure services. DBS also claims that the supervisory mechanism for offering a services package should be changed so that the Ministry of Communications will not require the obligation to obtain a permit in advance, but only the obligation to report and that the offered services package, which will include the Company's services, should not be limited to those also offered by the cable company.

In January 2009, the Ministry of Communications gave notice to DBS regarding certain changes to the license amendments under consideration. As part of the amendments, it will be permitted to offer any services package which another corporate group in Israel is able to offer (even if not offered in practice), benefits were granted for service packages that include broadcast and internet infrastructure services only; the services package approval mechanism and its amendments were set by the Ministry of Communications. In February 2009, DBS reiterated its objection to license amendments, its request to enable it to market a non-divisible services package and its objection to the supervisory mechanism that is under consideration by the Ministry of Communications, as well as any restriction relating to marketing television services together with the Company's internet browsing infrastructure services.

5.7 Property Plant and Equipment

DBS broadcasts to its subscribers via an engineering setup which contains a ground broadcasting center located in Kfar Saba as well as a secondary broadcasting site situated close to the Re'em Junction, broadcasting to the satellite the content received at the broadcasting centers via optical fibers, cassettes and direct satellite reception from the leased space segments on the Amos 1 and Amos 2 satellites (for lease conditions see section 5.16.2 below) and receiver dishes and decoders located in subscriber homes, enabling receipt of the satellite broadcasts and decoding in accordance with the broadcasting package purchased by the subscriber.

As of the date of the periodic report, DBS broadcasts various channels from any broadcasting center. Most house channels are broadcast from the broadcasting center in Kfar Saba and the other from the broadcasting center at Re'em. Furthermore, DBS maintains digital archives at the broadcasting centers for storing content for broadcasting.

5.7.1 Rental of structures

DBS's principal offices, including its management offices, the broadcast center and other operations departments, are in three buildings in the Eastern Industrial Zone at Kfar Saba, in an area covering approximately 10,330 sq m, alongside which there is a parking lot and adjacent facilities: An area of 8,335 sq m (which also contains the broadcasting center) is rented from a third party. The said rental period will expire in October 2014, and DBS has an option to extend the contract for a further five years, and this with a price increase of 5%. DBS has been given first-refusal rights to purchase the property from the landlord, should it be placed for sale. Another 1,994 sq m are in an adjacent building is leased from a third party. This rental period expires in July 2010.

In addition, DBS runs three operational centers, one being in the Nesher Industrial Zone (some 1,612 sq m in area, which is leased from a third party until May 2011), the second is located in the Industrial Zone at Kanot (some 1,487 sq m in area, which is leased from a third party until July 2011), and the third in Beer Sheva, some 1,100 sq m in area, which is

leased until October 2012, (with two options to extend rental; the first – for an extension of three years until October 2015 and the second – for an extension of five years until October 2020), which are used as technical service, telephone service and sales centers for subscribers. DBS also runs two employee recruitment centers. In addition to the three operational centers, DBS also runs a 1,540 sq m logistics warehouse located at Airport City, which is leased from a third party until May 2013 (with an option to extend the rental until May 2015).

5.7.2 **Terminal equipment**

DBS installs a receiver dish and other terminal equipment in subscriber homes, among them, decoders used as a receiving and decoding unit for the reception signals, which constitute an infrastructure to the subscriber's television screen (including PVR decoders and HD decoders) as well as smart cards used to decode the encrypted broadcasts, which are transmitted via the encryption system of NDS company (see section 5.16.3 below).

Some decoders are leased to subscribers in return for a fixed leasing fee paid during the broadcast reception period and some are lent to subscribers (some of these loans are made in return for a deposit which is reduced over the subscription period). A small number of the decoders are sold to subscribers and owned by them.

5.7.3 **Broadcast equipment**

In addition, DBS's plant and equipment also includes the broadcast and reception equipment at the central broadcasting center at Kfar Saba, which includes the reception systems at the broadcast centers, the compression, encryption, playing and uplink systems, and the compression systems at the secondary broadcast center at Reem Junction.

5.8 Intangible Assets

5.8.1 **Licenses**

DBS owns the following main licenses:

5.8.1.1 Broadcasting license valid until January 2014 – this license is material to DBS's operations and constitutes the regulatory permit for its broadcasting operations (for the conditions of this license, see section 5.15.2 below).

5.8.1.2 License for satellite television broadcasts in the Judea and Samaria region valid until 2010, and by virtue of this license whose provisions are similar to those of DBS's main broadcasting license, DBS broadcasts to the Judea and Samaria region. In February 2009, DBS applied to the Civil Administration for an extension of the license until 2014.

5.8.1.3 License to perform uplink operations (transfer of broadcasts from DBS's broadcasting center to the broadcasting satellite and implementation of set and ancillary operation activities), which is valid until January 2014 or until the end of DBS's broadcast license, whichever is the earlier. This license is material to DBS's operations and constitutes the regulatory permit for the transmission of broadcasting messages from the broadcasting center to the broadcasting satellites and from them to subscriber homes.

5.8.1.4 License for the provision of uplink/downlink services to other communication licensees which is valid until October 2013. As at the date of publication of this report, DBS does not use this license.

5.8.2 **Trademarks**

DBS owns a variety of trademarks designed to protect its various brands and services and also a number of trademarks which are in the process of being registered on the Register of Trademarks. The main registered trademarks relate to the protection of its trading name (Yes), its key content channel names, the channel packages it markets and its unique terminal equipment which it installs in subscriber homes.

5.8.3 **Costs of acquisition of subscribers.**

See Note 3 to the Company's financial statements for the year ended 31 December 2008, which are included in this periodic report.

5.8.4 Software

See Note 3 to the Company's financial statements for the year ended 31 December 2008, which are included in this periodic report.

5.9 Broadcasting Rights

5.9.1 DBS holds the broadcast rights of television content purchased from the owners of intellectual property rights in such content. Sometimes, DBS purchases the right to sell these content broadcast rights to third parties together with the rights themselves, for the purpose of broadcasting the content again. As at the date of this report, revenues from these sales do not amount to a significant percentage of DBS's revenues.

5.9.2 The broadcast of content in which DBS owns broadcast rights involves the payment of royalties to the owners of intellectual property – i.e., copyright and performers rights in sound recordings for actual broadcasting, including under the Copyright Law, 5768-2007 and the Performers and Broadcasters Rights Law, 5744-1984. Payment of royalties as aforesaid is performed via a number of organizations that operate in Israel, which collect the royalties owing to the owners of the intellectual property rights and in return provide the broadcasting entities with blanket licenses. For some of these licenses which represent principal royalty payments, the final sum owing from DBS for use under the license is prescribed in accordance with the final sum paid by the cable company to the licensee for every subscriber, either in the case of an agreement between them and the licensee or in the event of a judicial ruling on a dispute between the parties, the consideration owing from DBS being no less, in any event, than that paid currently under the license. Payments by DBS under these licenses are based mainly on a fixed payment and sometimes on various pricing methods, including those that depend on the number of subscribers as aforesaid.

5.9.3 At present, the trend of transmitting content over non-television media creates some uncertainty as to the payment of royalties for such transfer, inter alia due to the fact that to the best of DBS's knowledge, some of the authors are not represented by the aforesaid organizations with respect to such media.

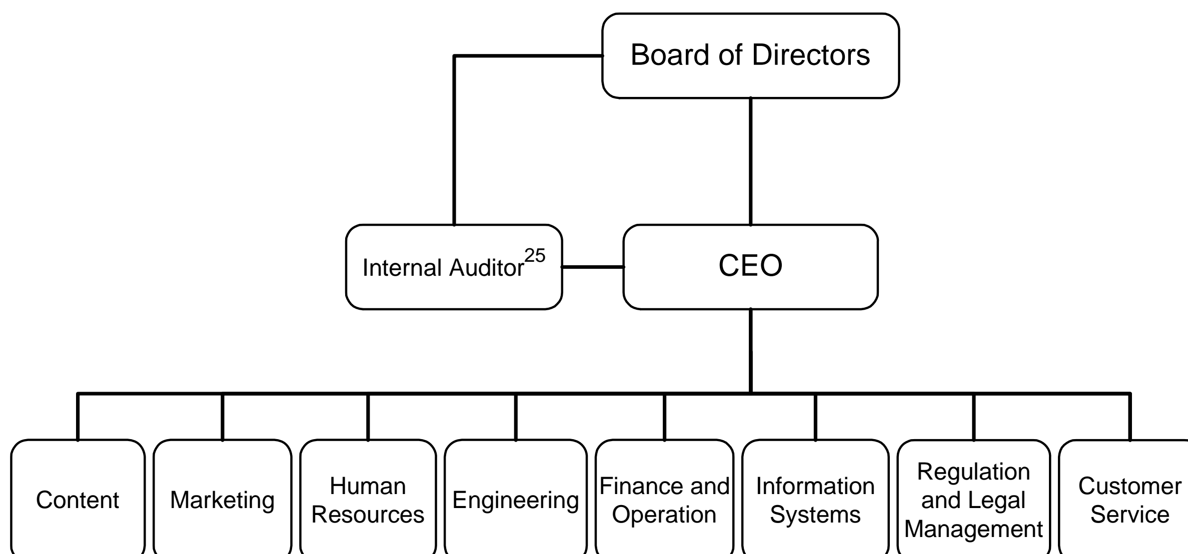
5.9.4 DBS participates, fully or partially, in investment in original productions that it broadcasts. In consideration for its investment, DBS is usually entitled, in addition to the right to broadcast the content as part of its transmissions, to rights in such content, in the percentages set out in agreements with the producers. Sometimes, DBS is also entitled to give permits to use rights and to participate in revenues flowing from additional uses of content over and above broadcast by DBS.

5.10 Human Resources

5.10.1 Organizational structure

DBS has eight departments, each one headed by a VP who is a member of DBS's management. DBS's departments are: marketing, customers (including recruitment of customers and service), content, engineering, finance and operations, human resources, regulation and legal administration, and information systems:

[25] The auditor is an external auditor



5.10.2 DBS personnel by division

Division	Number of Employees	
	As at December 31, 2008	As at December 31, 2007
Marketing Department	31	31
Customer Service	1,584[26]	1,506
Content Department	65	64
Engineering Department	82	80
Finance and Operations Department	110	108
Human resource department	40	40
Regulation and Legal Administration Department	3	2
Information Systems Department	77	66
Management and Spokesperson	7	3
Total	1,999	1,900

5.10.3 Training and development of human resources

DBS provides regular training for its customer service, technical service and sales personnel, via its training center.

DBS trains its employees on an ongoing basis and also carries out manager training and support on an ongoing basis.

5.10.4 Employee remuneration schemes

A. For options to officers at DBS, see also Note 26H to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

B. In September 2008, 4,250,000 Company options were allocated to the CEO of DBS, which may be exercised to ordinary shares of the Company at the exercise price of NIS 5.239352 per option (which was coordinated according to the Company's distribution of dividends as of allocation date). The options will vest in three equal annual portions, whereby the vested options will be exercisable for up to 5 years from

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[26] The increase in the number of employees in this department stems in part from the employment of employees for the customer service center in Beer Sheva, who in the past were employed by Bezeq On-line Ltd, which provided DBS with these call center services (see section 5.16.4 below).

the vesting date of the third option part. This allocation was made after the Antitrust Commissioner confirmed that she does not object to it and after the allocation was approved by DBS and the Company. The fair value of the options on the allocation date was NIS 10,280,000.

C. An existing annual grant plan is in place for the CEO of DBS for 2009-2010, based on the rate for meeting of certain goals as defined in the plan. An annual grant plan also exists for other officeholders. Furthermore, annual grants are given to other DBS employees from time to time at DBS discretion.

5.10.5 Bonuses and nature of employment agreements

DBS employees are employed under personal employment agreements, on the basis of a monthly salary or an hourly salary (usually service representatives and telephone sales representatives). The salaries of sales personnel, service personnel and collection employees are comprised of a base salary and commissions / bonuses based on performance. The employment agreements are usually for a non-specific period, and each party may terminate the agreement by prior notice in accordance with the agreement or the law.

DBS employs people at the telephone service call center on weekly days of rest and on days of rest prescribed by the State. In March 2007, DBS filed an application for a permit for such employment for 2007. The permit has not yet been received. DBS has also filed such an application for 2008 and approval was received for 2008 and 2009.

5.11 Raw Materials and Suppliers

5.11.1 Main raw materials

The main raw materials used by DBS for its broadcasting operations are:

A. Television content

The broadcasting rights purchased by DBS are presented in DBS's books on the basis of their cost, where the broadcasting usage rights relating to the screening of movies and television programs includes payments made to rights providers pursuant to the agreements with them.

The broadcasting rights are amortized in accordance with their purchase agreements, on the basis of the actual content screening (where the part which is not amortized by the end of the agreement period is amortized in full on the basis of the agreement period) or in equal parts on the basis of the rights agreement period.

The costs of original productions made for DBS which, under purchase agreements, may be broadcast a number of times or which may be sold to third parties are deemed to be part of DBS's broadcast rights inventory, and the cost of them is amortized over the period of their expected use, or in accordance with the estimated number of future screenings of such programs, but in any event, are amortized in full upon expiration of the broadcast rights under the contract.

In view of the proliferation of content providers from which DBS purchases broadcasting rights, DBS does not have a main provider and is not materially dependent on one single content provider. However, in the Israeli sport broadcasting sector there is dependence, as at the date of this report, on the purchase of broadcasting rights for local sport channels from these two content providers.

B. Space segments

DBS leases rights to satellite space segments via which DBS broadcasts from the satellites to the reception dishes installed in subscriber homes. The space segments are leased by means of long-term agreements with the owner of the rights to the space segments (see section 5.16.2 below).

DBS is dependent on the continuing regular availability of the space segments (see section 5.16.2 below).

Through July 2008, DBS leased space segments from another owner of rights on Amos 1 satellite of the Israel Aircrafts Industries Ltd. (see section 5.16.2 below). As of the reporting date, DBS is makes partial payments on account of the rental debt for

the lease period that terminated on Amos 1 satellite, and which payment was overdue. Due to arrears in payments by DBS set out in the above agreement, DBS is negotiating with the IAI due to the latter's demand to repay the entire debt. For the settlement agreement with HLL regarding the amount of the annual rental payments owing to HLL for lease of the space segments on the Amos 2 satellite, see section 5.18.7 below.

C. Digital decoders

DBS purchases digital decoders for the purpose of receiving and decoding its encrypted broadcasts at customer homes. DBS is dependent upon the suppliers from whom the decoders are purchased, including PVR decoders (ADB via Eurocom – see section 5.16.1 below, and UEC). With respect to the acquisition of decoders and their maintenance, replacement of a decoder supplier with another supplier does not in itself entail substantial additional costs, but the replacement would require a significant preparation period to adapt the decoders of the other supplier to DBS's broadcasting and encryption system, which might cause DBS to lose revenues. Maintenance of decoders which is not carried out by the specific supplier from whom they are purchased may involve additional costs and maintenance complications. For a description of DBS's contracts with decoder suppliers, see section 5.16.1 below.

Operating and encryption systems

DBS purchases from NDS services linked to the operating systems of its broadcasting setup and encryption means (see section 5.16.3 below) as well as hardware for these services. DBS is dependent upon the regular provision of these services.

5.12 Working Capital

5.12.1 Customers

DBS collects subscriber fees from its customers at the end of each calendar month for the previous completed calendar month. As at December 31, 2008, customer credit amounted to approximately NIS 152,876,000 net.

5.12.2 Supplier credit

The average supplier credit period in 2008 was 111 days.

5.12.3 Deficit in working capital

As at December 31, 2008, DBS's deficit in working capital amounted to NIS 1,329,796,000.

5.13 Financing

5.13.1 Average interest rate for loans

5.13.1.1 Shareholders

The loans granted to DBS by its shareholders (among them the Company) are divided into three types:

A. CPI-linked non -interest bearing loans.

B. CPI-linked loans bearing annual interest of 5.5%.

C. CPI-linked loans bearing annual interest of 11%.

These loans were included in the financial statements of DBS at their discounted value based on the interest rate of 11.64%-15.63%, constituting the fair value for July 2007. The current finance expenses in the financial statements are recorded in accordance with these rates, with the addition of linkage to the index. For further information, see Note 13E to the Company's financial statements for the year ended December 31, 2008, included in this periodic report.

5.13.1.2 Institutional bodies

The loans provided to DBS by institutional bodies in 2005 (see section 5.16.8 below) are linked to the consumer price index and bears interest at an annual rate of 11%.

Debentures (Series A) of DBS are linked to the consumer price index and as at the date of this report, bear annual interest at a rate of 8.4% (see section 5.13.7 below).

5.13.1.3 Banks

Short-term credit – the average interest rate for this credit for 2008 was 6.68%.

Long-term credit –

- Loans based on prime interest rates where the average interest rate for 2008 was 6.577%.
- On December 31, 2008, DBS long-term bank loans were extended for a further period of two years at fixed annual interest rate of 5.52%.

5.13.2 Credit restrictions applicable to corporations

Under a financing agreement between DBS and a consortium of banks that provided DBS with banking finance, as re-expressed in August 2003 and amended from time to time (the Finance Agreement and the Banks, respectively), DBS must comply with all the following financial criteria:

A. Minimum overall income

B. Minimum operating surplus

C. Minimum operating surplus less DBS investment in decoders and modems

D. Maximum and minimum supplier credit

E. Minimum targets for coverage of the bank debt and debt balances

F. Maximum overall finance requirements

G. Maximum churn rate

The values for compliance with the financial criteria are variable and are measured quarterly (except for a different measure of the criterion of the maximum subscriber churn rate). Non-compliance grants the banks the right to demand early repayment of the loans and the right not to provide DBS with the balance of any unused credit line. During 2005, the banks completed providing the entire credit limit to which DBS was entitled under the financing agreement (apart from the sum of approximately half a million shekels) in return for the provision of shareholders' loans by the shareholders of DBS in the rates required under the financing agreement (apart from shareholders loans which the banks waived under the amendment to the financing agreement dated December 2005, as replaced in the schedule to the financing agreement dated May 2006) (in this section: the Amending Document)). Under the amending document, the banks confirmed that actual investments by shareholders in DBS by the end of 2005, despite certain deficits therein compared with the values prescribed in advance in the financing agreement do not constitute a breach of the financing agreement. Under the amending document, additional bank credit was granted, which was paid up by the end of 2008.

During 2006, DBS began gradual repayment of the bank credit that it had taken, until full repayment in 2013.

In July 2007, the finance agreement was amended via an addendum to it. Under this addendum, inter alia, the financial target conditions that DBS is required to comply with as of Q2 of 2007 and until 2013 (the date of full repayment of the bank credit) were amended. The amendment also prescribed a mechanism for determining the rate of receipts of issues of debentures (series A) of DBS, including future extensions of the series, if any, to be used for repayment of the bank credit. In this regard, see also Note 13 to the Company's financial statements for the period ended December 31, 2008, which are included in this periodic report and section 5.13.7 below.

5.13.3 In addition to the abovementioned financial commitments, pursuant to the finance agreement additional restrictions anchored therein apply to DBS, the main ones being:

A. Restrictions related to compliance with its business plan, update of such plan and dealing in operations that are not an integral part of its current operations.

B. Restrictions on the assumption of third-party liabilities, including the receiving and granting of credit.

C. Restrictions on the distribution of profits and payment of management fees or similar payments to shareholders.

D. Restrictions on the creation of pledges and sale of certain assets without consent from the banks.

E. Restrictions on DBS's transactions with interested parties, changes of ownership in DBS, the purchase of securities in any corporation and the offering of its securities to the public (including the issue of debentures).

F. Restrictions with respect to the shareholders loans provided to DBS by its shareholders, including the inferiority thereof to the bank credit (and debentures that are to be issued to the public, if any), and restrictions relating to the repayment thereof prior to repayment of the bank credit in full, except with respect to shareholders' loans provided by the shareholders of DBS after April 1, 2004, which DBS may repay on account thereof prior to repayment of the full bank credit, on the conditions set out in the financing agreement (DBS and the banks have agreed that they will view the loans received by DBS from institutional bodies in 2005 (see section 5.16.8 below) as being part of the aforesaid shareholders' loans, and accordingly, DBS may repay them under certain restrictions as set out in the financing agreement, prior to full repayment of the bank credit).

G. Restrictions with respect to the issue of shares of other securities of DBS without the consent of the banks, with the exception of issue of securities to shareholders of DBS permitted subject to the conditions set out in the financing agreement.

DBS is bound by mandatory repayment of sums that it receives with respect to the placements of shares or debentures to the public, sale or transfer of property and certain cash surpluses of DBS, on the conditions and at the rates set out in the financing agreement. DBS may, voluntarily, effect early repayment sums received with respect to placements of shares or debentures to the public, which may remain after the aforesaid mandatory repayment, on such conditions and at such rates as are set out in the financing agreement.

The financing agreement also sets out provisions regarding various reports which DBS is required to provide to the banks, including with respect to examination of its compliance with financial conditions.

The financing agreement sets out a list of events which amount to breach thereof, and which entitle the banks, under the conditions set out in the financing agreement, to make the bank credit immediately repayable.

5.13.4 DBS has taken a floating charge in favor of the banks, and has taken out fixed charges in favor of the banks over its rights under substantial agreements to which it is a party, over its unissued registered capital, over its goodwill, over certain intellectual property rights, and over the insurance rights to which it is entitled under the insurance policies issued to it (the charge does not apply to DBS's rights under its broadcast license). These charges were taken at equal rank, *pari-passu*, with similar charges created by DBS in favor of the holders of its Debentures (Series A) (see section 5.13.7 below).

5.13.5 The shareholders of DBS, with the exception of the Company, have charged the DBS shares that they hold in favor of the banks, in assurance of the sums that the banks provided and will provide to DBS. Most of the shareholders also charged their rights to repayment of the shareholders' loans granted to DBS in favor of the banks and confirmed to the banks that pending repayment of the full bank credit, the shareholders' loans would be inferior to the bank credit, that they would not effect dispossession of them and that they would not require that they be paid back nor any security in assurance of them. In view of the restrictions on the Company's ability to charge its assets as a result of the negative pledge created by the Company in favor of its creditors, on November 23, 2000 the Company gave a guarantee of DBS's debts to the banks, provided that the amount which the banks receive in repayment by the Company of its guarantee does not exceed the value of its shares in DBS on the date on which the banks realize the shares which the other shareholders charged in their favor. The Company also gave an undertaking to sell its shares if the shares charged by the banks are sold. Pursuant to a deed of amendment of the guarantee of May 2, 2002, the Company consented that in the event of realization of

the collateral given by the other shareholders the Company would waive repayment of the shareholders' loans it granted to DBS. The Company also consented that its guarantee would also apply, mutatis mutandis, to the options allotted to DBS and to the right to receive them.

The shareholders in DBS with the exception of Gilat DBS Ltd., gave an undertaking to the banks inter alia not to oppose the sale or other realization of their shares in DBS, which had been pledged or in respect of which a guarantee had been given (by the Company), so that the bank could make the sale without disturbance in the form of a friendly liquidation.

5.13.6 As at the date of this report, DBS is not in compliance with all of its undertakings under the financing agreement to take out insurance with respect to its operations and assets, including with respect to the duty to take out satellite failure insurance for the satellites on which DBS leases space segments for the purpose of its broadcasts. DBS is negotiating with the banks for relief with respect to its insurance undertakings, which will enable it to comply with these undertakings.

In addition, arrears in DBS's payments to the Israel Aviation Industry (as set out in section 5.11.1 B above), constitutes a prima facie breach of the financing agreement, however, the banks have allowed DBS not to deem the demand by IAI for repayment of the debt owing to it (as stipulated in section 5.11.1 B above), and non-payment of the debt, as a breach by DBS of the financing agreement, provided that by December 31, 2009, the parties reach a written arrangement regarding repayment of such debt, and that during the period prior to the aforesaid date, IAI does not institute any measures for collecting its debt as aforesaid.

In light of the forecasts of DBS management regarding the business results for 2009, DBS made a request of the banks to plan and adjust the financial commitment targets for 2009 so as to match its budget. During March 2009, consent was received from the banks to amend these commitment targets.

In the assessment of DBS's management, the sources of funding available to it will be sufficient for its needs for activities in the coming year, in accordance with the cash flow forecasts approved by the board of directors of DBS. If additional sources are required in order to meet the needs of operations for the coming year, DBS shall adapt its operations so as not to require additional sources above those available to it.

As at December 31, 2008, DBS was in compliance with the financial covenants under the financing agreement (following relief that it received from the banks in March 2009) with respect to the target of on of the covenants as at December 31, 2008. In light of the fact that this relief and commitment target amendment for 2009 were given after the balance sheet date, the loans from the banks are presented as part of short term liabilities.

5.13.7 **<u>Private issue of debentures</u>**

In July 2007, DBS raised the sum of approximately NIS 620 million as part of a private issue to institutional investors of registered Debentures (Series A) which were listed on TACT Institutional at TASE (the Debentures). For the purpose of this issue, the Debentures were rated by Maalot the Israel Securities Rating Company Ltd. which, to the best of DBS's knowledge, has changed its name to Standard & Poors Maalot Ltd. (Maalot) as BBB- / stable.

The Debentures are to be repaid in eight annual principal payments, in the months of July 2010-2017, the principal payments in each of the years 2010-2013 being at a rate of 8% of the par value of the Debentures, and the principal payments in the rest of the years 2014-2017 being at a rate of 17% of the par value of the Debentures. The Debentures are linked to the consumer price index as of the index for the month of June 2007, and bear annual linked interest at a rate of 7.9% per annum (subject to various possible adjustments in accordance with the conditions of the Debentures) which shall be paid in half-yearly installments in the months of January through July of each of the years 2009-2017. DBS has not undertaken to list the Debentures for trading on TASE, however, in the event of listing of the Debentures for trading on TASE, the annual interest to be paid on them as of such date shall be reduced to 7.4%. Since the Debentures were not listed for trading on the Stock Exchange by July 31, 2008, the annual interest rate paid on them increased, in accordance with the terms and conditions of the debentures as of July 31, 2008, to 8.4% for so long as such listing does not take place (and in the event of later listing, the interest rate will be decreased from that point to 7.4% as aforesaid). Under the terms of the Debentures, if the rating of the Debentures falls by two rating points without the

Debentures being listed for trading, then the annual interest rate shall be increased by half a percent, but to a rate no higher than 8% until the original rating is regained or the Debentures are listed for trading (in which case, the interest rate will again be decreased as referred to above). In addition, if DBS does not comply with the financial commitments set out in the financing agreement between it and the banks, and as a condition of the banks' waiver of such breach, DBS shall undertake to pay the banks a supplement on the bank credit margin to the banks, and if at that time the Debentures are not listed for trading, then so long as it pays the banks the supplement on the bank credit margin as aforesaid and the Debentures are not listed for trading, DBS shall pay the debenture holders an annual interest supplement in the same amount.

Additional provisions have also been made in the Debentures, including with respect to payments related to them, dates of payment, and the method of convening of general meetings of Debenture holders.

With respect to the issue of the Debentures, DBS and Hermetic Trusts (1975) Ltd. (the Trustee) executed a deed of trust in July 2007 (for the main points of the deed of trust, see section 5.16.6 below).

The Debentures are secured by a first degree floating charge, unlimited as to sum, over all of DBS's assets (apart from exceptions stemming from the provisions of the Communications Law) created by DBS in favor of the Trustee, including a condition restricting the creation of additional charges (apart from charges and actions during the ordinary course of business and charges and actions permitted under the deed of trust) and a first degree fixed charge, unlimited as to sum, over the rights and assets of DBS, charged by it in favor of the banks (apart from exceptions stemming from the provisions of the Communications Law) (the Trustee's Guarantees). The Trustee's Guarantees are ranked first and equal (pari passu) to the floating charges and fixed charge created by DBS in favor of the banks, in assurance of the bank credit (the Bank Guarantees), without taking into account the dates of creation of the various guarantees and/or the dates of registration of such with the Companies Registrar and/or the Registrar of Pledges. The creation of other charges by DBS in favor of the banks shall be subject to the consent of the Trustee, unless such charges are also registered in favor of the Trustee. In the event of exercise of the Trustee's Guarantees and/or the Banks' Guarantees and/or exercise of the assets the subject of such guarantees, including by the holders of other securities who may be given a charge over such assets, the proceeds of exercise shall be distributed pro rata between the Trustee, the Banks and the aforesaid holders, and each chargee shall receive its pro rata share of the proceeds, equal to its pro rata share of the debt to it (as defined in the deed of trust) divided by the total debt secured by such assets.

For the purpose of rating the debentures, DBS has undertaken to Maalot (and to it alone) that it shall not make payment on account of the shareholders loan prior to the end of the life of the Debentures.

In October 2007, Maalot gave notice that the rating of the Debenture is on the watch list due to interferences in DBS's transmissions (see section 5.20.3.18 below), due, in its opinion, to the fact that such disturbances caused higher expenses than expected, to deviations from DBS's business plan and to the filing of a number of lawsuits against it. In February 2008, Maalot informed DBS that DBS had been taken off the above watchlist, and that the debentures were rated at stable / BBB-, inter alia because DBS was able to maintain its subscriber base and to meet the subscription target that it had set for itself prior to the disturbances. On August 2008, Maalot announced the validation of the existing rating.

On October 21, 2007, DBS received a letter from the Trustee of the Debentures stating that following interruptions in transmissions and various items published regarding that, including regarding a reduction in the number of DBS subscribers, and regarding the compensation that DBS would grant its subscribers, it wished to receive various documents and certificates from DBS in order to clarify whether the aforesaid events and their long-term impacts might harm DBS's undertakings to the debenture holders. In the assessment of management of DBS, based on conversations with the Trustee, in light of its being taken off the watch list, the Trustee is not expected to require further particulars beyond the ordinary reporting requirements under the deed of trust.

For further details about this placement, see Note 13 to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

5.13.8 The Corporation's credit facility

DBS's line of credit is NIS 960 million. As at December 31, 2008, DBS had used approximately NIS 881 of this line of credit. For further details see Note 13 to the Company's financial statements for the period ended December 31, 2008 which is included in this periodic report.

For the position taken by the Ministry of Communications regarding limitations on provision of shareholders loans by the Company to DBS, see section 5.6.4.2 below and Note 33 to the Company's financial statements for the period ended December 31, 2008, included in this periodic report.

5.14 Taxation

See Note 8 to the Company's financial statements for the period ended 31 December 2008, which are included in this periodic report

5.15 Restrictions on and Supervision of the Corporation

5.15.1 Subjection of activities to specific laws

DBS's operations are regulated by and subject to a special extensive system of laws (from primary legislation to administrative directives and Council decisions). The above legislation, secondary legislation, resolutions of the Council and administrative directives have substantial impact on DBS and its operations. Likewise, legislation and secondary legislation in the field of communications in general has a substantial impact on DBS.

Restrictions are applicable to DBS under the Communications Law and the regulations promulgated pursuant thereto. The Telecommunications (Proceedings and Conditions for Grant of Satellite Broadcasting License) Regulations, 5758-1998 (the License Regulations), determine the processes and conditions for receipt of a broadcasting license, and also various restrictions applicable to a licensee during the term of the license. The License Regulations prescribe, inter alia, suitability conditions for a satellite broadcasting licensee, relating to the direct or indirect holdings of the broadcasting licensee and the interested parties therein, in cable broadcasting franchisees, in franchisees pursuant to the Second Authority for Television and Radio Law, 5750-1990, and in proprietors of daily newspapers.

In October 2008, the Ministry of Communications informed DBS that due to the fact that Bank Leumi Ltd (hereinafter, in this section: Bank Leumi) is part of the consortium of banks in whose favor some of the DBS shareholders attached the DBS share capital held by them on the one hand and on the other hand Bank Leumi's holding in part of the share capital of Keshet Broadcasting Ltd., the concession holder in accordance with the Second Authority for Television and Radio, 5750-1990. As of October 31, 2008 on which the transfer provisions set forth in the Regulations for the granting of a license expired with respect to a parallel holding as aforesaid at a rate exceeding 25% of the concession holder's equity, and one of the qualifying restrictions set forth in the Regulations for granting licenses, in the opinion of the Ministry of Communication, will be applicable with regard to DBS (also see section 5.15.2 above). The permission to surpass expiry of the transfer provision as aforesaid, was given to DBS by Bank Leumi and by the Ministry of Communication, which formulated an agreement between them , according to which the Ministry of Communication shall not deem the attachment of DBS shares in favor of Bank Leumi as non-compliance with the aforesaid restrictions, subject to the split of the attachment deed of the attached DBS shares (or most of them), so that only the appropriate portion of DBS shares attached to all the banks will be attached to Bank Leumi for a defined period which as not yet been agreed upon. To the best of DBS's knowledge, a detailed settlement has not yet been signed between Bank Leumi and the Ministry of Communication. The Communications Ministry informed DBS that the matter was sent for assessment by the Attorney General.

The Telecommunications (Television Broadcasts via Satellite) (License Fee and Royalties) Regulations, 5759-1999 (the Royalty Regulations) as amended in August 2006, provide the

rate of royalties and the broadcast license fees to be paid by a licensee for satellite broadcasts to the State. Under those regulations, DBS owes royalties in a rate of 3.5% of its revenues from the provision of broadcasting services in the years 2004 and 2005, in the rate of 3% for 2006 and in a rate of 2.5% for 2007. The royalty rate will be 2% in 2008, 1.5% in 2009 and 1% from 2010 onwards. In February 2008, an agreement was signed between DBS and the State regarding the spreading of payment royalty sums under which DBS undertakes that the sum of royalties for the period commencing in July 2007 and ending in September 2008 (but not more than the sum set out in the Agreement), plus interest differentials, would be paid in 11 monthly installments commencing in February 2009.

Under Section 6WW of the Communications Law, the license may prescribe the maximum prices that a subscriber may be billed. As at the date of this report, no such prices have been prescribed.

In accordance with the requirements of the broadcasting license and regulations determined by the Council, from 2004 to 2009 (inclusive), each year DBS shall invest in local productions an amount which is not less than 8% of its revenue from subscriber fees. Pursuant to the Council's confirmation, DBS was in compliance with its original production obligation for 2007 (including the proportionate share of completing past debts) apart from non-substantial deviations in the sub-division into various kinds.

Under the requirements of the law and the license, DBS is required to allow independent channel producers under section 6EEE of the Communications Law to make use of its infrastructure in order to distribute transmissions to its subscribers, in return for payment to be set out in an agreement, and in the absence of any agreement, in consideration for payment to be prescribed by the Minister, upon consultation with the Council. For further information relating to the hearing announced by the Ministry of Communications with regard to transmission fees to be paid by independent channel producers as aforesaid, see section 5.15.3 below.

In January 2009, the amendment to the Consumer Protection Law, on the issue of fixed transactions, came into effect. This amendment stipulates, inter alia, the obligation to give notice of the termination of the transaction period and obligates receipt of the customer's agreement to extend the contract beyond the fixed transaction period.

5.15.2 Operations subject to broadcasting license

DBS's operations are subject to the provisions of its broadcasting license. The Communications Law, the License Regulations and the broadcast license stipulate a number of grounds on the basis of which the Minister of Communications can terminate, restrict or make the broadcasting license conditional, after consultation with the Council and the granting of a hearing to the broadcasting licensee, among them, violation of the provisions of the law or rules and regulations pursuant thereto, a material violation of the terms of the broadcasting license or a non-material violation which was not amended after a warning from the Minister or the Council, the cessation of broadcasts for an unreasonable period of time or the total cessation of broadcasts for 14 consecutive days, noncompliance of the licensee with the restrictions determined in relation thereto in the License Regulations, and the appointment of a receiver or temporary liquidator for the licensee or the issuing of a liquidation order, all pertaining to the licensee.

The Minister of Communications, in consultation with the Council, and after granting the broadcasting licensee an opportunity to make its arguments and considering the harm to its rights, may change the terms of the broadcasting license, inter alia, for the purpose of the goals stipulated in the license. In addition, the Council alone has concurrent authority to amend the broadcasting license, provided that the broadcast licensee is first of all given an opportunity to make claims.

5.15.3 Principal restrictions by virtue of the law and broadcasting license

The Communications Law and Broadcasting Regulations stipulated the following principal general conditions: The broadcasting license may not be transferred or attached. Encumbrance of the broadcasting license, insofar as it may be encumbered under the law, requires prior written approval from the Minister of Communications; transfer, encumbrance or attachment of any of the assets of the broadcasting license from August 2001 onwards, which were not granted advance permission in the license, require approval from the Minister of Communications, except for encumbrance of an asset in favor of a banking

corporation (in this respect DBS received the consent of the Ministry of Communications for a charge that DBS sought to create inter alia over the "license assets" in favor of the trustee for the debenture holders); an encumbrance placed on any of the broadcasting license's assets shall only be exercised in the manner prescribed by the Minister of Communications; DBS's broadcasts to be in accordance with the broadcast license and their scope subject to the provisions of the law; a change, directly or indirectly, in control or holding of the means of control in a percentage of 10% or more and changes in a holding of the means of control in any percentage resulting in a person becoming a controlling party of the licensee (as defined in the Regulations for the granting of a license) requires prior written approval from the Minister of Communications, after consultation with the Council. In the event that the change in the holding of the means of control does not exceed 15% of the holding of the means of control in a company whose shares are listed on the Stock Exchange, the said approval is not required with respect to the shares that are listed on the Stock Exchange and their attached rights, provided that it is not a change in the control thereof and a report has been delivered as set forth in the license. Reporting requirements were stipulated concerning holders of the means of control and restriction on encumbrance of the means of control; cross-ownership in the licensee is prohibited as set forth in the License Regulations; competition pertaining to the provision of broadcasts and services shall not be prejudiced, including terminal equipment or other telecommunications services, by any agreement, arrangement or understanding to which the broadcasting licensee, any body in which the broadcasting licensee, an officer of the broadcasting licensee, or any owner of a right in a company owning a broadcasting license (and also an officer of the owner of a right therein) are parties, unless approved in advance and in writing by the Council; advertising broadcasts are prohibited (this prohibition also applies to the cable companies) except for the transmission of foreign channels containing advertisements which are not aimed primarily at Israel and except for sponsorships and service broadcasts, under restrictions prescribed by the Council.

The broadcasting license also stipulates conditions for the establishment of a satellite broadcasting system and its operation; conditions relating to subscriber services, including the obligation to receive approval of the subscription contract from the Council and the Court for standardized contracts; the obligation to connect applicants and the prohibition of preconditions; the obligation to provide the services throughout the year; prohibition on discriminating among subscribers, with the exception of offering different rates for types of subscribers reasonably categorize; maintaining a subscriber service center, maintaining a supply and maintenance system and ongoing maintenance of terminal equipment and subscriber privacy; conditions relating to provision or disconnection of services and conditions relating to supervision of the operations of the owner of a broadcasting license and the obligation to submit reports to the Ministry of Communications, and conditions relating to the compliance of the terminal equipment installed by DBS to the standard.

The broadcasting license stipulates provisions regarding the types of payments that the broadcasting licensee may collect from its subscribers. The licensee is under an obligation to give notice in writing to the chairman of the Council of any change in the price list approved by the Council immediately upon publication of such or upon notice of a change to subscribers, whichever is the earlier, and the chairman may, if he is of the opinion that such change might cause harm to competition, misleading of the public, discrimination among subscribers, unfair competition, or that it does not comply with the provisions of the law, the regulations, the rules, the license or the Council's policy, instruct the licensee not to change the price list or given notice that he intends to place the change before the Council for discussion. If the chairman does not give the licensee notice as aforesaid prior to the date of commencement of the change, the change shall come into force. With respect to reductions, discounts and promotions (for a restricted period), DBS is required to notify the chair of the Council no later than the date of publication or commencement, whichever is the earlier, and the chair may intervene if he finds them to be misleading to the public or as drawing distinctions between subscribers.

The broadcasting license sets out a number of provisions that relate to the content of DBS's broadcasts, including approval of the channels broadcast by DBS and amendments in respect of them by the Council (including the content of DBS's basic package), approval of the electronic program guide (EPG) which is part of DBS's digital service to its subscribers and approval of pay per view broadcasts.

DBS is also required to transmit the television and radio (FM) channels broadcast nationally in Israel including the educational television channel and must carry broadcasts

to its subscribers. At present, DBS transmits the broadcasts of two special channels, the Music Channel (Music 24) and a Russian language channel (Israel Plus), in consideration for a payment which the Minister is required to prescribe. DBS as the aforesaid special channels are in legal proceedings with respect to the debt for the transmission fee that DBS is claiming from the channels, including with respect to the Minister's power to require them to pay such a transmission fee. In February 2008, the Ministry of Communications informed DBS that it intended to announced a hearing with regard to the transmission fees to be paid by independent channel producers, including must carry broadcasts, to DBS for transmitting the broadcasts over its infrastructure. The Ministry attached to its letter, a draft economic opinion prepared by the Ministry according to which transmission fees will include a fixed component of NIS 1.2 million and a component dependant on the number of subscribers to the channel producer, which will not exceed one million shekel in any case. As at the report date, the hearing has yet to be published.

In February 2008, the Council published a decision, according to which it is considering to re-examine the advertising terms for a special news channel which will be broadcast as part of the cable company and DBS broadcasts and the integration of commercials in its broadcasting. During 2008, the Council published its intention to publish a tender for a special Arabic channel. For this purpose the Council announced a public hearing in which it wished to examine a few benefits in the area of original productions and news production in Arabic as well as changes in the identity of entities which may compete for ownership of the channel. As of the date of this report, the two aforesaid tenders have not yet been published.

Pursuant to a decision of the Council dated March 2006, DBS, including its shareholders, are entitled to own up to 30% of the local channels broadcast in DBS's broadcasts (compared with a 20% restriction that applies to the cable company).

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

In November 2005, DBS submitted its position to the Ministry of Communications, stating that the administrative directives should remain in place, while cancelling the early notice prescribed in them, which requires that notice be given to a party whose subscribers disconnect from its services. DBS also contended that the provisions of the law granting ownership of infrastructure to the multi-channel television provider that installs it in the homes of its subscribers, should be rescinded. At the very least, contended DBS, if the directive remains in place, its proper interpretation should not grant the cable companies ownership of the wiring they installed in private houses. DBS also stated that the amount prescribed in the law as the consideration to be paid for purchasing the wiring (NIS 120), is baseless and that if the directive is retained, the amount should be considerably reduced.

In March 2006, the cable company gave notice to the director general of the Ministry of Communications that in light of DBS's breaches of the administrative order, it was ceasing to accept disconnection notices sent to it by DBS, and indeed, the cable company ceased accepting any notices under the administrative order, including connection plans and termination notices. DBS dismissed the claims made by the cable company and argued that by refusing to receive notices from DBS, not only was the cable company in breach of the administrative order, it was also in breach of its license and of the agreements via which it had contracted with its customers, since it continued charging subscribers a subscription fee despite knowing that such subscribers had disconnected from their broadcasts. DBS also demanded that the Ministry of Communications order the cable company to stop charging subscribers immediately upon receipt of notice of disconnection.

As at the present date, the Ministry of Communications has not yet commented on the issue, and the cable company continues not to accept notices from DBS.

In the assessment of management of DBS, if the administrative order is cancelled, without an appropriate alternative arrangement enabling one supplier to make use of the infrastructure of the other in subscriber homes, this will constitute a substantial barrier to the transition of subscribers between the various suppliers.

5.16 Substantial Agreements

Following is a summary description of the principal agreements likely to be considered as material agreements not in the normal course of business of DBS which have been signed and/or are valid in the period of the periodic report:

5.16.1 <u>Agreements for the purchase of decoders</u>

In August 2000 DBS signed an agreement for the purchase of decoders with Advanced Digital Broadcast Ltd. (ADB) and Eurocom Marketing (1986) Ltd. (hereinafter in this section: Eurocom) in which Mr. Shaul Elovitch, an interested party in DBS, is also an interested party (the ADB Agreement). Under the ADB Agreement, DBS purchased a minimum number of decoders from ADB and is also entitled to purchase additional decoders from time to time in accordance with a purchase order which DBS is to send to Eurocom. DBS is also responsible for the converters and support service thereof via Eurocom .Following the assignment of ADB's rights and obligations under the ADB Agreement to another corporation, Advanced Digital Broadcast S.A., an addendum to the ADB Agreement was signed in April 2008, governing such assignment and making certain amendments to the ADB Agreement. In April 2008, an agreement was signed to extend the warranty period for a certain series of decoders.

In 2007 and 2008, DBS purchased decoders from ADB which enable viewing using HD technology. DBS also ordered PVR decoders which will enable viewing HD broadcasts.

In 2008, DBS purchased decoders from Eurocom for approximately NIS 32 million.

For the legal proceedings regarding the deficit demand from the Customs Department of the Taxation Authority for decoders purchased by DBS from Eurocom and smart cards imported by Eurocom for DBS, which were resolved in the reporting year, see section 5.18.5 below.

Purchase of PVR decoders – in July 2004, DBS entered into a contract with UEC Technologies (Pty) Limited (UEC) for the development, manufacture and supply of PVR decoders. The agreement is for 5 years and is automatically renewed for additional terms of one year each, unless one of the parties gives notice otherwise. DBS was also awarded a warranty period and support services for the decoders, including a local repair laboratory.

5.16.2 <u>Space segment lease agreements</u>

First space agreement

In order to transmit the satellite broadcasts DBS signed an agreement in April 1999 with the HLL Communications Ltd. (HLL), in which there is an interested party which is also an interested party in DBS, and with Israel Aircraft Industries for the leasing of space segments in the Amos 1 satellite as amended in May 2003 (the First Space Agreement). The lease period for Amos 1 satellite terminated in June 2008.

For information relating to lease fee debts for Amos 1 satellite see section 5.11.1 above.

The First Space Agreement regulated mechanisms guaranteeing reserve and backup in the event of satellite faults. Inter alia, it was prescribed that the satellite’s reserve transponder used as backup for the satellite’s entire capacity would serve as reserve capacity for DBS if the reserve transponder were used to restore any satellite capacity. HLL undertook to make available one space segment within six months and within a further three months another reserve space segment which would be used as reserve capacity for the satellite’s entire capacity. In the event of a fault contemporaneous with another capacity DBS has priority for the restoration of the capacity that it has leased.

Second space agreement

In May 2000, DBS signed another agreement with HLL to lease space segments on the Amos 2 satellite, as amended in May 2003 (the second space agreement), whereby DBS is to lease no fewer than 12 space segments on the two satellites (of which 8 on Amos 1) from HLL, and one year later, shall lease two additional segments on Amos 2 on the same polarity, so there will be no need to adjust DBS's receiver dishes. According to the second space agreement, the capacity that was leased on Amos 1 was transferred to Amos 2 and to Amos 3, whose positioning in space was completed in July 2008.

Pursuant to the second space agreement, the lease period for the space segments on Amos 2 and Amos 3 is for 12 years from the date on which Amos 2 was positioned in space (which took place during April 2004) or until the end of the life of Amos 2, the earlier of the two. The consideration for the lease determined in the second space agreement consists of annual lease fees to be paid in monthly installments, the amount of which depends on the total number of segments which DBS, its shareholders and lessors affiliated with it and/or with its shareholders, as defined in the second space agreement will lease on the Amos 2 and Amos 3 satellites. The second space agreement brings together space segments which are to be used as reserve capacity for the leased capacity on Amos 2, and alternative capacity if the leased capacity becomes unusable, and awards DBS the right of first refusal to lease other space segments on Amos 2 under the terms specified in the agreement.

HLL has undertaken to act to extend the lease period for the space segments beyond the current lease period, and for this purpose to endeavor to station a subsequent satellite in a suitable position, with similar technical characteristics, so that it will not be necessary to make changes to the receiver systems of DBS subscribers, under the conditions determined in the agreement, until December 31, 2013, provided that an appropriate agreement for the continuation of the satellite's life is signed by the parties, as shall be determined in said agreement, pursuant to which DBS will lease at least 14 space segments in consideration of annual leasing fees under similar commercial conditions.

In February 2008, an amendment to the second space agreement was signed between DBS and HLL, according to which, inter alia:

1. DBS will lease 13 space segments instead of 14 from HLL.
2. DBS will terminate the lease of the 13 space segments by the signing of another agreement between the parties, in accordance with the mechanism set forth in the agreement.
3. A mechanism was set up for partial backup on Amos 3 in the event of non-accessibility of space segments on the Amos 2 satellite.

As at the date of this report, DBS is leasing ten space segments on the Amos 2 satellite and two space segments on Amos 3. The leasing fee in 2008 amounted to approximately NIS 78 million.

5.16.3 Information and encryption system development agreement

In October 2000, DBS signed an agreement with NDS Limited (NDS) for the development, licensing, supply, training, assimilation and maintenance of software and equipment for encryption, broadcasting, compression operations and ancillary operations required for DBS's multi-channel, broadcasting system, including development of a smart card inserted into a special decoder drive, by means of which the subscriber's viewing options can be controlled. The smart card may be updated using a satellite broadcasting signal. NDS undertook to adapt its equipment and services to the decoders purchased by DBS in accordance with the provisions of the agreement. NDS also undertook to provide DBS with support services and provide a warranty for its products. Pursuant to the agreement DBS may order and pay for additional broadcasting equipment and software and also make modification to the existing ones under the conditions set forth in the agreement. The provisions of the agreement were applied in January 2006, mutatis mutandis, to the advanced (second generation) version of the smart card. In addition, DBS has also entered into a number of agreements with NDS for the development and implementation of a system of applications to enable DBS to offer its subscribers interactive services via yesMax decoders and VOD services. DBS is paying for NDS services and products based mainly on the number of decoders that it uses and the number of its active subscribers.

5.16.4 Telephone call center service agreement

DBS operates one of its telephone call centers via Bezeq Online Ltd. (Bezeq Online), a wholly owned subsidiary of the Company, which employs staff who serve as service representatives for DBS, under an agreement of June 2001, which is in force until the end of 2010.

Until the end of 2008, Bezeq Online provided services, as aforesaid, with respect to an additional telephone call service center.

5.16.5 Finance agreement with the banks

For a summary of the main points of the agreement, see section 5.13 above and Note 13 to the Company's financial statements for the year ended December 31, 2008, which are included in this periodic report.

5.16.6 Deed of trust relating to debentures (Series A)

With respect to the issue of the Debentures (Series A) of DBS, a deed of trust was signed in July 2007 between DBS and the Trustee. The deed makes various provisions regarding the relationship between DBS and the holders of the Debentures (via the Trustee) including with respect to the possibility that DBS might increase the Debenture series and issue additional debentures and/or securities. A restriction is also prescribed depending on DBS's EBITDA with respect to DBS's right to register first degree charges in favor of the holders of additional securities as aforesaid, and/or allow them to participate in charges in favor of the Trustee, without requiring the Trustee's consent.

The deed of trust sets out various events, the occurrence of which requires the Trustee to convene a meeting of holders of the Debentures, in which, if the event has not yet been dealt with, the holders may decide, in a resolution requiring a 75% majority of the Debenture holders represented at the vote, to make the Debentures immediately repayable (in which case, the Trustee must exercise the securities granted to it) the events including: Non-payment of a sum owed by DBS on time after a warning period; appointment of a temporary liquidator, temporary or permanent receiver to DBS and/or over all or most of DBS's assets, the passing of a winding up resolution by DBS (except for winding up for the purpose of merger with another company and/or a restructuring of DBS), institution of proceedings against DBS under section 350 of the Companies Law or grant of an order under such provision, and the imposition of attachment orders or certain acts in execution of judgment, not cancelled within the periods set out in the deed; exercise of the banks' guarantees (as defined in section 5.13.7 below) or exercise of charges over most of DBS's assets by third parties; the making of another series of debentures issued by DBS immediately repayable, if the balance to be paid out is greater than the sum set out in the deed; termination of DBS' business or an intention so to do, and the creation of circumstances giving rise to a real probability that DBS will cease paying its debts or running its business; cessation of rating of the Debentures by any rating company for the period and under the conditions set out in the deed (so long as DBS is not a reporting corporation under the Securities Law); and if DBS breaches or does not fulfill any substantial condition or undertaking included in the Debenture or the deed of trust (except for non-payment as aforesaid) which the Trustee may deem to be harmful to the rights of the holders of the Debentures, and such breach is not remedied within the warning period set out in the deed.

DBS has also undertaken, under the deed of trust to carry out various acts and to issue various documents and consents to the Trustee and/or provide access to DBS' information and documents, in the events and under the conditions set out in the deed of trust.

For the principal conditions of the Debentures and the securities created by DBS under the deed of trust, see section 5.13.7 above.

5.16.7 Agreements with DBS shareholders

A. The founders agreement dated December 4, 1998 between the Company, Eurocom Communications Ltd (whose holding was later transferred to Eurocom DBS Ltd), Lidan – Business Ventures Ltd (whose holdings in DBS were later transferred to Lidan Investment Agencies (1994) Ltd) and Gilat Communications Ltd. (whose DBS holdings

were later transferred to Gilat DBS Ltd), which regulates the establishment of DBS, its administration and the relationships between the shareholders[27].

B. An agreement dated December 30, 1998 between DBS shareholders and DBS regulates, inter alia, the setting up of an executive committee and its authority.

C. An agreement dated November 2001 between the DBS shareholders[28] and DBS, modified the dilution formula set forth in the founders agreement and stipulated that the DBS shareholders' holdings will be adjusted to their pro rata share of investments in DBS, so that for the purpose of dilution, the investments (made by way of shareholders loans) would bear, as of the date fixed in the agreement, CPI linkage differentials and annual cumulative linked interest rate of 5.5% from the date of the establishment of DBS.

D. An agreement dated December 30, 2002 as amended on August 8, 2003, between DBS shareholders and DBS, prioritizes shareholders loans granted subsequent to July 10, 2002 over earlier loans. The agreement also prescribed that these loans will bear CPI linkage differentials and annual accrued linked interest rate of 5.5%, whereby a loan extended on April 27, 2003 will bear CPI linkage differentials and annual accrued linked interest rate of 11%. Furthermore, the agreement prescribed a mechanism for the allocation of shares or options for shareholders who will invest in DBS, so that their holdings in DBS will reflect their adjusted investments in it. The agreement also prescribed the information rights as prescribed for the shareholders who are not interested parties.

5.16.8 <u>Agreements with institutional organizations</u>

According to agreements of March and April 2005, loans were provided to DBS by a number of institutional bodies, in the total sum (principal) of NIS 100 million, linked to the CPI and bearing interest at an annual rate of 11%, the date of repayment of which is December 31, 2013. This credit was taken on inferior terms with respect to payment, compared with the bank credit, with exceptions similar to those that apply to shareholders' loans provided by the shareholders of DBS. After April 1, 2004, these loans were received under three different loan agreements between DBS, the Company and each of the institutional bodies, and in assurance of repayment of the 2005 institutional loans, the Company gave an undertaking to pay sums on account of the loans the amount of which is to be set based on the formula set out in the agreements (which is conditional, inter alia, on the value of DBS's debts), as set out in Note 13 to the financial statements of the Company for the period ended December 31, 2008, which includes this periodic report. The lenders, the Company and the banks agreed that in the event of exercise of the Company's guarantee to the banks (see section 5.13.5 above), the lenders shall be entitled (each pro rata their share) to a proportionate share of the exercise receipts, at the rate set out in the agreements.

5.17 Joint Venture Agreements

5.17.1 For further information relating to joint ventures with the Company regarding acquisition and marketing of internet connection infrastructure see section 5.6.5 G above.

5.17.2 In 2008 DBS and Bezeq International Ltd. decided to terminate their joint venture for the supply of a services package that includes multi-channel television services (supplied by DBS), internet infrastructure connection and internet access services (supplied by Bezeq International Ltd.). The joint venture operates under the brand name yes-Wow! Termination of the joint venture is expected to take effect by the end of 2009.

5.17.3 Under the venture, each party bears its own expenses (i.e. Bezeq International Ltd. regarding all matters relating to internet access services and DBS regarding all matters relating to multi-channel television services).

5.17.4 For the joint venture between DBS and Walla! Communications Ltd. with respect to the website, see section 5.2 above.

[27] DBS is not a party to this agreement.

[28] Gilat DBS Ltd. did not sign this agreement, however did not dispute it and signed at a later stage on an amendment to this agreement.

5.18 Legal Proceedings

5.18.1 On November 6, 2006, a claim and application for certification as a class action was filed against DBS, alleging that DBS did not refund the full amount of the deposit due to the applicant and other subscribers who chose to terminate their agreement with DBS. The deposit was paid to DBS as collateral for terminal equipment loaned to the subscribers. The applicant did not specify the total amount of the damage to the members of the group, alleging that this information is available to DBS, and she estimates that the cumulative damage to all members of the group is over NIS 16 million.

5.18.2 On January 5, 2005, DBS filed a claim in the Local Court at Tel Aviv against a company and two of its subscribers following information that it had received that the broadcasts of channels 5+ and Tchelet, originally produced by it, were being transmitted on the internal cable network of the town of Efrata in Judea, and were being received in all of the homes of that town that were connected to such cable network. Investigations by DBS showed that the channels' transmissions were being received via two decoders which contained DBS smart cards, and that those decoders were decoders that had been given to the defendants. It also became apparent that transmission of the broadcasts of the channels in the town was being performed via the broadcast center operated by the defendants in the town. DBS demanded to charge the defendants to pay compensation in the sum of NIS 2,000,000 for filing fee purposes, and in addition, DBS petitioned for a declaratory order to the effect that the defendants had breached DBS's rights under the Copyright Ordinance. Since liquidation orders and receivership orders were issued against the two defendants in the file, and in light of information regarding the poor financial situation of the remaining defendant in the file, DBS decided to withdraw the claim. On August 9, 2006, DBS filed a debt claim in the sum of NIS 27,200,000 to the Official Receiver for the debt of one of the defendants. On July 19, 2007, DBS submitted closing statements in the debt claim to the special manager appointed by the Official Receiver.

5.18.3 On December 3, 2002, a claim and application for certification as a class action was filed with the District Court against DBS, the Cable and Satellite Broadcasts Council and the Ministry of Communications with respect to the broadcasts of the sports channel 5+. According to the applicants, the broadcast of channel 5+ contravenes the conditions set out in the Council's approval of broadcast of it, and divest channel 5 of content, in contravention of the provisions of these conditions. On November 9, 2006, a settlement was signed between the plaintiffs and DBS, under which DBS undertook to broadcast various sports transmissions as part of Channel 5, for one full season of the relevant sporting areas, during the years 2006/2007, and other sporting areas during 2007/2008. The settlement was filed with the court on November 11, 2006. This is subsequent to a similar settlement signed between the plaintiffs and the cable company. Subsequent to the opinions submitted by the parties, on February 28, 2007, the ruling of the court was published to the effect that the value of the benefit was assessed at $ 10 million and costs were ruled to counsel for the plaintiff in the amount of NIS 2.5 million, and remuneration to the plaintiffs in the sum of NIS 400,000. DBS and the cable companies decided that the division between the parties would be 30-70%, and accordingly, on April 26, 2007, DBS's share (30% of the total sum) was transferred to counsel for the class plaintiffs. On April 16, 2007, the class plaintiffs filed an appeal to the Supreme Court against the sum set as remuneration to the plaintiffs, and an application to increase such sum. On May 16, 2007, DBS together with the cable companies filed a counter appeal regarding the valuation of the benefit (and accordingly, regarding the fees of counsel for the plaintiffs), and regarding the plaintiff's remuneration. On February 20, 2008, the court ratified the announcement of the parties in respect of broadcasting alternative content instead of the content described in section 131.1.2 of the settlement agreement of November 9, 2006, however prohibited its broadcast on Channel 5. The parties filed their closing statements for the appeal and counter appeal. The date for the hearing was set for June 17, 2009.

5.18.4 On July 11, 2007, an application was filed with the District Court at Tel Aviv to approve the filing of a class action against DBS and against Pizza Meter Co. Ltd., which was later substituted under the amended application of the applicant with Pizza Meter Holdings Ltd. (Pizza Meter) with respect to a campaign by DBS under which subscribers who joined the campaign were entitled to 52 vouchers for a family pizza from Pizza Meter for one year. According to the applicant, in May 2007, there was a change in the policy for exercising these vouchers, mainly in that delivery services were no longer provided, and this made it impossible to use the vouchers, in contravention of the conditions promised to subscribers when they joined the campaign. The applicant seeks to sue DBS on grounds of breach of

contractual obligation, breach of duty of good faith in entering into a contract, unjust enrichment, misleading conduct and unfair trading due to false description. On September 2, 2007, Pizza Meter gave notice to DBS of termination of exercise of the campaign vouchers by it as of September 6, 2007, following transfer of title to and all of the rights in the Pizza Meter brand from Pizza Meter Holdings Ltd. to Pizza Meter Israel – Management (2005) Ltd. DBS contacted all of its customers who had not yet reached the end of the campaign period, offering them compensation, even though it was Pizza Meter that breached the commitment. On December 4, 2007, the applicant filed a revised application for certification. On March 2, 2008, DBS filed its response to the application for certification and on April 27, 2008, the applicant filed the response. In the absence of a response by Pizza Meter, the applicant filed an application for a ruling against Pizza Meter in the absence of a defense.

Closed legal proceedings

5.18.5 In December 2006, Eurocom Digital Communications Ltd. (Eurocom Communications) received a deficit demand from the Customs Department for payment of purchase tax and VAT (including linkage differentials, interest and fines) in the amount of NIS 10 million for PVR decoders that DBS purchased from Eurocom and which Eurocom imported for DBS. Smart cards belonging to DBS arrived in the same shipment. In July 2008, Eurocom Communications and DBS signed a settlement agreement with the Customs Department, ending the dispute in relation to the deficit demand.

5.18.6 In April 2008, the application for certification as a class action against DBS, filed with the Tel Aviv District Court with regard to the disruptions in DBS broadcasts which occurred in September 2007 was dismissed following an understanding reached with another application for certification as a class action regarding the conduct of the proceedings filed by him alone, as described in Note 17 A (44) to the Company's financial statements for the year ended December 31, 2008, included in this periodic report.

5.18.7 In February 2008, DBS signed a settlement agreement with HLL to terminate the arbitration procedure between the parties in relation to the amount of monthly payment due to HLL for leasing space segments on the Amos 2 satellite under the agreement between the parties (see section 5.16.2 above).

For additional details regarding the legal proceedings, see Note 17 to the company's financial statements for the year ended 31 December 2008, which are included in this periodic report.

5.19 Goals and Business Strategy

5.19.1 DBS's goals are to continue the trend of increasing DBS's revenues, by continuing a gradual increase in the number of DBS subscribers, and by continuing the increase in average revenue per subscriber (ARPU).

5.19.2 In order to achieve these goals, DBS intends to invest considerable efforts in the field of marketing and sales and in appropriate marketing strategies, which are intended for the continued recruitment of subscribers, via DBS's sales system, to continue its efforts to create differentiation and innovation in the content of its broadcasts and increasing such compared with those of the cable company and by increasing the content purchased by each subscriber; to continue expanding DBS's added value services, and to continue investing in customer services and in retention of existing customers and to increase revenues from them. These efforts include DBS's striving to increase penetration of PVR decoders among its subscribers so as to increase DBS's revenues and its subscribers' loyalty to DBS's services, and to obtain the required permits for marketing a total service package alongside television services and internet browsing packages together with telephony services. DBS is working on launching VOD services.

5.19.3 DBS's goals with respect to increasing the number of subscribers and the ARPU are based on forecasts by management of DBS, based on the current trend in the broadcast market and on DBS's presumptions regarding competition in the field of broadcasts and regulations, which apply and which shall apply to DBS's operations and the restrictions imposed upon DBS and its operations, taking into account the restrictions applying to and that shall apply to the Company, which affect DBS. However, the forecasts of management of DBS might not come to fruition due to changes in demand in the broadcast market, due

to increased competition in this field, due to the entry of additional entities into the broadcasting field or alternative fields and due to regulatory restrictions imposed or which might be imposed on DBS or on its joint ventures with the Company (see section 5.6.5 above). Realization of DBS's goals with respect to the marketing of services packages as aforesaid are also dependent upon obtaining the statutory and regulatory consents required for such purpose (see section 5.6.5 above). With respect to the launch of the VOD services, these are dependent upon the availability of the types of decoders via which this service can be received (see section 5.4 above). Increasing the penetration rates of PVRs depends also on the availability of such decoders and the dates of supply of them by the manufacturer.

5.20 Risk Factors

The following are the threats, weaknesses and risk factors of DBS (the Risks) deriving from its general environment, from the industry and from the special nature of its operations. It should be emphasized that the risks set out below are rated according to various levels of reasonableness of occurrence, and the reasonableness of the occurrence of some of them, in DBS's assessment, would be very low. However, each risk has an effect irrespective of the reasonableness of its coming about.

5.20.1 Macro risks

5.20.1.1 Financial risks – a substantial part of DBS' expenses and investments are linked to fluctuations in the exchange rate of the US dollar. Therefore, strong fluctuations in the exchange rate will have a substantial effect on the business results of DBS. In addition, loans taken out by DBS from banks, from its shareholders and from institutional entities are partly linked to the consumer price index and therefore sharp rises in inflation might have a substantial affect on DBS's business results.

5.20.1.2 Recession – an economic recession, increase in unemployment rates and a decrease in disposable income might bring about a decrease in the number of DBS' subscribers, a decrease in DBS' revenues and harm to its business results.

The current economic recession, which includes, inter alia, by increased unemployment and reduced available income, together with the accelerated competition, is liable to lead to the aforesaid damages. Furthermore, if the economic slump leads to harming the operations or termination of the operations of significant suppliers, it is possible that this will have a negative impact on DBS's operations.

5.20.1.3 Security situation – a continued unstable security situation in most of Israel, which disrupts the day-to-day lives of residents, might bring about a downturn in DBS's business results.

5.20.2 Sector risks

5.20.2.1 Dependence on licenses – DBS provides multi-channel television broadcasts in accordance with a broadcast license and via other licenses. Breach of the provisions of the licenses as well as the provisions of the law under which the licenses are issued, are likely to bring about, subject to the conditions set out for such in the licenses, the cancellation amendment or suspension of the licenses and as a result of such, substantial harm to DBS's ability to continue operating in the field, and to imposition of monetary sanctions on DBS.

5.20.2.2 Changes in regulation – DBS's operations and broadcasts are subject to a licensing system, oversight and approvals from various regulatory bodies, and consequently DBS is likely to be influenced and restricted by considerations of the policy dictated by these entities and by changes in communications legislation; the content of DBS's broadcasts is subject to special legislative arrangements, to supervision by the Council and to the obtaining of consents from the Council and the Ministry of Communications. A very high level of regulatory intervention and changes in regulation have an effect on DBS's operations and could substantially harm its financial results.

5.20.2.3 Strong competition – the field of broadcasts is characterized by a very high penetration rate and very strong competition, which requires DBS to

constantly and continually investing in recruiting and retaining customers; and dealing with high transfer rates of customers between DBS and the cable company. The offer of a bundle of services containing multi-channel television, internet and telephony, which are not offered in this format by DBS, also increases the ability of the cable company to compete. Non-provision of VOD services by DBS when the cable company does offer such services to its customers also harms DBS's ability to compete. For further information regarding potential new competitors and alternative services to the broadcasting market see section 5.6 above.

5.20.2.4 Development of new technology – there is a risk in the development of new technology which will prevail over existing technology and turn the existing technology into old technology, and as a result a need for large monetary investments in order to retain competitive standing or alternatively in the event of development of new technologies that enable entry into the field of multi-channel broadcasts without making heavy financial investments, the entry barriers into the field might be lowered and this will constitute a threat to DBS's competitive status. For IPTV technology see section 5.1.4.2 above.

5.20.2.5 Setting up alternative infrastructure to that of multi-channel broadcasts – amendments to legislation and regulations might enable the setting up of infrastructure or systems for provision of television services that might constitute a substitute for DBS's services and harming its financial results. For the terrestrial distribution system see section 5.1.3.1 above. For digital radio broadcasts see section 5.1.1 above.

5.20.2.6 Types of payments and supervision of tariffs – DBS's license provides the kinds of payments that DBS is permitted to collect. In addition, the Council has the power not to approve amendments to the price list or campaigns or discounts initiated by DBS. These restrictions affect DBS's ability to conduct its own commercial prices policy.

5.20.2.7 Piracy – DBS is exposed to attempted pirated connection by viewers wishing to receive DBS broadcasts without paying a subscription fee. DBS assesses this phenomenon as being marginal only.

5.20.2.8 Exposure to claims regarding broadcast of content that breaches legal provisions – DBS is exposed to claims regarding broadcast of content that breaches legal provisions, including breach of intellectual property rights, damage to privacy, damage to good name, broadcast of prohibited content, etc. Its agreements with content suppliers and program producers usually include an undertaking by the supplier / producer to indemnify DBS in the event of contact that infringes the provisions of the agreement and the law.

5.20.3 <u>Special risks to DBS</u>

5.20.3.1 Need for receiving approval from financing banks for the performance of operations by DBS – the doing of operations and certain proceedings are dependent upon the receipt of the prior consent of the banks. This restriction might hinder DBS's operations.

5.20.3.2 Exposure to the provision of immediately repayable credit as a result of non-compliance with loan agreements – failure by DBS to comply with the provisions of the financing agreement or with the provisions of the deed of trust signed with the trustee for the debenture holders might, in accordance with and subject to the provisions of each of the aforesaid agreements respectively, give the relevant lenders grounds for making all of the credit provided to DBS immediately repayable and the exercise of the securities provided by DBS and its shareholders to the banks. Exercise of such securities by the banks constitutes grounds for making the debentures immediately repayable, however, making the debentures immediately repayable constitutes grounds for making the bank credit immediately repayable.

5.20.3.3 Restrictions that are the result of the ownership structure – restrictions imposed upon the Company restrict it from providing sources of finance to DBS and from cooperating for the purpose of offering a communications service bundle. These

restrictions substantially affect DBS's commercial situation and its ability to compete – see sections 5.1.2 and 5.1.3.7 above.

5.20.3.4 Maintenance of sufficient cash flow – DBS is required to maintain cash flows sufficient for compliance with its business plan and with payment of the credit that it took. Failure to pay such credit on time constitutes grounds for making the bank credit and debentures immediately repayable in accordance with and subject to the provisions and restrictions of the financing agreement and the deed of trust, accordingly.

5.20.3.5 Malfunction and damage to satellite – DBS broadcasts through space segments on the Amos 1 and Amos 2 satellites stationed in identical points in space. Operational malfunction or damage to one of the satellites is liable to disrupt and reduce the scope of DBS broadcasts, and such disruption and reductions are expected to be more significant in the event of a failure on Amos 2 satellite. Nonetheless, the duplication of the satellites by means of which broadcasts are transmitted to subscribers enables a significant reduction of the risk entailed by damage to one of them, and improves the survival ability of the broadcast. If there is a malfunction in one of the satellites, it will be possible to move most of the channels broadcast by DBS via the existing space segments on the other satellite, and perhaps even via additional segments on the satellite that might be made available for DBS's use, but not all the channels broadcast. DBS has no insurance for loss of revenues causes due to satellite malfunction.

5.20.3.6 Dependence on the holders of rights in space segments – DBS is very substantially dependent upon HLL as the exclusive holder of rights and the sole supplier of space segments used by DBS.

5.20.3.7 Dependence on software, equipment, content, infrastructure and service providers – DBS is dependent upon certain software, equipment, content and services providers, including broadcast distribution services, and failure to receive the products or services provided by them might harm DBS's ability to function or its rate of growth.

5.20.3.8 Dependence on use of internal wiring – DBS depends on the use of internal wiring in some of the subscriber homes, which is owned by the cable companies, and the use of which is effected in accordance with the administrative order. As set out in section 5.15.3 above, in 2005, the Ministry of Communications gave notice that it was considering canceling the administrative order. If the administrative order is cancelled, without an appropriate alternative arrangement enabling one supplier to make use of the infrastructure of the other in subscriber homes, this will constitute a substantial barrier to the recruitment of subscribers to DBS.

5.20.3.9 Harm to broadcast centers – harm to a broadcast center might cause a significant difficulty for continued broadcasts, however, the splitting of broadcasts into two broadcast centers (Kfar Saba and Reem Junction) significantly reduces the risk involved in harm to one of them and improves the possibility that most of the broadcasts will survive. In the event of damage to one of the broadcasting centers, DBS can continue broadcasting the primary channels from another broadcasting center (while the Kfar Saba center is able to broadcast the greatest number of channels). All the broadcasting centers have the identical encryption system and therefore, backup is also available for the encryption system in the event of damage to one of the broadcasting centers.

DBS's assessment as set out in this paragraph is forward-looking information. This assessment is based on the provision of back-up services from the supplier with whom DBS has contracted, in the event of harm to the broadcast center at Kfar Saba. This assessment might not be realized or might be partially realized or otherwise, if DBS is not permitted to receive such back-up services.

5.20.3.10 Malfunction of DBS computer systems – a significant malfunction in DBS central computer systems is liable to harm its operational capacity. DBS has a remote backup site which is intended for activation and provision of partial computer services within a few hours in the event of malfunction, and however, certain

DBS operational capacities will not be able to be executed without the proper running of the central computer systems.

5.20.3.11 Technical inferiority and the inability to offer combined services – DBS's technology is technically inferior to that of its competitors. This technical inferiority prevents DBS from providing telephony services, internet and various interactive services, including VOD, over its infrastructure, and requires it to purchase these services or to enter into joint venture agreements in order to provide such services to its customers.

5.20.3.12 Inability to offer a combined analog and digital package – DBS provides its customers with digital decoders only, whilst the cable company can provide both analog and digital decoders. The offer of two kinds of decoders makes the cost of equipment cheaper for subscribers, and improves the cable company's ability to compete.

5.20.3.13 Defects in the encryption system – DBS's broadcasts are based on the encryption of broadcasts transmitted via satellites and encoded via smart cards that are installed in the decoders in subscribers' homes. Defects in the encryption system or breach of it might enable broadcasts to be viewed without payment being made to DBS, thereby causing a reduction in revenues and a breach of the agreements between DBS and its content suppliers.

5.20.3.14 Exposure due to broadcast of channels without an agreement – DBS broadcasts approximately 10 channels to its subscribers which are broadcast from their broadcast origin as unencrypted satellite broadcasts, and which can be received in Israel (even without a decoder) without any agreement with the owners of the broadcast rights. DBS makes an effort to regulate contracts with owners of broadcasting rights.

5.20.3.15 Exposure to class actions – given the large number of its subscribers, DBS is exposed to class actions and the more subscribers, the greater the exposure to class actions in significant sums. For applications pending against DBS for approval of claims as class actions see section 5.18 above.

5.20.3.16 Compliance with conditions and instructions of the Ministry of the Environment regarding the broadcast center – in the event of failure to comply with the conditions and instructions of the Ministry of the Environment with respect to the broadcast center, DBS is exposed to the sanctions set out in the law.

5.20.3.17 Secondary allocation of frequency range – the frequency range used by DBS to transmit its broadcasts from the broadcast satellites to the satellite dishes installed at subscribers' homes, and allocated in accordance with a license by the Ministry of Communications is defined as the frequency range allocated under secondary allocation, such that there is an Israeli entity which is permitted to make primary authorized use of the frequency range. If the owner of the primary allocation uses the frequency range on an ongoing and significant basis, disruptions may occur to the quality and/or availability of DBS's broadcasts to its subscribers which might cause harm to the financial results of DBS. As at the date of this report, to the best of DBS's knowledge, the owner of the primary allocation has not made use of these frequencies in such a way as to cause significant and/or ongoing disruptions to DBS's broadcasts. Since DBS's broadcasts are wireless transmissions from the broadcast satellites on which DBS leases space segments, to the satellite dishes in subscribers' homes, the broadcast of wireless signals in the same frequency range might cause disruptions to the quality and/or availability of the broadcasts provided by DBS to its subscribers and harm to its financial results.

5.20.3.18 Disturbances to broadcasts – since DBS's broadcasts are wireless transmissions from broadcast centers to broadcast satellites and from those to the reception dishes in subscriber homes, the broadcast of wireless signals in the same frequency range, and extreme weather conditions of heavy rain, hail or snow, might cause disruptions to the quality and/or availability of the broadcasts provided by DBS to its subscribers and may cause harm to its financial results.

During the period September 5 to October 9 2007, non-continuous disruptions were found in DBS's broadcasts, which occurred at various strengths and scope and which caused disruptions to the quality and availability of DBS's broadcasts, mainly in the north of the country and along the coast. To the best of DBS's knowledge, and as it was informed by government entities following the actions taken to locate the problem, the source of the disruptions was an external element which executed broadcasting activities in the range of frequencies in which DBS transmits its broadcasts.

In this regard, in October 2007, the government decided to appoint an inter-ministerial team to examine all of the aspects and issues arising with respect to said disruptions, and in broader contexts as well. As of the date of this report, the team's conclusions have not yet been published.

Despite the fact that the disruptions to its broadcasts had been caused by external entities and not by DBS's own act or omission, DBS had opened all of the channels marketed by it (with the exception of erotic channels and pay per view movie channels) to all of its subscribers for free, for a period of three months from the middle of October 2007 until January 15, 2008, and subscribers who, under their contracts, pay a separate fee to purchase "premium" channels will be credited for such payment. This compensation and the other expenses and damages caused to DBS with respect to these disruptions caused harm to DBS's financial results.

5.20.4 The following table sets out the risk factors based on their nature and ranking according their effect in the opinion of DBS's board of management. Note that DBS's assessments below regarding the level of exposure of DBS to a risk factor reflects the level of impact of such risk factor presuming realization of the risk factor, and this shall not amount to an assessment nor shall it give any weighting to the chances of the realization of such factor. Likewise, the order of appearance of the risk factors above and below is not necessarily based on the risk involved in each risk factor, or the probability of its occurrence:

	Level of Effect		
	Major	**Moderate**	**Minor**
Macro risk			
Financial risks		X	
Security situation			X
Recession			X
Sector risk			
Dependence on licenses		X	
Changes in regulation	X		
Fierce competition	X		
Development of new technology	X		
Tariff control			X
Piracy			X
Exposure to claims for broadcasting infringing content			X
Specific risk			
Need for approval for company operations from financing banks			X
Exposure to bank credit becoming immediately repayable due to non compliance with financing agreements		X	
Restrictions due to structure of ownership	X		
Need for sufficient cash flows	X		
Satellite malfunction and damage	X		
Dependence upon space segment supplier	X		
Dependence on suppliers of content, equipment and infrastructure	X		
Dependence on suppliers of essential content		X	
Damage to broadcast centers	X		
Malfunction of computer systems			X
Technical inferiority and inability to offer combined services		X	

	Level of Effect		
	Major	**Moderate**	**Minor**
Inability to offer combined analog and digital packages			**X**
Encryption system	**X**		
Exposure regarding broadcast of channels without agreement			**X**
Stamp duty			**X**
Legal Proceedings		**X**	
Compliance with environmental restrictions			**X**
Secondary allocation of frequencies			**X**
Disruptions of broadcasts	**X**		

Date

Bezeq – The Israel Telecommunication Corp. Ltd

Names and titles of signatories:

Shlomo Rodav, Chairman of the Board
Avi Gabbay, CEO

Chapter B of the Periodic Report

Directors' Report on the State of the Company's Affairs
For the year ended December 31, 2008

We respectfully present the Directors' Report on the state of affairs of "Bezeq" - The Israel Telecommunication Corp. Limited (hereinafter: the “Company") and the consolidated Group companies (the Company and the consolidated companies together are hereinafter referred to as the “Group"), for the year ended December 31, 2008 (hereinafter: the “Directors' Report").

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

1) **Fixed-line domestic communications**

2) **Cellular**

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

4) **Multi-channel television**

The Company has another area of activity which is not material to the Group's operations, and it has been included in the Company’s financial statements on December 31, 2008 as a business segment consisting mainly of customer call center services and investment in a venture capital fund.

Revenues in the reporting year amounted to NIS 1,521 million compared with NIS 1,361 million in the corresponding year. The increase in revenues stemmed primarily from a decline in operating and general expenses from NIS 5,841 to NIS 5,437 which was offset against an increase in finance expenses from NIS 349 million to NIS 581 million. The revenues attributable to the Company's shareholders amounted to NIS 1,627 million compared with NIS 1,330 million in the corresponding year. The increase in revenues for the year stemmed primarily from an increase in revenues in all the segments with the exception of the multi-channel television segment where the loss increased. See below for further details.

1. Financial position

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

B. The Group's assets on December 31, 2008 amounted to NIS 14.31 billion, compared with NIS 15.16 billion on December 31, 2007, a decline of NIS 845 million. NIS 6.04 billion (42%) of the Group’s assets are property, plant and equipment, compared with NIS 6.06 billion (40%) on December 31, 2007.

The decrease in the Group’s assets stemmed from the fixed-line domestic communications segment. There was a decline in current assets in this segment, compared with the previous year, in the amount of NIS 499 million, mainly due to the realization of financial assets held for trading and a decline in cash and cash equivalents, which were used to pay a dividend of NIS 1.51 billion for repayment of liabilities and investment activity. Furthermore there was a decline in the customer balance mainly because the delay in the sending of customer invoices caused by the transition to a new billing system had to be overcome. In addition there was a decline in the depreciated cost of the fixed assets resulting from the gap between the depreciation expenses and the investment made in the reporting period.

In the cellular segment, assets increased from NIS 4.34 billion on December 31, 2007 to NIS 4.64 billion on December 31, 2008. Most of the increase was due to an investment in frequency rights and fixed assets for the operation of the new network (using UMTS/HSPA technology). Moreover there was an increase in the customer balance which stemmed primarily from the termination of the discounting of credit card payments.

On the other hand, there was a reduction in cash balances mainly because of the distribution of a dividend and there was also a decrease in inventory caused by a reduction in the inventory of CDMA handsets.

In the international communication, internet and NEP services segment, assets increased from NIS 887 million on December 31, 2007 to NIS 994 million on December 31, 2008. The increase stemmed primarily from a rise in advance long-term expenses for capacity usage rights, a rise in

cash balances and a rise in customer balances and in inventory caused by an increase in all the components of the segment's operations.

In the multi-channel television segment there was a moderate increase in total assets from NIS 1.10 billion on December 31, 2007 to NIS 1.13 billion on December 31, 2008.

C. The shareholders' equity attributed to Company shareholders on December 31, 2008 amounted to NIS 4.72 billion, comprising 33% of the total balance sheet, compared with NIS 4.54 billion on December 31, 2007, which comprised 30% of the total balance sheet. The increase in shareholders' equity stemmed primarily from the Group's revenues for the year most of which was offset by the distribution of a dividend in the amount of NIS 1.51 billion.

The Group's debt to financial institutions and debenture holders on December 31, 2008 amounted to NIS 6.05 billion, compared with NIS 6.74 billion on December 31, 2007. The decrease is mainly due to payment of debentures in the domestic fixed line communications segment in the amount of NIS 593 million and payment of loans and debentures in the cellular segment. The Group's total payment of debentures, loans and short-term borrowings amounted to NIS 912 million. The decrease was partially offset mainly by a revaluation of CPI-linked loans and debentures caused by a rise in the CPI.

D. The Company's auditors have highlighted the financial position of D.B.S. Satellite Services (1998) (DBS) as at December 31, 2008, in the financial statements. As mentioned in Notes 13C(3) and 33(3) to the financial statements, at December 31 2008 DBS is not in compliance with the financial covenants set for it, after receipt of a relief in connection with those covenants on March 5, 2008, updating the stipulations for 2008. Subsequent to the balance sheet date DBS is in compliance with the financial conditions set for it, following updates to the conditions for 2008. After the balance sheet date DBS received a relief in connection with the financial criteria as at December 31, 2008, and consequently as at the approval date of these statements DBS is in compliance with the conditions set in the financing agreement. The continuation of DBS's operations is also conditional on compliance with the conditions set for 2009 and/or with further reliefs. The management of DBS believes that the financial resources available to it will be sufficient for its operating needs in the coming year based on the forecasted cash flow approved by DBS's board of directors.

2. Results of operations

A. Principal results

There were no changes in the Group's revenues in 2008 compared with the previous year and they amounted to NIS 12.41 billion. Revenue stability stems from an increase in revenues in the cellular and multi-channel television segment which was fully offset by a decrease in the fixed-line domestic communications segment.

The Group's depreciation and amortization expenses amounted to NIS 1,703 million compared with NIS 1,769 million in the previous year, a decrease of 3.7%.

Most of the decline stemmed from the fixed-line domestic communications segment and the multi-channel television segment and it was partially offset by an increase in revenues from the cellular segment.

In 2008 the Group's salary expenses amounted to NIS 2,354 million compared with NIS 2,375 million in the previous year, a decrease of 1%. The decrease stemmed primarily from a decline in salary expenses in the fixed-line domestic communications segment which was partially offset by an increase in salary expenses in the other Group segments.

In 2008 the Group's operating and general expenses amounted to NIS 5,437 million compared with NIS 5,841 million in the previous year, a decrease of 7%. The decrease stems primarily from a decline in expenses in all the Group's principal segments.

Earnings for the year which will be attributed to the Company's shareholders in 2008 amounted to NIS 1,627 million. The earnings were affected by the early application of international standards whereby 58% of DBS's losses were included in the Company's shareholders' share – for details see Note 3V(1) of the financial statements.

B. **Operating segments**

Below are operations data by segment presented in accordance with the Group's operating segments:

Revenues by operating segments	1-12/2008		1-12/2007	
	NIS millions	% of total revenues	NIS millions	% of total revenues
Fixed-line domestic communications	5,498	44%	5,713	46%
Cellular	4,713	38%	4,684	38%
International communication Internet and NEP	1,306	11%	1,304	11%
Multi-channel television services	1,513	12%	1,415	11%
Other and offsets	(623)	(5%)	(716)	(6%)
Total	12,407	100%	12,400	100%

Operating profit by operating segments	1-12/2008		1-12/2007	
	NIS millions	% of total earnings	NIS millions	% of total earnings
Fixed-line domestic communications	1,475	27%	1,319	23%
Cellular	933	20%	805	17%
International communication Internet and NEP	242	19%	204	16%
Multi-channel television services	177	12%	56	4%
Other and offsets	(10)		(8)	
Consolidated operating profit/ Percentage of the group's revenues	2,817	23%	2,376	19%

Fixed-line domestic communications segment

Revenues:

Revenues in 2008 amounted to NIS 5.5 billion compared with NIS 5.71 billion in the previous year, a decline of 3.8%.

The decline in the segment's revenues stemmed from a decrease in interconnect fees to the cellular networks in the amount of NIS 137 million (there was a parallel decrease in expenses). An additional decrease stemmed from a decrease in the number of lines (primarily as a result of number mobility), a decrease in call traffic and a tariff reduction in June 2007 and June 2008. The decrease in revenues was moderated mainly by ongoing growth in revenues from high-speed internet service (ADSL) caused by an increase in subscriber numbers and in domestic network sales. There was also an increase in revenues from data communication services.

Costs and expenses:

Depreciation and amortization expenses in 2008 amounted to NIS 852 million compared with NIS 941 million in the previous year, a decrease of 9.5%. The decrease was caused by the end of the depreciation of fixed assets, a decrease in investments in new assets and a change in the useful life and scrap value estimate of fixed assets.

Salary expenses in 2008 amounted to NIS 1,202 million compared with NIS 1,293 million in the previous year, a decrease of 7%. The decrease in salary expenses stemmed primarily from employee retirement and a decrease in ancillary salary expenses which was partially offset by share-based payments and salary updates.

Operating and general expenses in 2008 amounted to NIS 1,873 million compared with NIS 2,121 million in the previous year, a decline of 11.7%. The decrease stemmed primarily from a decrease in interconnect expenses to the cellular networks in the amount of NIS 139 million, together with a decrease in revenues, and from a decrease in maintenance expenses by subcontractors and marketing expenses, as part of the application of streamlining processes. Part of the decrease stemmed from an update in provisions for royalties and international communication providers.

Other operating expenses, net in 2008 amounted to NIS 96 million compared with NIS 39 million in the previous year. This was caused mainly by the recording of provisions for claims in the previous year compared with an increase in retirement expenses for early retirement severance pay in the reporting year and a decrease in capital gains.

Profitability:

Operating profit in the segment in 2008 amounted to NIS 1,475 million compared with NIS 1,319 million in the previous year, an increase of 11.8%. The improvement in operating profit stems from the changes described above in the expenses and revenue items.

Cellular segment

Revenues:

In 2008 revenues in the segment amounted to NIS 4.71 billion compared with NIS 4.68 billion in the previous year, an increase of 0.6%.

The increase stemmed primarily from a rise in the number of subscribers, in particular 3G subscribers, which led to a rise in revenues from usage fees and revenues from content services. The increase in revenues was partially offset by erosion in the average subscriber revenue which was caused mainly by tariff erosion and a decrease in traffic minutes. Moreover there was a decrease in revenues from the sale of terminal equipment caused by a decline in the number of sales and upgrades of end user equipment which was offset by an increase in sales and upgrade prices.

Costs and expenses:

Depreciation and amortization expenses in 2008 amounted to NIS 523 million compared with NIS 479 million in the previous year, a decrease of 9.2%. The increase stems partly from the accelerated depreciation of fixed asset items resulting from the transition to the new network.

Salary expenses in 2008 amounted to NIS 638 million compared with NIS 598 million in the previous year, an increase of 6.7%. The rise in salary expenses stemmed primarily from the share-based payment plan for managers.

Operating and general expenses in 2008 amounted to NIS 2,619 million compared with NIS 2,802 million in the previous year, a decrease of 6.5%. The decrease stemmed primarily from a decrease in the number of handsets sold and upgraded and from their price which was partially offset by a rise in site maintenance expenses.

Profitability:

Operating profit in the segment in 2008 amounted to NIS 933 million compared with NIS 805 million in the previous year, an increase of 15.9%. The improvement in operating profit stemmed from the changes described above in the expenses and revenue items.

International communication, internet and NEP segment

Revenues:

In 2008 revenues in the segment amounted to NIS 1,306 million compared with NIS 1,304 million in the previous year. Segment revenues remained similar in the reporting years, however there was a decline in revenues from call transfer activity between communication providers in the world and from PBX sales activity. On the other hand there was an increase in segment revenues from outbound international calls following an increase in the number of outbound minutes as well as an increase in revenues in the internet sector caused by an increase in the number of broadband customers and an increase in integration operations and communication solutions for corporate customers.

Costs and expenses:

Depreciation expenses in 2008 amounted to NIS 80 million compared with NIS 87 million in the previous year, a decrease of 7%. The decrease stems from the end of the depreciation of assets in 2007.

Salary expenses in 2008 amounted to NIS 260 million compared with NIS 240 million in the previous year, an increase of 8.3%. The increase in salary expenses stems from the share-based payment plan for managers, a headcount increase and salary updates.

Operating and general expenses in 2008 amounted to NIS 724 million compared with NIS 773 million in the previous year, a decrease of 6.3%. The decrease stemmed primarily from a reduction in call transfer activity between communication operators in the world together with a decrease in revenues.

Profitability:

Operating profit in the segment in 2008 amounted to NIS 242 million compared with NIS 204 million in the previous year, an increase of 18.6%. The improvement in operating profit stems from the changes described above in the expenses and revenues items.

Multi-channel television segment

Revenues:

Revenues in the segment in 2008 amounted to NIS 1,513 million compared with NIS 1,415 million in the previous year, an increase of 7%. The increase stemmed from a rise in the number of subscribers and a rise in average customer revenue.

Costs and expenses:

Depreciation and amortization expenses in 2008 amounted to NIS 250 million compared with NIS 273 million in the previous year, a decrease of 8.5% caused by the end of depreciation and a change in asset useful life estimates.

Salary expenses in 2008 amounted to NIS 197 million compared with NIS 180 million in the previous year, an increase of 9.4% caused by a rise in headcount primarily resulting from the end of installation agreements with subcontractors.

Operating and general expenses in 2008 amounted to NIS 888 million compared with NIS 906 million in the previous year, a decrease of 2%. The decrease in expenses was primarily in space section costs for broadcasting and marketing expenses.

Profitability:

Operating profit in the segment in 2008 amounted to NIS 177 million compared with NIS 56 million in the previous year, an increase of 216%. The improvement in operating profit stems primarily from the above-mentioned increase in revenues.

C. **Financing expenses, net**

The Group's net financing expenses in 2008 amounted to NIS 581 million compared with NIS 349 million in the previous year, an increase of 66.5%. The increase stems from finance revenues of NIS 96 million which were formerly recorded because of a change in the minority shareholder loan capitalization rate in the multi-channel television segment. Moreover there was an increase in linkage differential expenses (less the effect of hedging transactions) because of an increase in the index to which most of the Group's debit balance is linked. In addition, there was a decrease in deposit interest revenues because of a decrease in the Group's liquid financial balances.

In the domestic fixed line communications segment in 2008, net financing expenses amounted to NIS 125 million compared with NIS 188 million in the previous year, a decrease of 33.5%. The decrease in net financing expenses compared with the previous year stemmed primarily from an increase in revenues from shareholders' loans for DBS amounting to NIS 117 million and a decrease in interest expenses resulting from a decrease in the financial liabilities. The decrease in interest expenses was partially offset against a decrease in linkage differentials and a decrease in financing income from deposits and investments in securities.

In the cellular segment net financing revenues amounted in 2008 to NIS 2 million compared with financing expenses of NIS 5 million in 2007.

In the multi-channel television segment net financing expenses in 2008 amounted to NIS 441 million compared with NIS 168 million in the previous year, an increase of 163%. Most of the change stemmed from finance revenue amounting to NIS 213 million which was recorded in the third quarter of the previous year because of a change in the capitalization rate of shareholders' loans. Furthermore the rise in the index rate in the period caused a rise in the financing expenses.

D. **Income tax**

The Group's tax expenses in the reporting year amounted to NIS 720 million, representing approximately 32% of pre-tax profit, compared with NIS 672 million in the previous year, representing 33% of pre-tax profit. Most of the decrease in the rate of tax on profits before income tax is due to a tax rate reduction as well as cancellation of the inflation condition tax law. The decrease is moderated by the increase in DBS's losses which may not be offset for tax purposes.

E. **Main data from the Group's consolidated statements of income** (in NIS millions)

	Q1 2008	Q2 2008	Q3 2008	Q4 2008	2008	2007	Increase (Decrease)	%
Revenues [1]	3,100	3,086	3,159	3,062	12,407	12,400	7	0%
Costs and expenses [2]	2,436	2,286	2,337	2,531	9,590	10,024	(434)	(4%)
Operating profit	664	800	822	531	2,817	2,376	441	19%
Financing expenses – net [3]	100	183	186	112	581	349	232	66%
Earnings before Group's equity in profits of associates	564	617	636	419	2,236	2,027	209	10%
Equity in profits of associates	1	1	2	1	5	6	(1)	(17%)
Profit before income tax	565	618	638	420	2,241	2,033	208	10%
Income tax	180	205	207	128	720	672	48	7%
Profit for the year	385	413	431	292	1,521	1,361	160	12%
Attributable to:								
The Company's equity holders	411	456	462	298	1,627	1,330	297	22%
Non-controlling interest	(26)	(43)	(31)	(6)	(106)	31	(137)	-
Profit for the year	385	413	431	292	1,521	1,361	160	12%

Comparison of 2008 fourth quarter results with the results of the third quarter

Details of the material changes:

(1) Total revenues declined by NIS 97 million of which NIS 76 million was in the mobile telephone segment. The decline in the segment's revenues was primarily in revenues from the sale of end user equipment and cellular services.

(2) The total costs and expenses increased by NIS 194 million compared with the prior quarter. Most of the increase originates from the fixed-line domestic communications segment. In this segment there was an increase in the fourth quarter resulting from the recording of a provision for early retirement caused by the decision to expand the early retirement agreement also for 2009. In addition, in this quarter there were updates of other actuarial liabilities. An increase in capital gains in the quarter partially offset these costs.

(3) Net financing expenses decreased by NIS 74 million compared with the prior quarter, mainly as a result of the decline in the CPI to which most of the Group's liabilities are linked.

3. Liquidity and sources of financing

Consolidated cash flows generated by operating activities in 2008 amounted to NIS 3.41 billion, compared with NIS 2.95 billion in the previous year, an increase of NIS 468 million. The increase in cash flows generated by operating activities is mainly due to the increase in operating profit of all the

Group's segments and a change in the accounts receivable balance which was partially offset by a change in the accounts payable balance and provisions.

Cash flows generated by operating activities are one of the sources of financing of the Group's investments, which during the reporting year included NIS 1,300 million invested in development of communications infrastructures, and NIS 469 million in intangible assets and deferred expenses, compared with investments amounting to NIS 973 million and NIS 273 million, respectively, in the previous year. During the reporting year, the Group realized investments in net financial assets of NIS 332 million, compared with net realizations of NIS 705 million in the prior year.

In the reporting year, the Group repaid debts and paid interest of NIS 1,103 million, of which NIS 714 million was on account of debentures, NIS 148 million in loans, NIS 50 million in short-term credit, and NIS 243 million in interest payments. In contrast the Group received a receipt for the removal of net derivative financial instruments in the amount of NIS 52 million. This compares with the repayment of a net debt and interest payments amounting to NIS 3,116 million in the previous year. In the reporting year a cash dividend of NIS 1.51 billion was paid and in the previous year the amount was NIS 2.86 billion.

The monthly average short-term credit balance from banks in 2008 amounted to NIS 79 million. The monthly average of long-term liabilities to financial institutions and debenture holders in 2008 amounted to NIS 6,193 million.

The working capital deficit on December 31, 2008 was negative, and amounted to NIS 1,279 million, compared with NIS 919 million on December 31, 2007. Most of the increase in working capital deficit is derived from a decrease in working capital in the cellular segment which was mitigated by an improvement in the international communication, internet and NEP segment.

The Company's board has examined the Company's projected cash flow, including credit sources and credit-raising options, and has determined despite the deficit in working capital, the Company does not have a liquidity problem.

The above information includes forward-looking information which is based on the Company's assessments. The actual results might differ materially from the assessments described above if a change occurs in one of the factors taken into account when making them.

4. The connection between the compensation granted pursuant to Article 21 and the contribution made by the recipient to the corporation in relation to each of the five highest salary recipients among its officers

The board of directors believes that the remuneration paid to the five senior officers as described in section 7A of chapter D of this periodic report is fair and reasonable considering the size of the Corporation, the scope and complexity of its operations and businesses as well as the assignments and responsibility shouldered by these senior officers. The considerations guiding the board of directors of the Company (or of the subsidiary, where applicable) in the determination of the remuneration of the senior officers is based, inter alia on the status and position of each one, his contribution to the advancement of the Corporation and its financial results. Moreover, the board of directors believes that the scope of remuneration of these senior officers does not deviate from what is customary in similar corporations in the market.

5. Group involvement in the community and donations

The Group is active in the community through its involvement in social institutions and organizations which are active for education, welfare and other purposes. Its contributions in the reporting year amounted to NIS 5.3 million. In addition, Group employees volunteer in additional and diverse community involvement activities. In the Cast Lead operation the Company provided public telephones, laptop computers and free internet use to residents in the south of the country and soldiers. The Group intends to increase its philanthropy budget for 2009.

6. Exposure to and management of market risks

Responsibility for management of the Company's market risks

The person responsible for management of the Company's market risks is Alan Gelman, the Deputy CEO and CFO. For details of his education and experience, see Section 12 (C) in Chapter D of the Periodic Report.

Market risks and the Company's risk management policy

The Company is exposed to market risks as a result of changes in interest rates, exchange rates, inflation, the prices of raw materials and equipment, and the prices of securities.

On June 26, 2008 the Company adopted a financial exposure policy which replaces the previous exposure management policy. A board resolution allows for a transition of three months, with the aim of allowing the adjustment of exposure management to the new policy. The main relevant transactions in the reporting period were made according to the prior exposure policy as described in the board of directors' report from 2007. The primary purpose of the new policy is to minimize significant exposures to the market risks which are liable to affect the Group's cash flow and financial results. In accordance with the said policy the Company will implement hedging transactions, partially, based on circumstances and its discretion, mainly in order to reduce its exposure to changes in foreign currency exchange rates and in the CPI.

The Company will monitor the Group's exposure management on a monthly basis, including recommendations for change in respect of the exposure and management, if required.

At least once a year, the board of directors of the Company and of each of the main subsidiaries will discuss the exposure to financial risks. If the overseeing level considers a deviation from the goals, its recommendations will be presented to the board of directors.

Inflation – the Company has a significant surplus of liabilities over CPI-linked assets and the bulk of its financial exposure derives from the risk of a rise in inflation. The rate of inflation also has an effect on the Company's revenues and operating results in the course of the year.

The Company's tariff updating mechanism, which was laid down in regulations and is reviewed once a year, is influenced by the CPI. As a result, the annual rate of inflation and its distribution over the year can have a material influence on the erosion of the Company's tariffs and on its revenues over the year. The rate of inflation affects the Company's expenses but some of these expenses, mainly salary expenses, have other direct or indirect linkage mechanisms.

The Company invests a considerable part of its cash balances in unlinked shekel value deposits, and these investments are exposed to changes in their real yield caused by changes in the rate of inflation. In order to minimize this exposure, the board of directors of the Company decided to implement full or partial hedging transactions at its discretion, in accordance with the following:

A. Hedging activity will be implemented mainly by means of CPI-shekel forward transactions which guarantee a designated rise in the CPI over a designated period.

B. Transactions will be implemented after deliberation and in accordance with market trading restrictions and on occasions where the price is deemed to be attractive in relation to the Bank of Israel Inflation Target Center.

C. It will be possible to reduce a hedging position by closing existing transactions before their expiry date.

D. As long as this exposure is more than NIS 500 million, the hedging rate will not be less than 20% of the exposure and will not exceed 80% of the exposure; as long as this exposure is below NIS 500 million, the hedging rate will not exceed 50% of the exposure.

In the reporting period the Company implemented hedging transactions against the index since they were made as forward transactions. The financial statements include financing revenues of NIS 5 million from these hedging transactions.

Interest – The Company's exposure to change in the interest rate largely depends on the character of its financial liabilities and assets as well as future financial requirements, The Company's debentures bear fixed interest and therefore a change in the interest rate will affect the fair value and not their book value.

The Company has investments in negotiable bonds that are shown in the Company's books at their market value. This market value is influenced by changes in the interest rates in the economy.

At the date of this report, the Company does not hedge against the aforementioned exposures. It is not inconceivable, however, that it will do so under future market circumstances. Furthermore, the Company takes into account such influences when considering the types of loans it takes and when managing its investment portfolio.

Exchange rates – A change in the shekel exchange rate constitutes economic exposure in that it can affect the Company's future earnings and cash flows, mainly the repayment of currency-linked liabilities and payments for the currency-linked purchase of equipment and raw materials.

In order to minimize this exposure, the board of directors decided that the Company should hedge its accounting exposure to exchange rate risks subject to the following principles and rules:

1. The unhedged exposure to exchange rate risks would not exceed an amount equivalent to $200 million
2. Hedging of purchase and/or investment transactions would take place, if at all, on the date of the purchase and/or investment decision and the decision to do this would be part of the purchase and/or investment decision itself.

The Company recorded no significant costs in making hedging transactions against the exchange rate, since they were made as forward transactions. The financial statements include financing revenues of

Prices of raw materials and equipment – Cash flows generated by the Company's operations are used partially for investment in equipment. The prices of equipment are affected by the indices to which they are linked, including sectoral price indices, exchange rates and global prices. The Company does not hedge against this exposure.

Prices of securities – The Company invests a small part of its financial balances in securities. The investment policy was determined by the Company's board of directors. With the aim of preventing fluctuations in the portfolio's yield, the board of directors set investment principles whereby most of the investment will be in bonds and shekel deposits. The types of investment and their proportional part in the investment portfolio were determined according to criteria based on linkage, rating, redemption date, liquidity and risk. According to this investment policy the Company has no authority to invest in shares as part of the management of its investment portfolio. As at the date of publication of the reports, the total investment in securities is negligible.

Risks and risk management in the consolidated companies – According to the decision of the board of directors, each of the companies in the Group is required to manage a risk policy and routinely monitor performance. The persons responsible for management of the market risks in the principal consolidated companies are the deputy CFOs of those companies. Pelephone's policy is to partly hedge its accounting and cash flow exposure to market risks based on its assessments and expectations of the parameters affecting the risk. DBS enters into future dollar/shekel hedging transactions in order to protect its projected cash flow.

The consolidated financial statements include finance expenses of NIS 22 million from hedging transactions, including forward transactions and purchase of options in the reporting year.

Linkage based report – Note 31 to the Financial Statements includes information on the linkage terms of the financial balances in the Group.

For further details of the Group's financial risk management see Note 30 to the financial statements.

Below is an analysis of the sensitivity of the Group's assets and liabilities to changes in foreign currency exchange rates, the CPI, interest and market prices of securities.

Sensitivity analysis 2008 (in NIS millions)

Sensitivity to changes in the dollar/NIS exchange rate – 2008

The table shows the items sensitive to fluctuations in the dollar/shekel exchange rate. The sensitivity of the items in the balance sheet was examined, as were off-balance sheet items. The firm commitments are off-balance sheet commitments, denominated and/or linked to the dollar and therefore sensitive to changes in the exchange rate. The fair value of the firm commitments was calculated by discounted future cash flow. The Group has minor exposure to changes in the exchange rate of other foreign currencies, with the exception of the US dollar.

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	5%	At a dollar rate of 3.802	-5%	-10%
Cash	1	1	12	(1)	(1)
Trade receivables	7	3	70	(3)	(7)
Long-term trade receivable	1	1	15	(1)	(1)
Investments	5	3	50	(3)	(5)
Trade payables	(25)	(13)	(251)	13	25
Firm commitments - suppliers	(42)	(21)	(417)	21	42
Firm commitments – space segments	(54)	(27)	(539)	27	54
Firm commitments – vehicle leasing	(1)	(1)	(14)	1	1
Firm commitments - rent	(4)	(2)	(36)	2	4
Guarantees	(7)	(4)	(75)	4	7
Hedging instruments not recognized for accounting					
Dollar/shekel forward transactions	22	11	3	(11)	(22)
Options					
Dollar/shekel sale option	2	2	(3)	(3)	(7)
Dollar/shekel purchase option	3	2	2	(1)	(2)
Total	**(92)**	**(45)**	**(1,183)**	**45**	**88**

Sensitivity to changes in the CPI – 2008

A sensitivity analysis of 5% and 10% (up and down) was conducted on an inflation assessment of 2% per year, based on the Inflation Target Center at the Bank of Israel. The analysis of sensitivity to changes in the CPI includes an additional scenario of 1.5% per month (up and down) which examines the most extreme monthly change in the CPI which occurred in the past ten years (a monthly change of 1.5% in April 2002).

The Group has debentures and loans from banks and other sources, which are linked to the CPI. The Group also has firm commitments (for rent, vehicle leasing and agreements with suppliers), which are linked to the CPI. The fair value of the firm commitments was calculated by discounting the future cash flow.

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	1.5%	0.2%	0.1%		(0.1%)	(0.2%)	(1.5%)
Trade receivables	-	-	-	24	-	-	-
Long-term trade receivables	1	-	-	35	-	-	(1)
Other liabilities and provisions	(2)	-	-	(155)	-	-	2
Other long-term liabilities	-	-	-	(6)	-	-	-
Firm commitments – vehicle leasing	(3)	-	-	(215)	-	-	3
Firm commitments – suppliers	(1)	-	-	(36)	-	-	1
Firm commitments - rent	(9)	(1)	(1)	(588)	1	1	9
Guarantees	-	-	-	(8)	-	-	-
Debentures issued to financial institutions and others	(8)	(1)	(1)	(554)	1	1	8
Debentures issued to financial institutions and others	(12)	(2)	(1)	(820)	1	2	12
Debentures issued to financial institutions and others	(11)	(1)	(1)	(724)	1	1	11
Debentures issued to the public – Series 4	(15)	(2)	(1)	(1,031)	1	2	15
Debentures issued to the public – Series 5	(27)	(4)	(2)	(1,810)	2	4	27
Loans from banking institutions	(5)	(1)	-	(317)	-	1	5
Loans from others	(2)	-	-	(156)	-	-	2
Loans provided by the minority in a subsidiary	(7)	(1)	-	(449)	-	1	7
Hedging instruments not recognized for accounting							
CPI forward transactions	26	3	2	(5)	(2)	(3)	(26)
Total	**(75)**	**(10)**	**(5)**	**(6,815)**	**5**	**10**	**75**

Sensitivity to changes in real shekel interest rates – 2008

The Group's companies have index-linked debentures at fixed interest. These debentures are sensitive to changes in the real shekel interest rate. Debentures issued to the public – Series 4 – were traded on December 31, 2008 with a yield of 3.83% and an average duration of 1.36. Debentures issued to the public – Series 5 – were traded on December 31, 2008 with a yield of 3.92% and an average duration of 4.32.

Changes in the fair value of debentures were calculated by discounting the future cash flows. The fair value of the debentures is presented at the stock market value, in other words, by multiplying the market price on December 31, 2008 with the quantity of the issued nominal value. The fair value of non-negotiable debentures was calculated by discounting the future cash flows at an average interest rate of 4.16% to 9.1%. Loans from banks and other institutions are linked to the CPI and sensitive to changes in real shekel interest. These loans were discounted at an average interest rate of 5.68% - 11.30%.

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	5%		-5%	-10%
Debentures issued to financial institutes and others	2	1	(554)	(1)	(2)
Debentures issued to financial institutes and others	11	5	(820)	(5)	(11)
Debentures issued to financial institutes and others	24	12	(724)	(12)	(25)
Debentures issued to the public -Series 4	5	3	(1,031)	(3)	(5)
Debentures issued to the public - Series 5	29	15	(1,810)	(15)	(30)
Bank loans	4	2	(317)	(2)	(4)
Loans from others	8	4	(156)	(4)	(8)
Hedging instruments not recognized for accounting					
CPI forward transactions	(5)	(2)	(5)	2	5
Total	**78**	**40**	**(5,417)**	**(40)**	**(80)**

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Sensitivity to changes in nominal shekel interest rates – 2008

The sensitivity analysis of the shekel interest rate includes another scenario (12% up and down), which examines the most extreme daily change that occurred in the last ten years (a daily change of 12% in December 2001). The Group has accounts receivable in installments. The fair value of these balances is calculated by discounting the future cash flow at an interest rate of 7.5%. The Group has unlinked loans from banking institutions at fixed interest. The loans were discounted at an average interest rate of 7.52%.

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	12%	10%	5%		-5%	-10%	-12%
Shekel deposits	-	-	-	556	-	-	-
Accounts receivable paid in installments	(8)	(7)	(3)	1,041	3	7	8
Investments, deposits and debit balances	(1)	(1)	-	128	-	1	1
Long-term accounts receivable	-	-	-	34	-	-	-
Loans from banking corporations	17	14	7	(808)	(7)	(15)	(18)
Hedging instruments not recognized for accounting							
CPI forward transactions	5	4	2	(5)	(2)	(4)	(5)
Dollar / shekel forward transactions	-	-	-	3	-	-	-
Options							
Dollar / shekel sale option	-	-	-	(3)	-	-	-
Dollar / shekel purchase option	-	-	-	2	-	-	-
Total	**13**	**10**	**6**	**948**	**(6)**	**(11)**	**(14)**

Sensitivity to changes in US dollar interest rates – 2008

The sensitivity analysis of the dollar interest rate includes another scenario (15% up and down), which examines the most extreme daily change that occurred in the last ten years (a daily change of 15% in June 2003).

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	15%	10%	5%		-5%	-10%	-15%
Dollar deposits	-	-	-	5	-	-	-
Firm commitments – space segments	20	13	7	(539)	(7)	(14)	(21)
Hedging instruments not recognized for accounting							
Dollar/shekel forward transactions	-	-	-	3	-	-	-
Options							
Dollar / shekel sale option	-	-	-	(3)	-	-	-
Dollar / shekel purchase option	-	-	-	2	-	-	-
Total	**20**	**13**	**7**	**(532)**	**(7)**	**(14)**	**(21)**

Sensitivity analysis 2008 (in NIS millions)

Sensitivity to changes in the dollar/NIS exchange rate – 2007

The table shows the items sensitive to changes in the dollar/shekel exchange rate. The sensitivity of the items in the balance sheet was tested, as were off-balance sheet items. The firm commitments are off balance-sheet commitments, denominated and/or linked to the dollar and therefore sensitive to changes in the exchange rate. The fair value of the firm commitments was calculated by discounting the future cash flow. The Group has insignificant sensitivity to changes in the exchange rate of other foreign currencies, with the exception of the US dollar.

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	5%	At a dollar rate of 3.846	-5%	-10%
Cash	8	4	83	(4)	(8)
Trade receivables	6	3	58	(3)	(6)
Accounts receivable and debit balances	0.1	0.1	1	(0.1)	(0.1)
Investments	10	5	9	(5)	(10)
Long-term trade receivables	2	1	25	(1)	(2)
Accounts payable	(31)	(16)	(313)	16	31
Other liabilities	(0.1)	(0.1)	(1)	0.1	0.1
Firm commitments – space sections	(61)	(31)	611	31	61
Firm commitments - suppliers	(43)	(22)	(435)	22	43
Firm commitments - rent	(4)	(2)	(45)	2	4
Firm commitments – vehicle leasing	(2)	(1)	(19)	1	2
Guarantees	(8)	(4)	(85)	4	8
Hedging instruments not recognized for accounting					
Dollar/shekel forward transactions	35	18	(11)	(18)	(35)
Total	**(88)**	**(45)**	**(1,258)**	**45**	**88**

Sensitivity to changes in the CPI – 2007

A sensitivity analysis of 5% and 10% (up and down) was conducted on an inflation assessment of 2% per year, based on the Inflation Target Center at the Bank of Israel. Another scenario of 1.5% (up and down) reflects the most extreme change that occurred in the last ten years (a monthly change of 1.5% in April 2002) in the CPI. The Group has debentures and loans from banks and other sources which are linked to the CPI. Additionally, the Group has firm commitments (for rent and vehicle leasing agreements with suppliers) which are linked to the CPI. The fair value of the firm commitments was calculated by discounting the future cash flow.

	Profit (loss) from changes			**Fair value**	**Profit (loss) from changes**		
	1.5%	**0.2%**	**0.1%**		**0.1%**	**0.2%**	**1.5%**
Trade receivables	0.2	-	-	15	-	-	(0.2)
Investments and debit balances	0.1	-	-	11	-	-	(0.1)
Long-term trade receivables	0.3	-	-	24	-	-	(0.3)
Other liabilities and provisions	(2)	(0.3)	(0.1)	(131)	0.1	0.3	2
Firm commitments – vehicle leasing	(0.7)	(0.1)	(0.1)	(52)	0.1	0.1	0.7
Firm commitments - rent	(9)	(1)	(1)	(579)	1	1	9
Firm commitments - suppliers	(2)	(0.2)	(0.1)	(105)	0.1	0.2	2
Guarantees	(0.5)	-	-	(33)	-	-	0.5
Debentures issued to financial institutions and others	(12)	(2)	(1)	(776)	1	2	12
Debentures issued to financial institutions and others	(14)	(2)	(1)	(928)	1	2	14
Debentures issued to financial institutions and others	(10)	(1)	(1)	(650)	1	1	10
Debentures issued to the public- series 4	(20)	(3)	(1)	(1,340)	1	3	20
Debentures issued to the public- series 5	(26)	(3)	(2)	(1,706)	2	3	26
Bank loans	(7)	(1)	(0.5)	(461)	0.5	1	7
Loans from others	(2)	(0.3)	(0.1)	(137)	0.1	0.3	2
Loans provided by the minority in a subsidiary	(6)	(1)	(0.4)	(375)	0.4	1	6
Hedging instruments not recognized for accounting							
Hedging transactions against the index	54	7	4	53	(4)	(7)	(54)
Total	**(56.6)**	**(7.9)**	**(4.3)**	**(7,170)**	**4.3**	**7.9**	**56.6**

Sensitivity to changes in real shekel interest rates – 2007

The Group's companies have index-linked debentures at fixed interest. The debentures are sensitive to changes in the real shekel interest rate. The debentures issued to the public – Series 4 – were traded on December 31, 2007 with a yield of 3.04% and an average duration of 1.83. The debentures issued to the public – Series 5 – were traded on December 31, 2007 with a yield of 4.45% and an average duration of 5.07.

Changes in the fair value of debentures was presented by discounting the future cash flows. The fair value of the debentures is presented according to the value on the stock exchange, in other words, by multiplying the market price on December 31, 2007 by the amount of the issued nominal value. The fair value of non-negotiable debentures was calculated by discounting the future cash flows by an average interest rate of 4.18% to 8.14%. Loans linked to the CPI and sensitive to changes in real shekel interest, from banks and other institutions, were discounted at an average interest rate of 3.88 to 10.84%.

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	10%	**5%**		**-5%**	**-10%**
Debentures issued to the public - Series 4	7	4	(1,340)	(4)	(7)
Debentures issued to the public - Series 5	36	18	(1,706)	(19)	(37)
Debentures issued to financial institutions and others	5	2	(776)	(2)	(5)
Debentures issued to financial institutions and others	12	6	(928)	(6)	(12)
Debentures issued to financial institutions and others	24	12	(650)	(13)	(26)
Bank loans	4	2	(461)	(2)	(4)
Loans from others	8	4	(137)	(4)	(8)
Total	**96**	**48**	**(5,998)**	**(50)**	**(99)**

Sensitivity to changes in nominal NIS interest rates – 2007

The sensitivity analysis of the shekel interest rate in dollar/shekel forward transactions includes another scenario (12% up and down), which examines the most extreme daily change that occurred in the last ten years (a daily change of 12% in December 2001).

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	12%	**10%**	**5%**		**-5%**	**-10%**	**-12%**
Investments, deposits and debit balances		(1)	(0.4)	150	0.4	1	
Long-term trade receivables		(2)	(1)	176	1	2	
Trade receivables paid in installments		(6)	(3)	936	3	7	
Hedging instruments not recognized for accounting							
Dollar/shekel forward transactions	1	0.5	0.2	(11)	(0.2)	(0.5)	(1)
Total	**1**	**(8.5)**	**(4.2)**	**1,251**	**4.2**	**9.5**	**(1)**

Sensitivity to changes in dollar interest rates - 2007

The sensitivity analysis of the dollar interest rate includes another scenario (15% up and down), which examines the most extreme daily change that occurred in the last ten years (a daily change of 15% in June 2003). The increase in the dollar interest lowers the fair value of forward transactions by reducing the interest difference.

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	15%	**10%**	**5%**		**-5%**	**-10%**	**-15%**
Firm commitments – space segments	24	16	8	(611)	(8)	(17)	(26)
Hedging instruments not recognized for accounting							
Dollar/shekel forward transactions	(1)	(0.4)	(0.2)	(11)	0.2	0.4	1
Total	**23**	**15.6**	**7.8**	**(622)**	**(7.8)**	**(16.6)**	**(25)**

Sensitivity to changes in prices of negotiable shekel securities – 2007

The Company has unlinked shekel debentures. The sensitivity analysis of the shekel debentures (unlinked) was made at values of 1.25% and 2.50%, based on a historical examination of the maximum change in prices of shekel debentures.

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	2.50%	**1.25%**		**-1.25%**	**-2.50%**
Investment in securities	2	1	78	(1)	(2)
Total	**2**	**1**	**78**	**(1)**	**(2)**

Sensitivity to changes in prices of index-linked negotiable securities – 2007

The sensitivity analysis of the debentures was made at values of 1% and 2%, based on a historical examination of the maximum change in the prices of index-linked and debentures.

	Profit (loss) from changes		Fair value	Profit (loss) from changes	
	2%	**1%**		**-1%**	**-2%**
Investment in securities	3	1	149	(1)	(3)
Total	**3**	**1**	**149**	**(1)**	**(3)**

Sensitivity to changes in prices of negotiable securities – 2007

The sensitivity analysis of the share includes another scenario (118% up and 80% down), which examines the most extreme daily change that occurred in the last five years (a maximum daily change of 118% on March 6, 2003 and a minimum daily change of 80% on August 13, 2002.

	Profit (loss) from changes			Fair value	Profit (loss) from changes		
	118%	**10%**	**5%**		**-5%**	**-10%**	**80%**
Shares	-	3	2	34	(2)	(3)	-
Pointer share	5	0.4	0.2	4	(0.2)	(0.4)	(3)
Convertible debentures (shares)	-	0.1	0.1	1	(0.1)	(0.1)	-
Other	-	0.2	0.1	2	(0.1)	(0.2)	-
Total	**5**	**3.7**	**2.4**	**41**	**(2.4)**	**(3.7)**	**(3)**

7. Directors with accounting and financial expertise and independent directors

A. The Company's Board of Directors determined that the minimum number of directors who have accounting and financial expertise, as required by the provisions of the Companies Law, is one (and together with the external directors – two). The Board of Directors believes that this number will enable it to fulfill the duties imposed upon it by law and by the documents of association, including review of the financial condition of the Company and preparing and approving the financial statements, taking into consideration the volume and complexity of its operations

B. Serving directors in the Company who have the above skills are Shlomo Rodav (chairman), Zehavit Cohen, Menachem Inbar, Yoav Rubinstein, David Gilboa, Eyal Yaniv (external director) and Yitzhak Edelman (external director). For information about their relevant education and experience, see Section 11 in Chapter D of the Periodic Report.

C. The Company has not adopted in its articles the directive concerning the percentage of independent directors as defined in Article 19.2 (E) of the Companies Law.

8. Disclosure regarding an internal auditor in a reporting corporation

8.1 The Company's internal auditor

a. Name: Malka Dror

b. Date of commencement of office: August 14, 2006 (appointed as acting), and from June 28, 2007, permanent appointment

c. The internal auditor complies with the conditions set forth in Article 3(A) of the Internal Audit Law. Qualifications: BA in Economics (Hebrew University); CISA (Certified Information Systems Auditor) – USA)

d. The internal auditor complies with the provisions of Article 8 of the Internal Audit Law and Article 146(B) of the Companies Law.

e. Ms. Dror (who has been employed in the Company since 1985) was allocated, before her appointment to the position of internal auditor, options to purchase Company shares as part of two allocations of options to all the employees in the Company: 44,287 options to purchase the Company's shares held by the State as part of an option outline for Company employees for 2005 on November 15, 2005, within the framework of the State's obligations in connection with the Company's privatization process (at the report date the auditor has exercised and sold 29,526 of these options), and 32,856 options of the Company to purchase its shares as part of the option outline for Company employees on February 22, 2007. In addition, pursuant to a resolution adopted by the board of directors on March 10, 2008, the internal auditor has been allocated 100,000 options as part of allocation of options to middle-managers in the Company according to an outline published on March 11, 2008. The Company believes that these holdings do not affect the quality of the internal auditor's work.

f. Employment basis: The internal auditor is a Company employee.

8.2 Method of appointment

Audit committee discussions at its meetings on June 17, 2007 and June 21, 2007.

The committee recommended appointing Malka Dror as the Company's internal auditor. Later on, the committee recommended appointing her to the Company management and granting her salary conditions and accompanying rights that are within the range of those granted to VPs in the Company. The board of directors approved the appointment on June 28, 2007.

Summary of the reasons for approving the appointment

The board of directors approved the appointment of Malka Dror who served as acting internal auditor, as internal auditor following the recommendation of the audit committee, due to her qualifications and professional experience.

Duties, authority and tasks of the internal auditor

The authority and responsibility of the Company's internal auditor are determined in the Company's internal audit procedure. The procedure was updated and approved by the board's audit committee on December 27, 2007.

Duties of the internal auditor according to the Company's internal audit procedure

To examine the propriety of the operations of the Company, its officers and senior employees from the following aspects: compliance with applicable laws and regulations and proper business practices; principles of sound management, efficiency, thrift and integrity, to verify that they were carried out lawfully by a qualified person, that they were accepted according to business considerations and that they contribute to the achievement of the Company's defined goals; compatibility with the policy and decisions made by the board of directors and Company management.

Authorities of the internal auditor according to the Company's internal audit procedure

a. The Company's internal auditor may demand and receive any information, explanation and document required at her discretion for the performance of her duty, and every Company employee is obliged to furnish any document or information at the Company's internal auditor's first request. The internal auditor will be invited to all meetings of management, the board of directors and its committees. The internal auditor may, with the approval of the audit committee chairman, examine a complaint received by the auditing department as part of the auditing work.

b. At least once a year, the Company's internal auditor will hold a work meeting with each of the internal auditors of the Company's subsidiaries to discuss the subsidiary company's audit plan and its implementation.

8.3 Organizational officer responsible for the internal auditor

According to a resolution of the Company's board of directors, the chairman of the board is the organizational officer responsible for the internal auditor.

8.4 Work plan

a. The work plan is annual.

b. **Considerations in determining the internal audit work plan**

The guiding principle behind the annual work plan for the internal audit is the risk inherent in the Company's processes and operations. To assess the risks, the audit prepares a 'control risk survey' of the Company at least once every three years. As part of this survey, the audit examines, in cooperation with the Company's senior management, the material exposures and risks in the Company's operations and the control environment existing for management of these risks. The survey findings are used to compile the topics for the annual and multi-year work plan.

The considerations taken into account in the compilation of the work plan are as follows: reasonable coverage of all the Company's areas of business according to exposure to material risk (finance; sales and marketing; personnel and payroll, investments, mergers and acquisitions; safety and security; information technology – IT; economics and logistics; engineering and planning).

c. **Entities involved in determining the work plan**

Internal auditor, management, CEO, board's audit committee, chairman of the board of directors.

d. **Entity accepting and approving the work plan**

The board's audit committee

e. **The auditor's discretion to deviate from the work plan**

The auditor may propose subjects at her discretion or at the request of the CEO, and she may also recommend reducing or halting an examination of a topic approved in the work plan. In any event the approval of the audit committee chairman is required.

f. During the reporting year the auditor did not examine any material transactions.

8.5 The audit's response to corporations comprising a material holding

The work plan of the audit unit does not include an audit in corporations representing material holdings. In all the corporations representing material holdings of the Company, there are internal auditors (either as employees or outsourced). The audit reports are discussed in the audit committees and/or boards of directors of these corporations, on which senior executives of

the Company serve. The internal auditor may, under the internal audit procedure, and at her discretion, receive the audit reports of the subsidiaries' statements and hold meetings with each of the auditors of the subsidiary companies, at least once a year, to discuss the audit plan and its implementation in the subsidiary company.

8.6 Scope of employment

a. **Number of hours of employment in the year**

The audit's work plan for 2008 included 10,800 audit hours. The internal audit unit at the end of the reporting year employed six fulltime auditors, including the internal auditor.

b. **Reduction in volume of internal auditor's work in the reporting year**

In accordance with the audit procedure, the internal auditor submitted to the audit committee the number of audit hours required for implementation of the annual work plan which derives from the multi-annual plan. The audit committee approved the work plan for 2009, the scope of which allowed for a reduction in the number of audit hours to 9,000 hours as well as a reduction in the number of employees by one internal auditor.

8.7 Preparation of the audit

a. **Work standards**

Bezeq's internal audit is prepared according to the binding standards of the Institute of Internal Auditors (I.I.A).

b. **The board's criteria for ensuring that the auditor complies with all the provisions in the standards**

In December 2004 an external audit investigation of Bezeq's internal audit unit was carried out in compliance with Standard 1312 of the IIA, which requires one external audit every five years. The conclusion of this audit was that the work of the Company's internal audit unit complies with accepted professional internal audit standards.

8.8 Accessibility to information

The internal auditor has been furnished with documents and information as stipulated in Article 9 of the Internal Audit Law, and she has been granted permanent direct access to the Company's information systems, including financial data.

8.9 Internal Auditor's report

a. The internal auditor submits the audit reports in writing.

The internal auditor routinely submits the audit reports during the reporting year to the board chairman, CEO, audit committee chairman and committee members. The board's audit committee conducts regular discussions of the audit reports. Following are the dates for submission of the auditor's reports and the dates for discussion by the audit committee in the reporting year:

No.	Report publication date	Audit committee discussion date
1	January 2007	January 2008
2	March 2007	January 2008
3	March 2007	January 2008
4	March 2007	January 2008
5	December 2007	January 2008
6	December 2007	February 2008
7	November 2007	February 2008
8	August 2007	March 2008
9	October 2007	March 2008
10	November 2007	March 2008
11	November 2007	March 2008
12	February 2008	May 2008

No.	Report publication date	Audit committee discussion date
13	February 2008	May 2008
14	January 2008	May 2008
15	May 2008	May 2008
16	January 2008	June 2008
17	February 2008	June 2008
18	January 2008	June 2008
19	May 2008	October 2008
20	July 2008	October 2008
21	July 2008	October 2008
22	July 2008	October 2008
23	September 2008	December 2008
24	December 2008	December 2008
25	December 2008	December 2008
26	December 2008	January 2009
27	December 2008	January 2009
28	December 2008	January 2009

In addition, the audit prepared a survey on the risks of embezzlement and fraud which was delivered in October 2008 and discussed by the audit committee in December 2007.

8.10 Assessment of the board of directors regarding the work of the Internal Auditor

Based on sections 8.1 – 8.9 above and the reports received from the internal auditor, the members of the Company's board of directors believe, based on the reports received from the Company's auditor, that that the scope of the Company audit performed in 2008, the nature and continuity of the internal auditor's activities as well as the work plan, are reasonable in the circumstances and they achieve the objectives of the audit.

8.11 Remuneration

a. The internal auditor is not one of the five highest salaried of the corporation's senior officers. The employment conditions of the internal auditor have been discussed and approved by the audit committee and board of directors as follows: Monthly salary of NIS 40,000 linked to the CPI and annual target-based bonus determined in advance by the audit committee and approved by the board of directors, of up to 50% of the annual salary without related expenses.

b. As set forth in section (8.1)(e) above, the internal auditor holds Company share options that were allocated to her as a Company employee.

c. The board of directors believes that the remuneration received by the internal auditor does not affect her professional judgment.

9. Critical accounting estimates

The preparation of the financial statements according to international accounting principles obligates the management to make estimates and assessments that influence the reported values of assets and liabilities, income and expenses, and disclosure relating to contingent assets and liabilities. Management bases its estimates and assessments on past experience and on additional factors, value appraisals and opinions which it believes are relevant, taking into account the circumstances. The actual results can differ from those assessments based on various assumptions and conditions. Information on the principal matters of uncertainty in critical assessments and judgments in the application of the accounting policy is provided in the Financial Statements (see Note 2F). We believe that these assessments and estimates are critical because every change in them and in the assumptions has the potential to materially affect the financial statements.

Estimated useful life of property, plant and equipment

The estimated useful lives of property, plant and equipment serve to determine the depreciation expenses that will be recorded in the reporting year. The main part of the communications infrastructure is managed in accordance with asset groups. The depreciation rates are based on the average useful life of an asset group and not of each individual asset. The useful life of an asset group is examined periodically and is based on past experience, taking into consideration expected technological changes, Company plans or other changes. If such changes take place earlier than expected or differently from expected, the remaining useful life of such assets may be shortened. This results in an increase in future depreciation expenses. If the changes take place later than expected, the remaining useful life may be extended, and this results in a decrease in the depreciation expenses. Given the importance of the Group's depreciation expenses, such changes can have a material effect on the results of the actions and the financial position of the Group.

Assessing the value of items of property, plant and equipment

Certain property plant and equipment items have been re-estimated to fair value upon the transition to IFRS based on their deemed cost, which was determined on the basis of their value on the transition date (January 1, 2005) in accordance with the Group's estimate based on the valuation of an external appraiser. In addition, the costs of dismantling, clearing and restoring sites were capitalized to the date of transition to IFRS. The residual value of the Company's copper cables was determined on the basis of the Company's assessment. The use of estimates and value appraisals affects the fixed asset and depreciation expenses items – see Note 9 to the Financial Statements.

Liability for employee benefits

These liabilities are based on actuarial calculations which include many calculation assumptions which can be different in practice. The assumptions relate, *inter alia*, to interest rates for capitalization, mortality tables, wage creep and turnover rates.
(Concerning changes in estimates due to these liabilities, see Note 16 to the Financial Statements.)

Deferred taxes

Deferred taxes are calculated at the tax rate expected to be in effect on their date of utilization. The tax benefit is included in the financial statements since the Company's business plans anticipate realization of the tax benefit. By nature, actual business results may differ from business plans, and this can affect the future realization of the tax benefit (see Note 8 to the financial statements).

Provisions and contingent liabilities

The Group's companies have contingent liabilities in amounts for which the possible maximum exposure is considerable. Among these, class actions in extremely significant amounts are pending against Group companies.

Every year the Company makes estimates of the potential liabilities associated with every claim and complaint. It is naturally very difficult to determine the outcomes of the claims. The Company uses its best judgment and the assessments of its legal advisers to determine whether it is reasonable for the Company to bear the costs of settling claims and whether they can be reliably estimated.

Taking into consideration the uncertainty inherent in legal claims, it is possible that all or some of them will be concluded with charges for the Company, in amounts materially different from the provisions included in the financial statements, if any. For details of provisions and contingent liabilities, see Notes 15 and 17 to the financial statements.

Provision for doubtful debts

The financial statements include a provision for doubtful debts calculated in general terms from the volume of trade receivable balances, based on assessments and past experience, and specifically in respect of debts whose collection is in doubt. Actual results might differ from the assessments and estimates made, and could affect the results of operations accordingly (see Note 7 to the financial statements).

Goodwill and the value of investment in subsidiary companies

The value of the Company's holding in DBS and in Pelephone, for examining the need for a reduction in respect of impairment, is calculated by estimating the present value of future cash flows. The estimate is based on various forecasts, including, among others, projected cash flows for the coming years, a forecast of the number of subscribers and average revenue per user (ARPU), and business forecasts. These are based on assumptions, estimates and sensitivity to changes in the discount interest rate (see Note 10 to the financial statements).

Options plan for employees

The fair value of the options granted to Company employees was determined according to the Company's assessment, based on the opinion of an external appraiser. The value set reflects the fair value of the services rendered to the Company in exchange for the options, and was measured by the Black and Scholes model and based on parameters that include the share price on the grant date, the exercise price, weighted average of expected useful life of the option warrant, volatility of the share price and risk-free interest rate of government bonds (see Note 26 to the financial statements).

Assessment of financial instruments

The value of financial instruments is calculated according to their classification, based on market prices, present value of the cash flows and various value assessment models. The values are sensitive to changes in the parameters serving as the basis for these assessments (see Note 31 to the financial statements).

Inventory

Inventory is measured as the lower of the cost and net sale value. The net sale value is an estimate that could be affected by various events and uncertainties. (See Note 3J to the financial statements.)

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

The board of directors is responsible for oversight. The board of directors appointed a balance sheet committee with the following tasks and composition:

a. Most of the committee members will have accounting and financial expertise, and at least one is an external director.

b. The balance sheet committee will discuss the financial statements before they are discussed in the board meeting, and will make recommendations to the board in respect of their approval. The committee will invite the auditors to participate in these discussions. The balance sheet committee will hold discussions and make recommendations to the board as follows: determining accounting policy and defining procedures for financial reporting and recording.

c. The balance sheet committee will monitor changes in the accounting regulations and discuss their effect on the Company, it will discuss issues that arising in the auditors' audit and discuss changes in the internal reporting systems.

d. The balance sheet committee will monitor and supervise implementation of the accounting policy that was determined and implementation of the regulations that were determined for financial reporting and recording.

e. The balance sheet committee will give an opinion on the abovementioned subjects, and other financial and accounting subjects, when discussing the financial statements and whenever a specific issue of substantial scope arises in any of the abovementioned subjects.

f. The balance sheet committee will advise the board of directors in the matter of the scope of the auditors' work and their fee.

g. The balance sheet committee will be responsible for the board's contact with the auditors regarding their work.

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

11. Disclosure concerning the fees of the auditing accountant

Below are the fees paid to the auditing accountants of the main companies in the Group for auditing services and audit-related services:

Company	Auditor	Details	2008 (NIS '000)		2007 (NIS '000)	
			Fee	Hours	Fee	Hours
Bezeq	Somekh Chaikin	Audit	2,107	9,800	1,785	9,000
		Other services	716	2,610	452	1,475
Pelephone	Somekh Chaikin	Audit	800	3,950	650	4,200
		Other services	279	870	43	152
DBS	Kesselman & Kesselman (2007) and Somekh Chaikin (2007 – 2008)		545 [2]	2,500	621	4,300 [1]
Bezeq International	Somekh Chaikin	Audit	472	2,250	485	2,310
		Other services	24	110	124	590

The auditors' fee was discussed by the board's audit committee and approved by the Company's board. The fees were determined in relation to the hours and hourly tariff in the previous year and with adaptation to the changes and events which occurred in the reporting year.

(1) The audit hours in 2007 in DBS included overlapping between the auditors and the hours stemming from the Company's first audit.

(2) Including NIS 135,000 approved in 2008 for an addition to the 2007 audit.

12. Details of series of liability certificates

1.

		Series 4 debentures	Series 5 debentures
A	Issue date	01.06.2004	01.06.2004
B	Total par value on issue date	1,200,000,000 NIS	600,000,000 NIS
C	Par value	900,000,000 NIS	2,386,967,000 NIS (1)
D	Par value reassessed for report date (linked to the CPI)	990,959,163 NIS	2,628,207,579 NIS (2)
E	Accumulated interest	27,746,857 NIS	81,255,418 NIS
F	Fair value	1,031,400,000 NIS	2,866,747,367 NIS
G	Stock exchange value	1,031,400,000 NIS	2,866,747,367 NIS
H	Interest type	Fixed at 4.8%	Fixed at 5.3%
I	Principal payment dates	June 1 every year until 1.6.2011	June 1 every year from 1.6.2011 until 1.6.2016
J	Interest payment dates	June 1 every year until 1.6.2011	June 1 every year from 1.6.2011 until 1.6.2016
K	Linkage	The principal and interest are linked to the CPI (base index April 2004)	The principal and interest are linked to the CPI (base index April 2004)

(1) Of which NIS 880.1 million par value held by a wholly-owned subsidiary.
(2) Of which NIS 969 million held by a wholly-owned subsidiary.

Trust company – Mizrachi Tefahot Trust Company
The contact person in the trust company is Assaf Weiss, Adv. His email address is: assafw@umtb.co.il . The trustee's address is 123 Hahashmonaim Street, Tel Aviv.

2.

Rating agency	Rating	Rating changes	Rated credit type
Standard & Poor's Maalot	AA+	August 25, 2008 – the rating of the Company was raised from AA to AA+ with a stable outlook. The rating increase was based mainly on the Group's improvement in performance and operational efficiency, stability of the Company's management structure and a change in the business risk structure resulting from a change in the Group's revenue mix. October 13, 2008 – validation of the same rating and this was, inter alia, after an examination of the expected ramifications of the exercise of the purchase option (10.66%) exercised by Ap.Sb Ar.	All debenture series
Midroog	AA1	May 21, 2008 – restoration of the Company's rating outlook from negative to stable in view of an improvement in the Company's financial results and continued presentation of a strong financial profile, compensation for the erosion in the fixed-line domestic communications segment by means of operations in the other segments and very low levels of financing, despite a distribution of all the year's profit as a dividend after sale of the Company's controlling interest.	Debentures Series 4 and 5

The rating reports are attached in an appendix.

3. During and at the end of the reporting year the Company has met all the conditions and commitments pursuant to the deed of trust and there have been no conditions constituting cause to present the certificates of liability for early repayment. No collateral has been given to secure payment for the holders of the certificates of liability. There is no encumbrance whatsoever on the certificates of liability.

13. Miscellaneous

A. In October 2007, the board of directors readopted a code of ethics. The code of ethics establishes principles and rules of conduct to direct the actions of officers, managers and employees. The code of ethics was prepared in 2005 and a number of amendments and updates were incorporated in its new version. The board of directors authorized the management to act to assimilate the code of ethics in the Company and determined that the code of ethics will be a part of the Company's binding regulations. As at the end of 2008 the code of ethics has been assimilated by the Company's managers. As of 2009 it is being assimilated by the Company's employees as part of the management routine.

B. On September 4, 2007 Shlomo Rodav was appointed chairman of the Company's board of directors. On the same day, the Company's board of directors resolved, pursuant to section 50 (a) of the Companies Law 5759-1999 and Articles 119 and 121.1 of the Articles of Association, that the powers of the CEO in everything relating to the Company's subsidiary companies, whether the holding in them is direct or indirect, (including Pelephone Communications Ltd., Bezeq International Ltd., DBS Satellite Services (1998) Ltd. and Walla! Communications Ltd., Bezeq Zahav Holdings Ltd. and BezeqCall Ltd.), would be transferred to the board of directors and the board of directors adopted the resolutions for implementation of the above.

C. As the challenges facing the global economic environment have translated into a slowdown in the Israeli economy, Bezeq is monitoring the potential impacts on its business on an ongoing basis. Despite this challenging economic backdrop, in 2009 we aim to maintain EBITDA, operating cash flows and gross capital expenditures close to those of full year 2008 performance levels. This forecast is underpinned by the strength of Bezeq's comprehensive consumer and business communications offerings, a strict focus on improving operating efficiencies and strong operating cash flows. With specific regards to gross capital

expenditures, 2009 will reflect continuing investment in Pelephone's HSPA network investment, which was successfully launched with national coverage at the end of January 2009, and the modular deployment of Bezeq's Next Generation Network (NGN), expanding its coverage to reach a meaningful part of Israeli households during 2010.

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

D. As at December 31, 2008 the scope of the Group's net contractual liabilities (including off balance sheet and less the scope of the hedging transactions) which are linked to the dollar amounted to NIS 836 million and the scope of the Group's net liabilities (including off balance sheet and less the scope of the hedging transactions) which are linked to the CPI amounted to NIS 5,064 million. The dollar exchange rate rose by 5.8% between December 31, 2008 and the date of signing the financial statements and the known CPI declined by 0.7% in December, January, and February 2009.

E. The Company is exposed to changes in the prices of copper which cause changes in the residual value of the Company's copper cable infrastructure. For further details, see Note 9(B) to the financial statements.

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

Shlomo Rodav Chairman of the Board of Directors	Abraham Gabbay CEO

"BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED
DECEMBER 31, 2008

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

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

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

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

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

Somekh Chaikin, a partnership registered under the Israeli Partnership Ordinance, is the Israeli member firm of KPMG International, a Swiss cooperative.

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

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

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

Somekh Chaikin
Certified Public Accountants

March 23, 2009

Consolidated Balance Sheets at December 31

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

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

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

* See Note 3U

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

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

Consolidated Statements of Income for the Year Ended December 31

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

* See Note 3U.

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

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

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

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

Consolidated Statements of Cash Flows for the Year Ended December 31

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

* See Note 3U.

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

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

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

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

NOTE 1 – REPORTING ENTITY

A. Bezeq – The Israel Telecommunication Corp. Ltd. ("the Company") is a company registered in Israel whose shares are traded on the Tel Aviv Stock Exchange. The official address of the Company is 132 Menachem Begin Road, Tel Aviv. The consolidated financial statements of the Company at December 31, 2008 include those of the Company and of its subsidiaries (together – "the Group"), as well as the rights of the Group in associates. The Group is a principal provider of communications services in Israel (see also Note 28 – Segment Reporting).

B. On October 11, 2005, core control in the Company was transferred from the State to Ap.Sb.Ar. Holdings Ltd. and the Company ceased to be a government company. In September 2008, Ap.Sb.Ar. Holdings Ltd. exercised an option to increase its holdings by 10.66% and the percentage of its holding in the Company increased to 40.66%, as a result of which the State's holding decreased to 4.95% and from that date the State ceased to be an interested party in the Company by virtue of its holdings. The Company was declared a monopoly in the main areas in which it operates. All the main segments of operation of the Group are in competition. The activities of the Group are subject, as a rule, to official regulation and oversight.

C. The Company is subject to various sets of laws that regulate and restrict its business activities, including its tariffs. Arrangements pursuant to Sections 15 – 17 of the Communications Law apply to the Company's service tariffs, which are prescribed in regulations which are automatically updated in accordance with a linkage formula, all as provided in the regulations and relying on the recommendations of public committees which have a mandate to review the Company's tariffs. The intensifying competition and the entirety of the changes in the communications market could have an adverse effect on the business results of the Group.

NOTE 2 – BASIS OF PRESENTATION

A. Definitions

In these financial statements –

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

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

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

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

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

(6) Investees – Subsidiaries or associates.

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

NOTE 2 – BASIS OF PRESENTATION (CONTD.)

A. Definitions (contd.)

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

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

B. Statement of compliance with International Financial Reporting Standards

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

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

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

C. Functional currency and presentation currency

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

D. Basis of measurement

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

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

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

E. Addition of very significant valuations

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

NOTE 2 – BASIS OF PRESENTATION (CONTD.)

F. Use of estimates and judgment

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

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

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

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

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES

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

A. Basis of Consolidation

(1) Subsidiaries

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (C0NTD.)

(2) Special-purpose entity

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

(3) Associates (accounted by the equity method)

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

(4) Transactions eliminated upon consolidation

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

B. Foreign currency transactions

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

C. Financial Instruments

(1) Non-derivative financial instruments

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

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

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (C0NTD.)

C. Financial Instruments (contd.)

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

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

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

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

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

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

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

(2) Derivative financial instruments

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

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

C. Financial Instruments (contd.)

(2) Derivative financial instruments (contd.)

Economic hedging

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

Separable embedded derivatives

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

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

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

(4) Share capital – Ordinary shares

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

D. Property, plant and equipment

(1) Recognition and measurement

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

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

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

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

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

(2) Subsequent costs

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

D. Property, plant and equipment (contd.)

(3) Capitalisation of borrowing costs

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

(4) Depreciation

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

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

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

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

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

E. Non-current assets held for sale

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

F. Broadcasting rights

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

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

G. Intangible assets

(1) Goodwill

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

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

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

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

(2) Software development costs

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

(3) Subscriber acquisition

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

G. Intangible assets (contd.)

(4) Software

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

(5) Frequency usage rights

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

(6) Other intangible assets

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

(7) Subsequent costs

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

(8) Amortisation

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

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

H. Leased properties

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

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

H. Leased properties (contd.)

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

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

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

J. Inventory

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

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

K. Impairment

(1) Financial assets

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

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

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

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

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

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

K. Impairment (contd.)

(2) Non-financial assets

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

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

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

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

L. Employee benefits

(1) Post-employment benefits

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

a. Defined contribution plans

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

b. Defined benefit plans

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

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

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

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

(2) Other long-term employee benefits

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

L. Employee benefits (contd.)

(3) Severance pay benefits and voluntary retirement benefits

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

(4) Short-term benefits

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

(5) Share-based payment transactions

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

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

M. Provisions

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

(1) Contingent liabilities

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

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

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

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

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

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

M. Provisions (contd.)

(2) Reorganisation

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

(3) Onerous contracts

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

(4) Site dismantling and clearing costs

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

(5) Warranty

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

N. Revenue

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

(1) Equipment sales

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

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

N. Revenue (contd.)

(2) Service revenue

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

(3) Sales on credit

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

(4) Multi-component sale agreements

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

(5) Gross or net-based revenue reporting

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

(6) Lease of satellite decoders

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

O. Finance income and expenses

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

O. Finance income and expenses (contd.)

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

Gains and losses from exchange rate differences are reported net.

P. Income tax expense

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

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

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

Q. Earnings per share

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

R. Segment reporting

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

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

R. Segment reporting (contd.)

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

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

S. Transactions with a controlling shareholder

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

T. Dividend declared subsequent to the balance sheet date

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

U. Reclassified amounts

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

V. Early application of accounting standards

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

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

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

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

V. Early application of accounting standards (contd.)

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

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

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

(1) IFRS 8 – Operating Segments (“the Standard”). The Standard states that segment reporting should be in accordance with the “management approach”, namely – in accordance with the internal reporting format to the decision-makers in the entity. The Standard will apply to annual periods commencing January 1, 2009 or thereafter.

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

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

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

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

X. New standards and interpretations not yet adopted

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

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

NOTE 4 – DETERMINING FAIR VALUE

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

A. Property, plant and equipment

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

B. Investments in shares and debentures

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

C. Customers and other trade receivables

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

NOTE 4 – DETERMINING FAIR VALUE (CONTD.)

D. Derivatives

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

E. Non-derivative financial liabilities

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

F. Share-based payment transactions

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

NOTE 5 – CASH AND CASH EQUIVALENTS

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

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

NOTE 6 – INVESTMENTS, INCLUDING DERIVATIVES

A. Segmentation by investment classification

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

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

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

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

B. Segmentation by types of securities

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

NOTE 7 – TRADE AND OTHER RECEIVABLES

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

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

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

Following is the customer debt aging at the reporting date:

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

Movement in provision for doubtful debts during the year:

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

NOTE 8 – INCOME TAX

A. General

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

B. Reconciliation of effective tax rate

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

C. Income tax attributable directly to equity

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

NOTE 8 – INCOME TAX (CONTD.)

D. Deferred tax assets which were not recognised

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

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

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

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

E. Recognised tax assets and deferred tax liabilities

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

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

NOTE 8 – INCOME TAX (CONTD.)

F. Changes in temporary differences during the year

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

NOTE 8 – INCOME TAX (CONTD.)

G. Amendments to the Income Tax Ordinance

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

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

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

H. Adjustments Law

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

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

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

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

I. Final tax assessments

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

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

NOTE 9 – PROPERTY, PLANT AND EQUIPMENT

A. Composition and movement

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

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

A. Composition and movement (contd.)

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

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

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

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

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

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

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

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

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

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

A. Composition and movement (contd.)

h. (contd.)

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

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

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

j. Concerning liens, see Note 19.

NOTE 10 – INTANGIBLE ASSETS

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

(1) Fully depreciated intangible assets.

NOTE 10 – INTANGIBLE ASSETS (CONTD.)

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

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

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

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

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

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

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

NOTE 10 – INTANGIBLE ASSETS (CONTD.)

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

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

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

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

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

NOTE 11 – DEFERRED AND OTHER EXPENSES

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

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

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

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

(2) See Note 3I.

NOTE 12 – ASSOCIATES ACCOUNTED BY THE EQUITY METHOD

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

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

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

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

Composition of the investment

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

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

C. Movement in investments is as follows:

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

D. Holding percentage and market value

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

E. Stock options plan for Walla employees

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

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

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

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

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

A. Composition

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

* See Note 3U.

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

B. Terms and debt repayment schedule

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

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

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

B. Terms and debt repayment schedule (contd.)

Debt payable in future years based on repayment schedules:

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

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

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

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

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

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

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

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

B. Terms and debt repayment schedule (contd.)

(2) (contd.)

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

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

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

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

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

The debentures were listed for trading on the stock exchange.

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

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

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

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

B. Terms and debt repayment schedule (contd.)

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

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

C. Charges and collateral

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

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

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

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

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

The undertaking includes, *inter alia*:

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

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

C. Charges and collateral (contd.)

(2) a (contd.)

(2) Compliance with the following financial stipulations:

a. An undertaking that Pelephone's debt will not exceed three times its equity and an undertaking that as long as that ratio exceeds 2.5, dividends will not be distributed and management fees will not be paid to the shareholders.

b. Pelephone undertook that the amount of its debts will not exceed NIS 3.8 billion (linked to the CPI known in January 2002).

c. An undertaking towards a certain bank that its total debt to it will not exceed 40% of its total debts to all the financial entities.

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

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

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

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

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

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

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

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

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

C. Charges and collateral (contd.)

(3) (contd.)

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

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

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

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

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

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

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

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

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

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

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

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

D. Debenture issue expenses

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

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

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

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

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

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

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

NOTE 14 – TRADE AND OTHER PAYABLES, INCLUDING DERIVATIVES

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

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

NOTE 15 – PROVISIONS

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

* See Note 3U.

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

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

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

NOTE 16 – EMPLOYEE BENEFITS

A. Composition

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

* See Note 3U.

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

A. Composition (contd.)

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

* See Note 3U.

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

B. Actuarial assumptions

The principle actuarial assumptions at the date of the report:

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

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

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

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

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

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

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

* At a discount rate based on American corporate debentures.

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

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

B. Actuarial assumptions (contd.)

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

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

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

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

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

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

C.

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

* See Note 3U.

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

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

D. Defined contribution plans

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

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

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

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

E. Defined benefit plan

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

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

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

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

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

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

F. Other long-term employee benefits

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

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

G. Benefits in respect of layoffs and early retirement

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

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

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

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

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

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

H. Other

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

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

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

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

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

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

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

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

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

H. Other (contd.)

(1) (contd.)

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

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

NOTE 17 – CONTINGENT LIABILITIES

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

In the opinion of the managements of the Group's companies, which is based, *inter alia*, on legal opinions regarding the risks related to the claims, including the applications for certification of the class actions, appropriate provisions have been included in the financial statements (Note 15), where warranted, to cover the exposure resulting from such claims.

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

Concerning applications for certification as class actions regarding which the Group has exposure beyond the aforesaid (since the claims do not state an exact amount), see claims in sections A (5) a. and b. and (36) below.

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

A. Claims

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(2) (contd.)

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

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

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

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

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(5) d. (contd.)

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

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

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

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

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

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

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

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

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

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

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

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

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

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

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

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

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

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

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

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

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

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

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

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

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

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

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

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

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

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

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

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

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

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

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

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

Claims in respect of which the exposure cannot be calculated

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

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

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

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

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

Claims which cannot yet be assessed

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

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies

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

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

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

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (contd.)

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

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

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

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (contd.)

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

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

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

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

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (contd.)

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

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

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

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

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

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

D. Claims in an associate

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

D. Claims in an associate (contd.)

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

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

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

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

NOTE 18 – COMMITMENTS

A. Engagements in lease agreements and rentals

Contractual rental payments during the next 5 years, are calculated according to the rent in effect at December 31, 2008 are as follows:

For the year ended December 31,	NIS millions
2009	**192**
2010	**197**
2011	**128**
2012	**89**
2013 onwards	**139**
	745

B. Some of the sites that Pelephone leases are on lands of Israel Lands Administration ("the Administration"). Pelephone has an agreement for payments to which the Administration is entitled for the period through December 31, 2008. See Note 17.C(9) for the matter of a demand for payment received by Pelephone from the Administration after the balance sheet date.

C. At December 31, 2008, DBS is bound by agreements to purchase broadcasting rights amounting to approximately NIS 83 million.

D. At December 31, 2008, DBS is bound by agreements to purchase channels. In the year ended December 31, 2008, expenses in respect of consumption of purchased channels amounted to approximately NIS 242 million.

NOTE 18 – COMMITMENTS (CONTD.)

E. Lease of space segments

(1) DBS has an agreement for leasing space segments of the Amos 2 satellite with HLL Spacecom Satellite Communications Ltd. ("HLL"). The term of the lease will end 12 years after the satellite is positioned in space or at the end of the life of the satellite, whichever is earlier. The satellite was positioned in space in April 2004.

(2) In addition, DBS entered into an agreement with HLL on July 15, 2008, whereby it will lease 13 space segments in the Amos 2 and Amos 3 satellites, stating that by December 31, 2009 only 12 segments will be leased, and lease of the 13th segment will be by notice by either party of its wish to do so.

The projected annual lease fees in the coming years under these agreements are as follows:

	NIS millions
2009	**91**
2010 - 2013	**395**
2014 onwards	**222**

In May 2003, an agreement was signed with Israel Aircraft Industries ("IAI"), regulating the debts of DBS in respect of leasing the space segments for the period up to May 2002. At December 31, 2008, partial payment has been made on account of the lease fee debt for the prior periods which are overdue. In view of DBS's arrears in the payments prescribed in the above agreement, in March 2006 IAI demanded settlement of the entire debt and the interest on it. Since IAI's demand, DBS and IAI have been negotiating settlement of the debt. DBS is continuing to repay the debt on a regular basis.

In addition, DBS and HLL are in dispute in respect of the amount of the annual payments, and DBS's entitlement to a certain discount on the lease fees. In February 2008, a settlement agreement was signed between DBS and HLL for cessation of the arbitration proceeding between the parties concerning the amount of the monthly payment due to HLL for the lease of space segments in the Amos 2 satellite.

F. The Group has a number of operating lease agreements for periods of up to 4 years in respect of vehicles it uses. The contractual annual lease fees, calculated according to the fees in effect at December 31, 2008, are approximately NIS 240 million.

G. In accordance with the requirements of the license and the principles laid down by the Council for Cable and Satellite Broadcasts, in 2006-2009 DBS must invest in content broadcasts not less than 8% of its revenues from subscriber fees in local productions in the same year.

H. Rights to frequencies

Pelephone uses frequencies in the 850 MHz range, granted pursuant to its license. In addition, during 2008 Pelephone approached the Ministry of Communications, requesting to exercise its rights to a band of frequencies in the MHz 2100 range. To exercise this right, Pelephone is required to pay an additional sum of approximately NIS 181 million for license fees and retroactive frequency fees from the date on which it won a tender for these frequencies to the date of exercise of the right to receive them. In September 2008, Pelephone paid the aforesaid amount for receipt of the frequencies from the Ministry of Communications and for their use. In January 2009, the Ministry of Communications confirmed to Pelephone the return of the 5 MHz frequency range, known as TDD, from the aforementioned band of frequencies.

NOTE 18 – COMMITMENTS (CONTD.)

I. Purchase of capacity

In October 2006, Bezeq International entered into an agreement with Mediterranean Nautilus Limited ("Med-Nautilus"), for an additional purchase of an irrevocable right is use of sea-bed cable capacity in 2007, in a total amount of approximately NIS 74 million. The agreement granted an option for additional purchases, which was exercised during 2008.
In March 2008, another agreement was signed with Med-Nautilus for additional purchases in a total amount of approximately NIS 35 million, and an option to purchase additional rights of use was also exercised during 2008.

J. For engagements for the purchase of property, plant and equipment, see Note 9I above.

NOTE 19 – SECURITIES, LIENS AND GUARANTEES

A. In May 2003, the Company provided, at the behest of the Ministry of Communications, a bank guarantee of USD 10 million in connection with its general license for implementing telecommunications operations and for providing telecommunication services.

B. The Company provided a guarantee in favour of banks in connection with credit of up to NIS 70 million granted to a subsidiary.

C. For guarantees provided by the Company for its past investments in India, see Note 17A(15).

D. The Company provided a guarantee of approximately NIS 10 million for DBS in respect of a bank guarantee of approximately NIS 36 million which DBS had provided in favour of the State of Israel. The guarantee is valid until December 31, 2010.

E. In February 2002 and May 2005, at the demand of the Ministry of Communications, Bezeq International provided bank guarantees of approximately NIS 9.4 million and NIS 1.5 million respectively, for fulfilment of all the terms of the license to provide international telecommunication services. In addition, at the behest of the Ministry of Communications and after the balance sheet date, Bezeq International topped up a bank guarantee of approximately NIS 1.1 million for the provision of VOB services. At the balance sheet date, Bezeq International had provided additional bank guarantees in a total amount of approximately NIS 8 million.

F. Pelephone provided guarantees of approximately NIS 73 million in favour of third parties, of which approximately NIS 38 million in favour of the Ministry of Communications, in connection with a guarantee for fulfilment of the terms of its license.

G. To secure its liabilities, DBS provided documentary credit and guarantees amounting to approximately NIS 38 million (including a bank guarantee of NIS 36 million in favour of the State of Israel).

H. The shareholders in DBS (except for one of them) have pledged their shares in favour of the banks. In view of a negative pledge of the Company (see Note 13), the Company provided the banks with a perpetual guarantee for payment of the debts of DBS. The guarantee is up to a maximum amount equal to the percentage of the Company's holding in DBS, multiplied by the value of DBS as derives from realisation of the pledged shares of the other shareholders. If the Company joins the sale in the framework of realisation of the pledged shares of the other shareholders, the amount of the guarantee will not exceed the amount of the proceeds the Company will receive from realisation of its shares in DBS. The note of guarantee includes numerous restrictions on the Company in realising the shares it holds, and lists events of violation which, if committed, will enable the banks to call in the guarantee. Furthermore, the Company undertook to put its shares up for sale if the shares pledged to the bank are sold, and agreed that in the event of realisation of collateral provided by the other shareholders, the Company would forgo repayment of shareholder loans provided for DBS and that the guarantee would apply, *mutatis mutandis*, also to stock options which the Company would receive from DBS and to the right to receive them.

NOTE 19 – SECURITIES, LIENS AND GUARANTEES (CONTD.)

H. (contd,)

Except for one, the shareholders in DBS, have made a commitment to the banks not to oppose the sale or other realisation of their shares in DBS, which were pledged or for which a guarantee was provided (by the Company), in a way that will enable the banks to accomplish a friendly liquidation.

I. For securities, charges and stipulations given by the Company and subsidiaries in connection with loan covenants and borrowings, see Note 13.

NOTE 20 – EQUITY

A. Details of movements in equity

	Share capital	Translation fund	Capital reserve in respect of activities between a corporation and a controlling shareholder	Capital reserve in respect of available-for-sale financial assets	Capital reserve in respect of options for employees	Deficit balance	Total	Non-controlling interest	Total equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
	Refers to equity holders of the Company								
Balance at January 1, 2008	6,132	-	390	4	287	(2,268)	4,545	(373)	4,172
Total revenues and expenses recognised	-	(4)	-	(4)	-	1,625	1,617	(106)	1,511
Dividends to Company shareholders	-	-	-	-	-	(1,514)	(1,514)	-	(1,514)
Share-based payments	-	-	-	-	75	-	75	-	75
Transfers by non-controlling interest	-	-	-	-	-	-	-	8	8
Balance at December 31, 2008	6,132	(4)	390	-	362	(2,157)	4,723	(471)	4,252

NOTE 20 – EQUITY (CONTD.)

A. Details of movements in equity (contd.)

	Equity capital	Share premium	Capital reserve in respect of activities between a corporation and a controlling shareholder	Capital reserve in respect of available-for-sale financial assets	Capital reserve in respect of options for employees	Deficit balance	Total	Non-controlling interest	Total equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
	Refers to equity holders of the company								
Balance at January 1, 2007	6,309	1,623	384	1	287	(2,849)	5,755	(564)	5,191
Total revenues and expenses recognised	-	-	-	3	-	1,341	1,344	31	1,375
Dividends to Company shareholders	-	-	-	-	-	(760)	(760)	-	(760)
Dividends to Company shareholders – distribution that does not pass the earnings test	(177)	(1,623)	-	-	-	-	(1,800)	-	(1,800)
Change in the repayment date of a loan extended by the non-controlling interest in a subsidiary	-	-	-	-	-	-	-	160	160
Payments to a former senior officer	-	-	6	-	-	-	6	-	6
Balance at December 31, 2007	6,132	-	390	4	287	(2,268)	4,545	(373)	4,172

NOTE 20 – EQUITY (CONTD.)

A. Movements in equity (contd.)

	Equity capital	Share premium	Capital reserve in respect of activities between a corporation and a controlling shareholder	Capital reserve in respect of available-for-sale financial assets	Capital reserve in respect of options for employees	Deficit balance	Total	Non-controlling interest	Total equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
	Refers to equity holders of the company								
Balance at January 1, 2006	6,309	1,623	384	6	-	(1,762)	6,560	(505)	6,055
Total revenues and expenses recognised	-	-	-	(5)	-	813	808	(59)	749
Dividends to Company shareholders	-	-	-	-	-	(1,900)	(1,900)	-	(1,900)
Share-based payments made by the company	-	-	-	-	287	-	287	-	287
Balance at December 31, 2006	6,309	1,623	384	1	287	(2,849)	5,755	(564)	5,191

NOTE 20 – EQUITY (CONTD.)

B. Share capital

	Registered		Issued and paid in	
	December 31, 2008	December 31, 2007	December 31, 2008	December 31, 2007
	No. of shares	No. of shares	No. of shares	No. of shares
Ordinary shares of NIS 1 par value	**2,749,000,000**	2,749,000,000	**2,605,045,611**	2,605,045,611

C. Following completion of the sale of 30% of the State's shares in the Company to Ap.Sb.Ar. on October 11, 2005 and Ap.Sb.Ar.'s exercise of the option to increase its holdings in the Company by another 10.66% in September 2008 (see also Note 1), the State's holdings in the Company decreased at that date to approximately 4.95%.

D. The Board of Directors of the Company, at its meeting on March 1, 2006, decided that resolutions concerning distribution of a dividend would be passed on a specific basis, in accordance with the financial results of the Company, its financial position and other relevant circumstances and data. This resolution superseded earlier resolutions in the matter of dividend policy.

E. On July 31, 2008, the Board of Directors of the Company resolved to recommend to the general meeting of the shareholders of the Company to increase the registered capital of the Company by 251,000,000 shares of NIS 1 par value each. A general meeting has not yet been called to discuss the matter.

F. The Company also issued stock options to employees, managers and senior employees in the Group (see Note 26).

G. Description of the funds

Translation fund
A translation fund includes all the foreign currency differences arising from translation of financial statements of a consolidated partnership whose functional currency is a foreign currency.

Capital reserve for assets available for sale
A fair value reserve includes the net cumulative change in the fair value of financial assets available for sale which were not recognised in profit and loss, until the assets are disposed of.

Capital reserve for activities between the Company and a controlling shareholder
This reserve relates to benefits granted by the State as controlling shareholder in the Company, to employees, in cash and in equity instruments of the Company.

Capital reserve for employee stock options
This reserve relates to a benefit granted to employees by means of share-based payments.

NOTE 20 – EQUITY (CONTD.)

H. Dividends

The following dividends were announced and paid by the Company:

	For the year ended December 31	
	2008	2007
	NIS millions	NIS millions
In April 2008, a cash dividend was distributed (NIS 0.26 per share)	**679**	-
In October 2008 a cash dividend was distributed (NIS 0.32 per share)	**835**	-
In February 2007, a cash dividend was distributed (NIS 0.69 per share)(1)	**-**	1,800
In October 2007 a cash dividend was distributed (NIS 0.29 per share)	**-**	760
	1,514	2,560

(1) On December 28, 2006, the general meeting of the shareholders of the Company approved the recommendation of the Board of Directors of the Company concerning distribution of a cash dividend of NIS 1,800,000,030 (comprising NIS 0.69 per share), as a distribution not in compliance with the earnings test. The distribution was subject to the approval of the court. On February 4, 2007, the court approved the distribution, and the distribution was made on February 26, 2007.

(2) In November 2006, a dividend was declared in the amount of NIS 300 million (NIS 0.12 per share). The dividend was paid in January 2007.

I. On March 23, 2009, the Board of Directors of the Company resolved to recommend to the general meeting of the shareholders of the Company to distribute a cash dividend to the shareholders of in the approximate amount of NIS 792 million, which at the distribution date equates to NIS 0.3 per share. The rate of the dividend that will actually be paid will be determined on the basis of the issued and paid up share capital of the Company at the end of the business day on May 11, 2009.

NOTE 21 – REVENUE

	For the year ended December 31		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Fixed-line domestic communications			
Landline telephony	**3,470**	3,798	4,068
Internet – infrastructure	**790**	711	606
Transmission, data communication and others	**978**	935	895
	5,238	5,444	5,569
Cellular telephone			
Cellular services and terminal equipment			
Sale of terminal equipment	**3,756**	3,669	3,524
	692	711	617
	4,448	4,380	4,141
International communications, internet and network end point services	**1,243**	1,226	1,219
Multi-channel television	**1,447**	1,331	1,284
Others	**31**	19	19
	12,407	12,400	12,232

NOTE 22 – SALARIES

	For the year ended December 31		
	2008	**2007**	**2006**
	NIS millions	**NIS millions**	**NIS millions**
Salaries and related expenses –			
Operating	**1,787**	1,833	1,784
General and administrative	**725**	733	727
Share-based payments	**75**	-	287
Total salaries and related expenses	**2,587**	2,566	2,798
Less – Salaries charged to investments in property, plant and equipment and in intangible assets	**233**	191	212
	2,354	2,375	2,586

NOTE 23 – OPERATING AND GENERAL EXPENSES

	For the year ended December 31		
	2008	**2007**	**2006**
	NIS millions	**NIS millions**	**NIS millions**
Cellular telephone expenses	**1,723**	1,828	1,854
General expenses	**1,115**	1,187	1,169
Materials and spare parts	**809**	924	923
Consumption of satellite services content	**447**	426	441
Building maintenance	**331**	332	348
Services and maintenance by sub-contractors	**364**	381	428
International communication expenses	**273**	338	384
Motor vehicle maintenance expenses	**192**	183	190
Royalties to the State of Israel	**134**	194	180
Collection fees	**49**	48	50
	5,437	5,841	5,967

NOTE 24 – OTHER OPERATING EXPENSES, NET

	For the year ended December 31		
	2008	**2007**	**2006**
	NIS millions	**NIS millions**	**NIS millions**
Provision in respect of severance pay in early retirement	**165**	51*	290*
Capital gains from realisation of property, plant and equipment (mainly real estate)	**(18)**	(105)	(159)
Capital gain from sale of satellite communication operation	**(50)**	-	97
Provision in respect of contingent liabilities	**(5)**	80	-
Provision for impairment of long-term loans	**4**	17	-
Others	**-**	(4)	3
	96	39	231

* See Note 3U and Note 25.

NOTE 25 – FINANCING EXPENSES, NET

	For the year ended December 31,		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Interest income from bank deposits, investments and others	**61**	116	195
Net change in the fair value of financial assets measured at fair value through profit and loss (mainly for forward transactions)	**-**	168	-
Income in respect of borrowing grossed up in sales, net of discount commission	**69**	63	49
Interest income and dividend from financial assets available for sale	**-**	6	30
Net profit from realisation of financial assets available for sale transferred from equity	**-**	-	5
Income from financial liabilities provided by the non-controlling interest in a subsidiary	**-**	96	-
Other financing income	**36**	38	77
Total financing income	**166**	487	356
Interest expenses in respect of financial liabilities	**337**	420	477
Linkage differentials, net	**272**	193	6
Exchange rate differences, net	**1**	114	12
Net change in the fair value of financial assets measured at fair value through profit and loss	**32**	-	103
Expenses in respect of capitalisation of loans provided by the non-controlling interest in a subsidiary	**6**	23	50
Impairment in respect of available-for-sale financial assets	**13**	10	-
Other financing expenses	**86**	76*	65*
Total financing expenses (1)	**747**	836	713
Financing expenses, net	**581**	349	357
(1) Net of amounts capitalised in the amount of	**35**	2	1
Stated directly in equity			
Net change in fair value of financial assets classified as available for sale	**-**	4	(1)
Net change in the fair value of financial assets classified as available for sale and transferred to profit and loss	**(5)**	-	(5)

* See Note 3U. Reclassification of approximately NIS 40 million in respect of financing expenses for a provision for severance upon early retirement, which was stated in the past under Other Operating Expenses, net.

NOTE 26 – SHARE-BASED PAYMENTS

A. (1) Following public offering under a prospectus of the Company and the State on May 24, 2004, and closing the sale of core control in the Company from the State to Ap.Sb.Ar. on October 11, 2005, Company employees are entitled to payment in respect of those sales by means of grant of 4.71% of the shares of the Company held by the State. Allocation of the shares will be by means of a stock options plan as described in the outline published by the Company on November 15, 2005.

(2) Following an agreement signed with the employees (see Note 16H) in the matter of an employee stock options plan for 3% of the issued and paid up capital of the Company, on February 22, 2007, the Board of Directors approved the plan. On March 25, 2007, 78,092,000 options were allocated, and on January 2, 2008 another approximately 59,000 options were allocated to two employee-directors. The expenses in respect of this grant were recorded in 2006, since in that year a promise was made to the employees, with the terms of the grant. The value of the grant was determined at February 22, 2007, which is the grant date.

B. On November 20, 2007, the Board of Directors of the Company resolved to adopt a stock options plan for managers and senior employees in the Company and/or in associates, allocating up to 65,000,000 non-marketable options exercisable for up to 65,000,000 shares of the Company and comprising approximately 2.5% of the issued share capital of the Company, and at full dilution – approximately 2.37% of the share capital.

On December 25, 2007, the Company published an outline for the allocation of up to 65,000,000 options in accordance with the Securities (Details of an outline offering of securities to employees) Regulations, 5760-2000, in which it described, *inter alia*, the terms of the plan, and also a private placement report in accordance with the Securities (Private placement of securities in a listed company) Regulations, 5760-2000.

The stock options plan and the allocation of the options under it, were approved by the general meeting of the Company on January 31, 2008, in accordance with the Company's Articles of Association (in certain cases, there is a statutory requirement to obtain additional approval from the general meeting).

Exercise of the options under the plan was contingent upon obtaining the appropriate approvals as set forth in the provisions of the Communications (Telecommunications and broadcasts) (Determination of an essential service provided by Bezeq, The Israel Telecommunication Corp. Ltd.) Order, 5757-1997 ("the Telecommunications Order"). Subsequent to exercise of the option to purchase shares by the controlling shareholder in the Company, Ap.Sb.Ar. Holdings Ltd. and the resulting increase in the percentage of its holding in the Company's shares to 40.66%, exercise of the options under the plan will be permitted also without need for amendment of the Telecommunications Order.

The options will vest in three equal annual portions. The vesting dates of each portion will fall at the end of each of the first, second and third years after the grant date, and the expense for each portion will be spread over its vesting period. In addition, the plan sets forth conditions which, if met, bring forward the vesting date.

Exercise of the options for shares will be by means of a cashless exercise mechanism, unless the Board of Directors decides otherwise.

The exercise price set for the grant of 49,500,000 options is NIS 5.50 (adjusted for distribution of a dividend in cash or in kind). On June 26, 2008, the Board of Directors resolved that the exercise price for future grants of options, as would be approved by the Board of Directors from time to time, will be the same as the average stock exchange closing price of the Company's share in the 30 trading days prior to the date of the Board of Directors' decision to grant options to those offerees.

NOTE 26 – SHARE-BASED PAYMENTS (CONTD.)

C. Of the options, at the date of the financial statements 61,550,000 options have actually been allocated, as follows:

(1) 52,550,000 options, with a theoretical economic value of approximately NIS 147 million (of which 17,750,000 options to the CEO of the Company and senior officers who are key personnel in the Group and the theoretical economic value of which is approximately NIS 45 million), based, *inter alia*, on the share price on the grant date, a risk-free annual interest rate of between 5.09% and 5.68%, a weighted average life expectancy of between 4.5 and 5.5 years, an exercise price between NIS 5.5 and NIS 6.35 , as described above, an annual standard deviation between 22.7% and 24.3%. The grant date was determined as the later of the date of the general meeting and the date of the notice to the employees. The restriction described above by virtue of the Telecommunications Order was taken into account in calculating the theoretical economic value of the options, assuming that the restriction can be resolved.

(2) On April 17, 2008, the Board of Directors of the Company resolved to allocate 9,000,000 options to the Chairman of the Board in accordance with the plan described in Section A above, subject to a number of changes relating to the terms of his options. The allocation to the Chairman was approved by the general meeting of the shareholders of the Company on June 1, 2008.
The options will vest in 12 equal quarterly portions. The vesting dates of each portion will fall at the end of each quarter from the grant date, and the expense will be spread for each portion in accordance with its vesting period. In addition, the plan sets terms which, if met, will bring the vesting date forward.

The exercise price of each option is NIS 6.4405 per share. The price was set according to the share price on the date on which the Chairman took up his post – September 4, 2007 (which was NIS 6.649 per share) and after adjustment for distribution of a net dividend in the amount of NIS 0.26 per share, for which the X-day was April 14, 2008. The closing price of the Company's share on June 1, 2008, the date of approval by the general meeting, was NIS 6.494 per share.

The theoretical economic value of the options granted to the Chairman as described above, according to a weighted Black and Scholes model, is approximately NIS 16 million, based, *inter alia*, on the share price on the grant date, a risk-free annual interest rate of 5.1%, a weighted average life expectancy of 4 years, the exercise price noted above, an annual standard deviation of 23.11%, and a solution to the restriction described in B. above as imposed by the Telecommunications Order.

NOTE 26 – SHARE-BASED PAYMENTS (CONTD.)

D. The terms of the options

Grant date / Eligible employees	No. of instruments in thousands	Vesting terms	Contractual duration of the options
A. Grant of options from the State to employees on October 11, 2005	122,698	Immediate (subject to lock-up – commencing at the end of two years, for three years – one third each year)	4 years
B. Grant of options to employees on February 22, 2007(1)	78,151	Immediate (subject to lock-up for two years)	5 years
C. Grant to Chairman of the Board on April 17, 2008	9,000	12 quarterly portions	4 years
D Approval and/or grant of options to managers, senior employees and officers up to December 31, 2008	52,550	Three equal annual portions	8 years
Total options for shares	262,399		

(1) The expenses for this grant were recorded in 2006, since in that year a promise was made to the employees, with the terns of the grant.
(2) The options referred to in Sections A and B are delivered by physical delivery of the shares.
The options referred to in Section C and D are delivered by way of cashless exercise.

See Section I below on the matter of the approval or grant of options after the balance sheet date.

E. Number of options and weighted average of the exercise price

	No. of options	No. of options
	For the year ended December 31,	
	2008	2007
	(In thousands)	(In thousands)
Balance at January 1	**200,849**	200,849
Options granted during the year	**61,550**	-
Options forfeited during the year	**(4,000)**	-
Options exercised during the year	**(35,000)**	-
Balance in circulation at the end of the period	**223,399**	200,849
Exercisable at the end of the period subject to lock-up terms	**119,050**	200,849
Exercisable at the end of the period not subject to lock-up	**48,299**	**-**

After the balance sheet date, approximately 12,376,000 of the options granted by the State to employees on October 11, 2005, were exercised

The average share price in 2008 and 2007 was NIS 6.409 per share and NIS 6.82 per share, respectively.

For the balance of the options issued at December 31, 2008, the exercise price is in the range of NIS 1.94 to NIS 6.12, and the weighted average of the remaining contractual life is 3.18 years.

NOTE 26 – SHARE-BASED PAYMENTS (CONTD.)

F. Additional details concerning share-based payments settled in derivatives:

The fair value of the services received in consideration of the stock options granted, is based on the fair value of the granted options, measured on the Black and Scholes model, based on the following parameters:

	For the year ended December 31,	
	2008	2007
Weighted average of the fair value at the grant date	**NIS 2.65**	–
Share price	**NIS 6.18 – 7.049**	–
Exercise price	**NIS 5.5 – 6.44**	–
Expected volatility	**22.7% - 24.3%**	–
Duration of the option	**4 – 5.5 years**	–
Risk-free interest rate (based on government bonds)	**5.09% - 5.68%**	–

Due to the mechanism for adjustment to distribution of a dividend, the expected dividend rate assumed in the calculation of fair value is 0%.

G. Salary expense in respect of share-based payments

	For the year ended December 31,		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Options for shares granted in 2008 (1)	**75**	-	-
Options for shares granted in 2006	**-**	-	287
	75	-	287

(1) Calculation of the salary expense assumed approximately 5% in respect of forfeiture, for each year.

H. (1) The employment agreement of DBS with a number of senior employees states that if DBS adopts a stock options plan for its employees, in which employees will be granted a right to purchase shares of DBS, such a plan will include those employees. The exact percentage of options each employee will receive under the plan will be determined at the exclusive discretion of the management of DBS. At the date of signing the financial statements, DBS has not adopted an employee stock options plan and accordingly, no options have been allocated.

(2) Under the employment agreement of DBS with a number of senior employees, DBS undertook to grant each such employee options entitling each of them to purchase from DBS, by way of allocation, ordinary shares of NIS 1 par value each, in consideration of their par value. In addition, the employment agreements with the employees stated the number of options and the terms of their exercise. In November 2008, DBS signed agreements cancelling the above undertaking in consideration of payment of a onetime bonus, and included in the financial statements expenses reflecting the bonus. At the balance sheet date, DBS remains with an undertaking to grant options of DBS to the CEO alone. The allocation requires the approval of the board of directors and of the banks. The options have not yet been granted to the CEO, and accordingly, the provisions of IAS 2 on the subject of capital grants to employees have not been applied.

NOTE 26 – SHARE-BASED PAYMENTS (CONTD.)

I. On January 21, 2009, the Board of Directors of the Company approved the grant of the 400,000 options to senior employees in the Group and 100,000 options to an employee-director, in accordance with the plan described in section B. above. The grant to the employee-director is subject to the approval of the general meeting. On February 19, 2009, the Board of Directors of the Company approved the grant of the additional 1,600,000 options to senior employees in the Group in accordance with the same plan. The theoretical economic value of the options granted after the balance sheet date, which was calculated at the date of approval of the grant by the Board of Directors, relying on a weighted Black and Scholes model, is approximately NIS 4.2 million.

NOTE 27 – EARNINGS PER SHARE

Basic earnings per share

Calculation of the basic earnings per share at December 31, 2008 was based on the profit relating to the ordinary shareholders, and on a weighted average number of ordinary shares in circulation, calculated as follows:

	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Profit attributable to the ordinary shareholders			
Profit attributable to the ordinary shares	**1,627**	1,330	809
Weighted average of the number of ordinary shares			
Weighted average of the number of ordinary shares	**2,605**	2,605	2,605

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Diluted earnings per share

Calculation of the diluted earnings per share at December 31, 2008 was based on the earnings relating to the ordinary shareholders, and on a weighted average number of ordinary shares (diluted), as follows:

	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Profit attributable to the ordinary shareholders (diluted)			
Profit attributable to the ordinary shares (basic and diluted)	**1,627**	1,330	809
Weighted average of the number of ordinary shares			
Weighted average of the number of ordinary shares (basic)	**2,605**	2,605	2,065
Effect of the options on the shares	**44**	36	-
Weighted average of the number of ordinary shares (diluted)	**2,649**	2,641	2,605

The average market value of the Company's shares, for calculating the diluting effect of the options on the shares, was based on the market prices in the period during which the options were in circulation.

NOTE 28 – SEGMENT REPORTING

The Group operates in various segments in the communications sector, so that every company in the Group operates in one separate business segment. The primary reporting format, by business segments, is based on the Group's management and internal reporting structure.

Each company provides services in the segment in which it operates, using the property, plant and equipment and the infrastructure it owns. The infrastructure of each company is used only for providing its services. Each of the companies in the Group is exposed to different risks and yield expectations, mainly in the matter of the technology and the competition in the segment in which it operates.

Accordingly, the separable component in the Bezeq Group which provides a service or a group of related services, and which is exposed to different risks and yield expectations than those of other segments, is every company in the Group.

Based on the above, the business segments of the Group are as follows:

- Bezeq, The Israel Telecommunication Corp. Ltd. – fixed line domestic communications.
- Pelephone Communications Ltd. – cellular communications.
- Bezeq International Ltd. – international communications, internet services and network end point.
- D.B.S. Satellite Services (1998) Ltd. – multi-channel television.

The other companies in the Group are presented under the "Others" item.

Inter-segment pricing is set at the price determined in a transaction between unrelated parties.

The results, assets and liabilities of a segment include items directly attributable to that segment, as well as those that can be allocated on a reasonable basis. Unallocated items include mainly investments and the revenue from them, loans and borrowings and their related expenses, and assets and liabilities in respect of taxes.

Segment capital expenditure is the total cost incurred during the period to acquire property, plant and equipment and intangible assets.

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation

	Year ended December 31, 2008						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue							
Revenue from external sources	5,179	4,448	1,243	1,506	31	-	12,407
Inter-segment revenues	319	265	63	7	44	(698)	-
Total revenue	5,498	4,713	1,306	1,513	75	(698)	12,407
Segment results	1,475	933	242	177	-	(10)	2,817
Financing costs, net							(581)
Profit after financing expenses							2,236
Equity in profits of associates accounted by the equity method							5
Profit before income tax							2,241
Income tax							720
Profit							1,521
Attributable to:							
Shareholders of the Company							1,627
Non-controlling interest							(106)
Profit for the year							1,521

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2008						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Segment assets	7,325	4,641	947	1,129	51	(181)	13,912
Investments in associates accounted by the equity method							32
Unallocated assets							367
Total assets							14,311
Segment liabilities	1,570	834	268	592	28	(181)	3,111
Unallocated liabilities							6,948
Total liabilities							10,059
Capital expenses	608	911	113	262	2		
Depreciation	709	424	41	219	1		
Amortisation of intangible assets	143	99	34	310	3		
Share-based payments	38	25	10	2	-		

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2007						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue							
Revenue from external sources	5,373	4,380	1,226	1,403	18	-	12,400
Inter-segment revenues	340	304	78	12	46	(780)	-
Total revenue	5,713	4,684	1,304	1,415	64	(780)	12,400
Segment results	1,319*	805	**204**	48	-	-	2,376*
Financing costs, net							(349)*
Profit after financing expenses							2,027
Equity in profits of associates accounted by the equity method							6
Profit before income tax							2,033
Income tax							672
Profit							1,361
Attributable to:							
Shareholders of the Company							1,330
Non-controlling interest							31
Profit for the year							1,361

* See Note 3U.

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2007						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Segment assets	7,756*	4,290	837*	1,097	59	(229)*	13,810*
Investments in associates accounted by the equity method							37
Unallocated assets							1,309*
Total assets							15,156
Segment liabilities	1,969*	798	330*	592*	37	(229)*	3,497*
Unallocated liabilities							7,487*
Total liabilities							10,984
Capital expenses	520	440	108*	299	3		
Depreciation	789	398	46	244	3		
Amortisation of intangible assets	152*	80	29	26	2		

* See Note 3U.

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2006						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue							
Revenue from external sources	5,514	4,141	1,219	1,339	19	-	12,232
Inter-segment revenues	285	337	82	23	37	(764)	-
Total revenue	5,799	4,478	1,301	1,362	56	(764)	12,232
Segment results	765*	692	**119**	8	-	-	1,584*
Financing costs, net							(357)*
Profit after financing expenses							1,227
Equity in profits of associates accounted by the equity method							11
Profit before income tax							1,238
Income tax							488
Profit							750
Attributable to:							
Shareholders of the Company							809
Non-controlling interest							(59)
Profit for the year							750

* See Note 3U.

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2006						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Segment assets	9,837	3,717	784*	1,008	47	(214)*	15,179*
Investments in associates accounted by the equity method							32
Unallocated assets							2,334*
Total assets							17,545
Segment liabilities	2,320	756	346	584	33	(209)*	3,830*
Unallocated liabilities							8,524*
Total liabilities							12,354
Capital expenses	511	337	47	208	2		
Depreciation	875	407	38	268	3		
Amortisation of intangible assets	151*	63	31*	25	3		
Losses from impairment of intangible assets and property, plant and equipment	5	-	-	-	1		
Share-based payments	287	-	-	-	-		

* See Note 3U

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES

A. The Company and its subsidiaries provide a range of communication services, such as telephony, access, information and data communication, transmission, satellite and video, infrastructure, international communications and internet, multi-channel television, cellular, network end point, and others ("the Services").

Among the entities for which the Company and its subsidiaries provide the Services, there are also interested parties in the Company, including Ap.Sb.Ar. which until September 25, 2008 held 30% of the Company's shares, the State of Israel, which until such date held approximately 16% of the Company's shares (after the exercise of the option by Ap.Sb.Ar. for the purchase of 10.66% of the Company's shares from the State, Ap.Sb.Ar.'s holding in the Company increased to 40.66% and the State ceased to be an interested party), and the Zeevi group, which holds 17.75% of the Company's shares through a receiver appointed for those shares on behalf of certain banks.

In view of the above, as far as interested parties in the Company are concerned, which are not the State of Israel, the Services provided to them by the Company and its subsidiaries are negligible transactions, and accordingly, in accordance with Article 64(3)(d)(1) of the Securities (Preparing annual financial statements) Regulations, 5753-1993 ("the Regulations"), they are not described in these financial statements.

With regard to the State of Israel as an interested party in the Company until September 25, 2008, below are the characteristics and scope of the transactions with the State pursuant to Article 64(3)(d)(2) of the Regulations:

(1) The provision of diverse services to the State and its many branches, including Government ministries, Companies, and Authorities ("State Authorities").

(2) The consideration for most of the transactions which the Company has with State Authorities are paid at tariffs set in the Regulations. The other transactions carried out by the Company with the State, (i.e. those for which the consideration is not paid at those tariffs), such as for services for which the regulations do not set a tariff, custom-ordered work, contract work, excavation and installation, and maintenance of transmitters, as well as transactions carried out by the Company's subsidiaries with the State authorities – all these are transactions are conducted in the normal course of business at market prices, and where each individual transaction or service, of itself, is not material for the Company.

(3) For details of the transactions with government ministries until September 25, 2008, see section E below.

Arrangements which are not in compliance with these terms are disclosed separately in the financial statements.

B. Most of the Companies in the Group are required to pay royalties to the Government of Israel. Commencing January 2001, the revenue base requiring the payment of royalties was broadened, concurrently with a gradual reduction in the rate of the royalties, until a uniform rate was arrived at for all communications operators. In August 2006, an amendment to the royalties regulations was published, which regulates the reduction of 0.5% per year in their rate for all the licensees required to pay them, commencing January 1, 2006, until a rate of 1% per year is reached in 2010. The Ministry of Communications also gave notice that it will work for amendment of the regulations so that the Company will be exempted retroactively, from January 2004, from the duty to pay royalties in respect of revenues from services which have been opened to competition. On December 31, 2007, the Ministers of Finance and Communications submitted a draft amendment of the regulations to the Knesset Finance Committee. The regulations have not yet been promulgated.

C. On May 8, 2005, a new commercial agreement was signed between the Company and the Ministry of Defence on behalf of the State of Israel, for the provision of communication services by the Company. The agreement was approved beforehand by the Audit Committee of the Board of Directors and by the Board of Directors on May 3, 2005, and required, since the Company was at that time under government control, the approval of the general meeting of the shareholders of the Company (by a special majority), as required by the Security (Transactions between a company and its controlling shareholder) Regulations, 5761-2001. Approval of the agreement was delayed at the request of the

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

Ministry of Communications and the Antitrust Commissioner, to enable receipt of the Company's remarks on questions they had raised. On August 23, 2006, the Company received a copy of a letter from the Antitrust Authority to the legal representative of the Ministry of Defence and the IDF, in which the Authority gave notice that the agreement does not contravene the provisions of the Antitrust Law, 5748-1988, and that the Authority sees no justification, at the present time, for insisting on cancellation of the agreement.

The Company forwarded a copy of the letter to the Ministry of Communications. The financial statements include the income according to the new agreement. However, the Ministry of Communications believes that the agreement includes discounts which the Company is not authorised to grant, and that it was signed for too long a term. On March 27, 2007, the Ministry demanded (following an earlier request on December 4, 2006), that the agreement be amended so as not to violate the provisions of the law and of the Company's license. The Company notified the Ministry of Defence of cancellation of the discount arrangements and is charging the IDF at the tariffs stated in the Agreement from July 2002, which preceded the current agreement, although the Ministry of Defence pays the Company according to the tariffs in the present agreement. At this stage the Company is unable to assess the developments and therefore the financial statements include the income from the Ministry of Defence according to the tariffs in the agreement dated May 8, 2005, which are lower than the tariffs. Subsequently, the Company approached the Attorney General for a decision between the Ministry of Defence and the Ministry of Communications on the question of the 2005 agreement. It is noted that in any event, the term of the 2005 agreement ended in May 2008 and the parties are negotiating terms for continuation of the engagement.

D. On July 29, 2007, an agreement was signed (after being approved by the general meeting of the shareholders of the Company on March 23, 2006) with a corporation owned and controlled by the shareholders of Ap.Sb.Ar., whereby the Company will be granted regular management and consultation services, including by means of currently-serving and future directors of the Company and/or its subsidiaries, all for a consideration of USD 1.2 million per year. The term of the agreement is from October 11, 2005 (the date on which Ap.Sb.Ar. purchased 30% of the shares of the Company), and ends on December 31, 2008. On September 28, 2008, the general meeting of shareholders of the Company approved an extension of the management agreement for an additional period of three years, under the same terms as the original agreement.

E. Transactions and balances with interested parties and related parties

	For the year ended December 31		
	2008	**2007**	**2006**
	NIS millions	**NIS millions**	**NIS millions**
Sales of products and services			
To the State of Israel*	**273**	365	370
Others	**1**	-	3
Expenses			
State of Israel *			
Royalties	**102**	194	181
Frequencies	**21**	25	29
Investments			
Rights to frequencies*	**181**	-	-

* Until September 25, 2008, when the State ceased to be an interested party in the Company.
For other balances with related parties, see relevant notes.

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

F. Benefits to key managerial personnel

	For the year ended December 31, 2008	
	Number of persons	NIS thousands
Salary [2]	5	**10,355**
Bonuses[3]	5	**8,959**
Share-base payments (see Note 26)	5	**30,024**
		49,338

(1) Key managerial personnel in the Group in 2008 include the Chairman of the Board and the CEO of the Company, as well as the three CEOs of Pelephone, Bezeq International and DBS.

(2) Changes in other provisions (which are included in total salary) are not material, except for a decrease in the provision for notice for the CEO of the Company, in the amount of NIS 746,000, in accordance with his employment agreement.

(3) The bonus to the Chairman of the Board, NIS 3,245 million, requires the approval of the general meeting of the shareholders of the Company.

	For the year ended December 31,			
	2007		2006	
	No. of persons	NIS thousands	No. of persons	NIS thousands
Total cost of salary	3	10,479[2]	2	13,386[3]

(1) Key managerial personnel in 2007 and 2006 include the Chairman of the Board and the CEO of the Company.

(2) Including salary and bonuses to former CEO and Chairman and to the present CEO in respect of his term of office as former CEO of Bezeq International. The salary of the Chairman includes approximately NIS 4.6 million, based on the estimated cost of salary and future payments. This cost does not include this provision, nor the salary and payments to whoever served as Acting CEO in the period from April 1, 2007 to June 26, 2007, nor special compensation to the former CEO of the Company, Mr. Amnon Dick, as described in section H below.

(3) Includes a bonus in the amount of NIS 2.4 million to the retiring CEO. Following a request of the Securities Authority regarding senior officer bonuses, the aforementioned bonus to the CEO was cancelled. The Company decided that if this bonus is not returned to the Company, it will institute legal proceedings to collect the debt. However, the former CEO has made allegations which are denied by the Company.

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

G. Benefits to Directors

	For the year ended December 31		
	2008	2007	2006
	NIS thousands	NIS thousands	NIS thousands
Remuneration to directors who are not employed by the Company (1)	**619**	372	167
Number of directors receiving the remuneration	**3**	4	2
Pay of employee-directors (2)	**1,120**	996	1,010
Number of directors receiving the pay	**2**	2	2
Management fees to a controlling company	**4,238**	5,127	5,000

(1) From the date of transfer of control in the Company to Ap.Sb.Ar., the directors serving on the Board of Directors of the Company, except for the external directors, do not receive compensation from the Company.

(2) This is the salary paid to employee-directors in respect of their work in the Company; they do not receive any additional pay in respect of their service as directors in the Company. For the matter of stock options allocated to them in 2006 and the resolution of the Board of Directors of the Company concerning an additional allocation to an employee-director on January 21, 209, see Note 26.

(3) On December 3, 2003, the general meeting of the shareholders of the Company approved an obligation to indemnify officers of the Company in the matter of the framework agreement signed between the Company and the State, including in connection with an allotment of shares to the State pursuant to the framework agreement. The obligation was limited to NIS 890 million (the amount of capital raised), linked to the CPI published after completion of raising the capital for the Company in accordance with the framework agreement.

(4) On May 13, 2004, the general meeting of the shareholders of the Company approved a commitment to officers in the matter of indemnity and insurance, as follows:

a. An obligation of the Company regarding the provision of a loan to officers to financing reasonable litigation expenses in legal proceedings, and an undertaking of the Company to purchase insurance policies for officers at reasonable cost.

b. Grant of notes of indemnity in advance to officers of the Company in the following matters:
(1) A claim of a shareholder who held 15% or more of the share capital of the Company. The total amount of indemnity will not exceed USD 150 million, plus USD 30 million for legal expenses (a claim of this kind was excluded under the officers' insurance policies of the Company).

(2) In all matters relating to a prospectus for an offer for sale of securities of the Company by the State of Israel and an offering by the Company, which was published at the end of May 2004. The total amount of the indemnity (including undertakings to indemnify in advance which were given until publication of the prospectus and for undertakings to indemnify in advance which will be given, if given, immediately prior to the transfer of control in the Company by the State), will not exceed 25% of the equity of the Company (according to the 2003 financial statements, linked to the CPI of November 2003).

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

G. Benefits to Directors (contd.)

(5) On April 20, 2004, the Board of Directors of the Company resolved that the Company will indemnify the employees of the Group who participated in the preparation of the prospectus published in May 2004, and who are not officers of the Company, for a financial liability which would be imposed upon them and for reasonable litigation expenses they would incur, regarding all matters relating to the prospectus, in the format of the indemnification letter which was given to the officers.

(6) On April 6, 2005, the general meeting of the shareholders approved an indemnification commitment in respect of a financial liability that would be imposed on officers of the Company and in respect of reasonable litigation expenses which they would incur, relating directly or indirectly to a proceeding for the sale of the State's holdings in the Company.
The indemnification commitment will be provided to officers who served and/or were appointed and/or will be appointed by the Company, commencing from the start of the Company's preparations for the sale proceeding and until the date of the closing of the sale proceeding.

The total amount of the indemnification will not exceed 25% of the equity of the Company (according to the 2004 financial statements, linked to the CPI of November 2004), including in respect of undertakings to indemnify in advance which were provided through the date of issuance of the indemnity note, together with an undertaking to indemnify in advance in accordance with the letter of the Minister of Finance dated April 21, 2004, which will be given, if given, immediately prior to transfer of the controlling interest in the Company by the State.

(7) On May 16, 2005, the general meeting of the shareholders approved the insurance of the officers of the Company, as follows:

Approval of the exercise of an option to purchase a run-off policy for the officers' liability to the Company, with the terms of the current policy, with the following changes:

a. For a period of seven years from the date of the closing of the transfer of the State's shares in the Company which are being sold pursuant to the decision of the Ministerial Committee for Privatisation Affairs on July 19, 2004 ("the Sale Closing Date").

b. The total amount of the insurance cover will not exceed USD 150 million, plus USD 30 million in respect of legal expenses in Israel only.

c. Limits of liability:

   (1) Cover for the first 3 years at a limit of liability of USD 150 million, plus USD 30 million in respect of legal expenses in Israel only.

   (2) Cover for an additional 3 years at a limit of liability of USD 75 million, plus USD 15 million in respect of legal expenses in Israel only.

   (3) Cover for the seventh year at a limit of liability of USD 25 million, plus USD 5 million in respect of legal expenses in Israel only.

   It should be noted that there is one limit of liability for each run-off policy.

d. The premium for the entire period of insurance – USD 3 million (in a one-time advance payment).

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

G. Benefits to Directors (contd.)

(8) The same general meeting on May 16, 2005 approved grant of an undertaking in advance to indemnify the officers of the Company who were serving with the Company at the time the indemnification commitment was provided, which will apply on the Sale Closing Date, or who served during the seven years prior to that date, for a financial liability that would be imposed upon that person in each of the events listed in the documents of indemnification and on the terms set out in them, where the officer acted in good faith and had reasonable grounds for assuming that the action is in the best interests of the Company. The indemnification commitment will not apply regarding an event for which an insurer acknowledged liability under an insurance policy, but if the officer was charged, due to an indemnifiable event, with a sum exceeding the amount paid to him by the insurer, the Company will indemnify him with the difference, and subject to the amount of the indemnity for all the officers in the Company not exceeding USD 150 million plus USD 30 million in respect of legal expenses in Israel only per claim, and in total for a year of insurance in the period of insurance. Upon closing the transaction of sale of the State's shares to Ap.Sb.Ar (October 11, 2005), this undertaking came into force.

The resolutions referred to in sections 6, 7 and 8 above will be applied from the Sale Closing Date (October 11, 2005).

(9) On August 3, 2005, the special general meeting of the shareholders of the Company approved the extension of the term of the officers' insurance policy, including a run-off option, for a period of up to 4 months, at a cost of USD 112,500 per month, commencing July 31, 2005 (the date of expiry of the prior insurance policy). Upon closing the transaction for the sale of the State's shares to Ap.Sb.Ar. (October 11, 2005), the run-off option was exercised and that policy expired.

(10) On December 26, 2007, the general meeting of the shareholders of the Company approved a "framework transaction" for the Company's engagement, during the normal course of business, in future insurance policies (after expiry of the policy approved at the same general meeting) to cover the liability of directors and officers as may be from time to time, including directors and officers who are or who are likely to be considered controlling shareholders in the Company, all the officers in companies in which the Company holds 50% or more, officers representing the Company in companies in which the Company holds 20% or more, and senior employees who are not officer, for managerial actions taken by them, and all by way of a "framework transaction" as defined in the Companies (Reliefs in transactions with an interested party Regulations, 5760-2000, at an annual premium of up to USD 510,000 plus a sum constituting up to 20% of that premium respect of the insurance cover existing today.

On October 30, 2008, the Board of Directors of the Company approved purchase of an insurance policy to cover the liability of directors and officers for a period of one year commencing October 11, 2008, with a limit of liability of USD 100 million per claim and in total for the period, and in addition, a limit of liability of USD 30 million per claim and for all the claims for the period of insurance, in respect of legal expenses in Israel only, as well as a limit of liability of USD 50 million or subsidiaries (as part of the aforementioned limit of liability), in a "framework transaction" which was approved by the general meeting of the shareholders of the Company on December 26, 2007. The annual premium for the policy is approximately USD 369.000.

(11) On January 17, 2007, the general meeting of the Company approved a commitment to indemnify the officers in the Company in accordance with the indemnity note, for any liability or expense imposed on the officer due to his actions in his capacity as an officer in the Company (including his actions in subsidiaries), within the limitations provided in the Companies Law. The total amount of the indemnity was limited to a ceiling of 25% of the equity of the Company as may be at the time of actually paying the indemnity. The indemnity note will apply to types of events listed in an addendum to the note. Subsequently, approval was given for grant of indemnity for new officers who joined the Company.

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

F. Benefits to directors and the CEO (contd.)

(12) On June 1, 2008, the general meeting of the shareholders of the Company approved the terms of employment of the Chairman of the Board of the Company. Below are the main points of the agreement with the Chairman:

a. The Chairman is employed under a personal employment agreement as acting Chairman of the Board of Directors of the Company, in a full-time position, effective from September 4, 2007, the date on which the Chairman actually started working in the Company.

b. The salary of the Chairman is NIS 175,000 per month, linked to the CPI. In addition, Chairman in entitled to contributions to senior employees insurance, study fund and loss of earning capacity insurance. The Company will provide the Chairman with a company car, and will bear all the car maintenance expenses.

c. The Chairman will be granted 9,000,000 options, as described in Section 26.C(2) below.

d. A decision on the award of an annual bonus will be made at the discretion of the Board of Directors and subject to the approval of the Audit Committee of the Board of Directors and the general meeting. The amount of the annual bonus, if awarded, will be between six and eighteen monthly salaries.

e. Immediately after approval of the agreement by the general meeting, the Company will pay the Chairman a special "signature bonus" of NIS 1.2 million.

f. The Company will insure the Chairman with directors and officers insurance, and will indemnify him as is customary from time to time with regard to other directors in the Company.

g. The engagement between the Company and the Chairman is for an unlimited period, where each party is entitled to bring it to an end at any time and for any reason by giving 12 months' notice (the Company) or 6 months' notice (the Chairman).

H. On June 28, 2007, Ap.Sb.Ar., which holds 30% of the shares of the Company, notified the Company that it had signed an agreement with the former CEO of the Company, Mr. Amnon Dick, whereby Ap.Sb.Ar. would pay him special compensation of NIS 5.750 million, as a gesture for his contribution to the Company. The compensation was recorded in the Company's books as a salary expense, and concurrently – in a capital reserve operated between a corporation and a controlling shareholder.

I. Concerning guarantees to related parties, see Note 19.

NOTE 30 – FINANCIAL RISK MANAGEMENT

General

The Group is exposed to the following risks, arising from the use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk (which includes currency, interest and other price risks).

This Note provides information about the Group's exposure to each of the above risks, an explanation as to how the risks are managed, and the measurement processes. Other quantitative disclosure is included in the other Notes to the financial statements.

The Board of Directors is charged with overall responsibility for risk management and supervision in the Group. The purpose of risk management in the Group is to define and monitor those risks constantly, and to minimise their possible effects arising from the exposure on the basis of assessments and expectations for parameters that affect the risks. The Group's policy is to partially hedge exposure from fluctuations in foreign exchange rates, the CPI and interest rates.

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or the other party to a financial instrument fails to meet its contractual obligations, and it is derived mainly from debit balances of customers and other receivables and from investments in deposits and in securities.

Management has a credit policy in place and the Group's exposure to credit risks is monitored on a regular basis. Cash and investments in deposits and securities are deposited in highly-rated banks. Credit assessments are made on material customer balances, and collateral is required for financial assets.

Trade and other receivables

The Group's Management regularly monitors customer debts, and the financial statements include provisions for doubtful debts which properly reflect, in Management's estimation, the loss inherent in debts whose collection is in question. In addition, the balances of the trade receivables are widely spread.

Investments

The Group has investments in securities of the Government and of investment-grade companies, which are liquid and negotiable. Transactions involving derivatives are made with entities that have a high credit rating.

Guarantees

The Group's policy is to provide tender, performance and legal guarantees. In addition, the Company provides bank guarantees, where necessary, for banking obligations of subsidiaries. At December 31, 2008, the Group has the guarantees described in Note 19.

At the reporting date, there is no significant concentration of credit risks. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivatives, in the balance sheet.

Liquidity risk

Liquidity risk is the risk that the Group will be unable to honour its financial obligations on time. The Group's policy for liquidity management is to ensure, as far as possible, that it will always have sufficient liquidity to honour those obligations promptly, in normal conditions and in conditions of distress, without incurring undesirable losses. In addition, for the matter of the debentures held by a subsidiary, see Note 13(b)(3).

NOTE 30 – FINANCIAL RISK MANAGEMENT (CONTD.)

Market risks

Market risk is the risk that changes in market prices, such as foreign currency exchange rates, interest rates and the prices of securities, raw materials and other items, will influence the Group's revenues or the value of its holdings in financial instruments. The purpose of market risk management is to manage and oversee the exposure to market risks within accepted parameters to prevent significant cash flow exposures to market risks that will influence the Group's results, liabilities and cash flow in the short term (up to one year), while maximising the return on the risk.

During the normal course of its business, the Group takes full or partial hedging action and takes into account the effects of the exposure in its considerations for determining the type of loans it takes and in managing its investment portfolio.

CPI risk

Changes in the rate of inflation affect the Group's profitability and its future cash flows, mainly due to its CPI-linked liabilities. The Group has surplus liabilities over assets linked to the CPI. In applying a policy of minimising the exposure, the Group makes forward transactions against the CPI. The duration of the forward transactions is the same as or shorter than the duration of the hedged exposure. A considerable part of the cash balances is invested in deposits which are exposed to changes in their real value as a result of a change in the rate of the CPI.

Foreign currency risk

The Group is exposed to foreign currency risks mainly due to dollar-linked and euro-linked payments for purchases of terminal equipment and property, plant and equipment. In addition, it provides services for customers and receives services from suppliers worldwide for which it is paid and it pays in foreign currency, mainly the dollar. The Group has surplus liabilities over assets in foreign currency. In applying a policy of minimising the exposure, the Group makes forward transactions against the dollar and the euro, and purchases options against the dollar. The duration of the hedging transactions is the same as or shorter than the duration of the hedged exposures.

Interest risk

The Group is exposed to changes in the fair value as a result of investments in debentures bearing fixed interest and of borrowings at fixed interest. The Group is also exposed to changes in its cash flows as a result of borrowings at variable interest. The Group's liabilities at variable interest are mainly short term, and do not expose it to interest rate risk.

NOTE 31 – FINANCIAL INSTRUMENTS

Exposure to credit risk

The carrying amount of financial assets represents the maximum exposure to credit risk. The maximum exposure to credit risk as at the reporting date is:

	December 31, 2008	December 31, 2007
	NIS millions	NIS millions
	Carrying amount	Carrying amount
Cash and cash equivalents	**786**	1,203
Financial assets available for sale	**57**	115
Financial assets measured at fair value through profit and loss	**6**	294
Trade and other receivables	**3,070**	3,105
Bank deposit for provision of loans to employees	**130**	149
Other investments	**3**	3
Derivatives	**24**	61
	4,076	4,930

See Note 7 for the matter of maximum exposure to credit risk in respect of trade receivables.

NOTE 31 – FINANCIAL INSTRUMENTS (CONTD.)

Liquidity risk

Below are the contractual repayment dates of monetary liabilities, including interest payments:

	At December 31, 2008						
	Carrying amount	Contractual cash flow	6 months or less	6-12 months	1-2 years	3-5 years	More than 5 years
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Financial liabilities that are not derivatives:							
Trade payables	1,381	1,381	1,381	-	-	-	-
Other payables	658	658	653	5	-	-	-
Short-term borrowings	31	31	31	-	-	-	-
Bank loans (1)	1,168	1,207	915	52	54	131	55
Debentures issued to the public	2,737	3,229	466	-	450	1,396	917
Debentures issued to financial institutions and other (2)	2,001	2,734	390	123	491	849	881
Loans from institutional entities	109	266	-	-	-	266	-
	8,085	9,506	3,836	180	995	2,642	1,853
Derivative financial liabilities							
Forward contracts on currencies	1	2	1	-	1	-	-
Options on the rate of exchange	1	1	1	-		-	-
Forward contracts on the CPI	15	4	-	7	(3)	-	-
	17	7	2	7	(2)	-	-
Loans provided by the non-controlling interest in a subsidiary	449	1,329	-	-	-	-	1,329

(1) Including loans of a subsidiary amounting of approximately NIS 846 million, stated in the financial statements as short term due to non-compliance with financial covenants as set at December 31, 2008 (see Note 13B(1)).

(2) Including approximately NIS 116 million of debentures of the Company, stated in the financial statements as short term due to non-compliance with financial covenants (see Note 13C(1)).

NOTE 31 – FINANCIAL INSTRUMENTS (CONTD.)

Liquidity risk (contd.)

	At December 31, 2007						
	Carrying amount	Contractual cash flow	6 months or less	6-12 months	1-2 years	3-5 years	More than 5 years
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Financial liabilities that are not derivatives:							
Trade payables	1,533	1,533	1,533	-	-	-	-
Other payables	613	613	608	5	-	-	-
Short-term borrowings	81	81	-	81	-	-	-
Bank loans (1)	1,298	1,579	120	102	174	1,037	146
Debentures issued to the public	2,959	3,551	461	-	446	1,445	1,199
Debentures issued to financial and other institutions (2)	2,302	2,920	348	117	489	1,007	959
Institutional loans	105	254	-	-	-	-	254
	8,891	10,531	3,070	305	1,109	3,489	2,558
Derivative financial liabilities							
Forward contracts on currencies	11	11	11	-	-	-	-
Forward contracts on the CPI	-	1	-	1	-	-	-
	11	12	11	1	-	-	-
Loans provided by the non-controlling interest in a subsidiary	375	1,384	-	-	-	-	1,384

(1) Including loans of a subsidiary amounting to approximately NIS 846 million, stated in the financial statements as short term due to non-compliance with financial covenants as set at December 31, 2008 (see Note 13C(3)).

(2) Including approximately NIS 112 million of debentures of the Company, stated in the financial statements as short term due to non-compliance with financial stipulations (see Note 13C(1)).

NOTE 31 – FINANCIAL INSTRUMENTS (CONTD.)

Currency and CPI risks

The Group's currency risk based on denominated values is as follows:

	December 31, 2008				
	Unlinked	CPI-linked	In dollars or dollar-linked	In euro or euro-linked	Total financial balances
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Assets					
Cash and cash equivalents	771	-	12	3	786
Trade receivables	2,279	24	70	-	2,373
Other receivables	115	-	-	-	115
Other investments including derivatives	8	18	7	-	33
Long-term trade receivables	526	35	15	-	576
Long-term investments and loans including derivatives	131	1	50	-	182
Total assets	3,830	78	154	3	4,065
Liabilities					
Loans and borrowings	877	903	-	-	1,780
Trade payables	1,123	-	251	7	1,381
Other current liabilities and provisions	897	345	-	-	1,242
Long-term liabilities to banks and debentures	-	4,162	-	-	4,162
Loans provided by the non-controlling interest and others	-	558	-	-	558
Other long-term current liabilities and provisions	60	66	-	-	126
Total liabilities	2,957	6,034	251	7	9,249
Details of currency futures transactions					
Dollar/shekel forward transactions	(216)	-	216	-	-
CPI-linked shekel / shekel forward transactions	(1,720)	1,720	-	-	-
Euro/shekel forward transactions	(5)	-	-	5	-
Dollar/shekel Put options	-	-	(110)		(110)
Dollar/shekel Call options	-	-	110	-	100
	(1,941)	1,720	216	5	-

NOTE 31 – FINANCIAL INSTRUMENTS (CONTD.)

Currency and CPI risks (contd.)

	December 31, 2007					
	Unlinked	CPI-linked	In dollars or dollar-linked	In euro or euro-linked	Other foreign currency or linked to other foreign currency	Total financial balances
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Assets						
Cash and cash equivalents	1,115	-	83	4	1	1,203
Trade receivables	2,330	15	58	-	-	2,403
Other receivables	166	-	1	-	-	167
Other investments including derivatives	116	192	35	56	1	400
Long-term trade and other receivables	486	24	25	-	-	535
Long-term investments and loans including derivatives	149	16	60	-	-	225
Total assets	4,362	247	262	60	2	4,933
Liabilities						
Loans and borrowings	927	955	-	31	-	1,913
Trade payables	1,212	-	313	8	-	1,533
Other current liabilities and provisions	937	244	12	1	-	1,194
Long-term liabilities to banks and debentures	-	4,733	-	-	-	4,733
Loans provided by the non-controlling interest and others	-	480*	-	-	-	480
Other long-term current liabilities and provisions	57	59*	1	-	-	117
Total liabilities	3,133	6,471	326	40	-	9,970
Details of currency futures transactions						
Dollar/shekel forward transactions	(389)	-	389	-	-	-
CPI/shekel-linked forward transactions	(2,600)	2,600	-	-	-	-
	(2,989)	2,600	389	-	-	-

* See Note 3U.

NOTE 31 – FINANCIAL INSTRUMENTS (CONTD.)

Data in NIS for exchange rates and the CPI:

	December 31 2008	December 31 2007	December 31 2006	% of change December 31 2008	% of change December 31 2007
CPI in points(*)	**125.5**	120.9	116.9	**3.8**	3.40
1 US dollar	**3.802**	3.846	4.225	**(1.14)**	(8.97)
1 euro	**5.297**	5.659	5.564	**(6.39)**	1.71

(*) CPI for the month at average base of 100=1998.

Sensitivity analysis for changes in the CPI and foreign currency

Strengthening of the NIS against the following currencies at December 31, 2008 and 2007 would increase (decrease) the equity and the profit or loss by the amounts shown below. The analysis is made on the assumption that all other variables, and in particular the interest rates, would remain fixed.

	Equity NIS millions	Profit or loss NIS millions
December 31, 2008		
USD1 – 10% strengthening of the shekel vis-à-vis the dollar	**5**	**4**
Euro 1 – 5% strengthening of the shekel vis-à-vis the euro	**-**	**-**
CPI – 10% strengthening beyond the inflation forecast (inflation forecast of 2% per year)*	**(6)**	**(6)**
December 31, 2007		
USD1 – 10% strengthening of the shekel vis-à-vis the dollar	4	17
Euro 1 – 5% strengthening of the shekel vis-à-vis the euro	1	(1)
CPI – 5% strengthening beyond the inflation forecast (inflation forecast of 2% per year)	(2)	(2)

* Sensitivity rates are determined according to assessments based on variable conditions in the economy.

Weakening of the NIS against the above currencies at December 31, 2008 and 2007 would have the same effect in the opposite direction and in the same amounts, assuming all other variables remain fixed.

Interest rate risks

Profile of the Group's interest-bearing financial instruments at the reporting date is as follows:

	Carrying amount 2008 NIS millions	Carrying amount 2007 NIS millions
Fixed-interest instruments		
Financial assets	**2,162**	2,517*
Financial liabilities	**(6,015)**	(5,787)*
Loans provided by the non-controlling interest in a subsidiary	**(449)**	(375)
	(4,302)	(3,645)
Variable-interest instruments		
Financial assets	**-**	20*
Financial liabilities	**(31)**	(958)
	(31)	(938)

* See Note 3U.

NOTE 31 – FINANCIAL INSTRUMENTS (CONTD.)

Sensitivity analysis of the fair value for instruments at fixed interest
The Group's assets and liabilities at fixed interest are not measured at fair value through profit and loss, nor does the Group designate derivatives (interest swap contracts) as hedging instruments according to a hedge accounting model of fair value. Therefore, a change in interest rates at the reporting date will not affect profit and loss.

Sensitivity analysis of cash flow for instruments at variable interest
An increase of 100 basis points in the interest rate at the reporting date would decrease shareholders' equity and profit or loss by approximately NIS 0.23 million (2007-approximately NIS 7 million). This analysis assumes that all other variables, especially foreign currency rates, remain stable.

Fair value
The table below shows the differences between the carrying amount and the fair value of groups of financial instruments, where material differences exist among them. The carrying amount of financial assets does not differ significantly from their fair value. The fair value of long-term loans provided by the non-controlling interest in a subsidiary is similar to their carrying amount.

	December 31, 2008		December 31, 2007	
	Carrying amount	Fair value	Carrying amount	Fair value
	NIS millions	NIS millions	NIS millions	NIS millions
Short-term borrowing	**31**	**31**	81	81
Secured loans from banks and others				
CPI-linked	**481**	**473**	591	598
Unlinked	**846**	**808**	846	846
Debentures issued to the public				
CPI-linked	**2,816**	**2,841**	3,043	3,046
Debentures issued to financial institutions and others				
CPI-linked	**2,106**	**2,098**	2,302	2,354
Euro-linked	**-**	**-**	32	31
	6,280	**6,251**	6,895	6,956

Estimation of fair values
The methods used to estimate the fair values of financial instruments are described in Note 4.

Interest rates applied in the determination of fair value

	2008	2007
	%	%
Long-term trade receivables	**7.4**	7.3
Loans and receivables	**7.5**	5.5
Loans	**6.2**	5.3

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY

A. Statement of financial position

	Note	2008 NIS millions	2007 NIS millions
Assets			
Cash and cash equivalents		**93**	451
Investments, including derivatives		**23**	366
Trade receivables		**902**	1,059
Other receivables		**531**	181
Inventory		**11**	19
Assets classified as held for sale		**34**	17
Total current assets		**1,594**	2,093
Trade and other payables		**54**	51
Investments, including derivatives		**137**	174
Property, plant and equipment	32E	**3,647**	3,873
Intangible assets		**138**	176
Deferred and other expenses		**171**	185
Investments in associates accounted by the cost method		**4,961**	5,033
Deferred tax assets		**537**	643
Total non-current assets		**9,645**	10,135
Total assets		**11,239**	12,228

	Note	2008 NIS millions	2007 NIS millions
Liabilities			
Debentures	32F	**671**	722
Trade payables		**330**	448
Other payables, including derivatives		**530**	490
Current tax liabilities		**19**	57
Deferred income		**25**	21
Provisions		**253**	287
Employee benefits		**355**	663
Total current liabilities		**2,183**	2,688
Debentures	32F	**3,605**	3,974
Other long-term liabilities		**19**	7
Employee benefits		**219**	219
Total non-current liabilities		**3,843**	4,200
Total liabilities		**6,026**	6,888
Equity			
Share capital		**6,132**	6,132
Reserves		**752**	680
Capital deficit		**(1,671)**	(1,472)
Total equity		**5,213**	5,340
Total equity and liabilities		**11,239**	12,228

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

B. Income statement

	Note	For the year ended December 31		
		2008	2007	2006
		NIS millions	NIS millions	NIS millions
Revenue	32G	**5,498**	5,713	5,799
Costs and expenses				
Depreciation and amortisation		**852**	941	1,026
Salaries		**1,202**	1,293	1,557
Operating and general expenses	32H	**1,873**	2,121	2,233
Other operating expenses, net		**96**	39*	210*
		4,023	4,394	5,026
Operating profit		**1,475**	1,319	773
Financing expenses (income), net		**(244)**	43*	(669)*
Profit before income tax		**1,719**	1,276	1,442
Income tax		**400**	394	254
Profit for the year		**1,319**	882	1,188

* See Note 3U.

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

C. Statement of recognised income and expense for the year ended December 31

	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Net change in fair value of available-for-sale financial assets	-	5	(1)
Net change in fair value of available-for-sale financial assets transferred to profit and loss	**(5)**	-	(5)
Actuarial gains (losses) from a defined benefit plan	**(2)**	13	(3)
Taxes on income and expense charged directly to equity	**1**	(4)	2
Income and expenses charged directly to equity	**(6)**	14	(7)
Profit for the year	**1,319**	882	1,188
Total recognised income and expense	**1,313**	896	1,181

D. Statement of cash flows

	Note	2008	2007
		NIS millions	NIS millions
Cash flows from operating activities			
Profit for the year		**1,319**	882
Adjustments:			
Depreciation	32E	**709**	789
Amortisation of intangible assets		**114**	146
Amortisation of deferred and other expenses		**29**	6
Financing costs, net		**(426)**	189
Capital gain, net		**(68)**	(87)
Share-based payment transactions		**38**	-
Payments to former senior officer		**-**	6
Income tax expense		**400**	394
Impairment (appreciation) of loan to a related party		**143**	(183)
Change in inventory		**9**	(6)
Change in trade receivables		**154**	(201)
Change in other receivables		**(17)**	33
Change in other payables		**49**	(56)
Change in trade payables		**(88)**	27
Change in provisions		**(34)**	79
Change in employee benefits		**(306)**	(304)
Change in deferred income and others		**1**	(8)
Income tax paid		**(335)**	(324)
Net cash from operating activities		**1,691**	1,382*

* See Note 3U

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

D. Statement of cash flows (contd.)

	Note	2008 NIS millions	2007 NIS millions
Cash flows from investment activities			
Investment in intangible assets and in deferred expenses		**(98)**	**(93)**
Proceeds from sale of property, plant and equipment and deferred expenses		**144**	**169**
Realisation of current investments, net		**319**	**647**
Purchase of property, plant and equipment	32E	**(518)**	**(412)**
Proceeds from realisation of investments and long-term loans		**19**	54
Investments in associates accounted at cost		**(2)**	**(3)**
Dividend received		**302**	4*
Interest received		**34**	91*
Net cash generated by (used for) investment activities		**200**	457*
Cash flows from financing activities			
Issuance of debentures	32F	**-**	**1,200**
Repayment of debentures	32F	**(593)**	**(1,811)**
Dividend paid		**(1,514)**	**(2,860)**
Interest paid		**(183)**	**(238)**
Receipt (payment) in respect of settlement of derivative financial instruments, net		**52**	77
Net cash used for financing activities		**(2,238)**	**(3,632)**
Net increase (decrease) in cash and cash equivalents		**(347)**	(1,793)
Cash and cash equivalents at January 1		**451**	2,262
Effects of exchange rate fluctuations on cash and cash equivalent balances		**(11)**	(18)
Cash and cash equivalents at year end		**93**	451

	For the year ended December 31, 2006 NIS millions
Cash flows from operating activities	
Profit	1,188
Adjustment to profit	817
Net cash derived from operating activities	2,005
Cash flows derived from investment activities	1,349*
Cash flows used for financing activities	(2,776)
Net increase (decrease) in cash and cash equivalents	578
Cash and cash equivalents at January 1	1,679
Effects of exchange rate fluctuations on cash balances	5
Cash and cash equivalents at December 31	2,262

* See Note 3U.

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

E. Property, plant and equipment in the Company

Movement in property, plant and equipment	2008	2007
	NIS millions	NIS millions
Cost or deemed cost		
Balance at January 1	**16,385**	16,448
Additions	**504**	442
Disposals	**(184)**	(451)
Transfer to assets held for sale	**(53)**	(54)
Balance as at December 31	**16,652**	16,385
Depreciation and loss from depreciation of assets		
Balance at January 1	**12,512**	12,203
Depreciation for the year	**709**	789
Disposals	**(178)**	(440)
Transfer to assets held for sale	**(38)**	(40)
Balance at December 31	**13,005**	12,512
Carrying amount		
At January 1	**3,873**	4,245
At December 31	**3,647**	3,873

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

F. Debentures

Debt repayment terms and schedule

	Currency	Nominal interest rate %	Redemption year	December 31, 2008 Par value NIS millions	December 31, 2008 Carrying amount NIS millions	December 31, 2007 Par value NIS millions	December 31, 2007 Carrying amount NIS millions
Debentures issued to the public							
CPI-linked							
Series 4 and 5	Shekel	4.8-5.3	2009-2016	**3,287**	**3,740**	3,587	3,915
Debentures issued to banks and others							
CPI-linked	Shekel	4.8-6.35	2009-2014	**471**	**536**	689	750
Linked to the euro					**-**	22	31
					536		781
Total interest-bearing liabilities					**4,276**		4,696

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

F. Debentures (contd.)

Debentures to be redeemed in future years based on repayment schedules:

	December 31, 2008
	NIS millions
2009	**671**
2010	**481**
2011	**834**
2012	**477**
2013	**474**
2014 onwards	**1,339**
	4,276

G. Segmentation of Company revenues

	For the year ended December 31		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Telephony	**3,572**	3,905	4,148
Internet	**790**	712	608
Transmission and data communications	**811**	754	711
Other services	**325**	342	332
	5,498	5,713	5,799

H. Operating and general expenses in the Company

	For the year ended December 31		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Cellular telephone expenses	**894**	1,033	1,135
General expenses	**259**	268	258
Materials and spare parts	**99**	83	80
Building maintenance	**293**	297	312
Services and maintenance by subcontractors	**113**	156	179
International communication expenses	**1**	26	30
Vehicle maintenance expenses	**126**	127	137
Royalties to the State of Israel	**57**	98	66
Collection commissions	**31**	33	36
	1,873	2,121	2,233

NOTE 33 – GROUP ENTITIES

	Country of registration	Rate of ownership For the year ended December 31,	
		2008	**2007**
Pelephone Communications Ltd. (1)	Israel	**100**	100
Bezeq International Ltd. (2)	Israel	**100**	100
D.B.S. Satellite Services (1998) Ltd. (3)	Israel	**49.8**	49.8
Bezeq On Line Ltd. (4)	Israel	**100**	100
Bezeq Zahav (Holdings) Ltd. (5)	Israel	**100**	100
Stage One (6)	Israel	**71.8**	83

(1) Pelephone Communications Ltd.

Pelephone Communications Ltd. ("Pelephone") is a wholly-owned subsidiary of the Company. It provides cellular services and value added services, and sells and repairs terminal equipment.

Pelephone operates under an operating license from the Ministry of Communications – a general license for cellular services ("the License"). The License was received on February 7, 1996.

In the framework of winning an additional band of frequencies in December 2001, the term of the License was extended to 2022 with an option for extension, subject to the terms of the License, for an additional period of six years ("the Additional Period") and for renewal for one or more additional periods of six years after the Additional Period.

(2) Bezeq International Ltd.

Bezeq International Ltd. ("Bezeq International") is wholly-owned by the Company, and was incorporated on April 5, 1995 to engage in international communications in accordance with a Government decision on December 28, 1994 and following a change in the general license of the Company. Since 1999, Bezeq International has also been providing internet access services. Bezeq International has holdings in the Walla! Communications Group Ltd. (see Note 12). Following the merger with BezeqCall Communications Ltd. ("BezeqCall"), BezeqCall's network end point license was assigned to Bezeq International.

On February 8, 2009, the Minister of Communications granted a special general license for the provision of domestic telecommunications services to B.I.P. Communications Solutions (a registered partnership), a company owned by Bezeq International.
The grant of this license was made possible by the VOB policy paper which states, *inter alia*, that after the Company's market share in domestic telephony decreases to 85%, Bezeq International will be able to receive a VOB license.

The license will allow Bezeq International to provide domestic telephony services over broadband (VOB) to private customers only. However, when the Company's market share in the business segment falls below 85%, Bezeq International will be able to provide these services to business customers as well.

(3) D.B.S. Satellite Services (1998) Ltd.

D.B.S. Satellite Services (1998) Ltd. ("DBS") was incorporated in Israel on December 2, 1998. In January 1999, DBS received a license from the Ministry of Communications to transmit satellite television broadcasts in Israel ("the License"). The term of the License when granted to the consolidated company is through January 2014, and can be extended for a period of six additional years on certain terms. In its operations, DBS is subject to the Communications (Telecommunications and broadcasts) Law, 5742-1982 ("the Communications Law'), its concomitant regulations and rules, and the terms of the License.

NOTE 33 – GROUP ENTITIES (CONTD.)

(3) D.B.S. Satellite Services (1998) Ltd. (contd.)

In July 2000, DBS ended its preparation stage and began to provide its customers with multi-channel television broadcasts in accordance with the License granted, in accordance with the Communications Law.

Pursuant to the Company's license, which includes a provision whereby the Company is obliged to maintain complete structural separation between it and its subsidiaries, including DBS, on March 31, 2004 the Minister of Communications published a document prohibiting certain cooperative business ventures between the Company and the subsidiaries, including DBS, unless, *inter alia*, the competitive status of DBS deteriorates materially.

Regarding the financial position of DBS, see below.

A. (1) Since commencing operations, DBS has accumulated considerable losses. DBS's losses in 2008 and 2007 amounted to approximately NIS 265 million and NIS 118 million, respectively. As a result of these losses, its capital deficit and its working capital deficit at December 31, 2008 amount to approximately NIS 2,892 million and NIS 1,333 million respectively.

The Company's investment in DBS (primarily in shareholder loans) at the balance sheet date amounts to approximately NIS 1,562 million (without interest and linkage). The balance of the current debt of DBS to the Company and its subsidiaries amounts to approximately NIS 99 million, of which approximately NIS 73 million is to the Company. The Company and DBS put together an arrangement for collection of the balance of DBS's debt to the Company which was in arrears, approximately NIS 55.6 million. Under the arrangement, the debt is being paid in 60 equal monthly instalments plus interest at prime +1.5%. At the balance sheet date, the balance of the debt covered by the arrangement is approximately NIS 31 million.
The balance of the debt to the Company outside the above arrangement, is current debt for which the agreed terms of payment are the usual credit terms between the Company and its customers. At the date of approval of the financial statements, DBS is not in compliance with the terms of the arrangement and these credit terms; however, the parties reached agreement on this matter.

(2) During 2005, the banks completed the provision of the entire credit facility to which DBS was entitled under the financing agreements. See Note 13C(3).

(3) On July 31, 2007, in a private placement, DBS issued approximately NIS 620 million par value of Debentures (Series A) to institutional investors, to be registered in a continuous institutional system on the Tel Aviv Stock Exchange. The net proceeds from the issuance amounted to approximately NIS 614 million. The terms of the debentures are explained in Note 13B and C above).

B. On August 2, 2006, the Company and DBS filed notices of a merger to the Antitrust Commissioner ("the Commissioner") regarding exercise of options for shares in DBS by the Company which, if exercised, would increase the Company's holdings in DBS from approximately 49.8% to approximately 58%. Following notice from the Antitrust Authority on December 31, 2006 of the Commissioner's opposition to the merger, the Company filed an appeal against that decision on May 15, 2007.

NOTE 33 – GROUP ENTITIES (CONTD.)

(3) D.B.S. Satellite Services (1998) Ltd. (contd.)

(B) (contd.)
On February 3, 2009, the Antitrust Court decided to approve the merger on terms that require approval by the Company within three months. The Antitrust Authority and Eurocom D.B.S. Ltd. (a shareholder in DBS) filed an appeal against the decision. In addition, after the Antitrust Authority application for a stay of execution of the decision was denied by the Antitrust Court and it filed an additional application for a stay of execution in the Supreme Court, the parties arrived at an arrangement as recommended by the court, which was validated as a decision, whereby execution of the merger is delayed for the time being, and the hearing of the appeals will be scheduled for the first week of June 2009.

(4) Bezeq On Line Ltd.

Bezeq On Line Ltd. ("Bezeq On Line") was established in December 2000 and commenced operation in 2001, providing call centre outsourcing services.

(5) Bezeq Zahav (Holdings) Ltd.

Bezeq Zahav (Holdings) Ltd. ("Bezeq Zahav") is wholly-owned and controlled by the Company. Bezeq Zahav was established in September 1995 and commenced operations in May 2004. Bezeq Zahav holds debentures issued by the Company.

(6) Stage One Venture Capital Fund (Israel L.P.

This is a venture capital fund in which the management rights are held by the SOCI, and the Company has rights in the profits – see Note 3A(2).

NOTE 34 – SELECTED CONDENSED DATA FROM THE FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD.

1. Pelephone Communications Ltd.

A. Statement of financial position

	December 31, 2008	December 31, 2007
	NIS millions	NIS millions
Current assets	**1,898**	**1,976**
Non-current assets	**2,746**	**2,363**
	4,644	**4,339**
Current liabilities	**1,502**	**1,106**
Long-term liabilities	**1,050**	**1,154**
Total liabilities	**2,552**	**2,260**
Shareholders' equity	**2,092**	**2,079**
	4,644	**4,339**

B. Income statement

	For the year ended December 31,		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Revenue from services and sales	**4,713**	4,684	4,478
Cost of services and sales	**3,216**	3,347	3,250
Gross profit	**1,497**	1,337	1,228
Sales and marketing expenses	**424**	430	417
General and administrative expenses	**140**	102	110
	564	532	527
Operating income	**933**	805	701
Financing expenses	**115**	114	107
Financing income	**(117)**	(109)	(89)
Financing expenses (income), net	**(2)**	5	18
Profit before income tax	**935**	800	683
Income tax	**253**	215	197
Profit for the year	**682**	585	486

NOTE 34 – SELECTED CONDENSED DATA FROM THE FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD. (CONTD.)

2. D.B.S. Satellite Services (1998) Ltd.

A. Statement of financial position

	December 31, 2008	December 31, 2007
	NIS millions	NIS millions
Current assets	**164**	157*
Non-current assets	**968**	943*
	1,132	1,100
Current liabilities	**1,497**	1,483
Long-term liabilities	**2,527**	2,246*
Total liabilities	**4,024**	3,729
Equity deficit	**(2,892)**	(2,629)
	1,132	1,100

B. Income statement

	For the year ended December 31,		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Revenue	**1,513**	1,415	1,355
Cost of revenue	**1,091**	1,117	1,139
Gross profit	**422**	298	216
Sales and marketing expenses	**128**	138	123
General and administrative expenses	**117**	104	92
	245	242	215
Operating income	**177**	56	1
Financing expenses	**493**	394	328
Financing income	**(52)**	(226)**	(9)
Financing costs, net	**441**	168	319
Loss before income tax	**(264)**	(112)	(318)
Income tax	**1**	6	2
Loss for the year	**(265)**	(118)	(320)

* See Note 3U.
** See Note 13E

NOTE 34 – SELECTED CONDENSED DATA FROM THE FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD. (CONTD.)

3. Bezeq International Ltd.

A. Statement of financial position

	December 31, 2008	December 31, 2007
	NIS millions	NIS millions
Current assets	**496**	415*
Non-current assets	**498**	472*
	994	887
Current liabilities	**254**	312
Long-term liabilities	**30**	26
Total liabilities	**284**	338
Shareholders' equity	**710**	549
	994	887

B. Income statement

	For the year ended December 31		
	2008	2007	2006
	NIS millions	NIS millions	NIS millions
Revenue	**1,306**	1,304	1,021
Operating expenses	**780**	859	662
Gross profit	**526**	445	359
Sales and marketing expenses	**181**	147	148
General and administrative expenses	**103**	94	72
Other expenses, net	**-**	-	7
Operating income	**242**	204	132
Financing costs, net			
Financing expenses	**8**	13	20
Financing income	**(7)**	(14)	(13)
Financing expenses (income), net	**1**	(1)	7
Equity in earnings of an associate accounted by the equity method	**5**	6	11
Profit before income tax	**246**	211	136
Income tax	**68**	58	40
Profit for the year	**178**	153	96

* See Note 3U.

** The above financial statements are presented in accordance with IFRSs only, Furthermore, commencing January 1, 2007, the financial statements include the operations of BezeqCall Communications Ltd.

Chapter D – Additional Details About the Corporation

1. Summary of the Quarterly Statements of Operations for the Year Ended December 31, 2008 (In NIS millions)

The quarterly financial statements were prepared to comply with the International Financial Reporting Standards (IFRS).

	Q1 2008	Q2 2008	Q3 2008	Q4 2008	2008	2007
Revenues	3,100	3,086	3,159	3,062	12,407	12,400
Costs and expenses	2,436	2,286	2,337	2,531	9,590	10,024
Operating income	664	800	822	531	2,817	2,376
Financing expenses	100	183	186	112	581	349
Profit before Group equity in affiliates	564	617	636	419	2,236	2,027
Equity in affiliates	1	1	2	1	5	6
Profit before income tax	565	618	638	420	2,241	2,033
Income tax	180	205	207	128	720	672
Profit for the period	385	413	431	292	1,521	1,361
Attributed to:						
Company shareholders	411	456	462	298	1,627	1,330
Minority rights in consolidated company	(26)	(43)	(31)	(6)	(106)	31
Profit for the period	385	413	431	292	1,521	1,361

2. Use of Proceeds from Securities with Reference to the Application of the Proceeds According to a Prospectus

No issue has been made on the basis of a Prospectus.

3. List of Investments in Subsidiaries and Related Companies as at the Balance Sheet Date*

Company name	Name of holder	Class of Share	Number of shares	Total par value	Rate of holding in %	Adjusted cost in NIS millions*	Adjusted balance sheet value in NIS millions*
Pelephone Communications Ltd.	The Company	Ordinary NIS 1	302,460,000	302,460,000	100%	2,537	2,537
Bezeq International Ltd.	The Company	Ordinary NIS 0.1	1,136,990,000	113,699,000	100%	364	364
DBS Satellite Services (1998) Ltd.[1]	The Company	Ordinary NIS 1	14,881	14,881	49.80%	1,232	902
Bezeq Online Ltd.[2]	The Company	Ordinary NIS 1	1,070,000	1,070,000	100%	24	24
Bezeq Zahav (Holdings) Ltd.[3]	The Company	Ordinary NIS 1	999,999	999,999	100%	1,003	1,003
Walla! Communications Ltd.[4]	Bezeq International	Ordinary NIS 1	15,562,759	15,562,759	34.25%[5]	80	59

Note: In addition to the subsidiaries above, the Adanet Business Group Ltd. and its subsidiaries are in liquidation/receivership proceedings.

* Stated in accordance with IFRS.

[1] D.B.S. Satellite Services (1998) Ltd. includes an investment of NIS 1,232 million which was made through loans. Of this, NIS 313 million is in loans linked to the known CPI, NIS 111 million in loans linked to the known CPI and bearing 5.5% interest, and NIS 808 million is in loans linked to the known CPI and bearing 11% interest.

[2] Bezeq Online Ltd. includes an investment of NIS 1 million extended as a shareholder loan. The loan is linked to the CPI and is interest-free. Moreover, on July 31, 2008 approval was granted to convert a convertible shareholder loan given by the Company to Bezeq Online Ltd. ("Bezeq Online") whose balance at June 30, 2008 was NIS 1,085,000 into paid-up share capital in Bezeq Online so that 1,085,000 ordinary shares of NIS 1 each were allotted to the Company.

[3] Loans were extended to the subsidiary Bezeq Zahav (Holdings) Ltd. for financing the purchase of Company debentures Series 4 and 5.

[4] Walla! Communications Ltd. includes an investment of NIS 0.5 million which was made by means of shareholders' loans from Bezeq International. The loans are linked to the CPI and are interest-free. During 2007, Bezeq International exercised another 0.5 million option warrants in consideration of NIS 0.9 million, which was set off against the balance of those loans. The share price on December 31, 2008 was 300 agorot.

[5] 32.42% in full dilution

4. Changes in Investments in Subsidiaries and Related Companies During the Report Period

Date of the change	Character of the change	Company name	Reported amounts NIS millions
1.08	Options for employees	Pelephone Communications Ltd.	14
1.08	Options for employees	Bezeq International Ltd.	6
1.08	Options for employees	Pelephone Communications Ltd.	2
12.08	Linkage differentials and interest	DBS	189
12.08	Premium reduction	Bezeq Zahav (Holdings) Ltd	(7)
12.08	Reassessment	Bezeq Zahav (Holdings) Ltd	42

5. Revenues of Subsidiaries and Related Companies and Revenues of the Corporation from Subsidiaries and Related Companies as at the Balance Sheet Date (In NIS millions)

Company name	Profit (loss) before tax	Profit (loss) after tax	Dividend	Management Fees	Interest
	NIS millions				
Pelephone Communications Ltd.	935	682	680	0	0
Bezeq International Ltd.	247	178	20	0	0
DBS Satellite Services (1998) Ltd.	(264)	(265)	0	0	70
Bezeq Online Ltd.	2	2	0	0	1
Bezeq Zahav (Holdings) Ltd.	0	0	0	0	44
Walla! Communications Ltd.*	25	17	0	0	0

* Walla! distributed a dividend of NIS 30 million. NIS 10 million was received by Bezeq International.

6. Stock Exchange Trading – Listed Securities – Dates and Reasons for Cessation of Trading

In 2008 no Company securities were listed for trading.

Following are dates and reasons for interruption of trade:

March 11, 2008 between 11:09 and 11:54 due to publication of annual financial statements.

September 21, 2008 between 17:28 and 17:38 due to a sharp fluctuation in the CPI.

November 20, 2008 between 17:40 and 17:59 due to a sharp fluctuation in the CPI.

7. A. Remuneration to Interested Parties and Executive Officers

Following are details of the remuneration paid in 2008 to each of the five highest-paid senior officers in the Company or in a corporation under its control, for service in the Company or a corporation under its control (cost to the employer on an annual basis):

Recipient					Remuneration for services (in NIS '000)							Other remuneration (in NIS '000)			Total (in NIS '000)
Name	Position	Employment basis	% of holding in Corporation's capital - shares	% of holding in Corporation's capital - options[6]	Salary	Bonus[7]	Share-based payment[8]	Management fee	Consultancy fee	Commission	Other	Interest	Rent	Other	Total
Shlomo Rodav	Chairman of Bezeq board of directors	Full time	-	0.33%	3,004	3,245	8,829	-	-	-	-	-	-	-	15,078
Gil Sharon	CEO Pelephone Communication Ltd.	Full time	-	0.19%	2,343	2,251	7,899	-	-	-	-	-	-	-	12,493
Abraham Gabbay	CEO Bezeq	Full time	0.001%	0.19%	1,507[9]	1,363	7,899	-	-	-	-	-	-	-	10,769
Alan Gelman	Bezeq Deputy CEO and CFO	Full time	-	0.13%	2,908[10]	785	5,058	-	-	-	-	-	-	-	8,751
Yitzhak Benbenisti	CEO Bezeq International Ltd	Full time	-	0.09%	1,705	1,000	3,761	-	-	-	-	-	-	-	6,466

[6] Options allotted in accordance with an option plan for senior managers and employees (2007) of the Company on the assumption of full exercise.

[7] The bonus for 2008 has not yet been paid to the senior officers. Furthermore, the bonus for 2008 for the chairman of the board of directors requires approval of the Company's general meeting of shareholders.

[8]. The Black and Scholes value at the allotment date. This is the relative value for share-based remuneration for options which were recognized in the financial statements in the reporting year (including depreciation at a rate of 5% for forfeiture in the event of failure to comply with the vesting period terms in connection with Mr. Sharon, Mr. Gabbay, Mr. Gelman and Mr. Benvenisti.

[9] The salary includes a deduction in the notice provision in the amount of NIS 746,000 in accordance with the employment agreement whereby the notice commitment would be reduced after the end of the first year of employment from twelve to six months.

[10] The salary includes a notice provision in the amount of NIS 1,082,000.

A. Shlomo Rodav is employed by the Company as active chairman of the board of directors under a personal employment agreement dated April 29, 2008. The agreement has been valid since September 4, 2007 which is the date on which he commenced working as chairman of the Company's board of directors. The agreement is for an unlimited period, and may be terminated by either party at any time and for any reason with 12 months notice (from the Company) and 6 months notice (from Mr. Rodav). Mr. Rodav's salary is linked to the CPI. Furthermore, on June 1, 2008, Mr. Rodav was granted a signature bonus of NIS 1,200,000 (which is not included in the sum of the bonus set forth in the table in section 7A above). (The bonus was recognized in the 2007 financial statements).

On June 1, 2008, 9,000,000 option warrants were allotted to Mr. Rodav at an exercise price of NIS 6.4405 (adjusted for distribution of a dividend). The Black and Scholes value of all the options allotted to Mr. Rodav is NIS 16.807 million. The options were divided into 12 (twelve) equal portions; the first portion vested after three months from the grant date, and another portion vests every three months thereafter, so that all the option warrants vest gradually over a period of three years from the grant date. The option warrants are exercisable from the end of the vesting period of each portion of option warrants until four years have elapsed from the grant date of the option warrants. In the event that the Company initiates the termination of Mr. Rodav's service on any date after one year from the grant date has elapsed, the vesting of all the option warrants will be accelerated and they will be exercisable on the date of termination of his service. In this case, the exercise period of the options will end 90 days from termination of his service or at the end of the exercise period, whichever is the earlier, and they will expire at the end of period mentioned. The option remuneration is granted in accordance with the option plan for senior managers and employees (2007) as reported in the Company's immediate report dated December 25, 2007 (in accordance with the plan 65,000,000 option warrants will be granted which are exercisable up to 65,000,000 Company shares) and in accordance with a material private placement report to the chairman of the board of directors, as approved by the general meeting of the Company's shareholders on June 1, 2008 and as reported in the Company's immediate report dated April 18, 2008.

The bonus for 2008 is subject to the approval of the general meeting of the Company's shareholders which has not yet been convened. It should be noted that in accordance with Mr. Rodav's employment agreement, as approved by the general meeting of the Company's shareholders on June 1, 2008 and as reported in the Company's immediate report dated April 18, 2008, the amount of the annual bonus, if it is decided to grant it, will amount to between six and eighteen monthly salaries. It was decided to approve the maximum bonus for Mr. Rodav pursuant to his employment agreement in recognition of his achievements during the 16 months of his work (no separate bonus was granted to Mr. Rodav for the period of his work from 2007) since September 2007. The board believes that Mr. Rodav has acted with professionalism, determination, diligence and success in the Company's key sectors of operation. This was reflected in the way in which he led the Company to excellent financial results in 2008, shaped the managements of the Company and the subsidiaries, promoted change processes in the organizational culture and improved the effectiveness of the work of the boards of directors of the Company and the subsidiaries. Mr. Rodav has made a significant contribution to processes which are important to the Company and the subsidiaries, including the start of the NGN project, Pelephone's UMTS project and other processes.

Changes in remuneration instituted in the reporting year: on September 28, 2008 an amendment was made to Mr. Rodav's employment agreement – vehicle maintenance, as specified in the immediate report dated September 28, 2008, whereby Bezeq will reimburse Mr. Rodav for his vehicle maintenance expenses based on price group 7 gross B (multiplied by the kilometers traveled) of the updated State Comptroller tariff. This is for the period from September 4, 2007 until Bezeq placed a vehicle at the disposal of the chairman.

B. Gil Sharon is employed by the subsidiary Pelephone Communication Ltd. ("Pelephone") under a personal employment agreement dated January 19, 2006. The agreement is for an unlimited period, and it may be terminated by either party at any time and for any reason with 12 months notice (from Pelephone) and 6 months notice (from Mr.. Sharon). Mr.. Sharon's salary is linked to the CPI.

On February 4, 2008, 5,250,000 option warrants were allotted to Mr.. Sharon at an exercise price of NIS 5.50 (adjusted for distribution of a dividend). The Black and Scholes value of all the options allotted to Mr.. Sharon is NIS 14.250 million. One third of the option warrants vest after one calendar year from the grant date has elapsed, another third of the option warrants vest after two calendar years from the grant date have elapsed and the final third of the option warrants vest after three calendar years from the grant date have elapsed. The option warrants may be exercised from the end of the vesting period of each portion of option warrants until five years have elapsed from the vesting date of the third option portion. The option remuneration is granted in accordance with the option plan for senior managers and employees (2007) (in accordance with the plan 65,000,000 option warrants will be granted which are exercisable into up to 65,000,000 Company shares) as reported in the Company's immediate report dated December 25, 2007.

The bonus for 2008 (which is 125% of Mr. Sharon's annual salary for 2008) is based on compliance with the EBITDA target pursuant to Pelephone's financial statements for 2008, as well as successful promotion of the UMTS project.

C. Abraham Gabbay is employed by the Company under a personal employment agreement dated July 19, 2007. The agreement is for an unlimited period, and it may be terminated by either party at any time and for any reason with 6 months' notice. Mr. Gabbay's salary is linked to the CPI.

On February 4, 2008, 5,250,000 option warrants were allotted to Mr. Gabbay at an exercise price of NIS 5.50 (adjusted for distribution of a dividend). The Black and Scholes value of all the options allotted to Mr. Gabbay is NIS 14.25 million. One third of the option warrants vest after one calendar year elapses after the grant date, another third of the option warrants vest after two calendar years elapse from the grant date and the final third of the option warrants vest after three calendar years elapse from the grant date. The option warrants are exercisable from the end of the vesting period of all the option warrants until five years elapse from the vesting date of the third portion. The option remuneration is granted in accordance with the option plan for senior managers and employees (2007) (in accordance with the plan 65,000,000 option warrants will be granted which are exercisable into up to 65,000,000 Company shares) and in accordance with a material private placement report for the company's CEO as reported in the Company's immediate report dated December 25, 2007.

The bonus for 2008 (which is 75.75% of Mr. Gabbay's annual salary) is based on two targets, the Company's financial statements for 2008, in accordance with the Company's financial statements for 2008 (Bezeq's unconsolidated statement): 1. 70% pursuant to compliance with the EBITDA target; 2. 30% pursuant to compliance with the expenses targets and on successful leadership of the change processes in the Company's organization culture.

D. **Alan Gelman** is employed by the Company as the deputy CEO and CFO under a personal employment agreement dated November 29, 2007. The agreement is for an unlimited period, and it may be terminated by either party at any time and for any reason with 6 months notice. Mr. Gelman's salary is linked to the CPI.

On March 7, 2008 3,500,000 option warrants were allotted to Mr. Gelman at an exercise price of NIS 5.50 (adjusted for distribution of a dividend). The Black and Scholes value of all the options allotted to Mr. Gelman is NIS 10.518 million. One third of the option warrants vest after one calendar year elapses after the grant date, another third of the option warrants vest after two calendar years elapse from the grant date and the final third of the option warrants vest after three calendar years elapse from the grant date. The option warrants are exercisable from the end of the vesting period of all the option warrants until five years elapse from the vesting date of the third portion. The option remuneration is granted in accordance with the option plan for senior managers and employees (2007) (in accordance with the plan 65,000,000 option warrants will be granted which are exercisable into up to 65,000,000 Company shares) and in accordance with a material private placement report to the Company's CEO as reported in the Company's immediate report dated December 25, 2007.

The bonus for 2008 (which is 56% of Mr. Gelman's annual salary) is based on compliance with the following targets, a consolidated EBITDA target (40%); a target of a consolidated net profit for the Group (10%); various management targets (50%).

E. Yitzhak Benbenisti is employed as CEO of the subsidiary Bezeq International Ltd. ("Bezeq International") under a personal employment agreement dated July 1, 2007. The agreement is for an unlimited period, and it may be terminated by either party at any time and for any reason with 3 months' notice. Mr. Benbenisti's salary is linked to the CPI.

On February 4, 2008, 2,500,000 option warrants were allotted to Mr. Benbenisti at an exercise price of NIS 5.50 (adjusted for distribution of a dividend). The Black and Scholes value of all the options allotted to Mr. Benbenisti is NIS 6.786 million. One third of the option warrants vest after one calendar year elapses after the grant date, another third of the option warrants vest after two calendar years elapse from the grant date and the final third of the option warrants vest after three calendar years elapse from the grant date. The option warrants are exercisable from the end of the vesting period of all the option warrants until five years elapse from the vesting date of the third portion. The option remuneration is granted in accordance with the option plan for senior managers and employees (2007) (in accordance with the plan 65,000,000 option warrants will be granted which are exercisable into up to 65,000,000 Company shares) and in accordance with a material private placement report to the Company's CEO as reported in the Company's immediate report dated December 25, 2007.

The bonus for 2008 (which is 83.3% of Mr. Benbenisti's annual salary for 2008) is based on compliance with the EBITDA target; pursuant to Bezeq International's financial statements for 2008.

Interested parties who receive remuneration from the Company

Rami Nomkin, an employee director, who serves as manager of the sales department, has been employed by the Company as a permanent transferred employee since 1966. All the remuneration paid to Mr. Nomkin is on account of his being a Company employee and not for his service as a Company director. Mr. Nomkin's total salary of NIS 566,850 is for 2008 and is linked to the professional salary tables. This salary includes a bonus for 2008 of NIS 18,660 which has not yet been paid, and which was determined in accordance with the criteria for all the Company's employees which are based on the Company's EBITDA results.

Yehuda Porat, an employee director, who serves as manager of the Company's security and safety department, is employed by the Company under a personal employment agreement dated October 29, 2007 (which was updated in March 2008). The agreement is for an unlimited period, and it may be terminated by either party at any time and for any reason with 3 months notice. All the remuneration (including options as set forth below) paid to Mr. Porat is on account of his being a Company employee and not for his service as a Company director. Mr. Porat's total salary of NIS 553,000 is for 2008 and is linked to the CPI. This salary includes a bonus for 2008 (which has not yet been paid) of NIS 85,000 which is subject to approval from the general meeting of Company shareholders which has not yet been convened. The bonus is determined in accordance with compliance with targets and the opinion of his manager.

On January 21, 2009 the Company's board of directors approved (after approval of the remuneration committee on January 4, 2009 and the audit committee on January 15, 2009) an allotment of 100,000 options to Mr. Porat, at an exercise price of NIS 5.9703 (adjusted for distribution of a dividend). The Black and Scholes value of all the options allotted to Mr. Porat is NIS 297,000. One third of the option warrants vest after one calendar year elapses after the grant date, another third of the option warrants vest after two calendar years elapse from the grant date and the final third of the option warrants vest after three calendar years elapse from the grant date. The option warrants are exercisable from the end of the vesting period of all the option warrants until five years elapse from the vesting date of the third portion. The allotment is subject to approval from the general meeting of the Company's shareholders which has not yet been convened, and all as set forth in the material private placement report which was reported in the Company's immediate report dated January 27, 2009.

Remuneration of two external directors is in accordance with the maximum tariffs (for an external director with expertise) determined in the Companies Regulations (Rules Concerning Remuneration and Expenses for an External Director), 2000, linked to the CPI as determined in mentioned regulations and which was updated in accordance with an amendment which took effect on March 6, 2008 and which was approved by the general meeting on June 1, 2008. The remuneration for 2008 for Dr Eyal Yaniv (who was appointed for three years from February 1, 2007) is NIS 289,406, and for Mr. Yitzhak Edelman (who was appointed for three years from January 31, 2008) is NIS 317,069 (including the reimbursement of travel expenses as approved by the general meeting of the Company's shareholders on September 28, 2008 and which was reported in the Company's immediate report on that date). Furthermore, in 2008 remuneration was paid in the amount of NIS 12,319 to the Company's former external director, Mr. David Blumberg, (who completed his service on February 1, 2008).

In the matter of management fees for Ap. Sb. Ar., see section 7B below.

7B. Transactions with controlling shareholders

Management fees for Ap. Sb. Ar.

For 2008 – NIS 4,238,000. On September 28, 2008 (after approval by the board of directors on July 31, 2008 and the audit committee on June 26, 2008) the general meeting of the Company's shareholders approved an extension of the agreement to provide management and consultancy services with Ap. Sb. Ar. Cayman L.P a corporation connected with Ap.Sb.Ar. Holding Ltd., a controlling shareholder in the Company, for an additional three-year period from January 1, 2009 through December 31, 2011, in consideration of US$ 1.2 million per annum, under the same conditions as the original agreement, as set forth in the immediate report published by the Company on August 13, 2008 pursuant to the securities regulations. In respect of this matter, see also note 29h to the financial statements.

8. Shares and Convertible Securities Held by Interested Parties in the Corporation, a Subsidiary or a Related Company, as Close as Possible to the Date of the Report

	Name of holder	Type of security	Number of convertible securities ratio 1:1	Number of Shares NIS1 p.v. each	Percentage of holding of control and equity	Number of NIS 1 p.v. shares fully diluted	Percentage of holdings fully diluted
1.	Zeevi Communications Holdings Ltd.[11]	Ordinary	-	459,331,617	17.63%	459,331,617	16.76%
2.	D.E. Dirot Elite Ltd.	Ordinary	-	3,097,697	0.12%	3,097,697	0.11%
3.	Ap. Sb. Ar. Holdings Ltd. through Romema Investments Co. Ltd.[12]	Ordinary	-	1,059,211,545	40.66%	1,059,211,545	38.64%
4.	Shlomo Rodav (chairman of the board of directors)[13]	Ordinary	9,000,000	-	0.33%	9,000,000	0.33%
5.	Ran Gottfried (director)	Ordinary		12,000	0.00%	12,000	0.00%
6.	Avi Gabbay[14](CEO)	Ordinary	5,250,000	20,600	0.00%	5,270,600	0.19%
7.	Rami Nomkin[15] (director)	Ordinary	57,625	-	0.00%	57,625	0.00%
8.	Yehuda Porat[16] (director)	Ordinary	42,981	-	0.00%	42,981	0.00%

9. Registered Capital, Issued Capital and Convertible Securities

- Registered capital 2,749,000,000 shares of NIS 1 par value each.
- Issued capital 2,605,045,611 shares of NIS 1 par value each, having equal rights.
- 78,151,368 options to employees for Company shares of NIS 1 par value each, in accordance with an outline dated February 22, 2007, were allotted on March 25, 2007 (including 59,574 options to two directors from the employees, which were allotted on January 2, 2008 in accordance with a private placement report dated October 29, 2007).
- In accordance with the option plans for senior managers and employees (2007) (on the basis of which 65,000,000 option warrants were allotted which the Company earmarked for exercise into up to 65,000,000 Company shares). As at the date of this report 59,550,000 options were allotted to employees for Company shares of NIS 1 par value each.
- There are no dormant shares.

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[11] On November 12, 2002, a receiver was appointed to this company, Adv. Alex Hartman, who is authorized to exercise the rights in respect of Bezeq's shares in accordance with the ruling and approval of the court. It should be noted that this company belongs to the Zeevi Group. Another company of the same group, D.E. Dirot Elite Ltd., (as specified in Section 2) also holds shares in Bezeq.

[12] On September 25, 2008, Ap. Sb. Ar. Holdings Ltd. acquired 277,697,862 ordinary Company shares from the State of Israel by means of full exercise of Ap. Sb. Ar.'s option by virtue of an agreement to acquire core control of the Company which was entered into by Ap. Sb. Ar and the State of Israel on October 11, 2005. The consideration for the exercise was NIS 1.08 billion. At the request of Ap. Sb. Ar. ownership of the acquired shares was registered in the name of Trust Company (Romema) Trustees Ltd. Following the exercise of said option the holdings of Ap. Sb. Ar. in the Company rose to 40.66% (38.64% with full dilution) and the percentage of the State's holdings decreased as a result thereof to 4.95% (0.96% with full dilution) and from that date the State ceased to be an interested party in the Company by virtue of its holdings.

[13] Options allotted to the chairman of the board of directors in accordance with a material private placement report of April 18, 2008 with the approval of the general meeting which was convened on June 1, 2008.

[14] On February 4, 2008, 5,250,000 options were allotted to the CEO in accordance with the private placement report of December 25, 2007.

[15] Options allotted to the employee director according to an outline dated November 15, 2005 and under an outline for employees dated February 22, 2007, subject to the approval of the general meeting which took place on December 26, 2007.

[16] Options allotted to the employee director according to an outline dated November 15, 2005 and under an outline for employees dated February 22, 2007, subject to the approval of the general meeting which took place on December 26, 2007. In addition on January 21, 2009, the Company's board of directors approved an allotment of 100,000 additional options which is subject to approval from the general meeting of the Company's shareholders which has not yet been convened.

10. Registered Address of the Corporation

Address: 132 Menahem Begin Street, Azrieli Center (The Triangular Tower), Tel Aviv.

Telephone 1: 03-6262200; Telephone 2: 03-6262201; Fax: 03-6262209

Email: linoryo@bezeq.co.il (Company Secretary)

11. Directors of the Corporation

A. (1) Name**: Shlomo Rodav** ID No. 030596860

(2) Date of Birth: October 27, 1949

(3) Address: 5 Kerem Hazeitim St., Savion

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Chairman of the Security Committee.

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: Yes

The director is Chairman of the Board of Directors (as of September 4, 2007).

(8) Date of commencement of tenure as a director: September 4, 2007

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

BA (Economics), Tel Aviv University.

MBA, Columbia University.

2003 - 2005 – chairman of the board of directors and CEO (2004 - 2005) of Gilat Satellite Networks Ltd.

1990 - 2007 – CEO, director and/or chairman of the board of directors of Kror Holdings Ltd. / Yafaora-Tavori Ltd. / Yafaora Ltd. / Tefogen Industries Ltd. / Whist Management Israel Ltd. / InirU Israel Ltd. / InirU Wireless Inc. / the Israel Shipping & Supply Corporation Ltd. / Nimphaea A.A. Ltd. / Turel Investments Ltd. Since August 2007, not acting as CEO and/or chairman of the board of directors of any of the above companies.

Chairman of the board of:

Bezeq International Ltd.

Pelephone Communications Ltd.

DBS Satellite Services (1998) Ltd.

Bezeq Online Ltd.

Walla! Communications Ltd.

Bezeq Zahav (Holdings) Ltd.

Member of the board of DBS Satellite Services (1998) Ltd.

(10) Related to an interested party in the Corporation: No

(11) The Company views the director as having accounting and financial expertise.

B. (1) Name: **Yitzhak Edelman** ID No. 50066174.

(2) Date of Birth: July 1, 1950

(3) Address: 4 Duchifat St., Tel Mond.

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Audit Committee, Balance Sheet Committee

(6) External Director: Yes

(7) Employee of the corporation, a subsidiary, related company or interested party: No

(8) Date of commencement of tenure as director: February 1, 2008

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

BA (Accounting and Economics), Tel Aviv University.

2005 - 2007 – Deputy CEO and VP Finances at Ness Technologies Ltd.

1996 - 2005 – Director of Finance Division at Cellcom.

Director of:

(10) Related to an interested party in the Corporation: No

(11) The Company views the director as having accounting and finance expertise

C. (1) Name: **Ran Gottfried** ID No. 006357206.

(2) Date of Birth: August 20, 1944

(3) Address: 64 Pinkas Street, Tel Aviv

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Audit Committee, Security Committee

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: No

(8) Date of commencement of tenure as director: November 24, 2005

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

Completed two years undergraduate degree studies in Economics and Social Sciences at Tel Aviv University.

From 2006 – 2009 – chairman of Power Paper Ltd.

From 2004 - 2006 – chairman of Careline-Neca

2003 – November 2005 CEO and partner, Magnolia Export Logistics Ltd.

2001 - November 2005 Chairman of the Board of Magnolia Silver Jewelry Ltd.

2000 - 2002 – Strategic adviser to cosmetic companies abroad.

1998 - 2000 – CEO and partner of NewPharm.

1995 - 2000 – CEO and partner of April Ltd.

Director of:

2003 - 2005 Director of Agis

Since 2006 Director of Frigo

(10) Related to an interested party in the Corporation: No

D. (1) Name: **David Gilboa** ID No. 51212587.

(2) Date of Birth: May 2, 1952

(3) Address: 9 Nahar Yarden St., Kiryat Ono

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Balance Sheet Committee

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: No

Accountant and Adviser of Moshe Arkin

(8) Date of commencement of tenure as a director: September 19, 2007

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

BA (Economics & Accounting), Tel Aviv University.

May 2008 – partner and senior manager in David Gilboa and Co., Accountants

2000 -2008: senior partner / manager – Chaikin, Cohen, Rubin and Gilboa, Certified Public Accountants.

Director of:

Bezeq International Ltd.

Bezeq Online Ltd.

David Gilboa & Co., Accountants

Gadad Consultancy and Investments (2006) Ltd.

(10) Related to an interested party in the Corporation: No

(11) The Company views the director as having accounting and finance expertise.

E. (1) Name: **Michael Grabiner** Passport No. 099096227

(2) Date of Birth: August 21, 1950

(3) Address: 35 Uphill Rd., London NW7 4RA, UK

(4) Citizenship: British

(5) Membership of Board of Directors Committees: No

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: Partner in Apax Partners Worldwide LLP.

(8) Date of commencement of tenure as a director: June 21, 2006

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

MA Economics and Politics, Cambridge University.

Partner, Apax Partners LLP

Director of:

Partnerships for Schools Ltd

Synetrix Holding Ltd

Pelephone Communications Ltd

Bezeq International Ltd

Ap. Sb. Ar. Cayman Ltd.

(10) Related to an interested party in the Corporation: Brother of director Steven Grabiner

F. (1) Name: **Steven Grabiner** Passport No. 024558479

(2) Date of Birth: September 30, 1958

(3) Address: 33 Jermyn St., London SW1Y 6DN, UK

(4) Citizenship: British

(5) Membership of Board of Directors Committees: No

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party:

Partner of Apax Partners Worldwide LLP, and head of Media Sector at Apax.

Acted as a director of the Company in the past, between October 11, 2005 and March 8, 2006, and acted several times as an alternate director.

(8) Date of commencement of tenure as a director: September 4, 2007

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

MBA, Manchester University.

Director of: Apax Partners Europe Managers Ltd

Apax Partners Worldwide LLP

Cloverhawk Ltd
ISC (International Sportsworld Communicators
Ap. Sb. Ar. Holdings Ltd
Yellow Green Finance & Investment Ltd
Purple Green Project & Investment Ltd

(10) Related to an interested party in the Corporation: Brother of director Michael Grabiner

G. (1) Name: **Dr. Eyal Yaniv** ID No. 05640644.

(2) Date of Birth: June 21, 1960

(3) Address: 38 Hakinor St., Petach Tikva

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Chairman of Audit Committee, Security Committee, Remunerations, Organization and Administration Committee.

(6) External Director: Yes.

(7) Employee of the corporation, a subsidiary, related company or interested party: No

(8) Date of commencement of tenure as director: February 1, 2007

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

BA Psychology and Computer Science, Bar Ilan University.

MA Psychology, Bar Ilan University.

Ph.D. Business Administration, Bar Ilan University.

LL.M., Kiryat Ono Academic College.

Until 2002, CEO of Non-Stop.

From 2002 – Strategic Marketing Adviser and Personal Management Coach

From 2003 – Head of Executive MBA Program and lecturer in Business Administration (Strategy, Enterprise and Marketing) at Bar Ilan University and at Hebrew University.

Director of other corporation: Logray Technology Ltd.

(10) Related to an interested party in the Corporation: No

(11) The Company views the director as having accounting and finance expertise.

H. (1) Name: **Zehavit Cohen** ID No. 058344797.

(2) Date of Birth: November 16, 1963

(3) Address: 4 Berkowitz St., Museum Tower, Tel-Aviv.

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Member of Audit Committee

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: CEO of Apax Partners Israel Ltd.

(8) Date of commencement of tenure as a director: June 21, 2006

(9) Education and employment during the past five years and details of the corporations in which she serves as director:

BA Accounting, Duquesne University
MBA - University of Pittsburgh
MA ABD Accounting, Wharton School of Management, University of Pennsylvania
From 1988 – Lecturer in Finance and Accounting, Wharton School of Management, University of Pennsylvania
From 1998 – Deputy CEO and Chief Financial Officer, IDB Development Company Ltd.
From 2003 - Chief Financial Officer, IDB Holdings Company Ltd.
From 1998 – Deputy CEO and Chief Financial Officer, IDB Holdings Company Ltd.
From 2006 – CEO, Apax Partners Israel Ltd.
Director of:
Tnuva Food Industries - Agricultural Cooperative Association in Israel Ltd.
Tnuva Cooperative Center for the Marketing of Agricultural Produce in Israel Ltd.

Yellow Green Finance & Investment Ltd.
Purple Green Project & Investment Ltd.
Ap. Ms. Tn. Holdings Ltd.
Am. Tn. Ap. P. Ltd.
Ap. Tn. Ltd.
Genetrix
Mabat – Fresh Meat Ltd.

(10) Related to an interested party in the Corporation: No

(11) The Company views the director as having accounting and finance expertise.

I. (1) Name: **Rami Nomkin** ID No. 042642306

(2) Date of Birth: January 14, 1949

(3) Address: 126 Mohliver Street, Yahud

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Balance Sheet Committee

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: The director is manager of the sales department.

(8) Date of commencement of tenure as director: January 17, 2007

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

High School Education

From 2009 - manager of Bezeq's sales department.

From 2001 - Business Center Manager at Bezeq Business

Until October 11, 2005 served as employee director.

Director of other corporation: No

(10) Related to an interested party in the Corporation: No

J. (1) Name: **Arieh Saban** ID No. 064902083

(2) Date of Birth: May 2, 1947

(3) Address: 59 Kaplan Street, Herzliya

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: No

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: No

(8) Date of commencement of tenure as director: October 11, 2005

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

From 2001 – partner in the Fox Kids Channel. All holdings were sold in December 2002.

For 15 years distributed and marketed children's television programs through Israel Audio Visual Corp.

Director of:

Bezeq International Ltd.

DBS Satellite Services (1998) Ltd.

(10) Related to an interested party in the Corporation: Yes

Brother of Haim Saban. Haim Saban is the controlling shareholder of SCG Israel Ventures LLC, which holds 45% of the capital and 40.5% of the voting rights in Ap. Sb. Ar. Holdings Ltd. Ap. Sb. Ar. Holdings Ltd. holds 30% of the Company's share capital (which is held in trust by Romema Investment Company Ltd.).

K. (1) Name: **Menahem Inbar*** ID No. 000483982

(2) Date of Birth: September 3, 1948

(3) Address: 5 Hagilad St., Ramat Gan

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Remuneration, Organization and Administration Committee

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party:

The Director assists Moshe Arkin, an interested party in the Company, with management of his investments.

(8) Date of commencement of tenure as director: October 11, 2005

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

BA Social Sciences, Bar Ilan University.

MA Law, Bar Ilan University.

Since 2000 – managing partner at Schifman-Inbar Ltd.

Director of:

DBS Satellite Services (1998) Ltd.

Pelephone Communications Ltd.

Alrov Israel Ltd.

Arkin Communications Ltd.

Schifman-Inbar Ltd.

Mobile Solid Ltd.

Carmel Investment Group Ltd.

Sphera Global Healthcare

Poalei Agudat Israel Bank Ltd.

HealOr Ltd.

(10) Related to an interested party in the Corporation: No

(11) The Company views the director as having accounting and finance expertise.

* The director holds 3% of the shares of Arkin Communications Ltd.

L. (1) Name: **Yehuda Porat** ID No. 059769455

(2) Date of Birth: February 18, 1968

(3) Address: 2 Mevo Haro'im, Har Adar 90836

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: (Observer on Security Committee pending amendment of articles of association and license)

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: Manager of the Security, Safety and Emergency Department of the Company.

(8) Date of commencement of tenure as director: January 17, 2007

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

LL.B., Kiryat Ono Academic College.

Practical Electronic Engineer, Bezeq College, Jerusalem

Member of the Israel Bar Association

Bugging Location and Detection course given by an external advisor to the Security Services

Bugging Detection course – R.E.I., USA

Basic Data Protection for Security Officers course – General Security Services

Interrogation course – General Security Services

Directors in Private and Public Companies course - The Israeli Center for Management

Advanced Directors course - The Israeli Center for Management

Analysis of Financial Reports and Corporate Value Assessment course - The Israeli Center for Management

Qualified Mediator course – Israel Bar Association

From 1999 - Manager of Bezeq's Bugging Detection and Special Jobs Department

Until October 11, 2005 served as employee director

(10) Director of other corporation: No

(11) Related to an interested party in the Corporation: No

M. (1) Name: **Adam Chesnoff*** ID No. 022113597

(2) Date of Birth: November 15, 1965

(3) Address: 10100 Santa Monica Blvd. Los Angeles, California 90067, U.S.A

(4) Citizenship: Israeli and American

(5) Membership of Board of Directors Committees:

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party:
Is a director of SCG Israel Ventures LLC, which holds 45% of the capital and 40.5% of the voting rights in Ap. Sb. Ar. Holdings Ltd. Ap. Sb. Ar. Holdings Ltd. holds 40.5% of the share capital of the Company (which is held in trust by Romema Investment Company Ltd.). The director holds 2% of SCG Israel Ventures LLC.

(8) Date of commencement of tenure as director: September 19, 2007
Acted in the past as director of the Company between October 11, 2005 and September 4, 2007.

(9) Education and employment during the past five years and details of the corporations in which he serves as director:
BA Economics and Management, Tel Aviv University
MBA, School of Business, UCLA
Since 2001, President of Saban Capital Group.
Director of:
Saban Capital Group (f/k/a KSF Corporation.) (Inc. in Delaware, USA).
Broadcast Media Partners, Inc. (inc. in Delaware, USA).
Broadcast Media Partners Holdings (inc. in Delaware, USA).
Univision Communications (inc. in Delaware, USA).
Saban Music Group Inc. (inc. in California, USA).
Far East Innovative Investment B.V. (inc. in the Netherlands).

(10) Related to an interested party in the Corporation: No

(11) The Company views the director as having accounting and finance expertise.
* Adam Chesnoff holds 2.025% of SCG Israel Ventures LLC.
SCG Israel Ventures LLC holds 45% of the capital and 40.5% of the voting rights in Ap. Sb. Ar. Holdings Ltd. Ap. Sb. Ar. Holdings Ltd. holds 40.66% of the share capital of the Company (which is held in trust by Romema Investment Company Ltd.).

N. (1) Name: **Kihara R. Kiarie** Passport No. 039101782

(2) Date of Birth: May 16, 1974

(3) Address: 10100 Santa Monica Blvd. Los Angeles, California 90067, U.S.A

(4) Citizenship: American

(5) Membership of Board of Directors Committees: Balance Sheet Committee

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: Is an officer (director) of Saban Capital Group, a company which has indirect holdings in Ap. Sb. Ar. Holdings Ltd.

(8) Date of commencement of tenure as director: November 24, 2005

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

B.Ec., Dartmouth College.

MBA, Harvard Business School.

2003-2006 – Saban Capital Group (Director).

1999-2001 – Associate (partner) in AEA Investors.

Director of:

2003 – 2006 Saban Capital Group

(10) Related to an interested party in the Corporation: No

O. (1) Name: **Yoav Rubinstein** Identity No. 16447153

(2) Date of Birth: May 17, 1973

(3) Address: Apartment 28, 2 Kehilat Venezia Street, Tel Aviv

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Chairman of Remuneration and Organization Committee, Balance Sheet Committee, Committee to Negotiate with Former CEO.

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: The director is a consultant for Apax Partners.

(8) Date of commencement of tenure as a director: June 21, 2006

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

BA Business Administration, Interdisciplinary Center

From 2009 – consultant for Apax Partners

From 2000 - Investment Manager, Apax Partners

Director of:

DBS Satellite Services (1998) Ltd.

Walla! Communications Ltd.

Yellow Green Finance & Investment Ltd

Purple Green Project & Investment Ltd

Ap. Sb. Ar. Holdings Ltd.

Ap. Sb. Ar. Cayman Ltd.

Genetrix

(10) Related to an interested party in the Corporation: No

(11) The Company views the director as having accounting and financial expertise.

P. (1) Name: **Elon Shalev** ID No. 050705276.

(2) Date of Birth: July 26, 1951

(3) Address: 70 Yehoshua Bin Nun Street, Tel Aviv.

(4) Citizenship: Israeli

(5) Membership of Board of Directors Committees: Audit Committee, Remunerations Organization & Administration Committee

(6) External Director: No

(7) Employee of the corporation, a subsidiary, related company or interested party: No

The director provides services to SCG Israel Ventures LLC which is a company indirectly controlled by Haim Saban.

Acted as a director of the Company in the past, between October 11, 2005 and March 8, 2006, and acted several times as an alternate director.

(8) Date of commencement of tenure as a director: September 4, 2007

(9) Education and employment during the past five years and details of the corporations in which he serves as director:

BA Political Science, Tel Aviv University.

Entrepreneur and Consultant

Director of:

Bezeq International Ltd.

DBS Satellite Services (1998) Ltd.

Shachal Medical Services Ltd. and its subsidiaries.

Logia Group Ltd. and its subsidiaries.

(10) Related to an interested party in the Corporation: No

12. Senior Officers of the Corporation

A. (1) Name: **Abraham Gabbay** ID No. 59777920

(2) Date of Birth: February 22, 1967

(3) Date of Commencement of Office: November 14, 2007

(4) Position in the Company: CEO

(5) Is he an interested party or related to a senior officer or to any interested party: Yes Interested party in the Corporation by virtue of his service as Company CEO.

Education and business experience over the past five years:

MBA, Hebrew University

6/07-11/07 – Acting CEO of Bezeq, The Israel Telecommunications Corp. Ltd.

7/03-6/07 – CEO Bezeq International

11/00-6/03 – VP Economics and Strategy

B. (1) Name: **Ran Guron** ID No. 024113268

(2) Date of Birth: December 25, 1968

(3) Date of Commencement of Office: January 9, 2006

(4) Position in the Company: VP Marketing

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

BA Economics and Business Administration, Hebrew University

MBA, Hebrew University

2003 - 2005 VP Marketing, Barak

1997 - 2002 VP Marketing Business Sector, Cellcom

C. (1) Name: **Alan Gelman** ID No. 015704307

(2) Date of Birth: November 5, 1955

(3) Date of Commencement of Office: February 15, 2008

(4) Position in the Company: CFO and Deputy CEO

Position in a subsidiary of the Company, in a related company or in an interested party of the Company:

Director of:

Pelephone Communications Ltd.

Walla! Communications Ltd.

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years:

B A., Queens College, NY

MBA, Hofstra University, NY

Certified Public Accountant in Israel.

CPA in the State of NY

2007 – CFO and Deputy CEO of Delek Group.

2001-2006 – CFO at Partner Communications Ltd.

D. (1) Name **Malka Dror** ID no. 056524358

(2) Date of Birth: July 7, 1960

(3) Date of Commencement of Office: June 28, 2007

(4) Position in the Company: Chief Internal Auditor

(5) Is she an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

BA Economics, Hebrew University

CISA qualification for the position of Controller of Computer Systems

Course in auditing and information systems security

Course in information systems analysis

6/07-8/06 acting internal auditor

12/04-8/06 - Manager, Audit Department and Deputy Internal Auditor – Bezeq

E. (1) Name **Guy Hadass** ID No. 029654472

(2) Date of Birth: September 8, 1972

(3) Date of Commencement of Office: December 9, 2007

(4) Position in the Company: Company spokesperson

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

BA Economics and Media, Hebrew University

MBA Tel Aviv University

2002-2007 – Globes [Israeli financial newspaper] journalist

F. (1) Name: **Itamar Harel** ID No. 028054666

(2) Date of Birth: October 18, 1970

(3) Date of Commencement of Office: October 25, 2007

(4) Position in the Company: VP, Manager of Private Division

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

BA Economics and Business Administration, Hebrew University

2002-2007 – Manager of Private Marketing Department and Manager of Private and Medium and Small Business Sales and Services Department at Bezeq

G. (1) Name: **Linor Yochelman** ID No. 032037939

(2) Date of Birth: February 11, 1975

(3) Date of Commencement of Office: August 19, 2007

(4) Position in the Company: Company Secretary

Position in a subsidiary of the Company, in a related company or in an interested party of the Company:

Company secretary of subsidiaries: Bezeq International Ltd.; Bezeq Online Ltd.; Bezeq Zahav Holdings Ltd.

(5) Is she an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

BA Business Administration, Interdisciplinary Center, Herzliya

LLB, Interdisciplinary Center, Herzliya.

2005-2007 Company secretary of The Phoenix Holdings Ltd.

2002-2005 – Assistant to Chief Judge of the Local Court, Tel Aviv.

H. (1) Name: **Ehud Mezuman** ID No. 052176336

(2) Date of Birth: February 17, 1954

(3) Date of Commencement of Office: October 25, 2007

(4) Position in the Company: VP Human Resources

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years:

3 years studies at Tel Aviv University – Social Sciences (no degree)

2005-2007 – Deputy VP Human Resources and Director of Management Development Department

2001-2005 – Director of Management Development & Training Department, Bezeq.

I. (1) Name**: Dudu Mizrachi** ID No. 024810368

(2) Date of Birth: January 28, 1970

(3) Date of Commencement of Office: June 28, 2007

(4) Position in the Company: VP Economics & Budgets

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

BA Economics, Hebrew University

2000-2007 – Director of Regulations Department at Bezeq

J. (1) Name**: Amir Nachlieli** ID No. 23012313

(2) Date of Birth: May 30, 1967

(3) Date of Commencement of Office: January 1, 2009

(4) Position in the Company: VP Legal Advice

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

2007-2008 – Legal adviser to Colmobil Ltd.

2005-2006 – Business Development, YaGusa Technology

2002-2004 - Legal adviser to Bezeq International (on behalf of Yossi Levi and Co. Law Office)

1995-2004 – Partner and lawyer in Yossi Levi and Co. Law Office

MBA (expanded major in Finance), Tel Aviv University

BA Economics, Hebrew University

LLB, Hebrew University

K. (1) Name: **Danny Oz** ID No. 054299953

(2) Date of Birth: June 16, 1956

(3) Date of Commencement of Office: September 1, 1998

(4) Position in the Company: Accountant and Deputy CFO.

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years:

BA Economics & Accounting, Hebrew University, Certified Public Accountant's License.

EMBA – Integrative Administration, Hebrew University

Since September 1998 – Company Accountant

L. (1) Name: **Yaakov Paz** ID No. 058610999

(2) Date of Birth: October 21, 1963

(3) Date of Commencement of Office: November 1, 2007

(4) Position in the Company: VP, Manager of Business Division

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

Since 2006 – Chairman of board of directors of Alcatel Telecom Israel Ltd.

2006 – CEO, DoubleU Advanced Mobile Solutions

2002-2006 – CEO and Chairman of Alcatel Telecom Israel Ltd.

M. (1) Name: **Sharon Fleischer Ben Yehuda** ID No. 028531648

(2) Date of Birth: April 25, 1971

(3) Date of Commencement of Office: June 1, 2006

(4) Position in the Company: VP Regulation

(5) Is she an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

BA Political Science, Hebrew University,

MA Public Policy and Administration, Hebrew University

Until May 31, 2006 – VP Regulation at Pelephone Communications Ltd.

2001-2005 – Manager, Regulation and Government Relations Department, Pelephone Communications Ltd.

1995-2001 – Senior Adviser to Director General at Ministry of Communications.

N. (1) Name: **Eli Frank** ID No. 053337739

(2) Date of Birth: July 6, 1955

(3) Date of Commencement of Office: September 19, 2006[17]

(4) Position in the Company: VP Information Systems

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

MBA, Tel Aviv University

BA Mathematics and Computer Science, Bar Ilan University.

Professional qualifications (Programming, Systems Analysis, etc.) MaMr.am [IDF Central Computing Facility]

Since 2004, information strategy and management consultant (freelance)

12/03-6/04 – VP and Department Manager Ness Information Technology Services Group

1999-2003 – VP CRM Systems Supply and Billing Division, Amdocs

O. (1) Name: **Yuval Keinan** ID No. 032089245

(2) Date of Birth: February 23, 1975

(3) Date of Commencement of Office: August 1, 2007

(4) Position in the Company: VP Engineering and Networks Division

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years:

BA Computer Science, Merci College

2005-2007 – VP Information Technologies (Engineering and Information Systems) at Bezeq International Ltd.

2003-2005 – Director, Engineering Operations, Bezeq International Ltd.

P. (1) Name: **Eyal Kamil** ID No. 057248999

(2) Date of Birth: August 30, 1961

(3) Date of Commencement of Office: December 05, 2006

(4) Position in the Company: VP Operations & Logistics

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years

BA, Industrial Engineering & Management, Tel Aviv University

MBA, Tel Aviv University

2005 – December 4, 2006 – Manager, Change Administration, Bezeq.

2001-2005 – Manager, Organization and Methods Department, Pelephone Communications Ltd.

Q. (1) Name: **Gil Sharon** ID No. 058381351

(2) Date of Birth: September 12, 1963

(3) Date of Commencement of Office: October 11, 2005

(4) Position in the Company: CEO of the subsidiary Pelephone Communication Ltd.

(5) Is he an interested party or related to a senior officer or to any interested party: No

(6) Education and business experience over the past five years:
BA Economics and Business Management, Hebrew University
MBA Tel Aviv University
2001-2005 Deputy CEO Pelephone Communication Ltd.

Bezeq International Ltd.

R. (1) Name: **Yitzhak Benbenisti** ID No. 059146415
(2) Date of Birth: January 21, 1965
(3) Date of Commencement of Office: November 11, 2007
(4) Position in the Company: CEO of the subsidiary Bezeq International Ltd.
(5) Is he an interested party or related to a senior officer or to any interested party: No
(6) Education and business experience over the past five years:
BA Economics, Hebrew University
MBA (major in finance and marketing), Hebrew University
May-November 2007 – acting CEO Bezeq International Ltd.
2003-2006 – Hewlett – Packard Israel – director and CEO of the personal computer and distribution channel division

DBS Satellite Services (1998) Ltd.

S. (1) Name: **Ron Eilon** ID No. 059211722
(2) Date of Birth: May 27 1965
(3) Date of Commencement of Office: August 28, 2006
(4) Position in the Company: CEO of the subsidiary DBS Satellite Services (1998) Ltd.
(5) Is he an interested party or related to a senior officer or to any interested party: No
(6) Education and business experience over the past five years
MBA Hebrew University
BA Economics, Hebrew University
MBA Finance and Accounting, Hebrew University
2003-2006 VP Finance, Bezeq Group
1999-2003 VP Finance, Mirs

The Corporation has no independent signatories.

Following are the names of the senior officers who completed their term of service during the course of 2008 and by the date of publication of the periodic report for 2008:

Directors:

David Blumberg – completed his tenure on February 1, 2008.

Senior officers who are not directors:

Ran Oz – completed his tenure as Deputy CEO and CFO on February 15, 2008.

Eli Mizroch – completed his tenure on August 25, 2008

Bosmat Chelouche – completed her tenure on December 31, 2008.

13. The Auditors of the Corporation

KPMG Somekh Chaikin – Certified Public Accountants (Isr.)
Address: 17 Ha'Arba'a Street
Millennium Tower KPMG Tel Aviv 64739, Tel: 03-684-8000

14. Change in the Memorandum or Articles of Association

On September 28, 2008 articles 95.3, 103.1 and 118 were amended as set forth in section 17.4 below.

15. Recommendations and Resolutions of the Directors Prior to the General Meeting and their Resolutions which are not Subject to the Approval of the General Meeting

15.1 March 10, 2008 – to recommend to the general meeting of shareholders of the Company to pay the shareholders of the Company a cash dividend in the total amount of NIS 679 million, representing NIS 0.2606480 per share and 26.06480% of the issued and paid-up share capital of the Company. The rate of the dividend that shall actually be paid shall be determined in accordance with the issued and paid-up share capital of the Company.

15.2 April 17, 2008 - to recommend to the general meeting of shareholders of the Company to amend the Company's articles (articles 95.3, 103.1, 118) as set forth in the immediate reports of April 18, 2008 and June 1, 2008.

15.3 July 31, 2008 - to recommend to the General Meeting to increase the registered capital of the Company by 251,000,000 ordinary shares of NIS 1 par value each, which shall have rights equal to those of the Company's ordinary shares of NIS 1 par value and to amend the Memorandum of Association accordingly. A general meeting has not yet been convened in respect of this matter.

15.4 August 20, 2008 - to recommend to the general meeting of shareholders of the Company to pay the shareholders of the Company a cash dividend in the total amount of NIS 835 million, representing NIS 0.3205318 per share and 32.05318% of the issued and paid-up share capital of the Company. The rate of the dividend that shall actually be paid shall be determined in accordance with the issued and paid-up share capital of the Company.

15.5 March 23, 2009 - to recommend to the general meeting of shareholders of the Company to pay the shareholders of the Company a cash dividend in the total amount of NIS 792 million, representing NIS 0.3040254 per share and 30.40254% of the issued and paid-up share capital of the Company. The rate of the dividend that shall actually be paid shall be determined in accordance with the issued and paid-up share capital of the Company.

15.6 In the matter of exceptional transactions see section 17.1.

16. Resolutions of a Special General Meeting

16.1 **Approval of issue of options (and shares deriving from exercise thereof) to senior management of the Group in accordance with the option plan under which up to 65,000,000 options, exercisable for 65,000,000 ordinary shares of NIS 1 par value each, constituting approximately 2.5% of the issued share capital of the Company (approximately 2.36% on full dilution) shall be issued, as follows**:

A. Issue of up to 41,350,000 options (and shares deriving from exercise thereof) exercisable for 41,350,000 ordinary shares of NIS 1 par value each to offerees in accordance with the outline published by the Company on December 25, 2007 and to the CEO of the Company under a private placement published by the Company on the same date.

B. Issue of the balance of the options in the plan included in the reserve under the plan (and the shares deriving from exercise thereof), and re-issue of all of the options issued under sub-section (A) above, which shall be included in the future in the reserve if not exercised (resolution of January 30, 2008).

16.2 **Approval of appointment and conditions of office of Mr. Yitzhak Edelman as external director for a period of three years (resolution of January 31, 2008).**

16.3 **Approval of extension of the agreement to provide management and consultancy services with Ap. Sb. Ar. Cayman L.P. (the "Management Company"),** a corporation linked to Ap. Sb. Ar. Holdings Ltd. ("Ap. Sb. Ar.") the controlling shareholder in the Company, for a period of three additional years from January 1, 2009 to December 31, 2011, under the terms of the original agreement, as set forth in a report pursuant to the Securities

Regulations (Transaction between a Company and its Controlling Shareholder) 5761 – 2001 which the Company published on August 13, 2008 (resolution of September 28, 2008).

16.4 **Approval of amendment to the Company's Articles (articles 95.3, 103.1 and 118), as follows**:

A. Article 95.3 of the Articles will be amended so that the following sentence will be added at the end: "The chairman of the board of directors will also be authorized to call an urgent discussion as mentioned above even without the agreement of all the directors up to four times a year or with the agreement of at least 75% of the directors an unlimited number of times".

B. Article 103.1 of the Articles will be amended as follows: "The Company's board of directors will appoint from among its classified members a security committee. The chairman of the board of directors will serve on the committee as the chairman of the security committee. Notwithstanding that set forth in article 101, in the event that the votes are tied, the chairman of the board of directors will have an extra vote".

C. Article 118 of the Articles will be amended so that the words: "or together with the CEO, as applicable" will be deleted, and it will be clarified that this relates to an officer who is not a director. The wording will be as follows: "Subject to the provisions of the Companies Law, a transaction of a company with an officer who is not a director, including the transaction/retirement terms, which is not an exceptional transaction, will be approved by the board of directors or by a committee which will consist of board members only". (Resolution of September 28, 2008).

16.5 Approval of an amendment to the agreement for the employment of the chairman of the board of directors – vehicle maintenance, as follows:

The wording of section 9.4 of the personal employment agreement of April 29, 2008 between Bezeq and Mr. Shlomo Rodav will be replaced by the following wording:

A) No later than ten days after approval from the competent entities in the Company of this agreement has been received, pursuant to section 22 hereunder, Bezeq will repay to the chairman the full value of the ancillary terms as set forth in sections 9.1 and 9.3 above for the period between September 4, 2007 and the end of the calendar month preceding the month in which such payment was granted.

B) Bezeq will also reimburse the chairman for his vehicle maintenance expenses based on price group 7 gross B (multiplied by the kilometers traveled) of the updated State Comptroller tariff. This is for the period from September 4, 2007 until Bezeq made a vehicle available to the chairman as set forth in section 9.2 above. The reimbursement mentioned in this subparagraph will be made no later than ten days after receipt of approval from the competent entities in the Company of the amendment to this article". (Resolution from September 28, 2008.)

16.6 Approval of reimbursement of travel expenses for external directors as follows:

To approve that in addition to compensation for the external directors in the maximum amount determined in the articles (which was approved by the general meeting of the Company on June 1, 2008), external directors are also entitled to receive reimbursement of travel expenses for their participation in board meetings and committees, insofar as the meetings are held outside the area in which an external director resides.

The reimbursement of the expenses will be in accordance with the State Comptroller tariff for variable expenses only and will vary depending on the value category of the vehicle used by the external director. This tariff includes travel expenses only and does not include vehicle maintenance expenses. The Company will compensate for these expenses by grossing them up fully. (Resolution of September 28, 2008.)

16.7 Approval of distribution of a cash dividend to the Company's shareholders in the total amount of NIS 835 million, which on the distribution date represents NIS 0.3205318 per share and 32.05318% of the issued paid-up capital of the Company. (Resolution of September 28, 2008.)

16.8 Approval of grant of indemnity for the deputy CEO and CFO Alan Gelman, with wording identical to the deed of indemnity granted to the other officers in the Company. (Resolution of September 28, 2008.)

17. Transactions Requiring Special Approvals

17.1 April 17, 2008

The board of directors approved employment terms of Mr. Shlomo Rodav as chairman of the Company's board of directors, as set forth in the immediate report of April 18, 2008.

17.2 On June 26, 2008

The board of directors approved payment of a special bonus to the legal counsel at a minimum amount of NIS 250 thousand and maximum amount of NIS 500 thousand.

17.3 March 23, 2009

The board of directors approved the grant of bonuses to the chairman of the board of directors and the CEO of Pelephone Communication Ltd. and the CEO of Bezeq International Ltd. as set forth in section 7A above and also the grant of bonuses to VP Marketing (NIS 435,000), VP Economics (NIS 370,000) and VP Engineering and Network (NIS 380,000).

18. Valid Insurances and Indemnities

Insurance

A resolution from May 16, 2005 regarding approval of the exercise of an option for the purchase of a run-off policy covering the liability of Company officers by virtue of which a run-off insurance policy was issued covering the liability of officers who served in the Company until the date of transfer of control, October 11, 2005, for a period of seven years from said date.

Resolution of August 3, 2005 regarding the extension of an officers' insurance policy including the run-off option, for a period of up to four months.

Resolution of December 26, 2007 regarding approval of purchase of insurance policies to cover liability of officers of the Company for a period of one year from October 11, 2007 with a liability ceiling of up to $ 150 million per claim and total for the entire insurance year. In addition, up to $ 30 million per claim and for total claims for the insurance period for legal expenses in Israel alone. Liability ceiling for subsidiaries – up to $ 50 million (as part of the aforesaid liability ceiling). Annual premium of up to $ 510,000 (resolution of December 26, 2007).

Resolution of December 26, 2007 regarding approval of "framework agreement" for the company's contracting in the ordinary course of its business in future insurance policies (following expiry of the current policy set out in sub-section (1) above) to cover the liability of directors and officers, as may be applicable from time to time, including directors and officers of companies in which the Company holds more than 50%, officers acting for the Company in companies in which the Company holds 20% or more and senior employees who are not officers regarding administrative acts done by them all via a "framework transaction" as defined in the Companies (Relief in Transactions with Interested Parties) Regulations, 5760-2000, at an annual premium in the sum of up to $ 510,000 plus a sum of up to 20% of the aforesaid premium for the sum of the current insurance premium.

Resolution of October 30, 2008 regarding the extension of a liability insurance policy for Company officers as part of a "framework agreement" which was approved by the general meeting of Company shareholders on December 26, 2007, for a period of one year from October 11, 2008 with the option of extending the policy until December 31, 2009. The liability ceiling of $ 100 million per claim and total for the entire insurance year. In addition, a liability ceiling of $ 30 million per claim and total claims for the insurance period for legal expenses in Israel alone. Liability ceiling for subsidiaries – up to $ 50 million (as part of the aforesaid liability ceiling). Total annual premium for the policy $ 369,000.

Indemnification

A resolution of January 17, 2007 concerning approval of the granting of an undertaking to indemnify in accordance with the Note to an undertaking to indemnify for each Company officer in respect of any liability or expense imposed on him by actions taken in his capacity as a Company officer (including his actions in subsidiaries), is within the limits laid down by the Companies Law. The amount of indemnification is capped at 25% of the Company's share capital as it shall be when the indemnification is granted. The undertaking to indemnify shall apply to a list of types of occurrences which is attached to the Note to an undertaking to indemnify which is attached to the immediate report

concerning the convening of a General Meeting to approve the granting of an indemnification commitment. During 2007–2008 and until the date of publication of this report, grant of indemnification was also approved for new officers who joined the Company.

It should be noted that in the past, the Company granted indemnity to officers in the following areas:

A. An undertaking to indemnify in respect of an allotment of shares, in all matters relating to the framework agreement from January 13, 2002.

B. An advance undertaking to indemnify for any expense or financial liability which is imposed on an officer following a proceeding filed against him in respect of the Company's prospectus from May 2004.

C. An advance undertaking to indemnify Company officers who served in the Company at the time the undertaking to indemnify was made or who were in office during the seven years preceding that date, for any expense or financial liability imposed on an officer due to a claim by a shareholder who held, at any time during the fours years preceding the date on which the undertaking to indemnify was given, 15% and more of the issued share capital of the Company.

D. An undertaking to indemnify to Company officers who served in the Company at the time an undertaking to indemnify was made or who were in office during the seven years preceding that date, to grant a loan for financing reasonable litigation expenses in a proceeding in which an officer is sued by another person, including a derivative action. The loan will become a grant if a competent court does not impose liability on the officer in a rule absolute.

E. The grant of an undertaking to officers that the insurance cover for events covered by an officers' insurance policy, which the Company purchased in July 2003, will be maintained for seven years, provided that the cost of the insurance premium is reasonable.

F. An undertaking to indemnify from April 6, 2005 for financial liability imposed on Company officers for reasonable litigation expenses incurred by them in all matters pertaining directly or indirectly to a sale of state holdings in the Company.

G. An undertaking from May 16, 2005 to indemnify Company officers who were in office during the seven years preceding the date of completion of the sale in the Company.

Date	Bezeq The Israel Telecommunication Corp. Ltd.

Names and titles of signatories:

Shlomo Rodav – Chairman of the Board

Abraham Gabbay – CEO