November 1, 2010

"Bezeq" The Israel Telecommunication Corp. Limited

Quarterly Report for the period ending Sept 30, 2010

Update of Chapter A (Description of Company Operations) of the Periodic Report for 2009

Directors' Report on the State of the Company's Affairs for the period ended Sept 30, 2010

Condensed Interim Consolidated Financial Statements as at Sept 30, 2010

UPDATE OF CHAPTER A (DESCRIPTION OF THE COMPANY'S BUSINESS)[1]
OF THE PERIODIC REPORT FOR 2009 ("THE PERIODIC REPORT")
OF "BEZEQ" – THE ISRAEL TELECOMMUNICATION CORP. LTD. ("THE COMPANY")

In this report, which contains an update of the chapter "Description of the Company's Business" from the 2009 Periodic Report, the Company has included, concerning itself and with regard to the market, forward-looking information as defined in the Securities Law, 5728-1968 ("the Securities Law"). Such information includes, inter alia, forecasts, objectives, assessments and estimates relating to future events or matters, the realization of which is not certain and is beyond the Company's control. Forward-looking information in this report will usually be identified specifically, or by statements such as "the Company expects", "the Company assesses", "it is the Company's intention", and similar phrases.

Forward-looking information is not proven fact and relies 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, which contained no undertaking as to the correctness or completeness of the information in them, and which were not checked independently by the Company for their correctness. The Company's assessments vary from time to time, depending on circumstances.

In addition, the occurrence and/or non-occurrence of the forward-looking information will be affected by factors that cannot be assessed in advance and are not within the Company's control, including the risk factors that characterize its operations, the developments in the general environment, and the external factors and the regulation that affect the Company's operations.

1. Description of General Development of Bezeq Group Operations

For Section 1.1 – Group Activity and Description of its Business Development

Regarding the chart describing the structure of holdings in the Company and the Company's holdings in its subsidiaries and affiliates: for closing the transaction for sale the core control of Ap.Sb.Ar. Holdings, Ltd. ("Ap.Sb.Ar.") to B Communications, Ltd.[2] ("B Communications"), see the update to Section 1.3.1(a) below. On the purchase of shares in Walla! Communications Ltd. ("Walla") by Bezeq International, Ltd. ("Bezeq International") and a tender offer of Bezeq International to purchase additional shares in Walla and purchase of all of Bezeq International's shares in Walla by the Company, see the update to Section 1.1.2 below.

The Company's policy of immediate reporting is based on considerations of quality and of quantity. In October 2010, the Company decided to the bar of quantitative materiality for immediate reporting on an event outside the corporation's business, commencing October 1, 2010. The decisions states that quantitative bar of materiality for events that affect net profit will be an effect of 5% or more on the net profit of Bezeq from continuing operations according to the most recent approved annual financial statements (approximately NIS 100 million in the annual financial statements for 2009).

Section 1.1.2 – Mergers and Acquisitions

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

On June 23, 2010, the Company received notification from Eurocom D.B.S. Ltd. ("Eurocom DBS"), a shareholder in DBS, stating that Eurocom DBS had entered into agreements to purchase all the holdings and rights of other shareholders in DBS,[3] and that in accordance with the Articles of Association of DBS and the DBS shareholders agreement, it is proposing that the Company exercise its right of first refusal. Subsequently, the Company gave notice that it has decided not to exercise the

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[1] The update is pursuant to Article 39A of the Securities (Periodic and Immediate Reports) Regulations, 5730-1970, and includes material changes or innovations that have occurred in the Company's business in any matter which must be described in the Periodic Report. The update relates to the Company's periodic report for the year 2009, and refers to the section numbers in Chapter A (Description of the Company's Business) in that periodic report.

[2] On March 16, 2010, 012 Smile Communications changed its name to B Communications Ltd.

[3] The other shareholders are Gilat D.B.S. Ltd., Lidan Investment Agencies (1994) Ltd. and Polar Communications Ltd. Subsequently, Eurocom DBS also gave notice of the execution of such an agreement with Mr. Yoav Harlap and his company Naniach Ltd.

right of first refusal, provided that the sale of the other holdings and rights as aforesaid is completed by no later than December 31, 2010, in view of the ruling of the Supreme Court on August 20, 2009 forbidding the Company from increasing its holdings in DBS beyond 50%. To the best of the Company's knowledge, the necessary approvals for completing the agreements have not yet been obtained.

Walla! Communications Ltd. ("Walla")

Following the notice of Haaretz Publishing Ltd. ("Haaretz") on March 14, 2010, of its engagement in the sale of the shares it holds in Walla, on April 25, 2010 Bezeq International exercised a right of first refusal concerning Haaretz's shares in Walla, to purchase 14,807,939 shares ("the Purchased Shares") in consideration of NIS 6 per share and a total of NIS 88,847,634. Upon receipt of the Purchased Shares, Bezeq International transferred 9,902,467 of the Purchased Shares to a trustee, who will hold them for it in a blind trust, so that after the transfer, Bezeq International held 20,468,231 shares, accounting for 44.99% of the issued and paid up share capital of Walla.

On September 2, 2010, Bezeq International completed the purchase of another 2,274,299 Walla shares (approximately 5% of the issued and paid up share capital of Walla) by means of a special tender offer in accordance with the Companies Law, 5759-1999 and the Securities (Tender offer) Regulations, 5760-2000, at NIS 6 per share and a total consideration of NIS 13,645,794.

Subsequently, and after receipt of the approval of the Antitrust Commissioner,[4] on September 21, 2010, 9,902,467 shares of Walla were transferred from the trustee back to Bezeq International, and the Company then purchased from Bezeq International all the Walla shares held by Bezeq International (a total of 32,644,997 shares) at NIS 6 per share (a total of approximately NIS 195.87 million), so that after the purchase, the Company holds 71.66% of the shares of Walla.

Acquisition of Yad2 – On September 2, 2010, in an engagement agreement, Walla completed the purchase of 75% of the share capital of Coral Tel Ltd. ("Yad2"), a private company that operates the Yad2 website in consideration of NIS 117.5 million, plus a sum that will be paid to some of the sellers and will be based on the working capital of Yad2 and subject to adjustments.

On this matter, see also Note 4B to the Company's consolidated financial statements for the period ended September 30, 2010, which are included in this quarterly report.

Section 1.1.4 – Holdings in the Company

The following are details of the rates of current holdings in the Company at September 30, 2010 and October 31, 2010, and also at full dilution (assuming exercise of all of the options allocated to Group employees).

Shareholders	Percentage of holdings			
	September 30, 2010	September 30, 2010 at full dilution	October 31, 2010	October 31, 2010 at full dilution
B Communications (SP2), Ltd.	30.39%	29.78%	30.37%	29.78%
Amitim	6.12%	6.00%	5.67%	5.56%
The public	63.49%	64.22%	63.96%	64.66%

For Section 1.2 – Segments of Operation

The operations of Walla are reported under the "Others" segment since its consolidation into the financial statements of the Group. On this matter, see Note 4(b)(1) to the consolidated financial statements of the Company for the period ended September 30, 2010, which are included in this quarterly report.

4 The approval is on terms similar to those in the approval of the prior merger.

For Section 1.3 – Investments in the Company's Equity and Transactions in its Shares

Section 1.3.1(a) – Transactions in Bezeq shares – Sale of core control

A. On April 14, 2010, the transaction was closed between Ap.Sb.Ar. and B Communications for the off-the-floor sale of all the Company shares owned by Ap.Sb.Ar. – 814,211,545 ordinary shares of NIS 1 par value each, constituting on that date approximately 30.44% of the Company's issued and paid up share capital. According to information provided to the Company, the transaction was closed after all preconditions to the agreement, including the regulatory approval required by law, were met. These include the following:

1. Approval of the Ministry of Communications for the transaction (including grant of control permits). The approval was made conditional on compliance with several conditions, whose principle points are that transactions for the purchase of end-user equipment between the Eurocom Group[5] and Pelephone be considered extraordinary transactions pursuant to Section 270(4) of the Companies Law and require, in addition to the internal approval process within Pelephone, an approval process in the Company; discussions of the matter by the Company's Board of Directors must be documented in detailed, comprehensive minutes and submitted to the scrutiny of the Director General of the Ministry of Communications (these two conditions were applied also to DBS, with regard to purchase of satellite end-equipment, see Section 5.17.3 below); Eurocom Group will not transfer to Pelephone information relating to supplies of products and services to its competitors; an employee of Nokia Cellular Communications Ltd. may not serve as a director of Pelephone and an employee of Pelephone may not serve as a director of Nokia Cellular Communications, Ltd.

2. Approval of the Antitrust Commissioner, which was made conditional on compliance with several conditions, mainly the imposition of a prohibition on Eurocom Group[6] from involvement in the decision on commercial conditions that a cellular company purchasing handsets from Eurocom Cellular Communications, Ltd. offers to consumers in Israel, other than participation in their financing, and obliging Eurocom Group to sell its holdings in DBS. Until completion of this sale, Eurocom Group must transfer its shares in DBS to a trustee who will act as owner of the shares and use its authority and/or rights to the best of its judgment for the benefit of DBS alone.

3. Approval the Prime Minister and the Minister of Communications in accordance with the provisions of the Communications (Telecommunications and Broadcasts) Law, 5742-1982, and the provisions of the Communications (Telecommunications and Broadcasts) (Determination of an essential service provided by Bezeq, The Israel Telecommunication Corp. Ltd) Order, 5767-1997.

Purchase of the shares in the Company was contracted through B Communications (SP2) Ltd., a private company, registered in Israel, wholly owned and controlled by B Communications (SP1) Ltd. which is wholly owned and controlled by B Communications, Ltd. which is an Israeli public company registered both on the Tel Aviv Stock Exchange and on NASDAQ. The controlling shareholder in B Communications is Internet Gold – Gold Lines, Ltd., which is owned and controlled by Eurocom Communications, Ltd.

For additional information on the closing of the transaction and on those who have become interested parties in the Company as a result of the transaction, see the Company's supplementary immediate report on an event or matter not in the ordinary course of the corporation's business, dated April 14, 2010, and the immediate report of the same date concerning the parties who have become interested parties in the Company by virtue of their holdings.

B. On the matter of approval of transactions with the B Communications Group – After the transfer of control in the Company, the competent bodies of the Company approved various engagements of

[5] For this matter, "Eurocom Group" means all of the corporations controlled, directly or indirectly, by Eurocom Holdings (1979) Ltd. with the exception of the Company, Pelephone Communications Ltd., Bezeq International Ltd. and B.I.P. Communications Solutions LP, as well as the employees of Bezeq and the aforementioned corporations, who do not work in other companies in the Group.

[6] For this matter, "Eurocom Group" means all the corporations controlled, directly or indirectly, by Eurocom Holdings (1979) Ltd. and/or Eurocom Media-Net Holdings, Ltd., as well as and any person associated with these corporations, with the exception of the Company and companies in which the Company holds more than 50% of the shares.

the Company and its subsidiaries[7] with B Communications Group, including extraordinary transactions. Such transactions are approved from time to time in accordance with the needs of the Company and its subsidiaries, and are duly reported to the public.

Section 1.3.2 – Employee stock option plans

A. Regarding the 2007 employee stock options plan, in light of the expectation that the exercise price of the options will fall below the nominal value of Company's share (NIS 1) as a consequence of adjusting the exercise price of the options for the distribution of a dividend – On March 18, 2010 the Board Of Directors of the Company gave its approval for the Company to convert part of the premium registered in the Company's books to share capital, in an amount equal to the difference between the nominal value of the share and the exercise price of the options that would be exercised in this plan, up to a total not exceeding NIS 22,469,081. Conversion of the premium to share capital will be recorded on the Company's books against the actual exercise of options at the time of exercise.

B. Regarding the November 2007 stock options plan for managers and senior employees of the Group – On March 3, 2010, after publishing its financial statements for 2009, the Company published an updated outline of the securities offered to employees.

For Section 1.4 – Distribution of Dividends.

Section 1.4.2 – Distribution of a dividend

On April 8, 2010 the Company's General Meeting of shareholders resolved (following the recommendation of the Company's Board of Directors from March 2, 2010) to distribute a cash dividend to the shareholders of the Company in the total sum of NIS 2,453 million, which were, at the determining date for the distribution (April 15, 2010) NIS 0.9170679 per share and 91.70679% of the Company's issued and paid up capital. The dividend was paid on May 3, 2010.

On September 12, 2010, the general meting of the shareholders of the Company (following the recommendation of the Board of Directors of the Company on August 2, 2010) approved the distribution of a cash dividend to the shareholders of the Company in the amount of NIS 1,280 million, which at the date of record (September 20, 2010) constituted NIS 0.4780459 per shares and 47.80459% of the issued and paid up capital of the Company. The dividend was paid on October 7, 2010.

Distributable retained earnings at the date of the report – NIS 588 million (surpluses accumulated in the past two years after deduction of prior distributions).

[7] On approval of engagements of the subsidiaries Pelephone Communications Ltd., Bezeq International Ltd. and Bezeq On Line Ltd. and of DBS – the approval in the Company is given after approval of the transactions by the competent bodies of those companies.

For Section 1.5 – Financial Information on Segments of Operation of Bezeq Group

Section 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)

	Q3 2010	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009
Revenue	1,323	1,307	1,304	1,316	1,343	1,318	1,326
Operating profit	556	503	490	161	491	434	437
Depreciation and amortization	171	171	170	194	184	205	211
EBITDA (Earnings before interest, taxes, depreciation and amortization)	727	674	660	355	675	639	648
Cash flows from operating activities	684	523	393	651	526	408	635
Payments for investment in property, plant & equipment and intangible assets	245	247	238	220	204	191	238
Proceeds from sale of property, plant & equipment	48	26	15	9	19	9	49
Number of active subscriber lines at end of period (in thousands)	2,395	2,425	2,458	2,489	2,518	2,547	2,579
Average monthly revenue per line (NIS)*	82	81	80	82	83	81	81
No. of outgoing minutes (in millions)	2,675	2,764	2,775	2,964	3,096	3,014	3,123
No. of incoming minutes (in millions)	1,665	1,634	1,623	1,674	1,731	1,659	1,654
Number of broadband internet subscribers at end of period (in thousands)	1,056	1,051	1,045	1,035	1,026	1,016	1,011
Average monthly revenue per broadband internet subscriber (NIS)	79	75	75	72	72	69	68

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

B. Pelephone (NIS millions except where stated otherwise)

	Q3 2010	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009
Revenue	1,442	1,429	1,393	1,393	1,372	1,346	1,265
Operating profit	356	362	322	251	316	321	302
Depreciation and amortization	149	149	149	158	155	151	139
EBITDA (Earnings before interest, taxes, depreciation and amortization)	505	511	471	410	471	472	441
Net profit	239	267	259	181	231	233	230
Cash flows from operating activities	400	378	350	55	395	290	375
Payments for investment in property, plant and equipment and intangible assets	99	114	92	101	146	163	149
Number of subscribers at end of period (in thousands)	2,825	2,807	2,789	2,766	2,721	2,694	2,669
Average monthly minutes of use (MOU) per subscriber	347	348	336	339	339	329	323
Average monthly revenue per user (ARPU) (NIS)	137	136	133	132	136	131	128
Number of 3G subscribers at end of period (in thousands)	1,775	1,698	1,619	1,531	1,407	1,307	1,217
% revenue from value added services and content out of revenue from cellular services (%)	24.5%	23.0%	22.6%	20.8%	20.0%	19.1%	18.5%

C. Bezeq International (NIS millions except where stated otherwise)

	Q3 2010	Q2 2010*	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009
Revenue	347	342	343	334	332	327	324
Operating profit	70	121	62	67	66	68	60
Depreciation and amortization	23	24	23	23	21	21	20
EBITDA (Earnings before interest, taxes, depreciation and amortization)	93	145	84	89	88	88	80
Net profit	53	108	46	49	51	56	44
Cash flows from operating activities	75	66	59	72	82	83	84
Payments for investment in property, plant and equipment and intangible assets **	30	33	37	39	33	26	21

* The results do not include the activities of Walla, but do include one-time profit generated in the second quarter of 2010 from the consolidation of Walla's operations in the financial statements of Bezeq International, and additional profit in the third quarter of 2010 in respect of the sale of Walla to Bezeq.

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

D. DBS (NIS millions except where stated otherwise)

	Q3 2010	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009
Revenue	395	396	391	390	380	376	384
Operating profit	72	7	59	63	61	59	66
Depreciation and amortization	68	68	64	63	59	56	57
EBITDA (Earnings before interest, taxes, depreciation and amortization)	140	75	122	126	120	115	122
Net profit	(78)	(143)	(8)	(38)	(88)	(95)	(1)
Cash flows from operating activities	126	109	121	91	135	93	91
Payments for investments in property, plant and equipment and in intangible assets*	64	63	61	53	87	60	61
No. of subscribers at end of period (in thousands)	575	573	571	571	567	562	560
Average monthly revenue per subscriber (NIS)	229	231	229	229	224	224	228

* This item also includes investments in the cost of subscriber acquisition.

For Section 1.7 – General environment and the effects of external factors on Group operations

In July 2010, the Ministry of Communications distributed a memo – The Israel Communications Authority Law, 5770-2010, concerning the establishment of a communications authority, which would be the main regulatory body for communications in Israel, both telecommunications and broadcasts, and would hold the powers of the Ministry of Communications, the Second Television and Radio Authority, the Second Authority Council and the Council for Cable and Satellite Broadcasts. According to the provisions of the law memo, the Government will appoint a Communications Council, which will set the Authority's policy for communications, except as concerns broadcast content, and will have various powers that will be granted by legislation n communications except on the matter of broadcast content, including grant of licenses, supervision of license-holders and setting fees, license fees and other payments noted in the memo, which will be paid by the license-holders. The Government will also appoint a Broadcast Content Council, which will set the policy of the Communications Authority for the content of broadcasts and will hold various positions and powers with regard to broadcast content, including supervision of license-holders' compliance with broadcasts on the terms of their licenses with regard to the content of broadcasts. The Company submitted its remarks on the memo on October 15, 2010.

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

For Section 2.2 – Products and Services

Section 2.2.4 – Transmission and data communication services

Concerning the letter of the Ministry of Communications dated January 5, 2010 – The Company submitted its remarks to the Ministry on March 7, 2010, stating that it operates in accordance with the law, that the pricing of services is reasonable and appropriate, and that its position is that there are no grounds for the allegations in this matter.

Concerning the letter of the Ministry dated January 24, 2010 – On October 31, 2010, the Company received a letter from the Director General at the Ministry of Communications, in which he notifies the Company that it was in breach of the provisions of its license by refusing the provide transmission services for the domestic operators Cellcom and Partner. Without derogating from its other powers, the Ministry advised that if the Company did not give notice within 7 working days that it had ceased the breach and that it would provide transmission services to whoever requests them in accordance with the terms of its license, the Ministry would be compelled to initiate a financial sanction proceeding according to the provisions of the Communications Law, or to consider any other step permitted under the principles of the regulations applicable to the Company.

For Section 2.3 – Breakdown of revenue and profitability of products and services

For data updates on the breakdown of Company revenues by products and services, see Note 8 to the Company's consolidated financial statements and Note 2 to the financial data from the interim separate condensed financial information at September 30, 2010, which is included in this quarterly report.

For Section 2.6 – Competition

Section 2.6.1 – Telephony

For sub-section A – On March 22, 2010, the Ministry of Communications published a hearing for HOT regarding the marketing of packages that include broadcast, telephony and internet access services, whereby it is considering determining that the maximum commitment period will be 18 months for all the services in the package, including broadcasts. In the opinion of the Ministry, this limitation will also apply to similar joint packages offered by the Company and its subsidiaries when they are permitted.

On July 19, 2010, the Company requested of the Ministry of Communications that in light of the decrease in the market share in the business sector to less than 85% (a level that was reached in September 2009), the Ministry expedite its handling of amending the Company's license so as to enable it to market joint packages also to the business sector.

For sub-section D – (1) On the Government decision to increase competition in the cellular segment – see Section 3.18.3.2 below. (2) On October 13, 2010, Partner announced that it had entered into an agreement to purchase O12 Smile Telecom Ltd., and that the closing of the transaction was subject to conditions, including regulatory approvals.

Section 2.6.2 – Broadband internet access (and for Sections 2.1.8, 2.6.3, 2.6.4)

On July 15, 2010, during its discussions of the Budget Law, the Government decided to instruct the Minister of National Infrastructures and the Minister of Finance to exercise their authority under the Electricity Economy Law, 5756-1996 ("the Electricity Economy law"), to permit Israel Electric Corporation ("IEC") to operate in communications, on certain terms, principally these: a "communications company" will be established to use the fixed-line communications infrastructure on the electricity grid; IEC will not hold more than 49% of the means of control in the communications company and will not control it; the controlling shareholder will be selected in a public election proceeding by an election committee to which IEC will appoint half the representatives and the State the other half; a communications license-holder, its controlling interest or a company they hold, shall not hold means of control in the communications company unless approved by the Minister of Communications; the communications company shall have a non-exclusive right of use of the infrastructures held by IEC; there will be full corporate, managerial and accounting separation between IEC and the communications company, and no cross-subsidization between them. The decision requires the Government's economics cabinet to make a decide on the establishment of the communications company within 45 days, and the necessary legislative amendments for implementation of the decision will be made to the Electricity Economy Law and the Communications (Telecommunications and broadcasts) Law, 5742-1982 ("the Communications Law").

On the UFI network of HOT – On September 1, 2010, HOT announced completion of the network upgrade.

On October 19, 2010, the Ministry of Communications published a draft ISP license for Hot Net, and draft amendments of licenses for HOT Telecom and HOT Broadcasts, and submitted them to HOT for comments. The drafts impose duties of structural separation, prohibit the transfer of commercial information, including about customers, and limitations on the marketing of bundles of joint services with HOT Net, including the need for the approval of such bundles, and a duty to sell the ISP service on the same terms whether in the bundle or not as part of the bundle.

Section 2.6.7 – Adoption of the conclusions of the Gronau Committee

Concerning tariff flexibility for Bezeq – alternative payments baskets – On July 15, 2010, the Government decided, during its discussions of the Budget Law, to amend the Communications Law and to modify the proceeding for approval of an alternative basket of payments in a way that shortens the proceeding and also allows approval in the absence of opposition within a certain time, based on a law memo that was distributed on June 30, 2010.

Concerning royalties – For the Government's decision on July 15, 2010 during its discussions of the Budget Law – see Section 2.16.3 below.

Section 2.6.8

Regarding the appointment of a committee to consider a tariff arrangement, the committee’s writ of appointment was issued on March 28, 2010. According to the writ, subjects not included therein may be brought for discussion in the committee only if the Minister of Communications does not object within seven days of the subject having been brought to his attention. Furthermore, if the committee considers formulating recommendations that are not consistent with recommendations of the Gronau Committee, as approved by the Minister of Communications (see section 2.6.7 in Chapter A of the Company’s Periodic Report at December 31, 2009), the committee will open the subject to public comment prior to making its recommendations. As requested, the Company presented its position to the committee and submitted a position paper on July 8, 2010.

For Section 2.7 – Property, Plant and Equipment, and Installations

Section 2.7.2 – Fixed-line domestic communications infrastructure

On the NGN – The Company is continuing to set up the network, and at the date of publication of this report, about 900,000 Company subscribers are connected to it. It is noted that a considerable number of the Company's customers who are connected to the NGN infrastructure are upgrading to surfing speeds as high as 10 mega or more.

Section 2.7.4 – Real estate

During the first nine months of 2010, the Company has sold eight properties with a total of area of approximately 16,500 sq.m. of land and 13,000 sq.m. built up, for a total amount of approximately NIS 148 million.

For Section 2.9 – Human Resources

On March 25, 2010, the Company received notice of a strike pursuant to the Labor Disputes Law, 5717-1957, which was declared by the Histadrut, commencing April 11, 2010. The issues in dispute, according to the notice, are disregard of union demands, action not yet been taken with regard to the transfer of control, and negotiations for signing a new collective agreement for regulating employees’ rights following transfer of the controlling share in the Company. As a result, negotiations are taking place between the management of the Company and the union.

Section 2.9.6 – Employee compensation plans

For Section 2.9.6.2 concerning adjustment of the exercise price lower than the par value of a Company share in the 2007 employee stock options plan, and for Section 2.9.6.3 concerning publication of revisions of the stock options plan for managers – see Section 1.3.2 above.

Section 2.9.7 – Officers and senior management employees in the Company

On October 14, 2010, the Board of Directors of the Company approved payment of compensation and reimbursement of travel expenses for an independent director, identical to that paid to an external director in the Company.

For Section 2.10 – Raw Materials and Suppliers, Purchase of Equipment, and Suppliers

Section 2.10.3 – Dependence on suppliers

The Company is dependent on Verse Networks for public switching equipment.

For Section 2.13 – Financing

Section 2.13.1 – Average and effective interest rate on loans, and for Section 2.13.4 – Credit received after December 31, 2009

On April 15, 2010, the Company completed the raising of debt in the amount of NIS 1.5 billion, through loans from Israeli banks for an average duration of 4.6 years. On May 6, 2010, the Company refinanced bank loans received on March 12, 2009 in the amount of NIS 400 million, through loans from Israeli banks for an average duration of 4.6 years. On September 1, 2010, the Company completed the raising of NIS 700 million of debt by means of loans from Israel banks at an average duration of 4.78 years (and on this matter, see Note 12(B) to the consolidated financial statements of the Company for the period ended September 30, 2010, which are included in this quarterly report.)

Below are up-to-date data on the average effective interest rate on the Company's bank loans at today's date:

Source of financing	Amount	Type of currency or linkage	Average interest rate	Effective interest rate
Banks	NIS 1,300 million	Unlinked NIS	Prime minus 0.23%	Prime* minus 0.20%
Banks	NIS 1,300 million	Unlinked NIS	5.35%	5.42%

* For prime at 3.5% in October 2010.

Section 2.13.7 – Credit rating

On May 27, 2010, the Company received notice from Standard & Poor's, which set the Company's international rating at (BBB+), and from Standard & Poor's Maalot which set the rating of the Company and its debentures at (AA+), ratifying these ratings and removing them from CreditWatch with negative outlook. The rating forecast is stable.

For Section 2.16 – Limitations and supervision of the Company's operations

Section 2.16.1 – Control of Company tariffs

In accordance with the Communications (Telecommunications and broadcasts) (Calculation and linkage of telecommunications payments) Notice, 5770-2010, the Company's tariffs were updated effective from June 1, 2010, based on the formula set in the Communications (Calculation and linkage of telecommunications payments) (Amendment) Regulations. 5770-2010, so that the fixed monthly payment for a telephone line and for a line in the combination digital network basic service increased by 3.9147% and fees for the other controlled services provided by the Company increased by 0.5669%. In addition, in accordance with the amendment to the Communications (Telecommunications and broadcasts) (Payments for interconnect) (Amendment No. 2) Regulations, 5770-2010, interconnect fees paid by cellular operators and domestic operators for call completion in a domestic operator network and interconnect fees paid by the international operators for international calls originating or ending in a domestic network, increased by 0.5669% commencing June 1, 2010.

On the reduction of call completion fees in the cellular networks commencing January 1, 2011, see Section 3.18.2.1 below.

Section 2.16.2 – The Company's general license

In the matter of the Minister of Communication's policy letter "Marketing Bundles", dated May 10, 2010, the Company's general license was amended so that subject to conditions, the Company may market to an individual subscriber a bundle of services that includes services provided by a subsidiary. These conditions include the existence of a group of services in similar format marketed by another license-holder, approval by the Director General of the Ministry of Communications for the requested bundle (including by his non-opposition within a fixed time), allowing the customer to purchase each service or package of services in the bundle separately, on the same terms as those offered for the bundle. The licenses of the subsidiaries were also amended, allowing them, subject to conditions, to market bundles that contain services of the Company. Subsequently, the Company started filing applications and receiving approvals for marketing such bundles, and has received the Ministry's approval to market services jointly with Bezeq International and with DBS.

During April 2010, the Ministry of Communications published a hearing for all communications operators on the subject of exit fees that a license-holder may demand of a private subscriber who does not comply with the commitment in the agreement between him and the license-holder. The hearing states that responses should be filed by June 1, 2010.

The main points of the hearing:

1. Limitation of the maximum penalty to a uniform formula: the product of 10% of the average monthly payment from the start of the commitment period multiplied by the number of months remaining to the end of the commitment on the date of its violation. The maximum penalty will include all the types of components of the "return of benefits" and nothing will be paid in excess of that amount.

2. "One-time" benefits such as gifts (laptop, packages of free services, etc.) will not be included in the return of benefits that can be demanded from the customer.

3. A customer who purchased a handset in a transaction on installments will not be required to pay the balance due for the handset in one payment when he exits and violates his commitment, but rather, the installments will continue as initially determined.

On June 1, 2010, the Company submitted its position opposing the arrangement as proposed.

For the Government decision (on July 15, 2010) and the Knesset passing the first reading in the matter of exit fees for the cellular operators, see the update to Section 3.18.3.2 below.

Section 2.16.3 – Royalties

On July, 15, 2010, the Government decided, during its discussions of the Budget Law to instruct the Ministers of Finance and Communications to amend the Royalties Regulations, as an emergency directive for a period of three years, so that the percentage to be paid as royalties by domestic operator license-holders, except for a general special domestic operator license-holder, and cellular, satellite and cable broadcast operator license-holders, will increase from 1% in 2010 to 2% in 2011 and 2.5% in 2012, 2013. Amendment of the royalties regulations applicable to the Company require approval by the Knesset Finance Committee.

Section 2.16.4 – Authority relating to real estate

On June 21, 2010, the Planning and Construction (Application for a permit, its terms and fees) Regulations, 5770-2010 were published and will come into force 90 days after their publication, imposing on an applicant for a permit to erect a residential building a duty to install infrastructure for telephone, radio, television and internet, so that the customer can choose whichever provider it wants. In commercial buildings, if communications installations are installed, the infrastructure must be laid underground. On August 31, 2010, the license of the Company (and that of HOT Telecom and of DBS) was amended so that if the Company uses internal wiring for providing its services, it has a duty to provide maintenance service for the interior wiring in apartments which was installed by the permit applicant, which will not grant it ownership or any proprietary rights in the internal wiring.

Section 2.16.7 – Antitrust laws

On September 1, 2010, the Company submitted a position paper to the Antitrust Authority, according to which Bezeq is not obliged to provide transmission services for competitors. The paper was submitted as part of the Antitrust Authority's review of the Company's conduct in the matter of providing its transmission services for use by competing communications companies, and after the Authority's request for and receipt of various relevant data.

Sub-section C – Terms of merger of the Company and Pelephone - On October 10, 2010, the terms of the merger were amended by removing certain restrictions, and in particular the sweeping ban on joint marketing of the Company's and Pelephone's services. Nevertheless, the conditions include certain restrictions on the joint marketing of services.

Section 2.16.8 – The Telegraph Ordinance

In the matter of the dispute in respect of fees in Judea, Samaria and Gaza – On May 26, 2010 a letter from the Attorney General's office demanded payment of approximately NIS 73.5 million in respect of a frequency debt. As noted in the Company's Periodic Report at December 31, 2009, the sum is in dispute. On September 1, 2010, the State authorities filed a claim on this matter in the Jerusalem District Court – see Section 2.18 below.

Section 2.16.11 – Erecting broadcasting facilities

Following a meeting in July 2009 of the Main Planning Subjects Sub-Committee of the National Council, in which the Ministry of Communications and Ministry of Transport were instructed to consider, prior to approval of NOP 36B by the National Council, grant of Civil Aviation Authority approvals for the existing broadcasting facilities of the Company that are supposed to be included in the plan, the Company, in coordination with the Ministry of Communications and the Ministry of Transport, mapped all the aforementioned broadcasting sites and obtained approval in principle for them from the Civil Aviation Authority.

For Section 2.17 – Substantial Agreements

Section 2.17.5

Following the sale of the core control in the Company by Ap.Sb.Ar. (see update to Section 1.3.1(a) above), the management agreement with a company owned and controlled by the shareholders in Ap.Sb.Ar. was terminated on April 14, 2010.

Furthermore, on June 10, 2010, the general meeting of the shareholders of the Company approved (after approval by the Audit Committee and the Board of Directors) the Company's engagement with Eurocom Communications, Ltd. in a new management agreement, under which the Company will receive ongoing management and advice services for USD 1.2 million per year. The term of the agreement is three years, commencing June 1, 2010.

For Section 2.18 – Legal Proceedings

General – Following the Company's decision to revise the materiality bar in the Group for the Company's reporting, effective from October 1, 2010 (see the update to Section 1.1 above), commencing from the current quarter remarks on and/or updates to legal proceedings will relate to those affecting the net profit from continuing operations of the Company by 5% (NIS 100 million or more), according to the most recent annual financial statements of the Company (unless there are other aspects and/or implications beyond the financial amount involved).[8]

Section 2.18.2 – In the matter of a claim filed in January 2004 against the Company and Makefet Fund by 320 employees on the matter of selection of a pension track: Following denial of the claim and of the subsequent appeal, a petition filed by the plaintiffs in the High Court of Justice for revocation of the decision of the National Labor Court was dismissed in limine on June 6, 2010.

Section 2.18.3 – In the matter of the claim and application for certification as a class action filed in September 2000 against the Company, alleging that the Company unlawfully collected "collection expenses": In March 2010, the District Court certified the case as a class action suit, where the cause of claim is restitution of the fee that the Company collected unlawfully, by virtue of Section 1 of the Unlawful Enrichment Law, and the class of the action is whoever who was debited with collection expenses despite having paid their bill before the Company began collection proceedings, from March 11, 1999 through December 7, 2006. The Company intends to file an application for leave to appeal this decision.

Section 2.18.6 – In the matter of a claim filed in December 2005 against the Company, alleging that it unlawfully collects payment for surfing in high-speed internet service when it is not technically capable of providing the service at the promised speed in certain areas: The parties filed a settlement arrangement in count, the main points of which are mechanisms for handling and control relating to

[8] Legal proceedings of the Company which were described in the past in the Company's reports, which do not reach the bar of materiality and for which updates are therefore not included here: Sections 2.18.5, 2.18.7, 2.18.8, 2.18.15 of the Periodic Report for 2009.

customer complaints about surfing malfunctions, and a relief for the benefit of the public whereby the Company will donate the sum of NIS 1.8 million, in accordance with its internal procedures. The arrangement is in the process of publication and approval.

Section 2.18.14 – In the matter of a claim for arbitration dated October 26, 2008, filed by one of the shareholders in DBS against the Company and another DBS shareholder: On June 30, 2010, following the parties' application for a stay of the arbitration proceedings in light of the plaintiff's execution of an agreement for the sale of its shares in DBS, the arbitrator decided to stay the arbitration proceedings until receipt of other notification from the parties. According to the plaintiff's notice, upon fulfillment of the preconditions in the agreement and it taking force, it will not wish to continue the proceeding.

Section 2.18.16 – In the matter of a claim and application for certification as a class action from November 2009 on the subject of the 144 information service: On May 27, 2010 the plaintiff gave notice that it was withdrawing the application for certification and the Court allowed the notice of withdrawal, dismissed the claim and struck out the application for certification.

On July 12, 2010, a claim and application for certification as a class action were filed in the Central District Court, alleging that the Company offers its customers to subscribe to call tracks for a fixed monthly payment which results in financial loss for customers for whom the track is not worthwhile, and deceives them. The plaintiff is claiming restitution of the difference between the amount paid by the customers in the monthly track, and the amount that they would have paid in the regular track, a sum that the plaintiff estimates in the "tens of millions of shekels", as well as compensation of NIS 1,500 per customer in respect of alleged invasion of privacy.

On July 28, 2010 the Company received an action together with an application for its certification as a class action, which were filed against it in the Tel Aviv District Court. According to the plaintiff, as a result of a malfunction in the telephone lines (which was not repaired by the Company for 34 hours), Company subscribers were denied the ability to call the telephony subscribers of Hot Telecom LP ("HOT"). It is alleged that this resulted in the Company causing its subscribers various wrongs, in respect of which the plaintiff demands compensation of NIS 100 per subscriber. The total amount of the claim is estimated by the plaintiff at NIS 250 million. The plaintiff is seeking certification of his claim as a class action in the name of the Company's subscribers. It is noted that in 2006, an application was filed for certification of a class action on the same subject in the name of HOT's subscribers, and that claim ended in 2009 in a settlement agreement (see Section 2.18.18 of the Company 2009 Periodic Report).

On September 1, 2010, a claim was filed against the Company in the Jerusalem District Court by the Ministry of Communications, the Commander of IDF Forces in Judea and Samaria, and the Civil Administration in Judea and Samaria, in the matter of payment of fees for setting up and operating microwave arteries in Judea and Samaria, in the amount of NIS 74 million. See also the update to Section 2.16.8 above.

In October 2010, a claim was filed against the Company in the Tel Aviv District Court, together with an application for its certification as a class action, in which it is alleged that the Company operates against the Consumer Protection Law in that it refrains from providing its customers with a written document stating the details required under that law, at the time it effects a change or addition to an ongoing transaction. The plaintiff is petitioning for an order and declaratory relief instructing the Company to comply with the aforementioned provisions of the law, as well as monetary reliefs (financial and non-financial) commencing October 10, 2008 through the date of filing the claim, in the amount of NIS 98 million. It is noted that in October 2010, similar claims were filed (by plaintiffs represented by the same lawyer) against Pelephone, Bezeq International and DBS. See also the updates to Sections 3.21, 4.19 and 5.20 below).

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

Section 3.7.2 4 – Competition

In September 2010, the MOC published a final tender for the grant of frequencies and a license to cellular operators who own infrastructure. In the tender, proposals must be submitted by February 2011. Below are the processes undertaken by the Ministry of Communications in order to facilitate the actions of new operators:

1. The draft Budget Law and Arrangements Law for 2011 include and amendment to the Communications Law that will oblige cellular operators that own infrastructure, to allow a new operator domestic roaming on their networks (see Section 3.18.3.2B).
2. In March 2010, a hearing was held on communications infrastructure cooperation among cellular communication licensees. According to the Ministry's proposal, after the frequencies are allocated to the new operator by tender and during the interim period until the new operator is able to fully deploy its cellular network, the new operator will be allowed to share the infrastructures of existing operators. The Ministry is proposing several ways for sharing infrastructure: sharing sites, sharing masts, sharing buildings, sharing imported equipment and sharing antennas. The Ministry is considering requiring existing licensees to share communications infrastructure, and the hearing requests the operators' position on how this might be implemented. Pelephone submitted its response to the hearing, stating that cooperation among operators already exists in the use of infrastructure (e.g. masts) where there is no restriction on such cooperation under the Antitrust Law, and that it is technically possible and financially justifiable for such cooperation to exist. The Ministry of Communications has not yet formulated its decision on the matter.
3. In October 2010, the Ministry of Communications published a hearing on the subject of domestic roaming from the engineering/technical aspect, in order to formulate an amendment to the cellular licenses that will regulate various types of communication for the implementation of domestic roaming. In the hearing, the Ministry requests the remarks of the operators on the various aspects, including the method by which domestic roaming can be achieved on the existing infrastructures. The Ministry also requests cost estimates and a timetable for the implementation of domestic roaming.

Section 3.7.2.7 – Competition

MVNO licenses were recently granted to a number of companies, and applications have been submitted to the Ministry of Communications by other companies for receipt of such licenses.

Section 3.15.6 – Credit rating

Following the notice of Standard & Poor's Maalot transferring the rating of Pelephone's October 2009 local debenture to CreditWatch, in May 2010 the rating agency ratified the AA+ rating for the issuer and for the debenture. The rating outlook is stable, and reflects the Standard & Poor's Maalot assessment that Pelephone will remain a material core holding in Bezeq Group.

In September 2010, Standard & Poor's Maalot announced that the rating forecast of Pelephone, AA+, remains unchanged despite the decision of the Ministry of Communications to reduce cellular network interconnect fees by 73%.

Section 3.17.1 – The environment

The regulations mentioned in this section do not include a chapter that was proposed, the subject of which was permitted maximum levels of human exposure to radiation from a source of radiation and the safety ranges from communication transmission facilities. The chapter also included a restriction on positioning a radiation source on roof balconies. Therefore, the Ministry for Protection of the Environment distributed to government ministries a proposed text for amendment of the Non-Ionizing Radiation (Amendment – Safety ranges and permitted maximum exposure levels for the matter of radiation in radio frequencies) Regulations, 5769-2009 ("the Proposed Regulations"). The text as proposed was opposed by the Minister of Communications due to the implications for the communications economy. However, the Ministry for Protection of the Environment sent to the Ministry of Communications a revised text, which the Ministry of Communications agreed to, allowing a source of radiation to be positioned on roof balconies. These regulations will be discussed on behalf of the Government by the Knesset's Domestic and Environment Committee. In addition, on June 27, 2010, an injunction was given (as part of a petition to the High Court of Justice, which is pending, concerning non-promulgation of regulations for the supervision of radiation), ordering the Minister for Protection of the Environment and the Minister of Communications to explain why the proposed regulations should not be brought immediately for approval of the Knesset's Domestic and Environment Committee, and the State is required to file its response affidavits by November 21, 2010.

On August 25, 2010, the Ministry for Protection of the Environment introduced a pilot maintaining supervision and continuous monitoring of centers of broadcasting. This does not refer to external monitoring of the radiation strength of the radio transmissions from the base sites, but rather, to the use of computerized recordings from a control system at the transmission sites and their examination for verification of relevant transmission data according to the system. Within this framework, the Ministry for Protection of the Environment announced, on August 22, 2010, the addition of two conditions to the Company's establishment and operation permits, whereby, inter alia, a continuous, computerized and real time report must be submitted to the Supervisor of Radiation, of the all the parameters that determine the level of radiation generated during the operation of the radiation source, and to refrain from disrupting the operations of the software and disrupting the transfer of the data to the Ministry for Protection of the Environment. Pelephone is participating in the pilot and implementing the guidelines of the Ministry in this matter. The addition of the conditions mentioned above is yet another layer in the trend towards more stringent Ministry requirements concerning broadcasting installations, a trend that could impede the terms of setting up new broadcasting installations and the terms of operating the existing ones.

For Section 3.18 – Restrictions on and regulation of Pelephone’s operations

Section 3.18.2.1 – Controlled tariffs, and for Section 3.7.2.3 – Competition

In September 2010, the Ministry of Communications published its decision on lowering interconnect tariffs in the networks of the cellular operators. The new tariffs are shown in the table below:*

	September 30, 2010 (current tariff)	2011	2012	2013	2014 and thereafter
Call minute completion tariff	25.1	6.87	6.34	5.91	5.55
SMS completion tariff	2.85	0.16	0.15	0.14	0.13

* The tariffs are in agorot and are shown without VAT.

The tariffs will be updated once a year on January 1st and linked to the CPI, where the base index is the average CPI for 2009, to which VAT will be added and the rate of royalties applicable to a cellular operator as provided in the regulations for payment of royalties.

Pelephone is unable, at this stage, to assess the full effect impact of the amendment over time, but estimates that the reduction in interconnect rates is liable to adversely and significantly affect the results of its operations.

Section 3.18.3.2 – Principal changes in Pelephone's license

A. During March 2010, the Ministry of Communications published a hearing of a list of changes to the cellular license in several consumer fields. The two central and most significant changes for Pelephone are the following:
Receipt of express permission from existing customers for using various content services (e.g. receiving SMS for payment, sending SMS at a special rate, access to the Company’s cellular portal, and others), rather those services being the default situation if instructions to block the services is not received from customers; Informing customers by SMS when they have used 75% and 90% of a package of services.

   These two changes are likely to have substantive business and operational consequences. Pelephone prepared its responses to all of the proposed changes and particularly to these two items, and requested frontal discussions with the Ministry of Communications on these issues.

B. Further to the Government approval in July 2010, the draft Budget Law for 2011 and the Arrangements Law passed their first reading in the Knesset in October 2010. Below are the main steps in the field of communications according to the drafts.

   1. To amend the Communications Law so that cellular operators who own infrastructure are required to allow domestic roaming on their networks for a new operator, for a period of up to 10 years or until the full deployment of the new operator's independent network. In the absence of consent to a tariff for the roaming between a cellular operator who owns infrastructure and a new operator, that tariff will be set at the interconnect tariff until a final tariff is set by the Ministers of Finance and Communications.

2. The amend legislation so that the exit fee will not exceed one tenth of the average monthly bill of the subscriber for services in the commitment period until the date of exit from the agreement, multiplied by the number of months remaining to the end of the term of the agreement, and the cancellation of the agreement shall not serve as cause for the cellular operator to call for immediate payment of the outstanding balance from the purchase of the terminal equipment. If agreement was reached between the subscriber and the cellular operator for the payment for terminal equipment to be by credit card in regular payments, the transaction shall be made as one transaction in installments, and not as a number of transactions.
   In readiness for tabling the sections of the Arrangements Law for discussion in the Knesset, the Ministerial Committee for Legislative Amendments approved a change in the arrangements section that deals with exit penalties, so that the proposed amendment will apply also to existing contracts.
3. To amend legislation so as to ensure complete neutrality in the cellular internet network.
4. To amend legislation in order to grant the Minister of Communications authority to draft various provisions concerning competition in the terminal equipment market.

These four sections must be approved by the Knesset, since their application required legislative amendments.

5. To amend legislation in order to raise the percentage to be paid in royalties by cellular operators to 2% in 2011 and 2.5% in 2012-2013.
6. Subject to hearings by the Ministry of Communications, Government decisions for promoting the following topics were approved:
   - Shortening the commitment period to 12 months.
   - Shortening the period of credits for the purchase of terminal equipment to 12 months.
   - Promoting the grant of licenses for a VOC operator.
   - Setting up an inter-ministerial committee to examine ways to achieve the sharing of cellular infrastructure.

The draft law is subject to additional approvals from Knesset bodies. Before the final approval of the law in the Knesset, the sections dealing with communications will be discussed by the Economics and Finance Committees, and Pelephone has been invited to attend those discussions.

Pelephone is unable at this stage to assess the impact of all the legislative amendments, amendments to the license and the steps described above. However, Pelephone believes that full or partial application of these steps could adversely affect the results of its operations.

Section 3.18.3.2B – Principal changes in Pelephone's license

Following the Ministry of Communications' notice to the High Court of Justice concerning changing its position on amendment of the license with regard to a mechanism for identifying users of erotic services as adults, on February 24, 2010 the petition on this matter was struck out at the request of the petitioner. Subsequent to that notice, a hearing was published for the operators, in which a more stringent adult identification mechanism was proposed, by means of adding a personal identification detail. Pelephone submitted its response to the hearing, stating that it opposes the change to the existing identification mechanism.

Section 3.18.3.2G – Principal changes in Pelephone's license

Further to the Ministry of Communications policy document concerning the marketing of joint packages by the Company and its subsidiaries when the Company's share in the fixed-line telephony market falls to 85%, in May 2010 the Ministry of Communications published a final amendment to the licenses of the Company and Pelephone concerning the marketing of joint packages in the private sector. See also the update for Section 2.16.2 above.

Section 3.18.3.2H – Principal changes in Pelephone's license

In May 2010, the Knesset Technology Science and Technology Committee decided that by the end of 2010, cellular operators would offer tariff plans in which the customer is allowed to limit its monthly bill to a particular sum, and that the matter would be regulated by the Ministry of Communications without need for legislation. Accordingly, the private bill on the matter was removed from the agenda.

Section 3.18.5 – Site construction licensing

NOP 36/A/1

Amendment of NOP 36/A/1 – The Ministry of Communications submitted its remarks on the text of the new NOP as approved by the National Council's Sub-committee for Planning, proposing mainly the removal/narrowing of various restrictions on the erection of new transmission facilities and joining existing facilities. On June 1, 2010, the National Council discussed the Ministry of Communications' remarks and decided to reject most of them and to approve the new text as approved by the Planning Sub-committee, while making minor changes. On August 1, 2010, the Ministerial Committee for Interior Affairs and Services convened to discuss approval of the new NOP, and resolved, at the request of the Minister of Communications, to postpone the discussion for several weeks to enable the Ministry of Communications to hold discussions with the Ministries of the Interior and Environmental protection to try to reach consensus on issues in dispute between the Ministries in connection with the plan. Approval of the NOP in its new version is now subject to the approval of the Government and publication in the Official Gazette for it to come into force.

Wireless access facility regulations

On March 9, 2010 a revised notice was filed in the High Court of Justice on behalf of the State, stating that on March 7, 2010, the Minister of the Interior had submitted to the Knesset Economics Committee for approval, the draft Planning and Construction (Installation of a wireless access facility for cellular communication) Regulations, 5770-2010 ("the Wireless Access Regulations" or, in this sub-section – "the Regulations"). The proposed Regulations are very narrow, and lay down extremely restrictive conditions for exemption from a building permit for a wireless access facility.

On July 15, 2010, another revised notice was filed in the High Court of Justice on behalf of the State, stating that on May 26, 2010 the Knesset Economics Committee had discussed the request of the Minister of the Interior for the approval of the Committee for the draft Wireless Access Regulations. At that meeting, the Economics Committee decided that it would discuss the draft Regulations further only after the fulfillment of the duty of consultation with the National Planning and Construction Council. On June 1, 2010, the National Council discussed the draft Wireless Access Regulations and decided, inter alia, that in view of regulation of the erection of communications facilities in NOP 36/A/1, the possibility of grant of exemption also according to the Regulations should be narrowed to the extent of its complete cancellation, and in these circumstances, it does not see fit to recommend that the Minister of the Interior promulgate the Regulations. On June 28, 2010, the Ministry of the Interior approached the Knesset Economics Committee and requested that the Committee hold another urgent discussion of the draft Regulations. On October 12, 2010 the Economics Committee discussed the draft Regulations again, but was unable to complete the discussion and the Chairman of the committee instructed that another meeting would be held on the subject.

During the same period, yet another revised notice was filed in the High Court of Justice on behalf of the State on September 15, 2010, stating that the Attorney General believes, inter alia, that due to the delay in bringing the Wireless Access Regulations before the Economics Committee for discussion and approval, it would be justified to give, instead of an interlocutory injunction on the petitions, a temporary injunction banning the erection of any more wireless access facilities with exemptions from building permits, where those facilities would be used by cellular license-holders to provide cellular services, until promulgation of the Wireless Access Regulations and until the arrangement laid down in them comes into force. The Attorney General also made clear that the arrangement in the Regulations reflects the proper balance between all the considerations relevant to the matter, and therefore, of the Wireless Access Regulations are approved and promulgated, and the Regulations and the arrangement laid down in them come into force, it is his opinion that there will be no cause for the intervention of the High Court of Justice for including the matter of cellular frequencies in the Communications (Telecommunications and broadcasts) (Frequencies for wireless access facilities) Regulations, 5762-2002.

In view of the foregoing, on September 16, 2010, the High Court of Justice gave a temporary injunction as requested in the Attorney General's notice one day earlier, and stated that the injunction would remain in force until the arrangement laid down in the draft Wireless Access Regulations comes into force or until another decision is made on the matter. In Pelephone's estimation, if the Wireless Access Regulations are approved as proposed, the possibility of using the exemption from a building permit track for setting up cellular access facilities will be very significantly reduced. This, together with the proposed severity of the conditions for erecting the base sites in the parallel track of the new NOP 36/A, can be expected to considerably raise the height of barriers to the erection of new transmission sites and access facilities, and also to adversely affect the quality of the cellular network.

Section 3.21 – Legal proceedings

General – On the matter of the Company's decision to raise the materiality bar for Company reporting, see the update of Section 2.18 above.[9]

Section 3.21.1 – In the matter of a claim filed in December 2000 in the District Court by the State against Pelephone, in respect of royalties allegedly payable for the period from January 1994 to February 1996:, in which the amount claimed is NIS 260 million at the date of the claim, including principal, linkage and interest – In September 2010, a decision was given against Pelephone, in which some of the State's allegations were allowed. The sum that Pelephone was required to pay was NIS 150 million (including principal, linkage and interest), and was paid in October 2010. Pelephone filed an appeal in October 2010 against the ruling in the Supreme Court.

Section 3.21.3 – In the matter of a claim and application for its certification as a class action filed in the District Court in December 2002 against Pelephone and Cellcom, in respect of interconnect fees for incoming calls for a total of NIS 4 billion, of which NIS 2.4 billion against Pelephone – In May 2010, the appeal against dismissal of the claim filed by the plaintiff, was dismissed.

Section 3.21.6 – In the matter of a claim and application for its certification as a class action which was filed in the District Court in June 2007 against Pelephone, concerning subscribers of an immigrants program in which the subscribers were debited in units of one minute, and concerning failure to include a list of tariffs with the agreements, in a total amount of NIS 239 million – In July 2010 the claim was dismissed.

Section 3.21.9 – In the matter of a claim and application for certification as a class action filed in the District Court in May 2008 against Pelephone and Only 5 Lottoclub Israel Ltd. for lack of clarity in the bill sent by Pelephone to Lottoclub customers for services it provided, ostensibly not in accordance with Pelephone's license and in which no amount is defined – In August 2010 the claim was dismissed.

Sections 2.21.12 and 2.21.13 – In the matter of two claims with applications for certification as class actions filed in January 2009 in the District Court for restitution of amounts allegedly collected by Pelephone for surfing on a handset while the handset is being repaired, one for NIS 219 million and the other for NIS 570 million – In June 2010 the two actions were dismissed following a settlement agreement between the parties.

In March 2010, a claim was filed in the Tel Aviv District Court together with an application for its certification as a class action. The total amount of the claim is NIS 4.2 billion, and the amount against Pelephone is NIS 2.1 billion. According to the applicants, Pelephone acts in contravention of its license and the law in that is does not purchase insurance covering liability for bodily harm arising from exposure to cellular radiation. The application also includes relief requested for an order instructing Pelephone to take out such insurance.

In May 2010, a claim was filed in the Central District Court together with an application for its certification as a class action. The action was filed against the four cellular companies (Pelephone, Partner, Cellcom and Mirs) where the amount against each of Pelephone, Partner and Cellcom is NIS 3.68 billion and the total amount of the action (against the four companies) is more than NIS 12 billion. According to the applicants, the cellular companies are in dereliction of the following duties: (1) to erect cellular antenna sites of the required scope, proportion and deployment; (2) to check, correct and provide information about the non-ionizing radiation values in cellular handsets after repair, etc.; (3) to warn against the risks involved in how the cellular handset is held. The application includes numerous other declaratory reliefs and applications for writs of mandamus relating to the above matters.

In June 2010, a claim was filed in the Central District Court together with an application for its certification as a class action. The amount of the personal claim is NIS 958 (plus linkage and interest). The total amount of the action is not stated, but the application notes that it is estimated in the hundreds of millions of shekels. According to the applicant, Pelephone collects payment from its customers for services to which the customers have not requested to subscribe, and transfers their personal information to external suppliers without approval, which contravenes the agreement and the law. The claim is for restitution of those moneys. The application also includes reliefs for orders instructing Pelephone, inter alia, to cease these debits and to cease transferring the information to suppliers.

[9] Legal proceedings of Pelephone which were described in the past in the Company's reports, which do not reach the bar of materiality and for which updates are therefore not included here: Sections 3.21.4, 3.21.8, 3.21.10, 3.21.18, 3.21.20 of the Periodic Report for 2009.

In August 2010, a claim and application for certification as a class action were filed in the Central District Court against Pelephone. The amount of the claim is not stated, but the application is estimated in the terns of millions of shekels. According to the applicant, Pelephone should refrain from collecting Value Added Tax from customers who use its services when they are outside Israel. The application also includes the relief of an order instructing Pelephone to cease charging its customers VAT on the services they use outside Israel, and an order instructing that the VAT collected to date on those services be reimbursed.

In October 2010, a claim was filed against Pelephone in the Tel Aviv District Court, with an application for certification as a class action in the amount of NIS 100 million. The applicant alleges that Pelephone operates in contravention of the Consumer Protection (Warranty and after-sales service) Regulations, 5766-2006, in giving a renovated handset or collecting "participation fees" during the warranty period of the handset. According to the applicant, such conduct results in subscriber losses estimated by the applicant in the amount noted above.

In October 2010, a claim and application for its certification as a class action were filed against Pelephone and others in the Tel Aviv District Court. The amount of the claim against Pelephone is NIS 1.6 billion, out of a total of NIS 3.2 billion. The claim is for the restitution of amounts collected by the respondents (and debited by means of the cellular phone bill), for services provided by respondents Unicell, Telemeser and Select by cellular telephone. The claim alleges that the applicants did not request to subscribe to the services of those respondents and therefore the debit for them is unlawful.

In October 2010, a claim and application for its certification as a class action in the amount of NIS 98 million were filed against Pelephone in the Tel Aviv District Court, alleging that Pelephone does not provide its customers with a written document as required under the Consumer Protection Law, when entering into an agreement for changing or adding to a continuing transaction. Similar claims by other plaintiffs (represented by the same lawyer) were also filed against the Company, Bezeq International and DBS – see a more detailed description in the updates of Sections 2.18, 4.19 and 5.20.

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

Section 4.1.2 – Legislative and statutory restrictions applicable to Bezeq International

In March 2010, the Ministry of Communications published a request for positions of cellular license-holders in the matter of providing broadband telephone services for a subscriber who is outside Israel. A possible decision by the Ministry of Communications on this question, allowing Bezeq International and the other companies to provide telephone services by means of broadband access to the internet, could impact positively on the business of Bezeq International.

Section 4.1.2.7 – Amendment of the general license – Sale of service bundles – On May 10, 2010 Bezeq International received a letter from the Director General of the Ministry of Communications, containing amendments to the licenses of the Company, Bezeq International and the other subsidiaries of the Company, relating to the marketing of bundles of services. See also the update to Section 2.16.2 above.

Section 4.1.5 – The structure of competition and changes occurring in it

On July 21, 2010, the Minister of Communications granted a license to Telaser International Communications Ltd. for providing international communication services. At this stage, the extent of influence on the performance of Bezeq International cannot be assessed.

For Section 4.14 – Investments

On October 31, 2010 the board of directors of Bezeq International, and on November 1, 2010 the Board of Directors of the Company gave its permission for Bezeq International to enter into agreements with various suppliers for laying an underwater optical fiber communications cable between Israel and Europe.

Section 4.14.1 – Walla! Communications Ltd. ("Walla")

On the purchase of the shares in Walla by Bezeq International, the tender offer of Bezeq International for the purchase of additional Walla shares and the Company's purchase of all Bezeq International's shares in Walla, see the update to Section 1.1.2 above.

For Section 4.17 – Restrictions and control of Bezeq International's operations

On the hearing in April 2010 which relates also to Bezeq International, in the matter of exit fees that a license-holder is entitled to demand of a private subscriber, see the update to Section 2.16.2 above.

For Section 4.19 – Legal Proceedings

General – On the Company's decision to raise the materiality bar for Company reporting, see the update to Section 2.18 above.[10]

Section 4.19.1 – In the matter of the claim and application for certification as a class action filed on September 16, 2001 against Bezeq International and the State of Israel, based on the allegation that Bezeq International's tariffs for international telecommunication services in the period from May 10, 1996 through July 8, 1997 were exorbitant and unreasonable, and which was certified as a class action on December 25, 2003 – On April 26, 2010, the Supreme Court allowed the appeal filed by Bezeq International and the State (after hearing applications for leave to appeal that they filed as if they had been granted leave to appeal), and ruled that there is no justification for certifying the claim as a class action.

On April 13, 2010, Partner Communications, Ltd. filed a petition in the High Court of Justice, in which it asked the Court to order revocation of Article 11(B)(3) of the Communications (Telecommunications and broadcasts) (Proceedings and conditions for receipt of a general license for providing international telecommunications services) Regulations, 5764-2004, which prevents it, as a cellular license-holder, or its subsidiary, from receiving a general license for providing international communication services. In its petition, Partner argues, inter alia, that the decision of the Minister of Communications in the matter of the subject of the petition was intended to protect existing international telecommunication service license-holders, and for this reason, Bezeq International was joined as a respondent to the petition. Partner's entry into the international telecommunication market, if the petition is allowed, could have an adverse effect on Bezeq International in this area.

On May 24, 2010, Partner Communications Ltd. filed another petition in the Supreme Court, requesting an order nisi prohibiting the Ministry of Communications from amending the Communications (Telecommunications and broadcasts) (Payments for interconnect) Regulations, 5760-2000, so as to determine in them that for outgoing calls from a cellular telephone to abroad, a uniform interconnect fee will be set which is the same as the interconnect fee for incoming calls. According to the petitioner, such a decision narrows its license and is harmful to competition. Partner attached to its petition an application for an interlocutory injunction, in which requested that the decision on amendment of the regulations be delayed and not to allow amendment of the regulations until the petition is heard. Since the Minister of Communications' decision to amend the regulations is linked to his decision to allow Partner to compete in the international calls market, Bezeq International (and its other competitors in this market) was joined as a respondent to the petition. Bezeq International filed its response to the petition, as did the other parties, following which the Court decided that the application for an interlocutory order should be dismissed and that the petition should be heard before a bench. At the date of this report, Bezeq International does not appear to be at risk from this petition.

In October 2010, a claim was filed against Bezeq International in the Tel Aviv District Court, together with an application for its certification as a class action in the amount of NIS 39 million. The claim alleges that Bezeq International does not provide its customers with a written document as required under the Consumer Protection Law, when entering into an agreement for changing or adding to a continuing transaction. Similar claims by other plaintiffs (represented by the same lawyer) were also filed against the Company, Pelephone and DBS – see a more detailed description in the updates of Sections 2.18, 3.21 and 5.20.

[10] Legal proceedings of Bezeq International which were described in the past in the Company's reports, which do not reach the bar of materiality and for which updates are therefore not included here: Section 4.19.2 in the Periodic Report for 2009.

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

For Section 5.1.3 – Market developments in the segment of operation

Section 5.1.3.1 – In July 2010 the Government decided to impose on the Ministry of Communications and the Ministry of Finance, together with the Second Authority for Television and Radio and the Council, the formulation of recommendations for expansion of the DTT array and how it should operate, including in the matter of legislative amendments required for the purpose, and to submit them for Government approval by the end of 2010.

Section 5.1.3.2 – In May 2010, the Government withdrew the Television Broadcasts (Legislative amendments) Bill, 5760-2009.

In July 2010, the Second Authority for Television and Radio (Amendment No. 33) (Transition from franchises to licenses in television broadcasts) Bill, 5770-2010, which deals mainly with a change in the regulation method in commercial broadcasts (following the recommendation of the committee headed by the Director General of the Ministry of Communications mentioned in Section 5.1.3.4 of the Company's 2009 Periodic Report), with a transition from a franchise method to the grant of licenses for commercial television broadcasts for all, which meets the threshold conditions laid down in the Bill without a tender proceeding ("Commercial Licensee-Holder"). In the Bill, the transition date between the methods is given as January 1, 2012. Under the Bill, inter alia, every Commercial License-Holder will be entitled to be included in the array of DTT broadcasts and may broadcast the dedicated channel in Hebrew, if it requests to be included in the DTT array. The dedicated channel broadcaster in Hebrew will be exempt from transition fees to DBS and the cable company for the first two years of its broadcasts. The Bill also states that the Council may set the number of channels of the television franchisees, of the Knesset channel, of the dedicated channels and of the IBA broadcasts, and that the Council, together with the Second Television and Radio Authority Council, will decide on the location of the channel number on which the Commercial License-Holders will broadcast, and a tender will be held for the identity of the license-holders who will use the channel number on which franchisees currently broadcast. At the date of this report, the Bill is being discussed by the Knesset Economics Committee.

Section 5.1.6 – Main entry and exit barriers for the segment of operation

On the matter of the recent erosion of the main entry barriers to the segment of operation – Keshet Broadcasts Ltd., a franchisee for broadcasting on the second commercial channel, recently launched an application on the mako website enabling easy viewing of a range of content channels by computer.

In addition, there has been an increase in accessing video content through broadband infrastructure, whether with or without the authorization of the holders of the rights in that content.

Section 5.1.7 – Substitutes for and changes in products in the segment

Section 5.1.7.3 – Access to video content is partly through internet sites that are not authorized by the holders of the copyright in that content to distribute it.

Section 5.1.7.4 – See the update to Section 5.1.6 above.

In the second quarter of 2010, Israel Electric Corporation ("IEC") received a license for trial provision of high-speed internet services at speeds higher than the standard Israel, using its own optical fiber infrastructure. The provision of such high-speed internet services by IEC could expedite the development of a trend for transferring video content via the internet. See also the update for Section 2.6.2 above.

For Section 5.4 – New products

In March 2010, DBS launched VOD services for its subscribers. DBS believes that its offering of VOD services accords with the regulation to which it is currently subject. This position of DBS is subject to publication of the conclusions of the committee appointed by the Minster of Communications to consider the regulation of broadcasts using new platforms and technologies (see Section 5.1.3.6 of the Company’s 2009 Periodic Report), which could result in the imposition of conditions and restrictions on the provision of VOD services by DBS, including the very fact of their provision.

In May and June 2010, the cable company addressed DBS by letter (which were forwarded to the Ministry of Communications), in which it alleged, inter alia, that it had identified unusual and severe electronic disturbances in its internet and telephony services and that the source of these disturbances was in DBS's customer connection to the VOD services (in one of the ways used by DBS for this purpose) using wiring that is also used by the cable company for transmitting DBS's services. The cable company demanded that DBS cease use of the cable company's infrastructure, repair every installation made allegedly unlawfully, and cease provision of the VOD service. DBS rejected the demand to cease its VOD service and proposed a joint investigation of the existence and source of the disturbances. In July 2010 the Ministry of Communications hosted a meeting on the matter, to which representatives of the cable company and DBS were invited, and at which it was agreed that the matter would be investigated further and ways to resolve the disturbances would be considered.

Section 5.7.4 – Positive and negative factors in competition

In June 2010 the Minister of Communications amended the license of DBS. The amendment states, inter alia, that DBS may offer services bundled with a service of the Company. In October 2010, DBS submitted a request to the Ministry of Communications to market bundles of services together with the Company. See also the update for Section 2.16.2 above.

Section 5.10.1 – Licenses

Section 5.10.1.2 – In May 2010 the head of the Civil Administration for Judea and Samaria extended the license of DBS for broadcasting in those areas, to December 2016.

For Section 5.11 – Broadcasting rights

Section 5.11.2 – According to the immediate report published by the cable company in July 2010, an award was given in the arbitration between the cable company and the Union of Composers, Songwriters and Publishers of Israeli Music Ltd. ("ACUM"), in connection with deciding on a mechanism for the computation of annual royalties for the use of works whose rights are protected by ACUM. According to the report, the arbitrator's award accepted in principle the model outline for computing the royalties as presented by ACUM in the proceeding, except for certain modifications, and determined that the model should apply also for the matter of the royalties difference from 2003 onwards, according to a calculation that would be made by the parties to the arbitration in an agreed way. The cable company noted that it intends to appeal the arbitrator's award. Since the award and the other arbitration documents were not submitted to DBS, DBS does not know the model adopted and the reasons for the arbitrator's award. Nevertheless, as agreed between DBS and ACUM, the royalty amounts paid to ACUM since 2003 might be revised, inter alia, depending on the agreement that is reached by the cable company and ACUM, and according to ACUM, depending also on the decision of the arbitrator. Accordingly, DBS's management estimates that following the award, DBS could be charged with payment differences in significant amounts in respect of the past, and with royalty payments that are significantly higher than the sums paid to date. Therefore, DBS revised its estimate for royalties since 2003. Revision of the royalties estimate was based on the model outline for the computation of royalties that was accepted by ACUM a short time after the arbitrator gave his award, with adjustments as assessed by the management of DBS, and on that basis DBS made a material provision in its financial statements at June 30, 2010. With the other copyright organizations, payment of royalties for the period of engagement with them has been agreed with some, and for the rest, DBS might be required to pay non-material differences.

In October 2010, a private bill was tabled before the Knesset for amendment of the Copyright Law, 5768-2007 and the Performers and Broadcasters Law, 5744-1984, so that a broadcaster will be able to copy, imprint, reproduce, perform in public and broadcast a musical work without permission from the holder of the copyright, provided that the holder had permitted its publication in the past for commercial uses and that the broadcaster pays appropriate royalties to the body overseeing its broadcasts. Under the Bill, the Minister of Communications would be authorized to set the appropriate percentage for the royalties to be paid to the copyright holder, whether as a rule or for types of copyright, as he decides, provided that those rates do not exceed 4% of the total revenue of the broadcaster from broadcasting the musical work of the copyright holder, after deduction of the amount it expended for that broadcast; the Minister of Communications would also be authorized, under the Bill, to determine the date of payment.

For Section 5.13 – Raw materials and suppliers

In May 2010, DBS and the Company formulated an arrangement as to the amount of DBS's debt to the Company in respect of various communications services at July 31, 2009, in view of the dispute that arose between them. In the arrangement, the amount of the debt was stated at NIS 31.5 million, which would be paid to the Company in 36 equal monthly installments bearing interest at prime + 1.5% and plus statutory VAT in respect of the interest. In October 2010, an agreement was approved for deferral of some of the arrangement installments, and for deferral of payments that DBS owes the Company under a prior agreement between them for the rescheduling of DBS's debt in respect of the purchase of internet infrastructure. Under the agreement, 18 installments from the May 2010 agreement and 15 installments from the earlier agreement will be postponed for 18 months, and during that period the payments will bear annual interest at prime + 3%. The agreement can be cancelled by giving notice on the terms laid down in it. On this matter, see also Note 4(a)(2) to the consolidated financial statements of the Company for the period ended September 30, 2010, which are included in this quarterly report.

For Section 5.15 – Financing

Sections 5.15.2 and 5.15.3 – Credit restrictions applicable to the Company

In March 2010, an amendment to DBS's bank financing agreement ("the Financing Agreement") was signed and came into force. According to this agreement, inter alia, an additional Israeli bank ("the Joining Bank") joined DBS's current bank consortium ("the Current Banks"). In this context, the Joining Bank provided DBS with a proportionate share of DBS's current credit facility, and also granted DBS NIS 255 million in long-term credit, most of which was used for joining (proportionately) DBS's long-term credit facility for repayment and early repayment of DBS's debts to the Current Banks, and the balance, NIS 46 million, will be used to meet DBS's current needs.

Pursuant to the amended agreement, DBS created a floating charge in favor of the Joining Bank similar to those listed in favor of the Current Banks, and the Joining Bank was added to the fixed charge in favor of the Current Banks. Furthermore, shareholders in DBS[11] signed amendments to the deeds of liability, deeds of pledge and guarantees, as the case may be, that they signed in the past in favor of the Current Banks, concerning the addition of the Joining Bank.

According to the amended agreement, the repayment period for bank credit (both the long-term loans and at the current credit facility) was extended to the end of 2015, and the banks also agreed that the loans extended to DBS by institutions (see Section 5.18.5 of the Company's 2009 Periodic Report) can be repaid on schedule.

Under the amended agreement, the financial covenants listed in the Financing Agreement have been replaced with new ones, which will apply until 2015 and are suited to DBS's business plan The new covenants:

A. Minimum repayment ability
B. Minimum EBITDA.
C. Maximum and minimum supplier credit.

The values for compliance with the financial covenants are variable, and are measured quarterly. Non-compliance with the covenants grants the banks a right to demand early repayment of the loans in accordance with the conditions of the Financing Agreement.

DBS is in compliance with the covenants in the Financing Agreement at September 30, 2010, after being granted a relief by the banks in October 2010 in relation to the target of one of the covenants at September 30, 2010, which was needed in view of the material provision made by DBS as aforesaid in Section 5.11.2 above. Since that relief was granted after the balance sheet date, the bank loans are stated under short-term liabilities. DBS was granted a similar relief for the targets of the financial covenants at December 31, 2010.

At the date of this report, DBS is looking into the possibility of issuing another series of NIS 400 million of debentures, which would be secure by senior liens on its assets as generated, in favor of the banks and the holders of its debentures (series A), pari passu with those liens. The proceeds from the issuance would be earmarked for repayment of loans taken by DBS in 2005 (see Section 5.15.8 below), and for repayment of part of the bank debt. DBS is negotiating with the banks to amend the financing agreement to anchor that partial repayment of the bank debt by amending the financial covenants. It is possible that by the time of completion of the issuance, if implemented, and the engagement with the banks for amendment of the financing agreement, such changes will already apply.

[11] Other than Lidan, to which DBS undertook to use its best efforts so that as soon as possible after the amended agreement comes into force, Lidan will sign the amendment to its deed of liabilities in favor the banks and the of pledge in favor of the banks.

Section 5.15.8 – Private issue of debentures

In April 2010, the rating agency Maalot announced that it had raised the rating of the debentures (Series A) issued by DBS one grade from (ilBBB-) to (ilBBB), inter alia because of its evaluation of the substantive improvement in DBS's liquidity because of the new loan received from the Additional Bank, as described in the update to section 5.15.2 above, and because of the ongoing improvement in the coverage ratios, the ability to generate cash flows, and liquidity of DBS since the previous rating date. In addition, the rating company added DBS to the CreditWatch with positive outlook, noting that it hopes to complete its consideration of a possible improved rating within three months, after a deeper study of DBS's business plan and its impact on its financial profile.

In June 2010 Maalot raised the rating of DBS and of its debenture (series A) another grade, from ilBBB to ilBBB+, and removed the rating from CreditWatch with positive outlook. The higher rating was explained, inter alia, by the improving trend in financial rations and the ability to generate cash flows, even though the rating agency still had concerns about the possibility that DBS might deviate in the medium term from its goals according to its business plan. Maalot gave DBS a positive rating outlook.

In October 2010, Maalot raised the rating of DBS and the rating of the debentures (Series A) to ilA-. Among the reasons given for raising the rating were the improved liquidity of DBS following the announcement of a new series of debentures, and better financial flexibility in view of an expected amendment to the financing agreement with the banks. The same rating was given to the new series of debentures that DBS intends to issue. Maalot also stated that the rating outlook is stable, since it assesses the operating performance of DBS, its liquidity profile and its more balanced repayment schedule can be expected to contribute to rating stability in the medium term unless material changes occur in the structure of DBS's equity or in its liquidity. Maalot also noted that if any material changes are made to the terms of the issuance, which could damage the quality of DBS's credit, or if the issuance is cancelled, Maalot would reconsider the rating of DBS and could possibly lower the rating.

For Section 5.17 – Restrictions on and supervision of the Company

Section 5.17.1 – Subjection of activities to specific laws

In April 2010, the subsidiary of Bank Leumi notified DBS that it has closed the transaction for the sale of all its holdings in Keshet Broadcasts Ltd.

On the matter of the Government decision to raise the royalties percentage, see the update for Section 2.16.3 above.

Section 5.17.3 – Principal restrictions under the law and the broadcasting license

At the date of this report, the Council is holding a hearing regarding shortening the period of campaigns offered by DBS (and the cable companies) to its subscribers and setting a uniform special offer period for all service components. At the hearing, the Council is considering, among other things amendment of DBS's license so that the commitment period for subscribers to its services in the consideration of a benefit or discount will be limited to only 18 months. DBS has submitted its opposition to such an amendment. The Council has not yet made its decision in the hearing. Concurrently with the hearing proceedings, the Ministry of Communications announced in March 2010 that it is considering amending the license of Hot Telecom LP, so that a private subscriber who purchased a service package that also includes broadcasts from the cable company, for which the commitment period for the broadcast component is limited by the broadcast license, the limit would apply to the services included in that package. In September 2010, the Council decided that commencing November 2010, DBS may collect from subscribers who sign up for a campaign that includes a commitment period and who request to disconnect from its broadcasts before the end of that period of commitment, reimbursement of the cost of the benefit equal to the lower of two amounts: the cost of the benefit in the campaign, or the balance of the payments the subscriber would have had to pay it if it remained connected to DBS services until the end of the commitment period. The decision applies also to existing DBS campaigns. DBS requested that the Council postpone the date on which its decision will come into force for another three months. The Council concurred, and accordingly, the decision will take effect in January 2011.

In the matter of the dedicated channels – In March 2010 a bill mandating that the dedicated channels would be exempt from payment of transition fees to the cable company and to DBS, passed its fist reading in the Knesset. In July 2010, the bill was approved for its second and third reading in the Knesset. In September 2010, DBS petitioned the High Court of Justice against the force and application of those exemption provisions. For details about the petition, se the update to Section 5.20 below.

In April 2010, in the context of the Ministry of Communications' approval of DBS's request, as required by its license for approval of transferring the means of control in the company (direct and indirect) in respect of the purchase of control in the company (see section 1.3.1a, above) and the transfer of the holdings of Eurocom DBS Ltd. in DBS to a trustee, the Ministry of Communications decided to apply the following main conditions to DBS:

A. No change, direct or indirect, in the trustee's holdings of the means of control in DBS may be made unless the change received the prior written approval of the Minister of Communications, after he has consulted with the Council.

B. The trustee will not act in accordance with guidance received from any party which has a direct or indirect interest in an area of regulation of the Ministry of Communications, unless it has received the approval from the Ministry of Communications.

C. A transaction between DBS and Eurocom Group[12] concerning satellite terminal equipment will be considered an extraordinary transaction as defined in section 270(4) of the Companies Law and therefore, in addition to the approval proceeding in DBS's organs, it requires approval by the organs of the Company pursuant to section 275 of the Companies Law.

D. Discussions by the board of directors of DBS concerning transactions as described in paragraph C, above, will be documented in detailed, comprehensive minutes that are signed by the chairman of the meeting and submitted to the Director General of the Ministry of Communications for his scrutiny.

For the matter of using infrastructure in the subscriber's home – In July 2010 an agreement was signed between DBS and the cable company, in which DBS will pay the cable company approximately NIS 4 million in settlement of its demands in respect of the use of infrastructure in the subscriber's home which was installed by the cable company up to the end of 2010. Under the agreement, commencing 2011, there will be no obligation for one of the parties to pay the other for the use of wiring. In addition, the parties agreed on a joint approach to the Ministry of Communications concerning amendment of the administrative provisions, mainly cancellation of the duty to give notice so that a licensee to which a subscriber connects will forward the disconnection notice from the subscriber to the licensee from which the subscriber was disconnected only after the connection is made to the other licensee. The agreement will come into force only after approval by the Antitrust Commissioner for exemption from approval of the terms included in the agreement as a cartel. The Antitrust Commissioner gave his approval in September 2010, and DBS and the cable company submitted to the Ministry of Communications the application for amendment of the administrative provisions. The Ministry of Communications has not yet given its decision on the matter.

In June 2010, DBS learned that the Ministry of National Infrastructures is preparing draft regulations ("the Draft Regulations") pursuant to the Sources of Energy Law, 5750-1989, which will define the maximum output in waiting mode for instruments that are listed in the Draft Regulations and which include digital converters. The output cited in the Draft Regulations for digital converters is considerably lower than the actual and accepted consumption if digital converters in general, including those used by DBS. DBS approached the Ministry on the matter and requested that the digital converters be excluded from application of the regulations and at least that the progress of the regulations be halted so that the matter can be studied and the right to a hearing be exercised.

<u>For Section 5.20 – Legal proceedings</u>

<u>General</u> – On the Company's decision to raise the materiality bar for Company reporting, see the update to Section 2.18 above.[13]

Petition to the High Court of Justice in the matter of transfer fees of dedicated channels – In September 2010, DBS filed a petition in the Supreme Court, sitting as the High Court of Justice, against the provisions in the Communications Law that exempt the operators of dedicated channels from payment of transfer fees to DBS. In its petition, DBS asks the Court to rule that application of the relevant section was made conditional on receipt of appropriate compensation from the State for the unlawful harm to its property. Alternatively, the Court was requested to declare that the section referred to is not in keeping with the Basic Laws and therefore is provisions should not be applied to

[12] For the definition of "Eurocom Group" for this matter, see Footnote 5.

[13] Legal proceedings of DBS which were described in the past in the Company's reports, which do not reach the bar of materiality and for which updates are therefore not included here: Section 5.20.1 in the Periodic Report for 2009, and a claim from July 2001 described in the reports of June 2010.

DBS until such compensation is regulated, and alternatively to the alternative, DBS requested that the Court rule that the section is void in that it is unconstitutional. The petition is scheduled for hearing before a bench in May 2011.

In October 2010, a claim was filed against DBS in the Tel Aviv District Court, together with an application for its certification as a class action in the amount of NIS 98 million. The claim alleges that DBS does not provide its customers with a written document as required under the Consumer Protection Law, when entering into an agreement for changing or adding to a continuing transaction. Similar claims by other plaintiffs (represented by the same lawyer) were also filed against the Company, Pelephone and Bezeq International – see a more detailed description in the updates of Sections 2.18, 3.21 and 4.19

<u>Section 5.22.2 – Sectoral risks</u>

Access to video content via the internet – The internet enables access to video content, including by means of programming file sharing of creators with or without the authorization of the holders of the copyright. The increase in this trend could make it more difficult for DBS to recruit and retain subscribers and to offer its services. DBS estimates that the extent of the impact of this risk is minor. .

November 1, 2010	
Date	Bezeq – The Israel Telecommunication Corp. Ltd.

Names and titles of signatories:
Shlomo Rodav, Chairman of the Board
Avraham Gabbay, CEO

Chapter B of the Periodic Report

Directors' Report on the State of the Company's Affairs for nine-month and three-month periods ended September 30, 2010

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

The Directors’ Report includes a condensed review of the Company’s affairs, and it assumes that the Directors’ Report at December 31, 2009 is also available to the reader.

Commencing April 25, 2010, the financial statements of Walla! Communications Ltd. ("Walla") are consolidated in the financial statements of the Group (see Note 4B to the financial statements).

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

1) **Domestic fixed-line communications**

2) **Cellular**

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

4) **Multi-channel television**

The Company has additional areas of operation which are not material to the Group's operations, and they are included in the financial statements as another business segment. These include the operation of a portal, content websites and online commercial websites (through Walla), and customer call center services.

Profit from continuing operations in the period amounted to NIS 1,868 million, compared with NIS 1,795 million in the corresponding period last year. Profit from continuing operations in the Quarter and in the corresponding quarter amounted to NIS 588 million. The results of the period and the Quarter were influenced mainly by an increase in revenues, which was partially offset by an increase in operating and general expenses, finance expenses and share in losses of equity accounted affiliates.

In the corresponding period and quarter, profit for the period included profit from an operation that was discontinued following termination of the consolidation of the financial statements of D.B.S. Satellite Services (1998) Ltd. ("DBS"). As a result, profit for the corresponding period was NIS 3,174 million, compared with NIS 1,868 million in the reporting period, and in the corresponding quarter was NIS 2,063 million compared with NIS 588 million in the present Quarter.

A. Board of Directors explanations for the state of the Company's affairs, the results of its operations, its equity, cash flows, and other matters

1. Financial position

A. The Group's assets at September 30, 2010 amounted to NIS 15.25 billion, compared to NIS 14.53 billion on September 30, 2009. Of these sums, NIS 5.53 billion (about 36%) are property, plant and equipment, compared to NIS 5.46 billion (about 38%) on September 30, 2009.

The increase in assets is due mainly to an increase in the assets of the Domestic fixed-line communications segment. Additional increase resulted from consolidation of the assets of Walla with those of the Group (see Note 4B to the financial statements). The increase was moderated by a decrease in the assets of the Cellular segment and of the International communications, internet and NEP services segment, as explained below.

In the Domestic fixed-line communications segment, there was an increase of NIS 706 million in total assets, excluding investment in associates, compared with the corresponding period. The increase stemmed mainly from an increase in cash balances and in the balance of property, plant and equipment.

In the Cellular segment, assets decreased from NIS 4.90 billion on September 30, 2009 to NIS 4.85 billion at September 30, 2010. The decrease stemmed mainly from a decrease in cash balances, financial assets held for sale, and in property, plant and equipment. The decrease was partially offset by an increase in the trade receivables, mainly as a result of an increase in revenues from the sale of user equipment on installments.

In the International communications, internet and NEP services segment, total assets decreased from NIS 1,056 million on September 30, 2009 to NIS 999 million at September 30, 2010. Most of the decrease is in cash balances as a result of the distribution of dividends. Investment in affiliates also decreased, due to the transfer of the holding in Walla. The decrease was partially offset by investments in capacity usage rights and in property, plant and equipment.

In the Multi-channel television segment, total assets increased from NIS 1,206 million on September 30, 2009 to NIS 1,260 million at September 30, 2010 mainly as a result of an increase in net investment balances in property, plant and equipment and in intangible assets.

B. Group debt to financial institutions and debenture holders at September 30, 2010, amounted to NIS 5.73 billion, compared to NIS 4.17 billion on September 30, 2009. The increase is accounted for mainly in the Domestic fixed-line communications segment due to receipt of a bank loan (see Note 12B to the financial statements). The increase was moderated by repayment of debentures in the Domestic fixed-line communications segment and by repayment of debentures and loans in the Cellular segment.

2. Results of operations

A. Principal results

Condensed consolidated profit and loss data:

	Nine months ended September 30				Three months ended September 30			
	2010	2009			2010	2000		
	NIS millions	NIS millions	Increase (Decrease)	%	NIS millions	NIS millions	Increase (Decrease)	%
Continuing operations:								
Revenue	8,929	8,587	342	4%	3,033	2,924	109	3.7%
Costs and expenses	6,086	6,095	(9)	(0.1%)	2,054	2,049	5	0.2%
Operating income	2,843	2,492	351	14.1%	979	875	104	11.9%
Finance expenses (income), net	87	(13)	100	-	74	16	58	362%
Profit after finance expense (income), net	**2,756**	**2,505**	**251**	**10%**	**905**	**859**	**46**	**5.4%**
Company's share in losses of affiliates	(180)	(8)	(172)	-	(71)	(12)	(59)	(492%)
Profit before income tax	**2,576**	**2,497**	**79**	**3.2%**	**834**	**847**	**(13)**	**1.5%**
Income tax	708	702	6	0.9%	246	259	(13)	5%
Profit for the period from continuing operations	1,868	1,795	73	4.1%	588	588	-	-
Profit from discontinued operations	-	1,379	(1,379)	-	-	1,475	(1,475)	-
Profit for the period	**1,868**	**3,174**	**(1,306)**	**(41.1%)**	**588**	**2,063**	**(1,475)**	**(71.5%)**
Attributed to:								
Company owners	1,868	3,237	(1,369)	(42.3%)	588	2,088	(1,500)	(71.8%)
Non-controlling rights	-	(63)	63	-	-	(25)	25	-
Profit for the period	**1,868**	**3,174**	**(1,306)**	**(41.1%)**	**588**	**2,063**	**(1,475)**	**(71.5%)**
Earnings per share								
Base earnings per share (NIS)								
Earnings from continuing operations	0.70	0.68	0.02	2.9%	0.22	0.22	-	-
Earnings from discontinued operations	-	0.55	(0.55)	-	-	0.57	(0.57)	-
	0.70	1.23	(0.53)	(43%)	0.22	0.79	(0.57)	(72.2%)
Diluted earnings per share (NIS)								
Earnings from continuing operations	0.69	0.67	0.02	3%	0.22	0.22	-	-
Earnings from discontinued operations	-	0.54	(0.54)	-	-	0.57	(0.57)	-
	0.69	1.21	(0.52)	(43%)	0.22	0.79	(0.57)	(72.2%)

Most of the increase in the Group's revenue is from the Cellular segment. In addition, group revenues increased due to the first-time consolidation of Walla and increased revenues from the International communications, internet and NEP services segment. The increase was moderated by a decrease in revenues from the Domestic fixed-line communications segment.

Depreciation and amortization expenses of the Group in the reporting period amounted to NIS 1,041 million, compared with NIS 1,109 million in the corresponding period, a decrease of about 6.1%.

The Group's depreciation and amortization expenses in the Quarter amounted to NIS 350 million, compared with NIS 361 million in the corresponding quarter, a decrease of about 3%.

The decrease stemmed from the Domestic fixed-line communications segment.

The salary expense of the Group in the reporting period amounted to NIS 1,486 million, compared with NIS 1,464 million in the corresponding period, an increase of about 1.5%.

Salary expense in the Quarter amounted to NIS 492 million, compared with NIS 475 million in the corresponding quarter, an increase of about 3.6%.

The increase in salary expense stemmed mainly from the "Other" segment, due to the first-time consolidation of Walla. Conversely, the increase was moderated in the reporting period by a decrease in the salary expense in the Domestic fixed-line communications segment.

Operating and general expenses of the Group in the reporting period amounted to NIS 3,713 million, compared with NIS 3,576 million in the corresponding period, an increase of about 3.8%.

Operating and general expenses in the Quarter amounted to NIS 1,271 million, compared with NIS 1,251 million in the corresponding quarter, an increase of about 1.6%.

The increase stemmed from a rise in the expenses of the Cellular and the International communications, internet and NEP services segments, and was moderated by a decrease in the expenses of the Domestic fixed-line communications segment.

The Group's Income from other operations, net, in the reporting period amounted to NIS 154 million, compared with NIS 54 million in the corresponding period.

Income from other operations, net, in the Quarter amounted to NIS 59 million, compared with NIS 38 million in the corresponding quarter.

The increase in the reporting period stemmed from the International communications, internet and NEP services segment, while the increase in the Quarter stemmed from the Domestic fixed-line communications segment.

Net finance expenses of the Group in the reporting period amounted to NIS 87 million, compared with NIS 13 million in the corresponding period,

In the Quarter, net finance expenses amounted to NIS 74 million, compared with NIS 16 million in the corresponding period.

The increase in net finance expenses is attributed mainly to the Domestic fixed-line communications segment and the Cellular segment.

The Group's share in the losses of equity accounted affiliates amounted to NIS 180 million in the reporting period compared with NIS 8 million in the corresponding period, and NIS 71 million in the Quarter, compared with a loss of NIS 12 million in the corresponding period.

Due to the termination of consolidation of the financial statements of DBS in the corresponding quarter, the Company's share in the losses of DBS in the amount of NIS 92 million, was classified under Discontinued operations. The balance of the increase was due to an increase in the Company's share in losses stemming from an increase in the losses of DBS in the period and the manner of their attribution among the various shareholders.

B. Segments of operation

The breakdown of operations by segment is presented according to the Group's segments of operation:

Revenue by segment of operations	1-9/2010		1-9/2009		7-9/2010		7-9/2009	
	NIS millions	% of total revenue	NIS millions	% of total revenue	NIS millions	% of total revenue	NIS millions	% of total revenue
Domestic fixed-line communications	3,934	44.1%	3,987	46.4%	1,323	43.6%	1,343	45.9%
Cellular	4,264	47.8%	3,983	46.4%	1,442	47.5%	1,372	46.9%
International communications, internet and NEP services	1,030	11.5%	984	11.5%	347	11.4%	332	11.4%
Multi-channel television	1,183	13.2%	1,140	13.3%	396	13.1%	380	13.0%
Others and offsets*	(1,482)	(16.6%)	(1,507)	(17.6%)	(475)	(15.6%)	(503)	(17.2%)
Total	8,929	100%	8,587	100%	3,033	100%	2,924	100%

* Offsets are mainly in respect of a segment that is an affiliate.

Operating income by segment of operations	1-9/2010		1-9/2009		7-9/2010		7-9/2009	
	NIS millions	% of segment revenue	NIS millions	% of segment revenue	NIS millions	% of segment revenue	NIS millions	% of segment revenue
Domestic fixed-line communications	1,549	39.4%	1,362	34.2%	556	42.0%	491	36.6%
Cellular	1,040	24.4%	939	23.6%	356	24.7%	316	23.0%
International communications, internet and NEP services	255	24.8%	194	19.7%	70	20.2%	66	19.9%
Multi-channel television	138	11.7%	186	16.3%	72	18.2%	61	16.0%
Others and offsets*	(139)		(189)		(75)		(59)	
Total	2,843	31.8%	2,492	29.0%	979	32.3%	875	29.9%

* Offsets are mainly in respect of a segment that is an affiliate.

Domestic fixed-line communications segment

Revenue:

Revenue in the reporting period amounted to NIS 3,934 million, compared to NIS 3,987 million in the corresponding period, a decrease of about 1.3%.

Revenues in the Quarter amounted to NIS 1,323 million compared to NIS 1,343 million in the corresponding quarter, a decrease of about 1.5%.

The decrease in the segment's revenue is due mainly to a decrease in revenue from telephony as a result of a decrease in the number of lines and in call traffic. The decrease was moderated by an increase in revenue from high-speed internet, data communication and transmission. Revenues from interconnect fees to the cellular networks also decreased compared with the corresponding period, albeit with a corresponding decrease in expenses.

Costs and expenses:

Depreciation expenses in the reporting period amounted to NIS 512 million, compared with NIS 600 million in the corresponding period, a decrease on about 14.7%.

Depreciation expenses in the Quarter amounted to NIS 171 million, compared with NIS 184 million in the corresponding quarter, a decrease of about 7.1%.

The source of this decrease is the end of depreciation of property, plant and equipment and a change in the scrap value of property, plant and equipment.

Salary expenses in the reporting period amounted to NIS 783 million compared to NIS 797 million in the corresponding period, a decrease of about 1.8%.

Salary expenses in the Quarter amounted to NIS 256 million compared to NIS 255 million in the corresponding quarter, an increase of about 0.4%.

The decrease in salary expenses in the reporting period stemmed mainly from a rise in salary attributed to investment. The decrease in the salary expense due to reduction of the number of employees in the reporting period and in the Quarter, was offset by salary increases.

Operating and general expenses in the reporting period amounted to NIS 1,187 million compared to NIS 1,282 million in the corresponding period year, a decrease of about 7.4%.

Operating and general expenses in the Quarter amounted to NIS 399 million compared to NIS 451 million in the corresponding quarter, a decrease of about 11.5%.

The decrease stemmed from a decrease in operating expenses due to the implementation of efficiency measures, a decrease in interconnect expenses to the cellular operators alongside a decrease in interconnect revenue, and a decrease in royalty expenses as a result of a 0.5% decrease in royalty rates.

Other operating income, net, in the reporting period amounted to NIS 97 million, compared to NIS 54 million in the corresponding period.

Other operating income, net, in the Quarter amounted to NIS 59 million, compared to NIS 38 million in the corresponding quarter.

The increase in this income stemmed mainly from an increase in capital gains from the sale of assets and copper, which was moderated by an increase in the early retirement severance expense.

Operating income:

Operating income in the segment in the reporting period amounted to NIS 1,549 million, compared with NIS 1,362 million in the corresponding period, an increase of about 13.7%.

Operating income in the Quarter amounted to NIS 556 million compared to NIS 491 million in the corresponding quarter, an increase of about 13.2%.

The increase in operating income stems from the changes described above in the income and expenses section.

<u>Cellular segment</u>

Revenue:

Segment revenue in the reporting period amounted to NIS 4,264 million compared to NIS 3,983 million in the corresponding period, an increase of about 7.1%.

Segment revenue in the Quarter amounted to NIS 1,442 million compared to NIS 1,372 million in the corresponding quarter, an increase of about 5.1%.

The segment's revenue from services in the reporting period amounted to NIS 3,405 million, compared with NIS 3,170 million in the corresponding period, an increase of 7.4%.

The segment's revenues from services in the Quarter amounted to NIS 1,159 million, compared with NIS 1,101 million in the corresponding quarter, an increase of 5.3%.

The increase in revenue from services stemmed from an increase in the number of subscribers and in ARPU, largely as a result of an increase in revenues from content services.

Revenue from the sale of terminal equipment in the reporting period amounted to NIS 859 million, compared with NIS 813 million in the corresponding period, an increase of 5.7%. This increase stemmed mainly from a rise in the prices of the terminal equipment.

Revenue from the sale of terminal equipment in the Quarter amounted to NIS 283 million, compared with NIS 271 million in the corresponding quarter, an increase of 4.4%. The increase stemmed mainly from a rise in the prices of the terminal equipment, and was partially offset by a decline in the quantity of sales.

Costs and expenses:

Depreciation and amortization expenses in the reporting period amounted to NIS 447 million compared to NIS 446 million in the corresponding period last year, an increase of approximately 0.2%.

Depreciation expenses in the Quarter amounted to NIS 149 million compared to NIS 156 million in the corresponding quarter, a decrease of approximately 4.5%.

Salary expense in the reporting period amounted to NIS 443 million compared to NIS 447 million in the corresponding period last year, an increase of approximately 0.9%.

Salary expense in the Quarter amounted to NIS 143 million compared to NIS 148 million in the corresponding quarter, a decrease of approximately 3.4%.

Operating and general expenses in the reporting period amounted to NIS 2,334 million compared to NIS 2,151 million in the corresponding period, an increase of approximately 8.5%. The increase in these expenses stemmed mainly from a rise in the costs of services along with an increase in rent and site maintenance expense, an increase in the expense for doubtful and bad debts, and an increase in the cost of terminal equipment due mainly to the rise in its prices.

Operating and general expenses in the Quarter amounted to NIS 794 million compared to NIS 753 million in the corresponding quarter, an increase of about 5.4%. The increase in these expenses in the Quarter stemmed mainly from a rise in the costs of services (mainly call completion and roaming fees) and an increase of NIS 26 million in the royalty expense following a court decision (see Note 5F to the financial statements). The increase was moderated by a decrease in advertising costs.

Operating income:

The segment's operating income in the reporting period amounted to NIS 1,040 million compared to NIS 939 million in the corresponding period, an increase of approximately 10.8%.

Operating income in the Quarter amounted to NIS 356 million compared to NIS 316 million in the corresponding quarter, an increase of approximately 12.7%.

The improvement in operating income is due to the changes described above in the expenses and revenues sections.

<u>International communications, internet and NEP services</u>

Revenue:

Segment revenue in the reporting period amounted to NIS 1,030 million compared to NIS 984 million in the corresponding period, an increase of about 4.7%.

Segment revenue in the Quarter amounted to NIS 347 million compared to NIS 332 million in the corresponding quarter, an increase of approximately 4.5%.

The increase in revenue in the reporting period stemmed mainly from growth in integration (IT and communications solutions for businesses) and Data activities, as well as from call transfers between carriers around the world. Conversely, revenue from outgoing call minutes decreased, due to the decline in traffic volume and a decrease in revenue from incoming traffic minutes.

Costs and expenses:

Depreciation expenses in the reporting period amounted to NIS 70 million compared to NIS 62 million in the corresponding period, an increase of about 12.9%.

Depreciation expenses in the Quarter amounted to NIS 23 million compared to NIS 21 million in the corresponding quarter, an increase of about 9.5%.

The increase in depreciation stemmed mainly from the amortization of rights to use capacity, development costs and subscriber acquisition costs.

Salary expense in the reporting period amounted to NIS 187 million compared to NIS 181 million in the corresponding period, an increase of about 3.3%.

Salary expense in the Quarter amounted to NIS 61 million compared to NIS 58 million in the corresponding quarter, an increase of about 5.2%.

Operating and general expenses in the reporting period amounted to NIS 581 million compared to NIS 547 million in the corresponding period, an increase of about 6.2%.

Operating and general expenses in the Quarter amounted to NIS 198 million compared to NIS 187 million in the corresponding quarter, an increase of about 5.9%.

The increase in these expenses corresponds to the increase in the segment's revenue.

Income from other operations, net, in the reporting period includes a capital gain of NIS 57.4 million from the revaluation of holdings at Walla following the assumption of control (see Note 4B to the financial statements).

Operating income:

Operating income in the segment in the reporting period amounted to NIS 255 million compared to NIS 194 million in the corresponding period, an increase of about 31%.

Operating income in the Quarter amounted to NIS 70 million compared to NIS 66 million in the corresponding quarter, an increase of about 6.1%.

The improvement in operating income is due to the changes described above in the expense and revenue sections.

Multi-channel television (stated by the equity method)

Revenue:

Segment revenue in the reporting period amounted to NIS 1,183 million compared to NIS 1,140 million in the corresponding period, an increase of about 3.8%.

Revenue in the Quarter amounted to NIS 396 million compared to NIS 380 million in the corresponding quarter, an increase of about 4.2%.

The increase in revenue is due to an increase in revenue from premium channels and a rise in advanced product consumption.

Costs and expenses:

Cost of sales in the reporting period amounted to NIS 842 million, compared with NIS 776 million in the corresponding period, an increase of about 8.5%. The increase stems mainly from a provision for copyright to AKUM (see Note 4A(3) to the financial statements), and from an increase in depreciation.

The cost of sales in the Quarter amounted to NIS 259 million, compared with NIS 262 million n the corresponding quarter, a decrease of about 1.1%.

Sales, marketing, administrative and general expenses in the reporting period amounted to NIS 203 million, compared with NIS 179 million in the corresponding period, an increase of about 13.4%. Most of the increase stemmed from high marketing expenses in the first quarter of 2010.

Sales, marketing, administrative and general expenses in the Quarter amounted to NIS 65 million, compared with NIS 58 in the corresponding quarter, and increase of about 12.1%.

Operating income:

Operating income in the reporting period amounted to NIS 138 million compared to NIS 186 million in the corresponding period, a decrease of about 25.8%.

Operating income in the Quarter amounted to NIS 72 million compared with NIS 61 million in the corresponding quarter, an increase of about 18%.

The changes in operating income stem mainly from changes described above in the expense and revenue sections.

C. <u>Finance expenses, net</u>

The Group's net finance expenses in the reporting period amounted to NIS 87 million compared to net finance income of NIS 13 million in the corresponding period. Net finance expenses in the Quarter amounted to NIS 74 million, compared with NIS 16 million in the corresponding quarter. The change in net finance expenses stems mainly from the Domestic fixed-line communications segment, due largely to a decrease in income from hedging transactions on the CPI as a result of a decrease in the balance of those transactions, and from a decrease in finance income from shareholder loans to DBS and in increase in credit at fixed and variable shekel interest. Conversely, linkage and interest expenses in respect of debentures have declined, due to a fall in the rate of rise in the CPI and a decrease in total liabilities.

Furthermore, part of the increase stemmed from the Cellular segment, due to interest and linkage of NIS 49 million in respect of a court decision on royalties (see Note 5F to the financial statements), which was partially offset by a decrease in loan valuation expenses.

D. <u>Income tax</u>

The Group's tax expense in the reporting period amounted to NIS 708 million, representing about 27.5% of profit before taxes, compared to NIS 702 million in the corresponding period, which represented about 28.1% of profit before taxes. The decrease in the rate of the tax expense out of profit before income taxes is due to a reduction in the tax rate compared with the corresponding period.

3. Equity

Equity attributed to the owners of the Company at September 30, 2010 amounted to NIS 4.71 billion, accounting for 30.9% of the total balance sheet, compared with NIS 6.16 billion and 42.4% of the balance sheet on September 30, 2009. The decrease in equity stems from the distribution of a dividend of NIS 3.7 billion, which was partially offset by the Group's profit.

4. Cash flow

Consolidated cash flow for the nine-month and three-month periods ended September 30, 2009, include cash flows from DBS operations until August 20, 2009. The consolidated cash flow for the reporting period and the Quarter to not include those operations.

Consolidated cash flow from operating activities in the reporting period amounted to NIS 2,948 million, compared with NIS 3,130 million in the corresponding period, a decrease of NIS 182 million. Most of the decrease stemmed from termination of the consolidation of the financial statements of DBS (in the corresponding period, the cash flow of DBS from operating activities, amounting to NIS 260 million, was included).

In addition, cash flow from operating activities in the Cellular segment and in the Domestic fixed-line communications segment increased, but was moderated by a decrease in the cash flow from operating activities in the International communications, internet and NEP services segment.

Consolidated cash flow from operating activities in the Quarter amounted to NIS 1,166 million, compared with NIS 1,097 million in the corresponding quarter, an increase of NIS 69 million. The increase stemmed from the Domestic fixed-line communications segment, mainly as a result of timing differences in payments to suppliers. The increase was partially offset by termination of the consolidation of the financial statements of DBS (in the corresponding quarter, the cash flow of DBS from operating activities, amounting to NIS 76 million, was included).

Cash flow from operating activities is one of the sources of financing the Group's investments. In the reporting period, the Group invested NIS 907 million in the development of communications infrastructure and NIS 234 million in intangible assets and deferred expenses, compared with an investment of NIS 1,125 million and NIS 247 million, respectively, in the corresponding period. In the Quarter, NIS 115 million were used for business combinations in the purchase of shares of Coral Tel Ltd. (operator of the Yad2 website), in addition to NIS 30 million, net, in the prior quarter for the purchase of Walla shares. Conversely, net proceeds of NIS 90 million were received from the sale of financial assets held for sale, compared with an investment of NIS 134 million in the corresponding quarter.

In the reporting period, the Group repaid net debts and paid interest in a total amount of NIS 1,318 million, of which NIS 687 million of debentures, NIS 433 million of loans and NIS 192 million of interest payments. In comparison, in the corresponding period the Group repaid net debt and paid interest in a total amount of NIS 1,096 million. In the same period, the Group received NIS 2,670 million of long-term loans, and NIS 21 million in proceeds from the exercise of employee stock options, and in comparison with receipt of NIS 400 million of loans, NIS 48 million of short-term credit and NIS 117 million in proceeds from the exercise of employee stock options in the corresponding quarter. Most of the cash flow used for finance activity is from the Domestic fixed-line communications segment.

A dividend of NIS 2,453 million was paid in the reporting period, compared with a dividend of NIS 792 million in the corresponding period.

The average of long-term liabilities to financial institutions and debenture-holders in the reporting period was NIS 4,684 million.

The average of supplier credit in the reporting period was NIS 1,018 million, and the average short-term customer credit was NIS 2,619 million. Average long-term customer credit was NIS 833 million.

The Group's working capital deficit at September 30, 2010 amounted to NIS 675 million, and of the Company, NIS 1,759 million, compared with NIS 313 million and NIS 1,338 million, respectively, on September 30, 2009. The increase in the working capital deficit stems mainly from an increase in financial and other short-term financial liabilities, which was largely offset by an increase in the cash balances.

The Board of Directors of the Company reviewed the projected cash flow of the Company, including sources of credit and the options for raising it, and determined that the deficit in working capital does not pose a liquidity problem for the Company.

The above is forward-looking information based on the Company's assessments. Actual results might differ substantially from those assessments if a change occurs in one of the factors that were taken into account in making them.

5. <u>Board of Directors remarks concerning market risks – exposure and management</u>

A. Further to the description in the Directors' Report for 2009, hedging transactions against market risks relating to exposure to changes in exchange rates and in the CPI, partially reduced this exposure.

B. During 2010, the Company raised NIS 2.6 billion of debt by means of loans from Israeli banks, of which NIS 400 million was against early repayment of bank loans raised in March 2009, as described in Note 12B to the financial statements. As a result, the asset surplus exposed to changes in nominal shekel interest on December 31, 2009, decreased by NIS 1,324 million. In addition, during the reporting period the Company hedged copper prices in a net amount of 640 tons at a total net financial value of USD 5.1 million. Other than that, the sensitivity analyses for the fair value and effect of the change in the market prices on the fair value of on or off-balance-sheet balances for which there are firm agreements at September 30, 2010, do not differ substantially from the December 31, 2009 report.

C. The linkage bases report at September 30, 2010 is not substantially different from the December 31, 2009 report, with the exception of the decrease in CPI-linked liabilities amounting to NIS 324 million, mainly due to repayment of NIS 759 of debentures. The decrease was moderated mainly by a rise in other current liabilities.

B. Corporate Governance

Disclosure regarding the process for approval of the Company's financial statements

The Company body responsible for oversight is the Board of Directors. The Board of Directors of the Company appointed the Financial Statements Review Committee, whose mandate and composition are described in the 2009 Directors' Report (the committee was formerly called the Balance-Sheet Committee).

The financial statements were discussed by the Financial Statements Review Committee and submitted to the Board of Directors for approval. The following officers attended the board discussion: Board members – Shlomo Rodav, Shaul Elovitz, Or Elovitz, Orna Elovitz-Peled, Aryeh Saban, Felix Cohen, Eldad Ben-Moshe, Rami Nomkin, Yehuda Porat, Eliahu Holzman, Yitzchak Idelman and Mordechai Keret. In addition, the following officers attended: Avraham Gabbay – CEO, Alan Gelman – CFO and Deputy CEO, and Amir Nachlieli – General Counsel. Representatives of the Company's auditors, Somekh Chaikin, also participated in the discussion.

C. Disclosure in connection with the Company's financial reporting

1. Critical accounting estimates

Preparation of the financial statements according to international accounting standards (IFRSs) requires management to make assessments and estimates that influence the reported values of assets, liabilities, income and expenses, and disclosure relating to contingent assets and liabilities. Management bases its estimates and assessments on past experience and on valuations, opinions and other factors which it believes are relevant in the circumstances. Actual results can differ from these assessments on different assumptions and in different conditions. Information on the principal matters of uncertainty in critical assessments and judgments in the application of the accounting policy, is provided in the annual financial statements. We believe that these assessments and estimates are critical since any change in them and in the assumptions behind them has the potential to materially affect the financial statements.

2. In their letter to the shareholders to the Company, the auditors drew attention to the material amounts for which claims have been filed against the Group, which cannot yet be assessed or in respect of which the exposure cannot be calculated.

D. Details relating to series of debt certificates

Below are the relevant data at September 30, 2010:

		Debentures Series 4	Debentures Series 5
A	Par value	NIS 300,000,000 (1)	NIS 2,386,967,000
B	Par value revalued at the report date (CPI-linked)	NIS 348,469,937	2,772,620,799 (2)
C	Accrued interest	NIS 5,575,519	48,982,967
D	Fair value	NIS 363,810,000	3,167,505,209
E	Stock exchange value	NIS 363,810,000	3,167,505,209

(1) On June 1, 2010, NIS 300,000,000 par value was repaid.

(2) Of which, NIS 1,022 million is held by a wholly-owned subsidiary.

On May 27, 2010, the Company received notification from Standard & Poor's Maalot, rating the Company and its debentures at AA+, confirming the present rating and removing it from CreditWatch with negative outlook. The rating forecast is stable.

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

Shlomo Rodav
Chairman of the Board

Avraham Gabbay
CEO

BEZEQ THE ISRAEL TELECOMMUNICATION CORP. LIMITED

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
SEPTEMBER 30, 2010
(UNAUDITED)

Condensed Consolidated Interim Financial Statements as at September 30, 2010 (unaudited)

Contents

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

Introduction

We have reviewed the accompanying financial information of Bezeq The Israel Telecommunication Corporation Ltd**.** and its subsidiaries ("the Group"), comprising of the condensed consolidated interim statement of financial position as of September 30, 2010 and the related condensed consolidated interim statements of income, comprehensive income, changes in equity and cash flows for the nine and three month periods then ended. The Board of Directors and Management are responsible for the preparation and presentation of this interim financial information in accordance with IAS 34 - "*Interim Financial Reporting"*, and are also responsible for the preparation of financial information for this interim period in accordance with Section D of the Securities Regulations (Periodic and Immediate Reports) 1970. Our responsibility is to express a conclusion on this interim financial information based on our review.

We did not review the condensed interim financial information of certain consolidated subsidiaries whose assets constitute 2.4% of the total consolidated assets as at September 30, 2010, and whose revenues constitute 0.9% and 1.5% of the total consolidated revenues for the nine and three month periods then ended, respectively. The condensed interim financial information of those companies was reviewed by other auditors whose review reports thereon were furnished to us, and our conclusion, insofar as it relates to amounts emanating from the financial information of such companies, is based solely on the said review reports of the other auditors.

Review scope

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

Conclusion

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

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

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

Somekh Chaikin
Certified Public Accountants

November 1, 2010

Condensed Consolidated Interim Statements of Financial Position

	September 30, 2010	September 30, 2009	December 31, 2009
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Assets			
Cash and cash equivalents	**1,346**	1,278	580
Investments, including derivatives	**66**	181	154
Trade receivables	**2,737**	2,473	2,491
Other receivables	**191**	187	171
Inventory	**178**	196	263
Assets held for sale	**30**	34	40
Total current assets	**4,548**	4,349	3,699
Investments, including derivatives	**134**	161	130
Trade and other receivables	**1,073**	809	887
Property, plant and equipment	**5,533**	5,459*	5,428*
Intangible assets	**2,221**	1,874	1,885
Deferred and other expenses	**300**	283*	301*
Investments in equity-accounted investees (mainly loans)	**1,111**	1,215	1,219
Deferred tax assets	**332**	385	392
Total non-current assets	**10,704**	10,186	10,242
Total assets	**15,252**	14,535	13,941

	September 30, 2010	September 30, 2009	December 31, 2009
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Liabilities			
Debentures, loans and borrowings	**954**	879	862
Trade payables	**1,086**	989	1,091
Other payables, including derivatives	**848**	714	697
Current tax liabilities	**377**	251	118
Deferred income	**32**	42	36
Provisions	**295**	365	380
Employee benefits	**351**	273	505
Dividend payable	**1,280**	1,149	-
Total current liabilities	**5,223**	4,662	3,689
Debentures	**1,958**	2,715	2,716
Bank loans	**2,815**	572	558
Employee benefits	**298**	271	294
Deferred income and others	**44**	5	5
Provisions	**68**	70	71
Deferred tax liabilities	**88**	52	70
Total non-current liabilities	**5,271**	3,685	3,714
Total liabilities	**10,494**	8,347	7,403
Equity			
Total equity attributable to Company shareholders	**4,714**	6,163	6,544
Non-controlling interests	**44**	25	(6)
Total equity	**4,758**	6,188	6,538
Total equity and liabilities	**15,252**	14,535	13,941

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

Date of approval of the financial statements: November 1, 2010

* Retrospective application by restatement, see Note 3

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

Condensed Consolidated Interim Statements of Income

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	**2009**	**2010**	**2009**	**2009**
	(Unaudited)	**(Unaudited)**	**(Unaudited)**	**(Unaudited)**	**(Audited)**
	NIS millions	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**
Continuing operations					
Revenue (Note 8)	**8,929**	8,587	**3,033**	2,924	11,519
Costs and expenses					
Depreciation and amortization	**1,041**	1,109	**350**	361	1,485
Salaries	**1,486**	1,464	**492**	475	1,990
Operating and general expenses (Note 9)	**3,713**	3,576	**1,271**	1,251	4,871
Other operating expenses (income), net	**(154)**	(54)	**(59)**	(38)	201
	6,086	6,095	**2,054**	2,049	8,547
Operating profit	**2,843**	2,492	**979**	875	2,972
Finance income (expenses)					
Finance expenses	**287**	331	**150**	168	398
Finance income	**(200)**	(344)	**(76)**	(152)	(429)
Finance expenses (income), net	**87**	(13)	**74**	16	(31)
Profit after finance expenses (income), net	**2,756**	2,505	**905**	859	3,003
Share in losses of equity-accounted investees	**(180)**	(8)	**(71)**	(12)	(34)
Profit before income tax	**2,576**	2,497	**834**	847	2,969
Income tax	**708**	702	**246**	259	807
Profit for the period from continuing operations	**1,868**	1,795	**588**	588	2,162
Discontinued operations					
Profit for the period from discontinued operations	**-**	1,379	**-**	1,475	1,379
Profit for the period	**1,868**	3,174	**588**	2,063	3,541

Condensed Consolidated Interim Statements of Income (Contd.)

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Attributable to:					
Company shareholders					
Profit for the period from continuing operations	**1,868**	1,791	**588**	586	2,157
Profit for the period from discontinued operations	**-**	1,446	**-**	1,502	1,446
	1,868	3,237	**588**	2,088	3,603
Non-controlling interests					
Profit for the period from continuing operations	**-***	4	**-***	2	5
Loss for the period from discontinued operations	**-**	(67)	**-**	(27)	(67)
	-	(63)	**-**	(25)	(62)
Profit for the period	**1,868**	3,174	**588**	2,063	3,541
Earnings per share					
Basic earnings per share (NIS)					
Profit from continuing operations	**0.70**	0.68	**0.22**	0.22	0.82
Profit from discontinued operations	**-**	0.55	**-**	0.57	0.55
	0.70	1.23	**0.22**	0.79	1.37
Diluted earnings per share (NIS)					
Profit from continuing operations	**0.69**	0.67	**0.22**	0.22	0.80
Profit from discontinued operations	**-**	0.54	**-**	0.57	0.54
	0.69	1.21	**0.22**	0.79	1.34

* Less than NIS 500,000

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

Condensed Consolidated Interim Statements of Comprehensive Income

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Profit for the period	**1,868**	3,174	**588**	2,063	3,541
Other comprehensive profit (loss) for the period, net of tax	**3**	-	**3**	(1)	(11)
Total comprehensive income for the period	**1,871**	3,174	**591**	2,062	3,530
Attributable to:					
Company shareholders					
Profit for the period from continuing operations	**1,871**	1,791	**591**	585	2,146
Profit for the period from discontinued operations	**-**	1,446	**-**	1,502	1,446
	1,871	3,237	**591**	2,087	3,592
Non-controlling interests					
Profit for the period from continuing operations	**-***	4	**-***	2	5
Comprehensive loss for the period from discontinued operations	**-**	(67)	**-**	(27)	(67)
	-	(63)	**-**	(25)	(62)
Comprehensive income for the period	**1,871**	3,174	**591**	2,062	3,530

* Less than NIS 500,000

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

Condensed Consolidated Interim Statements of Changes in Equity

	Share capital	Premium on share capital	Capital reserve for employee options	Capital reserve for a transaction between a corporation and a controlling shareholder	Other reserves *	Retained deficit	Total	Non-controlling interests	Total equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
	Attributable to Company shareholders								
Nine months ended September 30, 2010 (unaudited)									
Balance at January 1, 2010 (audited)	6,187	275	210	390	(5)	(513)	6,544	(6)	6,538
Comprehensive income for the period (unaudited)	**-**	**-**	**-**	**-**	**3**	**1,868**	**1,871**	**-**	**1,871**
Dividend to shareholders of the Company (unaudited)	**-**	**-**	**-**	**-**	**-**	**(3,733)**	**(3,733)**	**-**	**(3,733)**
Share-based payments (unaudited)	**-**	**-**	**16**	**-**	**-**	**-**	**16**	**-**	**16**
Exercise of options into shares (unaudited)	**19**	**81**	**(79)**	**-**	**-**	**-**	**21**	**-**	**21**
Transfer of funds by non-controlling interests (unaudited)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**2**	**2**
Non-controlling interests in a business combination (unaudited)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**57**	**57**
Increase in holding in a subsidiary (unaudited)	**-**	**-**	**-**	**-**	**(5)**	**-**	**(5)**	**(9)**	**(14)**
Balance at September 30, 2010 (unaudited)	**6,206**	**356**	**147**	**390**	**(7)**	**(2,378)**	**4,714**	**44**	**4,758**
Nine months ended September 30, 2009 (Unaudited)									
Balance at January 1, 2009 (audited)	6,132	-	362	390	(4)	(2,165)	4,715	(471)	4,244
Comprehensive income for the period (unaudited)	-	-	-	-	-	3,237	3,237	(63)	3,174
Dividend to shareholders of the Company (unaudited)	-	-	-	-	-	(1,941)	(1,941)	-	(1,941)
Share-based payments (unaudited)	-	-	35	-	-	-	35	-	35
Exercise of options into shares (unaudited)	49	247	(179)	-	-	-	117	-	117
Derecognition of non-controlling interests for deconsolidation of a company (unaudited)	-	-	-	-	-	-	-	551	551
Transfer of funds by non-controlling interests (unaudited)	-	-	-	-	-	-	-	8	8
Balance at September 30, 2009 (unaudited)	6,181	247	218	390	(4)	(869)	6,163	25	6,188

* Including translation reserve, available for sale assets and transactions with non-controlling interests.

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

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

	Share capital	Premium on share capital	Capital reserve for employee options	Capital reserve for a transaction between a corporation and a controlling shareholder	Other reserves *	Retained deficit	Total	Non-controlling interests	Total equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
	Attributable to Company shareholders								
Three months ended September 30, 2010 (Unaudited)									
Balance at July 1, 2010 (unaudited)	6,203	345	153	390	(5)	(1,686)	5,400	49	5,449
Comprehensive income for the period (unaudited)	**-**	**-**	**-**	**-**	**3**	**588**	**591**	**-**	**591**
Dividend to shareholders of the Company (unaudited)	**-**	**-**	**-**	**-**	**-**	**(1,280)**	**(1,280)**	**-**	**(1,280)**
Share-based payments (unaudited)	**-**	**-**	**5**	**-**	**-**	**-**	**5**	**-**	**5**
Exercise of options into shares (unaudited)	**3**	**11**	**(11)**	**-**	**-**	**-**	**3**	**-**	**3**
Transfer of funds by non-controlling interests (unaudited)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**2**	**2**
Non-controlling interests in a business combination (unaudited)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**2**	**2**
Increase in holding in a subsidiary (unaudited)	**-**	**-**	**-**	**-**	**(5)**	**-**	**(5)**	**(9)**	**(14)**
Balance at September 30, 2010 (unaudited)	**6,206**	**356**	**147**	**390**	**(7)**	**(2,378)**	**4,714**	**44**	**4,758**
Three months ended September 30, 2009 (Unaudited)									
Balance at July 1, 2009 (unaudited)	6,172	203	244	390	(3)	(1,808)	5,198	(503)	4,695
Comprehensive income for the period (unaudited)	-	-	-	-	(1)	2,088	2,087	(25)	2,062
Dividend to shareholders of the Company (unaudited)	-	-	-	-	-	(1,149)	(1,149)	-	(1,149)
Share-based payments (unaudited)	-	-	7	-	-	-	7	-	7
Exercise of options into shares (unaudited)	9	44	(33)	-	-	-	20	-	20
Derecognition of non-controlling interests for deconsolidation of a company (unaudited)	-	-	-	-	-	-	-	551	551
Transfer of funds by non-controlling interests (unaudited)	-	-	-	-	-	-	-	2	2
Balance at September 30, 2009 (unaudited)	6,181	247	218	390	(4)	(869)	6,163	25	6,188

* Including translation reserve, available for sale assets and transactions with non-controlling interests.

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

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

	Share capital	Premium on share capital	Capital reserve for employee options	Capital reserve for a transaction between a corporation and a controlling shareholder	Other reserves *	Retained deficit	Total	Non-controlling interests	Total equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
	Attributable to Company shareholders								
Year ended December 31, 2009 (audited):									
Balance at January 1, 2009 (audited)	6,132	-	362	390	(4)	(2,165)	4,715	(471)	4,244
Comprehensive income for the year (audited)	-	-	-	-	(1)	3,593	3,592	(62)	3,530
Dividends to Company shareholders (audited)	-	-	-	-	-	(1,941)	(1,941)	-	(1,941)
Share-based payments (audited)	-	-	49	-	-	-	49	-	49
Exercise of options into shares (audited)	55	275	(201)	-	-	-	129	-	129
Derecognition of non-controlling interests for deconsolidation of a company (audited)	-	-	-	-	-	-	-	551	551
Dividend paid to non-controlling interests less transfer of funds (audited)	-	-	-	-	-	-	-	(24)	(24)
Balance at December 31, 2009 (audited)	6,187	275	210	390	(5)	(513)	6,544	(6)	6,538

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

Condensed Consolidated Interim Statements of Cash Flows

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cash flows from operating activities					
Profit for the period	**1,868**	3,174	**588**	2,063	3,541
Adjustments:					
Depreciation	**823**	1,037*	**277**	332*	1,343*
Amortization of intangible assets	**198**	202	**65**	60	266
Amortization of deferred and other expenses	**20**	16*	**8**	6*	22*
Profit from deconsolidation of a subsidiary	**-**	(1,538)	**-**	(1,538)	(1,538)
Profit from increase in control in an investee	**(57)**	-	**-**	-	-
Share in losses of equity-accounted investees	**180**	8	**71**	12	34
Finance expenses, net	**77**	367	**43**	195	362
Capital gain, net	**(115)**	(54)	**(86)**	(30)	(64)
Share-based payments	**16**	35	**5**	7	49
Income tax expenses	**708**	702	**246**	259	807
Proceeds (payment) for derivatives, net	**(1)**	14	**-**	(2)	11
Change in inventory	**89**	(47)	**(4)**	(8)	(114)
Change in trade and other receivables	**(288)**	(474)	**(44)**	(215)	(546)
Change in trade and other payables	**86**	228	**242**	54	247
Change in provisions	**(91)**	22	**(79)**	11	36
Change in broadcasting rights	**-**	(49)	**-**	15	(49)
Change in employee benefits	**(153)**	(126)	**(100)**	(71)	115
Change in deferred income and others	**(1)**	(41)	**6**	7	(41)
Income tax paid, net	**(411)**	(346)	**(72)**	(60)	(565)
Net cash from operating activities	**2,948**	3,130	**1,166**	1,097	3,916
Cash flow used in investment activities					
Investment in intangible assets and deferred expenses	**(234)**	(247)	**(76)**	(91)	(349)
Proceeds from sale of property, plant and equipment	**89**	102	**48**	40	90
Change in current investments, net	**90**	(134)	**(20)**	(40)	(134)
Purchase of property, plant and equipment	**(907)**	(1,125)	**(300)**	(369)	(1,363)
Proceeds from disposal of investments and long-term loans	**12**	43	**8**	2	93
Investments and long-term loans	**(4)**	(4)	**(1)**	(1)	(4)
Business combinations less cash acquired	**(145)**	-	**(115)**	-	-
Dividend received	**-**	5	**-**	-	6
Interest received	**9**	26	**2**	13	29
Net cash used for investment activities	**(1,090)**	(1,334)	**(454)**	(446)	(1,632)

* Retrospective application by restatement, see Note 3

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

Condensed Interim Statements of Cash Flows (contd.)

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cash flow for finance activities					
Bank loans received	**2,670**	400	**770**	-	400
Repayment of debentures	**(687)**	(672)	**(65)**	(63)	(682)
Repayment of loans	**(433)**	(86)	**(9)**	(24)	(109)
Short-term borrowing, net	**(6)**	48	**(231)**	7	48
Dividend paid	**(2,453)**	(792)	**-**	-	(1,941)
Interest paid	**(192)**	(338)	**(17)**	(80)	(354)
Proceeds for derivatives, net	**-**	11	**-**	-	43
Transfer of funds by non-controlling interests less					
Dividend distributed, net	**2**	8	**2**	2	(24)
Increase in holding in a subsidiary	**(14)**	-	**(14)**	-	-
Proceeds from exercise of employee options	**21**	117	**3**	20	129
Net cash from (used for) finance activities	**(1,092)**	(1,304)	**439**	(138)	(2,490)
Net increase (decrease) in cash and cash equivalents	**766**	492	**1,151**	513	(206)
Cash and cash equivalents at beginning of period	**580**	786	**195**	765	786
Cash and cash equivalents at end of period	**1,346**	1,278	**1,346**	1,278	580

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

NOTE 1 – REPORTING ENTITY

A. Bezeq – The Israel Telecommunication Corp. Ltd. ("the Company") is a company registered in Israel whose shares are traded on the Tel Aviv Stock Exchange. The condensed consolidated financial statements of the Company include those of the Company and its subsidiaries (together – "the Group"), as well as the interests of the Group in associates. The Group is a principal provider of communication services in Israel (see also Note 10 – Segment Reporting).

B. As from April 14, 2010, B Communications (SP2) Ltd. (B Communications) is the controlling shareholder of the Company, after acquiring the shares of the Company from Ab.Sp.Ar. At September 30, 2010, B Communications holds 30.39% of the Company's shares. B Communications is wholly owned and controlled by B Communications (SP1) Ltd., which is wholly owned and controlled by B Communications Ltd. (formerly 012 Smile Communications Ltd.).

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

D. On April 25, 2010, Bezeq International completed the acquisition of the shares held by Haaretz Newspaper Publishing Ltd. in Walla! Communications Ltd. (Walla) and on September 21, 2010, Bezeq International sold all of its holdings in Walla to the Company. As from April 25, 2010, the Group consolidates Walla in its financial statements. See Note 4 below.

NOTE 2 – BASIS OF PREPARATION

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

B. The condensed consolidated interim financial statements do not contain all the information required in full annual financial statements, and should be reviewed in the context of the annual financial statements of the Company and its subsidiaries at December 31, 2009 and the year then ended, and their accompanying notes ("the annual financial statements"). The notes to the interim financial statements include only the material changes that have occurred from the date of the most recent annual financial statements until the date of these consolidated interim financial statements.

C. The condensed consolidated interim financial statements were approved by the Board of Directors on November 1, 2010.

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

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

NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICY

The significant accounting policies applied in these condensed consolidated interim financial statements are consistent with those applied in the annual financial statements for the year ended December 31, 2009, except for application of new standards and amendments to standards, as set out below.

Initial implementation of new accounting standards

Commencing from January 1, 2010, the Group applies the amendment to IAS 17 – *Leases: Classification of Leases of Land and Buildings* ("the Amendment"). The Amendment eliminates the requirement to classify a lease of land as an operating lease when the title is not expected to pass to the lessee at the end of the lease term.
The Company leases land from the Israel Land Administration, accounted for as an operating lease. Subsequent to adoption of the Amendment, the Company classified the lease of the land retrospectively as a finance lease. Accordingly, the land is stated as property, plant and equipment in the statement of financial position as at September 30, 2010 and December 31, 2009, in the amount of NIS 151 million and NIS 125 million, respectively.

NOTE 4 – GROUP ENTITIES

A detailed description of the Group entities appears in Note 13 to the Group's annual financial statements as at December 31, 2009. Below are details of the material changes that occurred in connection with the Group entities since publication of the annual financial statements.

A. Equity-accounted associates

DBS Satellite Services (1998) Ltd.

(1) On March 18, 2010, the board of directors of the Company, as shareholder in DBS Satellite Services (1998) Ltd. ("DBS"), approved the amendment to the financing agreement between DBS and the banks that provide financing for the operations of DBS ("the banks"). Under the amendment, another bank will join the banks and the amount and terms of the financing provided to DBS will be adjusted. Concurrently, amendments were approved to the deed of amendment to the shareholders' loans and the deed of amendment to the guarantee provided by the Company in favor of the banks, such that they would apply to the adjusted financing arrangement. These amendments do not significantly increase the Company's exposure (if at all).

(2) At September 30, 2010, the balance of DBS's current debt to the Company and its subsidiaries amounts to NIS 59 million, of which NIS 47 million is to the Company. Further to Note 13(A)(2) to the financial statements as at December 31, 2009 in respect of DBS's current debt to the Group companies, in May 2010, the general meeting of the Company's shareholders approved an arrangement for DBS's debt to the Company for communication services, amounting to NIS 31.5 million at July 31, 2009 (reflecting a compromise between the Company's position and that of DBS). Under the arrangement, DBS will repay the debt to the Company in 36 equal monthly payments of NIS 875,000 each plus VAT and interest at prime + 1.5% plus VAT for the interest.

Subsequent to the reporting date, in October 2010, the general meeting of the Company's shareholders approved an amendment to this debt arrangement and to another debt arrangement from September 2006 between the Company and DBS. Under the amendments, all the payments in both debt arrangements that are due from July 2010 to December 2011 will be deferred for 18 months, against payment of annual interest of prime + 3% plus VAT for the interest. The deferred payments amount to NIS 45.4 million. The general meeting also approved a similar arrangement for DBS's debt of NIS 8.37 million to Bezeq International.

(3) Following a ruling in the arbitration regarding the formula for calculating royalties for broadcasting works with rights that are administered by the composers, lyricists, poets and music publishers society (ACUM Ltd.), DBS included a material provision in its financial statements as at June 30, 2010. See Note 6(C) to the financial statements of DBS attached to these statements.

NOTE 4 – GROUP ENTITIES (CONTD.)

A. Equity-accounted associates (contd.)

DBS Satellite Services (1998) Ltd. (contd.)

(3) (contd.)

DBS is in compliance with the financial covenants set out in the finance agreement as of September 30, 2010, after receiving relief from the banks in October 2010 in relation to the target of one of the covenants at September 30, 2010, which was required in view of the significant provision recorded by DBS as aforesaid. As this relief was received subsequent to the reporting date, DBS's bank loan of NIS 817.323 million is stated as a short-term liability. DBS received similar relief for the targets of the financial covenants for December 31, 2010.

The management of DBS believes that the financing resources available to the company will be sufficient for its operational requirements for the coming year, based on the projected cash flow approved by the board of directors of DBS. If additional resources are required to meet its operational requirements in the coming year, DBS will adapt its operations to preclude the need for additional resources beyond those available to it.
For additional details see Note 4 to the financial statements of DBS as at September 30, 2010, which are attached to these financial statements.

B. Subsidiaries

(1) Walla! Communications Ltd.

On April 25, 2010, Bezeq International acquired 14,807,939 ordinary shares of Walla, representing 32.55% of the issued and paid up share capital of Walla, in an off-floor transaction, for NIS 89 million. Following the acquisition, Bezeq International is the controlling shareholder in Walla and as from April 25, 2010, Bezeq International began to consolidate Walla in its financial statements.

On August 29, 2010, Bezeq International acquired an additional 2,274,299 shares of Walla (representing 5% of the issued and paid up share capital of Walla) through a special tender offer, at a price of NIS 6 per share and a total of NIS 13.6 million.
On September 21, 2010, after receiving approval from the Antitrust Commissioner for the merger with Walla, the Company acquired from Bezeq International all the shares held by Bezeq International, representing 71.76% of the issued and paid up share capital of Walla, for NIS 196 million.

The contribution of Walla to profit and revenue as from the beginning of the consolidation and through to September 30, 2010 amounted to NIS 4.8 million and NIS 78 million, respectively. Had the acquisition taken place on January 1, 2010, the revenue in the consolidated statement of income and the consolidated profit in the period would not have been materially different. Management assumes that the fair value adjustments at the acquisition date, which were determined, are the same as the adjustments that would have been received had the acquisition taken place on January 1, 2010. As from the date of consolidation, the operations of Walla are included under the Others segment (see Note 10). In accordance with IFRS, the holdings in Walla prior to the acquisition were estimated at the share price which was included in the acquisition transaction. As a result, a profit of NIS 57 million was included under other operating revenue in the consolidated financial statements.

The Group carried out temporary attribution of the acquisition cost in relation to the fair value of the assets and liabilities that were acquired in the context of a business combination. The fair value of the acquired assets and liabilities is adjustable up to twelve months from the acquisition date.

NOTE 4 – GROUP ENTITIES (CONTD.)

B. Subsidiaries (contd.)

(1) Walla! Communications Ltd. (contd.)

Acquisition of the Group's assets and liabilities at the acquisition date had the following effect:

	Values recognized at the acquisition date
	(Unaudited)
	NIS millions
Identifiable assets and liabilities, net	111
Prior equity rights in an acquiree	(94)
Goodwill upon acquisition	70
Non-controlling interests	(57)
Cost of business combination	30
Proceeds paid in cash	(89)
Cash acquired	59
Cash paid, net	(30)

(2) Coral Tell Ltd.

On September 2, 2010, Walla finalized the agreement of July 8, 2010 with the shareholders of Coral-Tell Ltd. ("Yad2"), which operates the classified ads site Yad2. Under the agreement, Walla will acquire 75% of the share capital of Yad2 for NIS 117.5 million, plus an additional sum to be paid to some of the sellers, based on the total working capital of Yad2 and subject to adjustments. Under the acquisition agreement, Walla has a call option locked for three years at a price based on the value of Yad2 that is not less than NIS 125 million and not more than NIS 200 million. Additionally, Walla granted a put option for all of Walla shares, at a fixed price of NIS 125 million based on the value of Yad2, to non-controlling interests in Yad2. The options are exercisable after three years from finalization of the transaction for a period of one year. Under the purchase agreement, Walla and the non-controlling interest in Yad2 agreed to distribute a maximum dividend.

Due to the call and put options, the business combination was accounted for as acquisition of 100% of the rights in Yad2 and the consideration for the business combination includes the fair value of liabilities expected to be paid to the non-controlling interests in Yad2.

Walla carried out temporary attribution of the acquisition cost in relation to the fair value of the assets and liabilities that were acquired in the context of a business combination. The fair value of the acquired assets and liabilities is adjustable up to twelve months from the acquisition date. Had the acquisition taken place at the beginning of the year, the revenue in the consolidated statement of income and the consolidated profit in the period would not have been materially different.

NOTE 4 – GROUP ENTITIES (CONTD.)

B. Subsidiaries (contd.)

(2) Coral Tell Ltd. (contd.)

Acquisition of the Group's assets and liabilities at the acquisition date had the following effect:

	Values recognized at the acquisition date
	(Unaudited)
	NIS millions
Identifiable assets and liabilities, net	76
Goodwill upon acquisition	79
Put option for non-controlling interests	(38)
Payables for investment	(2)
Cost of business combination	115
Proceeds paid in cash	(116)
Cash acquired	1
Cash paid, net	(115)

NOTE 5 – CONTINGENT LIABILITIES

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

In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 279 million, where provisions are required to cover the exposure resulting from such claims.
In the opinion of the managements of the Group companies, the additional exposure at September 30, 2010, due to claims filed against the Group companies on various matters and which are unlikely to be realized, amounts to NIS 12.9 billion (of which an amount of NIS 4 billion is for claims, which at this stage, cannot be assessed, as set out in sections B and D below). For updates in this matter subsequent to the reporting date, see section B below). This amount and all the amounts of the additional exposure in this note are linked to the CPI and before the addition of interest.

For applications for certification as class action of lawsuits to which the Group has exposure beyond the aforesaid (since the claims do not state an exact amount), see sections B and D below.

The contingent liabilities of the Group are described in detail in Note 18 to the financial statements of the Group as at December 31, 2009. Following is a detailed description of the Group's contingent liabilities at September 30, 2010, classified into groups with similar characteristics.

A. Employee claims

At September 30, 2010, the additional exposure (beyond the provisions included in these financial statements) for employee claims amounts to NIS 1.4 billion and relates mainly to claims filed by groups of employees or individual claims with wide ramifications. In the opinion of the management of the Company, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 117 million, where provisions are required to cover the exposure resulting from such claims.

NOTE 5 – CONTINGENT LIABILITIES (CONTD.)

B. Customer claims

At September 30, 2010, the additional exposure (beyond the provisions included in these financial statements) for customer claims amounts to NIS 5 billion. Of these claims, there are claims amounting to NIS 260 million, which, at this stage, cannot yet be estimated. There are other claims for which the Group has additional exposure beyond the aforesaid, which cannot be quantified, as the exact amount of the claims is not stated in the claim. In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 56 million, where provisions are required to cover the exposure from such claims.

Subsequent to the reporting date, customers of Group companies filed a number of claims, amounting to NIS 2.06 billion, which cannot be assessed at this stage.

C. Supplier and communication provider claims

At September 30, 2010, the amount of the additional exposure for claims filed by suppliers and communication providers (beyond the provisions included in these financial statements) amounts to NIS 977 million. In the opinion of the managements of the Group companies, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions amounting to NIS 11 million, where provisions are required to cover the exposure resulting from such claims.

D. Claims for punitive damages

At September 30, 2010, the amount of the additional exposure (beyond the provisions included in these financial statements) for punitive damages amounts to NIS 4.9 billion. This amount does not include claims for which the insurance coverage is not disputed. Of these claims, there are claims amounting to NIS 3.7 billion, which, at this stage, cannot yet be estimated. There are other claims for which the Group has additional exposure beyond the aforesaid, which cannot be quantified, as the exact amount of the claim is not stated in the claim.
In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 2.6 million, where provisions are required to cover the exposure resulting from such claims.

E. Claims by entrepreneurs and companies

At September 30, 2010, the amount of the additional exposure for claims filed by entrepreneurs and companies (beyond the provisions included in these financial statements) amounts to NIS 318 million. In the opinion of the managements of the Group companies, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions amounting to NIS 10 million, where provisions are required to cover the exposure resulting from such claims.

F. Claims by the State and authorities

At September 30, 2010, the amount of the additional exposure for claims filed by the State of Israel and various authorities (beyond the provisions included in these financial statements) amounts to NIS 280 million. In the opinion of the managements of the Group companies, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions amounting to NIS 82 million, where provisions are required to cover the exposure resulting from such claims.

In December 2000, the government filed a claim against Pelephone for royalties allegedly due from January 1994 to February 1996. The amount in the claim is NIS 260 million at the date of the claim, including principle, linkage differences and interest. In September 2010, the court ruled against Pelephone, accepting some of the government's claims. Pelephone was required to pay the government NIS 150 million, including principle, linkage differences and interest, which is included as a liability in these financial statements. This amount was paid in October 2010. Additionally, in October 2010 Pelephone filed an appeal of the ruling at the Supreme Court. Prior to the ruling, the Group included a provision for the claim in its financial statements, amounting to NIS 76 million.

For claims against DBS, see Note 5 to the financial statements of DBS as at September 30, 2010, which are attached to these financial statements.

NOTE 6 – EQUITY AND SHARE-BASED PAYMENTS

A. Share capital

Registered			Issued and paid up		
September 30, 2010	September 30, 2009	December 31, 2009	September 30, 2010	September 30, 2009	December 31, 2009
(Unaudited)	(Unaudited)	(Audited)	(Unaudited)	(Unaudited)	(Audited)
Number of shares	Number of shares	Number of shares	Number of shares	Number of shares	Number of shares
2,749,000,000	2,749,000,000	2,749,000,000	**2,678,944,392**	2,653,896,660	2,659,727,630

B. In January and March 2010, the board of directors of the Company approved the allotment of 1,000,000 options to senior employees in the Group, under the plan set out in Note 27(A)(3) to the financial statements as at December 31, 2009. The theoretical economic value of the allotted options, calculated at the date of approval of the allotment by the board of directors, according to a weighted Black and Scholes model, is NIS 3.2 million.

C. Following the exercise of options by employees in accordance with the options plans described in Note 27 to the financial statements as at December 31, 2009, in the nine months ended September 30, 2010, the Company issued 19,216,762 ordinary shares of NIS 1 par value each.

D. Subsequent to the reporting date and through October 31, 2010, following the exercise of options by the employees, in accordance with the options plans set out in Note 27 to the financial statements as at December 31, 2009, the Company issued 2,059,219 ordinary shares of NIS 1 par value each.

E. Dividends

(1) The Company paid dividends as follows:

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cash dividend paid in October 2010 (NIS 0.478 per share) (2)	**1,280**	-	**1,280**	-	-
Cash dividend paid in May 2010 (NIS 0.917 per share)	**2,453**	-	**-**	-	-
Cash dividend paid in October 2009 (NIS 0.43 per share)	**-**	1,149		1,149	1,149
Cash dividend paid in May 2009 (NIS 0.3 per share)	**-**	792	**-**	-	792
	3,733	1,941	**1,280**	1,149	1,941

(2) On August 2, 2010, the board of directors of the Company resolved to recommend to the general meeting the distribution of a cash dividend to the shareholders in the amount of NIS 1.280 million. On September 12, 2010 the general meeting approved payment of the dividend and it was paid on October 7, 2010.

NOTE 7 – TRANSACTIONS WITH INTERESTED AND RELATED PARTIES

A. Further to Note 30(B) to the financial statements as at December 31, 2009, in respect of the management and consultation services agreement with Ap.Sb.Ar. and the subsequent sale of the controlling stake in the Company by Ap.Sb.Ar., on April 14, 2010, the management agreement between the Company and a company owned and controlled by the shareholders in Ap.Sb. Ar was terminated.
In addition, in May 2010, the general meeting of the shareholders of the Company approved a new agreement between the Company and Eurocom Communications Ltd. Under the agreement, Eurocom will provide the Company ongoing management and consultation services for an annual fee of $1.2 million. The term of the agreement is for three months as from June 1, 2010.

B. Subsequent to the transfer of control in the Company, the certified bodies of the Company approved a series of agreements between the Company and its subsidiaries and DBS with B Communications Group, including extraordinary transactions. The transactions are approved from time to time according to the requirements of the Company and its subsidiaries and are reported to the public according to the law.

Material balances with interested and related parties

	Nine months ended		Three months ended		Year ended
	September 30		September 30		December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue:					
Associates	**119**	185	**46**	78	224
Related parties	**9**	-	**4**	-	-
Expenses:					
Associates	**2**	3	**2**	2	3
Related parties	**204**	-	**118**	-	-
Investments:					
Related parties	**55**	-	**26**	-	-

Material balances with interested and related parties

	September 30	December 31,
	2010	2009
	(Unaudited)	(Audited)
	NIS millions	NIS millions
Receivables - associates, net	**59**	70
Loans to an associate	**1,111**	1,165
Liabilities to related parties, net	**(139)**	-
Loan from related parties to an associate	**(903)**	-

NOTE 7 – TRANSACTIONS WITH INTERESTED AND RELATED PARTIES (CONTD.)

C. Further to Note 30(F) to the financial statements as at December 31, 2009, on April 8, 2010, the general meeting of the Company's shareholders approved a maximum bonus for 2009 for the chairman of the Company's board of directors, under the terms of his employment agreement, as approved by the general meeting on June 1, 2008, of 18 monthly salaries, amounting to NIS 3.44 million.

D. Further to Note 30 (G)(11) to the financial statements as at December 31, 2009 regarding the conversion of the D&O insurance policy to a runoff policy, in March 2010, the general meeting of the Company's shareholders approved the agreement for acquisition of the runoff policy. In addition, further to the transfer of control in the Company and the appointment of new directors, in May 2010, the general meeting of the Company's shareholders approved a letter of indemnity for the directors, in the format that is accepted in the Company as approved by the general meeting.

E. In May 2010, the general meeting of the Company's shareholders approved the settlement agreement between the Company and the former CEO of the Company, in which all of the mutual claims of the parties are dismissed, including claims against other Group companies and their representatives. Under the agreement, the Company paid the former CEO a lump sum of NIS 9 million.

NOTE 8 – REVENUE

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Domestic fixed-line communications					
Fixed line telephony	**2,302**	2,440	**765**	810	3,247
Internet - infrastructure	**720**	638	**249**	230	862
Transmission, data communication and other	**707**	717	**239**	239	940
	3,729	3,795	**1,253**	1,279	5,049
Cellular					
Cellular services and terminal equipment	**3,220**	2,987	**1,098**	1,040	4,013
Sale of terminal equipment	**854**	813	**280**	271	1,119
	4,074	3,800	**1,378**	1,311	5,132
International communications, internet services and NEP	**1,004**	949	**337**	319	1,276
Other	**122**	43	**65**	15	62
	8,929	8,587	**3,033**	2,924	11,519

NOTE 9 – OPERATING AND GENERAL EXPENSES

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cellular telephone expenses	**1,381**	1,309	**469**	457	1,750
General expenses	**866**	796	**303**	305	1,140
Materials and spare parts	**765**	718	**245**	236	1,003
Services and maintenance by sub-contractors	**86**	104	**26**	31	146
Building maintenance	**201**	218	**80**	77	295
International communication expenses	**242**	242	**84**	81	313
Vehicle maintenance expenses	**94**	91	**30**	30	124
Royalties to the State of Israel	**61**	74	**28**	26	66
Collection fees	**17**	24	**6**	8	34
	3,713	3,576	**1,271**	1,251	4,871

NOTE 10 – SEGMENT REPORTING

A. Operating segments

	Nine months ended September 30, 2010 (unaudited)						
	Domestic fixed-line communication	Cellular telephone	International communication and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue from external sources	**3,726**	**4,073**	**1,004**	**1,181**	**115**	**(1,181)**	**8,918**
Inter-segment revenue	**208**	**191**	**26**	**2**	**26**	**(442)**	**11**
Total revenue	**3,934**	**4,264**	**1,030**	**1,183**	**141**	**(1,623)**	**8,929**
Depreciation and amortization	**512**	**447**	**70**	**200**	**7**	**(195)**	**1,041**
Segment results – operating profit	**1,549**	**1,040**	**255**	**138**	**12**	**(151)**	**2,843**
Finance expenses	**190**	**95**	**8**	**368**	**-**	**(374)**	**287**
Finance income	**(132)**	**(72)**	**(5)**	**(2)**	**-**	**11**	**(200)**
Total finance expenses (income), net	**58**	**23**	**3**	**366**	**-**	**(363)**	**87**
Segment profit (loss) after finance expenses, net	**1,491**	**1,017**	**252**	**(228)**	**12**	**212**	**2,756**
Share in the (profits) losses of equity-accounted investees	**-**	**-**	**4**	**-**	**-**	**(184)**	**(180)**
Segment profit (loss) before income tax	**1,491**	**1,017**	**256**	**(228)**	**12**	**28**	**2,576**
Income tax	**405**	**252**	**48**	**1**	**3**	**(1)**	**708**
Segment results – net profit (loss)	**1,086**	**765**	**208**	**(229)**	**9**	**29**	**1,868**

NOTE 10 – SEGMENT REPORTING (CONTD.)

A. Operating segments (contd.)

	Nine months ended September 30, 2009 (unaudited)						
	Domestic fixed-line communication	Cellular telephone	International communication and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue from external sources	3,787	3,799	944	1,137	37	(1,137)	8,567
Inter-segment revenue	200	184	40	3	17	(424)	20
Total revenue	3,987	3,983	984	1,140	54	(1,561)	8,587
Depreciation and amortization	600	446	62	171	1	(171)	1,109
Segment results – operating profit	1,362	939	194	186	3	(192)	2,492
Finance expenses	247	75	8	383	6	(388)	331
Finance income	(269)	(67)	(13)	(13)	-	18	(344)
Total finance expenses (income), net	(22)	8	(5)	370	6	(370)	(13)
Segment profit (loss) after finance expenses, net	1,384	931	199	(184)	(3)	178	2,505
Share in profits (losses) of equity-accounted investees	-	-	5	-	-	(13)	(8)
Segment profit (loss) before income tax	1,384	931	204	(184)	(3)	165	2,497
Profit from discontinued operations	-	-	-	-	-	1,379	1,379
Income tax	413	237	53	1	(1)	(1)	702
Segment results – net profit (loss)	971	694	151	(185)	(2)	1,545	3,174

NOTE 10 – SEGMENT REPORTING (CONTD.)

A. Operating segments (contd.)

	Three months ended September 30, 2010 (unaudited)						
	Domestic fixed-line communication	Cellular telephone	International communication and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue from external sources	1,252	1,378	337	394	61	(392)	3,030
Inter-segment revenue	71	64	10	2	10	(154)	3
Total revenue	1,323	1,442	347	396	71	(546)	3,033
Depreciation and amortization	171	149	23	68	2	(63)	350
Segment results – operating profit	556	356	70	72	9	(84)	979
Finance expenses	84	65	2	151	1	(153)	150
Finance income	(54)	(27)	(1)	(2)	-	8	(76)
Total finance expenses (income), net	30	38	1	149	1	(145)	74
Segment profit (loss) after finance expenses, net	526	318	69	(77)	8	61	905
Share in profits of equity-accounted investees	-	-	-	-	-	(71)	(71)
Segment profit (loss) before income tax	526	318	69	(77)	8	(10)	834
Income tax	149	79	16	1	2	(1)	246
Segment results – net profit (loss)	377	239	53	(78)	6	(9)	588

NOTE 10 – SEGMENT REPORTING (CONTD.)

A. Operating segments (contd.)

	Three months ended September 30, 2009 (unaudited)						
	Domestic fixed-line communication	Cellular telephone	International communication and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue from external sources	1,278	1,309	317	378	15	(378)	2,919
Inter-segment revenue	65	63	15	2	5	(145)	5
Total revenue	1,343	1,372	332	380	20	(523)	2,924
Depreciation and amortization	184	156	21	59	-	(59)	361
Segment results – operating profit	491	316	66	61	2	(61)	875
Finance expenses	126	36	2	162	1	(159)	168
Finance income	(123)	(22)	(4)	(13)	-	10	(152)
Total finance expenses (income), net	3	14	(2)	149	1	(149)	16
Segment profit (loss) after finance expenses, net	488	302	68	(88)	1	88	859
Share in the (profits) losses of equity-accounted investees	-	-	1	-	-	(13)	(12)
Segment profit (loss) before income tax	488	302	69	(88)	1	75	847
Profit from discontinued operations	-	-	-	-	-	1,475	1,475
Income tax	169	71	18	1	(1)	1	259
Segment results – net profit (loss)	319	231	51	(89)	2	1,549	2,063

NOTE 10 – SEGMENT REPORTING (CONTD.)

A. Operating segments (contd.)

	Year Ended December 31, 2009						
	Domestic fixed-line communication	**Cellular telephone**	**International communication and internet services**	**Multi-channel television**	**Others**	**Adjustments**	**Consolidated**
	NIS millions	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**
Revenue from external sources	5,039	5,130	1,273	1,529	54	(1,529)	11,496
Inter-segment revenue	264	246	45	1	20	(553)	23
Total revenue	5,303	5,376	1,318	1,530	74	(2,082)	11,519
Depreciation and amortization	794	603	84	234	4	(234)	1,485
Segment results – operating profit	1,523	1,190	261	248	4	(254)	2,972
Finance expenses	295	100	12	478	-	(487)	398
Finance income	(310)	(90)	(15)	(8)	(23)	17	(429)
Total finance expenses (income), net	(15)	10	(3)	470	(23)	(470)	(31)
Segment profit (loss) after finance expenses, net	1,538	1,180	264	(222)	27	216	3,003
Share in the (profits) losses of equity-accounted investees	-	-	7	-	-	(41)	(34)
Segment profit (loss) before income tax	1,538	1,180	271	(222)	27	175	2,969
Profit from discontinued operations	-	-	-	-	-	1,379	1,379
Income tax	431	305	71	1	2	(3)	807
Segment results – net profit (loss)	1,107	875	200	(223)	25	1,557	3,541

NOTE 10 – SEGMENT REPORTING (CONTD.)

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

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue					
Revenue from reporting segments	**10,411**	10,094	**3,508**	3,427	13,527
Revenue from other segments	**141**	54	**71**	20	74
Cancellation of revenue from inter-segment sales, other than revenue from sales to an associate reporting as a segment	**(442)**	(424)	**(154)**	(145)	(553)
Cancellation of revenue for a segment classified as an associate (up to August 20, 2009 - discontinued operations)	**(1,181)**	(1,137)	**(392)**	(378)	(1,529)
Consolidated revenue	**8,929**	8,587	**3,033**	2,924	11,519

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Profit or loss					
Operating profit or loss for reporting segments	**2,982**	2,675	**1,047**	934	3,216
Profit or loss for other categories	**4**	3	**9**	2	4
Cancellation of capital gain for sale of Walla in Bezeq International	**(5)**	-	**(5)**	-	-
Cancellation of expenses from a segment classified as an associate (up to August 20, 2009 - discontinued operations)	**(138)**	(186)	**(72)**	(61)	(248)
Finance income (expenses), net	**(87)**	13	**(74)**	(16)	31
Share in the profits (losses) of equity-accounted investees	**(180)**	(8)	**(71)**	(12)	(34)
Consolidated profit before income tax	**2,576**	2,497	**834**	847	2,969

NOTE 11 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD. AND BEZEQ INTERNATIONAL LTD.

1. Pelephone Communications Ltd.

A. Statement of financial position

	September 30, 2010	September 30, 2009	December 31, 2009
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Current assets	**2,013**	2,030	2,102
Non-current assets	**2,838**	2,872	2,888
	4,851	4,902	4,990
Current liabilities	**1,193**	1,251	1,519
Long term liabilities	**752**	909	921
Total liabilities	**1,945**	2,160	2,440
Equity	**2,906**	2,742	2,550
	4,851	4,902	4,990

B. Statement of income

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue from services	**3,405**	3,170	**1,159**	1,101	4,256
Revenue from sale of terminal equipment	**859**	813	**283**	271	1,120
Revenue from services and sales	**4,264**	3,983	**1,442**	1,372	5,376
Cost of services and sales	**2,784**	2,627	**941**	910	3,592
Gross profit	**1,480**	1,356	**501**	462	1,784
Selling and marketing expenses	**351**	325	**115**	116	461
General and administrative expenses	**89**	92	**30**	30	133
	440	417	**145**	146	594
Operating profit	**1,040**	939	**356**	316	1,190
Finance expenses	**95**	75	**65**	36	100
Finance income	**(72)**	(67)	**(27)**	(22)	(90)
Net finance expenses (income)	**23**	8	**38**	14	10
Profit before income tax	**1,017**	931	**318**	302	1,180
Income tax	**252**	237	**79**	71	305
Profit for the period	**765**	694	**239**	231	875

NOTE 11 - CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD. AND BEZEQ INTERNATIONAL LTD. (CONTD.)

3. Bezeq International Ltd.

A. Statement of financial position

	September 30, 2010	September 30, 2009	December 31, 2009
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Current assets	**459**	513	547
Non-current assets	**540**	543	559
	999	1,056	1,106
Current liabilities	**258**	279	367
Long term liabilities	**31**	37	37
Total liabilities	**289**	316	404
Equity	**710**	740	702
	999	1,056	1,106

B. Statement of income

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue	**1,030**	984	**347**	332	1,318
Operating expenses	**616**	584	**208**	195	777
Gross profit	**414**	400	**139**	137	541
Selling, marketing and development expenses	**141**	131	**48**	47	175
General and administrative expenses	**80**	75	**26**	24	105
Other income, net	**(62)**	-	**(5)**	-	-
	159	206	**69**	71	280
Operating profit	**255**	194	**70**	66	261
Finance expenses	**8**	8	**2**	2	12
Finance income	**(5)**	(13)	**(1)**	(4)	(15)
Net finance expenses (income)	**3**	(5)	**1**	(2)	(3)
Share in earnings of equity-accounted associates	**4**	5	**-**	1	7
Profit before income tax	**256**	204	**69**	69	271
Income tax	**48**	53	**16**	18	71
Profit for the period from continuing operations	**208**	151	**53**	51	200
Profit (loss) for the period from discontinued operations	**-***	-	**-***	-	-
	208	151	**53**	51	200

* Less than NIS 500,000

NOTE 12 – MATERIAL EVENTS DURING THE REPORTING PERIOD

A. On March 25, 2010, the Company received notice of a strike, in accordance with the Settlement of Labor Disputes Law, 5719-1957, which was declared by the Histadrut Labor Union, as from April 11, 2010. According to the notice, the dispute relates to the Company's disregard of the demand of the workers' union to negotiate for a collective agreement to regulate the rights of employees following transfer of the controlling stake in the Company, before taking steps to transfer control. Consequently, negotiations between the Company's management and the workers' union are underway.

B. In the reporting period, the Company completed debt financing amounting to NIS 2.6 billion, through loans from banks in Israel. Of this amount, NIS 400 million is against early repayment of bank loans from March 2009. Loans of NIS 1.3 billion are at fixed interest and the balance of NIS 1.3 billion are at variable interest, payable as follows:

1) Loans of NIS 1.1 billion, which are unlinked and bear variable interest of prime minus 0.21%, are repayable in four equal annual payments of the principal between 2013 and 2016. The interest on the loans is payable twice a year.

2) A loan of NIS 200 million, which is unlinked and bears variable interest of prime minus 0.33%, is repayable in six equal annual payments of the principal between 2012 and 2017.

3) Loans of NIS 800 million, which are unlinked and bear average fixed interest of 5.56%, are repayable in four equal annual payments of the principal between 2013 and 2016. The interest on the loans is payable twice a year.

4) Loans of NIS 500 million, which are unlinked and bear average fixed interest of 5%, are repayable in four equal annual payments of the principal between 2012 and 2017.

DBS SATELLITE SERVICES (1998) LTD.

CONDENSED INTERIM FINANCIAL STATEMENTS
SEPTEMBER 30, 2010
(UNAUDITED)

Condensed Interim Financial Statements at September 30, 2010 (unaudited)

Contents

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

Introduction
We have reviewed the accompanying financial information of DBS Satellite Services (1998) Ltd ("the Company"), comprising of the condensed interim statement of financial position as of September 30, 2010 and the related condensed interim statements of income, comprehensive income, changes in equity and cash flows for the nine and three month periods then ended. The Board of Directors and Management are responsible for the preparation and presentation of this interim financial information in accordance with IAS 34 - "*Interim Financial Reporting"*, and are also responsible for the preparation of financial information for this interim period in accordance with Section D of the Securities Regulations (Periodic and Immediate Reports) - 1970. Our responsibility is to express a conclusion on this interim financial information based on our review.

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

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

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

Without qualifying our above conclusion, we draw attention to Note 4 regarding the financial condition of the Company. As stated in the aforementioned Note, as of the date of financial position, the Company is in compliance with the financial covenants set out in the finance agreement, after receiving relief from the banks subsequent to the balance sheet date in respect of said date and in respect of December 31, 2010. The management of the Company believes that the financing resources available to the Company will be sufficient for its operational requirements for the coming year, based on the projected cash flow approved by the board of directors of the Company.

Additionally, we draw attention to Note 22B to the Company's annual financial statements as at December 31, 2009, regarding the class action filed against the Company in respect of disruptions to the Company's broadcasts. In accordance with the assessment of the Company's management, which is based on the opinion of its legal counsels, the Company has included an appropriate provision in its financial statements.

Somekh Chaikin
Certified Public Accountants

October 31, 2010

Condensed Interim Statements of Financial Position at

	September 30, 2010	September 30, 2009	December 31, 2009
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Assets			
Short-term deposits	**-**	3,000	3,020
Trade receivables	**161,431**	151,404	160,152
Other receivables	**8,961**	9,222	8,177
	170,392	163,626	171,349
Total current assets			
Broadcasting rights – net of rights exercised	**309,829**	301,722	284,766
Property, plant and equipment, net	**699,899**	679,052	682,473
Intangible assets, net	**80,124**	61,582	67,043
Total non-current assets	**1,089,852**	1,042,356	1,034,282
Total assets	**1,260,244**	1,205,982	1,205,631

Condensed Interim Statements of Financial Position at

	September 30, 2010	September 30, 2009	December 31, 2009
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Liabilities			
Bank credit	**866,511**	255,400	283,698
Current maturities for debentures	**55,698**	54,710	54,812
Trade payables and service providers	**381,531**	411,857	406,389
Other payables	**219,227**	133,926	143,343
Provisions	**9,678**	8,505	8,079
Total current liabilities	**1,532,645**	864,398	896,321
Debentures	**580,684**	624,415	625,741
Institutional loans	**199,657**	176,674	181,729
Bank loans	**-**	668,573	607,036
Shareholder loans	**2,213,651**	1,916,416	1,981,887
Other liabilities	**62,059**	20,402	14,288
Employee benefits	**7,554**	7,444	7,389
Total non-current liabilities	**3,063,605**	3,413,924	3,418,070
Total liabilities	**4,596,250**	4,278,322	4,314,391
Capital deficit			
Share capital	**29**	29	29
Share premium	**85,557**	85,557	85,557
Option warrants	**48,219**	48,219	48,219
Capital reserve	**1,537,271**	1,537,271	1,537,271
Capital reserve for share-based payments	**9,087**	6,198	6,931
Accumulated deficit	**(5,016,169)**	(4,749,614)	(4,786,767)
Total capital deficit	**(3,336,006)**	(3,072,340)	(3,108,760)
Total liabilities and capital	**1,260,244**	1,205,982	1,205,631

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

Date of approval of the financial statements: October 31, 2010

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

Condensed Interim Income Statements

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenue	**1,182,710**	1,140,330	**395,347**	380,451	1,530,435
Cost of revenue	**842,188**	775,905	**258,524**	261,836	1,042,101
Gross profit	**340,522**	364,425	**136,823**	118,615	488,334
Sales and marketing expenses	**103,521**	90,217	**31,543**	28,779	122,312
General and administrative expenses	**99,283**	88,543	**33,538**	29,175	117,805
	202,804	178,760	**65,081**	57,954	240,117
Operating profit	**137,718**	185,665	**71,742**	60,661	248,217
Finance expenses	**136,959**	148,177	**56,393**	57,549	177,900
Finance income	**(2,354)**	(13,580)	**(2,427)**	(12,978)	(8,347)
Shareholders' finance expenses	**231,764**	234,901	**95,550**	104,205	300,373
Finance expenses, net	**366,369**	369,498	**149,516**	148,776	469,926
Loss before taxes on income	**(228,651)**	(183,833)	**(77,774)**	(88,115)	(221,709)
Income tax	**751**	931	**577**	342	745
Loss for the period	**(229,402)**	(184,764)	**(78,351)**	(88,457)	(222,454)
Basic and diluted loss per share (in NIS)	**(7,673)**	(6,180)	**(2,621)**	(2,959)	(7,441)

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

Condensed Interim Statements of Comprehensive Income

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Loss for the period	**(229,402)**	(184,764)	**(78,351)**	(88,457)	(222,454)
Other comprehensive income components:					
Actuarial gains from a **defined benefit** plan	**-**	-	**-**	-	537
Other comprehensive income for the period	**-**	-	**-**	-	537
Total comprehensive loss for the period	**(229,402)**	(184,764)	**(78,351)**	(88,457)	(221,917)

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

Condensed Interim Statements of Changes in Equity

	Share capital	Share premium	Option warrants	Capital reserve	Capital reserve for share-based payments	Accumulated Deficit	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
For the nine-month period ended September 30, 2010 (unaudited)							
Balance at January 1, 2010 (audited)	29	85,557	48,219	1,537,271	6,931	(4,786,767)	(3,108,760)
Activity in the period (unaudited):							
Comprehensive loss for the period	**-**	**-**	**-**	**-**	**-**	**(229,402)**	**(229,402)**
Share-based payments (unaudited)	**-**	**-**	**-**	**-**	**2,156**	**-**	**2,156**
Balance at September 30, 2010 (unaudited)	**29**	**85,557**	**48,219**	**1,537,271**	**9,087**	**(5,016,169)**	**(3,336,006)**
For the nine-month period ended September 30, 2009 (unaudited)							
Balance at January 1, 2009 (audited)	29	85,557	48,219	1,537,271	1,636	(4,564,850)	(2,892,138)
Activity in the period (unaudited)							
Comprehensive loss for the period	-	-	-	-	-	(184,764)	(184,764)
Share-based payments (unaudited)	-	-	-	-	4,562	-	4,562
Balance at September 30, 2009 (unaudited)	29	85,557	48,219	1,537,271	6,198	(4,749,614)	(3,072,340)

The accompanying notes are an integral part of the condensed interim financial statements

Condensed Interim Statements of Changes in Equity (Cont.)

	Share capital	Share premium	Option warrants	Capital reserve	Capital reserve for share-based payments	Accumulated Deficit	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
For the three-month period ended September 30, 2010 (unaudited)							
Balance at July 1, 2010 (unaudited)	29	85,557	48,219	1,537,271	8,376	(4,937,818)	(3,258,366)
Activity in the period (unaudited):							
Comprehensive loss for the period	**-**	**-**	**-**	**-**	**-**	**(78,351)**	**(78,351)**
Share-based payments (unaudited)	**-**	**-**	**-**	**-**	**711**	**-**	**711**
Balance at September 30, 2010 (unaudited)	**29**	**85,557**	**48,219**	**1,537,271**	**9,087**	**(5,016,169)**	**(3,336,006)**
For the three-month period ended September 30, 2009 (unaudited)							
Balance at July 1, 2009 (unaudited)	29	85,557	48,219	1,537,271	4,689	(4,661,157)	(2,985,392)
Activity in the period (unaudited):							
Comprehensive loss for the period	-	-	-	-	-	(88,457)	(88,457)
Share-based payments (unaudited)	-	-	-	-	1,509	-	1,509
Balance at September 30, 2009 (unaudited)	29	85,557	48,219	1,537,271	6,198	(4,749,614)	(3,072,340)

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

Condensed Interim Statements of Changes in Equity (Cont.)

	Share capital	Share premium	Option warrants	Capital reserve	Capital reserve for share-based payments	Accumulated Deficit	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
For the year ended December 31, 2009 (audited)							
Balance at January 1, 2009 (audited)	29	85,557	48,219	1,537,271	1,636	(4,564,850)	(2,892,138)
Activity in 2009:							
Comprehensive loss for the period (audited)	-	-	-	-	-	(221,917)	(221,917)
Share-based payments (audited)	-	-	-	-	5,295	-	5,295
Balance at December 31, 2009 (audited)	29	85,557	48,219	1,537,271	6,931	(4,786,767)	(3,108,760)

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

Condensed Interim Statements of Cash Flows

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Cash flows from operating activities					
Loss for the period	**(229,402)**	(184,764)	**(78,351)**	(88,457)	(222,454)
Adjustments					
Depreciation and amortization					
Finance costs, net	**199,710**	171,035	**67,780**	58,928	234,203
Loss (profit) from sale of property, plant and equipment	**328,576**	356,751	**126,292**	156,170	455,232
Share-based payments	**(44)**	(191)	**(15)**	1	(236)
Income tax expenses	**2,156**	4,562	**711**	1,509	5,295
	751	931	**577**	342	745
Change in trade receivables	**(1,279)**	1,472	**(1,137)**	3,355	(7,277)
Change in other receivables	**(784)**	(961)	**3,684**	(2,223)	84
Change in trade payables and service providers	**(58,028)**	37,554	**(70,358)**	10,151	5,466
Change in other payables and provisions	**93,332**	(12,649)	**25,832**	(19,424)	(15,231)
Change in broadcasting rights, net of rights exercised	**(25,063)**	(48,389)	**(2,943)**	15,193	(31,433)
Change in employee benefits	**165**	2,394	**93**	366	(82)
Change in other liabilities	**47,321**	(7,410)	**54,487**	(541)	(13,524)
	586,813	505,099	**205,003**	223,827	633,242
Income tax paid	**(751)**	(1,246)	**(577)**	(342)	(1,060)
Net cash flows from operating activities	**356,660**	319,089	**126,075**	135,028	409,728
Cash flows for investment activities					
Repayment of short-term deposits	**3,298**	-	**42**	-	-
Purchase of property, plant and equipment	**(151,461)**	(174,485)	**(52,441)**	(72,635)	(214,368)
Proceeds from sale of property, plant and equipment	**1,493**	578	**1,056**	578	949
Acquisition of intangible assets	**(10,221)**	(10,636)	**(2,500)**	(5,449)	(9,262)
Payments for subscriber acquisition	**(27,299)**	(23,615)	**(9,771)**	(9,304)	(37,931)
Net cash used for investment activities	**(184,190)**	(208,158)	**(63,614)**	(86,810)	(260,612)

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

Condensed Interim Statements of Cash Flows (Contd.)

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Cash flows for finance activities					
Bank loans received	**255,000**	-	**-**	-	-
Repayment of bank loans	**(283,105)**	-	**-**	-	-
Repayment of debenture principal	**(55,020)**	-	**(55,020)**	-	-
Short-term bank credit, net	**4,685**	46,771	**22,489**	6,148	13,532
Interest paid	**(94,030)**	(157,702)	**(29,930)**	(54,366)	(162,648)
Net cash used for finance activities	**(172,470)**	(110,931)	**(62,461)**	(48,218)	(149,116)
Change in cash flow and cash equivalents	**-**	-	**-**	-	-
Balance of cash and cash equivalents at beginning of period	**-**	-	**-**	-	-
Balance of cash and cash equivalents at end of period	**-**	-	**-**	-	-

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

NOTE 1 – THE REPORTING ENTITY

DBS Satellite Services (1998) Ltd. (the "Company"), was incorporated in Israel on December 2, 1998 and its head office is located at 6 Hayozma Street, Kfar Saba, Israel. In January 1999 the Company received a license from the Ministry of Communications for satellite TV broadcasts (the "License"). The License granted to the Company is valid until January 2017 and it may be extended for a further six years under certain conditions. The Company's operations are subject, inter alia, to the Communications Law (Telecommunications and Broadcasts) Law 5742-1982 (the "Communications Law"), the regulations and rules promulgated by virtue thereof and the conditions of the License.

Pursuant to the license of Bezeq The Israel Telecommunications Corporation Ltd. ("Bezeq"), Bezeq is obligated to implement full structural separation between it and its subsidiaries and between it and the Company. In May and June 2010 the licenses of Bezeq and the Company respectively were amended in a manner permitting them, under certain conditions, to market joint service packages.

In August 2009 the Supreme Court accepted the Antitrust Commissioner's appeal of the ruling of the Antitrust Tribunal approving a merger (as defined in the Antitrust Law, 1948-1988) between the Company and Bezeq by exercising the share options held by Bezeq in the Company, subject to certain conditions, and ruled against the merger.

NOTE 2 – BASIS OF PREPARATION

A. Statement of compliance with IFRS

The condensed interim financial statements have been prepared in accordance with IAS 34, Interim Financial Reporting, and do not contain all the information required for full annual financial statements. They should be read together with the financial statements at December 31, 2009 and for the year then ended (the "Annual Statements"). Furthermore, these statements have been prepared in accordance with the provisions of Section D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

The condensed interim financial statements were approved by the Company's board of directors on October 31, 2010.

B. Use of estimates and discretion

During the preparation of the condensed financial statements in accordance with the IFRS, the Company's management is required to use its discretion when making estimates, assessments and assumptions which affect the implementation of policy and the sums of assets and liabilities, income and expenses.

It should be clarified that the actual results may differ from these assessments. The management's discretion when implementing the Company's accounting policy and the principal assumptions used in the estimates involving uncertainty are consistent with those applied in the annual financial statements.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES

The Company's accounting policy in these condensed interim financial statements is the same policy applied in the annual statements. The Company does not recalculate its actuarial obligations in each interim reporting period unless in the interim period there are material changes in the benefit plans or material changes in market conditions which affect its obligations. Consequently, actuarial profits or losses are not recognized in the reporting period.

A. Changes in the CPI and foreign currency exchange rates

Following are the change rates which occurred in the CPI and in the exchange rates of the US$ in the accounting periods:

	USD exchange rate	CPI
	%	%
Nine months ended September 30:		
2010	**(2.91)**	**1.9**
2009	(1.16)	3.42
Three months ended September 30		
2010	**(5.42)**	**1.23**
2009	(4.11)	1.26
Year ended December 31, 2009	(0.71)	3.91

NOTE 4 – FINANCIAL POSITION OF THE COMPANY

A. Since the start of its operations, the Company has accumulated significant losses. The Company's loss for 2009 amounted to approximately NIS 222 million and the loss for the nine-month period ended September 30, 2010 amounts to approximately NIS 229 million. As a result of these losses, the Company's capital deficit and working capital deficit at September 30, 2010 amounted to approximately NIS 3.336 billion and approximately NIS 1.362 billion, respectively.

B. 1. In March 2010 an amendment to the Company's bank financing agreement (the “Amendment Agreement”) was signed and took effect, whereby, inter alia, an additional Israeli bank was attached (the “Joining Bank”) to the present bank consortium (the “Present Banks”). When it joined, the Joining Bank provided the Company with its proportionate share of the Company's regular credit facilities and also granted the Company long-term credit in the amount of NIS 255 million, most of which was used for its addition (in its proportionate share) to the Company's long-term credit facilities, for the repayment and early repayment of the Company's debts to the Present Banks. The balance of approximately NIS 46 million will be used for the Company's ongoing requirements.

Under the Amendment Agreement, a floating lien was created for the Joining Bank, similar to those in favor of the Present Banks, and the Joining Bank was also included in the fixed lien in favor of the Present Banks. The Company's shareholders also signed the amendments to bonds, mortgage deeds and letter of guarantee, as applicable, which had previously been signed by them in favor of the Present Banks, for the addition of the Joining Bank.

Under the Amendment Agreement, the term of the bank loan repayment was extended (both the long-term loans as well as the ongoing facilities) until the end of 2015, after receipt of the consent of the banks for repayment of the loans provided by institutional entities on the repayment date (December 31, 2013).

NOTE 4 – FINANCIAL POSITION OF THE COMPANY (CONTD.)

B. 1. (contd.)

Under the Amendment Agreement, the financial covenants stipulated in the financing agreement were replaced by the following new covenants which apply until 2015 and are compatible with the Company's business plan:

A. Minimum solvency;

B. Minimum EBITDA ;

C. Maximum and minimum supplier credit;

The values for complying with the financial criteria vary and are measured each quarter. Under the terms of the financing agreement, the banks are entitled to call for early repayment of the loans in the event of failure to comply with the covenants.

2. The Company complied with the financial covenants under the financing agreement at September 30, 2010, after receiving relief from the banks in October 2010 in relation to the purpose of one of the conditions at September 30, 2010 which was required in light of the material provision made by the Company as aforesaid in section 6C. In view of the fact that this relief was granted after the balance sheet date, the bank loans totalling NIS 817.323 million are stated as part of the short-term liabilities. The Company has also received a similar relief in relation to the purpose of the above-mentioned financial covenant at December 31, 2010.

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

NOTE 5 – CONTINGENT LIABILITIES

Lawsuits

A. Employee claims

During the normal course of business, collective and individual claims were filed against the Company by employees and former employees of the Company. These are claims which are primarily allegations of non-payment of salary components and delay in salary payment. At September 30, 2010 all these claims totaled NIS 1,713,000. In the opinion of the Company's management which is based, inter alia, on legal opinions regarding the likelihood of success of the claims, appropriate provisions totaling NIS 722,000 have been included in the financial statements where provisions are needed to cover the exposure resulting from such claims.

B. Customer claims

During the normal course of business, claims were filed against the Company by its customers. These are primarily applications for certification as class actions (and the ensuing claims), which deal mainly with allegations regarding the unlawful collection of payment and impairment of the services provided by DBS. At September 30, 2010 these claims totaled NIS 244.380 million. In the opinion of the Company's management which is based, inter alia, on legal opinions regarding the likelihood of success of the claims, appropriate provisions totaling NIS 8.797 million have been included in the financial statements where provisions are needed to cover the exposure resulting from such claims.

Of these claims there are claims totaling approximately NIS 50.028 million which cannot yet be assessed.

NOTE 5 – CONTINGENT LIABILITIES (CONTD.)

Lawsuits (contd.)

B. Customer claims (contd.)

During the quarter and also after the date of the financial statements, two more claims were filed against the Company plus an application for certification as class actions, but at this stage they cannot be assessed. The first claim has been estimated by the claimant at approximately NIS 50 million. The second claim has been estimated by the claimant at NIS 98 million.

C. Supplier and telecommunications supplier claims

During the normal course of business, various legal claims have been filed against the Company by suppliers who supply the Company with goods and/or services. The main claim was filed for alleged damage caused to a supplier as a result of the Company's negligence. At September 30, 2010, these claims totaled NIS 49.584 million. In the opinion of the Company's management which is based, inter alia, on legal opinions regarding the likelihood of success of the claims, appropriate provisions totaling NIS 158,000 have been included in the financial statements where provisions are needed to cover the exposure resulting from such claims.

NOTE 6 – MATERIAL EVENTS IN THE REPORTING PERIOD

A. In April 2010, in the framework of the approvals of the Ministry of Communications of the Company's request, under its licenses, to approve the transfer of control (directly or indirectly) in connection with the acquisition of control of the Company and transfer of the holdings of Eurocom DBS Ltd. in the Company to a trustee, the Ministry of Communications decided to impose the following key conditions on the Company:

1) Any change, direct or indirect, in the trustee's holdings of the means of control in the Company is subject to the prior written approval of the Minister of Communications, after consultation with the Council.

2) The trustee shall not act on the basis of an instruction received from any entity whose interest is related, directly or indirectly, to an area regulated by the Ministry of Communications, without obtaining approval from the Ministry of Communications for this purpose.

3) A transaction between the Company and the Eurocom Group concerning satellite terminal equipment shall be considered, in addition to approval from the Company's institutions, as an extraordinary transaction, as defined in section 270(4) of the Companies Law and as such is subject to approval from the Company's institutions, under section 275 of the Companies Law.

4) The discussions of the Company's board of directors of these above transactions shall be documented in detailed and complete minutes which shall be signed by the chairman of the meeting and submitted for review to the Director-General of the Ministry of Communications.

B. In March 2010 the Knesset plenum passed the first reading of a bill to exempt designated channels from payment of transition fees to the Cable Company and the Company. In July 2010 the Knesset passed the second and third readings of the bill.

NOTE 6 – MATERIAL EVENTS IN THE REPORTING PERIOD (CONTD.)

C. Pursuant to an Immediate Report published by HOT Telecommunications Systems Ltd. (the "Cable Company"), in July 2010, there was a ruling in the arbitration between the Cable Company and the Association of Composers, Authors and Publishers of Music in Israel (ACUM) in connection with the determination of a mechanism for calculating annual royalties for the use of works whose rights are protected by ACUM. According to this report, the arbitrator's ruling accepted in principle ACUM's model for calculation of royalties in said proceeding, with the exception of certain changes, and determined that this model would also apply to the difference in royalties from 2003 onward, to be calculated by the parties to the arbitration in a settlement. The Cable Company noted that it intended to appeal the arbitrator's ruling. Since the arbitrator's ruling and the remaining arbitration documents were not submitted to the Company, the Company does not know which model was adopted and the reasons for the arbitrator's ruling. However, pursuant to the agreements between the Company and ACUM, the royalties paid to ACUM since 2003 are likely to be updated, inter alia, depending on the agreement to be reached by the Cable Company and ACUM, and according to ACUM, also subject to the arbitrator's ruling. Consequently, the Company's management believes that after the arbitration ruling, the Company could be required to pay significant sums retroactively. In light of this fact, the Company updated its estimate of the royalties as from 2003. The updated estimate was prepared on the basis of the model for calculation of royalties which was accepted by ACUM shortly after the arbitration ruling, with adjustments in accordance with the estimate of the Company's management. This was the basis on which the Company made a material provision in its financial statements at June 30, 2010.

D. As part of a VAT audit carried out in the Company, an input tax assessment of NIS 9,500,000 (including interest and linkage) was issued to the Company in the Eilat region for the period between January 2006 and July 2010. In September 2010 the Company filed an appeal against the assessment requesting its cancellation. The Company believes, based on the opinions of its legal advisers, that at this stage there is a reasonable chance (more than 50%) that the assessment will be canceled in full.

E. In September 2010 the Council decided that as of November 2010, DBS would be authorized to collect from subscribers signing up for an offer with a commitment period and wishing to leave DBS prior to the end of said commitment period, repayment of the cost of the benefit which is equal to the lower of the following two amounts: repayment of the benefit cost stipulated in the offer, or the remaining payments which subscribers would have had to pay if they had remained with DBS until the end of the commitment period. The decision is also applicable to existing DBS offers. DBS applied for a three-month deferral of the decision's effective date. The decision's effective date was accordingly deferred until January 2011.

NOTE 7 – MATERIAL EVENTS AFTER THE BALANCE SHEET DATE

A. In October 2010, Maalot upgraded the rating of DBS and of its debentures (Series A) to ilA-. The upgrade was explained, inter alia, by an improvement in DBS's liquidity following the expected issuance of a new series of debentures as well as increased financial flexibility in light of an expected amendment to the financing agreement with the banks. This upgrade was also granted to the new series of debentures which the Company is scheduled to issue. Maalot also announced that the rating outlook is stable in view of its assessment that DBS's operational performance, its liquidity profile and more balanced installment schedule are expected to contribute to rating stability in the medium term unless there are material changes in DBS's capital structure or liquidity. Maalot also announced that if there are material changes in the issuance's conditions which are liable to harm DBS's credit quality, or if the issue is canceled, Maalot is likely to review DBS's rating and consider a downgrade.

NOTE 7 – MATERIAL EVENTS AFTER THE BALANCE SHEET DATE (CONTD.)

B. The Company and Bezeq – The Israel Telecommunications Corporation Ltd. ("Bezeq") formulated a debt restructuring arrangement for the debt balance of NIS 31.5 million owed by the Company to Bezeq for communication services at July 31, 2009 (which reflects a compromise between the Company's position and that of Bezeq). Under the arrangement the Company will repay the debt to Bezeq in 36 equal monthly installments of NIS 875,000 each plus interest at prime + 1.5% plus VAT according to the law, for the interest. The debt arrangement was approved by the Company's board of directors on November 1, 2009 and by the general meeting of Bezeq on May 20, 2010. In October 2010 an agreement was approved to defer part of the payments under the above-mentioned arrangement and also to defer payments owed by DBS to Bezeq under a previous agreement between it and the Company for the restructuring of the Company's debt for purchase of an internet infrastructure. Under the agreement, 18 payments of said agreement and the 15 payments remaining under the previous agreement will be deferred for 18 months, where in the deferral period the payments will bear annual interest of prime plus 3%. The agreement may be terminated by prior notice, under the conditions stipulated therein.

C. At the date of this report, the Company is examining the possibility of issuing another series of debentures totaling approximately NIS 400 million which will be guaranteed by senior liens on the Company's assets in favor of the banks and holders of debentures (Series A), pari passu, with these liens. The receipts from this issuance are earmarked for repayment of the loans the Company received in 2005 as well as for repayment of some of the bank debts. The Company is negotiating with the banks to amend the financing agreement which will anchor this partial repayment of the bank debt by amending the financial covenants. It is possible that by the time the issuance, if implemented, is completed, and the agreements with the banks for amendment of the financing agreement are completed, there will be changes in that stated above.

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

On the date of approval of the financial statements, the Company's board of directors does not have an incumbent chairman. Consequently the Company's board of directors has authorized David Efrati, a director in the Company, to serve as chairman of the board of directors' meeting convened to approve the financial statement and to sign the Company's financial statements at September 30, 2010.

BEZEQ THE ISRAEL TELECOMMUNICATION CORP. LIMITED

SEPARATE CONDENSED CONSOLIDATED INTERIM FINANCIAL INFORMATION
SEPTEMBER 30, 2010
(UNAUDITED)

Separate condensed interim financial information as at September 30, 2010 (unaudited)

Contents

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Special review report to the Shareholders of "Bezeq" The Israel Telecommunication Corp. Limited, on separate interim financial information according to Regulation 38D of the Securities Regulations (Periodic and Immediate Reports) – 1970

Introduction
We have reviewed the separate interim financial information presented in accordance with Regulation 38D of the Securities Regulations (Periodic and Immediate Reports) – 1970 of "Bezeq" The Israel Telecommunication Corp. Limited (hereinafter – the Company), as at September 30, 2010 and for the nine and three month periods then ended. The separate interim financial information is the responsibility of the Company's Board of Directors and of its Management. Our responsibility is to express a conclusion on the separate interim financial information based on our review.

We did not review the condensed interim financial information of equity accounted investees the investment in which amounted to NIS 235 million as at September 30, 2010, and the Group's share in their profits (losses) amounted to NIS 0.5 million and NIS (3.5) million for the nine and three month periods then ended, respectively. The condensed interim financial information of those companies was reviewed by other auditors whose review reports thereon were furnished to us, and our conclusion, insofar as it relates to amounts emanating from the financial information of such companies, is based solely on the said review reports of the other auditors.

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

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

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

Sincerely,

Somekh Chaikin
Certified Public Accountants (Isr.)

November 1, 2010

Condensed interim information on financial position

	September 30, 2010 (Unaudited) NIS millions	September 30, 2009 (Unaudited) NIS millions	December 31, 2009 (Audited) NIS millions
Assets			
Cash and cash equivalents	**1,104**	775	360
Investments, including derivatives	**188**	34	10
Trade receivables	**825**	872	845
Receivables	**93**	110	555
Inventory	**8**	12	9
Assets held for sale	**30**	34	40
Total current assets	**2,248**	1,837	1,819
Investments, including derivatives	**99**	114	100
Trade and other receivables	**202**	90	102
Property, plant and equipment	**3,936**	*3,761	*3,771
Intangible assets	**242**	170	193
Investments in investees	**6,885**	6,776	6,566
Deferred tax assets	**326**	375	383
Total non-current assets	**11,690**	11,286	11,115
Total assets	**13,938**	13,123	12,934

	September 30, 2010	September 30, 2009	December 31, 2009
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Liabilities			
Debentures, loans and borrowings	**946**	693	685
Trade payables	**319**	223	263
Other payables, including derivatives	**512**	502	537
Loans from subsidiaries	**91**	-	250
Current tax liabilities	**257**	83	86
Deferred income	**17**	21	19
Provisions (Note 4)	**269**	268	279
Employee benefits	**316**	236	469
Dividend payable	**1,280**	1,149	-
Total current liabilities	**4,007**	3,175	2,588
Debentures	**2,363**	3,166	3,166
Bank loans	**2,600**	383	383
Employee benefits	**251**	231	247
Deferred income and others	**3**	5	6
Total non-current liabilities	**5,217**	3,785	3,802
Total liabilities	**9,224**	6,960	6,390
Equity			
Share capital	**6,206**	6,181	6,187
Share premium	**356**	247	275
Reserves	**530**	604	595
Retained earnings (deficit)	**(2,378)**	(869)	(513)
Total equity	**4,714**	6,163	6,544
Total equity and liabilities	**13,938**	13,123	12,934

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

Date of approval of the financial statements: November 1, 2010

* Retrospective application by restatement, see Note 3 to the condensed consolidated interim financial statements

The accompanying notes are an integral part of the condensed interim financial information.

Condensed interim information on income

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue (Note 2)	**3,934**	3,987	**1,323**	1,343	5,303
Costs and expenses					
Depreciation and amortization	**512**	600	**171**	184	794
Salaries	**783**	797	**256**	255	1,094
General and operating expenses (Note 3)	**1,187**	1,282	**399**	451	1,690
Other operating expenses (income), net	**(97)**	(54)	**(59)**	(38)	202
	2,385	2,625	**767**	852	3,780
Operating profit	**1,549**	1,362	**556**	491	1,523
Finance expenses (income)					
Finance expenses	**190**	247	**84**	126	295
Finance income	**(132)**	(269)	**(54)**	(123)	(310)
Finance expenses (income), net	**58**	(22)	**30**	3	(15)
Profit after finance expenses (income) net	**1,491**	1,384	**526**	488	1,538
Share in profits of investees, net	**782**	728	**211**	231	958
Profit before income tax	**2,273**	2,112	**737**	719	2,496
Income tax	**405**	413	**149**	169	431
Profit after income tax	**1,868**	1,699	**588**	550	2,065
Profit from deconsolidation of a subsidiary	**-**	1,538	**-**	1,538	1,538
Profit for the period	**1,868**	3,237	**588**	2,088	3,603

The accompanying notes are an integral part of the condensed interim financial information.

Condensed interim information on comprehensive income

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Profit for the period	**1,868**	3,237	**588**	2,088	3,603
Other comprehensive profit (loss) for the period, net of tax	**3**	-	**3**	(1)	(11)
Total comprehensive income for the period	**1,871**	3,237	**591**	2,087	3,592

The accompanying notes are an integral part of the condensed interim financial information.

Condensed interim information on cash flows

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cash flows from operating activities					
Profit for the period	**1,868**	3,237	**588**	2,088	3,603
Adjustments:					
Depreciation	**457**	539*	**153**	176*	715*
Amortization of intangible assets	**55**	61	**18**	8	79
Profit from deconsolidation of a subsidiary	**-**	(1,538)	**-**	(1,538)	(1,538)
Share in profits of equity-accounted investees	**(782)**	(728)	**(211)**	(231)	(958)
Finance expenses (income), net	**40**	(52)	**28**	(30)	(44)
Capital gain, net	**(115)**	(50)	**(86)**	(30)	(64)
Share-based payments	**8**	18	**2**	5	25
Income tax expenses	**405**	413	**149**	169	431
Change in inventory	**1**	(2)	**1**	3	1
Change in trade and other receivables	**(52)**	(2)	**(17)**	(31)	26
Change in trade and other payables	**44**	(24)	**119**	(13)	1
Change in provisions	**(10)**	15	**(1)**	6	25
Change in employee benefits	**(149)**	(118)	**(94)**	(45)	118
Net cash from (used for) operating activities for transactions with investees	**11**	(12)	**17**	1	2
Income tax paid, net	**(181)**	(188)	**18**	(12)	(202)
Net cash from operating activities	**1,600**	1,569	**684**	526	2,220
Cash flows from investment activities					
Investment in intangible assets	**(105)**	(92)	**(40)**	(31)	(133)
Proceeds from sale of property, plant and equipment	**89**	77	**48**	19	86
Change in current investments, net	**-**	4	**-**	(1)	6
Purchase of property, plant and equipment	**(625)**	(541)	**(205)**	(173)	(720)
Proceeds from disposal of investments and long-term loans	**2**	43	**(2)**	2	46
Interest received	**7**	23	**1**	13	25
Purchase of a subsidiary	**(196)**	-	**(196)**	-	-
Net cash from investment in investees (mainly dividend)	**1,076**	570	**442**	140	578
Net cash from (used for) investment activities	**248**	84	**48**	(31)	(112)

* Retrospective application by restatement, see Note 3 to the condensed consolidated interim financial statements

The accompanying notes are an integral part of the condensed interim financial information.

Condensed Interim Statements of Cash Flows (Contd.)

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cash flow from finance activities					
Bank loans received	**2,600**	400	**700**	-	400
Repayment of bank loans	**(400)**	-	**-**	-	-
Short-term borrowing, net	**-**	-	**(226)**	-	-
Repayment of debentures	**(558)**	(547)	**-**	-	(556)
Dividend paid	**(2,453)**	(792)	**-**	-	(1,941)
Interest paid	**(153)**	(161)	**-**	(9)	(167)
Proceeds for derivatives, net	**-**	12	**-**	1	44
Proceeds from exercise of employee options	**21**	117	**3**	20	129
Receipt (repayment) of loans from investees, net	**(161)**	-	**(111)**	-	250
Net cash from (used for) finance activities	**(1,104)**	(971)	**366**	12	(1,841)
Net increase in cash and cash equivalents	**744**	682	**1,098**	507	267
Cash and cash equivalents at beginning of period	**360**	93	**6**	268	93
Cash and cash equivalents at end of period	**1,104**	775	**1,104**	775	360

The accompanying notes are an integral part of the condensed interim financial information.

NOTE 1 – METHOD FOR PREPARING THE FINANCIAL INFORMATION

A. Definitions

The Company: Bezeq The Israel Telecommunication Corporation Ltd.

“Associate”, "the Group”, “Investee”, “Interested Party”: as defined in the consolidated financial statements of the Company for 2009.

B. Main points of the method for preparing of the financial information

The separate interim financial information is stated in accordance with Article 38(D) of the Securities Regulations (Periodic and Interim Reports), 5730-1970 and does not include the information required under the provisions of Article 9(C) and the Tenth Addendum of the Securities Regulations (Periodic and Interim Reports), 5730-1970 in respect of separate financial information of the corporation. The report should be read together with the separate financial information as at December 31, 2009 and for the year then ended and together with the condensed consolidated interim statements as at September 30, 2010 (“the consolidated reports”).

NOTE 2 – REVENUE

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Telephony	**2,368**	2,510	**788**	843	3,333
Internet	**720**	638	**249**	221	863
Transmission and data communications	**663**	637	**219**	217	851
Other services	**183**	202	**67**	62	256
	3,934	3,987	**1,323**	1,343	5,303

NOTE 3 – OPERATING AND GENERAL EXPENSES

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2010	2009	2010	2009	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cellular telephone expenses	**599**	621	**198**	211	823
General expenses	**181**	193	**65**	83	266
Materials and spare parts	**55**	62	**16**	21	80
Building maintenance	**183**	204	**64**	72	278
Services and maintenance by sub-contractors	**57**	69	**18**	21	96
Vehicle maintenance expenses	**72**	70	**24**	23	96
Royalties to the State of Israel	**24**	37	**8**	12	18
Collection fees and sundry	**16**	26	**6**	8	33
	1,187	1,282	**399**	451	1,690

NOTE 4 – CONTINGENT LIABILITIES

During the normal course of business, legal claims were filed or are pending against the Company ("hereinafter in this section: "claims").

The financial statements of the Company include provisions of NIS 269 million for the claims.
The additional exposure beyond these provisions for claims that are unlikely to be realized amounts to NIS 3 billion.
Additionally, out of these claims, there are also claims amounting to NIS 260 million, which at this stage, cannot be assessed, as well as additional claims for which the Company's additional exposure exceeds the aforesaid, as the exact amount of the claim is not stated in the claim.
Subsequent to the reporting date, customers of the Company filed a number of claims, amounting to NIS 98 million, which cannot be assessed at this stage.

For further information about contingent liabilities, see Note 5 to the consolidated financial statements - Contingent Liabilities.

NOTE 5 - SUBSTANTIAL AGREEMENTS AND TRANSACTIONS WITH INVESTEES

A. Loans

1) On March 21, 2010, the Company provided a loan of NIS 45 million to Bezeq International Ltd. ("Bezeq International"), subject to the terms of the framework loan agreement between the companies. The loan, which is linked to the CPI and bears annual interest of 4%, was repayable in four equal monthly payments (principal and interest), commencing on June 1, 2010. On September 1, 2010, Bezeq International completed repaying the full amount of the loan that it had received.

2) On May 31, 2010, the Company took out a loan of NIS 90 million from Pelephone Communications Ltd. ("Pelephone"), subject to the terms of the framework loan agreement between the companies. The loan, which bears annual interest of 4% and is linked to the CPI, will be repaid on January 6, 2011.

   In addition, on June 15, 2010, Pelephone provided the Company with another loan of NIS 110 million. The loan, which is linked to the CPI and bears annual interest of 4%, was repaid on July 6, 2010.

3) In respect of the loan provided by the Company to Bezeq On-line Ltd. ("Bezeq On-line"), after repayment of NIS 2.5 million on June 30, 2010 and additional repayment of NIS 1 million on September 15, 2010, the balance of the loan amounts to NIS 7 million at September 30, 2010.

B. Dividends

On May 2, 2010, the Company received a dividend of NIS 200 million from Pelephone.
On September 3, 2010, the Company received a dividend of NIS 210 million from Pelephone.
On September 21, 2010, the Company received a dividend of NIS 196 million from Bezeq International.

C. Material transactions

On September 21, 2010, Bezeq International sold the Company all of its holdings in Walla for NIS 196 million.
For further information, see Note 4(B) to the consolidated statements – Group Entities.

NOTE 6 – SUBSEQUENT EVENTS

A. October 3, 2010, Pelephone provided the Company with another loan of NIS 110 million. The loan, which is linked to the CPI and bears annual interest of 4%, is repayable on January 6, 2011.

B. On October 31, 2010, the board of directors of Bezeq International approved the distribution of a dividend amounting to NIS 20 million.