Chapter B of the Periodic Report

Directors' Report on the State of the Company's Affairs For the three and nine months ended September 30, 2009

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 months ended September 30, 2009 ("the Period") and the three months then ended ("the Quarter").

The Directors' Report includes a condensed review of the Company's affairs and it assumes that the Directors' Report at December 31, 2008 is also available to the reader.

Commencing August 21, 2009, the Company ceased to consolidate DBS's statements with its financial statements, and the investment in DBS is stated by the equity method from that date.

At the date of termination of consolidation, the Company set its investment in DBS at a fair value of NIS 1.175 billion, and recognized profit of NIS 1.538 billion (see Note 4 to the financial statements).

The Group continues to report on four segments in its financial statements, including multichannel television.

Profit for the reporting period amounted to NIS 3.174 billion (of which NIS 1.379 billion is from discontinued operations), compared to profit of NIS 1.229 billion in the corresponding period last year. The profit attributable to the shareholders of the Company amounted to NIS 3.237 billion (of which NIS 1.466 billion is from discontinued operations).

Profit for the third quarter amounted to NIS 2.063 billion (of which NIS 1.475 billion is from discontinued operations), compared to NIS 431 million in the corresponding quarter of 2008. The profit attributable to the shareholders of the Company amounted to NIS 2.088 billion (of which NIS 1.502 million is from discontinued operations). The exceptional increase in profit stemmed mainly from the reporting of the Company's investment in DBS at fair value as described above.

Further increase in profit for the period stemmed from a rise in revenues from NIS 8.314 billion to NIS 8.587 billion, and a decrease in financing expenses from NIS 125 million to NIS 13 million. In the present quarter, revenue increased to NIS 2.924 billion, compared to NIS 2.806 billion in the corresponding quarter of 2008.

The increase in profit for the period derived from an increase in profit in all the main segments (decrease of the loss in the multi-channel television segment). For further details, see below.

1. Financial position

A. The financial statements are prepared in accordance with International Financial Reporting Standards (IFRSs).

B. The Group's assets as at September 30, 2009 amounted to NIS 14.53 billion,[1] compared to approximately NIS 14.74 billion on September 30, 2008. Of these, NIS 5.3 billion (36%) are property, plant and equipment, compared to NIS 5.96 billion (40%) on September 30, 2008.

The decrease in the Group's assets is due to termination of consolidation of DBS's financial statements with the Company's financial statements (DBS's assets at September 30, 2008 amounted to NIS 1.15 billion). The decrease was reflected mainly in property, plant and equipment and in broadcasting rights. Intangible assets also decreased, due to the cancellation of goodwill. The decrease offset the determination of the investment in DBS at a fair value of NIS 1.175 billion.

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

In the domestic fixed-line communications segment there was a decrease of NIS 214 million in total assets, excluding investment in associates, compared to the corresponding period. The decrease stemmed mainly from a decrease in the deferred tax balance.

In the cellular segment, assets increased from NIS 4.54 billion at September 30, 2008 to NIS 4.90 billion at September 30, 2009. Most of the increase stemmed from an increase in the trade receivables, due mainly to an increase in revenues from sales of terminal equipment in installments. In addition, there was an increase due to investment in property, plant and equipment for the installation and operation of the new network (in HSPA/UMTS technology).

In the international communications, internet and NEP segment, there was an increase in total assets from NIS 961 million on September 30, 2008 to NIS 1.056 billion at September 30, 2009. Most of the increase is in cash balances and other long-term assets which are due to additional acquisitions of rights to use capacities with the aim of increasing operational ability in the segment. The increase was offset mainly by a reduction in the current asset balance (excluding cash).

In the multi-channel television segment, there was an increase in total assets from NIS 1.15 billion on September 30, 2008 to NIS 1.21 billion at September 30, 2009, which stemmed mainly from an increase in broadcasting rights and an increase in the net investment balance in intangible assets.

C. The equity attributable to the shareholders of the Company at September 30, 2009, amounted to NIS 6.16 billion, representing 42% of the total balance sheet, compared to NIS 4.39 billion on September 30, 2008, representing 30% of the total balance sheet. The increase in equity is mainly due to the Group's profit, which was partially offset by the distribution and announcement of a dividend of NIS 1.94 billion during the period.

D. Group debt to financial institutions and debenture holders at September 30, 2009, amounted to NIS 4.17 billion, compared to NIS 6.22 billion on September 30, 2008. The decrease is mainly due to termination of consolidation of DBS with the financial statements of the Company (DBS's debt to financial institutions and debenture holders at September 30, 2008 amounted to NIS 1.73 billion). In addition, there was a decrease in the cellular segment due to repayment of debentures and loans. In the domestic fixed-line segment, debentures of NIS 547 million were repaid and loans were taken in the amount of NIS 400 million.

2. Results of operations

The income statement for the nine and three months ended September 30, 2009 is stated without consolidation of DBS's financial statements. The operating results of DBS for the period up to August 20, 2009 and the comparative figures were presented as a discontinued operation. Consolidated income statements for the nine and three months ended September 30, 2008 were restated in order to reflect the operation that was discontinued following deconsolidation separately from continuing operations.

A. Principal results

Condensed consolidated profit and loss data:

	Nine months ended September 30				Three months ended September 30			
	2009	2008			2009	2008		
	NIS millions	NIS millions	Increase (decrease)	%	NIS millions	NIS millions	Increase (decrease)	%
Continuing operations								
Revenue	8,587	8,314	273	3.3%	2,924	2,806	118	4.2%
Costs and expenses	6,095	6,126	(31)	(0.5%)	2,049	2,031	18	0.89%
Operating profit	2,492	2,188	304	13.9%	875	775	100	12.9%
Financing expenses (income), net	(13)	125	(138)	-	16	57	(41)	(71.9%)
Profit after financing expenses (income)	**2,505**	**2,063**	**442**	**21.4%**	**859**	**718**	**141**	**19.6%**
Company's share in profits (losses) of associates accounted by the equity method	(8)	4	(12)	-	(12)	2	(14)	-
Profit before income tax	**2,497**	**2,067**	**430**	**20.8%**	**847**	**720**	**127**	**17.6%**
Income tax	702	591	111	18.8%	259	207	52	25.1%
Profit for the period from continuing operations	**1,795**	**1,476**	**319**	**21.6%**	**588**	**513**	**75**	**14.6%**
Discontinued operations Profit (loss) for the period from discontinued operation	**1,379**	**(247)**	**1,626**	**-**	**1,475**	**(82)**	**1,557**	**-**
Profit for the period	**3,174**	**1,229**	**1,945**	**158.3%**	**2,063**	**431**	**1,632**	**378.7%**
Attributable to:								
Shareholders of the Company	3,237	1,329	1,908	143.6%	2,088	462	1,626	351.9%
Non-controlling interests	(63)	(100)	37	37%	(25)	(31)	6	19.4%
Profit for the period	**3,174**	**1,229**	**1,945**	**158.3%**	**2,063**	**431**	**1,632**	**378.7%**
Earnings per share								
Basic earnings per share (NIS)	1.23	0.51	0.72	141.2%	0.79	0.18	0.61	338.9%
Diluted earnings per share (NIS)	1.21	0.50	0.71	142%	0.79	0.17	0.62	364.7%

The Group's revenues in the first nine months of 2009 amounted to NIS 8.59 billion, compared to NIS 8.31 billion in the corresponding period, an increase of 3.3%. The Group's revenues in the third quarter of 2009 amounted to NIS 2.92 billion, compared to NIS 2.81 billion in the corresponding quarter, an increase of 4.2%.

Most of the increase stemmed from the cellular segment, and was partially offset by a decrease in the domestic fixed-line communications segment.

Depreciation and amortization expenses of the Group in the first nine months of 2009 amounted to NIS 1.109 billion, compared to NIS 1.094 billion in the corresponding period, an increase of 1.4%. Most of the increase stemmed from the cellular segment, and was partially offset by a decrease in the domestic fixed-line communications segment.

The Group's depreciation and amortization expenses in the third quarter of 2009 amounted to NIS 361 million, compared to NIS 365 million in the corresponding quarter, a decrease of 1.1%.

Salary expenses of the Group in the first nine months of 2009 amounted to NIS 1.464 billion, compared to NIS 1.632 billion in the corresponding period, a decrease of 10.3%.

The Group's salary expenses in the third quarter of 2009 amounted to NIS 475 million, compared to NIS 528 million in the corresponding quarter, a decrease of 10%.

The decrease stems from lower salary expenses in all the segments that are consolidated in the Company's financial statements.

Operating and general expenses of the Group in the first nine months of 2009 amounted to NIS 3.576 billion, compared to NIS 3.439 billion in the corresponding period, an increase of 4%.

The Group's operating and general expenses in the third quarter of 2009 amounted to NIS 1.251 billion, compared to NIS 1.145 billion in the corresponding quarter, an increase of 9.3%. The increase stems from a rise in expenses in the cellular and international communications, internet and NEP segments, which were moderated by a decrease in the expenses of the domestic fixed-line communications segment.

B. Segments of operation

Operating data by segment are presented according to the Group's segments of operation:

Income by segment of operations	1-9/2009		1-9/2008		7-9/2009		7-9/2008	
	NIS millions	% of total revenue	NIS millions	% of total revenue	NIS millions	% of total revenue	NIS millions	% of total revenue
Domestic fixed-line communications	3,987	46.4%	4,150	49.9%	1,343	45.9%	1,388	49.5%
Cellular	3,983	46.4%	3,575	43.0%	1,372	46.9%	1,214	43.3%
International communications, internet and NEP services	984	11.5%	969	11.6%	332	11.4%	329	11.7%
Multi-channel television	1,140	13.3%	1,136	13.7%	380	13.0%	375	13.3%
Other	54	0.6%	57	0.7%	18	0.6%	20	0.7%
Adjustments *	(1,561)	(18.2%)	(1,573)	(18.9%)	(521)	(17.8%)	(520)	(18.5%)
Total	8,587	100%	8,314	100%	2,924	100%	2,806	100%

(*) Mainly multichannel television activities which are not included in the consolidated financial statements.

Operating profit by segment of operations	1-9/2009		1-9/2008		7-9/2009		7-9/2008	
	NIS millions	% of total revenue	NIS millions	% of total revenue	NIS millions	% of total revenue	NIS millions	% of total revenue
Domestic fixed-line communications	1,362	34.2%	1,243	30%	491	36.6%	428	30.8%
Cellular	939	23.6%	774	21.7%	316	23%	293	24%
International communications, internet and NEP services	194	19.7%	176	18.2%	66	19.9%	59	17.9%
Multi-channel television	186	16.3%	122	10.7%	61	16%	52	13.9%
Other	3	5.6%	1	1.8%	2	11.1%	1	5%
Adjustments (*)	(192)		(128)		(61)		(58)	
Consolidated operating profit/ percentage of Group revenue	2,492	29%	2,188	26.3%	875	29.9%	775	27.6%

(*) Mainly multichannel television activities which are not included in the consolidated financial statements.

Domestic fixed-line communications

Revenue:

Revenue in the first nine months of 2009 amounted to NIS 3.987 billion compared to NIS 4.15 billion in the corresponding period, a decrease of 3.9%. Revenue in the quarter amounted to NIS 1.343 billion compared to NIS 1.388 billion in the corresponding quarter, a decrease of 3.2%.

The decrease in the segment's revenue is due mainly to a decrease in the number of lines and in call traffic, and to lower interconnect fees to the cellular networks (as well as a decrease in the expense). The decrease is moderated by an increase in revenue from high-speed internet, data communication and transmission.

Depreciation and amortization expenses in the first nine months of 2009 amounted to NIS 600 million compared to NIS 643 million in the corresponding period, a decrease of 6.7%. Depreciation and amortization expenses in the quarter amounted to NIS 184 million compared to approximately NIS 214 million in the corresponding quarter, a decrease of 14%.

The decrease is due mainly to the end of depreciation of property, plant and equipment and to a change in estimated useful life of the existing network which will be replaced with the NGN.

Salary expenses in the first nine months of 2009 amounted to NIS 797 million compared to NIS 905 million in the corresponding period, a decrease of 11.9%. Salary expenses in the quarter amounted to NIS 255 million compared to NIS 289 million in the corresponding quarter, a decrease of 11.8%.

The decrease in salary expenses stemmed mainly from a rise in the attribution of salary expenses to property, plant and equipment, *inter alia*, due to the NGN deployment work.

Operating and general expenses in the first nine months of 2009 amounted to NIS 1.282 billion compared to NIS 1.398 billion in the corresponding period last year, a decrease of 8.3%. Operating and general expenses in the quarter amounted to NIS 451 million compared to NIS 464 million in the corresponding period, a decrease of 2.8%.

The decrease is mainly due to a decrease in the interconnect fees expenses to cellular operators, alongside a decrease in income from interconnect fees and from an increase in expenses capitalized to investment as well as the implementation of efficiency measures that resulted in a decrease in operating expenses.

Other operating income, net, in the first nine months of 2009 amounted to approximately NIS 54 million, compared to NIS 39 million in the corresponding period.

Other operating income, net, in the quarter amounted to approximately NIS 38 million, compared to NIS 7 million in the corresponding quarter.

The increase in income stemmed mainly from an increase in capital gains, which was moderated by a decrease in expenses in respect of provisions in the corresponding period.

Profitability:

Operating income in the segment in the first nine months of 2009 amounted to NIS 1.362 billion compared to NIS 1.243 billion in the corresponding period, an increase of 9.6%. Operating income in the segment in the quarter amounted to NIS 491 million compared to NIS 428 million in the corresponding quarter, an increase of 14.7%.

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

Cellular

Revenue:

Revenue in the segment in the first nine months of 2009 amounted to NIS 3.983 billion compared to NIS 3.575 billion in the corresponding period, an increase of 11.4%. Revenue in the segment in the quarter amounted to NIS 1.372 billion compared to NIS 1.214 billion in the corresponding quarter, an increase of 13%.

The increase in revenue stems mainly from an increase in revenues from the sale of terminal equipment and a rise in tariffs in the quarter, as well as from the number of sales. Revenue also increased from cellular services, due mainly to an increase in average revenue per user (ARPU), largely as a result of an increase in revenue from content services and an increase in the number of subscribers.

Costs and expenses:

Depreciation and amortization expenses in the first nine months of 2009 amounted to NIS 445 million compared to NIS 388 million in the corresponding period, an increase of 14.7%. Depreciation and amortization expenses in the quarter amounted to NIS 155 million compared to NIS 129 million in the corresponding quarter, an increase of 20.2%.

The increase is mainly due to an increase in amortization expenses for network equipment as a result of operation of the new network with HSPA/UMTS technology together with the existing network. There is also an increase in amortization expenses for subscriber acquisition.

Salary expenses in the first nine months of 2009 amounted to NIS 447 million compared to NIS 486 million in the corresponding period, a decrease of 8%. Salary expenses in the quarter amounted to NIS 148 million compared to NIS 157 million in the corresponding quarter, a decrease of 5.7%.

The decrease in salary expenses is mainly due to a decrease of share-based payments for managers and a decrease in the average number of positions in the first nine months compared to the corresponding period.

General and operating expenses in the first nine months of 2009 amounted to NIS 2.152 billion compared to NIS 1.927 billion in the corresponding period, an increase of 11.7%. General and operating expenses in the quarter amounted to NIS 754 million compared to NIS 635 million in the corresponding quarter, an increase of 18.7%.

The increase was mainly due to an increase in purchase prices of terminal equipment, an increase in network maintenance expenses as a result of operation of the new network together with the existing network, an increase in expenses for doubtful debts in the period, and an increase in advertising expenses for launching the new network.

Profitability:

Operating profit in the segment in the first nine months of 2009 amounted to NIS 939 million compared to NIS 774 million in the corresponding period, an increase of 21.3%. Operating profit in the segment in the quarter amounted to NIS 316 million compared to NIS 293 million in the corresponding quarter, an increase of 7.8%.

The increase in operating profit is due to the changes described in the revenue and expenses section above.

International communications, internet services and NEP

Revenue:

Revenue in the segment in the first nine months of 2009 amounted to NIS 984 million compared to NIS 969 million in the corresponding period, an increase of 1.6%.

Revenue in the segment in the quarter amounted to NIS 332 million compared to NIS 329 million in the corresponding quarter, an increase of 1%.

The increase in revenue is mainly due to an increase in the number of broadband subscribers, an increase in integration activities as well as an increase in data activities. Conversely, there was a decrease in revenue from outgoing calls mainly due to a decrease in the volume of traffic. In addition, there was a decrease in revenue from the sale of private exchanges (PBX).

Costs and expenses:

Depreciation and amortization expenses in the first nine months of 2009 amounted to NIS 62 million compared to NIS 60 million in the corresponding period, an increase of 3.3%. Depreciation expenses in the quarter amounted to NIS 21 million compared to NIS 20 million in the corresponding quarter, an increase of 5%.

The change is due to further acquisition of capacity user rights and reduction of subscriber acquisition costs.

Salary expenses in the first nine months of 2009 amounted to NIS 181 million compared to NIS 197 million in the corresponding period, a decrease of 8%. Salary expenses in the quarter amounted to NIS 58 million compared to NIS 67 million in the corresponding quarter, a decrease of 13.4%.

The decrease in salary expenses is due to a decrease in the number of positions, a decrease in share-based payments to managers and capitalization of commissions to sales staff for acquisition of subscribers.

General and operating expenses in the first nine months of 2009 amounted to NIS 547 million compared to NIS 535 million in the corresponding period, an increase of 2.2%. General and operating expenses in the quarter amounted to NIS 187 million compared to NIS 183 million in the corresponding quarter, an increase of 2.2%.

The growth corresponds with the change in segment revenue in the areas of its operations.

Profitability:

Operating profit in the segment in the first nine months of 2009 amounted to NIS 194 million compared to NIS 176 million in the corresponding period, an increase of 10.2%.

Operating profit from the segment in the quarter amounted to NIS 66 million compared to NIS 59 million in the corresponding quarter, an increase of 11.9%.

The increase in operating profit is due to the changes described in the revenue and expenses section above.

Multichannel television (stated using the equity method)

Revenue:

Revenue in the segment in the first nine months of 2009 amounted to NIS 1.14 billion compared to NIS 1.136 billion in the corresponding period, an increase of 0.4%. Revenue in the segment in the quarter amounted to NIS 380 million compared to NIS 375 million in the corresponding quarter, an increase of 1.3%.

The increase in revenue is mainly due to an increase in revenue from advanced services and premium channels and due to the increase in the number of subscribers. On the other hand, as a result of the updated internet agreement with the Company, there is a decrease of NIS 39 million in internet revenue in the first nine months of 2009, and NIS 10 million in the quarter compared to the corresponding period.

Costs and expenses:

Depreciation expenses in the first nine months of 2009 amounted to NIS 168 million compared to NIS 184 million in the corresponding period, a decrease of 8.7%. Depreciation expenses in the quarter amounted to NIS 56 million compared to NIS 59 million in the corresponding quarter, a decrease of 5%.

The decrease is due to the extension of the customer commitment period for special offers, which accordingly affected the depreciation rate for installations.

Salary expenses in the first nine months of 2009 amounted to NIS 153 million compared to NIS 142 million in the corresponding period, an increase of 7.7%. Salary expenses in the quarter amounted to NIS 51 million compared to NIS 45 million in the corresponding quarter, an increase of 13.3%.

The increase in salary expenses is mainly due to an increase in the number of employees in the call centers and an increase in the technical service system while reducing outsourcing services.

Operating and general expenses in the first nine months of 2009 amounted to NIS 634 million compared to NIS 688 million in the corresponding period, a decrease of 7.8%. Operating and general expenses in the quarter amounted to NIS 213 million compared to NIS 218 million in the corresponding period, a decrease of 2.3%.

The decrease in expenses is mainly due to a reduction in internet operations due to the new agreement with the Company, which was offset by an increase in content costs.

Profitability:

Operating profit in the segment in the first nine months of 2009 amounted to NIS 186 million compared to NIS 122 million in the corresponding period, an increase of 52.5%. Operating profit in the segment in the quarter amounted to NIS 61 million compared to NIS 52 million in the corresponding quarter, an increase of 17.3%.

The increase in operating profit is due to the changes described in the expenses and revenue section above.

C. Financing expenses, net

The Group's net financing income in the first nine months of 2009 amounted to NIS 13 million compared to NIS 125 million in the corresponding period.

Financing expenses in the quarter amounted to NIS 16 million compared to NIS 57 million in the corresponding quarter, a decrease of 71.9%.

The Group's debt to financial institutions and debenture holders is mostly linked to the CPI and financing expenses are influenced by fluctuations in the index. In the reporting period, there was a lower rate of rise in the index to which the debt balance is linked, compared to the corresponding quarter and revaluation of liabilities resulted in a decrease in the Group's financing expenses compared to the corresponding period. There was also a decrease in financing expenses, due to the increase in revenue from hedging transactions and a decrease in the financial debt.

The change stems mainly from the domestic fixed-line communications segment where net financing expenses in the first nine months of 2009 amounted to NIS 22 million, compared to NIS 102 million in the corresponding period. The change is due to the reasons described above.

In the quarter there was a higher rate of rise in the index to which the debt balance is linked, however, an increase in revenue from hedging transactions and a decrease in the financial debt resulted in a decrease in financing expenses compared to the corresponding period.

D. Income tax

The Group's tax expenses in the first nine months of 2009 amounted to NIS 702 million, representing 28.1% of pre-tax profit, compared to NIS 591 million in the corresponding period, representing 28.6% of pre-tax profit. Tax expenses in the quarter amounted to NIS 259 million, representing 30.6% of pre-tax profit, compared to NIS 207 million in the corresponding period, representing 28.8% of pre-tax profit. Most of the change in the pre-tax expense rate is due to a lower tax rate compared to the corresponding period, which was offset by the decrease in the net deferred tax assets, as a result of the decrease in the tax rate, as stated in Note 15(B) to the financial statements

3. Liquidity and sources of financing

Consolidated cash flow for the nine and three months ended September 30, 2009, including cash flow from DBS operations up to August 20, 2009 (for details of the amounts see Note 4 (2) to the financial statements).

Consolidated cash flows generated by operating activities in the first nine months of 2009 amounted to NIS 3.13 billion, compared to NIS 2.59 billion in the corresponding period, an increase of NIS 540 million. The increase in cash flows generated by operating activities is mainly due to an increase in operating profit in all segments of the Group, a change in the balances of trade and other payables and a decrease in payments for early retirement. The increase was partially offset by an increase in trade receivables.

Cash flow from operating activities is one of the Group's financing sources. In the reporting period, an amount of NIS 1.125 billion was invested in development of communication infrastructure and NIS 247 million in intangible assets and deferred expenses, compared to NIS 962 million and NIS 385 million, respectively, in the corresponding period. Additionally, an amount of NIS 134 million was invested in net current investments, compared with realization of NIS 314 million in the corresponding period.

In the reporting period, the Group repaid debts and paid interest amounting to NIS 1.096 billion, of which NIS 672 million was on account of debentures, NIS 86 million on account of loans and NIS 338 million in interest payments. Conversely, the Group received loans of NIS 400 million, short-term credit of NIS 48 million and proceeds from the exercise of options for employees of NIS 117 million, compared to repayment of debts and interest payments of NIS 1.08 billion in the corresponding period.

In the reporting period, cash dividends in the amount of NIS 792 million were paid, compared to NIS 679 million paid in the corresponding period.

In the first nine months of 2009, the average monthly short-term bank credit amounted to NIS 73 million. In the first nine months of 2009, the average monthly long-term liabilities to financial institutions and debenture holders amounted to NIS 5.777 billion.

The working capital deficit at September 30, 2009 amounted to NIS 313 million, compared to NIS 738 million in the corresponding period. Most of the improvement in working capital is due to deconsolidation of DBS (the working capital deficit of DBS at September 30, 2008 amounted to NIS 526 million). The improvement was partially offset by an increase in the working capital deficit in the domestic fixed-line communications segment and a decrease in working capital in the cellular segment.

The Board of Directors of the Company reviewed the Company's projected cash flows, including credit sources and possible sources of raising credit, and determined that the working capital deficit does not indicate liquidity problems in the Company.

The abovementioned is forward-looking information based on the Company's assessments. Actual results could be materially different from these assessments if a change occurs in one of the factors taken into consideration while making them.

4. Market risks – Exposure and management

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

B. Sensitivity analyses of the fair value and the effect of the change in market prices on the fair value of balance-sheet balances and off-balance sheet balances for which there are firm agreements at September 30, 2009, are not materially different from those of December 31, 2008, with the exception of deconsolidation of DBS, which reduced the Group’s exposure to changes in the CPI by NIS 2.574 billion, exposure to changes in the real shekel interest rate by NIS 2.015 billion, exposure to changes in the nominal shekel interest rate by NIS 804 million and exposure to changes in the dollar interest rate by NIS 535 million.

Exposure to changes in the exchange rate of the dollar decreased by NIS 632 million due to deconsolidation and was mainly offset by an increase in the scope of other firm agreements with suppliers.

C. The linkage base report at September 30, 2009 is not substantially different from the December 31, 2008 report, with the exception of the decrease in net CPI-linked liabilities amounting to NIS 3.064 billion, of which NIS 2.52 billion is due to deconsolidation of DBS.

5. Critical accounting estimates

The preparation of the financial statements according to international accounting standards requires the 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, taking into account the circumstances. The actual results can differ from those assessments based on various assumptions and conditions. Information on the principal matters of uncertainty in critical assessments and judgments in the application of the accounting policy is provided in the annual financial statements. We believe that these assessments and estimates are critical since every change in them and in the assumptions has the potential to materially affect the financial statements.

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

The Board of Directors is responsible for oversight. The names of the Company's directors are listed in Chapter D of the Periodic Report for 2008. The Board of Directors appointed a balance sheet committee, whose mandate and composition are described in the Directors' Report for 2008. The financial statements were discussed at the balance sheet committee and submitted to the Board of Directors for approval. The following officers attended the board discussion: board members – Shlomo Rodav, Eyal Yaniv, Menachem Inbar, Michael Grabiner, Ran Gottfried, Yoav Rubinstein, Elon Shalev, Kihara R. Kiarie, David Gilboa, Rami Nomkin, Yitzhak Idelman, Yehuda Porat and Adam Chesnoff. In addition, the following officers attended: Avi Gabbay – CEO, Alan Gelman – CFO and Deputy CEO, and Amir Nachlieli – General Counsel. Representatives of Somekh Chaikin, the Company's auditors, also participated in the discussion.

7. Details of debenture series

Below are the updated details for September 30, 2009:

		Series 4 debentures	Series 5 debentures
A	Par value	NIS 600,000,000 (1)	NIS 2,386,967,000
B	Par value revalued at the report date (CPI-linked)	NIS 684,552,729	NIS 2,723,341,290 (2)
C	Accumulated interest	NIS 10,952,844	NIS 48,112,362
D	Fair value	NIS 727,440,000	NIS 3,172,040,446
E	Stock exchange value	NIS 727,440,000	NIS 3,172,040,446

(1) On June 1, 2009, NIS 300,000,000 par value was repaid.
(2) Of which, NIS 1.004 billion is held by a wholly-owned subsidiary.

In October 28, 2009, Standard & Poor's Maalot, which rates the Company's debentures, announced that it had placed the local rating of the Company's debentures (which are rated AA+) on CreditWatch Negative, following the Company's announcement regarding its agreement with the controlling shareholder in the Company, Ap.Sb.Ar. Holdings Ltd., for the sale of all its holdings in Bezeq (30.6%) to 012 Smile Communications Ltd., and the possible effect of the change in control on the capital structure of the Company.

8. Sundry and events subsequent to the date of the financial statements

A. On October 25, 2009, Ap.Sb.Ar notified the Company that it has entered into an agreement with 012 Smile Communications Ltd for an off-floor sale of 814,211,545 Company's ordinary shares of NIS 1 par value each, representing 30.6% of the issued and paid up share capital of all the Company's shares, for NIS 6,513,692,360. Pursuant to the notice, the share price in the transaction is NIS 8 per share. Completion of the transaction is subject to the receipt of regulatory approvals required by law no later than April 25, 2010. After completion of the transaction, Ap.Sb.Ar is not expected to hold shares in the Company.

B. On August 4, 2009, the Board of Directors of the Company resolved to recommend to the general meeting of the shareholders of the Company the distribution of a cash dividend in the total amount of NIS 1.149 billion. On September 2, 2009, the general meeting approved payment of the dividend and it was paid on October 5, 2009.

C. On October 27, 2009, the Finance Committee of the Knesset ratified an amendment to the Communications (Telecommunications and Broadcasts) (Royalties) Regulations, 5761-2001, which, to the best of the Company's knowledge, has not yet been published. The amendment includes an exemption for the payment of royalties for revenue from high-speed communication services, which commenced on January 1, 2004. As a result of this exemption, the Company received a refund of royalties estimated at NIS 30 million and royalty expenses will be reduced in the fourth quarter accordingly.

D. On November 4, 2009, the Board of Directors approved an early retirement plan for employees for 2010. Under the plan, 171 employees will retire from the Company at a total cost of NIS 225 million. The Board of Directors also resolved to approve an additional cost of NIS 41 million to complete the early retirement plan for 2009. See Note 15D(1) to the financial statements as at December 31, 2008. See Note 15D to the financial statements. In view of the aforesaid, the Company is expected to record a provision of NIS 266 million in its financial statements for the fourth quarter of 2009.

E. On May 27, 2009, the Company's Board of Directors resolved to change the organizational structure such that the Company's Internal Auditor will report to the CEO instead of the chairman of the Board of Directors.

F. Based upon the Bezeq Group's financial performance for the first nine months of 2009, which was materially stronger than the corresponding nine-month period in 2008, the Bezeq Group reiterates its outlook for 2009 and continues to anticipate achieving full-year revenue, net profit, EBITDA and operating cash flows above those for the full-year 2008 results. The Bezeq Group is maintaining its outlook for full-year 2009 gross capital expenditures, which are still expected to be close to the 2008 level.

The aforementioned guidance for the full-year 2009 is based on the anticipated Bezeq Group consolidated performance, which following the deconsolidation of yes financials as of August 21st, 2009, excludes the financial contribution of yes from both the 2009 and 2008 full-year periods.

The above includes forward-looking information, based on the Company's assessments. Actual results could be materially different from these assessments, bearing in mind the changes that might occur in the business conditions and the effects of regulatory decisions.

G. At September 30, 2009, the Group's net contractual dollar-linked liabilities (including off-balance sheet) amounted to NIS 1.003 billion and its net CPI-linked liabilities (including off-balance sheet) amounted to NIS 2.282 billion. The dollar exchange rate increased by 0.9% between September 30, 2009, and the date of signing the financial statements and the known CPI fell by 0.3% in September 2009.

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

Shlomo Rodav **Chairman of the Board**	**Avi Gabbay** **CEO**