November 4, 2009

# "Bezeq" The Israel Telecommunication Corp. Limited

# Quarterly Report for the period ending 30.9.09

## Update of Chapter A (Description of Company Operations) of the Periodic Report for 2008

## Directors' Report on the State of the Company's Affairs for the period ended Sept 30, 2009

## Condensed Interim Consolidated Financial Statements as at Sept 30, 2009

**UPDATE OF CHAPTER A (DESCRIPTION OF COMPANY OPERATIONS)[1]**
**OF THE PERIODIC REPORT FOR 2008 ("THE PERIODIC REPORT")**
**OF "BEZEQ" – THE ISRAEL TELECOMMUNICATIONS CORP. LTD. ("the Company")**

**In this report, which contains an update of the chapter regarding the description of the Company's business from the periodic report for 2008, the Company has included forward-looking information, as defined in the Securities Law 5728-1968 ("the Securities Law") with respect to both itself and the market. Such information includes forecasts, targets, appraisals and assessments which apply to future events or matters the realization of which is not certain and is not under the Company's control. Forward-looking information in this report will usually be identified specifically, or by employing statements such as "the Company expects", "the Company assesses", "it is the Company's intention", and similar statements.**

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

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

# 1. DESCRIPTION OF GENERAL DEVELOPMENT OF GROUP OPERATIONS

## Section 1.1 – Group activity and description of its business development

### Section 1.1.4 - Holdings of the Company

The following are details of the current rate of the Company's holdings, fully diluted, assuming exercise of all of the options actually allotted to employees of the Company at September 30, 2009 and November 3, 2009 (as set out in the Periodic Report for 2008 and in the update to section 1.3.2 below):

| Shareholders | Percentage of holdings | | |
|---|---|---|---|
| | At Sept. 30, 2009 | At November 3, 2009 | Fully diluted at Sept. 30, 2009 |
| **Ap.Sb.Ar.** | 30.68% | 30.64% | 29.69% |
| **State of Israel** | 2.98% | 2.79% | 0.96% |
| **Zeevi Group** | 11.58% | 7.05% | 11.21% |
| **Public** | 54.76% | 59.51% | 56.73% |

For details regarding the sale of shares in the Company by Ap.Sb.Ar. Holdings, Ltd. ("Ap.Sb.Ar.") and by the Ze'evi Group, see section 1.3, below.

### Section 1.1.5 – Mergers and Acquisitions – DBS

On August 20, 2009, the Supreme Court handed down its ruling on the appeals filed by the Antitrust Authority and Eurocom DBS Ltd. against the ruling of the Antitrust Tribunal on February 3, 2009 that approved the merger of the Company and DBS Satellite Services (1998) Ltd. ("DBS") subject to conditions. The Supreme Court accepted the appeal of the Antitrust Authority and decided not to approve the merger.

[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 in any matter which must be described in the Periodic Report. The update relates to the Company's periodic report for 2008 and relates to the section numbers in Chapter A (Description of Company Operations) in that periodic report.

In consideration of the decision of the Supreme Court, the Company no longer controls DBS. Accordingly, as of August 21, 2009, the company ceased consolidating its financial reports with the reports of DBS and the investment in shares of DBS is presented according to the equity value method as at that date. As at the date on which the consolidation was discontinued, the Company placed the investment in the shares and options in DBS and the loans the Company made to DBS according to their fair value, based on an assessment of value conducted by an external appraiser, according to which the value of the Company's investment in DBS is valued at approximately NIS 1,145-1,234 million. The company placed the investment of NIS 1,175 million and recognized profit of approximately NIS 1,538 million. For additional information on this matter, see Note 4 of the Financial Statements of the Company as at September 30, 2009.

It should be noted that on September 29, 2009, Polar Communications Ltd. ("Polar"), which owns shares in DBS gave notice that it had signed an agreement with a third party to sell approximately 2.54% of the shares in DBS that it holds and approximately 32% of all the loans it gave to DBS in return for consideration of NIS 40 million. Pursuant to this, on the same day, Polar sent notification to the other shareholders in DBS, including the Company, informing them of the transaction and of their right, in accordance with the DBS shareholders agreement and the articles of organization of DBS to realize within 45 days their right of first refusal for acquiring the shares sold, in accordance with their relative holdings in YES.

## Section 1.3 – Investments in equity and stock transactions

### Section 1.3.1 – Transactions in shares of Bezeq

**A. <u>Sale of the Controlling Stake</u>**

On October 25, 2009, the controlling shareholder in the Company, Ap.Sb.Ar., informed the Company that it concluded an agreement with 012 Smile Communications, Ltd. for an off floor sale of 814,211,545 ordinary shares of the Company, worth NIS 1 par value each, which are 30.6% of the issued and paid up share capital of the Company listed on the of Poalim (Romema) Trustees, Ltd. in consideration of the sum NIS 6,513,692,360. In accordance with the said notification, the share price set in the context of the transaction is NIS 8. Completion of the transaction is conditional of receiving the regulatory approvals required by law no later than April 25, 2010, including the following approvals: approval of the Ministry of Communications for the transaction (including granting control permits); approval of the Antitrust Commissioner for the transaction, approval of the Prime Minister and the Minister of the Communications, pursuant to provisions of the Communications Law (Telecommunications and Transmissions) 5742-1982 and provisions of the Communications Order (Telecommunications and Transmissions) (Determination of Critical Services Provided by Bezeq, the Israel Telecommunications Company, Ltd.) 5757-1997; any other approval or agreement required by law. After completion of the transaction, it is not expected that AP.SB.AR. will hold any more shares in the Company. For additional information see notes 1B and 15E of the financial statements for the period ending on September 30, 2009.

**B. <u>Other Transactions in Shares of Bezeq</u>**

1. On August 10, 2009, a transaction for the sale of 155,000,000 shares of Bezeq worth NIS 1 par value each, which were held by Ze'evi Communications Holdings, Ltd. (in receivership) was completed through the investment bank UBS Limited in consideration of NIS 1,151,650,000 (the sales was made in two stages, so that the value of the shares held by the purchaser would not exceed 4.99% of the Company's share capital.)

2. On August 11, 2009, a transaction for the sale of 149,376,642 shares of Bezeq worth NIS 1 par value each, which were held by AR.SB.AR. was completed through Citigroup Global Markets, Ltd. in consideration of NIS 1,120,324,815, so that after completion of the purchase no purchaser held more than 5% of the Company's share capital.

3. On September 17, 2009, a transaction for the distribution of 95,623,358 shares of Bezeq worth NIS 1 par value each, which were held by AR.SB.AR. was completed through Citigroup Global Markets, Ltd. in consideration of NIS 748,730,893, so that after completion of the purchase no purchaser held more than 5% of the Company's share capital.

4. On October 19, 2009, a transaction for the sale of 120,000,000 shares of Bezeq worth NIS 1 par value each, which were held by Ze'evi Communications Holdings, Ltd. (in

receivership) was completed through the investment bank UBS Limited in consideration of NIS 976,800,000.

Upon completion of the aforementioned sales of shares listed in section B, above, the holdings of AR.SB.AR. in the Company were reduced to approximately 30.68% (approximately 29.69% at full dilution) and the holdings of the Ze'evi Group in the Company were reduced to approximately 7.06% (approximately 6.84% at full dilution).

### Section 1.3.2 - Employee option schemes

Further to an option scheme for managers and senior employees of the Group of November 2007, to allot up to 65,000,000 options, since the date of publication of the Periodic Report for 2008 and until November 3, 2009, 600,000 additional options were allotted and 1,133,334 options expired, so that as at September 30, 2009 and as at November 3, 2009, 59,016,666 options, net (less expired options), have been allotted under the scheme.

## Section 1.4 – Distribution of dividends

### Section 1.4.1 – Dividend distribution policy

On August 4, 2009, the Board of Directors of the Company has also adopted a dividend distribution policy, whereby the Company will distribute to its shareholders on a semi-annual basis, cash dividends amounting to 100% of the net profit (attributable to the shareholders of the Company) recorded for the previous six-month period, based on the consolidated financial statements of the Company.

The implementation of this dividend policy is subject to Israeli law, including the distribution tests set forth in the Companies Law (1999), and is also subject to the Board of Directors' assessment of the Company's ability to meet its current and expected obligations, in consideration of its projected cash flows, activities and commitments, cash balances, future plans and financial position, as they may be from time to time. Each dividend distribution will be subject to the approval of the general meeting of shareholders of the Company, pursuant to the Company's bylaws.

### Section 1.4.2 – Distribution of dividends

On May 3, 2009, the general meeting of shareholders of the Company, following the recommendation of the Board of Directors of the Company on March 23, 2009, approved the distribution of a cash dividend to the shareholders of the Company in the amount of NIS 792 million, constituting, at the effective date for the distribution (May 11, 2009), the sum of NIS 0.3013025 per share and 30.13025% of the issued and paid up share capital of the Company. The dividend was paid to the shareholders of the Company on May 24, 2009.

On September 2, 2009, the general meeting of shareholders of the Company, following the recommendation of the Board of Directors of the Company of August 4, 2009, approved the distribution of a cash dividend to the shareholders of the Company in the amount of NIS 1,149 million, constituting, at the effective date for the distribution (September 22, 2009), the sum of NIS 0.4329743 per share and 43.29743% of the issued and paid up share capital of the Company. The dividend was paid to the shareholders of the Company on October 5, 2009.

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

### Section 1.5.3 Principal results and operational data

**A. <u>Bezeq Fixed line (the Company's activity as domestic operator)</u>**

(NIS millions except where stated otherwise)

| | Q3 2009 | Q2 2009 | Q1 2009 | Q4 2008 | Q3 2008 | Q2 2008 | Q1 2008 |
|---|---|---|---|---|---|---|---|
| Revenues | 1,343 | 1,318 | 1,326 | 1,348 | 1,388 | 1,354 | 1,408 |
| Operating profit | 491 | 434 | 437 | 232** | 428** | 442** | 373** |
| Depreciation and amortization | 184 | 205 | 211 | 209 | 214 | 211 | 218 |
| Earnings before interest, taxes, depreciation and amortization (EBITDA) | 675 | 639 | 648 | 441** | 642** | 653** | 591** |
| Payments for investment in property, plant and equipment and intangible assets | 224 | 191 | 238 | 170 | 156 | 132 | 158 |
| Proceeds from sale of property, plant and equipment and intangible assets | 40 | 8 | 50 | 47 | 12 | 25 | 60 |
| No. of active subscriber lines at end of period (in thousands) | 2,518 | 2,547 | 2,579 | 2,615 | 2,645 | 2,681 | 2,711 |
| Average monthly revenue per line (NIS) * | 83 | 81 | 81 | 82 | 85 | 82 | 84 |
| No. of outgoing minutes (in millions) | 3,095 | 3,014 | 3,123 | 3,154 | 3,428 | 3,346 | 3,511 |
| No. of incoming minutes (in millions) | 1,737 | 1,664 | 1,654 | 1,648 | 1,719 | 1,651 | 1,673 |
| No. of ADSL subscribers at end of period (in thousands) | 1,026 | 1,016 | 1,011 | 1,005 | 994 | 982 | 970 |
| Average monthly revenue per ADSL subscriber (NIS) | 72 | 69 | 68 | 67 | 68 | 66 | 68 |

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

** Reclassification of the sum of approximately NIS 26 million, spread over the four quarters of 2008, for financing costs for provisions for termination of labor relations under early retirement, presented in the past under the item of operating expenses (income) net.

**B. Pelephone**

(NIS millions except where stated otherwise)

| | Q3 2009 | Q2 2009 | Q1 2009 | Q4 2008 | Q3 2008 | Q2 2008 | Q1 2008 |
|---|---|---|---|---|---|---|---|
| Revenue | 1,372 | 1,346 | 1,265 | 1,138 | 1,214 | 1,188 | 1,173 |
| Operating profit | 316 | 321 | 302 | 159 | 293 | 266 | 215 |
| Depreciation and amortization | 155 | 151 | 139 | 135 | 129 | 130 | 129 |
| Earnings before interest, taxes, depreciation and amortization (EBITDA) | 471 | 472 | 441 | 294 | 422 | 396 | 344 |
| Net profit | 231 | 233 | 230 | 128 | 211 | 180 | 163 |
| Cash flow from current operations | 395 | 290 | 375 | 298 | 379 | 344 | 256 |
| Payments for investment in property, plant and equipment and intangible assets | 146 | 163 | 149 | 163 | 350 | 182 | 103 |
| Proceeds from sale of property, plant and equipment and intangible assets | - | 4 | - | 1 | - | 1 | 1 |
| No. of subscribers at end of period (in thousands) | 2,721 | 2,694 | 2,669 | 2,649 | 2,698 | 2,636 | 2,595 |
| Average monthly minutes of use (MOU) per subscriber* | 339 | 329 | 323 | 335 | 359 | 358 | 355 |
| Average monthly revenue per subscriber (ARPU) (in NIS)* | 136 | 131 | 128 | 122 | 129 | 128 | 126 |
| No. of subscribers at end of period (in thousands) | 1,407 | 1,307 | 1,217 | 1,151 | 1,068 | 977 | 867 |
| Revenues from value added services and content as % of revenues from cellular services | 20.3% | 19.2% | 18.5% | 18.4% | 16.2% | 15.5% | 15.0% |

* On December 31, 2008, Pelephone adopted a stricter policy for counting subscribers, by which subscribers who only receive SMS messages are not counted as subscribers. This change in policy led to the deduction of approximately 92,000 subscribers, the number of subscribers as at September 30, 2008 is prior to the deduction of those subscribers.

The decrease in MOU is the result of the transition to charging according to segments of one second that went into effect on January 1, 2009, which led to a reduction in the number of minutes billed.

## C. Bezeq International

(NIS millions except where stated otherwise)

| | Q3 2009 | Q2 2009 | Q1 2009 | Q4 2008 | Q3 2008 | Q2 2008 | Q1 2008 |
|---|---|---|---|---|---|---|---|
| Revenue | 332 | 327 | 324 | 337 | 329 | 326 | 314 |
| Operating profit | 66 | 68 | 60 | 65 | 59 | 63 | 55 |
| Depreciation and amortization | 21 | 21 | 20 | 20 | 20 | 20 | 20 |
| Earnings before interest, taxes, depreciation and amortization (EBITDA) | 88 | 88 | 80 | 85 | 79 | 83 | 75 |
| Net profit | 51 | 56 | 44 | 46 | 44 | 47 | 42 |
| Cash flow from current operations | 82 | 83 | 84 | 72 | 32 | 51 | 8 |
| Payments for investment in property, plant and equipment and intangible assets | 33 | 26 | 21 | 26 | 33 | 31 | 28 |
| Proceeds from sale of property, plant and equipment and intangible assets | - | - | - | 1 | - | - | - |

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

## D. DBS

(NIS millions except where stated otherwise)

| | Q3 2009 | Q2 2009 | Q1 2009 | Q4 2008 | Q3 2008 | Q2 2008 | Q1 2008 |
|---|---|---|---|---|---|---|---|
| Revenue | 380 | 376 | 384 | 377 | 375 | 380 | 381 |
| Operating profit | 61 | 59 | 66 | 55 | 52 | 43 | 27 |
| Depreciation and amortization | 59 | 56 | 57 | 66 | 59 | 60 | 65 |
| Earnings before interest, taxes, depreciation and amortization (EBITDA) | 120 | 115 | 122 | 122 | 111 | 103 | 92 |
| Net profit (loss) | (88) | (95) | (1) | (18) | (82) | (99) | (66) |
| Cash flow from current operations | 135 | 93 | 91 | 134 | 97 | 32 | 84 |
| Payments for investment in property, plant and equipment and intangible assets* | 87 | 60 | 61 | 63 | 56 | 40 | 79 |
| Proceeds from sale of property, plant and equipment and intangible assets | - | - | - | - | - | - | - |
| No. of subscribers at end of period (in thousands) | 567 | 562 | 560 | 560 | 556 | 551 | 549 |
| Average monthly revenue per subscriber (in NIS)* | 224 | 224 | 228 | 225 | 226 | 230 | 231 |

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

## Section 1.6 - Group forecast

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

## Section 1.8 - Group strategy

* **Frontrunner status** – reinforcement and strengthening of the Bezeq Group's status as the leading communications group in Israel.
* **Presence in central arenas in the communications market and availability for the end user** – the mobile market, the customer's home, the business sector, internet, television and content.
* **Total client solution** – provision of an inclusive communications solution for private and business customers based on a variety of services and products.
* **Substantial presence in all components of the value chain** – provision and reinforcement of the connection with the customer by maintaining quality service and innovation throughout the value chain: infrastructure, services and content.
* **Tailoring of service to customer** – focusing on the provision of tailored services to customers, with the services being provided at a high level, and full response to the needs of both private and business customers.
* **Innovation and technology** – the relative advantage of the companies in the Group will be based, inter alia, on leading and up-to-date technology in the market, such as technology that has matured sufficiently in order to enable deployment and provision of such services to a large scale, and with the requisite level of reliability.
* **Commercial focusing** – focusing on the core areas of the communications market and related areas, and focusing on the local market in Israel.
* Retention and reinforcement of the concept of quality, goodwill and assetization of the Group's brands.

Naturally, a review of the Group's strategy involves assessments regarding future developments in customer conduct and needs, rate of adoption of new services, technological developments, regulatory policy and the marketing strategy of competitors. However, there is no certainty that this strategy will in fact eventuate, or will eventuate in the manner set out above. The circumstances that might lead to failure of the strategy to eventuate, or to its absolute failure, depend, *inter alia*, on frequent technological changes and on regulatory compulsions.

## 2. FIXED-LINE DOMESTIC SERVICES – BEZEQ, THE ISRAEL TELECOMMUNICATION CORP. LTD. ("THE COMPANY")

#### Section 2.1.2 – General information on area of operations – statutory restrictions and special constraints

Tariffs were updated on June 1, 2009, and interconnect tariffs to the Company were reduced as of the same date. See update to section 2.16.1 below.

### Section 2.3 - Breakdown of revenues and profitability of products and services

For updates of data regarding the breakdown of the Company's revenues based on products and services, see Note 12B to the financial statements of the Company for the period ended on September 30, 2009.

### Section 2.6 – Competition

On May 10, 2009, HOT announced the establishment of a UFI (Ultra Fast Internet) network using Docsis3 technology. According to its announcement, the network will offer speeds of up to 100 mega. In accordance with its announcement, HOT launched the mentioned network in October 2009.

#### Section 2.6.1 – Telephony

With regard to the Company's petition to the High Court of Justice concerning enforcement of the structural separation rules on HOT – on June 4, 2009, the Ministry of Communications gave notice of an amendment of HOT Telecom's license with respect to structural separation between HOT Telecom and HOT Communications Systems Ltd. ("HOT Broadcasts") setting out restrictions on the structural separation obligation that had been part of HOT Telecom's license. Under these circumstances, and pursuant to supplementary notices by the Respondents (the State and HOT), on July 16, 2009, the Company filed a supplementary notice in which it requested that the Court set aside the petition. On July 19, 2009, the ruling of the Supreme Court was handed down stating that the petition should be set aside, in accordance with the petitioners' request, with no order being made as to costs.

On July 30, 2009, the Ministry of Communications issued a hearing for HOT Telecom after HOT Net, a limited partnership wholly owned by HOT Broadcasts, submitted a petition to receive a special license to provide Internet access services. The hearing relates to the amendment of the HOT Telecom's license prior to issuing a license to HOT Net, in order to set out the mechanisms that will make it possible for them to market a joint basket of services, while maintaining the limitations regarding the structure separation between HOT Telecom and HOT Broadcasts, and as a result thereof, between HOT Telecom and HOT Net.

Regarding the hearing on the issue of tariffs for PRI services (which are mainly fines for exiting the PRI service), on August 8, 2009, the Ministry of Communications decided to accept the manner of operation that the Company proposed for changes in this matter.

#### Section 2.6.2 – Broad Band Access to the Internet

On August 31, 2009, the Ministry of Communications published a request to receive public opinions regarding the organizing the structure of the market for broadband service over the cellular telephone network. Regarding this issue, please see the updates to Sections 3.7 and 4.1.2, below.

#### Section 2.6.7

Section H – NGN: In September 2009, the Company launched the NGN network and as of the date this report was published, approximately 270,000 of the Company's subscribers are connected to the network.

### Section 2.7 – Property, plant and equipment

#### Section 2.7.4 – Real estate

During the course of the first nine months of 2009, the Company sold seven real estate assets in a total area of approximately 41,400 $m^2$ in land and approximately 20,000 $m^2$ built-up, for a total sum of NIS 93 million (approximately NIS 65 million of which in the third quarter of 2009). Additionally, under the settlement agreement between the Company and the Israel Lands Administration, an agreement was signed in June 2009 between the parties to the effect that the Company undertook to return the Bayit VaGan installation to the State within 18 months of the date of execution of the agreement and to waive receipt of a substitute property for such property, in consideration for the sum of approximately NIS 6 million. The Company invested the above consideration in the purchase of offices for the purpose of providing services to the Israel Broadcast Authority.

## Section 2.9 – Human resources

On May 27, 2009, the Company's Board of Directors decided to the change the organizational structure so that the Company's Internal Auditor no longer reports to the Chairman of the Board but rather to the CEO.

Pursuant to a resolution of the Company's Board of Directors in 2008 to approve the retirement of 245 employees during 2009 in accordance with the conditions of the Collective Agreement of December 2006, 176 employees retired from the Company in this context as at November 3, 2009 (of whom 171 retired prior to September 30, 2009).

On November 4, 2009, the Company's Board of Directors approved an early retirement plan for employees for 2010, in which approximately 171 employees will retire from the Company at an overall cost of approximately NIS 225 million, in accordance with the conditions of the Collective Agreement of December 2006. Furthermore, the Company's Board of Directors decided at the same time to approve an additional expense of approximately NIS 41 million for the purpose of completing the 2009 early retirement plan. In consideration thereof, the Company is expected to record a provision of NIS 266 million for this purpose in its financial statements for Q4 2009.

## Section 2.13 – Finance

### Section 2.13.6 – Credit rating

On September 3, 2009, Moody's which rates the Company, gave notice that the Company's rating would remain Baa1 (stable).

On October 28, 2009, S&P which rates the Company, and Standard & Poor's Maalot which rates the Company's debentures, gave notice that it placed a Credit Watch with negative consequences on the rating of the international company which is BBB+ (BBB plus) and the rating of the Company's local debentures which are rated AA+ (AA plus) following the notification regarding that the Company's controlling shareholder AP.SB.AR. Holdings, Ltd. concluded a contract for the sale of its entire holdings in Bezeq (approximately, 30.6%) to Smile 012, Communications Ltd, and the possible impact of the change of control on the capital structure of the Company.

### Section 2.14 – Taxation

See Note 15(b) to the financial statements of the Company for the period ended on September 30, 2009.

## Section 2.16 – Limitation and regulation of Company activities

### Section 2.16.1 – Control of the Company's tariffs

Sub-section (a), regarding update of the Company's tariffs – According to the Communications (Telecommunications and Broadcasts) (Calculation of Payments and Linkage for Telecommunications Services) Announcement, 5769-2009, the Company's tariffs were updated as of June 1, 2009, based on the regular update formula in the Communications (Telecommunications and Broadcasts) (Calculation of Payments and Linkage for Telecommunications Services) (Amendment) Regulations 5767-2007, so that the monthly payment for a telephone line and for a basic ISDN (Integrated Services Digital Network) line rose by 3.8% and the other controlled services provided by the Company declined by 0.3183%.

Furthermore, pursuant to the amendment of the Communications (Telecommunications and Broadcasting) (Payments for Interconnect) (Amendment) Regulations, 5769-2009, the interconnect fee paid by cellular and domestic operators in respect of termination of a call on the domestic operator's network, and the interconnect fee the international operators pay in respect of an international call that begins or ends on the domestic operator's network, was reduced as of June 1, 2009 by 0.3183%.

**Section 2.16.2 – The Company's general license**

Concerning the letter of the Director General of the Ministry of Communications of March 9, 2009, in which he gave notice that he was considering imposing a monetary sanction on the Company for alleged breach of the provisions of its license with respect to structural separation, on April 26, 2009, the Company submitted its detailed remarks to the effect that the Company had not breached the provisions of its license with respect to structural separation, and no such breach can be attributed to it, and that in these circumstances and those described in the Company's document, a monetary sanction cannot be imposed on the Company. The Company also requested a hearing.

Concerning baskets of common services – According to the notice of the Ministry of Communications on July 8, 2009, the market share of the Company has fallen, in terms of normative revenue for June 2009, to 78.5% in fixed-line telephony in the private sector and to 86.3% in the business sector. In addition, the Ministry is employing another method of measurement intended for determining the discount brackets permitted to the Company with approvals of alternative tariff baskets as prescribed in the Gronau Report. By this measurement, the Company's market share in June 2009, in terms of regular (individual) lines based on normative revenue, declined to 77.2%, and in terms of access lines based on normative revenue, declined to 81.6%.

**Section 2.16.3 – Royalties**

On October 27, 2009, the Economic Committee of the Knesset approved the amendment to the regulations regarding royalties as described in the Company's periodic report for 2008.

**Section 2.16.6 – Rules and regulations under the Communications Law**

With respect to the Exceptions Committee – according to the Ministry of Communications notice dated June 16, 2009, the Ministry of Communications submitted draft regulations relating to the Exemption Advisory Committee for the approval of the Economic Committee of the Knesset.

**Section 2.16.11 – Establishment of Communications Installations**

Section D – The Company's reservations regarding the proposed wording of National Outline Plans for Communications, NOP 36A and NOP 36B was accepted in part by the investigator appointed in accordance with the Planning and Construction Law for hearing reservations regarding NOP 36A and NOP 36B but they were not included in the text submitted for the approval of the Subcommittee for Principles of Planning of the National Planning and Construction Committee in July 2009. The Company is working to change the proposed wording of the provisions of NOP 36A and NOP 36B

## Section 2.18 – Legal proceedings

For updates on the subject of legal proceedings, see Note 6 to the financial statements of the Company for the period ended September 30, 2009.

## 3. CELLULAR – PELEPHONE COMMUNICATIONS LTD. ("PELEPHONE")

**Section 3.1.9 – General Information on the Field of Activity**

In September 2009, Pelephone submitted an offer to acquire Mirs Communications, Ltd. in accordance the conditions set therein. It is emphasized that the offer is still in the stage of a proposal and it is not certain that the offer will be accepted. Similarly, the final conditions and limitations on which the transaction is based are yet to be determined. The transaction, if it is to occur, is conditional on various regulatory permits and it is also not certain that these will be received. According to information published in the media, other organizations are competing for the acquisition of Mirs and negotiations are being conducted with another competitor.

In September 2009, Netvision reported that, in the context of various works it is undertaking as a result of changes occurring and likely to occur in the communications market, it is in the very earliest preliminary stages of examining a business combination with Cellcom Israel, Ltd. According to the report, current regulations do not allow the aforementioned business combination and this move would be possible only if the relevant legislation is amended and would be conditional on receiving various permits as required by any law.

### Section 3.4 – New Products

In May 2009, Pelephone signed an agreement with Apple Sales International (“the manufacturer”) for the acquisition and distribution of iPhone handsets in Israel. Under the agreement, Pelephone undertakes to acquire a minimum number of handsets every year for three years. These quantities are a significant part of the number of handsets expected to be sold by Pelephone during the agreement period and represent approximately 5% of the cost of Pelephone’s annual services and sales. Under the agreement, the cost of the handsets for Pelephone depends on the prices that are in effect at the actual acquisition date.

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

### Section 3.7 – Competition

In August 2009, the Ministry of Communications issued a request to receive the public’s positions regarding organizing the structure of the market for broadband service over the cellular telephone network. In the context of the hearing the Ministry of Communications wanted to examine the possibility of separating the provision of access to the broadband network from the connection to the Internet (ISP), similar to the division that exists on the fixed line network. In this context, the Ministry will examine the following topics:

1. The mobile communications market, the market for providing infrastructure for accessing the Internet, the market for providing connection to the Internet (ISP) and the market for fixed line communications.
2. The welfare of the consumer as regards the price, quality and the variety of Internet services.

Pelephone submitted its position stating that it opposed the proposal.

**Section 3.7.1**

In March 2009, upon the recommendation of the Gronau Committee, the Ministry of Communications published a hearing on the issue of a change in the tariff structure and the method of billing for international calls via a cellular network. In May 2009, Pelephone submitted its response to the hearing and its objection to the proposed change.

According to government publications and pursuant to the government’s resolution to set up an inter-ministerial team regarding examination of interconnect tariffs, a joint team was set up between the Ministry of Communications and the Ministry of Finance which has recently completed a tender to select an international consultancy company to look into this matter. The company that was chosen was Nera. The issues defined for examination are examination of interconnect tariffs and examination of conditions of entry of new competitors onto the cellular market. During September 2009, representatives of Pelephone, the Ministry of Communications and Nera began working together.

Under the Ministry of Communications' work plan, the team is expected to submit recommendations at the beginning of 2010.

According to government publications, in government discussions regarding the State budget for 2009-2010, a recommendation was made to publish a frequency tender for an additional infrastructure-owning cellular carrier. Following this, the Ministry of Communications set up a tender committee which was supposed to publish a frequency tender as aforesaid by the end of the third quarter of 2009. The tender was expected to include various benefits aimed at removing obstacles and significantly facilitating the entry of another infrastructure-owning carrier. During October 2009, the Ministry of Communications published the main points of the planned tender, which were developed by the Tender Committee, while noting that they are subject to change in the final tender documents that will be published in the future.

1. The tender will offer two frequency bands to two operators.
2. Only Mirs and new operators who are not connected to existing cellular operators and comply with the threshold conditions will be permitted to participate in the tender.
3. The minimum price for acquiring a frequency band will be NIS 180 million per operator.
4. A mechanism for returning the cost of the license and the frequency fee to the winner of the tender during the first five years of operation in connection with an increase in the market share in the private sector.
5. The winner of the tender will be exempt from paying royalties to the State for the first five years of operation.
6. A period of seven years will be set for the winner of the tender to deploy the new network.
7. If a decision is made to reduce the interconnect charges, the winner of the tender will be required to pay according to the minimum tariff set.
8. In order to allow the winner of the tender to operate the network before it is fully deployed, the possibility of arranging cooperative use of the sites/domestic migratory services using the networks of existing cellular operators.

The committee is expected to issue the tender before the end of 2009.

**Section 3.7.2 – Mobile Virtual Network Operator (MVNO)**

In the context of discussions surrounding the Budget Law and the Arrangements Law for 2009 and 2010 conducted during the months of June – July 2009, an amendment to the Communications Law was approved to the effect that the Minister of Communications is expected to complete all of the proceedings required in order to grant licenses by October 1, 2009. Likewise, the amendment to the law also provided that should an MVNO license be awarded and in the event that such licensee has conducted negotiations with the existing operators which did not give rise to a positive result within a period of 6 – 9 months, and it is proven that this stemmed from anti-competitive conduct by the existing operators, the Minister of Communications shall intervene in the commercial conditions in accordance with the jurisdiction vested in him by law.

**Section 3.7.5 – WIMAX**

Further to the hearings held on the subject of the tenders for operating a network using WIMAX technology, the Ministry of Communications issued, in March 2009, a policy document regarding the allocation of frequencies for establishing a network using WIMAX technology. According to this policy document, the frequencies will be allocated through two separate tenders. In the first tender, frequencies will be allocated only to new operators and the second tender, issued after clearing another frequency in the aforementioned range, will be open to additional participants including existing cellular operators. As of the date of this report, neither of these tenders has been issued.

**Section 3.9.2 – Premises Used by Pelephone**

Regarding section 3.9.2.2 – In October 2009, the Court approved the compromise agreement between the parties. According to this agreement, the claim that Pelephone filed against the Israel Lands Administration et al. will be erased and the parties will negotiate the issue until December 31, 2009 for the purpose of resolving the issue out of court.

**Section 3.15.6 – Credit rating**

On July 9, 2009, Maalot gave notice of increase of the rating of Pelephone's debentures from AA minus to AA plus. The rating forecast is stable and reflects Maalot's assessment that Pelephone will continue to be strategically important to Bezeq and will maintain a strong level of profitability, and will create significant cash flows in the future.

On October 28, 2009, Standard & Poor's Maalot, which rates the Pelephone's debentures, gave notice that it placed a Credit Watch with negative consequences on the rating of the Pelephone's local debentures which are rated AA+ (AA plus) following the notification regarding the Company's controlling shareholder AP.SB.AR. Holdings, Ltd. conclusion of a contract for the sale of its entire holdings in Bezeq (approximately, 30.6%) to Smile 012, Communications Ltd, and the possible impact of the change of control on the capital structure of the Company (and therefore of Pelephone as well).

## Section 3.16 – Taxation

See Note 15(b) to the financial statements of the Company for the period ended on June 30, 2009.

**Section 3.18.2 – Control of tariffs**

Regarding section 3.18.2, see also section 3.7.1, above.

**Section 3.18.3.1 – Main changes in Pelephone's license**

Section A – further to hearings on the question of disconnecting the link between a terminal MRT equipment purchase transaction and the giving of benefits, the Ministry of Communications ruled that the MRT license of the cellular companies would be amended such that as of November 1, 2009, the licensee would not create any link between any benefit for MRT services granted to the subscriber and the fact that MRT terminal equipment in the subscriber's possession was purchased, rented or received from a licensee or other reseller acting for such licensee.

Section C – The changes in terms of the invoice structure will take effect in December 2009.

**Section 3.18.3.3 – Site construction licenses**

The team set up by the Attorney General to research the question of access facilities completed its work and submitted a report during the course of June 2009. The team's report was published on the websites of the Ministry for the Environment and the Ministry of Communications. In some of the team's conclusions, the representatives of the various ministries were in disagreement. The Ministry of Communications supported continuation of the exemption arrangement for a period of one to two years following the approval of NOP 36A1, in light of licensing difficulties mainly in urban areas, and an examination of the need for continuing the exemption in light of the quality of response that the NOP gives to the matter. The Ministries of the Interior and the Environment concluded that there was no justification for the exemption arrangement regarding cellular communications facilities to continue to exist. If the position of those ministries is accepted and the exemption arrangement is terminated, this will adversely affect deployment capabilities and the quality of the service that Pelephone will be able to provide to its customers, particularly in high-density areas. Prior to publication of the team's report, a further petition was filed with the High Court of Justice against the Attorney General, the inter-ministerial team and other persons, requesting remedies relating to the Attorney General's position supporting the continuation of the exemption from a building permit for wireless access facilities.

Following the report of the team and discussion of the subject held in September 2009, the Attorney General stated his position in a document dated September 9, 2009, according to which the Communications Regulations (Telecommunications and Transmissions) (Frequencies for Wireless Access Installations) 5762-2002 that includes the exemption from the requirement for a building permit according to Section 266c of the Construction and Planning Law, 5725-1965 for wireless access installations was enacted legally and properly. Despite this the Attorney General stated that in light of changes in law and in fact that have occurred in the intervening years and in light of their consequences, which became clear in the discussion and report of the team, the arrangement in its current form does strike a proper balance between the interests of the efficiency and competition and the interests expressed in the Planning and Construction Law. Furthermore, the Attorney General determined that the Ministries of the Interior and Communications would submit by the end of October 2009 regulations setting conditions that would limit and reduce application of the exemption from the requirement of building and use permit.

As for the private bills dealing with cancellation of the exemption from a permit for cellular wireless access facilities, the government decided to formulate its position in respect thereto only after publication of the inter-ministerial team's report. This position has not yet been formulated.

**Section 3.21 – Legal proceedings**

For updates on the subject of legal proceedings, see Note 6 to the financial statements of the Company for the period ended September 30, 2009.

## 4. INTERNATIONAL COMMUNICATIONS, INTERNET SERVICES AND NEP – BEZEQ INTERNATIONAL LTD. ("BEZEQ INTERNATIONAL")

**Section 4.1.2 – Legislative and statutory restrictions applicable to Bezeq International**

Special License for providing Internet access services – On August 10, 2009. Bezeq International received a special license for providing Internet access services. The services that Bezeq International is allowed to provide under terms of this license were previously supplied under the provisions of the General License for providing international telecommunications services of Bezeq International. Issuing this license is supposed to make the situation of Bezeq International equivalent to that of the other all other Internet providers who operate under a similar license. The license is valid until August 29, 2014.

Hearing regarding organization of the market structure for providing broadband service over the cellular telephone network – On August 31, 2009, the Ministry of Communications issued a request to receive the public's positions regarding organizing the structure of the market for broadband service over the cellular telephone network. In its request, the Ministry asked to examine the desirable structure for these services. The possible decision of the Ministry of Communications on this issue, which would change the current structure to one similar to the current structure for fixed line internet access could have substantive impact on the business of Bezeq International.

**Section 4.1.2.2 – General Special Domestic License**

On August 2, 2009, Bezeq International began to supply broadband domestic telephony services (VOB) to its private customers.

**Section 4.1.2.5 – Gronau Committee Report.**

In March 2009, the Ministry of Communications, upon the recommendation of the Gronau Committee, published a hearing regarding a change in the tariff structure and method of billing for international calls via cellular networks. In Bezeq International's response to the Ministry of Communications in the aforesaid hearing, Bezeq International expressed its objection to the proposed format for changing the tariff structure in overseas calls by cellular subscribers, pointed to possible faults as a result of its implementation, proposed reservations and limitations on its application and again warned the Ministry of Communications of the problems existing in the market for international telephony and internet access services provided by cellular operators.

### Section 4.4 – New products

In October 2009, Bezeq International launched the Private NGN service, which offers private customers who surf at high speeds (10 MB and higher) a separate internet network.

**Section 4.9.1 – Licenses to supply telecommunications services**

Beginning on August 10, 2009, the internet access services of Bezeq International are provided under a Special License for providing internet services, which is valid until August 29, 2014. For additional details, see section 4.1.2, above.

**Section 4.15.3 – Bank Guarantees**

In accordance with the requirements of the Ministry of Communications, Bezeq International provided a bank guarantee of NIS 10 million for compliance with all of the requirements of the Special License for providing fixed line domestic telephone services that was issued to BIP Communications Solutions (Limited Partnership), which is controlled by Bezeq International.

## Section 4.16 – Taxation

See Note 15(b) to the financial statements of the Company for the period ended on June 30, 2009.

### Section 4.17.2 – Interconnect charges

In the context of the Special License for providing fixed line domestic telephone services, BIP Communications Solutions (Limited Partnership) is entitled to receive interconnect charges, in accordance with regulations, for completing calls on the network that it operates and for outgoing international calls and is obligated to pay interconnect charges for completing cellular calls to the cellular operator's network or for completing fixed line domestic calls on the network of another license holder.

## Section 4.19 – Legal proceedings

For updates on the subject of legal proceedings, see Note 6 to the financial statements of the Company for the period ended September 30, 2009.

# 5. MULTI-CHANNEL TELEVISION – D.B.S. SATELLITE SERVICES (1998) LTD. ("DBS")

### Section 5.1.3 – Developments in markets in the area of operation

**Section 5.1.3** – In May 2009, the Government made a decision in which it determined, *inter alia,* that some of the provisions included in the Arrangements in the State Economy (Legislative amendments for attaining budget targets and economic policy for the 2009 fiscal year) Bill, 5769-2008, published in October 2008 ("the Arrangements Bill") would be amended. The decision determined, among other things, that the date on which license-holders for broadcasting would be able to broadcast advertising will be postponed to January 1, 2012 (with an option to postpone the date of the permit for a period not exceeding three years); that the date on which the broadcasting licenses would be required to offer the basic package to their subscribers will be postponed to August 1, 2012 (with an option to postpone that date for no more than one year); that the broadcasting licensees will distribute to all their subscribers the broadcasts of a special license-holder for cable broadcasts without collecting payment from the subscriber beyond the access fee. The Government also decided that if the Communications Law is amended as proposed in the relevant sections of the Arrangements Bill, to direct the Minister of Communications and the Minister of Finance to request approval from the Knesset Finance Committee for regulations granting exemption from payment of royalties to broadcasting licensees commencing on the date on which the broadcasting licensees are required to offer the basic package. The decision also states that the date for completing set-up of the DTT array will be postponed to August 2009. In addition, the Government decision adopted the recommendations of the Mordechai Committee in everything relating to the transition of the Second Authority franchisees from a regimen of franchises to one of licenses for the establishment of a National Communications Authority. The decision also provides that a committee is to be set up to examine the advertising fees paid by advertisers and bodies that sell advertisements to advertising companies. In June 2009, it was resolved to split the remedies regarding the matters described above from the Arrangements Bill and the discussion of them was transferred to the Economics Committee in order to prepare for first reading.

**Section 5.1.3.1** – On August 2, 2009 the DTT system commenced broadcasting. In February 2009, the Minister of Finance made an order stating that DTT broadcast reception decoders will be exempt from purchase tax (as distinct from the decoders used by DBS which are subject to a 10% purchase tax).

**Section 5.1.3.4** – In May 2009, the Council resolved to defer commencement of the new policy until the end of September 2009 in order to reexamine other models for regulating sports broadcasts on the paid sports broadcasts. In September 2009, the Council issued an invitation to present positions regarding the proposed model and therefore announced that it is again considering a new policy, however unless another decision is made before the end of October 2009, the policy is expected to become effective on November 1, 2009. In October 2009, the Council decided, *inter alia*, to reinforce the sports offerings on the basic sports channel (Sport 5), to establish a broadcast format for the pay sports broadcasts "5+" and to prohibit live sports broadcasts on other pay sports channels, unless the conditions stated in the decision are met.

**Section 5.1.3.5** – In September 2009, the Council published a hearing, according to which:

a. The Council decided to amend the previous decision regarding the way in which special licenses are granted for movie channels and to examine, within six months from the day of the decision, the possibility of also canceling the Council's current policy that prohibits issuing special licenses to channels broadcasting series.

b. The Council will examine, within six months from the day of the decision, canceling the limitation in the current policy on the number special licenses that can be issued to a single organization.

c. The Council decided on certain leniencies in the production obligations holders of special licenses.

**Section 5.1.3.7** – For the merger of the Company and DBS, see section 1.1.5 above.

**Section 5.1.3.8** – In March 2009, the Ministry of Communications and the Council published a hearing on the question of the regulation of broadcasts over new broadcasting platforms and technologies. The hearing sought comments, *inter alia*, on the question of the characterization of the new services in respect of which the need for arrangement is being examined, including the nature and purpose of content, the method of distribution of such content, the handset that will enable its viewing, the need to distinguish linear broadcasts from VOD broadcasts, the method of offering services, the identity of the offerors, the extent to which the service providers are to be involved in various aspects of the service and the expectations of the reasonable consumer for regulatory protection. Comments were also requested regarding the scope of regulation necessary, including restrictions on adult broadcasts, protection of minors, classification and marking of broadcasts, original production obligations, a prohibition against broadcasting advertisements, and ethics in broadcasts. In addition, comments were also called for on the question of the need to protect new competitors and the impact that the regulation would have on the currently existing regulation. DBS presented its position in this hearing in May 2009.

## Section 5.2 – Products and Services

In April 2009, DBS began marketing PVR decoders capable of receiving HDTV broadcasts (as well as the other services that PVR decoders permit), at the same time as it expanded the supply of channels that it broadcasts using HD technology.

### Section 5.8 – Intangible assets

Section 5.8.1.2 – On May 4, 2009, a representative of the Civil Administration gave notice to DBS that the Civil Administration intended to extend the broadcast license in Judea and Samaria until 2014, overlapping the license in Israel, although the extension still requires a final resolution by the head of the Civil Administration.

### Section 5.11.1.B – Space segments

In June 2009, a letter was received from Aviation Industries containing a demand for immediate repayment of the debt still owed by DBS for use of the Amos 1 satellite, as well as payments of interest and additional sums allegedly owing to Aviation Industries by virtue of an agreement between the Parties. DBS has arguments against some of the sums alleged by Aviation Industries. In September 2009, the Company and Aviation Industries signed an agreement resolving the financial disputes between them.

## Section 5.14 – Taxation

See Note 15(b) to the financial statements of the Company for the period ended on September 30, 2009.

### Section 5.15.1 – Specific legal restrictions on operations

In March 2009, the Ministry of Communications gave notice to DBS that in the opinion of the legal counsel, and in the opinion of the Legal Department of the Ministry of Communications, the split of the deeds of pledge of shares of DBS charged to the consortium of banks into individual charges for each bank will not, in and of itself, affect Bank Leumi's status as a "holder" of DBS with respect to the qualification restriction set out in the License Regulations, in the absence of an amendment of the financing agreement. The Ministry of Communications gave further notice that it intends to take the necessary steps to ensure compliance with the conditions of the Regulations. Although DBS is of the opinion that the current state of affairs does not amount to a breach of the aforesaid qualification restriction, it is negotiating with the Ministry of Communications to arrive at an arrangement that will satisfy the Ministry in order to resolve the issue within such fixed period of time as may be agreed upon. In September 2009, Bank Leumi gave notice that its subsidiary concluded an agreement to sell its entire holding in Keshet Broadcasting, Ltd. conditional on compliance with the stipulated conditions, to Bank Leumi. In the opinion of DBS, if this transaction is completed, the subordination of shares in DBS will not be a breach of the aforementioned qualification restriction, even in the opinion of the Ministry of Communications.

Regarding the obligation to invest in local productions – In October 2009, the Council informed DBS, *inter alia*, that there is a deficit in its investment in local productions of the external production channels and that DBS must complete it during 2010 and 2011. Therefore, the chairperson of the Council imposed a financial sanction on DBS. Furthermore, the Council informed DBS that it had not met its obligation to invest in the television movie, cinema movie, complex drama and mini-series genres in 2008 (*inter alia*, because of deficiencies from the past) and that it must also complete this lack in during 2010 and 2011. A financial sanction was also imposed on DBS for not meeting this obligation. As of this report, DBS is studying the Council's notifications and the decision to impose the said financial sanctions on it.

**Section 5.15.3 – Principal restrictions by virtue of the law and broadcasting license**

With respect to transfer fees – In March 2009, the Ministry of Communications published a hearing regarding the setting of transfer fees that the producer of an independent channel, including the broadcaster of a designated channel, must pay DBS for use of its channels, noting that the outcome would constitute the basis for a resolution of the dispute between DBS and the designated channels, the sum of the payment set in the hearing being applicable as of 2007 and until the end of 2013 and the method of its calculation serving the parties as an outline for calculating the amount of the payment until 2006. The Ministry of Communications noted that the economic opinion that it attached to the hearing may be used as a basis for ruling in other disputes, if such arise between DBS and other independent channel operators. Under the aforesaid economic opinion, the usage fee will include a fixed component of an annual payment of approximately NIS 1.2 million, plus variable payment components amounting to approximately NIS 1 million with respect to an independent channel producer not financed by way of subscription fees. In June 2009, DBS submitted its position in the hearing. As at the date of this report, the Ministry of Communications' decision on this hearing has not yet been handed down. In July 2009, a bill was approved in preliminary reading to the effect that the designated channels would be exempt from payment of transition fees to the cable company. To the best of DBS's knowledge, this bill was approved by the Ministerial Committee on Legislation however the Minister of Communications has submitted an appeal against this decision.

## Section 5.18 – Legal proceedings

In April 2009, two claims were filed against DBS in the Regional Labor Court on behalf of 21 technicians (20 of whom are former employees of the Company previously and the other is still employed by the Company) in a total sum of NIS 1.3 million. The claim alleges that DBS owes the technicians for various salary components that the plaintiffs claim were not paid to them, and that DBS held over some of their salaries. A statement of defense was filed in July 2009.

**Section 5.18.1** – In June 2009, a settlement agreement was signed to the effect that without admitting to any of the claims DBS would compensate subscribers from whose deposits depreciation was alleged to have been unlawfully collected such that existing subscribers of DBS would be entitled to view 3 DVDbox movies without payment and subscribers who had left YES would be entitled to monetary compensation of NIS 25 or NIS 50 as set out in the Agreement or to 5 DVDbox movies without payment should they choose to return to DBS's broadcasts. It was further held that the lead plaintiff would be entitled to payment of the sum of NIS 50,000 and her attorneys would be entitled to the sum of NIS 450,000. The Court at which the agreement was submitted for approval held that this was an appropriate and reasonable arrangement and allowed DBS to publish an initial notice in this regard, which was published on June 18, 2009. On September 1, 2009, a request was submitted for approval of the compromise agreement and on September 2, 2009, the agreement was approved as a court ruling. On September 14, 2009, a second notice to the public was published.

**Section 5.18.2** – In April 2009, the Special Manager in the debt claim handed down a decision in which the debt claim that DBS filed was accepted in part, such that the sum of the debt to DBS was assessed in the sum of approximately NIS 180,000.

**<u>Section 5.18.3</u>** – On June 17, 2009, a hearing took place in the Supreme Court on the appeal and the counter appeal. At the recommendation of the Court, it was agreed that the appeal and the counter-appeal be struck out without any award as to costs, without the Court expressing any opinion as to the essence of the ruling of the District Court regarding remuneration and fees.

For updates on the subject of legal proceedings, see Note 6 to the financial statements of the Company for the period ended September 30, 2009.

| November 4, 2009 | |
|---|---|
| Date | Bezeq – The Israel Telecommunication Corp. Ltd. |

Names and titles of signatories:

Shlomo Rodav – Chairman of the Board

Abraham Gabbay – CEO

# 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 2009 NIS millions | Nine months ended September 30 2008 NIS millions | Increase (decrease) | % | Three months ended September 30 2009 NIS millions | Three months ended September 30 2008 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<br>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 21$^{st}$, 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**<br>**Chairman of the Board** | **Avi Gabbay**<br>**CEO** |

# BEZEQ THE ISRAEL TELECOMMUNICATION CORP. LIMITED

# CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
# SEPTEMBER 30, 2009
# (UNAUDITED)

**Contents**

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**Auditors' 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"), including the condensed consolidated interim statement of financial position as of September 30, 2009 and the condensed consolidated interim statements of income, comprehensive income, changes in equity and cash flows for the nine and three months then ended. The board of directors and the management are responsible for preparation and presentation of the financial information for these interim periods in accordance with IAS 34 - *Interim Financial Reporting*, and are also responsible for preparation of the interim financial information for these periods in accordance with Chapter D of the Securities Regulations (Periodic and Immediate Reports) 5730-1970. Our responsibility is to express a conclusion on the financial information for these interim periods based on our review.

We did not review the condensed interim financial statements of equity-accounted investees, the investment in which amounts to NIS 32 million as at September 30, 2009, and the share of the Group in their profits is NIS 5 million and NIS 1 million for the nine and three months then ended, respectively. The condensed interim financial information of those companies were reviewed by other accountants, whose reports have been furnished to us, and our conclusion, insofar as it relates to amounts included for those companies, is based on the reviews of the other accountants.

Review scope
We conducted our review in accordance with Accounting Standard no. 1 – *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* established by the Institute of Certified Public Accountants in Israel. A review of interim financial information consists of making enquiries, 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 and the review of other accountants, nothing has come to our attention that causes us to believe that this financial information is not prepared, in all material respects, in accordance with IAS 34.

Additionally, based on our review and the review of other accountants, nothing has come to our attention that causes us to believe that this financial information is not prepared, in all material respects, in accordance with the disclosure provisions in Chapter D of the Securities Regulations (Periodic and Immediate Reports) 5730-1970.

Without qualifying our above opinion, we draw attention to the claims made against the Group of which the exposure cannot yet be assessed or calculated, and other contingencies as described in Note 6B and 6C.

Furthermore, without qualifying our above opinion, we draw attention to Note 3A(5) as well as Note 4, with respect to the discontinued operation and early application of International Financial Reporting Standard 5 (as amended), including the restatement of prior reporting periods with respect to the discontinued operation.

Sincerely,

Somekh Chaikin
Certified Public Accountants
November 4, 2009

## Condensed Consolidated Interim Statements of Financial Position

| | September 30, 2009 | September 30, 2008 | December 31, 2008 |
|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions |
| **Assets** | | | |
| Cash and cash equivalents | **1,278** | 1,198 | 786 |
| Investments (including derivatives and financial reserves) | **181** | 61 | 33 |
| Trade receivables | **2,473** | 2,385 | 2,373 |
| Other receivables | **187** | 218 | 211 |
| Inventory | **196** | 159 | 158 |
| Assets classified as held for sale | **34** | 19 | 34 |
| **Total current assets** | **4,349** | 4,040 | 3,595 |
| Investments, including derivatives | **161** | 210 | 187 |
| Trade receivables | **809** | 584 | 576 |
| Broadcasting rights, net of rights exercised | **-** | 264 | 253 |
| Property, plant and equipment | **5,323** | 5,962 | 6,036 |
| Intangible assets | **1,874** | 2,665 | 2,674 |
| Deferred and other expenses | **419** | 390 | 411 |
| Investments in equity-accounted investees (mainly in loans) | **1,215** | 31 | 32 |
| Deferred tax assets | **385** | 595* | 550* |
| **Total non-current assets** | **10,186** | 10,701 | 10,719 |
| **Total assets** | **14,535** | 14,741 | 14,314 |

| | September 30, 2009 | September 30, 2008 | December 31, 2008 |
|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions |
| **Liabilities** | | | |
| Debentures, loans and borrowings | **879** | 1,014 | 1,780 |
| Trade payables | **989** | 1,243 | 1,381 |
| Other payables, including derivatives | **714** | 754 | 850 |
| Current tax liabilities | **251** | 119 | 45 |
| Deferred income | **42** | 34 | 62 |
| Provisions | **365** | 345 | 355 |
| Employee benefits | **273** | 434* | 412* |
| Dividend payable | **1,149** | 835 | - |
| **Total current liabilities** | **4,662** | 4,778 | 4,885 |
| Debentures | **2,715** | 3,966 | 3,943 |
| Bank loans | **572** | 1,084 | 214 |
| Loans from institutions | **-** | 154 | 158 ** |
| Loans provided by non-controlling interests in a subsidiary | **-** | 436 | 449 |
| Employee benefits | **271** | 253 | 265 |
| Deferred income and others | **5** | 14 | 27** |
| Provisions | **70** | 57 | 64 |
| Deferred tax liabilities | **52** | 73 | 65 |
| **Total non-current liabilities** | **3,685** | 6,037 | 5,185 |
| **Total liabilities** | **8,347** | 10,815 | 10,070 |
| **Equity** | | | |
| Share capital | **6,181** | 6,132 | 6,132 |
| Share premium | **247** | - | - |
| Reserves | **604** | 721 | 748 |
| Deficit | **(869)** | (2,461)* | (2,165)* |
| **Total equity attributable to shareholders of the Company** | **6,163** | 4,392 | 4,715 |
| **Non-controlling interests** | **25** | (466) | (471) |
| **Total equity** | **6,188** | 3,926 | 4,244 |
| **Total equity and liabilities** | **14,535** | 14,741 | 14,314 |

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

Date of approval of the financial statements: November 4, 2009

* Retrospective application by restatement, see Note 3C
** See Note 3D

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 |
|---|---|---|---|---|---|
| | 2009 | 2008* | 2009 | 2008* | 2008* |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| **Continuing operations** | | | | | |
| **Revenue (Note 10)** | **8,587** | 8,314 | **2,924** | 2,806 | 11,015 |
| **Costs and expenses** | | | | | |
| Depreciation and amortization | **1,109** | 1,094 | **361** | 365 | 1,458 |
| Salary | **1,464** | 1,632 | **475** | 528 | 2,161 |
| Operating and general expenses (Note 11) | **3,576** | 3,439 | **1,251** | 1,145 | 4,660 |
| Other operating expenses (income), net | **(54)** | (39)** | **(38)** | (7)** | 96 |
| | **6,095** | 6,126 | **2,049** | 2,031 | 8,375 |
| Operating profit | **2,492** | 2,188 | **875** | 775 | 2,640 |
| **Financing expenses (income)** | | | | | |
| Financing expenses | **331** | 428** | **168** | 154** | 494 |
| Financing income | **(344)** | (303) | **(152)** | (97) | (354) |
| Financing expenses (income), net | **(13)** | 125 | **16** | 57 | 140 |
| Profit after financing expenses (income) | **2,505** | 2,063 | **859** | 718 | 2,500 |
| **Share in the profit (loss) of equity-accounted investees** | **(8)** | 4 | **(12)** | 2 | 5 |
| Profit before income tax | **2,497** | 2,067 | **847** | 720 | 2,505 |
| **Income tax** | **702** | 591 | **259** | 207 | 719 |
| Profit for the period from continuing operations | **1,795** | 1,476 | **588** | 513 | 1,786 |
| **Discontinued operations** | | | | | |
| Profit (loss) for the period from discontinued operations (see Note 4) | **1,379** | (247) | **1,475** | (82) | (265) |
| **Profit for the period** | **3,174** | 1,229 | **2,063** | 431 | 1,521 |

* Restatement due to discontinued operations, see Note 4
** See Note 3D.

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

## Condensed Consolidated Interim Statements of Income (contd.)

| | Nine months ended September 30 | | Three months ended September 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2009 | 2008* | 2009 | 2008* | 2008* |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| **Attributable to:** | | | | | |
| **Shareholders of the Company** | | | | | |
| Profit for the period from continuing operations | **1,791** | 1,472 | **586** | 509 | 1,781 |
| Profit (loss) for the period from discontinued operations | **1,446** | (143) | **1,502** | (47) | (154) |
| | **3,237** | 1,329 | **2,088** | 462 | 1,627 |
| **Non-controlling interests** | | | | | |
| Profit for the period from continuing operations | **4** | 4 | **2** | 4 | 5 |
| Loss for the period from discontinued operations | **(67)** | (104) | **(27)** | (35) | (111) |
| | **(63)** | (100) | **(25)** | (31) | (106) |
| Profit for the period | **3,174** | 1,229 | **2,063** | 431 | 1,521 |
| **Basic earnings per share (in NIS)** | | | | | |
| Profit from continuing operations | **0.68** | 0.57 | **0.22** | 0.2 | 0.68 |
| Profit (loss) from discontinued operations | **0.55** | (0.06) | **0.57** | (0.02) | (0.06) |
| | **1.23** | 0.51 | **0.79** | 0.18 | 0.62 |
| **Diluted earnings per share (in NIS)** | | | | | |
| Profit from continuing operations | **0.67** | 0.55 | **0.22** | 0.18 | 0.68 |
| Profit (loss) from discontinued operations | **0.54** | (0.05) | **0.57** | (0.01) | (0.07) |
| | **1.21** | 0.50 | 0.79 | 0.17 | 0.61 |

* Restatement due to discontinued operations, see Note 4

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 |
|---|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 | 2008 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| **Profit for the period** | **3,174** | 1,229 | **2,063** | 431 | 1,521 |
| **Other items of comprehensive income including:** | | | | | |
| Net change in fair value of available-for-sale financial assets transferred to profit or loss | **-** | (5) | **-** | - | (5) |
| Actuarial losses from a defined benefit plan (1) | - | - | - | - | (2) |
| Foreign currency translation differences | **-** | (9) | **(1)** | 2 | (4) |
| Taxes in respect of other items of comprehensive income | **-** | 1 | **-** | - | 1 |
| **Other comprehensive income for the period, net of tax** | **-** | (13) | **(1)** | 2 | (10) |
| **Total comprehensive income for the period** | **3,174** | 1,216 | **2,062** | 433 | 1,511 |
| **Attributable to:** | | | | | |
| **Shareholders of the Company** | | | | | |
| Comprehensive income for the period from continuing operations* | **1,791** | 1,459 | **585** | 511 | 1,771 |
| Comprehensive profit (loss) for the period from discontinued operations* | **1,446** | (143) | **1,502** | (47) | (154) |
| | **3,237** | 1,316 | **2,087** | 464 | 1,617 |
| **Non-controlling interests** | | | | | |
| Comprehensive profit for the period from continuing operations * | **4** | 4 | **2** | 4 | 5 |
| Comprehensive loss for the period from discontinued operations | **(67)** | (104) | **(27)** | (35) | (111) |
| | **(63)** | (100) | **(25)** | (31) | (106) |
| Comprehensive income for the period | **3,174** | 1,216 | **2,062** | 433 | 1,511 |

* Restatement due to discontinued operations, see Note 4

(1) The Group does not re-examine its assessments, assumptions and estimates in each interim reporting period to calculate its employee liabilities, unless there are significant changes during the interim period. As a result, actuarial gains or losses in the reporting period are not recognized.

Due to first-time adoption of the revised IAS 1 in these financial statements, the presentation format of the statement of comprehensive income was changed. See also Note 3A(1) for a description of first-time adoption of the new standards.

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

## Condensed Consolidated Interim Statements of Changes in Equity

| | Attributable to owners of the Company | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Translation reserve | Capital reserve for a transaction between a corporation and a controlling shareholder | Capital reserve for available-for-sale assets | Capital reserve for options for employees | Deficit | Total | Non-controlling interests | Total equity |
| | NIS millions | | | | | | | | | |
| **Nine months ended September 30, 2009 (unaudited)** | | | | | | | | | | |
| **Balance at January 1, 2009 (audited)** | **6,132** | **-** | **(4)** | **390** | **-** | **362** | **(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 subsidiary (unaudited) | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **551** | **551** |
| Transfers by non-controlling interests (unaudited) | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **8** | **8** |
| **Balance at September 30, 2009 (unaudited)** | **6,181** | **247** | **(4)** | **390** | **-** | **218** | **(869)** | **6,163** | **25** | **6,188** |
| **Nine months ended September 30, 2008 (unaudited)** | | | | | | | | | | |
| **Balance at January 1, 2008 (audited)** | 6,132 | - | - | 390 | 4 | 287 | (2,276)* | 4,537 | (373) | 4,164 |
| Comprehensive income for the period (unaudited) | - | - | (9) | - | (4) | - | 1,329 | 1,316 | (100) | 1,216 |
| Dividend to shareholders of the Company (unaudited) | - | - | - | - | - | | (1,514) | (1,514) | - | (1,514) |
| Share-based payments (unaudited) | - | - | - | - | - | 53 | - | 53 | - | 53 |
| Transfers by non-controlling interests less dividend distributed (unaudited) | - | - | - | - | - | - | - | - | 7 | 7 |
| **Balance at September 30, 2008 (unaudited)** | 6,132 | - | (9) | 390 | - | 340 | (2,461)* | 4,392 | (466) | 3,926 |

* Retrospective application by restatement, see Note 3C

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

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

| | Attributable to owners of the Company | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Translation reserve | Capital reserve for a transaction between a corporation and a controlling shareholder | Capital reserve for available-for-sale assets | Capital reserve for options for employees | Deficit | Total | Non-controlling interests | Total equity |
| | NIS millions | | | | | | | | | |
| **Three months ended September 30, 2009 (unaudited)** | | | | | | | | | | |
| **Balance at July 1, 2009 (unaudited)** | **6,172** | **203** | **(3)** | **390** | **-** | **244** | **(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 subsidiary (unaudited) | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **551** | **551** |
| Transfers by non-controlling interests (unaudited) | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **2** | **2** |
| **Balance at September 30, 2009 (unaudited)** | **6,181** | **247** | **(4)** | **390** | **-** | **218** | **(869)** | **6,163** | **25** | **6,188** |
| **Three months ended September 30, 2008 (unaudited)** | | | | | | | | | | |
| **Balance at July 1, 2008 (unaudited)** | 6,132 | - | (11) | 390 | - | 322 | (2,088)* | 4,745 | (438) | 4,307 |
| Comprehensive income for the period (unaudited) | - | - | 2 | - | - | - | 462 | 464 | (31) | 433 |
| Dividend to shareholders of the Company (unaudited) | - | - | - | - | - | - | (835) | (835) | - | (835) |
| Share-based payments (unaudited) | - | - | - | - | - | 18 | - | 18 | - | 18 |
| Transfers by non-controlling interests less dividend distributed (unaudited) | - | - | - | - | - | - | - | - | 3 | 3 |
| **Balance at September 30, 2008 (unaudited)** | 6,132 | - | (9) | 390 | - | 340 | (2,461)* | 4,392 | (466) | 3,926 |

* Retrospective application by restatement, see Note 3C

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

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

| | Attributable to owners of the Company | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Share capital** | **Translation reserve** | **Capital reserve for a transaction between a corporation and a controlling shareholder** | **Capital reserve for available-for-sale assets** | **Capital reserve for options for employees** | **Deficit** | **Total** | **Non-controlling interests** | **Total equity** |
| **Year ended December 31, 2008 (audited)** | | | | | | | | | |
| **Balance at January 1, 2008 (audited)** | 6,132 | - | 390 | 4 | 287 | (2,276)* | 4,537 | (373) | 4,164 |
| Comprehensive income for the year (audited) | - | (4) | - | (4) | - | 1,625 | 1,617 | (106) | 1,511 |
| Dividends to shareholders of the Company (audited) | - | - | - | - | - | (1,514) | (1,514) | - | (1,514) |
| Share-based payments (audited) | - | - | - | - | 75 | - | 75 | - | 75 |
| Transfers by non-controlling interests less dividends distributed (audited) | - | - | - | - | - | - | - | 8 | 8 |
| **Balance as at December 31, 2008 (audited)** | 6,132 | (4) | 390 | - | 362 | (2,165)* | 4,715 | (471) | 4,244 |

* Retrospective application by restatement, see Note 3C

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

## Condensed Consolidated Interim Statements of Cash Flows

| | Nine months ended | | Three months ended | | Year ended |
|---|---|---|---|---|---|
| | September 30 | | September 30 | | December 31 |
| | 2009 | 2008 | 2009 | 2008 | 2008 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| **Cash flows from operating activities** | | | | | |
| Profit for the period | **3,174** | 1,229 | **2,063** | 431 | 1,521 |
| Adjustments: | | | | | |
| Depreciation | **1,033** | 1,061 | **331** | 354 | 1,394 |
| Amortization of intangible assets | **202** | 183 | **60** | 59 | 289 |
| Amortization of deferred and other expenses | **20** | 30 | **7** | 10 | 20 |
| Profit from deconsolidation of a subsidiary | **(1,538)** | - | **(1,538)** | - | - |
| Share in losses (gains) of equity-accounted investees | **8** | (4) | **12** | (2) | (5) |
| Financing costs, net | **367** | 538 | **195** | 217 | 562 |
| Capital gain, net | **(54)** | (21) | **(30)** | (2) | (68) |
| Share-based payment transactions | **35** | 53 | **7** | 18 | 75 |
| Income tax expenses | **702** | 591 | **259** | 207 | 719 |
| Proceeds (payment) for disposal of derivative financial instruments, net | **14** | (48) | **(2)** | (34) | (38) |
| Change in inventory | **(47)** | 43 | **(8)** | 28 | 42 |
| Change in trade receivables | **(489)** | (31) | **(246)** | 101 | (10) |
| Change in other receivables | **14** | (14) | **31** | - | (44) |
| Change in other payables | **117** | (15) | **15** | (19) | 15 |
| Change in trade payables | **111** | (280) | **39** | (3) | (225) |
| Change in provisions | **22** | (48) | **11** | (2) | (34) |
| Change in broadcasting rights net of rights exercised | **(49)** | (21) | **15** | 14 | (11) |
| Change in employee benefits, deferred income and other | **(167)** | (289) | **(64)** | (25) | (252) |
| Income tax paid | **(346)** | (368) | **(60)** | (140) | (535) |
| **Net cash flows from operating activities** | **3,129** | 2,589* | **1,097** | 1,212* | 3,415 |
| **Cash flow for investment activities** | | | | | |
| Investment in intangible assets and deferred expenses | **(247)** | (385) | **(91)** | (250) | (469) |
| Proceeds from sale of property, plant and equipment and deferred expenses | **102** | 101 | **40** | 14 | 147 |
| Change in current investments, net | **(134)** | 314 | **(40)** | - | 321 |
| Purchase of property, plant and equipment | **(1,125)** | (962) | **(369)** | (345) | (1,300) |
| Proceeds from realization of investments and long-term loans | **43** | 13 | **2** | 2 | 19 |
| Purchase of investments and long-term loans | **(4)** | (6) | **(1)** | (2) | (8) |
| Investment in an affiliate | **-** | (1) | **-** | - | - |
| Dividend received | **5** | 12* | **-** | 10* | 13 |
| Interest received | **26** | 46* | **13** | 12* | 64 |
| **Net cash used for investment activities** | **(1,334)** | (868) | **(446)** | (559) | (1,213) |

* See Note 3D

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 |
|---|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 | 2008 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| **Cash flow for financing activities** | | | | | |
| Receipt of loans | **400** | - | **-** | - | - |
| Repayment of debentures | **(672)** | (697) | **(63)** | (70) | (714) |
| Repayment of loans | **(86)** | (112) | **(24)** | (31) | (148) |
| Short-term borrowing, net | **48** | (5) | **7** | (73) | (50) |
| Dividend paid | **(792)** | (679) | **-** | - | (1,514) |
| Interest paid | **(338)** | (266) | **(80)** | (31) | (243) |
| Payment for disposal of derivative financial instruments, net | **11** | 36 | **-** | 7 | 52 |
| Transfers by non-controlling interests less dividend distributed, net | **8** | 7 | **2** | 3 | 8 |
| Proceeds from exercise of employee options | **117** | - | **20** | | - |
| **Net cash used for finance activities** | **(1,304)** | (1,716) | **(138)** | (195) | (2,609) |
| **Net increase (decrease) in cash and cash equivalents** | **491** | 5 | **513** | 458 | (407) |
| Cash and cash equivalents at the beginning of the period | **786** | 1,203 | **765** | 740 | 1,203 |
| Effect of fluctuations in the rate of exchange on cash balances | **1** | (10) | **-** | - | (10) |
| **Cash and cash equivalents at the end of the period** | **1,278** | 1,198 | **1,278** | 1,198 | 786 |

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 official address of the Company is 132 Menachem Begin Road, Tel Aviv. 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 communications services in Israel (see also Note 13 – Segment Reporting).

**B.** The controlling shareholder of the Company is Ap.Sb.Ar. Holdings Ltd. ("Ab.Sb.Ar.") which held 30.68% of the Company's shares as at September 30, 2009. 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 all the Company's shares that it holds for NIS 6,513,692,360. Completion of the transaction is subject to the receipt of the regulatory approvals required by law no later than April 25, 2010, including the following: approval of the transaction by the Ministry of Communications (including a control permit), approval of the transaction by the Antitrust Commissioner, approval by the Prime Minister and Minister of Communications according to the Communications (Telecommunications and Broadcasting) Law 5742-1982 and the Communications (Telecommunications and Broadcasting) (Determination of Essential Service Provided by Bezeq, The Israel Telecommunications Corp. Ltd.) Order 5757-1997 and any other approval or consent required by law. Following completion of the transaction, Ap.Sb.Ar. is not expected to hold any shares in the Company.

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 Group's operations are subject, as a rule, to official regulation and oversight.

**C.** The Company is subject to various sets of laws that regulate and restrict its business activities, including its tariffs, The Company's tariffs are regulated by sections 15 to 17 of the Communications Law. The Company's service tariffs which are prescribed in regulations are automatically updated in accordance with a linkage formula, as provided in the regulations and relying on the recommendations of public committees with a mandate to review the Company's tariffs. The intensifying competition and changes in the communications market could have an adverse effect on the business results of the Group.

**D.** Commencing August 21, 2009, the Company no longer consolidates the reports of DBS in its financial statements and the investment in DBS is stated according to the equity method commencing the abovementioned date. 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, 2008 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 interim financial statements.

**C.** The condensed consolidated interim financial statements were approved by the Board of Directors on November 4, 2009.

## NOTE 2 - BASIS OF PREPARATION (CONTD.)

**D. Use of estimates and judgment**

The preparation of condensed 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 these estimates.

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 applied in the annual financial statements.

The value of the investment in DBS was estimated in these financial statements according to the fair value based on the valuation carried out by an independent assessor. See Note 4.

## NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICY

The significant accounting policies applied in these condensed financial statements are consistent with those applied in the annual financial statements for the year ended December 31, 2008, except for application of new standards and amendments to standards, as set forth in section A below.

**A. Initial implementation of new accounting standards**

(1) Commencing from January 1, 2009, the Group applies IAS 1 – *Presentation of Financial Statements*, revised ("the Standard"). The Standard permits the presentation of one statement of comprehensive income (a statement combining profit or loss and other comprehensive income) or two statements (a separate income statement and a statement of comprehensive income). The Group opted to present income and expenses and other comprehensive income in two separate statements. The Group also presents a statement of changes in equity instead of disclosure in the notes, after the statement of comprehensive income. The statement includes changes in equity also arising from transactions with owners in their capacity as owners (such as dividends, transactions with controlling shareholders, and share issues). The Standard is applied retrospectively.

(2) Commencing from January 1, 2009, the Group applies IFRS 8 – *Operating Segments* ("the Standard"). The Standard states that segment reporting should be in accordance with the "management approach", namely – in accordance with the format of the internal reports to the Group's chief operational decision-maker.

An operating segment is a part of the Group that meets the three conditions set forth below:

A. The segment engages in business operations that may generate revenue and may incur expenses.
B. The operational results of the segment are reviewed regularly by the chief operational decision maker of the Group, in order to make decisions regarding resources to be allocated and to assess its performance.
C. Separate financial information is available.

First-time adoption of the Standard did not affect the composition of the Group's reporting segments.

(3) Commencing January 1, 2009, the Group applies IAS 19 – *Employee Benefits*, revised ("the Amendment"), in accordance with Improvements to International Financial Reporting Standards 2008 (Improvements to IFRSs). See section C below.

## NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICY (C0NTD.)

### A. Initial implementation of new accounting standards (contd.)

(4) IAS 28 – *Investments in Associates, revised (the Amendment)* In accordance with the Amendment, impairment of an investment in an associate is tested by testing the entire carrying amount of the investment. Accordingly, an impairment loss recognized per the investment is not specifically allocated to the goodwill included in the investment but to the overall investment, and therefore the full amount of an impairment loss that was recognized in the past may be reversed when the conditions for reversal of IAS 36 are met. Application of the standard did not have a material effect on the Group's financial statements.

(5) Since the Company opted for early application of IFRS 3 (as amended) and IAS 27 (2008) (see Note 3V (1) to the financial statements as at December 31, 2008), the Company also opted for early application of IFRS 5 (revised) as required by the Improvements to IFRSs for 2008. According to the revised standard, loss of control of a subsidiary is accounted for as a discontinued operation, when the subsidiary is a disposal group classified as a discontinued operation, regardless of whether the entity will retain a non-controlling interest in its former subsidiary (for example, when the investee becomes, after loss of control, an equity-accounted associate). In the reporting period, the Company lost its control in DBS Satellite Services Ltd. (DBS) (see Note 4), and from the date of the loss of control, DBS is an associate of the Company and the investment therein is accounted for by the equity accounting method. Accordingly, the Company presented the operations of DBS as discontinued operations in the income statement and included the required disclosures in the notes (see Note 4), including restatement of the prior reporting period.

### B. New standards and interpretations not yet adopted

(1) In the framework of *Improvements to IFRSs*, in April 2009 the IASB published and approved 15 amendments to various IFRSs on a wide range of accounting issues. The amendments are effective for annual periods commencing on or after January 1, 2010, with an option for early implementation, subject to the terms prescribed for each amendment.

Presented hereunder are the amendments that may be relevant and are expected to have an effect on the financial statements. The Group is assessing the effect of these amendments:

(a) IAS 17 – *Leases: Classification of Leases of Land and Buildings* (revised) ("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. Under the Amendment, classification of the land lease should be based on the regular criteria for classifying a lease as a finance or operating lease. The Amendment also states that when a lease includes both land and building elements, an entity should determine the classification of each element, based on the criteria in the Amendment, taking account of the fact that land normally has an indefinite economic life.

The Amendment is effective for annual financial statements commencing on or after January 1, 2010. Early application of the Amendment is permitted, with disclosure. The Amendment is effective retrospectively, that is, classification of the land lease is determined based on the information available when signing the lease. If there is a change in classification of the lease, the instructions of IAS 17 are effective prospectively from the date of the lease. If, however, information necessary to apply the Amendment retrospectively is not available, classification is determined based on the information available at the adoption date of the Amendment and the asset and liability related to a land lease that was classified as a finance lease as a result of the Amendment are recognized at their fair values at that date. Any difference between the fair value of the asset and the fair value of the liability is recognized through retained earnings.

## NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICY (CONTD.)

**B. New standards and interpretations not yet adopted** (contd.)

(1) (contd.)

(b) The appendix to IAS 18 includes an example that lists guidelines for identifying whether an entity is acting as a principle or an agent when selling goods or rendering services. In accordance with the amendment, an entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services.

(c) Amendment to IAS 39 – *Financial Instruments: Recognition and Measurement* (revised), treating loan prepayment penalties as an embedded derivative ("the Amendment"). Under the Amendment, if an exercise price of a prepayment option (a fine for prepayment) reimburses the lender for an amount not exceeding the approximate present value of the lost interest for the remaining term of the host contract, (the loan), then the economic characteristics and risks of the prepayment option are closely related to the host contract and the embedded derivative is not separated from the host contract. The amendment is to be effective for annual periods commencing on or after January 1, 2010.

(2) Amendments to IFRS 2 – *Share-Based Payment* ("the Amendments") Cash-settled share-based payment transactions in the Group. The Amendments address IFRS 2 and replace IFRIC 8 and IFRIC 11. The Amendments provide guidance for accounting treatment of share-based transactions in the Group, from the perspective of the entity which receives the goods or services as well as from the perspective of the entity settling the transaction.

The Amendment defines conditions for considering a share-based payment transaction as settled in equity instruments and in cash. The Amendment is not expected to have an effect on the financial statements of the Group.

**C. Retrospective application by restatement**

Commencing January 1, 2009, the Group applies IAS 19 – *Employee Benefits*, revised ("the Amendment"), in accordance with Improvements to IFRSs for 2008. The Amendment addresses the definition of "short-term employee benefits" and "other long-term employee benefits" to refer to when the liabilities are due to be settled. Accordingly, certain benefits are accounted for as short-term benefits. The Amendment is applied retrospectively.

The table below presents the effect of retrospective application of the relevant items.

## NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICY (CONTD)

### C. Retrospective application by restatement (contd.)

#### (1) Effect on the statement of financial position

| | As previously reported | Effect of retrospective application | Following retrospective application |
|---|---|---|---|
| | NIS millions | NIS millions | NIS millions |
| **September 30, 2008 (unaudited)** | | | |
| Deferred tax assets | 592 | 3 | 595 |
| Employee benefits (as part of current liabilities) | 423 | 11 | 434 |
| Deficit | (2,453) | (8) | (2,461) |
| **December 31, 2008 (audited)** | | | |
| Deferred tax assets | 547 | 3 | 550 |
| Employee benefits (as part of current liabilities) | 401 | 11 | 412 |
| Deficit | (2,157) | (8) | (2,165) |

#### (2) Effect on the statement of changes in equity

| | As previously reported | Effect of retrospective application | Following retrospective application |
|---|---|---|---|
| | NIS millions | NIS millions | NIS millions |
| **January 1, 2008 (audited)** | | | |
| Deficit | (2,268) | (8) | (2,276) |
| **July 1, 2008 (unaudited):** | | | |
| Deficit | (2,080) | (8) | (2,088) |

### D. Reclassified amounts

The condensed consolidated interim financial statements include reclassification of certain amounts of the comparative figures of the relevant sections.

## NOTE 4 – DISCONTINUED OPERATIONS

Further to Note 33(3)B to the financial statements as at December 31, 2008, regarding the merger notice filed by the Company and DBS Satellite Services Ltd. (DBS) to the Antitrust Commissioner ("the Commissioner") in respect of exercise of options for shares in DBS by the Company, on August 20, 2009, the Supreme Court accepted the Commissioner's appeal and ruled against the merger of the companies.

The ruling of the Supreme Court is conclusive. Up to the Supreme Court ruling, the Company consolidated the financial statements of DBS with its financial statements (the Company held 49.8% of the share capital of DBS), even though it did not have legal control of DBS, as due to a number of circumstances, including the additional potential voting rights which the Company had by virtue of the options, the Company believed that it was able to direct the financial and operational policy of DBS. The Company believes that the Supreme Court ruling, which constitutes a final and irrevocable external legal barrier to the possibility of the Company achieving over 50% of the voting rights in DBS, creates a material change in the management between the Company, DBS and its shareholders, and as a result the Company can no longer direct the financial and operational policy of DBS. Therefore, the Company cannot be perceived as controlling DBS (neither legally nor effectively). Accordingly, commencing August 21, 2009, the Company no longer consolidates DBS's financial statements with its reports, and the investment in DBS is stated according to the equity method commencing from that date. The DBS financial statements are attached to these financial statements.

From the deconsolidation date, the Company presented its investment in shares, option warrants and loans it extended to DBS according to the equity method based on the estimated value carried out by an independent assessor whose opinion is attached to these financial statements. According to the opinion, the value of the Company's investment in shares, options warrants and loans to DBS is estimated at between NIS 1.145 billion and 1.234 billion. The Company stated the investment at NIS 1.175 billion and recognized a profit of NIS 1.538 billion.

The Company has asked an external assessor to calculate the allocation of the fair value to the tangible and intangible assets of DBS (PPA). This work has not yet been completed and will be completed at the date of the annual financial statements. The Company's management estimates that this allocation does not have a material impact on the Company's results for the period between August 21, 2009 and September 30, 2009.

The consolidated income statements for the nine and three months ended September 30, 2009 are stated without consolidation of DBS's statements. The operating results of DBS for the period up to August 20, 2009 and the comparative figures were stated as discontinued operations.

The consolidated income statements for the nine months and three months ended September 30, 2008, and the year ended December 31, 2008 were restated in order to reflect the discontinued operations due to deconsolidation separately from continuing operations.

## NOTE 4 – DISCONTINUED OPERATIONS (CONTD.)

### (1) Results of discontinued operations

| | From January 1 to August 20 2009 | Nine months ended September 30 2008 | From July 1 to August 20 2009 | Three months ended September 30 2008 | Year ended December 31 2008 |
|---|---|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| Revenue | **970** | 1,136 | **210** | 375 | 1,513 |
| Cost of revenue | **663** | 831 | **149** | 267 | 1,091 |
| Gross profit | **307** | 305 | **61** | 108 | 422 |
| Selling and marketing expenses | **79** | 99 | **17** | 28 | 128 |
| General and administrative expenses | **74** | 84 | **15** | 28 | 117 |
| | **153** | 183 | **32** | 56 | 245 |
| Operating profit | **154** | 122 | **29** | 52 | 177 |
| Finance expenses, net | **313** | 369 | **92** | 134 | 441 |
| Loss before income tax | **(159)** | (247) | **(63)** | (82) | (264) |
| Income tax | **-** | - | **-** | - | 1 |
| Loss after income tax | **(159)** | (247) | **(63)** | (82) | (265) |
| Profit from deconsolidation of a subsidiary | **1,538** | - | **1,538** | - | - |
| Profit (loss) for the period from discontinued operations | **1,379** | (247) | **1,475** | (82) | (265) |

### (2) Cash flow from discontinued operations

| | From January 1 to August 20 2009 | Nine months ended September 30 2008 | From July 1 to August 20 2009 | Three months ended September 30 2008 | Year ended December 31 2008 |
|---|---|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| Cash flow from operating activities | **260** | 214 | **76** | 97 | 347 |
| Cash flow used for investment activities | **(176)** | (175) | **(55)** | (56) | (237) |
| Cash flow used for financing activities | **(84)** | (39) | **(21)** | (41) | (110) |
| Cash flow from discontinued operations | **-** | - | **-** | - | - |

## NOTE 4 – DISCONTINUED OPERATIONS (CONTD.)

### (3) Effect of discontinued operations on the financial situation of the Group

| | August 20 2009 (Unaudited) NIS millions |
|---|---|
| Working capital | **456** |
| Property, plant and equipment | **(678)** |
| Broadcasting rights – less rights used | **(302)** |
| Intangible assets (except for goodwill) | **(59)** |
| Goodwill | **(760)** |
| Debentures | **737** |
| Loans from banks and institutions | **1,019** |
| Non-controlling interests | **(551)** |
| Investment in equity-accounted investee (mainly in loans) | **1,175** |
| Loans from holders of non-controlling interests | **501** |
| Profit from deconsolidation of a subsidiary | **(1,538)** |
| **Total** | **-** |

## NOTE 5 – GROUP ENTITIES

A detailed description of the Group entities appears in Note 33 to the Group's annual financial statements as at December 31, 2008. Below are details of the material changes that occurred relating to the Group entities since publication of the annual financial statements.

**A. Pelephone Communications Ltd.**

(1) In May 2009, Pelephone signed an agreement with Apple Sales International ("the Manufacturer") for the acquisition and distribution of iPhone handsets in Israel. According to the agreement, Pelephone undertakes to purchase a minimum number of handsets every year for three years at the prices in effect at the manufacturer at the actual purchase date. Pelephone estimates that these quantities are a significant part of the number of handsets expected to be sold by Pelephone during the agreement period and that their cost will represent approximately 5% of the cost of Pelephone's annual services and sales in these years.

(2) In September 2009, Pelephone submitted a proposal for the acquisition of Mirs Communications Ltd., under the relevant terms. It is emphasized that the proposal is still in the submission stage and there is no certainty that the proposal will be accepted. Additionally, the final conditions and restrictions of the transaction, should it materialize, are yet to be defined. Should the transaction materialize, it will be subject to regulatory approvals, and there is no certainty that these approvals will be obtained. According to media reports, other entities are competing and there are negotiations with another offering entity.

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

(1) Commencing from August 21, 2009, the Company no longer consolidates the DBS reports with its financial statements and the investment in DBS shares is stated according to the equity method commencing from the abovementioned date. See Note 4.

(2) The terms of the loans and the credit facility that DBS received from the banks, amounting to NIS 960 million at September 30, 2009, impose various restrictions on DBS that include, inter alia, restrictions on providing a lien on or sale of certain assets, a restriction on receipt of credit from other banks without prior approval, a restriction concerning repayment of shareholders' loans, and a requirement for compliance with financial covenants ("the Covenants").

A. In January 2009, DBS applied to the banks requesting a revision of the stipulations for 2009 so as to adapt them to the 2009 budget. On March 15, 2009, the banks agreed to amend the stipulations.

B. As at September 30, 2009, DBS is in compliance with the covenants determined.

C. The DBS management believes that the sources of financing available to DBS will suffice for its operational requirements in the coming year, based on the projected cash flow approved by DBS's Board of Directors. If additional resources are required to meet its operational requirements during the year, DBS will adapt its operations to preclude the need for additional resources beyond those available to it.

(3) DBS's balance of current debt to the Company and its subsidiaries amounts to approximately NIS 69 million, of which approximately NIS 51 million is owed to the Company. The Company and DBS reached an agreement for collection of part of DBS's debt to the Company, which was in arrears. Under the arrangement, the debt is being paid in 60 equal monthly instalments plus interest at prime + 1.5%. As at balance sheet date, the balance of the debt covered by the arrangement is approximately NIS 22 million. The balance of the debt to the Company outside the above arrangement is a current debt. The parties are formulating another arrangement for payment of this debt.

(4) Digital Terrestrial TV (DTT) started broadcasting on August 2, 2009. The management of DBS believes that DTT could have a negative effect on its revenue.

## NOTE 6 – CONTINGENT LIABILITIES

### A. Claims

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

In the opinion of the Group companies' managements, which is based, *inter alia*, on legal opinions regarding the risks related to the claims, including the application for certification of the class actions, appropriate provisions have been included in the financial statements in the amount of NIS 352 million (not including provisions included in the financial statements of DBS), where warranted, to cover the exposure resulting from such claims.

In the opinion of the Group companies' managements, the additional exposure (in addition to the above provisions) at September 30, 2009, due to claims filed against the companies in the Group on various matters and in which the likelihood of realization is possible, amounts to approximately NIS 11.8 billion (not including the additional amount of exposure for claims against DBS), of which approximately NIS 3.3 billion relates to salary claims filed by groups of employees or by individual claims with wide ramifications. The above amounts are prior to addition of interest.

For applications for certification as class actions, regarding which the Group has exposure beyond the aforesaid (since the claims do not state an exact amount), see claims in Note 17A(5)a and b, (21) and (36) to the financial statements as at December 31, 2008.

For a detailed description of these claims, see Note 17A to the Group's annual financial statements as at December 31, 2008. Details of the significant changes to the status of the material contingent liabilities of the Group since December 31, 2008 are provided below.

(1) Further to Note 17A(2)(c). to the financial statements as at December 31, 2008, concerning the claim for the inclusion of a number of components in the salary used for the determination of pay for pension and the appeal filed following the dismissal of the claim, on September 23, 2009, the court dismissed all the items of the appeal.

(2) Further to Note 17A(6) to the financial statements as at December 31, 2008, regarding the claim for payment of monetary compensation of approximately NIS 60 million and for writs of mandamus filed by an international communications operator against the Company and Bezeq International, on January 27, 2009, the plaintiff filed a motion for amendment of the claim, so as to extend the claim period, change the method for calculating the damage and include a number of new facts, and alternately, a motion for splitting up of remedies. On May 15, 2009, the court approved, with the defendants' consent, partial acceptance of the plaintiff's motion, so as to include damages incurred by the plaintiff subsequent to the date of filing the statement of claim and to change the calculation method of the principle damage of diverting allocated customers and giving an advantage to Bezeq International in public telephones. Regarding other matters for which an amendment to the statement of claim was requested, the court ruled that should the plaintiff insist on amending the statement of claim for these issues as well, a motion for a hearing of the matter must be filed. If the motion for the amendment is approved in full, the scope of the claim (for fee purpose) will be updated to NIS 77 million. The parties were referred to another arbitration procedure in the case.

(3) Further to Note 17A(11) to the financial statements as at December 31, 2008, regarding the claim and application for certification as a class action against HOT and against the Company for a fault in the telephone line in the HOT network, on August 6, 2009, the settlement between the parties was given the validity of judgment. Under the settlement, HOT will grant the eligible members of the group the right to receive voice mail for one year, free of charge, or alternately, the right to another line for one year, free of charge, as they choose. Additionally, the Company will pay the representative plaintiff and his attorney NIS 170,000.

## NOTE 6 – CONTINGENT LIABILITIES (CONTD.)

### A. Claims (contd.)

(4) Further to Note 17A(20) to the financial statements as at December 31, 2008, regarding the claim filed in November 1997, together with an application for certification as a class action, against Bezeq International, the chairman of the board of directors of Bezeq International and the then CEO of Bezeq International, alleging that Bezeq International had abused its status in the international calls market and had implemented a deliberate policy of misleading the public on the subject of international call tariffs, on May 6, 2009, the Supreme Court dismissed the plaintiff's appeal of the district court ruling, which denied the application for certification of the claim as a class action.

On June 15, 2009, the plaintiff filed a motion for another hearing at the Supreme Court. At the reporting date, the court has yet to hand down a decision on the hearing of the motion.

(5) Further to Note 17A(24) to the financial statements as at December 31, 2008, regarding the claim and application for certification as a class action against Bezeq International, an associate of Bezeq International and members of the board of directors of those two companies in the matter of sending an advertisement without the consent of the recipient, violating the provisions of Amendment 40 to the Communications Law, Bezeq International filed an application for a summary dismissal of the application for certification as a class action, claiming lack of cause, as the law does not permit a claim for compensation without proof of harm, in this cause, under a class action. The plaintiff filed a response to the application for a summary dismissal and requested to amend the application for certification as a class action, such that the damage claimed will be compensation for harassing the plaintiff, wasting her time and curtailing her autonomy. The amount of damages claimed remained unchanged.

In the pre-trial hearing in May 2009, the plaintiff withdrew the claim at the recommendation of the court. The plaintiff informed the Bezeq International's attorney that she undertakes not to file a new motion, directly or indirectly, instead of the motion that was withdrawn.

(6) Further to Note 17A(29) to the financial statements as at December 31, 2008, regarding the claim against Pelephone, Cellcom and Partner in a total amount of NIS 449 million, of which NIS 167 million was attributed to Pelephone, for an excess amount charged for international calls, in August 2009 the claim was dismissed at the plaintiff's request.

(7) On May 4, 2009, a claim was filed in the Jerusalem District Court against Bezeq International, together with an application for certification as a class action. The plaintiff, who is a subscriber of Bezeq International's internet services, claims that he was overcharged for the internet services he received from Bezeq International, in violation of the agreement and the law. According to the plaintiff, Bezeq International breached the contract with him, misled him and acted in bad faith in the negotiations and its relations with him. The plaintiff applied for certification as a class action on behalf of a group that includes any subscriber to Bezeq International's internet services who does not have a written agreement and/or for whom the tariffs for services were increased after the initial agreement period, beyond any reasonable or acceptable amount and/or without their agreement or without notice and/or who had a uniform agreement with Bezeq International which does not comply with the requirements of the law, allowing price increases without notice and at a rate that is beyond the normal rate, for the period between November 2005 and December 2008. The total amount of the class action is NIS 217 million (the personal amount of the claim is NIS 2,802).

## NOTE 6 – CONTINGENT LIABILITIES (CONTD.)

### B. Claims which cannot yet be assessed or for which the exposure cannot be calculated

For a detailed description of the claims in respect of which the exposure cannot yet be assessed or calculated, see Note 17B to the Group's annual financial statements as at December 31, 2008. Details of material changes since December 31, 2008 are provided below.

**Claims for which exposure cannot be calculated**

(1) Further to Note 17B(1) to the financial statements as at December 31, 2008, regarding the claim filed against the Company and against the Makefet Fund by employees who retired under a retirement agreement signed in November 1997, which was dismissed by the court on December 11, 2008, the plaintiffs filed an appeal, which the Company received on April 5, 2009.

(2) In August 2009, a claim was filed in the Central District Court against Pelephone, together with an application for certification as a class action. The claim is for the refund of amounts collected by Pelephone by a stop order, alleging that this collection is in violation of Pelephone's license and the law. The personal amount of the claim is NIS 173. The amount of the class action is not stated. The claim includes a motion for remedy of a mandatory injunction ordering the defendant to stop collecting the amount, and a declarative remedy that the collection is in violation of the law.

**Claims which cannot yet be assessed**

(3) Further to Note 17B(7) to the financial statements as at December 31, 2008, regarding the application for certification of a class action in the amount of NIS 80 million against Pelephone in respect of deletion of messages from the voice mail box after a certain time, the plaintiff announced the withdrawal from the claim and the claim was terminated.

(4) In August 2009, a claim was filed in the Petach Tikva District Court against Pelephone, together with an application for certification as a class action. The claim refers to saving text messages sent via the Pelephone network, in Pelephone systems. The plaintiffs allege that saving the messages is a contravention of the law and Pelephone's license. The remedies requested are a declarative remedy that the information is held in contravention of the law, a mandatory injunction for its deletion, a mandatory injunction to prevent saving messages in the future and a monetary remedy of an undefined amount (to be determined by the court).

(5) In August 2009, a claim was filed in the Tel Aviv District Court against Pelephone, together with an application for certification as a class action, The total amount of the claim is NIS 19 million. The claim is for the refund of the amounts collected by defendant from its subscribers for the telephone book backup service provided to those subscribers.

(6) In August 2009, a claim was filed in the Tel Aviv District Court together with an application for certification as a class action. The claim was filed against Pelephone, another cellular operator and against a company providing services through the cellular telephone. The amount of the claim is NIS 33 million (without distribution among the respondents). The claim is for the refund of the amounts collected by the respondents (charged through the cellular account), for the service supplied by the third defendant through the cell phone. According to the claim, the plaintiff did not ask to join the service, and therefore the charge for the service is illegal.

## NOTE 6 – CONTINGENT LIABILITIES (CONTD.)

### B. Claims which cannot yet be assessed or for which the exposure cannot be calculated (contd.)

**Claims which cannot yet be assessed (contd.)**

(7) In August 2009, a claim was filed in the Tel Aviv District Court together with an application for certification as a class action, The claim was filed against Pelephone and against two other companies providing services through the cellular telephone (“the Other Defendants”). The total amount of the claim is NIS 200 million (without distribution among the defendants). The claim is for the refund of amounts collected by the respondents (charged through the cellular account) and for the services supplied by the other defendants through the cell phone information sent by SMS). The claim includes a motion for remedy of a mandatory injunction ordering the respondents to discontinue the charge. The applicant alleges that she did not ask to join the services of the other defendants, and therefore the charge for the services is illegal..

(8) In October 2009, a claim was filed in the Tel Aviv District Court against Pelephone, together with an application for certification as a class action. The amount of the claim is NIS 331 million. The applicant alleges that Pelephone is violating its license by offering benefits for the purchase of a handset and reimbursement of fines by competitors, for a period that is longer than the 18-month commitment period (36 months). The claim is for payment of compensation by Pelephone to its customers, in the amount of the benefit granted by Pelephone to these customers for the period exceeding 18 months, and for an injunction ordering Pelephone to restrict the benefit to 18 months.

(9) Further to Note 17B(5) and (6) to the financial statements as of December 31, 2008, a risk assessment for these claims was received and they include further exposure for claims filed against the Group companies for various subjects. The likelihood for the realization of these claims is described in section A above.

### C. Other contingencies

For a detailed description of other contingencies, see Note 17C to the Group’s annual financial statements as at December 31, 2008. Details of material changes since December 31, 2008 are provided below.

(1) Further to Note 17C(2) to the financial statements as at December 31, 2008, regarding the application for approval of the derivative claim against former members of the Company’s Board of Directors, for the transfer of funds from the Company to DBS contrary to the decisions of the Minister of Communications, on October 15, 2009, the court ruled to dismiss the application.

(2) Further to Note 17C(9) to the financial statements as at December 31, 2008, regarding the claim filed by Pelephone in January 2009 against the Israel Land Administration, the court approved the settlement between the parties, according to which the claim would be dismissed and the parties would negotiate by December 31, 2009 with the aim of settling their disagreement out of court.

(3) Further to Note 17C(10) to the financial statements as at December 31, 2008, regarding the letter from the Director General of the Ministry of Communications announcing that he intends to consider the imposition of financial sanctions on the Company in the amount of NIS 15 million for the alleged violation of provisions of the Company's general license relating to structural separation, on April 26, 2009, the Company submitted its detailed argument stating that the Company did not violate the provisions of its license relating to structural separation, and the aforesaid violation cannot be attributed to the Company, and under these circumstances and the circumstances described in the Company's document, financial sanctions cannot be imposed on the Company. The Company requested an oral hearing as well.

## NOTE 6 – CONTINGENT LIABILITIES (CONTD.)

### D. Claims against affiliates

Following the deconsolidation of DBS, as set forth in Note 4 above, these reports describe claims against DBS within this section – Claims against affiliates. Details of material changes in claims against DBS since December 31, 2008 are provided below.

(1) Further to Note 17A(45) to the financial statements as at December 31, 2008, regarding the application for certification of a class action against DBS relating to the termination of the Discovery Science and Adventure 1 channels, in July 2009, the district court approved the claim filed by the applicant as a class action solely for the contractual reason. Regarding the damage, the court ruled that the alleged damage relates to the proportionate amounts that were collected for the channels whose broadcasts were terminated, after termination of the broadcasts on January 15, 2008.

The court defined the group (including DBS customers who paid for viewing the science and nature package and whose charge was not terminated or reduced after the channels were no longer broadcasted up to August 18, 2008), and ruled that the remedy claimed is the refund of the proportionate payment paid by the group members for viewing both channels. The court further ruled that the key question common to the group members is whether the wording of the relevant instructions in the subscriber agreement credits the group members by reducing their charge (proportionately) after terminating the broadcast of the channels that were included in the package up to January 15, 2008. The parties are in the preliminary stages of negotiations for a settlement.

(2) Further to Note 17B(3) to the financial statements as at December 31, 2008, regarding the class action against DBS relating to communication with customers by telephone and not in writing, in September 2009, the application for certification as a class action was summarily dismissed, without an order to pay costs.

(3) Further to Note 17B(8) to the financial statements as at December 31, 2008 regarding the class action against DBS relating to non-disconnection of the applicant from HOT television services, in August 2009, the parties filed (with consent) a motion to approve the dismissal of the application and dismiss the claim, with payment of a symbolic amount to the applicant and her attorney.

(4) In June 2009, Israel Aerospace Industries (IAI) demanded immediate payment of the balance of DBS's debt for the use of the Amos 1 satellite and payment of interest and other amounts allegedly due to IAI by virtue of the agreement. DBS has counter claims against some of the amounts claimed by IAI. In September 2009, DBS and IAI signed an agreement settling all the financial disputes that arose between the parties.

## NOTE 7 – EQUITY

### A. Share capital

| Registered | | | Issued and paid up | | |
|---|---|---|---|---|---|
| September 30, 2009 | September 30, 2008 | December 31, 2008 | September 30, 2009 | September 30, 2008 | December 31, 2008 |
| (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 | 2,653,896,660 | 2,605,045,611 | 2,605,045,611 |

1. Following the exercise of options by employees in accordance with the options plans described in Note 26 to the financial statements as at December 31, 2008, in the nine months ended September 30, 2009, the Company issued 48,851,049 ordinary shares of NIS 1 par value each.

2. Subsequent to the reporting date and up to November 3, 2009, following the exercise of options by the employees, in accordance with the options plans set forth in Note 26 to the financial statements as at December 31, 2008, the Company issued another 3,459,373 ordinary shares of NIS 1 par value each.

3. In the reporting period, the Company granted options to senior employees in the Company (see Note 8).

### B. Dividends

(1) The Company paid dividends as follows:

| | Nine months ended September 30 | | Three months ended September 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 | 2008 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| Cash dividend paid in May 2009 (NIS 0.3 per share) | **792** | - | **-** | - | - |
| Cash dividend paid in October 2009 (NIS 0.43 per share) (2) | **1,149** | - | **1,149** | - | - |
| Cash dividend paid in April 2008 (NIS 0.26 per share) | **-** | 679 | **-** | - | 679 |
| Cash dividend paid in October 2008 (NIS 0.32 per share) (3) | **-** | 835 | **-** | 835 | 835 |
| | **1,941** | 1,514 | **1,149** | 835 | 1,514 |

(2) 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 to the shareholders 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.

(3) On August 20, 2008, 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 to the shareholders in the total amount of NIS 835 million (which is approximately NIS 0.32 per share). On September 28, 2008, the general meeting approved payment of the dividend and it was paid on October 29, 2008.

## NOTE 8 – SHARE-BASED PAYMENT

**A.** Further to Note 26(B) and (I) to the financial statements as at December 31, 2008, in the first nine months of 2009, the Board of Directors approved the allocation of 2,500,000 options exercisable into 2,500,000 ordinary shares of NIS 1 par value each to other senior employees in the Group. In addition, on May 3, 2009 the general meeting of the shareholders of the Company approved the allocation of 100,000 options exercisable into 100,000 ordinary shares of NIS 1 par value each to an employee-director.

The exercise price at the grant date of the options is between NIS 5.9703 and NIS 6.669 (adjusted to distribution of a dividend in cash or a dividend in kind) and the theoretic economic value, based on the weighted Black and Scholes model, is NIS 5.9 million based, inter alia, on the share price at the allocation date of between NIS 6.5 and NIS 7.172, annual risk-free interest of between 3.65% and 4.9%, expected life of between 4.5 and 8 years and annual standard deviation of between 24.56% and 26.63%.

**B.** Further to Note 26H to the financial statements as at December 31 2008, in July 2009 the board of directors of DBS approved an amendment to the employment agreement of DBS's CEO. Under the amendment, the undertaking to grant option warrants of DBS was cancelled and it was determined that the CEO is entitled to financial bonuses. Consequently, DBS included a liability in its financial statements that reflects the amounts of the unpaid bonuses according to this amendment.

## NOTE 9 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES

**A.** Further to Note 26(B) and (I) to the financial statements as at December 31, 2008, on May 3, 2009, the general meeting of the shareholders of the Company approved the allocation of 100,000 options exercisable into 100,000 ordinary shares of NIS 1 par value each to an employee-director. See Note 8.

**B.** Further to Note 29(F)(3) to the financial statements as at December 31, 2008, on May 3, 2009, the general meeting of the shareholders of the Company approved a maximum bonus for 2008 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 3.2 million.

## NOTE 10 - REVENUE

| | Nine months ended September 30 | | Three months ended September 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2009 | 2008* | 2009 | 2008* | 2008* |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| **Domestic fixed-line communications** | | | | | |
| Fixed line telephony | **2,440** | 2,632 | **810** | 858 | 3,472 |
| Internet - infrastructure | **638** | 585 | **230** | 194 | 790 |
| Transmission, data communication and other | **717** | 743 | **239** | 272 | 981 |
| | **3,795** | 3,960 | **1,279** | 1,324 | 5,243 |
| **Cellular** | | | | | |
| Cellular services and terminal equipment | **2,987** | 2,824 | **1,040** | 969 | 3,758 |
| Sale of terminal equipment | **813** | 549 | **271** | 179 | 692 |
| | **3,800** | 3,373 | **1,311** | 1,148 | 4,450 |
| **International communications, internet services and NEP** | **949** | 937 | **319** | 318 | 1,263 |
| **Other** | **43** | 44 | **15** | 16 | 59 |
| | **8,587** | 8,314 | **2,924** | 2,806 | 11,015 |

* Restatement due to discontinued operations, see Note 4

## NOTE 11 – OPERATING AND GENERAL EXPENSES

| | Nine months ended September 30 | | Three months ended September 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2009 | 2008* | 2009 | 2008* | 2008* |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| Cellular telephone expenses | **1,309** | 1,303 | **457** | 437 | 1,725 |
| General expenses | **796** | 743 | **305** | 266 | 1,008 |
| Materials and spare parts | **718** | 615 | **236** | 174 | 831 |
| Services and maintenance by sub-contractors | **104** | 126 | **31** | 40 | 204 |
| Building maintenance | **218** | 227 | **77** | 80 | 312 |
| International communication expenses | **242** | 198 | **81** | 65 | 272 |
| Vehicle maintenance expenses | **91** | 118 | **30** | 40 | 158 |
| Royalties to the State of Israel | **74** | 85 | **26** | 36 | 116 |
| Collection fees | **24** | 24 | **8** | 7 | 34 |
| | **3,576** | 3,439 | **1,251** | 1,145 | 4,660 |

* Restatement due to discontinued operations, see Note 4

## NOTE 12 – CONDENSED DATA FROM THE SEPARATE INTERIM FINANCIAL STATEMENTS OF THE COMPANY

### A. Profit or loss

| | Nine months ended September 30 | | Three months ended September 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** | **2008** |
| | **(Unaudited)** | **(Unaudited)** | **(Unaudited)** | **(Unaudited)** | **(Audited)** |
| | **NIS millions** | **NIS millions** | **NIS millions** | **NIS millions** | **NIS millions** |
| **Revenue (see B below)** | **3,987** | 4,150 | **1,343** | 1,388 | 5,498 |
| **Costs and expenses** | | | | | |
| Depreciation and amortization | **600** | 643 | **184** | 214 | 852 |
| Salary | **797** | 905 | **255** | 289 | 1,202 |
| General and operating expenses | **1,282** | 1,398 | **451** | 464 | 1,873 |
| Operating expenses (income), net | **(54)** | (39)* | **(38)** | (7)* | 96 |
| | **2,625** | 2,907 | **852** | 960 | 4,023 |
| Operating profit for the period | **1,362** | 1,243* | **491** | 428* | 1,475 |

* See Note 3D. Reclassification of NIS 25 million for the nine months ended September 30, 2008, of which NIS 6 million is for the three months then ended, for financing expenses in respect of a provision for severance in early retirement formerly stated under operating expenses (income), net.

### B. Revenue segmentation

| | Nine months ended September 30 | | Three months ended September 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** | **2008** |
| | **(Unaudited)** | **(Unaudited)** | **(Unaudited)** | **(Unaudited)** | **(Audited)** |
| | **NIS millions** | **NIS millions** | **NIS millions** | **NIS millions** | **NIS millions** |
| Telephony | **2,510** | 2,708 | **843** | 899 | 3,572 |
| Internet | **638** | 585 | **221** | 194 | 790 |
| Transmission and data communication | **637** | 596 | **217** | 200 | 811 |
| Other services | **202** | 261 | **62** | 95 | 325 |
| | **3,987** | 4,150 | **1,343** | 1,388 | 5,498 |

## NOTE 13 – SEGMENT REPORTING

Division of the Company's operations into reportable operating segments, under IFRS 8, is derived from management reports. Commencing August 21, 2009, the Company ceased to consolidate its financial statements with DBS's statements, and its investment in DBS is stated according to the equity method from that date (see Note 4). The Group continues to report on four segments in its financial statements, including multichannel television.

Details of operating segments and reconciliation between segment information and the consolidated statement:

### A. Reporting segments

| | Nine months ended September 30, 2009 (unaudited) | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Domestic fixed-line communications** | **Cellular telephone** | **International communications, internet and NEP services** | **Multi-channel television** | **Others** | **Adjustments** | **Consolidated** |
| | **NIS millions** | **NIS millions** | **NIS millions** | **NIS millions** | **NIS millions** | **NIS millions** | **NIS millions** |
| **Revenue** | | | | | | | |
| Total revenue from external sources | **3,795** | **3,800** | **949** | **1,140** | **43** | | |
| Revenue from inter-segment sales | **192** | **183** | **35** | **-** | **11** | | |
| Total revenue | **3,987** | **3,983** | **984** | **1,140** | **54** | **(1,561)** | **8,587** |
| Profit from operating segments | **1,362** | **939** | **194** | **186** | **3** | **(192)** | **2,492** |
| **Segment assets at September 30, 2009** | **11,940** | **4,902** | **1,056** | **1,206** | **99** | **(4,668)** | **14,535** |

## NOTE 13 –SEGMENT REPORTING (CONTD.)

### A. Reporting segments (contd.)

| | Nine months ended September 30, 2008 (unaudited)* | | | | | | |
|---|---|---|---|---|---|---|---|
| | Domestic fixed-line communications | Cellular telephone | International communications, internet and NEP services | Multi-channel television | Others | Adjustments | Consolidated |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| **Revenue** | | | | | | | |
| Total revenue from external sources | 3,960 | 3,373 | 937 | 1,136 | 44 | | |
| Revenue from inter-segment sales | 190 | 202 | 32 | - | 13 | | |
| Total revenue | 4,150 | 3,575 | 969 | 1,136 | 57 | (1,573) | 8,314 |
| Profit from operating segments | 1,243 | 774 | 176 | 122 | 1 | (128) | 2,188 |
| **Segment assets at September 30, 2008** | 11,257 | 4,538 | 961 | 1,150 | 105 | (3,270) | 14,741 |

* Restatement due to discontinued operations, see Note 4

## NOTE 13 –SEGMENT REPORTING (CONTD.)

### A. Reporting segments (contd.)

| | Three months ended September 30, 2009 (unaudited) | | | | | | |
|---|---|---|---|---|---|---|---|
| | Domestic fixed-line communications | Cellular telephone | International communications, internet and NEP services | Multi-channel television | Others | Adjustments | Consolidated |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| **Revenue** | | | | | | | |
| Total revenue from external sources | 1,279 | 1,311 | 319 | 380 | 15 | | |
| Revenue from inter-segment sales | 64 | 61 | 13 | - | 3 | | |
| Total revenue | 1,343 | 1,372 | 332 | 380 | 18 | (521) | 2,924 |
| Profit from operating segments | 491 | 316 | 66 | 61 | 2 | (61) | 875 |
| **Segment assets at September 30, 2009** | 11,940 | 4,902 | 1,056 | 1,206 | 99 | (4,668) | 14,535 |

## NOTE 13 –SEGMENT REPORTING (CONTD.)

### A. Reporting segments (contd.)

| | Three months ended September 30, 2008 (unaudited)* | | | | | | |
|---|---|---|---|---|---|---|---|
| | Domestic fixed-line communications | Cellular telephone | International communications, internet and NEP services | Multi-channel television | Others | Adjustments | Consolidated |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| **Revenue** | | | | | | | |
| Total revenue from external sources | 1,324 | 1,148 | 318 | 375 | 16 | | |
| Revenue from inter-segment sales | 64 | 66 | 11 | - | 4 | | |
| Total revenue | 1,388 | 1,214 | 329 | 375 | 20 | (520) | 2,806 |
| Profit from operating segments | 428 | 293 | 59 | 52 | 1 | (58) | 775 |
| **Segment assets as at September 30, 2008** | 11,257 | 4,538 | 961 | 1,150 | 105 | (3,270) | 14,741 |

* Restatement due to discontinued operations, see Note 4

## NOTE 13 –SEGMENT REPORTING (CONTD.)

### A. Reporting segments (contd.)

| | Year ended December 31, 2008 (audited)* | | | | | | |
|---|---|---|---|---|---|---|---|
| | Domestic fixed-line communications | Cellular telephone | International communications, internet and NEP services | Multi-channel television | Others | Adjustments | Consolidated |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| **Revenue** | | | | | | | |
| Total revenue from external sources | 5,243 | 4,450 | 1,263 | 1,513 | 59 | | |
| Revenue from inter-segment sales | 255 | 263 | 43 | - | 16 | | |
| Total revenue | 5,498 | 4,713 | 1,306 | 1,513 | 75 | (2,090) | 11,015 |
| Profit from operating segments | 1,475 | 933 | 242 | 177 | - | (187) | 2,640 |
| **Segment assets as at December 31, 2008** | 10,752 | 4,644 | 994 | 1,132 | 100 | (3,308) | 14,314 |

* Restatement due to discontinued operations, see Note 4

## NOTE 13 –SEGMENT REPORTING (CONTD.)

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

| | Nine months ended September 30 | | Three months ended September 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2009 | 2008* | 2009 | 2008* | 2008* |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| **Revenue** | | | | | |
| Total revenue from reporting segments | **10,094** | 9,830 | **3,427** | 3,306 | 13,030 |
| Total revenue from external sources in other segments | **54** | 57 | **18** | 20 | 75 |
| Cancellation of revenue for a segment that is an affiliate (up to August 20, 2009 – a discontinued operation) | **(1,140)** | (1,136) | **(380)** | (375) | (1,513) |
| Cancellation of revenue from inter-segment sales | **(421)** | (437) | **(141)** | (145) | (577) |
| Total consolidated revenue | **8,587** | 8,314 | **2,924** | 2,806 | 11,015 |

| | Nine months ended September 30 | | Three months ended September 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2009 | 2008* | 2009 | 2008* | 2008* |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| **Profit or loss** | | | | | |
| Total operating profit or loss for reporting segments | **2,675** | 2,309 | **934** | 826 | 2,817 |
| Profit or loss for other categories | **3** | 1 | **2** | 1 | - |
| Cancellation of expenses for a segment that is an affiliate (up to August 20, 2009 – a discontinued operation) | **(186)** | (122) | **(61)** | (52) | (177) |
| Financing income (expenses), net | **13** | (125) | **(16)** | (57) | (140) |
| Share in the profits (losses) of equity-accounted investees | **(8)** | 4 | **(12)** | 2 | 5 |
| Consolidated profit before income tax | **2,497** | 2,067 | **847** | 720 | 2,505 |

* Restatement due to discontinued operations, see Note 4

## NOTE 13 –SEGMENT REPORTING (CONTD.)

### B. Adjustments for segment reporting of revenue, profit or loss and assets (contd.)

| | September 30 | | December 31 |
|---|---|---|---|
| | 2009 | 2008* | 2008* |
| | (Unaudited) NIS millions | (Unaudited) NIS millions | (Audited) NIS millions |
| **Assets** | | | |
| Total assets from reporting segments | **19,104** | 17,906 | 17,522 |
| Assets attributable to activities in other categories | **99** | 105 | 100 |
| Investment in equity-accounted investees reported as a segment (mainly in loans) | **1,183** | - | - |
| Cancellation of assets for a segment classified as an affiliate | **(1,206)** | - | - |
| Less inter-segment assets | **(4,645)** | (3,270) | (3,308) |
| Total consolidated assets | **14,535** | **14,741** | **14,314** |

* Restatement due to discontinued operations, see Note 4

## NOTE 14 – CONDENSED DATA FROM THE FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD. AND BEZEQ INTERNATIONAL LTD.

### 1. Pelephone Communications Ltd.

#### A. Data from the statement of financial position

| | September 30, 2009 | September 30, 2008 | December 31, 2008 |
|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions |
| Current assets | **2,030** | 1,912 | 1,898 |
| Non-current assets | **2,872** | 2,626 | 2,746 |
| | **4,902** | 4,538 | 4,644 |
| Current liabilities | **1,251** | 1,092 | 1,502 |
| Long term liabilities | **909** | 1,075 | 1,050 |
| Total liabilities | **2,160** | 2,167 | 2,552 |
| Shareholders' equity | **2,742** | 2,371 | 2,092 |
| | **4,902** | 4,538 | 4,644 |

#### B. Data from the income statement

| | Nine months ended September 30 | | Three months ended September 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 | 2008 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| Revenue from services and sales | **3,983** | 3,575 | **1,372** | 1,214 | 4,713 |
| Cost of services and sales | **2,612** | 2,404 | **904** | 778 | 3,216 |
| **Gross profit** | **1,371** | 1,171 | **468** | 436 | 1,497 |
| Selling and marketing expenses | **340** | 298 | **122** | 107 | 424 |
| General and administrative expenses | **92** | 99 | **30** | 36 | 140 |
| | **432** | 397 | **152** | 143 | 564 |
| **Operating profit** | **939** | 774 | **316** | 293 | 933 |
| Financing expenses | **75** | 105 | **36** | 33 | 115 |
| Financing income | **(67)** | (92) | **(22)** | (28) | (117) |
| **Net financing expenses (income)** | **8** | 13 | **14** | 5 | (2) |
| **Profit before income tax** | **931** | 761 | **302** | 288 | 935 |
| Income tax | **237** | 207 | **71** | 77 | 253 |
| **Profit for the period** | **694** | 554 | **231** | 211 | 682 |

## NOTE 14 – CONDENSED DATA FROM THE FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD. AND BEZEQ INTERNATIONAL LTD. (CONTD.)

### 2. Bezeq International Ltd.

#### A. Data from the statement of financial position

| | September 30, 2009 | September 30, 2008 | December 31, 2008 |
|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions |
| Current assets | **513** | 471 | 496 |
| Non-current assets | **543** | 490 | 498 |
| | **1,056** | 961 | 994 |
| Current liabilities | **279** | 269 | 254 |
| Long term liabilities | **37** | 22 | 30 |
| Total liabilities | **316** | 291 | 284 |
| Shareholders' equity | **740** | 670 | 710 |
| | **1,056** | 961 | 994 |

#### B. Data from the income statement

| | Nine months ended September 30 | | Three months ended September 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 | 2008 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS millions | NIS millions | NIS millions | NIS millions | NIS millions |
| Revenue | **984** | 969 | **332** | 329 | 1,306 |
| Operating expenses | **584** | 582 | **195** | 200 | 780 |
| **Gross profit** | **400** | 387 | **137** | 129 | 526 |
| Selling and marketing expenses | **131** | 132 | **47** | 43 | 181 |
| General and administrative expenses | **75** | 79 | **24** | 27 | 103 |
| | **206** | 211 | **71** | 70 | 284 |
| **Operating profit** | **194** | 176 | **66** | 59 | 242 |
| Financing expenses | **8** | 11 | **2** | 2 | 8 |
| Financing income | **(13)** | (13) | **(4)** | (2) | (7) |
| **Net financing expenses (income)** | **(5)** | (2) | **(2)** | - | 1 |
| Share in earnings of equity-accounted affiliates | **5** | 4 | **1** | 1 | 5 |
| **Profit before income tax** | **204** | 182 | **69** | 60 | 246 |
| Income tax | **53** | 49 | **18** | 16 | 68 |
| **Profit for the period** | **151** | 133 | **51** | 44 | 178 |

## NOTE 15 – MATERIAL EVENTS DURING THE REPORTING PERIOD AND EVENTS SUBSEQUENT TO THE DATE OF THE FINANCIAL STATEMENTS

**A.** In March 2009, the Company raised bank credit amounting to NIS 400 million and the Company created a negative pledge in favor of the creditors. The debt is repayable in 2010-2013 and bears variable interest at prime + 0.85% to 1%.

**B.** On July 25, 2005, the Knesset passed the Law for the Amendment of the Income Tax Ordinance (No. 147), 5765-2005. The Law includes provisions for a gradual decrease in the corporate tax rate to a rate of 25%, commencing from the 2010 tax year.

On July 14, 2009, the Knesset passed the Economic Arrangements (Amendments for the Implementation of the 2009 and 2010 Economic Plan) Law, 5769-2009. The Law includes provisions for a further gradual decrease in the corporate tax rate to a rate of 18%, commencing from the 2016 tax year. Pursuant to the amendments, corporate tax rates applicable from the 2009 tax year onwards are as follows: 2009 tax year – 26%; 2010 tax year – 25%; 2011 tax year – 24%; 2012 tax year – 23%; 2013 tax year - 22%; 2014 tax year - 21%; 2015 tax year - 20%; and from the 2016 tax year onwards – 18%.

In the third quarter of 2009, following the change in the tax rate, there was a decrease of NIS 38 million in deferred tax assets, a decrease of NIS 9 million in deferred tax liabilities and an increase of NIS 29 million in tax expenses.

**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 regulations include clarification of the royalties that a licensee owes the State. The amendment also includes an exemption for 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. Royalty expenses will be reduced accordingly in the fourth quarter.

**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, according to the terms of the collective agreement of December 2006.
On the same date, 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 16H(1) to the financial statements as at December 31, 2008.
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**. Further to Ap.Sb.Ar.'s agreement for the sale of its holdings in 012 Smile Communications Ltd. (012 Smile), as described in Note 1B above, for the sake of caution, and in view of the possibility of the existence of a personal interest for Ap.Sb.Ar. in agreements of Group companies, as a supplier and/or customer, with companies of the 012 Smile Group, on November 4, 2009, the Board of Directors of the Company approved the agreements between the parties for a period of six months.
The transactions are in an annual volume of NIS 745 million, mainly in the acquisition and sale of equipment and services, service agreements and agreements for marketing alliances, which were routine prior to the date of signing the agreement between Ap.Sb.Ar. and 012 Smile and are continuing and/or renewed after that date as well. There are many agreements, none of which will have a material effect on the Company's profitability, assets or liabilities. In addition, all the transactions are during the regular course of business between the parties and according to market conditions.

# DBS SATELLITE SERVICES (1998) LTD.

# CONDENSED INTERIM FINANCIAL STATEMENTS
# AS AT SEPTEMBER 30, 2009
# (UNAUDITED)

**Condensed Interim Financial Statements as at September 30, 2009**

**Contents**

**Auditors Report for the Shareholders of**
**DBS Satellite Services (1998) Ltd.**

*Introduction*

We have reviewed the accompanying financial information of DBS Satellite Services (1998) Ltd. ("the Company"), including the condensed interim statement of financial position as at September 30, 2009 and the condensed interim statements of income, comprehensive profit, changes in equity and cash flows for the nine and three months periods then ended. The board of directors and the management are responsible for preparation and presentation of the interim financial information for these interim periods in accordance with International Accounting Standard IAS 34 - *Interim Financial Reporting*, and are also responsible for preparation of the financial information for these interim periods in accordance with Chapter D of the Securities Regulations (Periodic and Immediate Reports), -1970. Our responsibility is to express a conclusion on the financial information for the interim periods based on our review.

*Review scope*

We conducted our review in accordance with Accounting Standard no. 1 of the Institute of Certified Public Accountants in Israel – *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim financial information consists of making enquiries, 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 auditing 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 this financial information is not prepared, in all material respects, in accordance with International Accounting Standard IAS 34.

In addition to the aforesaid in the previous paragraph , based on our review, nothing has come to our attention that causes us to believe that this financial information is not prepared, in all material respects, in accordance with the disclosure provisions in Chapter D of the Securities Regulations (Periodic and Immediate Reports), -1970.

Without qualifying our above conclusion, we draw attention to Note 4 regarding the financial situation of the Company. As at September 30, 2009, the Company is in compliance with the financial covenants set for it, subsequent to receiving revised stipulations for 2009 from the banks on March 15, 2009, which will be adapted to the Company's budget.

The continuation of the Company's activities depends, *inter alia*, on its compliance with the stipulations determined for 2009 and/or further reliefs that will be received during the year. Based on the assessment of the Company's management, the sources of financing available to it will suffice for the Company's operating requirements for the forthcoming year, based on the cash flow forecast approved by the Company's Board of Directors.

Additionally, we draw attention to Note 22 to the Company's annual financial statements as at December 31, 2008, regarding the class action filed against the Company in respect of disruptions to the Company's broadcasts. Based on 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.

Yours sincerely,

Somekh Chaikin

Certified Public Accountants

November 1, 2009

## Condensed Interim Statements of Financial Position

| | September 30 2009 (Unaudited) NIS thousands | September 30 2008 (Unaudited) NIS thousands | December 31 2008 (Audited) NIS thousands |
|---|---|---|---|
| **Assets** | | | |
| Short-term deposits | **3,000** | 3,001 | 3,000 |
| Trade receivables | **151,404** | 150,978 | 152,876 |
| Other receivables | **9,222** | 14,606 | 8,261 |
| **Total current assets** | **163,626** | 168,585 | 164,137 |
| Broadcasting rights, net of rights exercised | **301,722** | 264,113 | 253,333 |
| Property, plant and equipment, net | **679,052** | 678,971 | 671,663 |
| Other intangible assets, net | **61,582** | 38,754 | 42,970 |
| **Total non-current assets** | **1,042,356** | 981,838 | 967,966 |
| **Total assets** | **1,205,982** | 1,150,423 | 1,132,103 |

| | September 30 2009 | September 30 2008 | December 31 2008 |
|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS thousands | NIS thousands | NIS thousands |
| **Liabilities** | | | |
| Credit from banks | **255,400** | 76,505 | 877,202 |
| Current maturities of debentures | **54,710** | - | - |
| Trade payables | **411,857** | 409,112 | 400,280 |
| Other payables | **133,926** | 200,339* | 210,921 |
| Provisions | **8,505** | 7,980* | 8,980 |
| **Total current liabilities** | **864,398** | 693,936 | 1,497,383 |
| Debentures | **624,415** | 657,751 | 654,780 |
| Loans from institutions | **176,674** | 154,327 | 157,700 |
| Bank loans | **668,573** | 846,230 | - |
| Loans from shareholders | **1,916,416** | 1,637,031 | 1,681,515 |
| Other liabilities | **20,402** | 30,029 | 27,812 |
| Employee benefits | **7,444** | 7,453 | 5,051 |
| **Total non-current liabilities** | **3,413,924** | 3,332,821 | 2,526,858 |
| **Total liabilities** | **4,278,322** | 4,026,757 | 4,024,241 |
| **Capital deficit** | | | |
| Share capital | **29** | 29 | 29 |
| Share premium | **85,557** | 85,557 | 85,557 |
| Option warrants | **48,219** | 48,219 | 48,219 |
| Capital reserves | **1,537,271** | 1,537,271 | 1,537,271 |
| Capital reserve for share-based payments | **6,198** | 77 | 1,636 |
| Accumulated deficit | **(4,749,614)** | (4,547,487) | (4,564,850) |
| **Total capital deficit** | **(3,072,340)** | (2,876,334) | (2,892,138) |
| **Total liabilities and capital** | **1,205,982** | 1,150,423 | 1,132,103 |

| Rimon Ben Shaul | Ron Eilon | Katriel Moriah |
|---|---|---|
| (Authorized to sign as chairman of the board**) | CEO | CFO |

* Restated – See Note 2.C.
** See Note 7.

Date of approval of the financial statements: November 1, 2009

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

## Condensed Interim Income Statements

| | Nine months ended | | Three months ended | | Year ended |
|---|---|---|---|---|---|
| | September 30 2009 | September 30 2008 | September 30 2009 | September 30 2008 | December 31 2008 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS thousands | NIS thousands | NIS thousands | NIS thousands | NIS thousands |
| Revenue | **1,140,330** | 1,136,387 | **380,451** | 375,150 | 1,512,632 |
| Cost of revenue | **775,905** | 831,025 | **261,836** | 266,678 | 1,091,171 |
| **Gross profit** | **364,425** | 305,362 | **118,615** | 108,472 | 421,461 |
| Selling and marketing expenses | **90,217** | 98,768 | **28,779** | 28,323 | 128,162 |
| General and administrative expenses | **88,543** | 84,782 | **29,175** | 27,736 | 116,151 |
| | **178,760** | 183,550 | **57,954** | 56,059 | 244,313 |
| **Operating profit** | **185,665** | 121,812 | **60,661** | 52,413 | 177,148 |
| Financing expenses | **148,177** | 172,582 | **57,549** | 61,038 | 229,650 |
| Financing income | **(13,580)** | (22,441) | **(12,978)** | (9,778) | (51,805) |
| Shareholders' financing expenses | **234,901** | 218,477 | **104,205** | 83,280 | 262,961 |
| Financing expenses, net | **369,498** | 368,618 | **148,776** | 134,540 | 440,806 |
| **Loss before income tax** | **(183,833)** | (246,806) | **(88,115)** | (82,127) | (263,658) |
| Income tax | **931** | 410 | **342** | - | 1,048 |
| **Loss for the period** | **(184,764)** | (247,216) | **(88,457)** | (82,127) | (264,706) |
| **Basic and diluted loss per share (in NIS)** | **(6,180)** | (8,241) | **(2,959)** | (2,737) | (8,919) |

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

## Condensed Interim Statements of Comprehensive Profit

| | Nine months ended | | Three months ended | | Year ended |
|---|---|---|---|---|---|
| | September 30 2009 | September 30 2008 | September 30 2009 | September 30 2008 | December 31 2008 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS thousands | NIS thousands | NIS thousands | NIS thousands | NIS thousands |
| Loss for the period | **(184,764)** | (247,216) | (88,457) | (82,127) | (264,706) |
| Other items of comprehensive profit: | | | | | |
| **Actuarial gains from a defined benefit plan (1)** | **-** | - | - | - | 127 |
| Other comprehensive profit for the period | **-** | - | - | - | 127 |
| Total comprehensive loss for the period | **(184,764)** | (247,216) | (88,457) | (82,127) | (264,579) |

Due to first-time adoption of the revised IAS 1 in these financial statements, the presentation format of the statement of comprehensive profit was changed. See also Note 3(1) for a description of first-time adoption of the new standards.

(1) The Company does not recalculate its actuarial commitments in each interim reporting period, unless there are significant changes in the benefit plans or fundamental changes in market conditions during the interim period, which affect the Company's commitments. As a result, actuarial gains or losses in the reporting period are not recognized.

The accompanying notes are an integral part of the 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 |
| **Nine months 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) |
| Movement in the period (unaudited) | | | | | | | |
| Comprehensive loss for the period | **-** | **-** | **-** | **-** | **-** | **(184,764)** | **(184,764)** |
| Share-based payments | **-** | **-** | **-** | **-** | **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)** |
| **Nine months ended September 30, 2008 (unaudited):** | | | | | | | |
| Balance at January 1, 2008 (audited) | 29 | 85,557 | 48,219 | 1,537,271 | - | (4,300,271) | (2,629,195) |
| Movement during the period (unaudited) | | | | | | | |
| Comprehensive loss for the period | - | - | - | - | - | (247,216) | (247,216) |
| Share-based payments (unaudited) | - | - | - | - | 77 | - | 77 |
| **Balance at September 30, 2008 (unaudited)** | 29 | 85,557 | 48,219 | 1,537,271 | 77 | (4,547,487) | (2,876,334) |

Due to first-time adoption of the revised IAS 1 in these financial statements, the presentation format of the statement of changes in equity was changed. See also Note 3(1) for a description of first-time adoption of the new standards.

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

## Condensed Interim Statements of Changes in Shareholders Equity (Contd.)

| | 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 |
| **Three months 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) |
| Movement 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)** |
| **Three months ended September 30, 2008 (unaudited):** | | | | | | | |
| Balance at July 1, 2008 (unaudited) | 29 | 85,557 | 48,219 | 1,537,271 | - | (4,465,360) | (2,794,284) |
| Movement in the period (unaudited) | | | | | | | |
| Comprehensive loss for the period | - | - | - | - | - | (82,127) | (82,127) |
| Share-based payments (unaudited) | - | - | - | - | 77 | - | 77 |
| **Balance at September 30, 2008 (unaudited)** | 29 | 85,557 | 48,219 | 1,537,271 | 77 | (4,547,487) | (2,876,334) |

Due to first-time adoption of the revised IAS 1 in these financial statements, the presentation format of the statement of changes in equity was changed. See also Note 3(1) for a description of first-time adoption of the new standards.

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

## Condensed Interim Statements of Changes in Shareholders Equity (Contd.)

| | 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 |
| **Year ended December 31, 2008 (audited)** | | | | | | | |
| Balance at January 1, 2008 (audited) | 29 | 85,557 | 48,219 | 1,537,271 | - | (4,300,271) | (2,629,195) |
| Movement in 2008 (audited) | | | | | | | |
| Comprehensive loss for the period | - | - | - | - | - | (264,579) | (264,579) |
| Share-based payments | - | - | - | - | 1,636 | - | 1,636 |
| **Balance at December 31, 2008 (audited)** | 29 | 85,557 | 48,219 | 1,537,271 | 1,636 | (4,564,850) | (2,892,138) |

Due to first-time adoption of the revised IAS 1 in these financial statements, the presentation format of the statement of changes in equity was changed. See also Note 3(1) for a description of first-time adoption of the new standards.

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

## Condensed Interim Statements of Cash Flows

| | Nine months ended | | Three months ended | | Year ended |
|---|---|---|---|---|---|
| | September 30 2009 | September 30 2008 | September 30 2009 | September 30 2008 | December 31 2008 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS thousands | NIS thousands | NIS thousands | NIS thousands | NIS thousands |
| **Cash flows from operating activities** | | | | | |
| Loss for the period | **(184,764)** | (247,216) | **(88,457)** | (82,127) | (264,706) |
| **Adjustments** | | | | | |
| Depreciation and amortization | **171,035** | 184,043 | **58,928** | 58,738 | 249,880 |
| Financing costs, net | **356,751** | 340,332 | **156,170** | 120,268 | 426,258 |
| Loss (profit) from the sale of property, plant and equipment | **(191)** | - | **1** | - | (124) |
| Share-based payments | **4,562** | 77 | **1,509** | 77 | 1,636 |
| Income tax expenses | **931** | 410 | **342** | - | 1,048 |
| Change in trade receivables | **1,472** | (5,454) | **3,355** | 5,690 | (7,352) |
| Change in other receivables | **(961)** | (6,340) | **(2,223)** | (2,332) | 5 |
| Change in trade payables | **37,554** | (51,926) | **10,151** | (25,325) | (61,394) |
| Change in other payables and provisions | **(12,649)** | 32,473 | **(19,424)** | 9,115 | 24,544 |
| Change in broadcasting rights net of rights exercised | **(48,389)** | (21,365) | **15,193** | 13,498 | (10,585) |
| Change in employee benefits | **2,394** | (464) | **366** | (28) | 912 |
| Change in other liabilities | **(7,410)** | (5,805) | **(541)** | (341) | (8,022) |
| | **505,099** | 465,981 | **223,827** | 179,360 | 616,806 |
| Income tax paid | **(1,246)** | (5,073) | **(342)** | - | (5,073) |
| **Net cash flows from operating activities** | **319,089** | 213,692 | **135,028** | 97,233 | 347,027 |
| **Cash flows for investing activities** | | | | | |
| Interest received | **-** | 35 | **-** | - | 76 |
| Acquisition of property, plant and equipment | **(174,485)** | (144,720) | **(72,635)** | (46,705) | (198,208) |
| Sale of property, plant and equipment | **578** | - | **578** | - | - |
| Acquisition of other intangible assets | **(10,636)** | (9,646) | **(5,449)** | (1,664) | (12,643) |
| Payments for subscriber acquisition | **(23,615)** | (20,403) | **(9,304)** | (7,481) | (26,690) |
| **Net cash used for investing activities** | **(208,158)** | (174,734) | **(86,810)** | (55,850) | (237,465) |

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

## Condensed Interim Statements of Cash Flows (cont.)

| | Nine months ended | | Three months ended | | Year ended |
|---|---|---|---|---|---|
| | September 30 2009 | September 30 2008 | September 30 2009 | September 30 2008 | December 31 2008 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS thousands | NIS thousands | NIS thousands | NIS thousands | NIS thousands |
| **Cash flows for financing activities** | | | | | |
| Short-term credit from banks, net | **46,771** | (4,938) | **6,148** | (40,084) | (50,471) |
| Interest paid | **(157,702)** | (34,020) | **(54,366)** | (1,299) | (59,091) |
| **Net cash used for financing activities** | **(110,931)** | (38,958) | **(48,218)** | (41,383) | (109,562) |
| **Change in cash and cash equivalents** | **-** | - | **-** | - | - |
| **Cash and cash equivalents for beginning of period** | **-** | - | **-** | - | - |
| **Cash and cash equivalents for end of period** | **-** | - | **-** | - | - |

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

## NOTE 1 – REPORTING ENTITY

DBS Satellite Services (1998) Ltd. (“the Company”) was incorporated in Israel on December 2, 1998. The Company’s head office is at 6, Hayozma St., Kfar Saba, Israel.
In January 1999, the Company received a license from the Ministry of Communications to broadcast satellite television to subscribers (“the License”). The broadcasting license is valid until January 2014 and can be extended for a further six years under certain conditions. The Company is subject to the Communications (Telecommunications and Broadcasts) Law 5742-1982 (“the Communications Law”) and its subsequent regulations and rules and to the license terms.
In July 2000, the Company started to provide multichannel television to its subscribers under the license and pursuant to the Communications Law.
Under the license of Bezeq The Israel Telecommunication Corporation Limited (“Bezeq”), Bezeq is required to maintain full structural separation between it and its subsidiaries, including the Company. Additionally, on March 31, 2004, the Minister of Communications published a document banning certain business alliances between Bezeq and its subsidiaries, including the Company, unless, inter alia, there is a material deterioration in the competitive status of the Company. The Ministry is considering the approval of certain exemptions regarding the restrictions relating to the alliances while amending the license. This process has not yet been completed.
On February 3, 2009, the Antitrust Tribunal approved the merger (as defined in the Antitrust Law, 5748-1988) between the Company and Bezeq by exercising the options held by Bezeq into Company shares, subject to certain conditions. According to announcements made by Bezeq to the public, the Antitrust Authority and Eurocom DBS Ltd. appealed the court ruling and Bezeq filed a counter petition against the amount of the bank guarantee that was ruled as part of the merger terms. Additionally, after the Antitrust Tribunal dismissed the motion of the Antitrust Authority to postpone the implementation of the ruling and the Antitrust Authority filed another motion at the Supreme Court to postpone the implementation, Bezeq and the Antitrust Authority reached an agreement at the recommendation of the court, which received the validity of judgment, to postpone implementation of the merger. It further arises from the reports that on April 30, 2009, the Board of Directors of Bezeq resolved to implement the merger under the conditions prescribed in the ruling of the Antitrust Tribunal and to inform the Antitrust Tribunal and the Supreme Court of this decision, without derogating from Bezeq’s claims in the counter petition. Implementation of the merger was subject to the decision of the Supreme Court regarding the counter petition filed against approval of the merger. In August 2009, the Supreme Court accepted the Antitrust Commissioner’s appeal of the ruling of the Antitrust Tribunal, and decided not to approve the merger.
Further to the announcement of the Second Authority, Digital Terrestrial TV (DTT) broadcasts started on August 2, 2009. The Company believes that DTT broadcasts could have a negative effect on its revenue.

## NOTE 2 - BASIS OF PREPARATION

### A. Statement of compliance

The condensed interim financial statements have been prepared in accordance with IAS 34, *Interim Financial Reporting*, and do not include all of the information required for full annual financial statements. They should be read in conjunction with the financial statements for the year ended December 31, 2008 (“the Annual Report”). Additionally, these statements were prepared in accordance with Chapter D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

The condensed interim financial statements were approved by the Board of Directors of the Company on November 1, 2009.

## NOTE 2 - BASIS OF PREPARATION (CONTD.)

### B. Use of estimates and judgments

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

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

### C. Reclassified amounts

In the financial statements of December 31, 2008, the provisions balance was presented as a separate item from the other payables balance of the Company's financial reports. Comparative figures at September 30, 2008 were reclassified accordingly so that other payables decreased by NIS 8 million.

## NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES

With the exception of the contents of section (1) below, the Company's accounting policy in these condensed interim statements is the same policy applied in the annual statements.
The changes made in the accounting policy for the preparation of the condensed interim financial statements and their effect are described below:

### (1) Initial application of new Accounting Standards

#### A. Presentation of financial statements

Commencing from January 1, 2009, the Company applies IAS 1 – *Presentation of Financial Statements*, revised ("the Standard"). The Standard permits the presentation of one statement of comprehensive profit (a statement combining profit or loss and other comprehensive profit) or two statements (a separate income statement and a statement of comprehensive profit). The Company opted to present income and expenses and other comprehensive profit in two separate statements – an income statement followed by a statement of comprehensive profit. The Company also presents a statement of changes in equity instead of disclosure in the notes, immediately after the statement of comprehensive profit. The statement includes changes in equity arising from transactions with owners in their capacity as owners (such as dividends, transactions with controlling shareholders, share issues and options). The Standard is applied retrospectively.

#### B. Employee benefits

Commencing from January 1, 2009, the Company applies IAS 19 – *Employee Benefits*, revised ("the Amendment"), in accordance with Improvements to International Financial Reporting Standards 2008 (Improvements to IFRSs). The amendment addresses the definition of "short-term employee benefits" and "other long-term employee benefits referring to when the benefits are due to be settled. Application of the revised standard did not have a material effect on the Company's financial statements.

## NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

**(2) New standards not yet adopted**

Amendments to IFRS 2 – *Share-Based Payment* ("the Amendments") – cash-settled share-based payment transactions. The amendments address IFRS 2 and replace IFRIC 8 and IFRIC 11. The amendments provide guidance on the accounting for share-based payment transactions among group entities, for both the entity that receives the goods or services and for the entity that settles the transaction.
Under the amendments, the entity receiving the goods or services will recognize the transaction as an equity-settled share-based payment when the entity awards its own equity instruments in the transaction, or when the entity has no obligation to settle the transaction. In all other circumstances, the entity will measure the transaction as a cash-settled share-based payment.
The entity that settles the award will measure the transaction as an equity-settled share-based payment only when it settles the transaction with the other equity instruments, otherwise, the entity will measure the transaction as a cash-settled share-based payment. The amendments are to be applied retrospectively for annual accounting periods commencing on or after January 1, 2010. Early application is permitted.
Application of the standard is not expected to have a material effect on the Company's financial statements.

## NOTE 4 – THE FINANCIAL POSITION OF THE COMPANY

**A.** Since the beginning of its operations, the Company has accumulated substantial losses. The Company's losses in 2008 amounted to NIS 265 million and the losses in the nine months ended September 30, 2009 amounted to NIS 185 million. As a result of these losses, the capital deficit and working capital deficit at September 30, 2009 amounted to NIS 3.072 billion and NIS 701 million, respectively.

**B.** The balance of the Company's bank loans and credit facility at September 30. 2009 was NIS 960 million, imposing various restrictions on the Company, including, inter alia, restrictions on providing a lien on or sale of certain assets, a restriction on receipt of credit from other banks without prior approval, a restriction concerning repayment of shareholders' loans, and a requirement for compliance with financial covenants ("the Conditions").

1. In January 2009, the Company applied to the banks requesting revision of the stipulations for 2009 so as to adapt them to the 2009 budget. On March 15, 2009, the banks agreed to amend the stipulations.

2. As at September 30, 2009, the Company is in compliance with the covenants set for it.

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

## NOTE 5 – CONTINGENT LIABILITIES

### Agreements

In June 2009, Israel Aerospace Industries (IAI) demanded immediate payment of the balance of the Company's debt for the use of the Amos 1 satellite and payment of interest and other amounts allegedly due to IAI under the agreement. In September 2009, the Company and IAI signed an agreement settling all the financial disputes that arose between the parties.

### Lawsuits

During the normal course of business, legal claims are filed against the Company, including applications for certification as class actions.

In the opinion of the Company's management, which is based, *inter alia*, on legal opinions as to the likelihood of success of the claims, including the application for certification of the class actions, the financial statements include appropriate provisions, where required, to cover the exposure resulting from such claims.

The additional exposure due to claims filed against the Company on various matters and in which the likelihood of realization is possible, amounts to NIS 253 million.

A detailed description of these contingent liabilities appear in Note 22 to the annual statements as at December 31, 2008.

There have been no material changes in the lawsuits up to the approval of these financial statements, with the exception of the following:

In April 2009, two claims were filed against the Company on behalf of 21 technicians (20 former employees of the Company and one technician who is still employed by the Company), in the amount of NIS 1.3 million. According to the claims, the Company owes the technicians for various salary components which were allegedly unpaid and the Company has withheld part of their wages. A statement of defense was filed in July 2009.

Further to Note 22.2.A to the financial statements as at December 31, 2008, in June 2009 the appeal and counter petition were brought before the Supreme Court. At the recommendation of the Court, it was agreed to dismiss the appeal and counter petition, without an order to pay costs and without the Court expressing any opinion on the ruling of the district court regarding the compensation and attorneys' fees.

Further to Note 22.2.B to the financial statements as at December 31, 2008, in September 2009, the application for certification as a class action was summarily dismissed, without an order to pay costs.
Further to Note 22.2.C to the financial statements as at December 31, 2008, in June 2009 a settlement agreement was signed to the effect that without admitting to any of the claims, the Company will compensate subscribers from whose deposits depreciation was alleged to have been unlawfully collected, existing subscribers of the Company will be entitled to view three DVDbox movies free of charge and subscribers who had left YES will be entitled to monetary compensation of NIS 25 or NIS 50 as set out in the agreement, or to five DVDbox movies free of charge should they choose to rejoin the Company's broadcasts. It was further determined that the lead plaintiff will be entitled to payment of NIS 50,000 and her attorneys will be entitled to payment of NIS 450,000. The court at which the agreement was submitted for approval ruled that this was an appropriate and reasonable arrangement and allowed the Company to publish an initial notice in this regard, which was published on June 18, 2009. On September 1, 2009, a motion was filed with the consent of the parties to approve the settlement, and on September 2, 2009, the agreement was given the validity of judgment. On September 14, 2009, a second notice was issued to the public.
Further to Note 22.2.H to the financial statements as at December 31, 2008, in August 2009 the parties filed (with consent) a motion to strike the applicant from the motion for approval and to dismiss the claim, with a token payment to the applicant and her attorney.

## NOTE 5 – CONTINGENT LIABILITIES (CONTD.)

**Lawsuits (contd.)**

Further to Note 22.2.Ito the financial statements as at December 31, 2008, in July 2009 the district court approved the claim filed by the applicant as a class action, solely for the contractual reason. Regarding the damage, the court ruled that the alleged damage relates to the proportionate amounts that were collected for the channels whose broadcasts were terminated, after termination of the broadcasts on January 15, 2008.
The court defined the group (including the Company's customers who paid for viewing the science and nature package and whose subscription fees were not terminated or reduced after the channels were no longer broadcasted up to August 18, 2008), and ruled that the remedy claimed is the refund of the proportionate payment paid by the group members for viewing both channels.
The court further ruled that the key question common to the group members is whether the wording of the relevant instructions in the subscriber agreement credits the group members by reducing their subscription fees (proportionately) after termination of the broadcasts of the channels that were included in the package up to January 15, 2008. The parties are in the preliminary stages of negotiations for a settlement.

## NOTE 6 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES

Further to Note 20.C.1 to the financial statements as at December 31 2008, in July 2009 the board of directors of the Company approved an amendment to the CEO's employment agreement. Under the amendment, the undertaking to grant option warrants of the Company was cancelled and it was determined that the CEO is entitled to financial bonuses. Consequently, the Company included a liability in its financial statements that reflects the amounts of the unpaid bonuses according to this amendment.

## NOTE 7 – APPOINTMENT OF THE CHAIRMAN OF THE BOARD FOR THE APPROVAL MEETING

On the approval date of the financial statements, the Company did not have a chairman of the board. As a result, the board of directors authorized Mr. Rimon Ben Shaul to serve as chairman at the board meeting convened to approve the financial statements, and subsequently to sign the Company's financial statements as at September 30, 2009.