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**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**F O R M 6-K**

**REPORT OF FOREIGN PRIVATE ISSUER PURSUANT TO RULE 13a-16 OR 15d-16 UNDER  
THE SECURITIES EXCHANGE ACT OF 1934**

**For the month of August 2011**

**B COMMUNICATIONS LTD.**

(Name of Registrant)

**2 Dov Friedman Street, Ramat Gan 52503, Israel**

(Address of Principal Executive Office)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F ☒

Form 40-F ☐

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): ☐

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): ☐

Indicate by check mark whether by furnishing the information contained in this Form, the registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes ☐

No ☒

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82- \_\_\_\_\_

This Form 6-K is being incorporated by reference into the Registrant's Form S-8 Registration Statement File No. 333-150173.

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B COMMUNICATIONS LTD.

The following exhibits are attached:

The attached exhibits pertain to the Registrant's controlled subsidiary, Bezeq The Israel Telecommunication Corp. Ltd., ("Bezeq" and together with its subsidiaries, "the Company"):

- 99.1 Condensed Consolidated Interim Financial Statements (Unaudited) of the Company dated June 30, 2011.
  - 99.2 Directors' Report on the State of the Company's Affairs for the six month and three-month periods ended June 30, 2011.
  - 99.3 Update of Chapter A (Description of Company Operations) of the Periodic Report for 2010.
  - 99.4 Bezeq Separate Condensed Interim Financial Information June 30, 2011 (Unaudited).
  - 99.5 DBS Satellite Services (1998) Ltd. Condensed Interim Financial Statements as at June 30, 2011 (Unaudited).
  - 99.6 Report on the Liabilities of the Reporting Corporation and Companies that that are Consolidated or Proportionately Consolidated in the Financial Statements as at June 30, 2011.
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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

B COMMUNICATIONS LTD.  
(Registrant)

By: /s/ Eli Holtzman  
Eli Holtzman  
Chief Executive Officer

Date: August 16, 2011

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## EXHIBIT INDEX

The attached exhibits pertain to the Registrant's controlled subsidiary, Bezeq The Israel Telecommunication Corp. Ltd., ("Bezeq" and together with its subsidiaries, "the Company"):

| <u>EXHIBIT NO.</u> | <u>DESCRIPTION</u> |
|--------------------|--------------------|
|--------------------|--------------------|

|      |                                                                                                                                                                                  |
|------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 99.1 | Condensed Consolidated Interim Financial Statements (Unaudited) of the Company dated June 30, 2011.                                                                              |
| 99.2 | Directors' Report on the State of the Company's Affairs for the six month and three-month periods ended June 30, 2011.                                                           |
| 99.3 | Update of Chapter A (Description of Company Operations) of the Periodic Report for 2010.                                                                                         |
| 99.4 | Bezeq Separate Condensed Interim Financial Information June 30, 2011 (Unaudited).                                                                                                |
| 99.5 | DBS Satellite Services (1998) Ltd. Condensed Interim Financial Statements as at June 30, 2011 (Unaudited).                                                                       |
| 99.6 | Report on the Liabilities of the Reporting Corporation and Companies that that are Consolidated or Proportionately Consolidated in the Financial Statements as at June 30, 2011. |

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**BEZEQ THE ISRAEL TELECOMMUNICATION  
CORPORATION LTD.**

**CONDENSED CONSOLIDATED INTERIM  
FINANCIAL STATEMENTS**

**JUNE 30, 2011**

**(UNAUDITED)**

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

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Condensed Consolidated Interim Financial Statements as at June 30, 2011 (unaudited)

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

*Introduction*

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

We did not review the condensed interim financial information of certain consolidated subsidiaries whose assets constitute 2.37% of the total consolidated assets as of June 30,2011, and whose revenues constitute 1.72% and 1.78% of the total consolidated revenues for the six and three month periods then ended, respectively. The condensed interim financial information of those companies was reviewed by other auditors whose review reports thereon were furnished to us, and our conclusion, insofar as it relates to amounts emanating from the financial information of such companies, is based solely on the said review reports of the other auditors.

*Scope of Review*

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

*Conclusion*

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

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

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

Somekh Chaikin  
Certified Public Accountants (Isr.)

August 1, 2011

## Condensed Consolidated Interim Statements of Financial Position

|                                                          | June 30, 2011<br>(Unaudited)<br>NIS millions | June 30, 2010<br>(Unaudited)<br>NIS millions | December 31,<br>2010<br>(Audited)<br>NIS millions |
|----------------------------------------------------------|----------------------------------------------|----------------------------------------------|---------------------------------------------------|
| <b>Assets</b>                                            |                                              |                                              |                                                   |
| Cash and cash equivalents                                | 463                                          | 195                                          | 365                                               |
| Investments, including derivatives                       | 24                                           | 47                                           | 7                                                 |
| Trade receivables                                        | 2,855                                        | 2,678                                        | 2,701                                             |
| Other receivables                                        | 233                                          | 266                                          | 227                                               |
| Inventories                                              | 277                                          | 169                                          | 178                                               |
| Assets classified as held for sale                       | 20                                           | 38                                           | 29                                                |
| <b>Total current assets</b>                              | <b>3,872</b>                                 | <b>3,393</b>                                 | <b>3,507</b>                                      |
| Investments, including derivatives                       | 112                                          | 138                                          | 129                                               |
| Trade and other receivables                              | 1,474                                        | 940                                          | 1,114                                             |
| Property, plant and equipment                            | 5,890                                        | 5,513                                        | 5,610                                             |
| Intangible assets                                        | 2,269                                        | 2,058                                        | 2,248                                             |
| Deferred and other expenses                              | 274                                          | 308                                          | 292                                               |
| Investments in equity-accounted investees (mainly loans) | 1,050                                        | 1,136                                        | 1,084                                             |
| Deferred tax assets                                      | 259                                          | 334                                          | 254                                               |
| <b>Total non-current assets</b>                          | <b>11,328</b>                                | <b>10,427</b>                                | <b>10,731</b>                                     |
| <b>Total assets</b>                                      | <b>15,200</b>                                | <b>13,820</b>                                | <b>14,238</b>                                     |

## Condensed Consolidated Interim Statements of Financial Position

|                                                            | <u>June 30, 2011</u> | <u>June 30, 2010</u> | <u>December 31,</u> |
|------------------------------------------------------------|----------------------|----------------------|---------------------|
|                                                            | <u>(Unaudited)</u>   | <u>(Unaudited)</u>   | <u>(Audited)</u>    |
|                                                            | <u>NIS millions</u>  | <u>NIS millions</u>  | <u>NIS millions</u> |
| <b>Liabilities</b>                                         |                      |                      |                     |
| Debentures, loans and borrowings                           | 1,249                | 1,182                | 949                 |
| Trade payables                                             | 1,005                | 988                  | 1,061               |
| Other payables, including derivatives                      | 855                  | 652                  | 770                 |
| Current tax liabilities                                    | 309                  | 195                  | 267                 |
| Deferred income                                            | 39                   | 33                   | 33                  |
| Provisions                                                 | 253                  | 371                  | 251                 |
| Employee benefits                                          | 488                  | 454                  | 269                 |
| Dividend payable (see Note 6)                              | 972                  | -                    | -                   |
| <b>Total current liabilities</b>                           | <b>5,170</b>         | <b>3,875</b>         | <b>3,600</b>        |
| Debentures                                                 | 2,034                | 1,995                | 1,967               |
| Bank loans                                                 | 3,701                | 2,052                | 2,801               |
| Employee benefits                                          | 267                  | 295                  | 305                 |
| Other liabilities                                          | 43                   | 5                    | 43                  |
| Provisions                                                 | 70                   | 73                   | 69                  |
| Deferred tax liabilities                                   | 66                   | 76                   | 83                  |
| Dividend payable (see Note 6)                              | 1,369                | -                    | -                   |
| <b>Total non-current liabilities</b>                       | <b>7,550</b>         | <b>4,496</b>         | <b>5,268</b>        |
| <b>Total liabilities</b>                                   | <b>12,720</b>        | <b>8,371</b>         | <b>8,868</b>        |
| <b>Equity</b>                                              |                      |                      |                     |
| Total equity attributable to equity holders of the Company | 2,438                | 5,400                | 5,327               |
| Non-controlling interests                                  | 42                   | 49                   | 43                  |
| <b>Total equity</b>                                        | <b>2,480</b>         | <b>5,449</b>         | <b>5,370</b>        |
| <b>Total equity and liabilities</b>                        | <b>15,200</b>        | <b>13,820</b>        | <b>14,238</b>       |

**Shaul Elovitch**  
Chairman of the Board of Directors

**Avi Gabbay**  
CEO

**Alan Gelman**  
Deputy CEO and CFO

Date of approval of the financial statements: August 1, 2011

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

## Condensed Consolidated Interim Statements of Income

|                                                      | Six months ended |              | Three months ended |              | Year ended   |
|------------------------------------------------------|------------------|--------------|--------------------|--------------|--------------|
|                                                      | June 30          |              | June 30            |              | December 31  |
|                                                      | 2011             | 2010         | 2011               | 2010         | 2010         |
|                                                      | (Unaudited)      | (Unaudited)  | (Unaudited)        | (Unaudited)  | (Audited)    |
|                                                      | NIS millions     | NIS millions | NIS millions       | NIS millions | NIS millions |
| <b>Continuing operations</b>                         |                  |              |                    |              |              |
| Revenues (Note 8)                                    | 5,806            | 5,896        | 2,893              | 2,981        | 11,987       |
| <b>Costs and expenses</b>                            |                  |              |                    |              |              |
| Depreciation and amortization                        | 683              | 691          | 348                | 348          | 1,409        |
| Salaries                                             | 1,072            | 994          | 540                | 489          | 2,024        |
| General and operating expenses (Note 9)              | 2,263            | 2,442        | 1,132              | 1,224        | 5,026        |
| Other operating expenses (income), net               | 188              | (95)         | (62)               | (70)         | (216)        |
|                                                      | 4,206            | 4,032        | 1,958              | 1,991        | 8,243        |
| Operating profit                                     | 1,600            | 1,864        | 935                | 990          | 3,744        |
| <b>Financing income (expenses)</b>                   |                  |              |                    |              |              |
| Financing expenses                                   | 259              | 137          | 157                | 101          | 391          |
| Financing income                                     | (177)            | (124)        | (95)               | (66)         | (282)        |
| Financing expenses, net                              | 82               | 13           | 62                 | 35           | 109          |
| Segment profit (loss) after financing expenses, net  | 1,518            | 1,851        | 873                | 955          | 3,635        |
| <b>Share of losses of equity-accounted investees</b> | 137              | 109          | 72                 | 86           | 261          |
| Profit before income tax                             | 1,381            | 1,742        | 801                | 869          | 3,374        |
| <b>Income tax</b>                                    | 390              | 462          | 216                | 231          | 932          |
| <b>Profit for the period</b>                         | 991              | 1,280        | 585                | 638          | 2,442        |
| <b>Attributable to:</b>                              |                  |              |                    |              |              |
| Owners of the Company                                | 992              | 1,280        | 585                | 638          | 2,443        |
| Non-controlling interests                            | (1)              | * -          | -                  | * -          | (1)          |
| <b>Profit for the period</b>                         | 991              | 1,280        | 585                | 638          | 2,442        |
| <b>Earnings per share</b>                            |                  |              |                    |              |              |
| Basic earnings per share (NIS)                       | 0.37             | 0.48         | 0.22               | 0.24         | 0.91         |
| Diluted earnings per share (NIS)                     | 0.36             | 0.47         | 0.21               | 0.24         | 0.90         |

\* Less than NIS 500,000

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

## Condensed Consolidated Interim Statements of Comprehensive Income

|                                                              | Six months ended |              | Three months ended |              | Year ended   |
|--------------------------------------------------------------|------------------|--------------|--------------------|--------------|--------------|
|                                                              | June 30          |              | June 30            |              | December 31  |
|                                                              | 2011             | 2010         | 2011               | 2010         | 2010         |
|                                                              | (Unaudited)      | (Unaudited)  | (Unaudited)        | (Unaudited)  | (Audited)    |
|                                                              | NIS millions     | NIS millions | NIS millions       | NIS millions | NIS millions |
| <b>Profit for the period</b>                                 | <b>991</b>       | 1,280        | <b>585</b>         | 638          | 2,442        |
| Other comprehensive profit (loss) for the period, net of tax | (1)              | -            | (1)                | 1            | 13           |
| <b>Total comprehensive income for the period</b>             | <b>990</b>       | 1,280        | <b>584</b>         | 639          | 2,455        |
| Attributable to:                                             |                  |              |                    |              |              |
| Owners of the Company                                        | 991              | 1,280        | 584                | 639          | 2,456        |
| Non-controlling interests                                    | (1)              | - *          | -                  | - *          | (1)          |
| <b>Total comprehensive income for the period</b>             | <b>990</b>       | 1,280        | <b>584</b>         | 639          | 2,455        |

\* Less than NIS 500,000

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

## Condensed Consolidated Interim Statements of Changes in Equity

|                                                                                                     | Share<br>capital | Share<br>premium | Capital<br>reserve<br>for<br>options<br>for<br>employees | Capital<br>reserve for a<br>transaction<br>between a<br>corporation<br>and a<br>controlling<br>shareholder | Other<br>reserves * | Deficit        | Total        | Non-<br>controlling<br>interests | Total equity |
|-----------------------------------------------------------------------------------------------------|------------------|------------------|----------------------------------------------------------|------------------------------------------------------------------------------------------------------------|---------------------|----------------|--------------|----------------------------------|--------------|
|                                                                                                     | NIS millions     | NIS millions     | NIS millions                                             | NIS millions                                                                                               | NIS millions        | NIS millions   | NIS millions | NIS millions                     | NIS millions |
| Attributable to owners of the Company                                                               |                  |                  |                                                          |                                                                                                            |                     |                |              |                                  |              |
| <b>Six months ended June 30, 2011</b>                                                               |                  |                  |                                                          |                                                                                                            |                     |                |              |                                  |              |
| (unaudited)                                                                                         |                  |                  |                                                          |                                                                                                            |                     |                |              |                                  |              |
| Balance at January 1, 2011 (audited)                                                                | 6,213            | 378              | 146                                                      | 390                                                                                                        | (10)                | (1,790)        | 5,327        | 43                               | 5,370        |
| Profit for the period (unaudited)                                                                   | -                | -                | -                                                        | -                                                                                                          | -                   | 992            | 992          | (1)                              | 991          |
| Other comprehensive income for the period (audited)                                                 | -                | -                | -                                                        | -                                                                                                          | (1)                 | -              | (1)          | -                                | (1)          |
| Total comprehensive income for the period (unaudited)                                               | -                | -                | -                                                        | -                                                                                                          | (1)                 | 992            | 991          | (1)                              | 990          |
| <b>Transactions with owners recognized directly in equity</b>                                       |                  |                  |                                                          |                                                                                                            |                     |                |              |                                  |              |
| Dividends to Company shareholders not in compliance with the earnings test (unaudited) (see Note 6) | (2,415)          | (396)            | -                                                        | -                                                                                                          | -                   | -              | (2,811)      | -                                | (2,811)      |
| Dividend to Company shareholders (unaudited)                                                        | -                | -                | -                                                        | -                                                                                                          | -                   | (1,163)        | (1,163)      | -                                | (1,163)      |
| Share-based payments(unaudited)                                                                     | -                | -                | 84                                                       | -                                                                                                          | -                   | -              | 84           | -                                | 84           |
| Exercise of options for shares (unaudited)                                                          | 16               | 53               | (59)                                                     | -                                                                                                          | -                   | -              | 10           | -                                | 10           |
| <b>Balance at June 30, 2011 (unaudited)</b>                                                         | <b>3,814</b>     | <b>35</b>        | <b>171</b>                                               | <b>390</b>                                                                                                 | <b>(11)</b>         | <b>(1,961)</b> | <b>2,438</b> | <b>42</b>                        | <b>2,480</b> |
| <b>Six months ended June 30, 2010</b>                                                               |                  |                  |                                                          |                                                                                                            |                     |                |              |                                  |              |
| (unaudited)                                                                                         |                  |                  |                                                          |                                                                                                            |                     |                |              |                                  |              |
| Balance at January 1, 2010 (audited)                                                                | 6,187            | 275              | 210                                                      | 390                                                                                                        | (5)                 | (513)          | 6,544        | (6)                              | 6,538        |
| Profit for the period (unaudited)                                                                   | -                | -                | -                                                        | -                                                                                                          | -                   | 1,280          | 1,280        | -                                | 1,280        |
| Transactions with owners recognized directly in equity                                              |                  |                  |                                                          |                                                                                                            |                     |                |              |                                  |              |
| Dividend to Company shareholders (unaudited)                                                        | -                | -                | -                                                        | -                                                                                                          | -                   | (2,453)        | (2,453)      | -                                | (2,453)      |
| Share-based payments(unaudited)                                                                     | -                | -                | 11                                                       | -                                                                                                          | -                   | -              | 11           | -                                | 11           |
| Exercise of options for shares(unaudited)                                                           | 16               | 70               | (68)                                                     | -                                                                                                          | -                   | -              | 18           | -                                | 18           |
| Non-controlling interests in a business combination (unaudited)                                     | -                | -                | -                                                        | -                                                                                                          | -                   | -              | -            | 55                               | 55           |
| <b>Balance at June 30, 2010 (unaudited)</b>                                                         | <b>6,203</b>     | <b>345</b>       | <b>153</b>                                               | <b>390</b>                                                                                                 | <b>(5)</b>          | <b>(1,686)</b> | <b>5,400</b> | <b>49</b>                        | <b>5,449</b> |

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

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

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

|                                                                 | Share<br>capital | Share<br>premium | Capital<br>reserve<br>for<br>options<br>for<br>employees | Capital<br>reserve<br>for a<br>transaction<br>between a<br>corporation<br>and a<br>controlling<br>shareholder | Other<br>reserves * | Deficit      | Total        | Non-<br>controlling<br>interests | Total equity |
|-----------------------------------------------------------------|------------------|------------------|----------------------------------------------------------|---------------------------------------------------------------------------------------------------------------|---------------------|--------------|--------------|----------------------------------|--------------|
|                                                                 | NIS millions     | NIS millions     | NIS millions                                             | NIS millions                                                                                                  | NIS millions        | NIS millions | NIS millions | NIS millions                     | NIS millions |
| Attributable to owners of the Company                           |                  |                  |                                                          |                                                                                                               |                     |              |              |                                  |              |
| <b>Three months ended June 30, 2011 (unaudited)</b>             |                  |                  |                                                          |                                                                                                               |                     |              |              |                                  |              |
| Balance at April 1, 2011 (unaudited)                            | 3,803            | -                | 170                                                      | 390                                                                                                           | (10)                | (1,383)      | 2,970        | 42                               | 3,012        |
| Profit for the period (unaudited)                               | -                | -                | -                                                        | -                                                                                                             | -                   | 585          | 585          | -                                | 585          |
| Other comprehensive income for the period (unaudited)           | -                | -                | -                                                        | -                                                                                                             | (1)                 | -            | (1)          | -                                | (1)          |
| Comprehensive income for the period (unaudited)                 | -                | -                | -                                                        | -                                                                                                             | (1)                 | 585          | 584          | -                                | 584          |
| <b>Transactions with owners recognized directly in equity</b>   |                  |                  |                                                          |                                                                                                               |                     |              |              |                                  |              |
| Dividend to Company shareholders (unaudited)                    | -                | -                | -                                                        | -                                                                                                             | -                   | (1,163)      | (1,163)      | -                                | (1,163)      |
| Share-based payments(unaudited)                                 | -                | -                | 41                                                       | -                                                                                                             | -                   | -            | 41           | -                                | 41           |
| Exercise of options for shares(unaudited)                       | 11               | 35               | (40)                                                     | -                                                                                                             | -                   | -            | 6            | -                                | 6            |
| Balance at June 30, 2011 (unaudited)                            | 3,814            | 35               | 171                                                      | 390                                                                                                           | (11)                | (1,961)      | 2,438        | 42                               | 2,480        |
| <b>Three months ended June 30, 2010 (unaudited)</b>             |                  |                  |                                                          |                                                                                                               |                     |              |              |                                  |              |
| Balance at April 1, 2011 (unaudited)                            | 6,201            | 338              | 154                                                      | 390                                                                                                           | (6)                 | 129          | 7,206        | (6)                              | 7,200        |
| Profit for the period (unaudited)                               | -                | -                | -                                                        | -                                                                                                             | -                   | 638          | 638          | -                                | 638          |
| Other comprehensive income for the period (audited)             | -                | -                | -                                                        | -                                                                                                             | 1                   | -            | 1            | -                                | 1            |
| Total comprehensive income for the period (unaudited)           | -                | -                | -                                                        | -                                                                                                             | 1                   | 638          | 639          | -                                | 639          |
| <b>Transactions with owners recognized directly in equity</b>   |                  |                  |                                                          |                                                                                                               |                     |              |              |                                  |              |
| Dividend to Company shareholders (unaudited)                    | -                | -                | -                                                        | -                                                                                                             | -                   | (2,453)      | (2,453)      | -                                | (2,453)      |
| Share-based payments(unaudited)                                 | -                | -                | 5                                                        | -                                                                                                             | -                   | -            | 5            | -                                | 5            |
| Exercise of options for shares(unaudited)                       | 2                | 7                | (6)                                                      | -                                                                                                             | -                   | -            | 3            | -                                | 3            |
| Non-controlling interests in a business combination (unaudited) | -                | -                | -                                                        | -                                                                                                             | -                   | -            | -            | 55                               | 55           |
| Balance at June 30, 2011 (unaudited)                            | 6,203            | 345              | 153                                                      | 390                                                                                                           | (5)                 | (1,686)      | 5,400        | 49                               | 5,449        |

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

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

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

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

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

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

## Condensed Consolidated Interim Statements of Cash Flows

|                                                                               | Six months ended |              | Three months ended |              | Year ended     |
|-------------------------------------------------------------------------------|------------------|--------------|--------------------|--------------|----------------|
|                                                                               | June 30          |              | June 30            |              | December 31    |
|                                                                               | 2011             | 2010         | 2011               | 2010         | 2010           |
|                                                                               | (Unaudited)      | (Unaudited)  | (Unaudited)        | (Unaudited)  | (Audited)      |
|                                                                               | NIS millions     | NIS millions | NIS millions       | NIS millions | NIS millions   |
| <b>Cash flows from operating activities</b>                                   |                  |              |                    |              |                |
| Profit for the period                                                         | 991              | 1,280        | 585                | 638          | 2,442          |
| Adjustments:                                                                  |                  |              |                    |              |                |
| Depreciation                                                                  | 527              | 546          | 268                | 274          | 1,114          |
| Amortization of intangible assets                                             | 143              | 133          | 73                 | 68           | 269            |
| Amortization of deferred and other expenses                                   | 13               | 12           | 7                  | 6            | 26             |
| Profit from a controlling shareholder in an investee                          | -                | (57)         | -                  | (57)         | (57)           |
| Share of losses of equity-accounted investees                                 | 137              | 109          | 72                 | 86           | 261            |
| Financing expenses, net                                                       | 119              | 34           | 83                 | 40           | 113            |
| Capital gain, net                                                             | (87)             | (29)         | (43)               | (2)          | (171)          |
| Share-based payment                                                           | 84               | 11           | 41                 | 5            | 35             |
| Income tax expenses                                                           | 390              | 462          | 216                | 231          | 932            |
| Expenses (income) for derivatives, net                                        | -                | (8)          | -                  | (12)         | 10             |
| Change in inventory                                                           | (104)            | 93           | (34)               | 15           | 84             |
| Change in trade and other receivables                                         | (507)            | (244)        | (186)              | (72)         | (300)          |
| Change in trade and other payables                                            | (69)             | (156)        | (164)              | (14)         | (21)           |
| Change in provisions                                                          | 2                | (12)         | (7)                | (8)          | (136)          |
| Change in employee benefits                                                   | 182              | (53)         | (49)               | (28)         | (215)          |
| Net income tax paid                                                           | (376)            | (339)        | (192)              | (194)        | (690)          |
| <b>Net cash from operating activities</b>                                     | <b>1,445</b>     | <b>1,782</b> | <b>670</b>         | <b>976</b>   | <b>3,696</b>   |
| <b>Cash flow used in investing activities</b>                                 |                  |              |                    |              |                |
| Investment in intangible assets and deferred expenses                         | (158)            | (158)        | (80)               | (70)         | (343)          |
| Proceeds from the sale of property, plant and equipment and deferred expenses | 236              | 41           | 49                 | 26           | 133            |
| Change in current investments, net                                            | (2)              | 110          | 6                  | (31)         | 138            |
| Purchase of property, plant and equipment                                     | (797)            | (607)        | (375)              | (326)        | (1,279)        |
| Proceeds from disposal of investments and long-term loans                     | 6                | 4            | 5                  | 2            | 11             |
| Investments and long-term loans                                               | (3)              | (3)          | (2)                | (2)          | (6)            |
| Payment for derivatives                                                       | (11)             | -            | -                  | -            | (2)            |
| Business combinations less cash acquired                                      | -                | (30)         | -                  | (30)         | (145)          |
| Interest and dividend received                                                | 12               | 7            | 9                  | 7            | 9              |
| <b>Net cash used in investing activities</b>                                  | <b>(717)</b>     | <b>(636)</b> | <b>(388)</b>       | <b>(424)</b> | <b>(1,484)</b> |

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

## Condensed Consolidated Interim Statements of Cash Flows (contd.)

|                                                             | Six months ended |                | Three months ended |                | Year ended     |
|-------------------------------------------------------------|------------------|----------------|--------------------|----------------|----------------|
|                                                             | June 30          |                | June 30            |                | December 31    |
|                                                             | 2011             | 2010           | 2011               | 2010           | 2010           |
|                                                             | (Unaudited)      | (Unaudited)    | (Unaudited)        | (Unaudited)    | (Audited)      |
|                                                             | NIS millions     | NIS millions   | NIS millions       | NIS millions   | NIS millions   |
| <b>Cash flows used in financing activities</b>              |                  |                |                    |                |                |
| Bank loans received                                         | 1,600            | 1,900          | 1,600              | 1,900          | 2,670          |
| Issue of debentures                                         | 400              | -              | 400                | -              | -              |
| Repayment of loans                                          | (24)             | (424)          | (15)               | (415)          | (448)          |
| Repayment of debentures                                     | (757)            | (622)          | (665)              | (416)          | (697)          |
| Short-term borrowing, net                                   | (3)              | 225            | (2)                | 225            | (6)            |
| Dividends paid                                              | (1,663)          | (2,453)        | (1,663)            | (2,453)        | (3,733)        |
| Interest paid                                               | (193)            | (175)          | (161)              | (145)          | (237)          |
| Proceeds from exercise of options and others                | 10               | 18             | 6                  | 3              | 24             |
| <b>Net cash used for financing activities</b>               | <b>(630)</b>     | <b>(1,531)</b> | <b>(500)</b>       | <b>(1,301)</b> | <b>(2,427)</b> |
| <b>Net increase (decrease) in cash and cash equivalents</b> | <b>98</b>        | <b>(385)</b>   | <b>(218)</b>       | <b>(749)</b>   | <b>(215)</b>   |
| Cash and cash equivalents at beginning of period            | 365              | 580            | 681                | 944            | 580            |
| <b>Cash and cash equivalents at end of period</b>           | <b>463</b>       | <b>195</b>     | <b>463</b>         | <b>195</b>     | <b>365</b>     |

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

Notes to the Condensed Interim Financial Statements as at June 30, 2011

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**NOTE 1 – REPORTING ENTITY**

- A. Bezeq – The Israel Telecommunication Corp. Ltd. (“the Company”) is a company registered in Israel whose shares are traded on the Tel Aviv Stock Exchange. The condensed consolidated financial statements of the Company include those of the Company and its subsidiaries (together referred to as “the Group”), as well as the Group’s interest in associates. The Group is a principal provider of communication services in Israel (see also Note 10 – Segment Reporting).
- B. As from April 14, 2010, the ultimate controlling shareholder in the Company is Shaul Elovitch, together with his brother, Yosef Elovitch, through their holdings in Eurocom Communications Ltd., the controlling shareholder in Internet Gold-Golden Lines Ltd., which controls B Communications Ltd. (“B Communications”). B Communications holds Company shares through a company that it controls. At June 30, 2011, this company held 31.23% of the Company’s shares. Each of these companies is also considered as a controlling shareholder in the Company.
- C. The Company is subject to various sets of laws that regulate and restrict its business activities, including its tariffs. The Company’s tariffs are regulated by provisions in the Communications Law. The Company’s service fees are regulated and adjusted according to a linkage formula. The Company was declared a monopoly in the main areas in which it operates. All of the operating segments of the Group are subject to competition. The operations of the Group are subject, in general, to government regulation and supervision. The intensifying competition and changes in the communication market could have an adverse effect on the business results of the Group.

**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 Regulations (Periodic and Immediate Reports), 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 as at December 31, 2010 and the year then ended, and their accompanying notes (“the Annual Financial Statements”). The notes to the interim financial statements include only the material changes that have occurred from the date of the most recent Annual Financial Statements until the date of these consolidated interim financial statements.
- C. The condensed consolidated interim financial statements were approved by the Board of Directors on August 1, 2011.
- D. **Use of estimates and judgment**

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

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

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

**NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICY**

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

**A. Recognition of actuarial gains or losses**

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

**B. Initial application of new accounting standards****(1) Related party disclosures**

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

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

**(2) Interim financial reporting**

As from January 1, 2011, the Company applies the amendment to IAS 34 – Interim Financial Reporting: significant events and transactions (“the Amendment”), issued under Annual Improvements to IFRSs, 2010 of the International Accounting Standards Board (IASB). The Amendment expands the list of events and transactions requiring disclosure in interim financial statements. In addition, the minimum requirement for disclosure in the current standard, prior to the Amendment, was eliminated. Application of the Amendment did not have an effect on the financial statements.

**C. New standards and interpretations not yet adopted**

(1) In May 2011, the IASB published a new set of accounting standards for consolidation of financial statements and related issues. The new set of standards is part of the joint consolidation project of the IASB and FASB and replaces the existing standards for consolidation of financial statements and joint ventures with a number of changes relating to associates. The Group is examining the effect of adopting the standards on the financial statements. New standards published:

- a. IFRS 10, Consolidated Financial Statements (“the Standard”) supersedes the guidelines of IAS 27, Consolidated and Separate Financial Statements and the guidelines of SIC 12, Consolidation - Special Purpose Entities for consolidation of financial statements, so that IAS 27 will continue to apply only to separate financial statements. The Standard is effective retrospectively for annual periods commencing on or after January 1, 2013. Early application is permitted, subject to disclosure and early adoption of the two other standards that were published at the same time: IFRS 11, Joint Arrangements and IFRS 12, Disclosure of Interests in Other Entities.
- b. IFRS 11, Joint Arrangements (“the Standard”) supersedes the guidelines of IAS 31, Interests in Joint Ventures (“IAS 31”) and amends some of the guidelines of IAS 28, Investments in Associates. The Standard will be applied retrospectively for annual periods beginning on or after January 1, 2013, however there are specific guidelines for retrospective application in some cases. Early application is permitted, subject to disclosure and early adoption of the two other standards that were published at the same time: IFRS 10, Consolidated Financial Statements and IFRS 12, Disclosure of Interests in Other Entities.

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

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

## C. New standards and interpretations not yet adopted (contd.)

## (1) (Contd.)

- c. IFRS12, Disclosure of Interests in other Entities ("the Standard") defines requirements for comprehensive disclosure for interests in subsidiaries, joint arrangements (jointly-controlled entities and joint ventures) in associates and structured entities. The Standard is effective for annual periods beginning on or after January 1, 2013. Early application is permitted, subject to early adoption of the two other standards that were published at the same time: IFRS 11, Joint Arrangements and IFRS 10, Consolidated Financial Statements. However, the other disclosure requirements according to IFRS 12 can also be early adopted without early adoption of the other standards.
- (2) In May 2011, IFRS 13, Fair Value Measurement ("the Standard") was published. The Standard supersedes the guidelines for fair value measurement in other IFRSs and will serve as the sole source for guidelines regarding fair value measurement under IFRS. For this purpose, the Standard defines fair value, provides guidelines for fair value measurement and determines new disclosure requirements for fair value measurement. The Standard is effective for annual periods beginning on January 1, 2013. Early implementation is permitted, with disclosure. The Standard will be applied prospectively and disclosure requirements will not apply to comparative information for periods prior to initial application of the Standards. The Group is examining the effect of adopting the Standard on the financial statements.
- (3) In June 2011, the amendment to IAS 19, Employee Benefits ("the Amendment") was published. The Amendment includes a number of revisions to accounting guidelines for employee benefits. The Amendment excludes the option of deferring recognition of actuarial gains and losses and unvested past service costs. Additionally, definitions of short-term employee benefits and other long-term employee benefits were changed and disclosure requirements were added for defined benefit plans, to provide more comprehensive information about the characteristics of defined benefit plans and the risks associated with these plans. According to the Amendment, termination benefits will be recognized at the earlier of the following dates: when the Group recognizes costs for a restructuring within the scope of IAS 37, Provisions, Contingent Liabilities and Contingent Assets, that included the payment of termination benefits; or when the entity can no longer withdraw the offer of those benefits. The Amendment is effective retrospectively for annual periods commencing on or after January 1, 2013. Early application is permitted, with disclosure. At this stage, the Group is examining the effect of adopting the Amendment on the financial statements.

## NOTE 4 – GROUP ENTITIES

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

## Equity-accounted associates

## DBS Satellite Services (1998) Ltd.

- (1) For information about the financial position of DBS, see Note 4 to the financial statements of DBS for the six and three months ended June 30, 2011, attached to these reports.
- (2) DBS has a current debt to the Group companies of NIS 58 million, of which NIS 48 million is to the Company.

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

**NOTE 5 – CONTINGENT LIABILITIES**

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

In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 236 million, where provisions are required to cover the exposure resulting from such claims.

In the opinion of the managements of the Group companies, the additional exposure at June 30, 2011, due to claims filed against Group companies on various matters and which are unlikely to be realized, amounts to NIS 13.8 billion (of which NIS 1.6 billion is for claims, which at this stage, cannot be assessed, as set out in sections B and E below). For updates subsequent to the reporting date, see section B below. This amount and all the amounts of the additional exposure in this note are linked to the CPI and are stated net of interest.

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

A detailed description of the Group's contingent liabilities appears in Note 18 to the Group's Annual Financial Statements as at December 31, 2010. Following is a detailed description of the Group's contingent liabilities at June 30, 2011, classified into groups with similar characteristics.

**A. Employee claims**

In the 2010 financial statements, the Group estimated that as at December 31, 2010, the additional exposure (beyond the provisions included in these financial statements) for employee claims amounts to NIS 2 billion and are mainly related to claims filed by groups of employees or individual claims with wide ramifications. Of this amount, a total of NIS 1.8 billion is for an individual procedure (the amount claimed is not material) and for indirect lateral effects that may arise from the grounds of the claim in this procedure. In respect of this procedure, subsequent to the approval date of the financial statements for 2010, the Company received a revised opinion that estimates that as at December 31, 2010, the claim is unlikely to be accepted. Accordingly, the Company believes that the exposure for NIS 1.8 billion out of the total exposure estimated by the Company is unlikely. At June 30, 2011, the possible exposure amounts to NIS 230 million, and refers to other claims described above. In the opinion of the management of the Company, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 99 million, where provisions are required to cover the exposure resulting from such claims.

**B. Customer claims**

At June 30, 2011, the amount of the additional exposure for customer claims amounts to NIS 6.9 billion (beyond the provisions included in these financial statements). Of these claims, there are claims amounting to NIS 1.6 billion, which, at this stage, cannot yet be estimated. There are other claims for which the Group has additional exposure beyond the aforesaid, which cannot be quantified, as the exact amount of the claim is not stated in the claims. In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 53 million, where provisions are required to cover the exposure arising from such claims.

In addition, subsequent to the reporting date, customer claims against Group companies with exposure of NIS 240 million came to an end.

**C. Supplier and communication provider claims**

At June 30, 2011, the amount of the additional exposure for supplier and communication provider claims amounts to NIS 997 million (beyond the provisions included in these financial statements). In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 9 million, where provisions are required to cover the exposure arising from such claims.

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

## NOTE 5 – CONTINGENT LIABILITIES (CONTD.)

## D. Claims for punitive damages

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

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

## E. Claims by developers and companies

At June 30, 2011, the amount of the additional exposure for claims by developers and companies amounts to NIS 250 million (beyond the provisions included in these financial statements). In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 11 million, where provisions are required to cover the exposure arising from such claims.

## F. Claims by the State and authorities

At June 30, 2011, the amount of the additional exposure for claims by the State and authorities amounts to NIS 285 million (beyond the provisions included in these financial statements). In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 63 million, where provisions are required to cover the exposure resulting from such claims.

For claims against DBS, see Notes 5 and 7 to the financial statements of DBS as at June 30, 2010, which are attached to these financial statements.

## NOTE 6 – EQUITY AND SHARE-BASED PAYMENTS

## A. Below are details of the Company's equity:

| Registered       |                  |                   | Issued and paid up |                  |                   |
|------------------|------------------|-------------------|--------------------|------------------|-------------------|
| June 30, 2011    | June 30, 2010    | December 31, 2010 | June 30, 2011      | June 30, 2010    | December 31, 2010 |
| (Unaudited)      | (Unaudited)      | (Audited)         | (Unaudited)        | (Unaudited)      | (Audited)         |
| Number of shares | Number of shares | Number of shares  | Number of shares   | Number of shares | Number of shares  |
| 2,825,000,000    | 2,749,000,000    | 2,825,000,000     | 2,702,114,767      | 2,675,835,682    | 2,685,917,052     |

- B. Following the exercise of options by employees in accordance with the options plans set out in Note 27 to the financial statements as at December 31, 2010, in the six months ended June 30, 2011, the Company issued 16,197,715 ordinary shares of NIS 1 par value each.
- C. Subsequent to the reporting date and through July 31, 2011, following the exercise of options by the employees, in accordance with the options plans set out in Note 27 to the financial statements as at December 31, 2010, the Company issued 3,938,563 ordinary shares of NIS 1 par value each.
- D. In March 2011, the Board of Directors of the Company approved the allotment of 1,900,000 options to Company employees, according to the 2010 employee options plan set out in Note 27(C) to the financial statements as at December 31, 2010. In practice, in April 2011, employees were allocated 1,306,374 options out of these options. The theoretical economic value of the allotted options, calculated at the allotment date and based on a weighted Black and Scholes model, is NIS 6 million.
- E. On April 13, 2011, the general meeting of the shareholders of the Company approved the recommendation of the Board of Directors of the Company of March 7, 2011 to distribute a cash dividend to the shareholders of the Company in the amount of NIS 1.163 billion, representing NIS 0.4305716 per share and 43.05716% of the Company's issued and paid up capital on the record date (May 4, 2011). The dividend was paid on May 19, 2011.

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

## NOTE 6 – EQUITY AND SHARE-BASED PAYMENTS (CONTD.)

- F. Further to Note 21(C) to the financial statements as at December 31, 2010 regarding a planned distribution of NIS 3 billion to the Company's shareholders, a sum not in compliance with the earnings test, as defined in section 302 Companies Law, 1999, on March 31, 2011 the court approved the Company's petition to approve the distribution.

The dividend is distributed in six equal semi-annual payments, from 2011-2013, (without interest or linkage payments), together with the Company's regular dividend distribution. The first payment of NIS 500 million (which at the record date, May 4, 2011 constitutes NIS 0.1851125 per share and 18.51125% of the Company's issued and paid up capital) was paid to shareholders on May 19, 2011.

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

The dividend is stated as follows:

|                         | June 30, 2011                   |                                                                                                                                                                       |
|-------------------------|---------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|                         |                                 | Presented in the<br>statement of<br>financial position<br>at current value<br>plus financing<br>expenses<br>Accumulated<br>from March 31,<br>2011 to June 30,<br>2011 |
|                         | Dividend to pay<br>undiscounted |                                                                                                                                                                       |
|                         | (Unaudited)                     | (Unaudited)                                                                                                                                                           |
|                         | NIS millions                    | NIS millions                                                                                                                                                          |
| Current liabilities     | 1,000                           | 972                                                                                                                                                                   |
| Non-current liabilities | 1,500                           | 1,369                                                                                                                                                                 |
|                         | 2,500                           | 2,341                                                                                                                                                                 |

On July 3, 2011, a holder of the Company's Debentures (Series 5) petitioned the court to order the Company to submit a revised opinion and to permit submission of responses in view of the revised opinion, including to submit objections, alleging that there has been a change in circumstances that justifies reassessment of the Company's solvency: raising debt of NIS 3 billion by the Company (as described in Note 12D below), immediately, instead of between 2011-2013, according to the assumption in the economic opinion attached to the Company's application, and the downgrade of the Company's rating to negative. On July 10, 2011, the Company submitted its response to the petition, claiming that the petition should be rejected since there have been no changes to the circumstances as alleged by the applicant and/or changes that justify reexamination of the decision regarding the reduction of capital, and that this was a final and absolute decision. On July 25, 2011, further to the court ruling, the Company received the response of the Israel Securities Authority ("the ISA") to the petition and to the Company's response, which did not require the ISA to address the issue in the petition: whether circumstances had changed since the court ruling. However, according to the ISA, if there is a material deterioration in the Company's position between the date that the commitment is provided and the distribution is approved and the date that the dividend is paid, the Company's Board of Directors will reassess the Company's compliance with the distribution test. If there are no appropriate profits for distribution, the Company will reapply for court approval, unless the court ruling includes instructions that also take into account future changes in the Company's circumstances. The case was scheduled for a hearing on September 19, 2011.

- G. On August 1, 2011, the Board of Directors of the Company resolved to recommend to the general meeting (which will convene on September 7, 2011) the distribution of a cash dividend to the shareholders in the amount of NIS 992 million. The record date for the distribution is September 18, 2011 and the payment date is October 5, 2011. In addition to this distribution (to the extent that it is approved), the second portion of the special dividend amounting to NIS 500 million will be paid (as set out in section F above).

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

## NOTE 7 –TRANSACTIONS WITH INTERESTED AND RELATED PARTIES

- A. Further to Note 30(F) to the financial statements as at December 31, 2010, on April 13, 2011, the general meeting of the Company's shareholders approved a maximum bonus for 2010 for the former chairman of the Company's Board of Directors, under the terms of his employment agreement, as approved by the general meeting on June 1, 2008, of 18 monthly salaries, amounting to NIS 3.507 million.
- B. Further to Note 30(E)(2)(m) to the financial statements as at December 31, 2010, regarding a framework transaction for three years for the Company's engagement in future insurance policies to cover D&O liability, in April 2011, the general meeting of the Company's shareholders approved the framework agreement.
- C. Further to Note 30 (E)(2)(n) to the financial statements as at December 31, 2010 regarding the Company's engagement in a D&O liability insurance policy for one year, beginning on April 14, 2011, the general meeting of the Company's shareholders approved the engagement in April 2011.
- D. On June 28, 2011, the Board of Directors of the Company approved a vote at the general meeting of DBS shareholders in favor of an agreement between DBS with Advanced Digital Broadcast SA ("ADB") and Eurocom Digital Communications Ltd. ("Eurocom Digital Communications") for the purchase of yesMaxHD converters and receipt of suppliers credit in USD from Eurocom for an additional 60 days in connection with the purchase of the converters, as follows: (1) An additional order of yesMaxHD converters from Eurocom Digital Communications and ADB, further to the orders approved at the Company's general meeting on July 29, 2010 and April 13, 2011, according to the framework agreement, at a total cost of USD 20.7 million (the price is for sea shipment; for earlier delivery that requires air shipment, DBS will cover the additional shipping cost); (2) supplier credit in USD from Eurocom Digital Communication for an additional 60 days ("the Additional Credit Period") in connection with the purchase of the converters. According to the framework agreement, the payment terms are EOM + 35 days. For the Additional Credit Period, DBS will pay interest at a rate of 1% (6% in nominal annual terms). The scope of the credit is estimated at an average of NIS 12 million and payment of the annual interest is estimated as NIS 724,000. The approval requires the approval of the general meeting of the Company's shareholders, which will convene on August 4, 2011.
- E. On June 28, 2011, the Board of Directors of the Company approved (after approval of the Audit Committee) preliminary commitments from Eurocom Capital Underwriting Ltd. ("Eurocom Capital Underwriting") (a company indirectly controlled by Eurocom Communications Ltd., the indirect controlling owner of the Company), in a tender for classified investors for a public offering of Debentures (Series 6-8) (as described in Note 12D below). In the Company's institutional tender of June 28, 2011, preliminary commitments amounting to 5% of the total debentures relevant to the preliminary commitments from classified investors for each of the Debentures Series (6 to 8) were received from Eurocom Capital Underwriting.

As part of the shelf offering prospectus, Eurocom Capital Underwriting acquired 43,938,000 Debentures (Series 6), 18,885,000 Debentures (Series 7) and 48,849,000 Debentures (Series 8).

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

## NOTE 8 – REVENUES

|                                                                | Six months ended |              | Three months ended |              | Year ended    |
|----------------------------------------------------------------|------------------|--------------|--------------------|--------------|---------------|
|                                                                | June 30          |              | June 30            |              | December 31   |
|                                                                | 2011             | 2010*        | 2011               | 2010*        | 2010          |
|                                                                | (Unaudited)      | (Unaudited)  | (Unaudited)        | (Unaudited)  | (Audited)     |
|                                                                | NIS millions     | NIS millions | NIS millions       | NIS millions | NIS millions  |
| <b>Domestic fixed-line communications</b>                      |                  |              |                    |              |               |
| Fixed line telephony                                           | 1,184            | 1,537        | 587                | 774          | 3,074         |
| Internet - infrastructure                                      | 534              | 471          | 269                | 235          | 977           |
| Transmission and data communication                            | 371              | 361          | 188                | 179          | 713           |
| Other services                                                 | 120              | 107          | 56                 | 52           | 226           |
|                                                                | <u>2,209</u>     | <u>2,476</u> | <u>1,100</u>       | <u>1,240</u> | <u>4,990</u>  |
| <b>Cellular</b>                                                |                  |              |                    |              |               |
| Cellular services and terminal equipment                       | 1,251            | 1,643        | 606                | 834          | 3,286         |
| Value-added services                                           | 580              | 479          | 297                | 246          | 1,014         |
| Sale of terminal equipment                                     | 1,014            | 574          | 513                | 288          | 1,176         |
|                                                                | <u>2,845</u>     | <u>2,696</u> | <u>1,416</u>       | <u>1,368</u> | <u>5,476</u>  |
| <b>International communications, internet and NEP services</b> | <u>629</u>       | <u>667</u>   | <u>314</u>         | <u>332</u>   | <u>1,334</u>  |
| <b>Other</b>                                                   | <u>123</u>       | <u>57</u>    | <u>63</u>          | <u>41</u>    | <u>187</u>    |
|                                                                | <u>5,806</u>     | <u>5,896</u> | <u>2,893</u>       | <u>2,981</u> | <u>11,987</u> |

(\*) Revenues from transmission and data communication and from value-added services were reclassified and presented separately.

## NOTE 9 – OPERATING AND GENERAL EXPENSES

|                                             | Six months ended |              | Three months ended |              | Year ended   |
|---------------------------------------------|------------------|--------------|--------------------|--------------|--------------|
|                                             | June 30          |              | June 30            |              | December 31  |
|                                             | 2011             | 2010         | 2011               | 2010         | 2010         |
|                                             | (Unaudited)      | (Unaudited)  | (Unaudited)        | (Unaudited)  | (Audited)    |
|                                             | NIS millions     | NIS millions | NIS millions       | NIS millions | NIS millions |
| Materials and spare parts                   | 788              | 520          | 397                | 257          | 1,049        |
| General expenses                            | 591              | 563          | 299                | 280          | 1,184        |
| Cellular telephone expenses                 | 434              | 912          | 220                | 476          | 1,866        |
| International communication expenses        | 152              | 158          | 75                 | 73           | 325          |
| Building maintenance                        | 135              | 121          | 67                 | 57           | 107          |
| Vehicle maintenance expenses                | 48               | 64           | 19                 | 33           | 132          |
| Services and maintenance by sub-contractors | 51               | 60           | 24                 | 27           | 265          |
| Royalties to the State of Israel            | 53               | 33           | 26                 | 17           | 74           |
| Collection fees                             | 11               | 11           | 5                  | 4            | 24           |
|                                             | <u>2,263</u>     | <u>2,442</u> | <u>1,132</u>       | <u>1,224</u> | <u>5,026</u> |

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

## NOTE 10 – SEGMENT REPORTING

## A. Operating segments

|                                                     | Six months ended June 30, 2011 (unaudited): |                    |                                                               |                             |              |              | Consolidated<br>NIS millions |
|-----------------------------------------------------|---------------------------------------------|--------------------|---------------------------------------------------------------|-----------------------------|--------------|--------------|------------------------------|
|                                                     | Domestic fixed-<br>line<br>communication    | Cellular telephone | International<br>communication<br>and<br>internet<br>services | Multi-channel<br>television | Others       | Adjustments  |                              |
|                                                     | NIS millions                                | NIS millions       | NIS millions                                                  | NIS millions                | NIS millions | NIS millions |                              |
| Revenues from external sources                      | 2,208                                       | 2,844              | 629                                                           | 810                         | 118          | (810)        | 5,799                        |
| Inter-segment revenues                              | 140                                         | 44                 | 33                                                            | -                           | 18           | (228)        | 7                            |
| Total revenues                                      | 2,348                                       | 2,888              | 662                                                           | 810                         | 136          | (1,038)      | 5,806                        |
| Depreciation and amortization                       | 333                                         | 282                | 51                                                            | 140                         | 11           | (134)        | 683                          |
| Segment results – operating profit                  | 728                                         | 756                | 121                                                           | 127                         | 5            | (137)        | 1,600                        |
| Financing expenses                                  | 215                                         | 36                 | 5                                                             | 298                         | 2            | (297)        | 259                          |
| Financing income                                    | (116)                                       | (55)               | (5)                                                           | (10)                        | -            | 9            | (177)                        |
| Total financing expenses (income), net              | 99                                          | (19)               | -                                                             | 288                         | 2            | (288)        | 82                           |
| Segment profit (loss) after financing expenses, net | 629                                         | 775                | 121                                                           | (161)                       | 3            | 151          | 1,518                        |
| Share of losses of equity-accounted investees       | -                                           | -                  | -                                                             | -                           | -            | 137          | 137                          |
| Segment profit (loss) before income tax             | 629                                         | 775                | 121                                                           | (161)                       | 3            | 14           | 1,381                        |
| Income tax                                          | 176                                         | 186                | 29                                                            | -                           | 1            | (2)          | 390                          |
| Segment results – net profit (loss)                 | 453                                         | 589                | 92                                                            | (161)                       | 2            | 16           | 991                          |

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

## NOTE 10 – SEGMENT REPORTING (CONTD.)

## A. Operating segments (Contd.)

|                                                                    | Six months ended June 30, 2010 (unaudited): |                    |                                                     |                          |              |              |              |
|--------------------------------------------------------------------|---------------------------------------------|--------------------|-----------------------------------------------------|--------------------------|--------------|--------------|--------------|
|                                                                    | Domestic fixed-line communication           | Cellular telephone | International communication and internet services * | Multi-channel television | Others       | Adjustments  | Consolidated |
|                                                                    | NIS millions                                | NIS millions       | NIS millions                                        | NIS millions             | NIS millions | NIS millions | NIS millions |
| Revenues from external sources                                     | 2,474                                       | 2,695              | 667                                                 | 787                      | 54           | (789)        | 5,888        |
| Inter-segment revenues                                             | 137                                         | 127                | 18                                                  | -                        | 16           | (290)        | 8            |
| Total revenues                                                     | 2,611                                       | 2,822              | 685                                                 | 787                      | 70           | (1,079)      | 5,896        |
| Depreciation and amortization                                      | 341                                         | 298                | 46                                                  | 132                      | 6            | (132)        | 691          |
| Segment results – operating profit                                 | 993                                         | 684                | 185                                                 | 66                       | 2            | (66)         | 1,864        |
| Financing expenses                                                 | 106                                         | 30                 | 6                                                   | 221                      | -            | (226)        | 137          |
| Financing income                                                   | (78)                                        | (45)               | (4)                                                 | (4)                      | (2)          | 9            | (124)        |
| Total financing expenses (income), net                             | 28                                          | (15)               | 2                                                   | 217                      | (2)          | (217)        | 13           |
| Segment profit (loss) after financing expenses, net                | 965                                         | 699                | 183                                                 | (151)                    | 4            | 151          | 1,851        |
| Share in the (profits) losses of equity-accounted investees        | -                                           | -                  | 3                                                   | -                        | -            | (112)        | (109)        |
| Segment profit (loss) before income tax from continuing operations | 965                                         | 699                | 186                                                 | (151)                    | 4            | 39           | 1,742        |
| Profit from discontinued operations                                | -                                           | -                  | 1                                                   | -                        | -            | (1)          | -            |
| Income tax                                                         | 256                                         | 173                | 32                                                  | -                        | 1            | -            | 462          |
| Segment results – net profit (loss)                                | 709                                         | 526                | 155                                                 | (151)                    | 3            | 38           | 1,280        |

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

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

## NOTE 10 – SEGMENT REPORTING (CONTD.)

## A. Operating segments (Contd.)

|                                                     | Three months ended June 30, 2011 (unaudited) |                       |                                                            |                             |              |              | Consolidated<br>NIS millions |
|-----------------------------------------------------|----------------------------------------------|-----------------------|------------------------------------------------------------|-----------------------------|--------------|--------------|------------------------------|
|                                                     | Domestic fixed-<br>line<br>communication     | Cellular<br>telephone | International<br>communication<br>and internet<br>services | Multi-channel<br>television | Others       | Adjustments  |                              |
|                                                     | NIS millions                                 | NIS millions          | NIS millions                                               | NIS millions                | NIS millions | NIS millions |                              |
| Revenues from external sources                      | 1,100                                        | 1,416                 | 314                                                        | 404                         | 59           | (404)        | 2,889                        |
| Inter-segment revenues                              | 70                                           | 22                    | 19                                                         | -                           | 10           | (117)        | 4                            |
| Total revenues                                      | 1,170                                        | 1,438                 | 333                                                        | 404                         | 69           | (521)        | 2,893                        |
| Depreciation and amortization                       | 171                                          | 143                   | 27                                                         | 71                          | 4            | (68)         | 348                          |
| Segment results – operating profit                  | 517                                          | 357                   | 60                                                         | 66                          | 4            | (69)         | 935                          |
| Financing expenses                                  | 135                                          | 21                    | 2                                                          | 160                         | 1            | (162)        | 157                          |
| Financing income                                    | (62)                                         | (30)                  | (3)                                                        | (6)                         | -            | 6            | (95)                         |
| Total financing expenses (income), net              | 73                                           | (9)                   | (1)                                                        | 154                         | 1            | (156)        | 62                           |
| Segment profit (loss) after financing expenses, net | 444                                          | 366                   | 61                                                         | (88)                        | 3            | 87           | 873                          |
| Share of losses of equity-accounted investees       | -                                            | -                     | -                                                          | -                           | -            | 72           | 72                           |
| Segment profit (loss) before income tax             | 444                                          | 366                   | 61                                                         | (88)                        | 3            | 15           | 801                          |
| Income tax                                          | 114                                          | 87                    | 15                                                         | -                           | 1            | (1)          | 216                          |
| Segment results – net profit (loss)                 | 330                                          | 279                   | 46                                                         | (88)                        | 2            | 16           | 585                          |

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

## NOTE 10 – SEGMENT REPORTING (CONTD.)

## A. Operating segments (contd.)

|                                                                    | Three months ended June 30, 2010 (unaudited): |                    |                                                                 |                             |              |              | Consolidated<br>NIS millions |
|--------------------------------------------------------------------|-----------------------------------------------|--------------------|-----------------------------------------------------------------|-----------------------------|--------------|--------------|------------------------------|
|                                                                    | Domestic fixed-<br>line<br>communication      | Cellular telephone | International<br>communication<br>and<br>internet<br>services * | Multi-channel<br>television | Others       | Adjustments  |                              |
|                                                                    | NIS millions                                  | NIS millions       | NIS millions                                                    | NIS millions                | NIS millions | NIS millions |                              |
| Revenues from external sources                                     | 1,239                                         | 1,367              | 332                                                             | 396                         | 41           | (398)        | 2,977                        |
| Inter-segment revenues                                             | 68                                            | 62                 | 10                                                              | -                           | 10           | (146)        | 4                            |
| Total revenues                                                     | 1,307                                         | 1,429              | 342                                                             | 396                         | 51           | (544)        | 2,981                        |
| Depreciation and amortization                                      | 171                                           | 149                | 23                                                              | 68                          | 5            | (68)         | 348                          |
| Segment results – operating profit                                 | 503                                           | 362                | 123                                                             | 7                           | 2            | (7)          | 990                          |
| Financing expenses                                                 | 79                                            | 18                 | 3                                                               | 154                         | -            | (153)        | 101                          |
| Financing income                                                   | (50)                                          | (11)               | (2)                                                             | (4)                         | (2)          | 3            | (66)                         |
| Total financing expenses (income), net                             | 29                                            | 7                  | 1                                                               | 150                         | (2)          | (150)        | 35                           |
| Segment profit (loss) after financing expenses, net                | 474                                           | 355                | 122                                                             | (143)                       | 4            | 143          | 955                          |
| Share in the profits (losses) of equity-accounted investees        | -                                             | -                  | 1                                                               | -                           | -            | (87)         | (86)                         |
| Segment profit (loss) before income tax from continuing operations | 474                                           | 355                | 123                                                             | (143)                       | 4            | 56           | 869                          |
| Profit from discontinued operations                                | -                                             | -                  | 1                                                               | -                           | -            | (1)          | -                            |
| Income tax                                                         | 125                                           | 88                 | 16                                                              | -                           | 2            | -            | 231                          |
| Segment results – net profit (loss)                                | 349                                           | 267                | 108                                                             | (143)                       | 2            | 55           | 638                          |

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

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

## NOTE 10 - SEGMENT REPORTING (CONTD.)

## A. Operating segments (contd.)

|                                                                    | Year ended December 31, 2010             |                    |                                                                 |                             |              |              | Consolidated<br>NIS millions |
|--------------------------------------------------------------------|------------------------------------------|--------------------|-----------------------------------------------------------------|-----------------------------|--------------|--------------|------------------------------|
|                                                                    | Domestic fixed-<br>line<br>communication | Cellular telephone | International<br>communication<br>and<br>internet<br>services * | Multi-channel<br>television | Others       | Adjustments  |                              |
|                                                                    | NIS millions                             | NIS millions       | NIS millions                                                    | NIS millions                | NIS millions | NIS millions |                              |
| Revenues from external sources                                     | 4,990                                    | 5,474              | 1,333                                                           | 1,578                       | 178          | (1,578)      | 11,975                       |
| Inter-segment revenues                                             | 273                                      | 258                | 47                                                              | 5                           | 32           | (603)        | 12                           |
| Total revenues                                                     | 5,263                                    | 5,732              | 1,380                                                           | 1,583                       | 210          | (2,181)      | 11,987                       |
| Depreciation and amortization                                      | 690                                      | 601                | 94                                                              | 285                         | 15           | (276)        | 1,409                        |
| Segment results – operating profit                                 | 2,043                                    | 1,383              | 320                                                             | 178                         | 14           | (194)        | 3,744                        |
| Financing expenses                                                 | 282                                      | 111                | 11                                                              | 500                         | 3            | (516)        | 391                          |
| Financing income                                                   | (192)                                    | (100)              | (6)                                                             | (9)                         | -            | 25           | (282)                        |
| Total financing expenses (income), net                             | 90                                       | 11                 | 5                                                               | 491                         | 3            | (491)        | 109                          |
| Segment profit (loss) after financing expenses, net                | 1,953                                    | 1,372              | 315                                                             | (313)                       | 11           | 297          | 3,635                        |
| Share in the profits (losses) of equity- accounted investees       | -                                        | -                  | 3                                                               | -                           | -            | (264)        | (261)                        |
| Segment profit (loss) before income tax from continuing operations | 1,953                                    | 1,372              | 318                                                             | (313)                       | 11           | 33           | 3,374                        |
| Profit from discontinued operations                                | -                                        | -                  | 1                                                               | -                           | -            | (1)          | -                            |
| Income tax                                                         | 527                                      | 339                | 65                                                              | 1                           | 4            | (4)          | 932                          |
| Segment results – net profit (loss)                                | 1,426                                    | 1,033              | 254                                                             | (314)                       | 7            | 36           | 2,442                        |

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

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

## NOTE 10 – SEGMENT REPORTING (CONTD.)

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

|                                                                                                                         | Six months ended |              | Three months ended |              | Year ended   |
|-------------------------------------------------------------------------------------------------------------------------|------------------|--------------|--------------------|--------------|--------------|
|                                                                                                                         | June 30          |              | June 30            |              | December 31  |
|                                                                                                                         | 2011             | 2010*        | 2011               | 2010*        | 2010         |
|                                                                                                                         | (Unaudited)      | (Unaudited)  | (Unaudited)        | (Unaudited)  | (Audited)    |
|                                                                                                                         | NIS millions     | NIS millions | NIS millions       | NIS millions | NIS millions |
| <b>Revenues</b>                                                                                                         |                  |              |                    |              |              |
| Revenues from reporting segments                                                                                        | 6,708            | 6,905        | 3,345              | 3,474        | 13,958       |
| Revenues from other segments                                                                                            | 136              | 70           | 69                 | 51           | 210          |
| Cancellation of revenues from inter-segment sales except for revenues from sales to an associate reporting as a segment | (228)            | (290)        | (117)              | (146)        | (603)        |
| Cancellation of revenue from a segment classified as an associate                                                       | (810)            | (787)        | (404)              | (396)        | (1,578)      |
| Other adjustments                                                                                                       | -                | (2)          | -                  | (2)          | -            |
| Consolidated revenues                                                                                                   | 5,806            | 5,896        | 2,893              | 2,981        | 11,987       |
|                                                                                                                         | Six months ended |              | Three months ended |              | Year ended   |
|                                                                                                                         | June 30          |              | June 30            |              | December 31  |
|                                                                                                                         | 2011             | 2010*        | 2011               | 2010*        | 2010         |
|                                                                                                                         | (Unaudited)      | (Unaudited)  | (Unaudited)        | (Unaudited)  | (Audited)    |
|                                                                                                                         | NIS millions     | NIS millions | NIS millions       | NIS millions | NIS millions |
| <b>Profit or loss</b>                                                                                                   |                  |              |                    |              |              |
| Operating profit for reporting segments                                                                                 | 1,732            | 1,928        | 1,000              | 995          | 3,924        |
| Cancellation of results of a segment classified as an associate                                                         | (127)            | (66)         | (66)               | (7)          | (178)        |
| Financing expenses, net                                                                                                 | (82)             | (13)         | (62)               | (35)         | (109)        |
| Share of losses of equity-accounted investees                                                                           | (137)            | (109)        | (72)               | (86)         | (261)        |
| Profit for operations classified in other categories                                                                    | 5                | 2            | 4                  | 2            | 14           |
| Other adjustments                                                                                                       | (10)             | -            | (3)                | -            | (16)         |
| Consolidated profit before income tax                                                                                   | 1,381            | 1,742        | 801                | 869          | 3,374        |

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

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

## NOTE 11 - SUMMARY OF FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD. AND BEZEQ INTERNATIONAL LTD.

## 1. Pelephone Communications Ltd.

## A. Statement of financial position

|                       | June 30, 2011<br>(Unaudited)<br>NIS millions | June 30, 2010<br>(Unaudited)<br>NIS millions | December 31,<br>2010<br>(Audited)<br>NIS millions |
|-----------------------|----------------------------------------------|----------------------------------------------|---------------------------------------------------|
| Current assets        | 2,220                                        | 1,983                                        | 2,071                                             |
| Non-current assets    | 3,103                                        | 2,868                                        | 2,821                                             |
|                       | <u>5,323</u>                                 | <u>4,851</u>                                 | <u>4,892</u>                                      |
| Current liabilities   | 1,406                                        | 1,155                                        | 1,198                                             |
| Long-term liabilities | 645                                          | 820                                          | 732                                               |
| Total liabilities     | 2,051                                        | 1,975                                        | 1,930                                             |
| Equity                | 3,272                                        | 2,876                                        | 2,962                                             |
|                       | <u>5,323</u>                                 | <u>4,851</u>                                 | <u>4,892</u>                                      |

## B. Statement of income

|                                           | Six months ended<br>June 30         |                                     | Three months ended<br>June 30       |                                     | Year ended<br>December 31         |
|-------------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-----------------------------------|
|                                           | 2011<br>(Unaudited)<br>NIS millions | 2010<br>(Unaudited)<br>NIS millions | 2011<br>(Unaudited)<br>NIS millions | 2010<br>(Unaudited)<br>NIS millions | 2010<br>(Audited)<br>NIS millions |
| Revenues from services                    | 1,294                               | 1,767                               | 628                                 | 894                                 | 3,536                             |
| Revenues from value added services        | 580                                 | 479                                 | 297                                 | 246                                 | 1,014                             |
| Revenues from sales of terminal equipment | 1,014                               | 576                                 | 513                                 | 289                                 | 1,182                             |
| Total revenues from services and sales    | 2,888                               | 2,822                               | 1,438                               | 1,429                               | 5,732                             |
| Cost of services and sales                | 1,829                               | 1,843                               | 927                                 | 920                                 | 3,754                             |
| Gross profit                              | 1,059                               | 979                                 | 511                                 | 509                                 | 1,978                             |
| Selling and marketing expenses            | 242                                 | 236                                 | 125                                 | 117                                 | 468                               |
| General and administrative expenses       | 61                                  | 59                                  | 29                                  | 30                                  | 127                               |
|                                           | 303                                 | 295                                 | 154                                 | 147                                 | 595                               |
| Operating profit                          | 756                                 | 684                                 | 357                                 | 362                                 | 1,383                             |
| Financing expenses                        | 36                                  | 30                                  | 21                                  | 18                                  | 111                               |
| Financing income                          | (55)                                | (45)                                | (30)                                | (11)                                | (100)                             |
| Financing expenses (income), net          | (19)                                | (15)                                | (9)                                 | 7                                   | 11                                |
| Profit before income tax                  | 775                                 | 699                                 | 366                                 | 355                                 | 1,372                             |
| Taxes on income                           | 186                                 | 173                                 | 87                                  | 88                                  | 339                               |
| Profit for the period                     | 589                                 | 526                                 | 279                                 | 267                                 | 1,033                             |

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

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

## 2. Bezeq International Ltd.

## A. Statement of financial position

|                       | June 30, 2011<br>(Unaudited)<br>NIS millions | June 30, 2010<br>(Unaudited)<br>NIS millions | December 31,<br>2010<br>(Audited)<br>NIS millions |
|-----------------------|----------------------------------------------|----------------------------------------------|---------------------------------------------------|
| Current assets        | 489                                          | 621                                          | 447                                               |
| Non-current assets    | 661                                          | 726                                          | 591                                               |
|                       | <b>1,150</b>                                 | <b>1,347</b>                                 | <b>1,038</b>                                      |
| Current liabilities   | 299                                          | 371                                          | 279                                               |
| Long-term liabilities | 20                                           | 64                                           | 25                                                |
| Total liabilities     | 319                                          | 435                                          | 304                                               |
| Equity                | 831                                          | 912                                          | 734                                               |
|                       | <b>1,150</b>                                 | <b>1,347</b>                                 | <b>1,038</b>                                      |

## B. Statement of income

|                                                                  | Six months ended<br>June 30         |                                      | Three months ended<br>June 30       |                                      | Year ended<br>December 31         |
|------------------------------------------------------------------|-------------------------------------|--------------------------------------|-------------------------------------|--------------------------------------|-----------------------------------|
|                                                                  | 2011<br>(Unaudited)<br>NIS millions | 2010*<br>(Unaudited)<br>NIS millions | 2011<br>(Unaudited)<br>NIS millions | 2010*<br>(Unaudited)<br>NIS millions | 2010<br>(Audited)<br>NIS millions |
| Revenue                                                          | 662                                 | 685                                  | 333                                 | 342                                  | 1,380                             |
| Operating expenses                                               | 387                                 | 411                                  | 194                                 | 201                                  | 822                               |
| <b>Gross profit</b>                                              | <b>275</b>                          | <b>274</b>                           | <b>139</b>                          | <b>141</b>                           | <b>558</b>                        |
| Selling, marketing and development expenses                      | 100                                 | 92                                   | 53                                  | 48                                   | 192                               |
| General and administrative expenses                              | 54                                  | 54                                   | 26                                  | 27                                   | 109                               |
| Other, net                                                       | -                                   | (57)                                 | -                                   | (57)                                 | (63)                              |
|                                                                  | <b>154</b>                          | <b>89</b>                            | <b>79</b>                           | <b>18</b>                            | <b>238</b>                        |
| <b>Operating profit</b>                                          | <b>121</b>                          | <b>185</b>                           | <b>60</b>                           | <b>123</b>                           | <b>320</b>                        |
| Financing expenses                                               | 5                                   | 6                                    | 2                                   | 3                                    | 11                                |
| Financing income                                                 | (5)                                 | (4)                                  | (3)                                 | (2)                                  | (6)                               |
| <b>Financing expenses (income), net</b>                          | <b>-</b>                            | <b>2</b>                             | <b>(1)</b>                          | <b>1</b>                             | <b>5</b>                          |
| Share in profits of equity-accounted investees                   | -                                   | 3                                    | -                                   | 1                                    | 3                                 |
| <b>Income before taxes on income</b>                             | <b>121</b>                          | <b>186</b>                           | <b>61</b>                           | <b>123</b>                           | <b>318</b>                        |
| Taxes on income                                                  | 29                                  | 32                                   | 15                                  | 16                                   | 65                                |
| <b>Profit for the period from continuing operations</b>          | <b>92</b>                           | <b>154</b>                           | <b>46</b>                           | <b>107</b>                           | <b>253</b>                        |
| <b>Profit (loss) for the period from discontinued operations</b> | <b>-</b>                            | <b>1</b>                             | <b>-</b>                            | <b>1</b>                             | <b>1</b>                          |
| <b>Profit for the period</b>                                     | <b>92</b>                           | <b>155</b>                           | <b>46</b>                           | <b>108</b>                           | <b>254</b>                        |
| <b>Attributable to:</b>                                          |                                     |                                      |                                     |                                      |                                   |
| Owners of Bezeq International                                    | 92                                  | 155                                  | 46                                  | 108                                  | 254                               |
| Non-controlling interests                                        | -                                   | - **                                 | -                                   | - **                                 | - **                              |
| <b>Profit for the period</b>                                     | <b>92</b>                           | <b>155</b>                           | <b>46</b>                           | <b>108</b>                           | <b>254</b>                        |

\* Restated following deconsolidation of previously consolidated subsidiary

\*\* Less than NIS 500,000

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

## NOTE 12 – MATERIAL EVENTS DURING THE REPORTING PERIOD AND SUBSEQUENT EVENTS

- A. On January 24, 2011, the Company's Board of Directors approved an early retirement plan for employees. According to the plan, up to 260 employees will retire from the Company at a total cost of up to NIS 281.5 million. The expense of NIS 281.5 million for the plan was recognized in the financial statements as other operating expenses.
- B. In May 2011, the Company completed raising debt totaling NIS 2 billion, through loans from Israeli banks and an institutional organization (a group) as well as a private placement of debentures to an institutional organization (group):
- (1) A loan of NIS 600 million, which is unlinked and bears variable interest at a rate of prime minus 0.8%, repayable in one payment in May 2012. The interest for the loan is paid every three months. Subsequently, on August 1, 2011, the Board of Directors approved the repayment of this loan and approved another loan of NIS 600 million instead, bearing interest at a rate of prime plus 0.15%. The principal will be paid in 12 equal annual payments in 2012-2013. The interest will be paid twice a year.
  - (2) Loans of NIS 500 million, which are unlinked and bear variable interest at a rate of prime plus 0.2%, repayable in eight equal semi-annual payments of the principal between 2017 and 2020. The interest on the loans is payable twice a year.
  - (3) Loans of NIS 500 million, which are unlinked and bear fixed annual interest at a rate of 6.85%, repayable in eight equal semi-annual payments of the principal between 2017 and 2020. The interest on the loans is payable twice a year.
  - (4) Unmarketable debentures in the amount of NIS 400 million, which are unlinked and bear fixed annual interest at a rate of 6.65%, repayable in eight equal semi-annual payments of the principal between 2017 and 2020. The interest on the debentures is payable twice a year.

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

- (1) The Company will not create additional pledges on its assets (a negative pledge), under the same terms as the negative pledge in favor of the banks and subject to the exceptions described in Note 14C(1) to the financial statements as at December 31, 2010.
- (2) The financing documents include accepted grounds for immediate repayment of the credit, including events of breach, insolvency, liquidation or receivership proceedings, as well as the right to call for immediate repayment if a third party lender calls for immediate repayment of the Company's debts in an amount exceeding the amount set.
- (3) In respect of the long-term credit provided to the Company, if the Company provides an undertaking to any lender (an additional lender) regarding financial covenants, the financing organizations may (under certain circumstances) require the Company to provide them with a similar undertaking.

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

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

## Notes to the Condensed Interim Financial Statements as at June 30, 2011

## NOTE 12 – MATERIAL EVENTS DURING THE REPORTING PERIOD AND SUBSEQUENT EVENTS (CONTD.)

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

- (1) 958,088,000 Debentures (Series 6) of record, of NIS 1 par value each for a gross consideration of NIS 958,088,000. The debentures are repayable in five equal annual payments on December 1st of each of the years 2018 to 2022 and bear fixed annual interest at a rate of 3.7%. The principal and interest of the debentures are linked to the CPI. The interest will be paid twice a year, beginning December 1, 2011.
- (2) 424,955,000 Debentures (Series 7) of record, of NIS 1 par value each for a gross consideration of NIS 424,955,000. The debentures are repayable in five equal annual installments on December 1 of each of the years 2018 to 2022 and bear variable annual interest at the short-term loan (Makam) yield plus a margin of 1.4%. The interest will be paid four times a year, beginning September 1, 2011. Debentures (Series 7) are not linked to the CPI or any currency.
- (3) 1,329,363,000 debentures (Series 8) of NIS 1 par value each, for a gross consideration of NIS 1,329,363,000. The debentures are repayable in three equal annual payments on June 1st of each of the years 2015 to 2017 and bear fixed annual interest at a rate of 5.7%. The interest will be paid twice a year, beginning December 1, 2011. Debentures (Series 8) are not linked to the CPI or any currency.

The total gross consideration for the debentures amounted to NIS 2,712,406,000. On July 3, 2011, the net consideration of NIS 2,694,283,579 for the issuance was received (net of issuance fees). A liability for the issuance was not recorded in these financial statements. The Company invested most of the proceeds of the issuance in a variety of shekel mutual funds.

The Company has provided the following undertakings for the debentures that were issued.

- (1) The Company will not create additional pledges on its assets unless pledges are created at the same time in favor of the debenture holders (negative pledge), under the same terms of the negative pledge in favor of the banks and subject to the exceptions described in Note 14C (1) to the financial statements as at December 31, 2010.
  - (2) The Company will take steps so that, to the extent under its control, debentures of the relevant series will be rated by at least one rating agency, so long as there are debentures of the relevant series in circulation.
  - (3) If the Company provides an undertaking towards any entity in respect of compliance with financial covenants, the Company will provide the same undertaking to its debenture holders (subject to certain exceptions).
  - (4) Standard grounds were included for immediate repayment of the debentures, including breach events, insolvency, dissolution procedures or receivership. In addition, a right has been established to call for immediate repayment if a third party lender calls for immediate repayment of the Company's debts in an amount exceeding the amount determined.
- E. In July 2011, the Board of Directors of the Company entered into negotiations to acquire land covering 25 hectares for the construction of offices and communication facilities to replace the existing offices that are currently leased. The estimated price of the lot is NIS 125 million plus VAT. According to the Company's preliminary estimates, the overall project cost is expected to amount to NIS 700 million (including the price of the lot as described above and the relevant levies). This cost will be allocated over the project period, according to the rate of construction.
- F. In 2011, the Company recognized a capital gain of NIS 56 million from the sale of real estate and NIS 31 million from the sale of copper cables. The total consideration for these sales amounts to NIS243 million (of which a total of NIS 26 million has not yet been received).

**NOTE 12 – MATERIAL EVENTS DURING THE REPORTING PERIOD AND SUBSEQUENT EVENTS (CONTD.)**

- G. In July 2011, the Ministry of Communications refunded NIS 41.4 million to Pelephone for excess frequency fees paid in 2008 when exercising the right to use 3G frequencies. When exercising this right, Pelephone was required to pay the frequency fees for 2003 through the date that it exercised its right in 2008. The Ministry of Communications based the charge on the maximum frequency fees set out in the regulations from 2003. As part of the legal proceedings instituted by other cellular companies, it was determined that the Ministry of Communications will charge the companies a reduced rate, which will increase gradually every year, and only charge the maximum rate beginning in the fifth year (2008). This amount includes interest and linkage differences of NIS 5.4 million, which will be recognized in the statement of income as financing interest. The balance will be recognized as amortization of the intangible asset.

**Directors' Report on the State of the Company's Affairs  
for the six-month and three-month periods ended June 30, 2011**

We respectfully present the Directors' Report on the state of affairs of Bezeq, The Israel Telecommunication Corp. Limited ("the Company") and the consolidated Group companies (the Company and the consolidated companies together are hereinafter referred to as "the Group"), for the six-month period ended June 30, 2011 (the "half") and for the three-month period then ended ("Quarter").

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

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

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

- 1) Domestic fixed-line communications**
- 2) Cellular**
- 3) International communications, Internet and NEP services**
- 4) Multi-channel television**

The Company has other areas of operation which are not material to the activities of the Group, and these are included in the financial statements as the "Others" segment. They are, mainly, Internet services and Internet portal operation (through Walla), and customer center services (through Bezeq On Line).

Profit for the reporting half amounted to NIS 991 million<sup>1</sup> compared with NIS 1,280 million in the corresponding period, a decrease of approximately 22.6%.

Profit for the reporting Quarter was NIS 585 million, compared with NIS 638 million in the corresponding quarter, a decrease of approximately 8.3%.

The results of the half were influenced mainly by a rise in other operating expenses, net, due to the recording of expenses in respect of an early retirement plan for 2011 arising from a Company commitment established with the January 2011 resolution of the Board of Directors and its communication to the public (see Note 12A to the financial statements). Expenses for early retirement in 2010 were recorded in the financial statements at December 31, 2009, since the Board of Directors' resolution on early retirement was adopted and communicated to the public in November 2009.

The decrease in profit for the Quarter stems from a decrease in operating income and an increase in finance expenses. See below for further details.

The Company's EBITDA (operating profit before depreciation and amortization) decreased from NIS 2,555 million in the corresponding period and NIS 1,338 million in the corresponding quarter, to NIS 2,283 million in the current period and NIS 1,283 million in the Quarter. Most of the decrease stems from the factors noted above which affected profit.

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<sup>1</sup> 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.

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

**1. Financial condition**

- a. The Group's assets at June 30, 2011 amounted to NIS 15.20 billion, compared with NIS 13.82 billion on June 30, 2010, of which NIS 5.89 billion (approximately 39%) is property, plant and equipment, compared with NIS 5.51 billion (approximately 40%) on June 30, 2010.

The increase in the Group's assets is in all segments, as explained below.

In the domestic fixed-line communications segment there was an increase of NIS 791 million in total assets, excluding investment in investee companies, compared with June 30, 2010, due mainly to an increase in fixed asset balances resulting from deployment of the NGN system and also from a rise in cash balances and intangible assets.

In the cellular segment, assets increased from NIS 4.85 billion on June 30, 2010 to NIS 5.32 billion at June 30, 2011. Most of the increase stems from a rise in customer balances, mainly due to an increase in revenues from sales of terminal equipment on installments and to an increase in inventory and cash balances, which were partially offset by a decrease in property, plant and equipment and in intangible assets.

In the international communications, Internet and NEP services segment, assets (excluding investment in associates) by NIS 143 million. Most of the increase was in fixed asset balances following investment in the sea-bed cable.

In the multi-channel television segment there was an increase in assets from NIS 1,245 million on June 30, 2010 to NIS 1,274 million at June 30, 2011, which stemmed mainly from an increase in intangible asset balances and in cash.

The assets of the "Others segment also increased, mainly due to Walla's purchase of shares in Coral Tel Ltd. (operator of the Yad2 website) in September 2010.

- b. The Group's debt to financial institutions and debenture holders at June 30, 2011 amounted to NIS 6.98 billion, compared with NIS 5.23 billion on June 30, 2010. The increase stemmed from the domestic fixed-line communications segment, due to receipt of bank loans and a private issue of debentures. The increase was moderated by the repayment of debentures in the segment, as well as the repayment of debentures and loans in the cellular segment.

## 2. Results of operations

### a. Result highlights

Condensed consolidated income statement:

|                                           | For the six months ended June 30, |                      | Increase (decrease) | Change       | For the three months ended June 30, |                      | Increase (decrease) | Change      |
|-------------------------------------------|-----------------------------------|----------------------|---------------------|--------------|-------------------------------------|----------------------|---------------------|-------------|
|                                           | 2011<br>NIS millions              | 2010<br>NIS millions |                     |              | 2011<br>NIS millions                | 2010<br>NIS millions |                     |             |
| Ongoing operations:                       |                                   |                      |                     |              |                                     |                      |                     |             |
| Revenues                                  | 5,806                             | 5,896                | (90)                | (2)%         | 2,893                               | 2,981                | (88)                | (3)%        |
| Costs and expenses                        | 4,206                             | 4,032                | 174                 | (4)%         | 1,958                               | 1,991                | (33)                | (2)%        |
| Operating income                          | 1,600                             | 1,864                | (264)               | (14)%        | 935                                 | 990                  | (55)                | (6)%        |
| Finance expenses, net                     | 82                                | 13                   | 69                  | -            | 62                                  | 35                   | 27                  | 77%         |
| <b>Profit after finance expenses, net</b> | <b>1,518</b>                      | <b>1,851</b>         | <b>(333)</b>        | <b>(18)%</b> | <b>873</b>                          | <b>955</b>           | <b>(82)</b>         | <b>(9)%</b> |
| Equity in losses of investees             | 137                               | 109                  | 28                  | 26%          | 72                                  | 86                   | (14)                | (16)%       |
| <b>Profit before income tax</b>           | <b>1,381</b>                      | <b>1,742</b>         | <b>(361)</b>        | <b>(21)%</b> | <b>801</b>                          | <b>869</b>           | <b>(68)</b>         | <b>(8)%</b> |
| Income tax                                | 390                               | 462                  | (72)                | (16)%        | 216                                 | 231                  | (15)                | (6)%        |
| <b>Profit for the period</b>              | <b>991</b>                        | <b>1,280</b>         | <b>(289)</b>        | <b>(23)%</b> | <b>585</b>                          | <b>638</b>           | <b>(53)</b>         | <b>(8)%</b> |
| Attributable to:                          |                                   |                      |                     |              |                                     |                      |                     |             |
| Company owners                            | 992                               | 1,280                | (288)               | (23)%        | 585                                 | 638                  | (53)                | (8)%        |
| Non-controlling interests                 | (1)                               | -                    | (1)                 | 100%         | -                                   | -                    | -                   | -           |
| <b>Profit for the period</b>              | <b>991</b>                        | <b>1,280</b>         | <b>(289)</b>        | <b>(23)%</b> | <b>585</b>                          | <b>638</b>           | <b>(53)</b>         | <b>(8)%</b> |
| Earnings per share:                       |                                   |                      |                     |              |                                     |                      |                     |             |
| Base earnings per share (NIS)             | 0.37                              | 0.48                 | (0.11)              | (22.9)%      | 0.22                                | 0.24                 | (0.02)              | (8.3)%      |
| Diluted earnings per share (NIS)          | 0.36                              | 0.47                 | (0.11)              | (23.4)%      | 0.21                                | 0.24                 | (0.03)              | (12.5)%     |

Most of the decrease in the Group's revenues stems from the decrease in revenues from interconnect fees in the cellular and domestic fixed-line communications segments, after their rate was lowered by about 70% compared with the rate in the corresponding period. The decrease was moderated by an increase in revenues from sales of terminal equipment in the cellular segment, and by the start of consolidation of Walla ("Others" segment) from April 25, 2010.

The Group's depreciation and amortization expenses in the half amounted to NIS 683 million, compared with NIS 691 million in the corresponding period, a decrease of 1.2%.

The decrease stemmed mainly from the cellular segment, due to items of property, plant and equipment which reached the end of their depreciation, notably the CDMA network, and was offset by an increase in depreciation in respect of new fixed asset items.

The Group's depreciation and amortization expenses in the current Quarter and in the corresponding quarter were NIS 348 million.

The Group's salary expense in the half amounted to NIS 1,072 million, compared with NIS 994 million in the corresponding period, an increase of 7.8%.

The salary expense in the Quarter amounted to NIS 540 million, compared with NIS 489 million in the corresponding period, an increase of 10.4%.

The increase in the salary expense stems mainly from the domestic fixed-line communications segment, and is due to an increase in share-base payments and a rise in wages. The increase was partially offset by an increase in salary attributable to investment and a decrease in the number of employees. The salary expense also increased with the consolidation of Walla.

The Group's operating and general expenses in the half amounted to NIS 2,263 million compared with NIS 2,442 million in the corresponding period, a decrease of 7.3%.

Operating and general expenses in the Quarter amounted to NIS 1,132 million compared with NIS 1,224 million in the corresponding quarter, a decrease of 7.5%.

The decrease stems from the domestic fixed-line communications and the cellular segments, due to a decrease in interconnect expenses as noted above. The decrease was moderated by a rise in the cost of selling terminal equipment in the cellular segment.

Other operating expenses, net, of the Group in the half amounted to NIS 188 million, compared with NIS 95 million in the corresponding period. The change stems from recording of expenses of NIS 281.5 million in the first quarter of 2011 in respect of early retirement in the domestic fixed-line communications segment (see Note 12A to the financial statements).

Other operating expenses, net, of the Group in the Quarter amounted to NIS 62 million, compared with NIS 70 million in the corresponding quarter.

The Group's finance expenses, net, in the half amounted to NIS 82 million, compared with NIS 13 million in the corresponding period.

Finance expenses, net, in the Quarter amounted to NIS 62 million, compared with NIS 35 million in the corresponding quarter.

The increase in net finance expenses stems mainly from the domestic fixed-line communications segment.

b. Segments of operation

Below are data by segment, presented in accordance with the Group's segments of operation:

| Revenues by operating segment                              | 1-6/2011     |              | 1-6/2010     |              | 4-6/2011     |              | 4-6/2010     |              |
|------------------------------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
|                                                            | NIS millions | % of revenue | NIS millions | % of revenue | NIS millions | % of revenue | NIS millions | % of revenue |
| Domestic fixed-line communications                         | 2,348        | 40.4%        | 2,611        | 44.3%        | 1,170        | 40.4%        | 1,307        | 43.8%        |
| Cellular                                                   | 2,888        | 49.7%        | 2,822        | 47.9%        | 1,438        | 49.7%        | 1,429        | 47.9%        |
| International communications,<br>Internet and NEP services | 662          | 11.4%        | 685          | 11.6%        | 333          | 11.5%        | 342          | 11.5%        |
| Multi-channel television                                   | 810          | 14.0%        | 787          | 13.3%        | 404          | 14.0%        | 396          | 13.3%        |
| Other and offsets*                                         | (902)        | (15.5)%      | (1,009)      | (17.1)%      | (452)        | (15.6)%      | (493)        | (16.5)%      |
| Total                                                      | 5,806        | 100%         | 5,896        | 100%         | 2,893        | 100%         | 2,981        | 100%         |

  

| Operating profit by operating segment                      | 1-6/2011     |              | 1-6/2010     |              | 4-6/2011     |              | 4-6/2010     |              |
|------------------------------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
|                                                            | NIS millions | % of revenue | NIS millions | % of revenue | NIS millions | % of revenue | NIS millions | % of revenue |
| Domestic fixed-line communications                         | 728          | 31.0%        | 993          | 38.0%        | 517          | 44.2%        | 503          | 38.5%        |
| Cellular                                                   | 756          | 26.2%        | 684          | 24.2%        | 357          | 24.8%        | 362          | 25.3%        |
| International communications,<br>Internet and NEP services | 121          | 18.3%        | 185          | 27.0%        | 60           | 18%          | 123          | 36.0%        |
| Multi-channel television                                   | 127          | 15.7%        | 66           | 8.4%         | 66           | 16.3%        | 7            | 1.8%         |
| Other and offsets*                                         | (132)        |              | (64)         |              | (65)         |              | (5)          |              |
| Consolidated operating profit / % of Group's revenues      | 1,600        | 27.6%        | 1,864        | 31.6%        | 935          | 32.3%        | 990          | 33.2%        |

\* Setoffs are mainly in respect of a segment that is an associate.

### **Domestic fixed-line communications segment**

#### **Revenues:**

Segment revenues in the first half of 2011 totaled NIS 2,348 million compared with NIS 2,611 million in the corresponding period, a decrease of 10.1%.

Segment revenues in the Quarter totaled NIS 1,170 million compared with NIS 1,307 million in the corresponding quarter, a decrease of 10.5%.

The decrease in segment revenues stemmed primarily from a decrease in revenues from interconnect fees to the cellular networks (with a corresponding decrease in expenses), due to those fees being lowered commencing January 1, 2011. Review of the effects of the change in interconnect tariffs on the Company's income shows that the lower tariffs reduced the segment's income by NIS 289 million in the half and by NIS 152 million in the Quarter.

In contrast, revenues from high-speed Internet increased, mainly as a result of an increase in the number of Internet subscribers and in increase in ARPU due to upgrading to higher surfing speeds and an increase in sales of home networks. Revenues from data communication and others also increased. The rise was partially offset by a decrease in revenues from telephony, mainly as a result of reduced call traffic and the number of lines.

#### **Costs and expenses:**

Depreciation and amortization expenses in the half amounted to NIS 333 million compared with NIS 341 million in the corresponding period, a decrease of 2.3%.

The source of the decrease is the end of depreciation of property, plant and equipment and an increase in the scrap value of property, plant and equipment. The decrease was partially offset by an increase in depreciation stemming from making investments in the NGN project.

Depreciation and amortization expenses in the current Quarter and in the corresponding quarter amounted to NIS 171 million.

The salary expense in the half amounted to NIS 575 million, compared with NIS 527million in the corresponding period, an increase of 9.1%.

The salary expense in the Quarter amounted to NIS 291 million, compared with NIS 250 million in the corresponding quarter, an increase of 16.4%.

The increase in the salary expense in the half resulted from an increase in share-based payments and a rise in wages, and was moderated mainly a rise in salaries attributable to investment and a decrease in the number of employees.

Operating and general expenses in the half amounted to NIS 524 million compared with NIS 788 million in the corresponding period, a decrease of 33.5%.

Operating and general expenses in the Quarter amounted to NIS 253 million compared with NIS 396 million in the corresponding quarter, a decrease of 36.1%.

The decrease stems from a decrease in interconnect fees to the cellular networks with a corresponding decrease in interconnect fee revenues, following reduction of the fees as noted above.

Other net operating expenses in the half amounted to NIS 188 million, compared with income of NIS 38 million in the corresponding period.

The transition from income to expenses stems from recording an expense provision of NIS 281.5 million in respect of early retirement severance liabilities (see Note 12A to the financial statements). Conversely, there is an increase in capital gains from the sale of real estate assets and copper (see Note 12F to the financial statements).

Other net operating expenses in the Quarter amounted to NIS 62 million, compared with income of NIS 13 million in the corresponding quarter

The increase in income stems mainly from and increase in capital gains on the sale of real estate properties and copper.

#### **Operating profit:**

Operating profit in the segment in the half amounted to NIS 728 million compared with NIS 993 million in the corresponding period, a decrease of 26.7%.

Operating profit in the segment in the Quarter amounted to NIS 517 million compared with NIS 503 million in the corresponding period, an increase of 2.8%.

The decrease stems from the changes described above in the income and expense items in the half, mainly the provision for early retirement severance liabilities.

Finance expenses, net:

Net finance expenses in the half amounted to NIS 99 million, compared with NIS 28 million in the corresponding period.

Net finance expenses in the Quarter amounted to NIS 73 million, compared with NIS 29 million in the corresponding quarter.

The increase stems mainly from an increase in borrowings at fixed and variable shekel interest, from a finance expense of NIS 30 million in respect of revaluation of a liability for a distribution that does not pass the profit test, and in the half, also a rise in linkage differential expenses in respect of debentures due to a rise in the known Index to which they are linked by a rate higher than in the corresponding period. The increase was moderated mainly by a rise in finance income from shareholder loans to DBS and by repayment of debentures.

### **Cellular segment**

Revenues:

Segment revenues in the first half of 2011 amounted to NIS 2,888 million compared with NIS 2,822 million in the corresponding period, an increase of 2.3%.

Segment revenues in the Quarter amounted to NIS 1,438 million compared with NIS 1,429 million in the corresponding quarter, an increase of 0.6%.

Segment revenues from services (including value added services) in the half amounted to NIS 1,874 million, compared with NIS 2,246 million in the corresponding period, a decrease of 16.6%.

Segment revenues from services in the Quarter amounted to NIS 925 million, compared with NIS 1,140 million in the corresponding period, a decrease of 18.9%.

The decrease in revenues from services is the result of the lower interconnect fee rates, which reduced revenues by NIS 431 million in the half and by NIS 218 million in the Quarter.<sup>2</sup> It is also noted that competition between the cellular companies has intensified in recent months, which has led to erosion of tariffs both for new customers and for existing customers as part of the effort to retain them. This is reflected in average monthly revenues per user.

Revenues from the sale of terminal equipment in the half amounted to NIS 1,014 million compared with NIS 576 million in the corresponding quarter, an increase of 76%.

Revenues from the sale of terminal equipment in the Quarter amounted to NIS 513 million compared with NIS 289 million in the corresponding period, an increase of 77.5%.

The increase in revenues from the sale of terminal equipment is due mainly to the rise in selling prices and upgrading of terminal equipment, and to an increase in the number of sales and upgrades following increased sales of smartphones.

Costs and expenses:

Depreciation and amortization expenses in the half amounted to NIS 282 million compared with NIS 298 million in the corresponding period a decrease of 5.4%.

Depreciation and amortization expenses in the Quarter amounted to NIS 143 million compared with NIS 149 million in the corresponding quarter, a decrease of 4.0%.

The decrease stems from items of property, plant and equipment which reached the end of their depreciation period, mainly in respect of the CDMA network, and was partially offset by an increase in depreciation in respect of new fixed asset items.

The salary expense in the half and in the corresponding half amounted to NIS 299 million.

The salary expense in the Quarter and in the corresponding quarter amounted to NIS 149 million.

Operating and general expenses in the half amounted to NIS 1,551 million compared with NIS 1,541 million in the corresponding period, an increase of 0.6%.

Operating and general expenses in the Quarter amounted to NIS 789 million compared with NIS 769 million in the corresponding quarter, an increase of 2.6%.

The increase stems mainly from an increase in the cost of selling terminal equipment, which is due mainly to an increase in the number of handsets sold and upgraded and to a rise in terminal equipment prices following increased sales of smartphones. The increase was largely offset by a fall in the prices of services, mainly the costs of call completion fees following the lowering of interconnect fees.

The lower interconnect fees reduced the operating and general expenses by NIS 306 million in the half and by NIS 156 million in the Quarter.<sup>2</sup>

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<sup>2</sup> The figure is calculated according to minutes actually used in the current period, multiplied by 17.82 agorot per minute, which is the difference between the interconnect fees in the current period (7.28 agorot per minute) and the interconnect fees in the corresponding period (25.1 agorot per minute).

Operating profit:

The segment's operating profit in the half amounted to NIS 756 million, compared with NIS 684 million in the corresponding period, an increase of 10.5%.

Operating profit in the Quarter amounted to NIS 357 million, compared with NIS 362 million in the corresponding quarter, a decrease of 1.4%.

The change in operating profit are as described above.

Finance income, net:

The segment's net finance income in the half amounted to NIS 19 million, compared with NIS 15 million in the corresponding period, an increase of 26.7%.

The increase in net finance income stems mainly from an increase in income from exchange rate differences following a fall in the dollar exchange rate in the period compared with an increase in the corresponding period, which was partially offset by an increase in expenses in respect of revaluation of borrowings following a greater rise in the known Index than in the corresponding half.

The segment's net finance income in the Quarter amounted to NIS 9 million, compared with net finance expenses of NIS 7 million in the corresponding quarter.

The increase in net finance income stems mainly from income from exchange rate differences following a fall in the dollar exchange rate compared with a rise in the rate in the corresponding quarter.

**International communications, Internet and NEP segment**

Revenues:

In the first half of 2011, segment revenues amounted to NIS 662 million compared with NIS 685 million in the corresponding period, a decrease of 3.4%.

Segment revenues in the Quarter amounted to NIS 333 million compared with NIS 342 million in the corresponding quarter, a decrease of 2.6%.

The decrease in revenues stems from fewer outbound and inbound minutes due to a decline in traffic volume in the market as a whole, and a decrease in call transfers between carriers around the world. Offsetting these was an increase in Internet revenues as a result of an increase in the number of customers and growth in integration activities (IT solutions and business communications).

Costs and expenses:

Depreciation and amortization expenses in the half amounted to NIS 51 million, compared with NIS 46 million in the corresponding period, an increase of 10.9%.

Depreciation and amortization expenses in the Quarter amounted to NIS 27 million, compared with NIS 23 million in the corresponding quarter, an increase of 17.4%.

The salary expense in the half amounted to NIS 129 million compared with NIS 126 million in the corresponding period, an increase of 2.4%.

The salary expense in the Quarter amounted to NIS 66 million compared with NIS 62 million in the corresponding quarter, an increase of 6.5%.

Operating and general expenses in the half amounted to NIS 361 million compared with NIS 385 million in the corresponding period, a decrease of 6.2%.

Operating and general expenses in the Quarter amounted to NIS 180 million compared with NIS 191 million in the corresponding quarter, an increase of 5.8%.

The decrease in these expenses parallels the decrease in the segment's revenues.

Revenues from other operations, net, in the half and in the second quarter of 2010 included a capital gain of NIS 57.4 million from revaluation of the holdings in Walla upon assuming control.

Operating profit:

Operating profit in the segment in the half amounted to NIS 121 million compared with NIS 185 million in the corresponding period, a decrease of 34.6%.

Operating profit in the segment in the Quarter amounted to NIS 60 million compared with NIS 123 million in the corresponding quarter, a decrease of 51.2%.

The decrease stems from the changes described above in the income and expense items, primarily the recording of a capital gain of NIS 57.4 million in the half and second quarter of 2010.

### **Multi-channel television (stated by the equity method)**

#### **Revenues:**

Segment revenues in the half amounted to NIS 810 million compared with NIS 787 million in the corresponding period, an increase of 2.9%.

Segment revenues in the Quarter amounted to NIS 404 million compared with NIS 396 million in the corresponding quarter, an increase of 2%.

Most of the increase stems from a rise in revenues from advanced products and from an increase in the number of segment customers.

#### **Costs and expenses:**

Cost of sales in the half amounted to NIS 541 million, compared with NIS 584 million in the corresponding period, a decrease of 7.4%.

Cost of sales in the Quarter amounted to NIS 269 million, compared with NIS 322 million in the corresponding quarter, a decrease of 16.5%.

Most of the decrease stems from a material provision for AKUM made in the corresponding half and quarter.

Sales, marketing, administration and general expenses in the half amounted to NIS 142 million, compared with NIS 138 million in the corresponding period, an increase of 2.9%.

Sales, marketing, administration and general expenses in the Quarter amounted to NIS 70 million, compared with NIS 67 million in the corresponding quarter, an increase of 4.5%.

#### **Operating profit:**

Operating profit in the half amounted to NIS 127 million compared with NIS 66 million in the corresponding period, an increase of 92.4%.

Operating profit in the Quarter amounted to NIS 66 million compared with NIS 7 million in the corresponding quarter.

The increase in operating profit stems from the changes described above in the income and expense items, and primarily from a material provision for AKUM made in the corresponding period and quarter.

#### **c. Income tax**

The Group's tax expense in the first half of 2011 amounted to NIS 390 million, representing approximately 28.2% of pre-tax profit, compared with NIS 462 million and 26.5% of pre-tax profit in the corresponding period. The rise in the tax rate out of pre-tax profit stems mainly from expenses not recognized for tax purposes and from timing differences in the recognition of expenses for tax purposes (primarily early retirement), which will be recognized when the tax rates are lower than those in effect today.

The tax expense in the Quarter amounted to NIS 216 million, representing approximately 27% of pre-tax profit, compared with NIS 231 million and 26.6% of pre-tax profit in the corresponding quarter.

### **3. Equity**

Equity attributable to the Company's owners at June 30, 2011 amounted to NIS 2.44 billion, which is approximately 16% of the total balance sheet, compared with NIS 5.4 billion and 39% of the balance sheet on June 30, 2010. The decrease in equity stemmed from the distribution of a dividend of NIS 2.44 billion during the second half of 2010 and in the first half of 2011, and from the distribution of a dividend that does not pass the profit test, in the amount of NIS 3 billion in the reporting period, which is stated at its present value of NIS 2.81 billion (see Note 6F to the financial statements). The decrease was partially offset by the Group's undistributed profits in the reporting period.

### **4. Cash flow**

Consolidated cash flow from operating activities in the first half of 2011 amounted to NIS 1,445 million, compared with NIS 1,782 million in the corresponding period, a decrease of NIS 337 million.

Consolidated cash flow from operating activities in the Quarter amounted to NIS 670 million, compared with NIS 976 million in the corresponding quarter, a decrease of NIS 306 million.

Most of the decrease stems from the cellular segment, primarily due to changes in the working capital and the increase in sales of terminal equipment on 36 installments.

Cash flow from operating activities is one of the sources for financing the Group's investments. In the reporting period these included NIS 797 million in the development of communications infrastructure compared with NIS 607 million in the corresponding period, and NIS 158 million in intangible assets and deferred expenses in the current and corresponding periods. In contrast, the domestic fixed-line communications segment received proceeds of NIS 235 million from the sale of fixed assets in the reporting period, compared with NIS 41 million in the corresponding period. In addition, in the cellular segment, net proceeds of NIS 110 million were received in the corresponding period from the sale of an investment in a money market fund.

In the reporting half, the Group repaid net debts and paid interest amounting to NIS 977 million, of which NIS 757 million of debentures, NIS 24 million of loans and NIS 193 million of interest payments, compared with net debt repayment and interest payments of NIS 996 million in the corresponding period. Conversely, the domestic fixed-line communications segment raised NIS 2 billion of debt in the Quarter (see Note 12B to the financial statements), compared with NIS 1.9 billion in the corresponding quarter.

In addition, a dividend of NIS 1.66 billion was paid in the Quarter, compared with NIS 2.45 billion in the corresponding quarter.

The average of long-term liabilities to financial institutions and debenture holders in the reporting period was NIS 6.113 billion.

Average supplier credit in the reporting period was NIS 1,033 million, and average short-term customer credit was NIS 2,781 million. Average long-term customer credit was NIS 1,170 million.

The Group's working capital deficit at June 30, 2011 amounted to NIS 1,298 million compared with NIS 482 million in the corresponding period, and in the Company was NIS 2,360 million compared with NIS 1,564 million in the corresponding period. The increase in the Group's working capital deficit stems mainly from the balance of the dividend payable and the increase in short-term financial and other liabilities.

The Board of Directors of the Company reviewed the current and foreseeable cash sources and needs, the investment needs of the Company and the sources of finance and the amounts that can potentially be raised for the Company. Based on a review of all these factors, the Board of Directors concluded that despite the working capital deficit, the Company does not have a liquidity problem. The Company can meet its present and future cash needs for the foreseeable future, both by means of generating cash from operations and by means of raising debt from bank and non-bank sources – see also Note 12 to the financials statements concerning raising NIS 2.7 billion in debentures offered to the public after the balance sheet date.

The above information includes forward-looking information based on the Company's assessments as to liquidity. Actual data might differ substantially from the above assessment if a change occurs in one of the factors taken into account in their making.

**B. Explanations of the Board of Directors relating to market risks and their management**

- a. Surplus assets exposed to changes in nominal shekel interest decreased by NIS 3,292 million to surplus liabilities exposed to changes in nominal shekel interest, as a result of the distribution that does not pass the profit test, is interest-free and unlinked (see Note 6F to the financial statements) and as a result of NIS 2 billion of debt raised in May 2011 (see Note 12B to the financial statements), of which NIS 900 million at fixed interest. Other than this, the sensitivity analyses for the fair value and effects of change in market prices on the fair value of the balance-sheet and off-balance-sheet balances with regard to which there is strong affinity at June 30, 2011, do not differ materially from the report on December 31, 2010.
- b. The linkage bases report at June 30, 2011 does not differ significantly from the report of December 31, 2010, except for the increase in unlinked liabilities of NIS 4,341 million described in Section 1 above.

**C. Corporate governance**

**1. Disclosure on the proceeding for approving the financial statements**

**1.1 Committee**

The Company's Financial Statements Review Committee is a separate committee from the Audit Committee, although some members of the Audit Committee are also members of the Financial Statements Review Committee (Mordechai Keret – external director, Yitzchak Idelman – external director, Dr. Yehoshua Rosenzweig – independent director).

**1.2 Committee members**

The committee has four members - Yitzchak Idelman – Chairman (external director), Mordechai Keret (external director), Eldad Ben-Moshe (independent director), and Dr. Yehoshua Rosenzweig (independent director), who was appointed to the committee on May 31, 2011. All four members have accounting and financial expertise, and all submitted a declaration prior to their appointment. For more information about the members of the committee, see Chapter D of the Company's 2010 Periodic Report.

**1.3 Proceeding for approval of the financial statements**

- a. The Financial Statements Review Committee discussed and prepared its recommendations to the Board of Directors at its meetings on July 25 and 28, 2011.
- b. All the members of the committee participated in the discussions.
- c. Other than the committee members, the following persons attended the committee's meeting on July 25, 2011: Chairman of the Board Shaul Elovitz, CEO Avi Gabbay, Deputy CEO and CFO Alan Gelman, comptroller Danny Oz, internal auditor Lior Segal, director Rami Nomkin, General Counsel Amir Nachlieli, and the outside auditors, and other office-holders in the Company. At the committee's meeting on July 28, 2011, the following persons attended in addition to the committee members: Chairman of the Board Shaul Elovitz, CEO Avi Gabbay, Deputy CEO and CFO Alan Gelman, comptroller Danny Oz, internal auditor Lior Segal, director Rami Nomkin, Company Secretary Linor Yochelman, General Counsel Amir Nachlieli, and the outside auditors, and other office-holders in the Company.
- d. The committee reviewed the assessments and estimates made in connection with the financial statements, internal controls relating to the financial reporting, the integrity and appropriateness of the disclosure in the financial statements, the accounting policy adopted and the accounting treatment applied in material matters of the corporation.
- e. At its meeting on May 5, 2011, the committee decided on the identity of the regular attendees of its meetings. The committee also decided that at the end of every quarterly meeting for approval of the financial statements, it would convene together with the internal auditor and the outside auditors only.
- f. The committee's recommendations were submitted to the Board of Directors in writing on July 28, 2011.
- g. The Board of Directors discussed the committee's recommendations and the financial statements on August 1, 2011.
- h. The Board of Directors believes that the recommendations of the Financial Statements Review Committee were submitted a reasonable time before the Board meeting (which the Board had determined to be not less than 72 hours), notwithstanding their scope and complexity.
- i. The Board of Directors accepted the recommendations of the committee, and resolved to approve the financial statements of the Company at June 30, 2011.

2. Commencing 2011, the Company ceased application of the Securities (Periodic and immediate reports) Regulations, 2009, in the matter of the internal control it implements, and instead it applies the provisions of the Sarbanes-Oxley Act (SOX) of 2002, as a significant subsidiary of a company traded in the US.

**D. Disclosure concerning the Company's financial reporting**

**1. Critical accounting estimates**

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

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

**3. Events after the balance-sheet date**

On August 1, 2011, 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 amount of NIS 992 million (see Note 6G to the financial statements).

**E. Details of a series of liability certificates**

1. Debentures Series 4 – NIS 300,000,000 par value was repaid on June 1, 2011, and the series has now been repaid in full.
2. Debentures Series 5 - Following are the updated data at June 30, 2011:

|    |                                                              | Debentures Series 5                  |
|----|--------------------------------------------------------------|--------------------------------------|
| A. | Par value                                                    | NIS 1,989,139,167 <sup>(1)</sup> (2) |
| B. | Par value revalued at the reporting date (linked to the CPI) | NIS 2,375,782,423 <sup>(3)</sup>     |
| C. | Accrued interest                                             | NIS 10,493,039                       |
| D. | Fair value                                                   | NIS 2,597,616,838                    |
| E. | Stock exchange value                                         | NIS 2,597,616,838                    |

(1) On June 1, 2011, NIS 397,827,833 par value was repaid.

(2) Of which, NIS 733.4 million par value is held by a wholly-owned subsidiary.

(3) Of which NIS 876 million is held by a wholly-owned subsidiary.

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

3. After the balance sheet date, on July 3, 2011, the Company issued Debentures Series 6, 7 and 8, as shown below, under a shelf offering report dated June 29, 2011 published pursuant to the shelf prospectus. The tender for the debentures was completed on June 30, 2011.

These debentures are not included in the Company's liabilities at June 30, 2011.

Details of the new debentures:

|           |                                                                                                                                            | <b>Debentures<br/>Series 6</b>                                                                | <b>Debentures<br/>Series 7</b>                                                              | <b>Debentures<br/>Series 8</b>                                                             |
|-----------|--------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------|
| <b>A.</b> | Issue date                                                                                                                                 | July 3, 2011                                                                                  | July 3, 2011                                                                                | July 3, 2011                                                                               |
| <b>B.</b> | Total par value on issue date                                                                                                              | NIS 958,088,000                                                                               | NIS 424,955,000                                                                             | NIS 1,329,363,000                                                                          |
| <b>C.</b> | Stock exchange value                                                                                                                       | Not yet trading on June 30, 2011                                                              |                                                                                             |                                                                                            |
| <b>D.</b> | Interest type                                                                                                                              | Fixed at 3.7%                                                                                 | Variable – short-term for one year + margin not exceeding 1.4%                              | Fixed at 5.7%                                                                              |
| <b>E.</b> | Repayment dates for principal                                                                                                              | December 1 <sup>st</sup> of each of the years 2018-2022                                       | December 1 <sup>st</sup> of each of the years 2018-2022                                     | June 1 <sup>st</sup> of each of the years 2015-2017                                        |
| <b>F.</b> | Interest payment dates                                                                                                                     | June 1 <sup>st</sup> and Dec. 1 <sup>st</sup> of every year from Dec. 1, 2011 to Dec. 1, 2022 | 1 <sup>st</sup> of March, June, Sept. and Dec. each year from Sept. 1, 2011 to Dec. 1, 2022 | June 1 <sup>st</sup> and Dec. 1 <sup>st</sup> every year from Dec. 1, 2011 to June 1, 2017 |
| <b>G.</b> | Linkage                                                                                                                                    | CPI – principal and interest (base index – May 2011)                                          | Unlinked                                                                                    | Unlinked                                                                                   |
| <b>H.</b> | Company's right to make early redemption                                                                                                   | No                                                                                            | No                                                                                          | No                                                                                         |
| <b>I.</b> | With the inclusion of Series 6-8 in the Company's liabilities – total liabilities out of the Company's total liabilities is expected to be | Material                                                                                      | Not material                                                                                | Material                                                                                   |

#### Series 6 and 7

Trust company – Reznik Paz Nevo Trusts Ltd.

Name of persons in charge at trust company – CPA Yossi Reznik and Adv. Liat Bachar-Segal

E-mail – [trust@rpn.co.il](mailto:trust@rpn.co.il); tel: 03-6393311; fax: 03-6393316

Address: 14 Yad Harutzim Street, Tel Aviv

#### Series 8

Trust company – Strauss Lazar Trust Co. (1992) Ltd.

Name of person in charge at trust company – CPA Uri Lazar

E-mail – [slcpa@slcpa.co.il](mailto:slcpa@slcpa.co.il); tel: 03-6237777; fax: 03-5613824

Address – 17 Yitzchak Sadeh Street, Tel Aviv

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

4. On April 3, 2011, the Company received notice from Midroog Ltd., a rating company, which rates the Debentures (Series 4 and 5) issued by the Company, of removal of those debentures from the Watch List while leaving the rating unchanged (Aa1) with negative outlook, due to the prospect of a capital reduction and the distribution of a dividend of NIS 3 billion decided upon by the Company and approved by the District Court.

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

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

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

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

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Shaul Elovitz  
Chairman of the Board

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Avraham Gabbay  
CEO

Date of signature: August 1, 2011



**Bezeq The Israel Telecommunication Corporation Limited**

**Quarterly Report for the Period ending June 30, 2011**

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

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

**UPDATE OF CHAPTER A (DESCRIPTION OF COMPANY OPERATIONS)<sup>1</sup>**

**OF THE PERIODIC REPORT FOR 2010 (THE "PERIODIC REPORT") OF**

**"BEZEQ" – THE ISRAEL TELECOMMUNICATIONS CORPORATION LIMITED (THE "COMPANY")**

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

**Section 1.1 – Bezeq Group activities and business development**

**Section 1.1.1 – General**

Following are details of the current holdings in the Company including the fully diluted holdings, assuming exercise of all the options allotted to the Group's employees and managers at June 30, 2011 and July 31, 2011 (the calculation is, inter alia, subsequent to the acquisition of Company shares by B Communications as described in the update to Section 1.3.1):

| Shareholders                           | Percentage of holdings |                  |                                             |
|----------------------------------------|------------------------|------------------|---------------------------------------------|
|                                        | At June 30, 2011       | At July 31, 2011 | Fully diluted at July 31, 2011 <sup>2</sup> |
| B Communications (through B Tikshoret) | 31.23%                 | 31.18%           | 30.16%                                      |
| The public                             | 68.67%                 | 68.82%           | 69.84%                                      |

**Section 1.3 – Investments in equity and share transactions**

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

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

**Section 1.3.1 – Transactions in Bezeq shares**

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

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

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

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

#### **Section 1.4 - Distribution of dividends**

##### **Section 1.4.2 – Distribution of dividends**

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

The outstanding, distributable profits at the reporting date are NIS 992 million.

On August 1, 2011, the Company's board of directors resolved to recommend to the general meeting of the Company's shareholders (convened for September 7, 2011) to distribute a cash dividend of NIS 992 million to the shareholders. The effective date for the distribution is September 18, 2011 and the payment date is October 5, 2011. The second portion of the special distribution, in the amount of NIS 500 million, will be distributed together with this cash dividend (insofar as it is approved), as specified in the update to section 1.4.3, and the distribution dates for the current dividend (the Effective Date, Ex-date, and the payment date) will be relevant for this portion as well.

##### **Section 1.4.3 – Distribution that does not pass the profit test**

On March 31, 2011 the Tel Aviv District Court approved a distribution which does not pass the profit test, in a total amount of NIS 3 billion which will be distributed to the Company's shareholders in six equal semi-annual payments from 2011 until 2013. Pursuant thereto, on May 19, 2011 the first portion of this distribution was distributed in a total amount of NIS 500 million (which on the record date for the distribution (May 4, 2011) represented NIS 0.1851125 per share and 18.51125% of its issued and paid-up capital), together with the distribution of the regular dividend as described in the update to section 1.4.2. The second portion of this distribution, in the amount of NIS 500 million, is expected to be distributed together with the current dividend, as specified in the update to Section 1.4.2. The Company recorded a liability in its financial statements at March 31, 2011 for the whole sum of the distribution (NIS 3 billion).

On July 3, 2011, a bearer of a Company debenture (Series 5) applied to the court to instruct the Company to submit an up-to-date opinion and to allow responses to be submitted in view of the revised opinion, including the filing of objections, and this given that in the applicant's opinion circumstances have changed that justify a re-examination of the Company's solvency: an immediate raising of debt by the Company in the amount of NIS 3 billion (instead of from 2011-2013, pursuant to the assumption in the economic opinion that was attached to the Company's request), and a change in Midroog's rating outlook for the Company to negative. On July 10, 2011, the Company filed its response to the application stating that the application should be rejected as circumstances have not changed as alleged by the applicant and/or that justify a re-examination of the resolution pertaining to the write-down of capital and due to the fact that this resolution is final and absolute. On July 25, 2011, pursuant to the court's ruling, the Company received a response to the application and the Company's response from the ISA, in which context the ISA did not discuss the subject of the application – whether or not circumstances had changed since the date of the court ruling. Nevertheless, the ISA is of the opinion that should there be a significant deterioration of the Company's financial position between the date of giving the obligation and receiving approval for the distribution, and the payment date of the dividend, the Company's board of directors would be well advised to reassess the Company's compliance with the distribution tests, and if there are insufficient distributable profits, it should re-apply for the court's approval, unless the court ruling prescribes instructions that also take into account future changes in the Company's circumstances. A hearing was set for this case on September 19, 2011.

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

### Section 1.5.4 – Principal results and operational data

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

|                                                                                                    | Q2 2011 | Q1 2011 | Q4 2010 | Q3 2010 | Q2 2010 | Q1 2010 |
|----------------------------------------------------------------------------------------------------|---------|---------|---------|---------|---------|---------|
| Revenues                                                                                           | 1,170   | 1,178   | 1,329   | 1,323   | 1,307   | 1,304   |
| Operating profit                                                                                   | 517     | 211     | 494     | 556     | 503     | 490     |
| Depreciation and amortization                                                                      | 171     | 162     | 178     | 171     | 171     | 170     |
| EBITDA                                                                                             | 688     | 373     | 672     | 727     | 674     | 660     |
| Net profit                                                                                         | 330     | 123     | 340     | 377     | 349     | 360     |
| Cash flow from current operations                                                                  | 496     | 419     | 540     | 684     | 523     | 393     |
| Payments for investment in property, plant & equipment and intangible assets                       | 319     | 319     | 302     | 245     | 247     | 238     |
| Proceeds from sale of property, plant & equipment                                                  | 48      | 187     | 43      | 48      | 26      | 15      |
| Free cash flow <sup>(1)</sup>                                                                      | 225     | 287     | 281     | 487     | 302     | 170     |
| Number of active subscriber lines at end of period (in thousands) <sup>(2)</sup>                   | 2,336   | 2,342   | 2,352   | 2,382   | 2,412   | 2,445   |
| Average monthly revenue per line (NIS) (ARPL) <sup>(3)</sup>                                       | 78      | 80      | 83      | 83      | 81      | 80      |
| No. of outgoing minutes (in millions)                                                              | 2,415   | 2,521   | 2,621   | 2,629   | 2,717   | 2,732   |
| No. of incoming minutes (in millions)                                                              | 1,535   | 1,577   | 1,644   | 1,665   | 1,634   | 1,623   |
| Number of internet subscribers at the end of the period (in thousands) <sup>(2)</sup>              | 1,088   | 1,079   | 1,066   | 1,056   | 1,051   | 1,045   |
| % of subscribers using NGN services out of total Internet subscribers connected to the NGN network | 40%     | 37%     | 34%     | 27%     | 23%     | 17%     |
| Average monthly revenue per Internet subscriber (NIS)                                              | 80      | 79      | 78      | 76      | 72      | 73      |
| Average bandwidth per Internet subscriber (Mbps)                                                   | 5.3     | 4.8     | 4.3     | 3.8     | 3.4     | 3.0     |
| Churn rate <sup>(4)</sup>                                                                          | 2.6%    | 3.1%    | 3.4%    | 3.1%    | 3.1%    | 3.0%    |

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

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

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

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

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

B. Pelephone  
(NIS millions unless stated otherwise)

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

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

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

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

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

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

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

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

C. Bezeq International  
(NIS millions unless stated otherwise)

|                                                                                                | Q2 2011 | Q1 2011 | Q4 2010 | Q3 2010 | Q2 2010 | Q1 2010 |
|------------------------------------------------------------------------------------------------|---------|---------|---------|---------|---------|---------|
| Income                                                                                         | 332     | 329     | 350     | 345     | 342     | 343     |
| Operating profit                                                                               | 60      | 61      | 65      | 70      | 124     | 62      |
| Depreciation and amortization                                                                  | 26      | 24      | 25      | 23      | 23      | 23      |
| EBITDA                                                                                         | 87      | 85      | 90      | 93      | 147     | 84      |
| Net profit                                                                                     | 46      | 46      | 46      | 53      | 108     | 46      |
| Cash flow from current operations                                                              | 68      | 42      | 92      | 75      | 66      | 59      |
| Payments for investments in property, plant and equipment and intangible assets <sup>(1)</sup> | 47      | 46      | 80      | 30      | 33      | 37      |
| Free cash flow <sup>(2)</sup>                                                                  | 21      | (4)     | 12      | 45      | 33      | 23      |
| Churn rate <sup>(3)</sup>                                                                      | 2.8%    | 2.9%    | 3.5%    | 3.2%    | 2.9%    | 3.2%    |

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

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

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

D. DBS  
(NIS millions unless stated otherwise)

|                                                                                                 | Q2 2011 | Q1 2011 | Q4 2010 | Q3 2010 | Q2 2010 | Q1 2010 |
|-------------------------------------------------------------------------------------------------|---------|---------|---------|---------|---------|---------|
| Revenue                                                                                         | 404     | 406     | 400     | 395     | 396     | 391     |
| Operating profit                                                                                | 65      | 61      | 41      | 72      | 7       | 59      |
| Depreciation and amortization                                                                   | 71      | 69      | 85      | 68      | 68      | 64      |
| EBITDA                                                                                          | 136     | 130     | 126     | 140     | 75      | 122     |
| Net profit (loss)                                                                               | (88)    | (73)    | (84)    | (78)    | (143)   | (8)     |
| Cash flow from current operations                                                               | 119     | 141     | 132     | 126     | 110     | 124     |
| Payments for investments in property, plant & equipment & intangible assets, net <sup>(1)</sup> | 64      | 71      | 90      | 63      | 63      | 61      |
| Free cash flow <sup>(2)</sup>                                                                   | 54      | 70      | 42      | 63      | 47      | 63      |
| Number of subscribers at the end of the period (thousands) <sup>(3)</sup>                       | 581     | 580     | 578     | 575     | 573     | 571     |
| Average monthly revenue per subscriber (NIS) (ARPU) <sup>(4)</sup>                              | 232     | 234     | 231     | 229     | 231     | 229     |
| Churn rate <sup>(5)</sup>                                                                       | 2.9%    | 3.3%    | 3.1%    | 3.3%    | 3.1%    | 3.5%    |

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

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

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

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

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

## **Section 1.6 – Forecast for the Group**

The Group's gross capital expenditures in 2011 are expected to be approximately 15% higher than in 2010, primarily due to an increase in investments in infrastructure by the Bezeq Group companies. The Bezeq Group is considering the possibility of purchasing real estate that will serve as the Group's headquarters, replacing leased properties. If the Group decides on this alternative, its gross capital expenditures in 2011 would increase by an additional 5% to 10%.

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

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

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

HOT-Mirs Group – on July 19, 2011, HOT announced that on that day, HOT's board of directors had approved an agreement with a company controlled by Altice VII S.A.r.l, which is the sole shareholder of HOT's controlling shareholder, and with a third party unrelated to HOT, to acquire all their rights in Mirs for the sum total of NIS 1,300 million, net of Mirs' debts. Completion of the transaction is subject to meeting preconditions, including the approval of a general meeting of HOT, regulatory approval and approval from banks.

IDB Group – Netvision Ltd. ("Netvision"), reported on July 27, 2011 that the boards of directors of Netvision and Cellcom Israel Ltd. ("Cellcom") had approved a merger agreement between Netvision and Cellcom and a wholly owned subsidiary of Cellcom in which all Netvision's shares would be acquired at an estimated value of NIS 1.5 billion. Netvision reported that completion of the transaction is contingent on obtaining additional approvals. Furthermore, the Antitrust Commissioner announced that a merger announcement does not have to be submitted in connection with this transaction.

### **Section 1.7.3 - Regulatory oversight and changes in the regulatory environment**

Sub-section A - Policy for regulating competition – Hayek Committee – the date for submitting public positions to the commission regarding the commission's recommendations on structural issues in the communications field was postponed to April 17, 2011. The Company, Pelephone, Bezeq International, and DBS submitted their comments to the commission which stated that the various comments would be published on the Ministry of Communications website.

Sub-section B – Increase in the rate of royalties – in addition to the petition filed by the Company in connection with increasing the rate of royalties, additional petitions were filed in the same matter by other communications companies, including Pelephone. All the petitions will be heard as one case. At a hearing of the petitions held at the High Court of Justice ("HCJ") on June 16, 2011, HCJ's decision was accepted in which by August 1, 2011, the State will announce its position regarding HCJ's proposal for ending impasse raised in the petition by mutual agreement. According to the proposal, the rate of royalties in 2012 will be 1.75% (instead of 2.5% in the regulations), and for subsequent years, HCJ's ruling 10289/05 shall apply, in which context the State announced that it is adopting the outline recommended by the Gronau Committee, whereby the rate of royalties applicable to the petitioner (Barak) will be reduced until they are entirely eliminated in 2012. Likewise, the State's position shall apply as presented in a written announcement given by them to the court in February 2009, whereby adoption of the said outline is subject to no circumstances occurring that have negative repercussions for the economy at the relevant dates. Accordingly, on July 31, 2011, the State announced its consent to HCJ's proposal.

Section D – limitation of the exit fee that a license-holder may collect from a subscriber: on June 19, 2011, the Knesset Economics Committee approved the bill in preparation for its second and third reading, with the following key changes: The provisions of the amendment to the law shall apply to a subscriber whose average monthly bills are less than NIS 5,000; an exit fee shall not be collected from a subscriber who entered into an agreement with the service provider after the onset date of the amendment to the law and then cancelled his subscription, and payment limited to 8% (of the monthly fees) may be collected from a subscriber who entered into an agreement before the amendment took effect and cancelled it afterwards.

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

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

**Section 2.7.2 – Domestic fixed-line communications infrastructure**

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

**Section 2.7.4 – Land**

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

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

**Section 2.9.7 - Employee benefit plans**

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

**Section 2.9.8 - Officers and senior management in the Company**

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

### **Section 2.13.1 – Average and effective interest rates on loans**

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

| Loan period      | Source of financing | Amount (NIS millions) | Currency or linkage | Type of interest and change mechanism          | Average interest rate | Effective interest rate | Interest range in 2011 |
|------------------|---------------------|-----------------------|---------------------|------------------------------------------------|-----------------------|-------------------------|------------------------|
| Long-term loans  | banks               | 1,800                 | Unlinked NIS        | Variable, based on prime rate*                 | 4.64%                 | 4.69%                   | 3.17%-4.95%            |
|                  | banks               | 1,800                 | Unlinked NIS        | Fixed                                          | 5.76%                 | 5.85%                   | 5%-6.85%               |
|                  | Non-Bank sources**  | 425                   | Unlinked NIS        | Variable, based on STGL interest per annum *** | 4.92%                 | 5.07%                   | -                      |
|                  | Non-Bank sources**  | 1,729                 | Unlinked NIS        | Fixed                                          | 5.92%                 | 6.10%                   | 5.70%-6.65%            |
|                  | Non-Bank sources**  | 2,527                 | CPI-linked NIS      | Fixed                                          | 4.61%                 | 4.12%                   | 3.70%-5.3%             |
| Short-term loans | banks               | 600                   | Unlinked NIS        | Variable, based on prime rate*                 | 3.95%                 | 4.01%                   | 3.7%-3.95%             |

\* Prime interest rate in July 2011 – 4.75%.

\*\* Non-bank sources include debt raised in accordance with a shelf prospectus from June 29, 2011 for Company debentures (Series 6, 7, and 8) for which the offer was completed on June 30, 2011 and settlement was completed on July 3, 2011.

\*\*\* Average STGL (makam) interest rate per annum for the last five days of trade immediately prior to the commencement of the interest period – 3.5180% for the current (first) interest period.

### **Section 2.13.3 – Credit received during the Reporting Period**

#### **Bank / institutional debt raised in May 2011**

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

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

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

Subsequently, on August 1, 2011, the Company's board of directors approved taking on a long-term debt of NIS 600 million (5.3 years duration) to replace the short-term debt in the same amount mentioned above. Upon taking this debt, the aforementioned letter of undertaking will be deleted.

#### **Debentures issued to the public in June 2011**

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

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

- (b) NIS 424,955,000 nominal value debentures (Series 7), bearing variable interest at the short-term government loan ("STGL") yield per annum ("base interest"), plus a margin of 1.40% at the rate determined in the issuance tender. The debentures (principal) shall be repaid in 5 equal, annual installments, payable on December 1 every year from 2018 through 2022 (inclusive). The first interest payment will be made on September 1, 2011, and subsequently the interest will be paid four times a year on March 1, June 1, September 1, and December 1 2011 through 2022 (in 2011 – on September 1, and December 1, only). The debentures (Series 7) are not linked to the CPI or to any currency.
- (c) NIS 1,329,363,000 nominal value debentures (Series 8), bearing fixed annual interest of 5.70%, as defined in the issuance tender. The debentures (principal) shall be repaid in 3 equal, annual installments, payable on June 1 every year from 2015 through 2017 (inclusive). The first interest payment will be made on December 1, 2011, and subsequently the interest will be paid twice a year on June 1 and December 1 every year from 2012 through 2016. The last interest payment will take place on June 1, 2017. The debentures (Series 8) are not linked to the CPI or to any currency.

In total, the Company received consideration of NIS 2,712,406,000 in respect of the debentures (Series 6-8), allotted according to the shelf proposal.<sup>3</sup>

**For further details on this subject, see the Company's shelf proposal report from June 29, 2011 and an announcement on the results of the issue according to the Company's shelf proposal report from June 30, 2011, which is incorporated by reference. See also Note 12 D to the Company's consolidated financial statements for the period ended June 30, 2011.**

#### **Section 2.13.6 - Credit rating**

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

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

On June 29, 2011, S&P Maalot announced that it had set a rating of iIAA+ (iIAA plus)<sup>4</sup> for the Company's new debentures (Series 6-8) in the amount of NIS 3 billion.

#### **Section 2.13.7 - Company assessment for raising financing and possible sources in 2011**

On this subject, see update to Section 2.13.3.

#### **Section 2.16.2 – the Company's domestic carrier license**

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

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

<sup>3</sup> Within the context of the issuance of the aforementioned debentures, Eurocom Capital Underwriting Ltd. (a company controlled indirectly by Eurocom Communications Ltd., the Company's indirect controlling shareholder), acquired 43,938,000 debentures (Series 6), 18,885,000 debentures (Series 7), and 48,49,000 debentures (Series 8). Accordingly, as of the date of the acquisition of the said debentures, Eurocom must report as a principal shareholder in the Company by virtue of its holdings.

<sup>4</sup> The Company's rating is iIAA+ - negative outlook.

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

#### **Section 2.16.8 – Antitrust Laws**

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

#### **Section 2.17.1(b) – Deed of Trust for debentures (Series 5) from May 24, 2011**

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

#### **Section 2.18 – Legal proceedings**

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

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

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

**Section 2.18.13** – In the matter of approval of an application for approval of a distribution which does not pass the profit test, see update to Section 1.4.3.

### **3. Mobile radio-telephone (cellular telephony) - Pelephone Communication Ltd. ("Pelephone")**

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

Various regulatory amendments, including a restriction on exit fees, led to the removal of transfer barriers and intensified the competition between the cellular operators and as a result, to an increase in the number of transferring subscribers among the cellular operators. This caused a churn rate of approximately 9.2% for the first six months of 2011, compared with 15.3% throughout 2010.

Vigorous subscriber traffic in the cellular market and a rise in demand for handsets and for smartphones in particular, contributed to an increase in revenues from terminal equipment which for the first six months of 2011 totaled NIS 1,014 million, representing 35.7% of total revenues, compared with 20.6% for the whole of 2010. Most terminal equipment is sold in 36 installments and this increase in sales led to an increase in the number of Pelephone's customers and a worsening of cash flows from on-going operations. In addition, in recent months competition between the companies has intensified, leading to an erosion of tariffs for both new and existing customers, as part of customer retention efforts.

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

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

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

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

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

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

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

### **Section 3.12.1 – Suppliers of terminal equipment**

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

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

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

### **Section 3.18.1 B – Wireless Telegraph Ordinance**

Concerning a refund of NIS 41.4 million that Pelephone received from the Ministry of Communications for frequency fees for which it had been overcharged when exercising the right to use 3-G frequencies, see Note 12 G to the Company's consolidated financial statements for the period ended June 30, 2011.

### **Section 3.18.4 – Site construction licensing**

On April 13, 2011, the State submitted another revised statement to HCJ whereby on April 11, 2011, the Tendering Committee announced the two winners of the tender for new cellular operators in Israel. In view of the above, and of the intention to give the new operators a license in the near future, the statement said that the Attorney General is considering applying to the HCJ to limit the temporary order that was issued regarding the possible erection of wireless access facilities by the two new operators, even without a building permit. Further to the above, it should be noted that on April 28, 2011, the Forum for Cellular Sanity filed another application for an interim injunction to prohibit progress for the supply of Fourth Generation broadcasts until a public hearing has been held or a ruling has been handed down on the petition. On July 3, 2011, HCJ rejected the application on the grounds that the requested relief was too general and far reaching. On June 5, 2011, HCJ issued a decision whereby the Attorney General must submit a further updated statement by July 19, 2011 that also addresses a limitation of the interim injunction.

### **Section 3.18.3 - Royalties**

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

### **Section 3.21 – Legal proceedings**

#### **A. Claims added during the period**

1. In June 2011, a claim was filed at the Tel Aviv District Court against Pelephone, Cellcom, Partner and Mirs, together with an application to certify it as a class action. The plaintiff estimates the amount of the claim against Pelephone at NIS 503 million. The claim refers to the sale of accessories used for carrying mobile handsets that do not comply with the instructions of the handset manufacturers and the Ministry of Health, regarding non-ionizing radiation. In addition to the financial relief, additional relief in the form of an injunction to prohibit the sale of these items, or alternatively to publish a warning, is requested.

#### **B. Information on terminated claims**

1. Section 3.21.1(M) – concerning a claim from October 2010 and an application to certify it as a class action for the restitution of amounts collected for services supplied by the respondents Unicell, Telemesser and Select by cellular telephone, in May 2011 the applicants withdrew their application (and undertook not to file it again) with the court's approval, which was given the validity of a court ruling.
2. Section 3.21.1(N) – concerning an action from October 2010 and an application for its certification as a class action alleging that Pelephone is acting in contravention of the Consumer Protection Law by failing to provide its customers with a written document containing the details required under the Consumer Protection law, when entering into an agreement for changing or adding to a continuing transaction, in June 2011, the court decided to allow the plaintiff to withdraw his application for certification.

#### **4. International communication, internet services and NEP– Bezeq International Ltd. (“Bezeq International”)**

### **Section 4.20 - Legal Proceedings**

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

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

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

**Section 5.1.4 - Market developments in the field of operation**

**Section 5.1.4A** - In March 2011 the Ministry of Communications published the Broadcasting via Digital Broadcasting Stations Bill, 2011. The bill is designed to expand the DTT setup within 24 months of the publication date of the law, so that, *inter alia*, the Knesset channel, Educational TV channel and other designated channels will be added to it. Any of the above channels may be added upon request with payment of a distribution fee. It is also proposed that the Minister of Communications may, in consultation with the Minister of Finance, the Council and the Second Authority, add more channels to the DTT setup by their request upon payment of a distribution fee. Furthermore, under the bill, beginning January 1, 2014, the DTT setup and its operation would be transferred from the Second Authority to a public body, statutory corporation or government company which are not broadcasters nor supervise TV or radio broadcasts, which shall be appointed by the Minister of Communications and Minister of Finance and approved by the government. Subsequently, in July 2011, the Carriage of the Digital Broadcast Station Transmissions Bill, 5711-2011, passed its first reading with some changes made in the legislative memorandum. Accordingly, the DTT setup will be expanded within two years of publication of the law or by December 31, 2013, whichever is earlier.

**Section 5.15 - Financing**

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

**Section 5.17 - Restrictions and supervision of the company**

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

**Section 5.17.13** – In March 2011 the Ministry of National Infrastructures published draft Energy Resource Regulations (Maximum Electrical Output in an Active Standby Situation of a Digital Set-Top Box for the Receipt of Television Broadcasts), 5771-2011 designed to regulate the maximum output of digital set-top boxes in an active standby situation. To the best of DBS's knowledge, this draft has not yet been discussed by the Knesset Economics Committee. Preliminary tests conducted by DBS indicate that the further the draft regulations progress toward binding legislation, the more adverse could be its effect on DBS's ability to continue using some of the decoders which its subscribers are currently using.

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

**Section 5.20 – Legal proceedings**

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

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

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August 1, 2011

Date

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Bezeq - The Israel Telecommunication Corp. Ltd.

Names and titles of signatories:

Shaul Elovitch, Chairman of the Board of Directors

Avi Gabbay, Chief Executive Officer

**BEZEQ THE ISRAEL TELECOMMUNICATION  
CORPORATION LIMITED**

**SEPARATE CONDENSED  
INTERIM FINANCIAL INFORMATION  
JUNE 30, 2011**

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

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Separate condensed interim financial information as at June 30, 2011 (unaudited)

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**Somekh Chaikin**  
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To:  
The shareholders of "Bezeq" The Israel Telecommunication Corp. Limited

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

*Introduction*

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

We did not review the separate interim financial information of investee companies the investment in which amounted to NIS 222 million as of June 30, 2011, and the Group's share in their profits amounted to NIS 0.5 and 2.6 million for the six and three month periods then ended, respectively. The financial statements of those companies was reviewed by other auditors whose review reports thereon were furnished to us, and our conclusion, insofar as it relates to amounts emanating from the financial statements of such companies, is based solely on the said review reports of the other auditors.

*Scope of Review*

We conducted our review in accordance with Standard on Review Engagements 1, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" of the Institute of Certified Public Accountants in Israel. A review of separate interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

A review is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards in Israel and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

*Conclusion*

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

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

Sincerely,

Somekh Chaikin  
Certified Public Accountants (Isr.)

August 1, 2011

## Condensed interim information on financial position

|                                    | June 30, 2011<br>(Unaudited)<br>NIS millions | June 30, 2010<br>(Unaudited)<br>NIS millions | December 31,<br>2010<br>(Audited)<br>NIS millions |
|------------------------------------|----------------------------------------------|----------------------------------------------|---------------------------------------------------|
| <b>Assets</b>                      |                                              |                                              |                                                   |
| Cash and cash equivalents          | 208                                          | 6                                            | 198                                               |
| Investments, including derivatives | 198                                          | 191                                          | 178                                               |
| Customers                          | 749                                          | 865                                          | 771                                               |
| Other receivables                  | 79                                           | 134                                          | 329                                               |
| Inventories                        | 8                                            | 9                                            | 15                                                |
| Loans to subsidiaries (Note 5)     | 281                                          | -                                            | -                                                 |
| Assets classified as held for sale | 20                                           | 38                                           | 29                                                |
| <b>Total current assets</b>        | <b>1,543</b>                                 | <b>1,243</b>                                 | <b>1,520</b>                                      |
| Investments, including derivatives | 81                                           | 96                                           | 96                                                |
| Trade and other receivables        | 223                                          | 96                                           | 206                                               |
| Property, plant and equipment      | 4,255                                        | 3,888                                        | 4,006                                             |
| Intangible assets                  | 308                                          | 221                                          | 276                                               |
| Investments in investees           | 7,136                                        | 6,828                                        | 6,939                                             |
| Deferred tax assets                | 252                                          | 327                                          | 248                                               |
| <b>Total non-current assets</b>    | <b>12,255</b>                                | <b>11,456</b>                                | <b>11,771</b>                                     |
| <b>Total assets</b>                | <b>13,798</b>                                | <b>12,699</b>                                | <b>13,291</b>                                     |

|                                       | June 30, 2011 | June 30, 2010 | December 31, 2010 |
|---------------------------------------|---------------|---------------|-------------------|
|                                       | (Unaudited)   | (Unaudited)   | (Audited)         |
|                                       | NIS millions  | NIS millions  | NIS millions      |
| <b>Liabilities</b>                    |               |               |                   |
| Debentures, loans and borrowings      | 1,241         | 1,163         | 941               |
| Trade payables                        | 167           | 228           | 306               |
| Other payables, including derivatives | 572           | 433           | 569               |
| Loans from subsidiaries               | -             | 201           | 203               |
| Current tax liabilities               | 250           | 80            | 229               |
| Deferred income                       | 21            | 18            | 17                |
| Provisions (Note 4)                   | 233           | 270           | 230               |
| Employee benefits                     | 447           | 414           | 233               |
| Dividend payable                      | 972           | -             | -                 |
| <b>Total current liabilities</b>      | <b>3,903</b>  | <b>2,807</b>  | <b>2,728</b>      |
| Debentures                            | 2,338         | 2,340         | 2,373             |
| Bank loans                            | 3,523         | 1,900         | 2,600             |
| Employee benefits                     | 221           | 248           | 259               |
| Deferred income and others            | 6             | 4             | 4                 |
| Dividend payable                      | 1,369         | -             | -                 |
| <b>Total non-current liabilities</b>  | <b>7,457</b>  | <b>4,492</b>  | <b>5,236</b>      |
| <b>Total liabilities</b>              | <b>11,360</b> | <b>7,299</b>  | <b>7,964</b>      |
| <b>Equity</b>                         |               |               |                   |
| Share capital                         | 3,814         | 6,203         | 6,213             |
| Share premium                         | 35            | 345           | 378               |
| Reserves                              | 550           | 538           | 526               |
| Deficit                               | (1,961)       | (1,686)       | (1,790)           |
| <b>Total equity</b>                   | <b>2,438</b>  | <b>5,400</b>  | <b>5,327</b>      |
| <b>Total equity and liabilities</b>   | <b>13,798</b> | <b>12,699</b> | <b>13,291</b>     |

**Shaul Elovitch**  
Chairman of the Board of Directors

**Avi Gabbay**  
CEO

**Alan Gelman**  
Deputy CEO and CFO

Date of approval of the financial statements: August 1, 2011

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

## Condensed interim information on income

|                                             | Six months ended |              | Three months ended |              | Year ended   |
|---------------------------------------------|------------------|--------------|--------------------|--------------|--------------|
|                                             | June 30          |              | June 30            |              | December 31  |
|                                             | 2011             | 2010         | 2011               | 2010         | 2010         |
|                                             | (Unaudited)      | (Unaudited)  | (Unaudited)        | (Unaudited)  | (Audited)    |
|                                             | NIS millions     | NIS millions | NIS millions       | NIS millions | NIS millions |
| <b>Revenues (Note 2)</b>                    | <b>2,348</b>     | <b>2,611</b> | <b>1,170</b>       | <b>1,307</b> | <b>5,263</b> |
| <b>Costs and expenses</b>                   |                  |              |                    |              |              |
| Depreciation and amortization               | 333              | 341          | 171                | 171          | 690          |
| Salaries                                    | 575              | 527          | 291                | 250          | 1,079        |
| General and operating expenses Note 3       | 524              | 788          | 253                | 396          | 1,609        |
| Other operating expenses (income), net      | 188              | (38)         | (62)               | (13)         | (158)        |
|                                             | <b>1,620</b>     | <b>1,618</b> | <b>653</b>         | <b>804</b>   | <b>3,220</b> |
| Operating profit                            | <b>728</b>       | <b>993</b>   | <b>517</b>         | <b>503</b>   | <b>2,043</b> |
| <b>Financing expenses</b>                   |                  |              |                    |              |              |
| Financing expenses                          | 215              | 106          | 135                | 79           | 282          |
| Financing income                            | (116)            | (78)         | (62)               | (50)         | (192)        |
| Financing expenses, net                     | <b>99</b>        | <b>28</b>    | <b>73</b>          | <b>29</b>    | <b>90</b>    |
| <b>Profit after financing expenses, net</b> | <b>629</b>       | <b>965</b>   | <b>444</b>         | <b>474</b>   | <b>1,953</b> |
| Share in profits of investees, net          | <b>539</b>       | <b>571</b>   | <b>255</b>         | <b>289</b>   | <b>1,017</b> |
| <b>Profit before income tax</b>             | <b>1,168</b>     | <b>1,536</b> | <b>699</b>         | <b>763</b>   | <b>2,970</b> |
| Income tax                                  | <b>176</b>       | <b>256</b>   | <b>114</b>         | <b>125</b>   | <b>527</b>   |
| <b>Profit for the period</b>                | <b>992</b>       | <b>1,280</b> | <b>585</b>         | <b>638</b>   | <b>2,443</b> |

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

## Condensed Interim Statement of Comprehensive Income

|                                                                             | Six months ended |              | Three months ended |              | Year ended   |
|-----------------------------------------------------------------------------|------------------|--------------|--------------------|--------------|--------------|
|                                                                             | June 30          |              | June 30            |              | December 31  |
|                                                                             | 2011             | 2010         | 2011               | 2010         | 2010         |
|                                                                             | (Unaudited)      | (Unaudited)  | (Unaudited)        | (Unaudited)  | (Audited)    |
|                                                                             | NIS millions     | NIS millions | NIS millions       | NIS millions | NIS millions |
| <b>Profit for the period</b>                                                | <b>992</b>       | <b>1,280</b> | <b>585</b>         | <b>638</b>   | <b>2,443</b> |
| <b>Items of other comprehensive income</b>                                  |                  |              |                    |              |              |
| Other comprehensive income (loss) for the period, net of tax                | (1)              | -            | (1)                | 1            | 8            |
| Other comprehensive income (loss) for the period, net of tax, for investees | -                | -            | -                  | -            | 5            |
| Other comprehensive income for the period, net of tax                       | (1)              | -            | (1)                | 1            | 13           |
| <b>Total comprehensive income for the period</b>                            | <b>991</b>       | <b>1,280</b> | <b>584</b>         | <b>639</b>   | <b>2,456</b> |

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

## Condensed interim information on cash flows

|                                                                                         | Six months ended |              | Three months ended |              | Year ended   |
|-----------------------------------------------------------------------------------------|------------------|--------------|--------------------|--------------|--------------|
|                                                                                         | June 30          |              | June 30            |              | December 31  |
|                                                                                         | 2011             | 2010         | 2011               | 2010         | 2010         |
|                                                                                         | (Unaudited)      | (Unaudited)  | (Unaudited)        | (Unaudited)  | (Audited)    |
|                                                                                         | NIS millions     | NIS millions | NIS millions       | NIS millions | NIS millions |
| <b>Cash flows from operating activities</b>                                             |                  |              |                    |              |              |
| Profit for the period                                                                   | 992              | 1,280        | 585                | 638          | 2,443        |
| Adjustments:                                                                            |                  |              |                    |              |              |
| Depreciation                                                                            | 296              | 304          | 152                | 153          | 618          |
| Amortization of intangible assets                                                       | 37               | 37           | 19                 | 18           | 72           |
| Share in profits of equity-accounted investees                                          | (539)            | (571)        | (255)              | (289)        | (1,017)      |
| Financing expenses, net                                                                 | 94               | 12           | 65                 | 16           | 69           |
| Capital gain, net                                                                       | (87)             | (29)         | (43)               | (2)          | (171)        |
| Share-based payment                                                                     | 83               | 6            | 42                 | 2            | 26           |
| Income tax expenses                                                                     | 176              | 256          | 114                | 125          | 527          |
| Change in inventory                                                                     | 7                | -            | 1                  | 2            | (6)          |
| Changes in trade and other receivables                                                  | 32               | (35)         | 29                 | 31           | 29           |
| Change in trade and other payables                                                      | (162)            | (75)         | (77)               | (32)         | 55           |
| Change in provisions                                                                    | 3                | (9)          | (7)                | (5)          | (45)         |
| Change in employee benefits                                                             | 176              | (55)         | (50)               | (28)         | (213)        |
| Expenses for derivatives, net                                                           | -                | -            | 2                  | -            | 11           |
| Net cash from operating (used for) operating activities for transactions with investees | (29)             | (6)          | 6                  | 3            | 2            |
| Net income tax paid                                                                     | (164)            | (199)        | (87)               | (109)        | (260)        |
| <b>Net cash from operating activities</b>                                               | <b>915</b>       | <b>916</b>   | <b>496</b>         | <b>523</b>   | <b>2,140</b> |
| <b>Cash flows from investment activities</b>                                            |                  |              |                    |              |              |
| Investment in intangible assets                                                         | (69)             | (65)         | (39)               | (32)         | (156)        |
| Proceeds from the sale of property, plant and equipment                                 | 235              | 41           | 48                 | 26           | 132          |
| Change in current investments, net                                                      | -                | -            | 8                  | -            | -            |
| Purchase of property, plant and equipment                                               | (569)            | (420)        | (280)              | (215)        | (876)        |
| Proceeds from disposal of investments and long-term loans                               | 3                | 4            | 2                  | 3            | 2            |
| Payment for derivatives                                                                 | (11)             | -            | -                  | -            | (2)          |
| Acquisition of a subsidiary from an investee                                            | -                | -            | -                  | -            | (196)        |
| Interest and dividend received                                                          | 10               | 6            | 8                  | 6            | 8            |
| Net cash from investment activities for transactions with Investees                     | 450              | 634          | 231                | 214          | 1,097        |
| <b>Net cash from (used for) investment activities</b>                                   | <b>49</b>        | <b>200</b>   | <b>(22)</b>        | <b>2</b>     | <b>9</b>     |

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

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

|                                                                               | Six months ended |                | Three months ended |                | Year ended     |
|-------------------------------------------------------------------------------|------------------|----------------|--------------------|----------------|----------------|
|                                                                               | June 30          |                | June 30            |                | December 31    |
|                                                                               | 2011             | 2010           | 2011               | 2010           | 2010           |
|                                                                               | (Unaudited)      | (Unaudited)    | (Unaudited)        | (Unaudited)    | (Audited)      |
|                                                                               | NIS millions     | NIS millions   | NIS millions       | NIS millions   | NIS millions   |
| <b>Cash flow from financing activities</b>                                    |                  |                |                    |                |                |
| Bank loans received                                                           | 1,600            | 1,900          | 1,600              | 1,900          | 2,600          |
| Issue of debentures                                                           | 400              | -              | 400                | -              | -              |
| Repayment of bank loans                                                       | -                | (400)          | -                  | (400)          | (400)          |
| Short-term borrowing, net                                                     | -                | 226            | -                  | 226            | -              |
| Repayment of debentures                                                       | (691)            | (558)          | (666)              | (416)          | (567)          |
| Dividend paid                                                                 | (1,663)          | (2,453)        | (1,663)            | (2,453)        | (3,733)        |
| Interest paid                                                                 | (177)            | (153)          | (157)              | (142)          | (196)          |
| Proceeds from exercise of options and others                                  | 10               | 18             | 6                  | 3              | 36             |
| Net cash from (used for) financing activities for transactions with investees | (433)            | (50)           | (230)              | 200            | (51)           |
| <b>Net cash from (used for) financing activities</b>                          | <b>(954)</b>     | <b>(1,470)</b> | <b>(710)</b>       | <b>(1,082)</b> | <b>(2,311)</b> |
| <b>Increase (decrease) in cash flow and cash equivalents</b>                  | <b>10</b>        | <b>(354)</b>   | <b>(236)</b>       | <b>(557)</b>   | <b>(162)</b>   |
| Cash and cash equivalents at beginning of period                              | 198              | 360            | 444                | 563            | 360            |
| <b>Cash and cash equivalents at the end of the period</b>                     | <b>208</b>       | <b>6</b>       | <b>208</b>         | <b>6</b>       | <b>198</b>     |

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

## Notes to the separate condensed interim financial information as at June 30, 2011

## NOTE 1 – METHOD FOR PREPARING THE FINANCIAL INFORMATION

## A. Definitions

The Company: Bezeq The Israel Telecommunication Corporation Ltd.

“Associate”, “the Group”, “Investee”, “Interested Party”: as defined in the consolidated financial statements of the Company for 2010.

## B. Main points of the preparation method of the financial information

The separate interim financial information is stated in accordance with Article 38(D) of the Securities Regulations (Periodic and Interim Reports), 1970 and does not include the information required under the provisions of Article 9(C) and the Tenth Addendum of the Securities Regulations (Periodic and Interim Reports), 1970 in respect of separate financial information of the corporation. The report should be read together with the separate financial information as at December 31, 2010 and for the year then ended and together with the condensed consolidated interim statements as at June 30, 2011 (“the Consolidated Statements”).

The accounting policy used in the preparation of this separate interim financial information is the same as the accounting policy described in the separate financial information as at December 31, 2010 and the year then ended.

## NOTE 2 – REVENUES

|                                      | Six months ended |              | Three months ended |              | Year ended   |
|--------------------------------------|------------------|--------------|--------------------|--------------|--------------|
|                                      | June 30          |              | June 30            |              | December 31  |
|                                      | 2011             | 2010         | 2011               | 2010         | 2010         |
|                                      | (Unaudited)      | (Unaudited)  | (Unaudited)        | (Unaudited)  | (Audited)    |
|                                      | NIS millions     | NIS millions | NIS millions       | NIS millions | NIS millions |
| Fixed-line telephony                 | 1,224            | 1,580        | 607                | 795          | 3,160        |
| Internet - infrastructure            | 534              | 471          | 269                | 235          | 977          |
| Transmission and data communications | 461              | 444          | 233                | 221          | 882          |
| Other services                       | 129              | 116          | 61                 | 56           | 244          |
|                                      | <u>2,348</u>     | <u>2,611</u> | <u>1,170</u>       | <u>1,307</u> | <u>5,263</u> |

## NOTE 3 – OPERATING AND GENERAL EXPENSES

|                                  | Six months ended |              | Three months ended |              | Year ended   |
|----------------------------------|------------------|--------------|--------------------|--------------|--------------|
|                                  | June 30          |              | June 30            |              | December 31  |
|                                  | 2011             | 2010         | 2011               | 2010         | 2010         |
|                                  | (Unaudited)      | (Unaudited)  | (Unaudited)        | (Unaudited)  | (Audited)    |
|                                  | NIS millions     | NIS millions | NIS millions       | NIS millions | NIS millions |
| Cellular telephone expenses      | 128              | 401          | 64                 | 211          | 801          |
| General expenses                 | 118              | 116          | 56                 | 56           | 250          |
| Materials and spare parts        | 39               | 39           | 17                 | 16           | 88           |
| Building maintenance             | 122              | 119          | 60                 | 58           | 240          |
| Services and maintenance         |                  |              |                    |              | 76           |
| by sub-contractors               | 38               | 39           | 18                 | 18           | 101          |
| Vehicle maintenance expenses     | 41               | 48           | 20                 | 25           | 31           |
| Royalties to the State of Israel | 28               | 16           | 14                 | 8            | 22           |
| Collection fees and sundry       | 10               | 10           | 4                  | 4            |              |
|                                  | <u>524</u>       | <u>788</u>   | <u>253</u>         | <u>396</u>   | <u>1,609</u> |

**Notes to the separate condensed interim financial information as at June 30, 2011**

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**NOTE 4 – CONTINGENT LIABILITIES**

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

The financial statements of the Company include provisions of NIS 233 million for Legal Claims.

The additional exposure beyond these provisions for the claims amounts to NIS 2.7 billion.

Additionally, out of these claims, there are also claims amounting to NIS 811 million, which cannot be assessed at this stage, as well as additional claims for which the Company’s additional exposure exceeds the aforesaid, as the exact amount of the claim is not stated in the claim.

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

In addition, subsequent to the reporting date, proceedings against the Company with exposure of NIS 136 million came to an end.

**NOTE 5 - SUBSTANTIAL AGREEMENTS AND TRANSACTIONS WITH INVESTEEES IN AND SUBSEQUENT TO THE REPORTING PERIOD**

- A. In respect of the loan provided by the Company to Bezeq Online Ltd. (as described in the separate financial information as at December 31, 2010 and the year then ended), after repayment of NIS 5 million during the period, the balance of the loan has been repaid.
- B. In May 2011, Pelephone Communications Ltd. ("Pelephone") paid the Company NIS 280 million for a dividend declared in May 2011. The entire amount was paid by offsetting the loan provided by the Company to Pelephone, and no cash was transferred between the companies. The loan is linked to the CPI and bears interest at a rate of 4%, repayable on May 17, 2012.

**DBS SATELLITE SERVICES (1998) LTD.**  
**CONDENSED INTERIM FINANCIAL STATEMENTS**  
**JUNE 30, 2011**  
**(UNAUDITED)**

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

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**Condensed Interim Financial Statements as of June 30, 2011**

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

*Introduction*

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

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

*Conclusion*

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

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

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

Somekh Chaikin  
Certified Public Accountants (Isr.)

July 26, 2011

## Condensed Interim Statements of Financial Position as of

|                                              | <b>June 30, 2011</b> | <b>June 30, 2010</b> | <b>December 31,</b>  |
|----------------------------------------------|----------------------|----------------------|----------------------|
|                                              | <b>(Unaudited)</b>   | <b>(Unaudited)</b>   | <b>(Audited)</b>     |
|                                              | <b>NIS thousands</b> | <b>NIS thousands</b> | <b>NIS thousands</b> |
| <b>Assets</b>                                |                      |                      |                      |
| Cash                                         | 19,990               | -                    | -                    |
| Trade receivables                            | 158,291              | 160,294              | 168,847              |
| Trade receivables and debit balances         | 10,613               | 12,645               | 11,150               |
| <b>Total current assets</b>                  | <b>188,894</b>       | <b>172,939</b>       | <b>179,997</b>       |
| Broadcasting rights, net of rights exercised | 313,778              | 306,886              | 304,490              |
| Property, plant and equipment, net           | 670,921              | 688,893              | 675,888              |
| Intangible assets, net                       | 100,728              | 75,830               | 82,769               |
| <b>Total non-current assets</b>              | <b>1,085,427</b>     | <b>1,071,609</b>     | <b>1,063,147</b>     |
| <b>Total assets</b>                          | <b>1,274,321</b>     | <b>1,244,548</b>     | <b>1,243,144</b>     |

## Condensed Interim Statements of Financial Position as of

|                                          | June 30, 2011<br>(Unaudited)<br>NIS thousands | June 30, 2010<br>(Unaudited)<br>NIS thousands | December 31,<br>2010<br>(Audited)<br>NIS thousands |
|------------------------------------------|-----------------------------------------------|-----------------------------------------------|----------------------------------------------------|
| <b>Liabilities</b>                       |                                               |                                               |                                                    |
| Borrowings from banks                    | 41,702                                        | 843,219                                       | 135,438                                            |
| Current maturities for debentures        | 57,271                                        | 55,020                                        | 56,062                                             |
| Trade payables and service providers     | 394,083                                       | 432,886                                       | 355,771                                            |
| Other payables                           | 161,028                                       | 138,760*                                      | 164,951                                            |
| Provisions                               | 85,456                                        | 79,515*                                       | 89,266                                             |
| <b>Total current liabilities</b>         | <b>739,540</b>                                | <b>1,549,400</b>                              | <b>801,488</b>                                     |
| Debentures                               | 1,172,863                                     | 628,441                                       | 1,030,973                                          |
| Loans from institutions                  | -                                             | 192,109                                       | -                                                  |
| Bank loans                               | 393,958                                       | -                                             | 470,810                                            |
| Loans from shareholders                  | 2,502,366                                     | 2,118,101                                     | 2,300,387                                          |
| Long-term trade payables                 | 41,434                                        | 7,402                                         | 54,264                                             |
| Employee benefits                        | 6,777                                         | 7,461                                         | 6,696                                              |
| <b>Total non-current liabilities</b>     | <b>4,117,398</b>                              | <b>2,953,514</b>                              | <b>3,863,130</b>                                   |
| <b>Total liabilities</b>                 | <b>4,856,938</b>                              | <b>4,502,914</b>                              | <b>4,664,618</b>                                   |
| <b>Capital deficit</b>                   |                                               |                                               |                                                    |
| Share capital                            | 29                                            | 29                                            | 29                                                 |
| Share premium                            | 85,557                                        | 85,557                                        | 85,557                                             |
| Share options                            | 48,219                                        | 48,219                                        | 48,219                                             |
| Capital reserves                         | 1,537,271                                     | 1,537,271                                     | 1,537,271                                          |
| Capital reserve for share-based payments | 9,990                                         | 8,376                                         | 9,391                                              |
| Accumulated deficit                      | (5,263,683)                                   | (4,937,818)                                   | (5,101,941)                                        |
| <b>Total capital deficit</b>             | <b>(3,582,617)</b>                            | <b>(3,258,366)</b>                            | <b>(3,421,474)</b>                                 |
| <b>Total liabilities and equity</b>      | <b>1,274,321</b>                              | <b>1,244,548</b>                              | <b>1,243,144</b>                                   |

David Efrati  
(Authorized to sign as chairman of the board)  
(See Note 8)

Ron Eilon  
CEO

Katriel Moriah  
CFO

Date of approval of the financial statements: July 26, 2011

\* Reclassified

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

## Condensed Interim Income Statements

|                                               | The six months ended |                  | The three months ended |                  | The year ended   |
|-----------------------------------------------|----------------------|------------------|------------------------|------------------|------------------|
|                                               | June 30, 2011        | June 30, 2010    | June 30, 2011          | June 30, 2010    | December 31,     |
|                                               | (Unaudited)          | (Unaudited)      | (Unaudited)            | (Unaudited)      | 2010             |
|                                               | NIS thousands        | NIS thousands    | NIS thousands          | NIS thousands    | (Audited)        |
| Revenues                                      | 809,510              | 787,363          | 403,960                | 395,947          | 1,582,930        |
| Cost of revenues                              | 540,896              | 583,664          | 268,997                | 322,111          | 1,128,848        |
| <b>Gross profit</b>                           | <b>268,614</b>       | <b>203,699</b>   | <b>134,963</b>         | <b>73,836</b>    | <b>454,082</b>   |
| Selling and marketing expenses                | 74,797               | 71,978           | 34,738                 | 33,042           | 143,202          |
| General and administrative expenses           | 67,134               | 65,745           | 34,912                 | 33,509           | 132,561          |
|                                               | 141,931              | 137,723          | 69,650                 | 66,551           | 275,763          |
| <b>Operating profit</b>                       | <b>126,683</b>       | <b>65,976</b>    | <b>65,313</b>          | <b>7,285</b>     | <b>178,319</b>   |
| Financing expenses                            | 96,651               | 84,296           | 51,723                 | 60,650           | 181,584          |
| Financing income                              | (10,453)             | (3,657)          | (6,481)                | (3,601)          | (9,313)          |
| Shareholders' financing expenses              | 201,979              | 136,214          | 108,258                | 92,928           | 318,499          |
| Financing expenses, net                       | 288,177              | 216,853          | 153,500                | 149,977          | 490,770          |
| <b>Loss before income tax</b>                 | <b>(161,494)</b>     | <b>(150,877)</b> | <b>(88,187)</b>        | <b>(142,692)</b> | <b>(312,451)</b> |
| Income tax                                    | 248                  | 174              | 177                    | 92               | 1,188            |
| <b>Loss for the period</b>                    | <b>(161,742)</b>     | <b>(151,051)</b> | <b>(88,364)</b>        | <b>(142,784)</b> | <b>(313,639)</b> |
| <b>Basic and diluted loss per share (NIS)</b> | <b>5,410</b>         | <b>5,053</b>     | <b>2,956</b>           | <b>4,776</b>     | <b>10,491</b>    |

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

## Condensed Interim Statements of Comprehensive Income

|                                                | The six months ended |                  | The three months ended |                  | The year ended   |
|------------------------------------------------|----------------------|------------------|------------------------|------------------|------------------|
|                                                | June 30, 2011        | June 30, 2010    | June 30, 2011          | June 30, 2010    | December 31,     |
|                                                | (Unaudited)          | (Unaudited)      | (Unaudited)            | (Unaudited)      | 2010             |
|                                                | NIS thousands        | NIS thousands    | NIS thousands          | NIS thousands    | (Audited)        |
|                                                |                      |                  |                        |                  | NIS thousands    |
| <b>Loss for the period</b>                     | <b>(161,742)</b>     | <b>(151,051)</b> | <b>(88,364)</b>        | <b>(142,784)</b> | <b>(313,639)</b> |
| <b>Other items of comprehensive income:</b>    |                      |                  |                        |                  |                  |
| Actuarial losses from a defined benefit plan   | -                    | -                | -                      | -                | (1,535)          |
| <b>Other comprehensive loss for the period</b> | <b>-</b>             | <b>-</b>         | <b>-</b>               | <b>-</b>         | <b>(1,535)</b>   |
| <b>Total comprehensive loss for the period</b> | <b>(161,742)</b>     | <b>(151,051)</b> | <b>(88,364)</b>        | <b>(142,784)</b> | <b>(315,174)</b> |

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

## Condensed Interim Statements of Changes in Equity

|                                                                  | <u>Share capital</u> | <u>Share premium</u> | <u>Share options</u> | <u>Capital reserve</u> | <u>Capital reserve for share-based payments</u> | <u>Accumulated deficit</u> | <u>Total</u>         |
|------------------------------------------------------------------|----------------------|----------------------|----------------------|------------------------|-------------------------------------------------|----------------------------|----------------------|
|                                                                  | <u>NIS thousands</u> | <u>NIS thousands</u> | <u>NIS thousands</u> | <u>NIS thousands</u>   | <u>NIS thousands</u>                            | <u>NIS thousands</u>       | <u>NIS thousands</u> |
| <b>Six months ended June 30, 2011 (unaudited)</b>                |                      |                      |                      |                        |                                                 |                            |                      |
| <b>Balance as of January 1, 2011 (audited)</b>                   | 29                   | 85,557               | 48,219               | 1,537,271              | 9,391                                           | (5,101,941)                | (3,421,474)          |
| <b>Total comprehensive income for the period</b>                 |                      |                      |                      |                        |                                                 |                            |                      |
| Loss for the period                                              | -                    | -                    | -                    | -                      | -                                               | (161,742)                  | (161,742)            |
| Other comprehensive loss for the period                          | -                    | -                    | -                    | -                      | -                                               | -                          | -                    |
| <b>Total other comprehensive loss for the period (unaudited)</b> | 29                   | 85,557               | 48,219               | 1,537,271              | 9,391                                           | (5,263,683)                | (3,583,216)          |
| <b>Transactions with owners recognized directly in equity</b>    |                      |                      |                      |                        |                                                 |                            |                      |
| Share-based payments                                             | -                    | -                    | -                    | -                      | 599                                             | -                          | 599                  |
| <b>Balance as of June 30, 2011 (unaudited)</b>                   | 29                   | 85,557               | 48,219               | 1,537,271              | 9,990                                           | (5,263,683)                | (3,582,617)          |
| <b>Six months ended June 30, 2010 (unaudited)</b>                |                      |                      |                      |                        |                                                 |                            |                      |
| <b>Balance as of January 1, 2010 (audited)</b>                   | 29                   | 85,557               | 48,219               | 1,537,271              | 6,931                                           | (4,786,767)                | (3,108,760)          |
| <b>Total comprehensive income for the period</b>                 |                      |                      |                      |                        |                                                 |                            |                      |
| Loss for the period                                              | -                    | -                    | -                    | -                      | -                                               | (151,051)                  | (151,051)            |
| Other comprehensive loss for the period                          | -                    | -                    | -                    | -                      | -                                               | -                          | -                    |
| <b>Total other comprehensive loss for the period (unaudited)</b> | 29                   | 85,557               | 48,219               | 1,537,271              | 6,931                                           | (4,937,818)                | (3,259,811)          |
| <b>Transactions with owners recognized directly in equity</b>    |                      |                      |                      |                        |                                                 |                            |                      |
| Share-based payments                                             | -                    | -                    | -                    | -                      | 1,445                                           | -                          | 1,445                |
| <b>Balance as of June 30, 2010 (unaudited)</b>                   | 29                   | 85,557               | 48,219               | 1,537,271              | 8,376                                           | (4,937,818)                | (3,258,366)          |

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

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

|                                                                  | <u>Share capital</u><br><u>NIS thousands</u> | <u>Share premium</u><br><u>NIS thousands</u> | <u>Share options</u><br><u>NIS thousands</u> | <u>Capital reserve</u><br><u>NIS thousands</u> | <u>Capital reserve for share-based payments</u><br><u>NIS thousands</u> | <u>Accumulated deficit</u><br><u>NIS thousands</u> | <u>Total</u><br><u>NIS thousands</u> |
|------------------------------------------------------------------|----------------------------------------------|----------------------------------------------|----------------------------------------------|------------------------------------------------|-------------------------------------------------------------------------|----------------------------------------------------|--------------------------------------|
| <b>Three months ended June 30, 2011 (unaudited)</b>              |                                              |                                              |                                              |                                                |                                                                         |                                                    |                                      |
| Balance as of April 1, 2011 (unaudited)                          | 29                                           | 85,557                                       | 48,219                                       | 1,537,271                                      | 9,689                                                                   | (5,175,319)                                        | (3,494,554)                          |
| <b>Total comprehensive income for the period</b>                 |                                              |                                              |                                              |                                                |                                                                         |                                                    |                                      |
| Loss for the period                                              | -                                            | -                                            | -                                            | -                                              | -                                                                       | (88,364)                                           | (88,364)                             |
| Other comprehensive loss for the period                          | -                                            | -                                            | -                                            | -                                              | -                                                                       | -                                                  | -                                    |
| <b>Total other comprehensive loss for the period (unaudited)</b> | <b>29</b>                                    | <b>85,557</b>                                | <b>48,219</b>                                | <b>1,537,271</b>                               | <b>9,689</b>                                                            | <b>(5,263,683)</b>                                 | <b>(3,582,918)</b>                   |
| <b>Transactions with owners recognized directly in equity</b>    |                                              |                                              |                                              |                                                |                                                                         |                                                    |                                      |
| Share-based payments                                             | -                                            | -                                            | -                                            | -                                              | 301                                                                     | -                                                  | 301                                  |
| <b>Balance as of June 30, 2011 (unaudited)</b>                   | <b>29</b>                                    | <b>85,557</b>                                | <b>48,219</b>                                | <b>1,537,271</b>                               | <b>9,990</b>                                                            | <b>(5,263,683)</b>                                 | <b>(3,582,617)</b>                   |
| <b>Three months ended June 30, 2010 (unaudited)</b>              |                                              |                                              |                                              |                                                |                                                                         |                                                    |                                      |
| Balance as of April 1, 2010 (unaudited)                          | 29                                           | 85,557                                       | 48,219                                       | 1,537,271                                      | 7,650                                                                   | (4,795,034)                                        | (3,116,308)                          |
| <b>Total comprehensive income for the period</b>                 |                                              |                                              |                                              |                                                |                                                                         |                                                    |                                      |
| Loss for the period                                              | -                                            | -                                            | -                                            | -                                              | -                                                                       | (142,784)                                          | (142,784)                            |
| Other comprehensive loss for the period                          | -                                            | -                                            | -                                            | -                                              | -                                                                       | -                                                  | -                                    |
| <b>Total other comprehensive loss for the period (unaudited)</b> | <b>29</b>                                    | <b>85,557</b>                                | <b>48,219</b>                                | <b>1,537,271</b>                               | <b>7,650</b>                                                            | <b>(4,937,818)</b>                                 | <b>(3,259,092)</b>                   |
| <b>Transactions with owners recognized directly in equity</b>    |                                              |                                              |                                              |                                                |                                                                         |                                                    |                                      |
| Share-based payments                                             | -                                            | -                                            | -                                            | -                                              | 726                                                                     | -                                                  | 726                                  |
| <b>Balance as of June 30, 2010 (unaudited)</b>                   | <b>29</b>                                    | <b>85,557</b>                                | <b>48,219</b>                                | <b>1,537,271</b>                               | <b>8,376</b>                                                            | <b>(4,937,818)</b>                                 | <b>(3,258,366)</b>                   |

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

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

|                                                               | <u>Share capital</u> | <u>Share premium</u> | <u>Share options</u> | <u>Capital reserve</u> | <u>Capital reserve for share-based payments</u> | <u>Accumulated deficit</u> | <u>Total</u>         |
|---------------------------------------------------------------|----------------------|----------------------|----------------------|------------------------|-------------------------------------------------|----------------------------|----------------------|
|                                                               | <u>NIS thousands</u> | <u>NIS thousands</u> | <u>NIS thousands</u> | <u>NIS thousands</u>   | <u>NIS thousands</u>                            | <u>NIS thousands</u>       | <u>NIS thousands</u> |
| <b>Year ended December 31, 2010 (audited)</b>                 |                      |                      |                      |                        |                                                 |                            |                      |
| <b>Balance as of January 1, 2010 (audited)</b>                | 29                   | 85,557               | 48,219               | 1,537,271              | 6,931                                           | (4,786,767)                | (3,108,760)          |
| <b>Total comprehensive income for the year</b>                |                      |                      |                      |                        |                                                 |                            |                      |
| Loss for the year                                             | -                    | -                    | -                    | -                      | -                                               | (313,639)                  | (313,639)            |
| Other comprehensive loss for the year                         | -                    | -                    | -                    | -                      | -                                               | (1,535)                    | (1,535)              |
| <b>Total other comprehensive loss for the year</b>            | <u>29</u>            | <u>85,557</u>        | <u>48,219</u>        | <u>1,537,271</u>       | <u>6,931</u>                                    | <u>(5,101,941)</u>         | <u>(3,423,934)</u>   |
| <b>Transactions with owners recognized directly in equity</b> |                      |                      |                      |                        |                                                 |                            |                      |
| Share-based payments                                          | -                    | -                    | -                    | -                      | 2,460                                           | -                          | 2,460                |
| <b>Balance as of December 31, 2010 (audited)</b>              | <u>29</u>            | <u>85,557</u>        | <u>48,219</u>        | <u>1,537,271</u>       | <u>9,391</u>                                    | <u>(5,101,941)</u>         | <u>(3,421,474)</u>   |

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

## Condensed Interim Statements of Cash Flows

|                                                         | The six months ended |                  | The three months ended |                 | The year ended   |
|---------------------------------------------------------|----------------------|------------------|------------------------|-----------------|------------------|
|                                                         | June 30, 2011        | June 30, 2010    | June 30, 2011          | June 30, 2010   | December 31,     |
|                                                         | (Unaudited)          | (Unaudited)      | (Unaudited)            | (Unaudited)     | 2010             |
|                                                         | NIS thousands        | NIS thousands    | NIS thousands          | NIS thousands   | (Audited)        |
| <b>Cash flows from operating activities</b>             |                      |                  |                        |                 |                  |
| Loss for the period                                     | (161,742)            | (151,051)        | (88,364)               | (142,784)       | (313,639)        |
| <b>Adjustments</b>                                      |                      |                  |                        |                 |                  |
| Depreciation and amortization                           | 139,724              | 131,930          | 71,131                 | 68,176          | 284,732          |
| Financing expenses, net                                 | 278,601              | 202,520          | 137,650                | 137,391         | 465,562          |
| Proceeds from sale of property, plant and equipment     | (65)                 | (29)             | (15)                   | (14)            | (35)             |
| Share-based payments                                    | 599                  | 1,445            | 301                    | 726             | 2,460            |
| Income tax expenses                                     | 248                  | 174              | 177                    | 92              | 1,188            |
| Change in trade receivables                             | 10,556               | (142)            | 5,009                  | (5,479)         | (8,695)          |
| Change in accounts receivable and debit balances        | 537                  | (1,448)*         | 1,173                  | (1,932)*        | 363*             |
| Change in trade payables and service providers          | 8,870                | 5,164*           | (5,846)                | (26,514)*       | (2,731)          |
| Change in other payables and provisions                 | (7,733)              | 67,500           | 2,654                  | 73,115          | 83,659           |
| Change in broadcasting rights, net of rights exercised  | (9,288)              | (22,120)         | (4,847)                | 6,836           | (19,724)         |
| Change in employee benefits                             | 81                   | 72               | (45)                   | 24              | (438)            |
|                                                         | 422,130              | 385,066          | 207,342                | 252,421         | 806,341          |
| Income tax paid                                         | (248)                | (174)            | (177)                  | (92)            | (1,188)          |
| <b>Net cash from operating activities</b>               | <b>260,140</b>       | <b>233,841</b>   | <b>118,801</b>         | <b>109,545</b>  | <b>491,514</b>   |
| <b>Cash flows used in investing activities</b>          |                      |                  |                        |                 |                  |
| Proceeds from the sale of property, plant and equipment | 198                  | 437              | 69                     | 253             | 1,589            |
| Purchase of property, plant and equipment               | (105,004)            | (99,020)         | (47,551)               | (50,599)        | (226,728)        |
| Acquisition of intangible assets                        | (10,990)             | (7,721)          | (7,177)                | (4,089)         | (14,897)         |
| Payments for subscriber acquisition                     | (19,517)             | (17,528)         | (9,667)                | (8,547)         | (36,756)         |
| <b>Net cash used in investing activities</b>            | <b>(135,313)</b>     | <b>(123,832)</b> | <b>(64,326)</b>        | <b>(62,982)</b> | <b>(276,792)</b> |

\* Reclassified

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

## Condensed Interim Statements of Cash Flow (contd.)

|                                                                 | The six months ended |                  | The three months ended |                 | The year ended   |
|-----------------------------------------------------------------|----------------------|------------------|------------------------|-----------------|------------------|
|                                                                 | June 30, 2011        | June 30, 2010    | June 30, 2011          | June 30, 2010   | December 31,     |
|                                                                 | (Unaudited)          | (Unaudited)      | (Unaudited)            | (Unaudited)     | 2010             |
|                                                                 | NIS thousands        | NIS thousands    | NIS thousands          | NIS thousands   | (Audited)        |
| <b>Cash flows used in financing activities</b>                  |                      |                  |                        |                 |                  |
| Repayment of loans from institutions                            | -                    | -                | -                      | -               | (115,731)        |
| Bank loans received                                             | -                    | 255,000          | -                      | -               | 255,000          |
| Repayment of bank loans                                         | (84,851)             | (283,105)        | (12,425)               | (37,187)        | (580,718)        |
| Repayment of debentures                                         | -                    | -                | -                      | -               | (55,020)         |
| Short-term bank credit from banks, net                          | (85,736)             | (17,804)         | (3,788)                | 5,376           | 41,232           |
| Interest paid                                                   | (52,803)             | (64,100)         | (16,925)               | (14,752)        | (203,444)        |
| Issue of debentures, net                                        | 118,553              | -                | (1,347)                | -               | 443,959          |
| <b>Net cash used for financing activities</b>                   | <b>(104,837)</b>     | <b>(110,009)</b> | <b>(34,485)</b>        | <b>(46,563)</b> | <b>(214,722)</b> |
| <b>Change in cash and cash equivalents</b>                      | <b>19,990</b>        | <b>-</b>         | <b>19,990</b>          | <b>-</b>        | <b>-</b>         |
| <b>Cash and cash equivalents at the beginning of the period</b> | <b>-</b>             | <b>-</b>         | <b>-</b>               | <b>-</b>        | <b>-</b>         |
| <b>Cash and cash equivalents at the end of the period</b>       | <b>19,990</b>        | <b>-</b>         | <b>19,990</b>          | <b>-</b>        | <b>-</b>         |

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

## Notes to the Financial Statements

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### NOTE 1 – REPORTING ENTITY

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

In January 1999, the Company received a license from the Ministry of Communications for satellite television broadcasts (“the License”). The License is valid until January 2017 and may be extended for a further six years under certain conditions. The Company’s operations are subject, inter alia, to the Communications Law (Telecommunications and Broadcasts), 5742-1982 (“the Communications Law”) and the regulations and rules promulgated thereunder and to the license terms.

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

In August 2009, the Supreme Court accepted the Antitrust Commissioner’s appeal of the ruling of the Antitrust Tribunal approving the merger (as defined in the Antitrust Law, 5748-1988) between the Company and Bezeq by exercising the options held by Bezeq into Company shares, subject to certain conditions, and ruled against the merger.

### NOTE 2 - BASIS OF PREPARATION

#### A. Statement of compliance

The condensed interim financial statements have been prepared in conformity with IAS 34, Interim Financial Reporting, and do not include all of the information required for full annual financial statements. They should be read in conjunction with the financial statements for the year ended December 31, 2010 (“the annual statements”). In addition, these statements have been prepared in conformity with the provisions of Chapter D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

The condensed interim financial statements were approved by the Company’s Board of Directors on July 26, 2011.

#### 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 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.

## Notes to the Financial Statements

## NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES

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

**A. Recognition of actuarial gains or losses**

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

**B. Initial application of new accounting standards****(1) Related party disclosures**

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

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

**(2) Interim financial reporting**

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

**C. New standards which have not yet been adopted**

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

## Notes to the Financial Statements

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

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

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

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

## NOTE 4 – FINANCIAL POSITION OF THE COMPANY

- A. Since the beginning of its operations, the Company has accumulated substantial losses. The Company's losses in 2010 amounted to NIS 314 million and losses in the six months ended June 30, 2011 amounted to NIS 162 million. As a result of these losses, the Company's capital deficit and working capital deficit at June 30, 2011 amounted to NIS 3,583 million and NIS 551 million, respectively.
- B.
1. In March 2011, the Company expanded Debentures (Series B) by issuing additional debentures in the amount of NIS 117 million par value and which totaled NIS 120 million. Maalot gave the Debentures (Series B) a rating of ilA-. According to the amendment to the Company's bank finance agreement, 50% of the proceeds from the issuance will be used for early partial repayment of the Company's long-term bank loans.
  2. At June 30, 2011, the Company is in compliance with the financial covenants set for it.
  3. The Company's management believes that the financial resources at its disposal will be sufficient for the Company's operations for the coming year, based on the cash flow forecast approved by the Company's board of directors. If additional resources are required to meet its operational requirements for the coming year, the Company will adapt its operations to preclude the need for additional resources beyond those available to it.

Notes to the Financial Statements

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## NOTE 5 – CONTINGENT LIABILITIES

**Legal claims****A. Employee claims**

During the normal course of business, employees and former employees filed collective and individual claims against the Company. Most of these claims are for alleged non-payment of salary components and delay in salary payment. At June 30, 2011, these claims amounted to NIS 1,632,000. In the opinion of the management of the Company, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 823,000, where provisions are required to cover the exposure resulting from such claims.

**B. Customer claims**

During the normal course of business, the Company's customers filed claims against the Company. At June 30, 2011, these claims amounted to NIS 1,082,083,000. In the opinion of the management of the Company, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 3,890,000, where provisions are required to cover the exposure resulting from such claims.

Of these claims, there are claims amounting to NIS 81,650,000 which cannot yet be assessed.

For changes subsequent to the reporting date, see Note 7.

**C. Supplier and communication provider claims**

During the normal course of business, suppliers of goods and/or services to the Company filed various claims against the Company. The main claim was filed for alleged damage to a supplier as a result of the Company's negligence. At June 30, 2011, these claims amounted to NIS 63,277,000. In the opinion of the management of the Company, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 170,000, where provisions are required to cover the exposure resulting from such claims.

**D. Investigation by the Authority**

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

**Notes to the Financial Statements**

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**NOTE 6 –EVENTS IN THE BALANCE SHEET PERIOD**

On June 19, 2011 the Knesset Economics Committee approved a bill for second and third readings, whereby, inter alia, the payment a licensee may collect from a subscriber canceling his contract, will be restricted to 8% of his average monthly bill until the cancellation date, multiplied by the number of months remaining until the end of the contract period. The restriction shall apply to subscribers whose average monthly bill is less than NIS 5,000; and it will be impossible to collect any payment from anyone entering into a new agreement with the licensee after the law takes effect, who requests cancellation of his agreement. The Company will review the effect of the bill, insofar as it will be approved by the Knesset, on subscriber behavior and the ensuing effect on its accounts.

**NOTE 7 – MATERIAL EVENTS SUBSEQUENT TO THE REPORTING DATE**

Further to the claim for broadcasting disruptions which was included in the customer claims described in note 21B to the 2010 annual financial statements, on July 21, 2011, a motion was filed in the Tel Aviv – Jaffa District Court to certify a settlement agreement in a class action which was filed against the Company in October 2007 in the amount of NIS 121 million in connection with disruptions in DBS's broadcasts and with problems in the functioning of its service setup during reception disruptions in September 2007. Under the settlement agreement, the Company will offer the following benefits to any subscriber living in northern towns in the disruption period, as detailed in the settlement agreement: anyone who is a current subscriber of the Company – 3 DVDBOX movies or one of the channel packages listed in the settlement agreement for 60 days; anyone who is no longer a subscriber of the Company – an option to subscribe to its services and become entitled to the above-mentioned benefits or to receive NIS 35.

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

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

**Regulation 9D – Report on the Liabilities of the Reporting Corporation and  
Companies that are Consolidated or Proportionately Consolidated  
in the Financial Statements as at June 30, 2011**

1 The liabilities of the reporting corporation, as a separate legal entity:

- A. Liability certificates issued by the reporting corporation, held by the public, except for the liability certificates held by the parent company of the reporting corporation, a controlling shareholder therein, corporations under their control or under the control of the reporting corporation.

|                    | <u>Principal<br/>payments</u><br><u>CPI-linked</u><br><u>(NIS)</u><br><u>NIS millions</u> | <u>Gross interest<br/>payments</u><br><u>(pre-tax)</u><br><u>NIS millions</u> |
|--------------------|-------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------|
| First year         | 300                                                                                       | 79                                                                            |
| Second year        | 300                                                                                       | 64                                                                            |
| Third year         | 300                                                                                       | 48                                                                            |
| Fourth year        | 300                                                                                       | 32                                                                            |
| Fifth year onwards | 300                                                                                       | 16                                                                            |
| Total              | <u>1,500</u>                                                                              | <u>239</u>                                                                    |

On July 3, 2011, the Company issued additional debentures (see Note 12D to the consolidated financial statements). The information in this report is correct as at June 30, 2011 and does not include the new debentures.

- B. Liability certificates and non-banking credit as follows:

Liability certificates issued by the reporting company, which are not held by the public, except for the liability certificates held by the parent company of the reporting corporation, a controlling shareholder therein, corporations under their control or under the control of the reporting corporation.

|                    | <u>Principal<br/>payments</u><br><u>CPI-linked</u><br><u>(NIS)</u><br><u>NIS millions</u> | <u>Principal<br/>payments</u><br><u>Unlinked (NIS)</u><br><u>NIS millions</u> | <u>Gross interest<br/>payments</u><br><u>(pre-tax)</u><br><u>NIS millions</u> |
|--------------------|-------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------|-------------------------------------------------------------------------------|
| First year         | 69                                                                                        | -                                                                             | 30                                                                            |
| Second year        | -                                                                                         | -                                                                             | 27                                                                            |
| Third year         | -                                                                                         | -                                                                             | 27                                                                            |
| Fourth year        | -                                                                                         | -                                                                             | 27                                                                            |
| Fifth year onwards | -                                                                                         | 400                                                                           | 100                                                                           |
| Total              | <u>69</u>                                                                                 | <u>400</u>                                                                    | <u>211</u>                                                                    |

- C. Credit received by the reporting corporation from the Bank of Israel

|                    | <u>Principal<br/>payments</u><br><u>Unlinked (NIS)</u><br><u>NIS millions</u> | <u>Gross interest<br/>payments</u><br><u>(pre-tax)</u><br><u>NIS millions</u> |
|--------------------|-------------------------------------------------------------------------------|-------------------------------------------------------------------------------|
| First year         | 677                                                                           | 211                                                                           |
| Second year        | 77                                                                            | 181                                                                           |
| Third year         | 475                                                                           | 168                                                                           |
| Fourth year        | 475                                                                           | 144                                                                           |
| Fifth year onwards | 2,496                                                                         | 323                                                                           |
| Total              | <u>4,200</u>                                                                  | <u>1,027</u>                                                                  |

- 2 For liabilities of the subsidiaries and the proportionately-controlled subsidiaries of the reporting corporation, except for companies that are themselves a reporting corporation, the following will be specified:

- A. Credit received by the subsidiaries from the Bank of Israel
- B. Total liability certificates issued by the subsidiaries

|                    | <b>Principal<br/>payments</b> | <b>Principal<br/>payments</b> | <b>Gross interest<br/>payments</b> |
|--------------------|-------------------------------|-------------------------------|------------------------------------|
|                    | <b>CPI-linked<br/>(NIS)</b>   | <b>Unlinked (NIS)</b>         | <b>(pre-tax)</b>                   |
|                    | <b>NIS millions</b>           | <b>NIS millions</b>           | <b>NIS millions</b>                |
| First year         | 181                           | 9                             | 34                                 |
| Second year        | 172                           | 11                            | 25                                 |
| Third year         | 173                           | 11                            | 17                                 |
| Fourth year        | 155                           | 12                            | 8                                  |
| Fifth year onwards | 20                            | 31                            | 3                                  |
| Total              | 701                           | 74                            | 87                                 |

- 3 Credit from Group companies or liability certificates held by Group companies:

Credit received by the reporting corporation from companies that are consolidated or proportionately consolidated in its financial statements, and the balance of liability certificates issued by the reporting corporation held by them.

|                    | <b>Principal<br/>payments</b> | <b>Gross interest<br/>payments</b> |
|--------------------|-------------------------------|------------------------------------|
|                    | <b>CPI-linked<br/>(NIS)</b>   | <b>(pre-tax)</b>                   |
|                    | <b>NIS million</b>            | <b>NIS millions</b>                |
| First year         | 175                           | 46                                 |
| Second year        | 175                           | 37                                 |
| Third year         | 175                           | 28                                 |
| Fourth year        | 175                           | 19                                 |
| Fifth year onwards | 175                           | 9                                  |
| Total              | 875                           | 139                                |