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 March 2013

INTERNET GOLD-GOLDEN LINES 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- __________

INTERNET GOLD-GOLDEN LINES LTD.

The following exhibit is attached:

Translated version of the 2012 Annual Report of Bezeq The Israel Telecommunication Corp. Ltd, or Bezeq, a controlled subsidiary of B Communications, the Registrant controlled subsidiary, published by Bezeq on March 14, 2013.

The attached exhibits pertain to Bezeq (“Bezeq” and together with its subsidiaries, “the Company”):

99.1 Periodic Report of the Company for the Year 2012: Chapter A - Description of Company’s Operations.

99.2 Periodic Report of the Company for the Year 2012: Chapter B - Directors' Report on the State of the Company's Affairs.

99.3 Periodic Report of the Company for the Year 2012: Chapter C - Financial Statements.

99.4 Bezeq Separate Financial Information for the Year ended December 31, 2012.

99.5 DBS Satellite Services (1998) Ltd. Financial Statements for the Year ended December 31, 2012.

99.6 Periodic Report of the Company for the Year 2012: Chapter D - Additional Information about the Company and Corporate Governance Questionnaire.

99.7 Report of the Company Concerning Effectiveness of the Internal Control over Financial Reporting (SOX format): Chapter E.

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.

Internet Gold-Golden Lines Ltd.
(Registrant)

By: /s/ Doron Turgeman
Doron Turgeman
Chief Executive Officer

Date: March 25, 2013

EXHIBIT INDEX

EXHIBIT NO. DESCRIPTION

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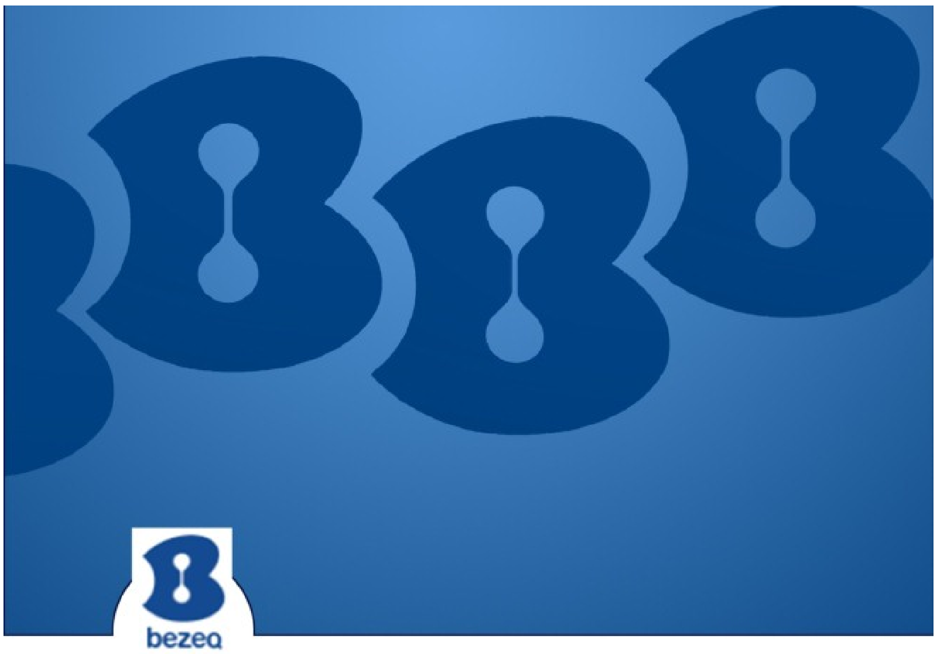
Exhibit 99.1

March 13, 2013

Bezeq The Israel Telecommunication Corporation Ltd.

Periodic Report for the Year 2012

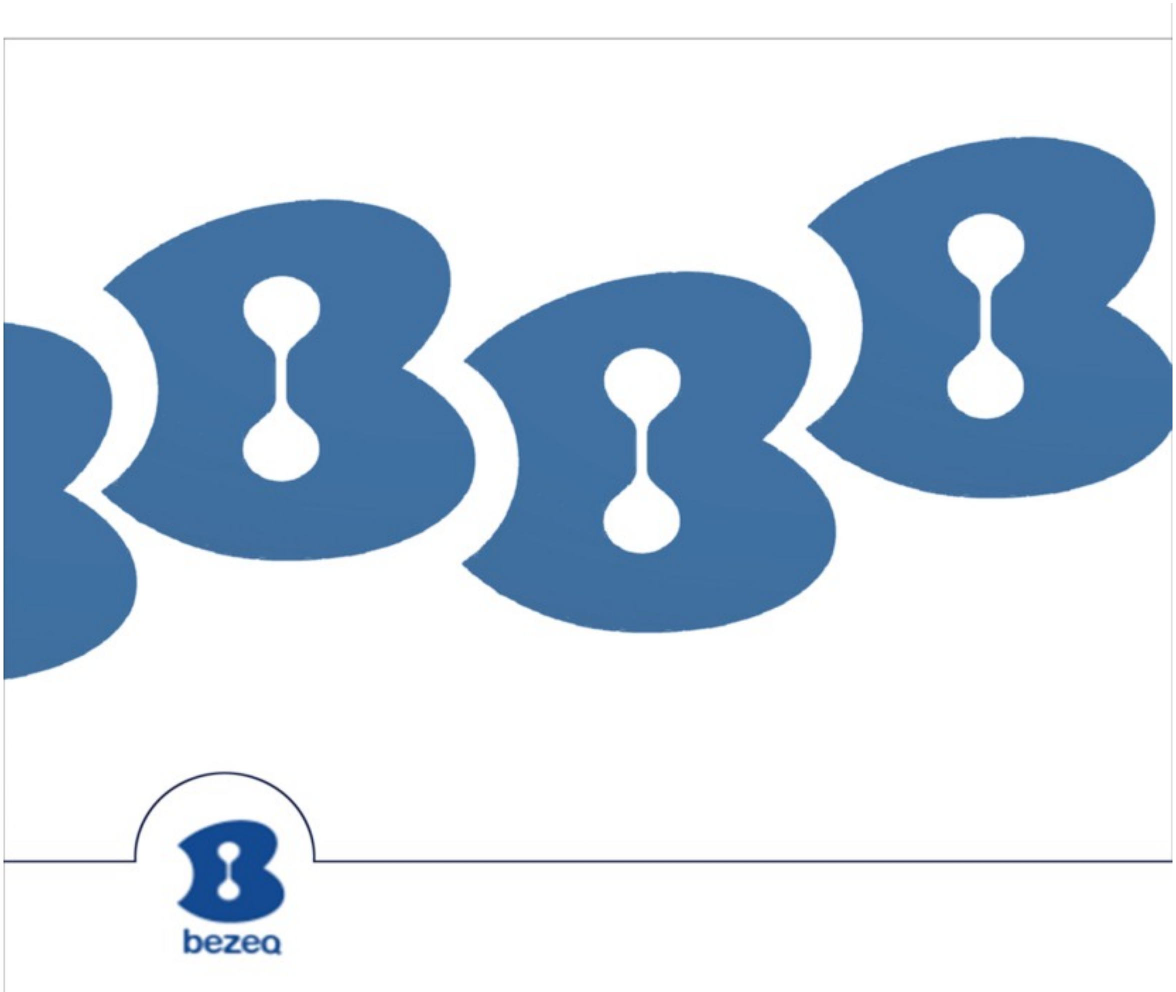
Chapter A	-	**Description of Company Operations**
Chapter B	-	**Directors' Report on the State of the Company's Business**
Chapter C	-	**Financial Statements**
Chapter D	-	**Additional Information about the Company and Corporate Governance Questionnaire**
Chapter E	-	**Report Concerning Effectiveness of the Internal Control over Financial Reporting (SOX format)**



Chapter A

(Description of Company Operations)

of the Periodic Report for 2012



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LIST OF TERMS

A. Names of laws appearing in the report

Consumer Protection Law	Consumer Protection Law, 1981
Antitrust Law	Antitrust Law, 1988
Arrangements Law	Economic Policy for 2011-2012 (Legislative Amendments) Law, 2011
Companies Law	Companies Law, 1999
Non-Ionizing Radiation Law	Non-Ionizing Radiation law, 2006
Second Authority Law	Second Authority for Television and Radio Law, 1990
Planning and Construction Law	Planning and Construction Law, 1965
Communications Law	Communications (Telecommunications and Broadcasts) Law, 1982
Securities Law	Securities Law, 1968
Class Actions Law	Class Actions Law, 2006
Communications Rules	Communications (Broadcasting Licensee) Rules, 1987
Telegraph Ordinance	Wireless Telegraph Ordinance [New Version], 1972
Communications Order	Communications (Telecommunications and Broadcasts) (Determination of an Essential Service Provided by Bezeq Israel Communications Corp.) Order, 1997
Frequency Regulations for Access Installations	Communications (Telecommunications and Broadcasts) (Frequencies for Wireless Access Installations) Regulations, 2002
Royalties Regulations	Communications (Telecommunications and Broadcasts) (Royalties) Regulations, 2001 and Communications (Telecommunications and Broadcasts) (Royalties) (Temporary Order) Regulations, 2011
Royalties Regulations (Satellite Broadcasts)	Communications (Telecommunications and Broadcasts) (Satellite Television Broadcasts) (License fees and Royalties), 1999
Interconnect Regulations	Communications (Telecommunications and Broadcasts) (Payments for Interconnect) Regulations, 2000
Satellite Broadcasting License Regulations	Communications (Telecommunications and Broadcasts) (Proceedings and Conditions for Grant of a Satellite Broadcasts License), 1998
International Operator License Regulations	Communications (Telecommunications and broadcasts) (Proceedings and terms for receipt of a general license for providing international telecommunications services) Regulations, 2004

B. Other main technological terms appearing in the report[1]

Bezeq On Line	Bezeq On Line Ltd.
Bezeq International	Bezeq International Ltd.
Bezeq Zahav Holdings	Bezeq Zahav (Holdings) Ltd.
B.I.P	B.I.P Communications Solutions (Limited Partnership) which is controlled by Bezeq International
B Communications	B Communications Ltd. (formerly – 012 Smile Communications Ltd.)
2012 Financials	The consolidated financial statements of the Company for the year ended December 31, 2012

[1] Please note that the definitions are for reader convenience only, and are not necessarily identical to the definitions in the Communications Law or its Regulations.

DBS 2012 Financials	The financial statements of DBS for the year ended December 31, 2012, which are attached to this report
interconnect fees	Interconnect fees (also called "call completion fees") are paid by one carrier to another for interconnection (see definition below)
DBS	D.B.S. Satellite Services (1998) Ltd.
HOT	HOT Communications Systems Ltd. and corporations under its control which operates in broadcasting (multi-channel television)
HOT Telecom	HOT Telecom Limited Partnership
Hot Mobile	Hot Mobile Ltd. (formerly Mirs Communications Ltd.) and corporations under its control
HOT-Net	HOT-Net Internet Services Ltd.
the Stock Exchange	The Tel Aviv Stock Exchange Ltd.
the Council	The Cable and Satellite Broadcasting Council
Walla	Walla! Communications Ltd. and corporations under its control
Hayek Commission	Committee headed by Mr. Amir Hayek for reviewing the structure and updating of Bezeq tariffs and for setting wholesale service tariffs in fixed-line communications
Eurocom DBS	Eurocom D.B.S. Ltd.
public switching	A telephony system supporting the connection of installations for passing calls between various end units
Mbps	Megabits per second; a unit of measure for the speed of data transfer
Domestic Carrier	An entity providing fixed-line domestic telephony services under a general or special domestic carrier license
PVR decoders	Digital decoders enabling viewing of satellite broadcasts, with recording ability on a hard disk (Personal Video Recorder) and enabling other advanced services, including HDPVR decoders
HDPVR decoders	PVR decoders that also enable receipt of HD broadcasts
Roaming	Roaming services allow a customer of one communications network to receive services from another communications network which is not his home network, based on roaming agreements between the home network and the host network
NEP	Network End Point – an interface to which a public telecommunications network and terminal equipment or a private network are connected. NEP services include the supply and maintenance of equipment and services on the customer's premises
Cellcom	Cellcom Israel Ltd. and corporations under its control
Pelephone	Pelephone Communications Ltd.
Partner	Partner Communications Ltd. and corporations under its control
interconnect	Interconnect enables telecommunications messages to be transferred between subscribers of various license-holders or services to be provided by one license-holder to the subscribers of another license-holder; interconnect is made possible by means of a connection between a public telecommunications network of one license-holder (e.g. the Company) and a public network of another license-holder (e.g. a cellular operator). See also the definition of "interconnect fees".
cellular	Mobile radio-telephone; cellular telephony
ITS license	General license for providing international telecommunications services
domestic carrier license	General license for providing fixed-line domestic telecommunications services

cellular license	General license for providing mobile radio-telephone services by the cellular method
broadcasting license	License for satellite television broadcasts
transmission services	Transfer service for electromagnetic signals or a series of bits between telecommunications facilities of a license-holder (excluding terminal equipment)
data communication services	Network services for transferring data from point to point, transferring data between computers and between different communications networks, communications network connection services for the Internet, and remote access services for businesses
012 Smile	012 Smile Telecom Ltd. and corporations under its control
ARPU	Average Revenue Per User
CDMA	Code Division Multiple Access – Access technology for cellular communications networks based on separation of subscribers by encoding
xDSL	Digital Subscriber Line – Technology that uses the copper wires of telephone lines to transfer data (the Internet) at high speeds by using frequencies higher than the audible frequency and therefore enabling simultaneous call and data transfer
DTT	Digital Terrestrial Television – Wireless digital broadcast of television channels by means of terrestrial transmission stations
GSM	Global System for Mobile Communications – International standard for cellular communications networks ("2nd Generation")
HD	High Definition TV
HSPA	High Speed Packet Access - cellular technology succeeding the UMTS standard, enabling data transfer at high speeds ("3.5 Generation")
IDEN	Integrated Digital Enhanced Network – wireless mobile communications technology that enables combining PTT and cellular telephony
IP	Internet Protocol. The protocol enables unity between voice, data and video services using the same network
IPVPN	Virtual Private Network based on IP and located on the public network, through which it is possible to (a) enable end users to connect to the organizational network by remote access, and (b) connect between the organization's branches (intranet)
ISP	Internet Service Provider – Holder of a special license for providing Internet access services. The Internet access provider is the entity enabling the end user to connect to TCP/IP protocol that links him and the global Internet
LTE	Long Term Evolution – standard for high-speed wireless communications using mobile devices, such as cellular telephones
MOU	Minutes of Use – the average number of minutes of use of a subscriber to the communications services
MVNO	Mobile Virtual Network Operator – A virtual cellular operator that uses the existing communications infrastructures of the cellular carriers without need for its own infrastructures
NDSL	A subscriber's line that provides only high-speed access by means of ISPs
NGN	Next Generation Network – The Company's new communications network, based on IP architecture
PSTN	Public Switch Telephone Network – The Company's long-standing domestic communications infrastructure
UMTS	Universal Mobile Telecommunications System - international standard for cellular communications developed from the GSM standard ("3rd Generation")

VDSL2	Very High Bit Rate Digital Subscriber Line – Digital Subscriber Line (DSL) with very high speed. One of the fastest technologies for data transfer at high bandwidth on ordinary telephone lines
VoB	Voice over Broadband – Telephony and associated services in IP technology using fixed-line broadband access services
VoC	Voice over Cellular Broadband – Telephony services over a cellular data communications channel ("Mobile VoB Services")
VOD	Video on Demand – Television services per customer demand
VoIP	Voice over Internet Protocol – Technology enabling the transfer of voice messages (provision of telephony services) by means of IP protocol
Wi Fi	Wireless Fidelity – Wireless access to the Internet within a local space

Chapter A – Description of the Company's Business

Bezeq – The Israel Telecommunication Corp., Limited ("the Company" or "Bezeq"), together with its subsidiaries, whether wholly or partly owned, whose financial statements are consolidated with those of the Company, as well as D.B.S. Satellite Services (1998) Ltd., an affiliate, are hereafter together referred to in this Periodic Report as "the Group" or "Bezeq Group".[2]

1. General development of the Group's business

1.1 Group activities and business development

1.1.1 General

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

The Company was established in 1980 as a government company to which the activities carried out until then at the Ministry of Communications were transferred, and it was privatized over a period of years. The Company became a public company in 1990 and its shares are traded on the Tel Aviv Stock Exchange.

Since April 14, 2010, the controlling shareholder of the Company is B Communications, through its wholly-controlled (indirectly) company B Tikshoret (SP2) Ltd. ("B Tikshoret"), which at March 11, 2013 holds 30.97% (30.19% at full dilution)[3] of the Company's shares. For details about the agreement for acquisition of control of the Company, see Section 1.3.1.

Below is a schematic of the structure of holdings in the Company, and the Company's holdings in the subsidiaries and main affiliates, at March 11, 2013.

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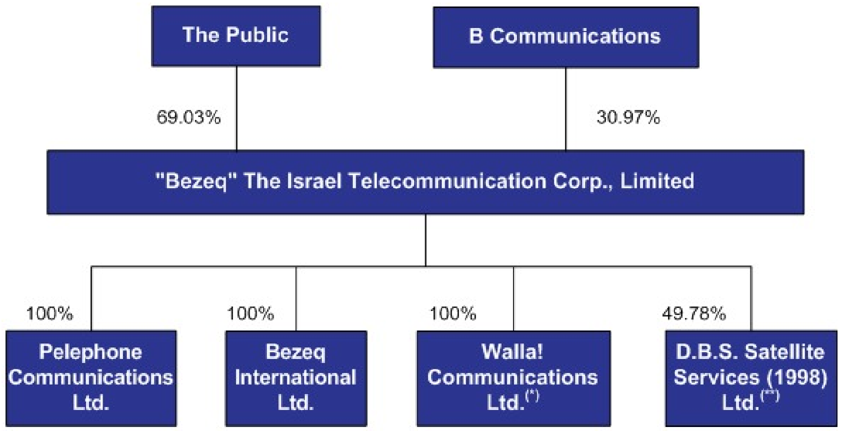
[2] We draw attention to the fact that the financial statements of DBS are not consolidated with those of the Company, and therefore, the definition of "the Group" in the 2012 financials differs from its definition in the Chapter "Description of the Corporation's Business" and no longer includes DBS.

[3] To the best of the Company's knowledge, B Tikshoret is a private company registered in Israel, wholly owned and controlled by B Tikshoret (SP1) Ltd., which is wholly owned and controlled by B Communications. B Communications is an Israeli public company whose shares are traded by way of double listing on the Stock Exchange and on the Nasdaq. The controlling shareholder in B Communications is Internet Gold – Golden Lines Ltd., and the controlling shareholder in Internet Gold – Golden Lines Ltd. is Eurocom Communications Ltd. ("Eurocom Communications"), which is controlled by Eurocom Holdings (1979) Ltd., in which the controlling shareholder is Mr. Shaul Elovitz. The shares of B Tikshoret in the Company are held through a trustee for B Tikshoret as the owner and for entities who made financing available to B Tikshoret as lien-holders.



(*) See section 1.1.2.

(**) The Company has options which, at the date of publication of the Periodic Report, grant a right to 8.6% of the shares of DBS. In view of the decision of the Supreme Court in 2009 not to approve the merger of the Company and DBS (see Section 2.16.8C), the Company ended its control in DBS and commencing August 21, 2009 it ceased consolidation of their financial statements and since that date its investment in DBS shares is stated by the equity method. On this matter, see Note 12 to the 2012 financial statements. The balance of DBS shares is held by Eurocom DBS.[4] To the best of the Company's knowledge, the voting rights for these shares are held by a trustee with an irrevocable power-of-attorney, in accordance with the conditions set in the agreement regarding acquisition of control, which stated, *inter alia*, that the trustee would act as owner of the shares. To the best of the Company's knowledge, the approval of the Antitrust Commissioner for B Communications' transaction to acquire control in the Company was made contingent, among other things, on the sale of Eurocom DBS's holdings in DBS within a defined period of time. See Section 1.3.1.

In addition, the Company holds 100% of the issued capital of Bezeq On-Line, which operates customer call centers of a scope that is not material to the Company, and 100% of the issued capital of Bezeq Zahav Holdings whose entire operation is the holding of Debentures Series 5 of the Company (see Section 2.17.1).

Below are details of the present holdings in the Company at full dilution, assuming exercise of all the options actually allotted to Group employees and managers (see Section 2.9.6) at December 31, 2012 and March 11, 2013:

	% of Holding		
Shareholders	**On December 31, 2012**	**On March 11, 2013**	**At full dilution on March 11, 2013[5]**
B Communications (through B Tikshoret)[6]	30.97%	30.97%	30.19%
The public	69.03%	69.03%	69.81%

4 A company controlled indirectly by Mr. Shaul Elovitch, the controlling shareholder (indirect) in the Company.

5 Full dilution was calculated assuming that all allotted options would be exercised for shares, in view of the Stock Appreciation Rights (SAR) mechanism in the 2007 stock option plans for managers and employees in the Group (see Section 2.9.6). This assumption is theoretical only, since in practice, under the terms of the plans and the outlines, the offerees who exercise the options will not be allotted all the shares underlying them but only a quantity that reflects the amount of the financial benefit embodied in the options.

6 Of the foregoing total holdings 4,000,000 shares are jointly held by the Chairman of the board of directors, Mr. Shaul Elovitch and his brother Mr. Yosef Elovitch, the controlling shareholders (indirectly) of the Company. 72,360 shares are held by Ms. Iris Elovitch, the wife of the controlling shareholder Shaul Elovitch and 11,556 shares are held by Ms. Orna Elovitch, the daughter-in-law of the controlling shareholder Shaul Elovitch. These shares total approximately 0.15% of all holdings in the Company.

1.1.2 Mergers and acquisitions

Full tender offer for Walla shares

On April 5, 2012, the full tender offer specification published by the Company for the purchase of all the shares held by shareholders from the public in Walla! was accepted by the majority prescribed in the Companies Law. Accordingly all Walla shares held by the public were acquired so that subsequent to the acquisition, as of April 15, 2012, Walla was delisted from the TASE and became a private company wholly owned by the Company. In this matter see Note 12.2 to the financial statements for 2012.

1.2 Segments of operation

The Group has four main segments of operation which correspond to the corporate division among the Group companies and report as business segments in the Company's consolidated financial statements (see also Note 28 to the 2012 Financials):

1.2.1 The Company – Fixed-line domestic communications

This segment consists primarily of the Company’s operation as a Domestic Carrier, including telephony services, Internet infrastructure and access services, transmission and data communications services. The Company's activities in the domestic fixed-line segment are described in Section 2 of this report.

1.2.2 Pelephone – Cellular communications

Cellular communications, marketing of terminal equipment, installation, operation and maintenance of cellular communication equipment and systems. Pelephone's operations are described in Section 3.

1.2.3 Bezeq International – International communications, Internet and NEP services

Internet access services (ISP), international communication services and NEP services. Bezeq International's operations are described in Section 4.

1.2.4 DBS – Multi-channel television

Multi-channel digital satellite television broadcasting services for subscribers (DBS) and the provision of value added services for subscribers. DBS's operations are described in Section 5.

It is noted that in addition, the Company's consolidated financial statements include an "Others" segment, which covers mainly Internet-related fields and the operation of Internet portals (through Walla), customer call center services (through Bezeq Online) and investment in a venture capital fund. The “Others” segment is not material at the Group level.

1.3 Investments in the Company's capital and transactions in its shares

1.3.1 Transactions in Bezeq shares – sale of core control

On April 14, 2010, a transaction was closed between the previous controlling shareholder in the Company, Ap.Sb.Ar. Holding Ltd. ("Ap.Sb.Ar") and B Communications, for the off-the floor sale of all of Ap.Sb.Ar's shares in the Company – 814,211,545 ordinary shares of NIS 1 par value each, accounting at that time for approximately 30.44% of the issued and paid up capital of the Company, at NIS 8 per share and a total consideration of NIS 6,513,692,260. These shares were acquired by B Communications.

The Company was informed that the transaction was closed after all the preconditions to the agreement were met, including receipt of all the regulatory approvals required by law, including the following approvals and conditions:

A. Ministry of Communication approvals (including grant of control permits). The approvals were made contingent upon certain conditions, mainly – a determination that transactions between Eurocom Group[7] and Pelephone for the purchase of terminal equipment would be considered an exceptional transaction under Section 270(4) of the Companies Law, and in addition to the approval proceeding at Pelephone, would also require an approval proceeding in the Company; Eurocom Group would not transfer to Pelephone any information relating to the supply / provision of products and services to its (Pelephone's) competitors; an employee of Eurocom Cellular Communications Ltd. would not serve as a director in Pelephone and vice versa. Other directives related to DBS shares held in trust (see sub-section 2 below).

[7] For this matter, Eurocom Group means all the corporations controlled, directly or indirectly, by Eurocom Holdings (1979) Ltd. and/or Eurocom Media-Net Holdings Ltd., excluding the Company, Pelephone, Bezeq International and B.E.P Communications Solutions LP, as well as employees of Bezeq and the above companies who are not employees in other companies in the Group.

B. Approval of the Antitrust Commissioner. The approval was made contingent upon certain conditions, mainly – the imposition of a ban on Eurocom Group[8] being involved in the determination of commercial terms that a cellular company purchasing terminal equipment from Eurocom Cellular Communications Ltd. offers consumers in Israel, other than participation in financing the sales campaigns of the cellular company, and a requirement for Eurocom Group to sell its holdings in DBS. Until those holdings were sold, Eurocom Group was required to transfer the voting rights for its shares in DBS to a trustee, who would act as owner of the shares and exercise its authority and/or rights at its discretion for the benefit of DBS only, under irrevocable power of attorney. Eurocom Group would not issue instructions or guidelines to the trustee (other than in connection with sale of the shares subject to the instructions in the Commissioner's decision), nor would the trustee be subject to the interests of Eurocom Group or its objectives, directly or indirectly. To the best of the Company's knowledge, the Eurocom Group is negotiating with the Antitrust Commissioner about the conditions mentioned regarding Eurocom Group's holdings in DBS. In the matter of Eurocom DBS's shares in DBS in respect of which the trustee received the aforementioned power of attorney, it was determined, with the approval of the Ministry of Communications, that any change in the trustee's holding in DBS requires the approval of the Ministry of Communications, and that the trustee would act on an instruction received from any entity that concerned, directly or indirectly, the arrangement of the Ministry of Communications only after receipt of the Ministry's approval.

C. Approval of the Prime Minister and the Minister of Communications in accordance with the orders of the Communications Law and of the Communications Order, including the approval of corporations from B Communications Group and the controlling individuals in it to control Bezeq ("the Control Permits"). The Control Permit is contingent, inter alia, upon the percentage of B Tikshoret's holding in the Company not falling below 30% ("the Minimum Percentage"), subject to a number of exceptions stated in the Communications Order.[9]

1.3.2 On June 1, 2011, the Company published a shelf prospectus for the issue of shares, debentures, convertible bonds, stock options, options for debentures and commercial papers, of a scope and under conditions to be determined in accordance with shelf proposal reports, if and insofar as the Company should publish them in the future ("the Shelf Prospectus"). Subsequently, on June 22, 2011, the Company published an amendment to the Shelf Prospectus in which changes were made mainly to the conditions of the debentures and deed of trust. In this regard, see also the Company's reports from June 1, 2011 and June 22, 2011 which include (respectively) the Shelf Prospectus and the Amended Shelf Prospectus. On June 29, 2011, the Company published a shelf offering report offering debentures to the public (Series 6-8). Distribution of dividends

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8 For this matter, Eurocom Group means all the corporations controlled, directly or indirectly, by Eurocom Holdings (1979) Ltd. and/or Eurocom Media-Net Holdings Ltd., as well as any person related to those companies and excluding the Company and companies in which the Company holds more than 50% of the shares.

9 It is noted that on February 2, 2011, the Prime Minister and Minister of Communications gave approval permitting the Minimum Percentage to fall to 29%, provided that the cause was an allotment of Company shares as part of an exercise of employee stock options, and for a period of six months from the date of decrease to below the Minimum Percentage. The approval will take effect on the date of the decrease to below the Minimum Percentage. At the end of the six months, the approval will expire and the Minimum Percentage will apply.

1.4 Dividend Distribution

1.4.1 Dividend policy

On August 4, 2009, the Board of Directors of the Company resolved to adopt a dividend distribution policy under which the Company would distribute to its shareholders, on a semi-annual basis, a dividend of 100% of the profits (after tax) ("Profit for the period attributable to the Company's owners") according to the consolidated financial statements of the Company. Implementation of the dividend distribution policy is subject to the provisions of any law, including the distribution tests laid down in the Companies Law, and to the Board's assessment as to the Company's ability to meet its existing and foreseen obligations, and all with due attention to the Company's projected cash flow, activities and liabilities, its cash balances, its plans and its situation from time to time, and subject to the approval of the general meeting of the shareholders of the Company for each specific distribution, as provided in the Company's Articles of Association. Since the date of that decision, the Company has not changed its dividend policy.

1.4.2 Distribution that does not pass the profit test

On December 3, 2011, the Tel Aviv District Court (Economic Department) approved a special distribution (the Special Distribution") in a total amount of NIS 3 billion, a sum which exceeds the Company's profits as defined in Section 302 of the Companies Law, where the amount of the Special Distribution would be distributed to the shareholders, as far as possible, in six equal semi-annual installments during the years 2011-2013 (without payment of interest and linkage) together with the expected distribution of the regular dividend

In its financial statements at March 31, 2011, the Company recorded a liability for the full amount of the Special Distribution. In this instance**,** see also Note 20.2.2 to the 2012 Financials.

For more details about the Special Distribution, see (1) the Company's immediate report relating to the distribution to shareholders dated December 31, 2010; (2) the immediate report on an application to the court for approval of a distribution which was published by the Company on January 26, 2011, to which the text of the application for approval of the distribution as filed in the court was attached, and (3) an immediate report about the distribution published by the Company on February 17, 2011,which includes explanations and additional emphases relating to the Planned Distribution, cited here by way of reference. In respect of the Company's rating, see Section 2.13.6.

It is the Company's position that its foreseeable finance expenses under the expected financial plan in connection with the resources required for a distribution that does not pass the profit test, is permitted net of tax. The Company received a legal opinion for its position. Nevertheless, the Company has not approached the tax authorities for a pre-ruling on the matter.

Immediately prior to the distribution of some of the installments of the Special Distribution, two private holders of Company debentures (Series 5), filed objections or quasi objections to the distributions, although these applications were dismissed or removed, and the distributions took place on schedule. At these hearings, pursuant to the Company's request, the court stipulated that there is no need for the Company to apply to the court prior to payment of each of the remaining installments of the Special Distribution, which the court approved on March 31, 2011. The Company therefore intends to continue to pay the dividend distributions as it has in the past, while reviewing its compliance with the profit test prior to the payments, and without such review necessitating any further application by the Company to the court. Regarding this, also see the Company's Immediate Report dated May 15, 2012, and supplementary immediate reports dated May 21, 2012, May 22, 2012, and May 30, 2012 cited here by way of reference. Furthermore, on March 13, 2013 another request was filed by a holder of debentures of the Company (one of the two mentioned above) in which he declared opposition to distribution of the fifth portion of the special distribution (see Section 1.4.3) and asked to instruct the company to publish, together with its 2012 Financials, a copy of the position paper regarding the distribution of the dividend and give him reasonable time to submit the reasons for his opposition. The opinion regarding the distribution of dividend is, in any case, published by the Company concurrent with the publication of this report.

1.4.3 Dividend distribution

Distributions made by the Company during 2011-2012 and up to the date of publication of this Periodic Report:

Distribution date	Distribution type	Total sum distributed (NIS millions)	Distribution per share (NIS)
May 19, 2011	Cash dividend	1,163	0.4305716
May 19, 2011	Cash dividend	500	0.1851125
October5, 2011	Cash dividend	992	0.3662451
October5, 2011	Cash dividend	500	0.1845993
May 21, 2012	Cash dividend	1,074	0.3951788
May 21, 2012	Cash dividend	500	0.1839752
October 19, 2012	Cash dividend	997	0.3659618
October 10, 2012	Cash dividend	500	0.1835315

The dividends listed above were distributed in accordance with the Company's dividend distribution policy, as specified in Section 1.4 שגיאה! מקור ההפניה לא נמצא. (Distribution of dividends in the amount of NIS 500 million on May 19, 2011, October 5, 2011, May 21, 2012 and October 10, 2012 as part of the Special Distribution defined in Section 1.4.2).

Outstanding, distributable profits at the reporting date - NIS 861 million (surpluses which were accumulated over the last two years, after deducting previous distributions, except for the Special Distribution).

On March 13, 2013, the Company's Board of Directors resolved to make a recommendation to the general meeting of the Company's shareholders to distribute a cash dividend in the total amount of NIS 861 million to the shareholders. At the date of the report, this dividend has not yet been approved by the general meeting. The determining date for the distribution is May 1, 2013 and the payment date is May 13, 2013. Together with this distribution (insofar as it is approved), the fifth installment of the Special Distribution in the amount of NIS 500 million will be distributed, as specified in Section 1.4.2, and the distribution dates for the fifth installment (the determining date, the ex-dividend date and the payment date) will be the same as the dates for distribution of the current dividend.

1.5 Financial information about the Group's segments of operation

All the data in this Section 1.5 are in NIS millions.

1.5.1 2012

	Domestic fixed line communications	Mobile radio telephone	International communications, Internet services and NEP	Multi-channel television	Others	consolidation adjustments**	Consolidated
Total revenues:							
External	4,339	4,371	1,286	1,636	256	(1,636)	10,252
From other segments of operation in the corporation	291	97	54	-	36	(452)	26
Total revenues	4,630	4,468	1,340	1,636	292	(2,088)	10,278
Total costs attributable to:							
Variable costs attributable to segment of operation*	832	1,767	624	587	134		
Fixed costs attributable to segment of operation*	1,845	1,809	497	796	171		
Total costs	2,677	3,576	1,121	1,383	305	((1819)	7,243
Costs that do not constitute revenue in another segment of operation	2,575	3,366	982	1,363	298	(1,347)	7,237
Costs that constitute revenues of another segment of operation	102	210	139	20	7	(472)	6
Total costs	2,677	3,576	1,121	1,383	305	(1,819)	7,243
Profit from operating activities attributable to owners of the Company	1,953	892	219	126	(13)	(142)	3,035
Profit from operating activities attributable to rights that do not grant control	-	-	-	127	-	(127)	-
Total assets attributable to operations at December 31, 2012	8,096	4,704	1,258	1,387	375	(55)	15,766
Total liabilities attributable to segment of operation at December 31, 2012	11,697	1,735	436	5,349	258	(6,169)	13,306

* The Group companies that are companies providing services (as opposed to manufacturing companies), do not operate a dedicated pricing system that differentiates between fixed and variable costs. The above distinction was made for the purposes of this report only. Variable costs are costs for which the companies have flexible management and control in the short-term and which directly affect output, compared with fixed expenses, which are not flexible in the short term and do not directly affect output.

** Details of consolidation adjustments – Transactions between segments of operation and transactions in multi-channel television.

1.5.2 **2011**

	Domestic fixed line communications	Mobile radio telephone	International communications, Internet services and NEP	Multi-channel television	Others	consolidation adjustments**	Consolidated
Total revenues:							
External	4,371	5,454	1,288	1,619	236	(1,619)	11,349
From other segments of operation in the corporation	277	94	66	-	41	(454)	24
Total income	4,648	5,548	1,354	1,619	277	(2,073)	11,373
Total costs attributable to:							
Variable costs attributable to segment of operation*	1,199	2,214	652	543	116		
Fixed costs attributable to segment of operation*	1,791	1,974	461	781	158		
Total costs	2,990	4,188	1,113	1,324	274	(1,758)	8,131
Costs that do not constitute revenues in another segment of operation	2,874	3,985	984	1,309	259	(1,308)	8,103
Costs that constitute revenues in other segments of operation	116	203	129	15	15	(450)	28
Total costs	2,990	4,188	1,113	1,324	274	(1,758)	8,131
Profit from ordinary operations attributable to owners of the Company	1,658	1,360	241	147	2	(163)	3,245
Profit from ordinary operations attributable to rights that do not grant control	-	-	-	148	1	(152)	(3)
Total assets attributable to operations at December 31, 2010	9,202	5,404	1,268	1,282	401	(226)	17,331
Total liabilities attributable to segment of operation at December 31, 2010	13,566	2,255	439	4,932	272	(6,821)	14,643

* The Group companies that are companies providing services (as opposed to manufacturing companies), do not operate a dedicated price system, which differentiates between fixed and variable costs. The above distinction was made for purposes of this report only. Variable costs are costs for which the companies have flexible management and control in the short-term and which directly affect output, compared with fixed expenses, which are not flexible in the short term and do not directly affect output.

** Details of consolidation adjustments – Transactions between segments of operation and transactions in multi-channel television.

1.5.3 2010

	Domestic fixed line communications	Mobile radio telephone	International communications, Internet services and NEP	Multi-channel television	Others	consolidation adjustments**	Consolidated
Total revenues:							
External	4,990	5,474	1,333	1,578	178	(1,578)	11,975
From other segments of operation in the corporation	273	258	47	5	32	(603)	12
Total income	5,263	5,732	1,380	1,583	210	(2,181)	11,987
Total costs attributable to:							
Variable costs attributable to segment of operation*	1,414	2,311	668	553	97		
Fixed costs attributable to segment of operation*	1,806	2,038	392	852	99		
Total costs	3,220	4,349	1,060	1,405	196	(1,987)	8,243
Costs that do not constitute revenue in another segment of operation	2,957	4,145	926	1,393	194	(1,377)	8,238
Costs that constitute revenue in other segments of operation	263	204	134	12	2	(610)	5
Total costs	3,220	4,349	1,060	1,405	196	(1,987)	8,243
Profit from ordinary operations attributable to owners of the Company	2,043	1,383	320	88	11	(104)	3,741
Profit from ordinary operations attributable to rights that do not grant control	-	-	-	90	3	(90)	3
Total assets attributable to operations at December 31, 2010	6,352	4,892	1,038	1,243	375	338	14,238
Total liabilities attributable to segment of operations at December 31, 2010	7,964	1,930	304	4,665	241	(6,236)	8,868

* The Group companies that are companies providing services (as opposed to manufacturing companies), do not operate a dedicated price system, which differentiates between fixed and variable costs. The above distinction was made for purposes of this report only. Variable costs are costs for which the companies have flexible management and control in the short-term and which directly affect output, compared with fixed expenses, which are not flexible in the short term and do not directly affect output.

** Details of consolidation adjustments – Transactions between segments of operation and transactions in multi-channel television.

For explanations about the development of the financial data shown in Sections 1.5.1, 1.5.2, and 1.5.3, see Section 1 of the Directors' Report on the State of the Company's Affairs.

1.5.4 Main results and operational data

Condensed data showing the results of each of the Company's main segments of operation in 2011 and 2012:

A. Bezeq Fixed-Line (the Company's domestic communications segment)

	2012	2011	Q4 2012	Q3 2012	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011
Revenues (NIS millions)	4,630	4,648	1,121	1,149	1,161	1,199	1,114	1,186	1,170	1,178
Operating profit (NIS millions)	1,953	1,658	558	419	437	539	384	546	517	211
Depreciation and amortization (NIS millions)	730	688	189	185	178	178	175	180	171	162
Operating profit before depreciation and amortization (EBITDA) (NIS millions)(7)	2,683	2,346	747	604	615	717	559	726	688	373
Net profit (NIS millions)	1,224	1,065	367	246	263	348	301	311	330	123
Cash flow from operating activities (NIS millions)	2,009	2,106	512	470	376	651	435	641	496	534*
Payments for investments in property, plant and equipment and intangible assets (NIS millions)(6)	958	1,165	202	249	238	269	259	268	319	319
Proceeds from the sale of property, plant and equipment and intangible assets (NIS millions)(6)	300	228	136	96	22	46	40	68	48	72*
Free cash flow (in NIS millions)(1)(8)	1,351	1,169	446	317	160	428	216	441	225	287
Number of active subscriber lines at the end of the period(2) (in thousands)	2,268	2,367	2,268	2,299	2,335	2,368	2,367	2,363	2,356	2,358
Average monthly revenue per line (NIS) (ARPL)(3)	73	76	71	73	73	74	70	78	77	79
Number of outgoing minutes (in millions)	8,691	9,758	1,979	2,126	2,226	2,360	2,339	2,482	2,415	2,521
Number of incoming minutes (in millions)	6,225	6,240	1,571	1,595	1,516	1,543	1,526	1,602	1,535	1,577
Number of Internet subscribers at the end of the period(2) (in thousands)	1,169	1,111	1,169	1,153	1,136	1,121	1,111	1,100	1,088	1,079
Percentage of subscribers using NGN services out of total Internet subscribers (%) (4)	62%	51%	62%	60%	57%	55%	51%	47%	40%	37%
Average monthly revenue per Internet subscriber (NIS)	81	80	80	80	80	84	81	81	80	79
Average broadband speed per Internet subscriber (Mbps)	9.6	6.7	9.6	9.0	8.3	7.5	6.7	6.0	5.3	4.8
Churn rate(5)	15.3%	11.6%	4%	4.2%	3.9%	3.2%	2.8%	2.8%	2.8%	3.3%

(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 (roughly) the first three months of the collection process)

(3) Excluding revenues from transmission and data communication, Internet services, services to communications operators and contract and other works: calculated according to average lines for the period

(4) The figures for 2011 and for Q1 2012 have been updated due to an updating of the number of the Company's internet subscribers connected to the NGN network.

(5) Number of telephony subscribers who left Bezeq Fixed-line during the period, divided by the average number of registered subscribers in the period. The numbers for the preceding quarters are presented after (immaterial) calculation accuracy of 0.1% per quarter.

(6) Excluding back to back acquisition and disposal of a real estate property during 2011.

(7) Operating profit before depreciation and amortization (EBITDA) is a financial index that is not based on generally accepted accounting principles. The Company presents this index as an additional index for assessing its business results since this index is generally accepted in the Company's area of operations which counteracts aspects arising from the modified capital structure, various taxation aspects and methods, and the depreciation period for fixed and intangible assets. This index is not a substitute for others based on generally accepted accounting principles and is not used as a single index for assessing business results or cash flows. In addition, the index presented in this report will probably not be calculated in the same way as parallel indices in other companies.

(8) Free cash flow is a financial index that is not based on generally accepted accounting principles. Free cash flow is defined as the net cash deriving from ongoing operations less cash used for purchasing/selling fixed and intangible assets. The Company presents free cash flow as an additional index for assessing its business results and cash flows because the Company believes that free cash flow is an important liquidity index that reflects cash resulting from ongoing operations after cash investments in infrastructure and other fixed and intangible assets.

B. Pelephone

	2012	2011	Q4 2012	Q3 2012	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011
Revenue from services (NIS millions)	3,261	3,637	754	816	857	834	849	914	925	949
Revenues from sale of terminal equipment (NIS millions)	1,207	1,911	273	233	291	410	390	507	513	501
Total revenue (NIS millions)	4,468	5,548	1,027	1,049	1,148	1,244	1,239	1,421	1,438	1,450
Operating profit (NIS millions)	892	1,360	167	199	259	267	262	342	357	399
Depreciation and amortization (NIS millions)	531	561	129	130	137	135	140	139	143	139
Operating profit plus depreciation (EBITDA) (NIS millions) (1)	1,423	1,921	296	329	396	402	401	481	500	539
Net profit (NIS millions)	698	1,056	134	154	194	216	204	263	279	310
Cash flow from operating activities (NIS millions)	1,728	800	388	490	556	294	223	168	101	308
Payments for investments in property, plant and equipment and intangible assets (NIS millions)	381	382	73	84	109	115	92	71	86	133
Free cash flow (in NIS millions) (1)	1,347	418	315	406	447	179	131	97	15	175
Number of subscribers at the end of the period (thousands) (2) (6)	2,800	2,847	2,800	2,839	2,859	2,876	2,847	2,842	2,827	2,861
Average number of minutes per subscriber per month (MOU) (3) (6)	419	375	442	425	409	399	384	385	370	359
Average monthly revenue per subscriber (NIS) (ARPU(6)	95	107	89	95	99	97	100	107	109	110
Churn rate (5) (6)	22.4%	22.9%	5.9%	6.7%	6.0%	3.9%	5.3%	6.1%	6.6%	5.0%

(1) For a description of EBITDA and free cash flow see notes (7) and (8) for the Bezeq Fixed-line table.

(2) Subscriber data include Pelephone subscribers (without subscribers from other operators hosted on the Pelephone network) and does 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 average monthly total revenue from cellular services, for Pelephone subscribers and subscribers of other media operators, including revenues received from cellular operators using Pelephone's network (from which the receipt of revenues commenced from 2012), repair and other services in the period, by the average number of active Pelephone subscribers in the same period.

(5) The churn rate is calculated at the ratio of 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.

(6) Due to increased movement of subscribers to pre-paid plans in the initial months of 2011 after reduction of the exit penalties, Pelephone decided not to include subscribers who had made no outgoing calls during the fourth quarter in the number of active subscribers. As a result, Pelephone eliminated 91,000 subscribers. These subscribers were eliminated retrospectively from each quarter in which they were moved to the pre-paid plans. Consequently, figures for subscribers, ARPU, MOU and churn rates were retroactively adjusted in each quarter.

C. Bezeq International

	2012	2011	Q4 2012	Q3 2012	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011
Revenues (NIS millions)	1,340	1,354	339	339	330	332	342	351	332	329
Operating profit (NIS millions)	219	241	61	55	53	50	59	61	60	61
Depreciation and amortization (NIS millions)	136	109	34	34	34	34	31	28	26	24
Operating profit before depreciation and amortization (EBITDA) (NIS millions)	355	350	95	89	87	84	89	89	87	85
Net profit (NIS millions)	160	182	45	40	39	36	44	46	46	46
Cash flow from operating activities (NIS millions)	272	243	87	63	64	58	76	57	68	42
Payments for investments in property, plant and equipment and intangible assets (NIS millions) (1)	173	288	38	28	36	71	103	92	47	46
Free cash flow (in NIS millions)(2)	99	(44)	49	35	28	(13)	(27)	(35)	21	(4)
Churn rate (3)	18.4%	12.6%	5.5%	4.6%	4.1%	4.3%	3.7%	3.2%	2.8%	2.9%

(1) For a description of EBITDA and free cash flow see notes (7) and (8) for the Bezeq Fixed-Line table.

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

(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

	2012	2011	Q4 2012	Q3 2012	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011
Revenues (NIS millions)	1,636	1,619	407	406	404	405	404	417	409	403
Operating profit (NIS millions)	253	295	73	61	65	63	106	52	74	54
Depreciation and amortization (NIS millions)	248	276	64	69	71	74	62	66	54	64
Operating profit before depreciation (EBITDA) (NIS millions)	501	571	137	130	136	137	168	118	128	118
Net profit (loss) (NIS millions)	(310)	(230)	(20)	(73)	(88)	(76)	7	(64)	(107)	(119)
Cash flow from current operations (NIS millions)	418	513	119	141	119	134	119	116	100	83
Payments for investments in property, plant and equipment and intangible assets (NIS millions) (1)	284	264	72	71	64	67	62	56	69	87
Free cash flow (NIS millions) (2)	134	250	47	70	55	67	57	60	31	(4)
Number of subscribers (3) (at the end of the period, in thousands)	578	586	578	580	581	585	586	585	582	581
Average monthly revenues per subscriber (ARPU)(4) (NIS)	234	232	234	234	232	232	229	237	234	231
Churn rate (5)	15.4%	11.9%	3.8%	3.3%	2.9%	2.8%	2.8%	3.6%	3.9%	4.1%

(1) For a description of EBITDA and free cash flow see notes (7) and (8) for the Bezeq Fixed-Line table.

(2) Subscriber – one household or small business customer. Where a business customer has many reception points or many converters (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 per small business customer.

(3) Monthly ARPU is calculated by dividing total DBS revenues (from content and equipment, premium channels, advanced products, and other services) by average number of customers.

(4) Number of DBS subscribers who left DBS during the period, divided by the average number of DBS registered subscribers in the period.

1.6 Group forecast

Based on the information which is currently known to the Bezeq Group, the Group's forecast for 2013 is as follows:

- Net profit attributable to shareholders is expected to be between NIS 1.7-1.8 billion.
- EBITDA[10] for 2013 is expected to be between NIS 4.25-4.35 billion.
- The Group expects free cash flow[11] in 2013 to be higher than NIS 2.7 billion.

In 2013, streamlining processes are expected to continue throughout the Group. In addition, the Company intends to accelerate the pace of the deployment of optical lines to customer premises and residential buildings (FTTB/H), so that during the year, a significant part of the network will be deployed. The pace of FTTB/H deployments are expected to increase in the following years.

The Company's forecasts in this section are forward-looking information, as defined in the Securities Law. The forecasts are based on the Company's estimates, assumptions and expectations, including:

The forecasts do not include the effect of employee retirement plans beyond those which have been discussed and approved in connection with previous years. To date, the employee retirement plan for 2013 has not yet been approved. The forecast may change, depending on the scope and specifications of the retirement plan that the Company adopts for 2013.

The forecasts do not include possible effects of the costs of the tenders for Generation 4 (LTE) frequencies for the cellular network, insofar as there are any. At this time, the tender for the LTE frequencies has not been published, although the Ministry of Communications announced its intention to allocate such tenders in 2012.

The Group's forecasts are based, *inter alia*, on its estimates regarding the structure of competition in the telecommunications market and regulation in this sector, the economic situation and accordingly, the Group's ability to implement its plans in 2013. Actual results may differ significantly from these estimates, taking note of changes which may occur in the foregoing, in business conditions and the effects of regulatory decisions, technology changes, developments in the structure of the telecommunications market, etc. or insofar as one or more of the risk factors listed in Sections 2.21, 3.20, 4.18, and 5.21 materializes.

1.7 General environment and influence of external factors on the Group's activities

The communications industry around the world and in Israel is characterized by rapid development and by frequent changes in technologies, in the business structure of the industry and in applicable regulation. Below is a description of the main trends and central characteristics of the communications industry in recent years, which have significantly affected the operations of the Group as a whole.

It is worth noting that over the last year, competition in the telecommunications industry, particularly in cellular telephony, has intensified (with the entry of new operators - Golan Telecom and Hot Mobile), with comprehensive service packages and communications packages being offered for a fixed price with unlimited use. This stronger competition has brought down prices, increased customer switching, led to a decline in the sale of cellular terminal equipment, a decline in the use of fixed-line telephony minutes, and higher churn rates (in fixed-line services, also due to cancellation of the charge for the ADSL only service), and this in turn has affected the Group's results. To reduce the impact on performance, the Group's companies are introducing streamlining and other measures to improve the services they provide and differentiate themselves from their competitors.

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10 EBITDA - operating profit before depreciation and amortization.

11 Free cash flow - cash from current operations less cash for the purchase/ sale of fixed assets and intangible assets, net.

1.7.1 Emergence of communication groups in the Israeli market and transition to competition among the groups

Whereas in the past competition in the communications market was mainly among independent communications service providers in each segment separately, more recently the trend has been to compete among communication groups operating in different segments of this market, as detailed in the following table and its notes[12]::

Group / Activity	Bezeq	IDB (a)	Partner (b)	Hot (c)
Cellular telephony	Pelephone	Cellcom	Partner	Hot Mobile
Fixed-line telephony	Bezeq Bezeq International	Cellcom Netvision	Partner 012 Smile	HOT Telecom
Internet services (fixed-line / cellular	Bezeq Pelephone Bezeq International	Cellcom Netvision	Partner 012 Smile	HOT Telecom HOT-Net
International calls	Bezeq International	Netvision	012 Smile	Hot Mobile
Multi-channel television	(DBS)[13]	-	-	HOT Broadcasts

a. **IDB Group** – To the best of the Company's knowledge, IDB Group provides communication services through Cellcom and Netvision, a wholly owned subsidiary of Cellcom. These companies provide cellular telephony services (including cellular Internet), fixed-line telephony mainly to business customers on its own infrastructure, transmission and data communication services for business customers through Cellcom's own transmission network, ISP services, international call services and fixed-line telephony services using VoB technology.

b. **Partner Group** – To the best of the Company's knowledge at the date of this periodic Report, Partner Group provides communication services through Partner, a public company and 012 Smile. Partner Group provides cellular telephony services (including cellular Internet), fixed-line telephony, transmission and data communications, ISP services, and fixed-line telephony services in VoB technology.

c. **HOT Group** – To the best of the Company's knowledge, HOT Group provides communications service through HOT, which is controlled by Mr. Patrick Drahy, and through Hot Mobile (formerly known as Mirs[14]). HOT Group owns a cable infrastructure which is deployed nationwide, and it provides multi-channel television services though HOT, as well as fixed-line telephony services. The group has Internet infrastructure and provides transmission and data communications services through HOT Telecom. Hot Mobile provides cellular communication services and iDEN technology. In April 2011 Hot Mobile won a bid for UMTS frequencies (see section 3.6.2.A) In December 2009, HOT-Net was granted an ISP license, subject to structural separation limitations between HOT-Net, HOT and HOT Telecom, and limitations on marketing joint service bundles that include HOT-Net's Internet access (among the limitations are an obligation to market bundles that correspond to competing ISPs, and an obligation to sell the ISP services separately and on the same terms as they are sold when part of the bundle (unbundling). In February 2012, HOT-Net's operations were launched.

Likewise, limitations were imposed separating the structure of Hot Mobile from that of HOT Telecom and HOT Broadcasting, including full segregation of management, as well as the separation of assets and employees. Hot Mobile was prohibited from transferring commercial information (including about customers) to HOT Telecom and HOT Broadcasting, or from receiving such information. However, Hot Mobile was permitted to offer and market HOT Telecom or HOT Broadcasting services that are not part of the joint bundles, and to transfer relevant information for this purpose.

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12 Regarding this, a group is characterized by proximity arising from the identity of shareholders, even though in some of the groups there is corporate, accounting or marketing segregation between the entities which belong to the Group.

13 As noted in section 1.1.1, the Company does not control DBS and following the decision of the Supreme Court in 2009, it is forbidden to control DBS. For the purpose of this report, DBS is shown as part of Bezeq Group even though it is not controlled by it.

14 According to a report by HOT dated November 28, 2011, Hot has entered into an agreement with a company controlled by Altice VII S.A.r.l., the only shareholder in the controlling shareholder of HOT, and with Migad Communications (a limited partnership), for the acquisition of all their rights in Mirs, so that Mirs is now wholly owned and controlled by HOT.

More recently there has been an increase in the consumption of "service bundles" (packages containing various communication services such as telephony, Internet and broadcasts). This trend is strengthening with the transition to technologies based on IP protocol, which promotes technology convergence between the different communication systems and with the start of penetration of integrated products enabling various communication solutions on the same handset (e.g. cellular and fixed-line telephony services in one handset. Communications groups market, or are likely to market in the future, "joint" service bundles consisting of different communications services of the companies in each group. As a rule, the marketing of the joint bundle enables the communications group to offer its customers tariffs that are more attractive than purchasing each service separately (in some cases with "cross-subsidization" among the bundle's components), and a total solution that does away with the need to be subscribed to a number of different providers. These trends may be reinforced when a retail market develops which allows operators that do not own infrastructures to offer full end-to-end service bundles (including infrastructure) to their customers.

Unlike the other groups, Bezeq Group is subject, at the date of this report, to the stricter limitations described below.

1.7.2 Activities of Bezeq Group as a communications group and the structural separation restriction

At the date of this report, the Group is subject to a number of regulatory limitations relating to the formation of joint ventures among the Group's companies.

A. Structural separation

The Domestic Carrier license states that the Company must maintain structural separation between itself and its subsidiaries.[15] This framework includes, *inter alia*, complete separation of the companies' managements.

The structural separation limitations put the Group in an inferior competitive position – which is worsening over time compared with mergers of other communications groups, which are not subject to such far-reaching limitations, and give rise to high management overhead.

For information pertaining to the policy document on increased competition, including recommendations concerning the cancellation of structural separation, see Section 1.7.3. If the conditions exist and the provisions of the policy document relating to structural separation are implemented, the rules that apply to the Group on this subject will change significantly.

B. Easing of structural separation – Limited approval for marketing joint bundles

The structural separation limitations prevented the Company from marketing joint service bundles. Following the decline of the Company's market share to below 85%,[16] in May 2010 the Company was permitted to offer private subscribers joint service bundles with the subsidiaries, and in July 2012 to offer a joint bundle to business subscribers, subject to approvals by the Ministry of Communications and other conditions laid down in the Domestic Carrier license, including these:

1. The bundles must be able to be unbundled, meaning that a service included in them will be offered separately and on the same terms.
2. At the time of submitting a request for approval of a bundle, there is a group of services in similar format being marketed to a subscriber as a package by a license-holder who is not a subsidiary of the Company, or there is a group that includes license-holders who provide a private subscriber with all the services included in the joint service bundle.

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15 Pelephone, Bezeq International (including the merged Goldnet partnership), DBS and Bezeq On Line.

16 The permit to market joint bundles was granted (by way of amendment of the Domestic Carrier license) pursuant to the policy paper published by the Minister of Communications in 2004, which stated that after the Company's market share in a particular segment (private or business) falls below 85%, it will be allowed to market joint service bundles with the subsidiaries in the same segment. The Company's market share in the private sector (calculated according to the method determined by the Ministry of Communications for this matter) fell below 85% in 2008, and in the business sector in September 2009.

Joint service bundles marketed by the subsidiaries including the services of the Company, are also subject, according to their licenses, to similar limitations, including unbundling (except for a bundle marketed by a subsidiary that contains only the Company's Internet infrastructure service). Additionally, pursuant to the Ministry's clarification regarding joint packages in the business sector, the Ministry does not view the amendment to the licenses as a change in the previously existing practice, with respect to the ability of ISPs which belong to the Group and others outside the Group to offer business customers the ISP component as well as the Company's infrastructure which is purchased as an input, without this being considered a "joint bundle".

These limitations, and in particular the unbundling obligation, which severely limits the Group's ability to offer discounts on the components of the bundle, puts the Group in a competitively inferior position as compared to the competing communication groups which are not subject to similar limitation in marketing joint bundles (other than a limitation on marketing a joint bundle of HOT-Net and other companies in HOT Group, as noted in Section 1.7.1).

Concerning collaboration with DBS for the sale of joint service bundles, see also Section 5.17.13.

C. Other limitations on offering benefits to Group companies and joint ventures among them

Other limitations on cooperative ventures between the Company and Group companies stem from various orders applicable to them, both under antitrust laws and conditions laid down by the Antitrust Commissioner in approvals of mergers between the Company and Group companies, which prohibit discrimination in favor of Group companies when providing certain services (see Section 2.16.8), and by power of the orders of the Company's license, which oblige it to provide its services equally to all. For further restrictions also see section 5.17.13.

D. Prohibition on control of DBS

The Company holds 49.78% of the shares of DBS,[17] with the balance held by Eurocom DBS which is (indirectly) controlled by Mr. Shaul Elovitch, who indirectly controls the Company.[18] In light of the holding structure in DBS, cooperative ventures between it and Group companies (such as agreements for mutual marketing of products and services) must currently be approved as transactions in which the controlling shareholder in the Company has a personal interest, in a way that could impede the business flexibility of the Group in such cooperative ventures.

In view of the position taken by the Antitrust Commissioner and the ruling of the Supreme Court in 2009 (see Section 2.16.8C), the Company refrained from increasing its holdings in DBS or controlling it, in a way that limits the Group's ability to benefit fully from the advantages which could have stemmed from the inclusion of DBS in the Group. If in the future these regulatory limitations and structural separation and the other limitations applicable to cooperative ventures between the companies in the Group are removed, then the options open to the Company to increase its holdings in DBS or to control it could create opportunities for the Group to utilize synergies with DBS or facilitate the utilization of such synergies. It is emphasized that at the date of this report, existing regulation does not allow the Company to increase its holdings in DBS or to control it.

With regard to cancellation of the structural separation in the multi-channel television segment see also Section 1.7.3.

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17 As well as options exercisable for additional shares in DBS – see Section 1.1.1.

18 On placing these shares in trust under irrevocable power of attorney in accordance with the terms laid down in the transaction for acquisition of control in the Company – see Section 1.3.1A.

1.7.3 Regulatory oversight and changes in the regulatory environment

Communications in Israel in general and the activities of the Company in particular, are subject to extensive regulation and close supervision. The main body overseeing the activities of the Group is the Ministry of Communications.[19] Regulation of the communications market in Israel is characterized by frequent changes, mainly aimed at increasing competition in the industry.

Considering the diversity of the Group's communication operations, regulatory developments could, in certain cases, have different effects on different areas of operation in the Group, meaning that changes in regulation that adversely affect one area, could potentially have a positive effect on another area (see for example, the effects of the reduction of interconnect fees for the cellular network in sub-section c. below). In certain cases, opposing effects on the areas of operation might be offset one against the other at the Group level.

Below is a description of some of the main regulatory developments, which affect a material part of the areas of operation of the Group during the reporting period.

A. Policy for regulating competition

On May 2, 2012 the policy document concerning expansion of competition in the fixed-line communications segment – wholesale market was published, according to which the Minister of Communications (“the Minister”) adopted the main recommendations of the committee appointed to review and revise the structure of Bezeq’s tariffs and to set wholesale service tariffs in the area of fixed-line communications, headed by Amir Hayek CPA ("Hayek Committee"), in the manner specified in that document which was included in the Company's Immediate Report dated May 2, 2012, cited here by way of reference ("Policy document on increased competition").Following are the key points in the document:

1. Owners of universal fixed-line access infrastructures who provide retail services, including the Company, will be obligated to sell wholesale services to holders of telecommunication licenses, including Bitstream Access, lease of access segments, dark fibers, tubes and transmission services, on a non-discriminatory basis and with no discounts for size. In this regard, a procedure was established for negotiating an agreement for these services and as soon as such agreement is signed, the infrastructure owner will publish a shelf offering for sale of the services based on the agreement and which also includes additional services as the Ministry determines from time to time ("the Shelf Offering"). In certain circumstances, the Minister has the power to stipulate conditions or prices for the services. The infrastructure owners must submit to the relevant license owners the distribution of their existing infrastructures, with exceptions to be defined.

2. Upon publication of the Shelf Offering, corporations with an interest in the infrastructure owner may also purchase wholesale services from it, without discrimination. The Company will be able to provide wholesale telephony services to its subsidiaries that are not supplied over a broadband network, provided that these services are also available to everyone and without discrimination.

3. Within nine months of publication of the Shelf Offering, the Minister will order elimination of the structural separation between the infrastructure provider who published the aforementioned offering and the international call providers and ISPs, changing it to accounting separation (unless the Minister believes that this will adversely affect competition or the public interest), so that the Company will be able to offer subsidized plans. Furthermore, insofar as the wholesale market develops and the degree of competition based on joint service bundles that combine fixed-line and mobile services in the private sector (according to indices or conditions stipulated by the Minister) allows this, the Minister will consider an easing or cancellation of the structural separation between an infrastructure provider and a cellular operator who has an interest in the said provider.

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[19] In July 2010, the Ministry of Communications distributed the Israel Communications Authority Law Memorandum, 2010, describing the establishment of a communications authority which would be the main regulatory body for communications in Israel, both in telecommunications and in broadcasts, which would be vested with the powers of the Ministry of Communications, the Second Authority, the Second Authority Council and the Council.

4. The Minister will review the subject of the unbundling of broadcast services included in the joint bundles, which also include Bezeq services (fixed or mobile) or broadband access services. The structural separation between the infrastructure providers and multi-channel TV sector will be eliminated by granting suppliers without nation-wide fixed-line infrastructure a reasonable possibility to provide a basic TV service package over the internet.

5. If no wholesale market develops in the correct manner (based on indices to be defined for this purpose) within 24 months of the publication of the policy document, the Minister will take action to implement structural separation between the infrastructure and the services provided by general domestic carrier license holders.

6. Within six months of publication of the Shelf Offering, the Minister will take action to change the method of oversight of the Company's prices so that prices will be controlled by the setting of a maximum price.

7. Within nine months, the Ministry of Communications will formulate regulations aimed at increasing the investment in and upgrading fixed-line communications infrastructure in Israel

On June 12, 2012, the Ministry of Communications began to convene an engineering forum of the operators regarding wholesale services, which discusses, inter alia, service portfolios (including service portfolios presented by the Company) for providing certain service configurations relating to the provision of Bitstream Access and passive infrastructures, concurrent with advanced negotiations which the Company is holding directly with various operators.

The Company is preparing to implement a wholesale market and provide wholesale services. The effects on the Company depend on the conditions, arrangements, and similar variables in implementing wholesale services some of which have not yet been defined, and it believes that in addition to the possible negative impact on revenues and the rendering of end-to-end services to subscribers, there may also be positive effects taking into account the possible elimination of structural separation and the end of control over the Company's prices, if and when they are implemented. The information in this paragraph includes forward-looking information, as defined in the Securities Law, which is based on the Company's estimates. Actual results may differ significantly from the aforementioned if any of the above assessments do not materialize.

In November 2012, the Company entered into agreement for Bitstream Access with Partner. The main points of the agreement are: definition of the principles and configuration of the service ("the Service Portfolio") for providing internet access which will support Media, Voice and TV internet services; the Company and Partner ("the Parties") will negotiate the prices of the service and all prices relating to the supply of the service during the period defined in the agreement. Should the parties fail to reach agreement on prices, they will wait for the final decision of the Ministry of Communications, based on the Policy Document of the Ministry of Communications; the parties will work towards signing a detailed agreement based on the principles prescribed in the Service Portfolio ("the Detailed Agreement"). After the parties have signed the Detailed Agreement, including any appendices, and finalized the prices, Bezeq will be able to publish the agreement as a shelf offering (as defined in the Policy Document, whereby any other entity may apply and receive the service under the same conditions). Similarly, in March 2013, the Company entered an agreement with Xfone for provision of Bitstream Access for a “small supplier,” an agreement which is not a Shelf Offering, as defined above.

On December 9, 2012, the Ministry of Communications' hearing of the Company's instruction was received, whereby the Company will give to Cellcom or to any license holder who applies to it for the purpose of exercising a wholesale market, detailed information about the sites, facilities and distribution of the Company's network. Bezeq submitted a detailed opinion to the Ministry concerning its objections to the aforementioned instruction and process, which the Company believes contains administrative deficiencies, lack of jurisdiction and are unreasonable.

B. Royalties

The Communications Law states that a holder of a license for providing telecommunications services shall pay royalties to the State out of its revenues from providing the services named in the Regulations. The Royalties Regulations impose on a general Domestic Carrier licensee (which includes the Company), an international call service license (which includes Bezeq International) and a cellular licensee (which includes Pelephone), a duty to pay royalties on its revenues (excluding VAT) from the services listed in the Schedule to the Regulations.

On August 1, 2012 an amendment was published to the Royalties Regulations which is relevant for the Company, Pelephone, DBS, BIP and Bezeq International, so that the rate of royalties for 2012 will be reduced on average to 1.75% for the Company and DBS, to 1.3% for Pelephone, (the rate of royalties for Bezeq International and BIP is 1%), and from 2013 it will be 0% for all of them.

For details about the amounts of royalties that Group companies paid in 2011 and 2012, see Sections 2.16.4, 3.15.3, 4.14.4 and 5.17.3.

C. Change in interconnect tariffs

The Interconnect Regulations set the interconnect tariffs to be paid to the Domestic Carrier, as well as limitations for the matter of the interconnect tariffs to be paid to a cellular operator. In September 2010 the regulations were amended so that commencing January 1, 2011, the interconnect tariffs that a cellular carrier can collect from other operators (Domestic Carrier, international call operator or another cellular operator) were lowered significantly. Below are the interconnect tariffs to a cellular operator that were valid on 31.12.2010, and the tariffs after the amendment:[20]

	From 2014 onwards	**2013**	**At Dec. 31, 2012**	**At Dec.31, 2011**	**At Dec. 31, 2010**
Call minute completion tariff	6.01	6.43	6.80	7.28	25.1
SMS (text) completion tariff	0.14	0.15	0.16	0.17	2.85

In the Company's domestic communications segment – The Company charges its customers for interconnect fees originating in the Company's network and terminating in the cellular networks, and pays the cellular operators the same amount for transferring call traffic in their network.

On February 28, 2013, the Company received an invitation to a hearing from the Ministry of Communications stating that it is considering reducing the interconnect fee for call completion on the network of a domestic fixed-line operator, including the Company, the maximum tariff and uniform at all times would be NIS 0.0104 per minute (instead of a rate of NIS 0.0421 at peak hours, and NIS 0.0232 non-peak hours, without VAT). This change, which would reduce the Company’s interconnect revenues, could be offset on Group level by reducing the costs incurred by the Company and its subsidiaries for interconnect fees. The Company estimates that the aforementioned tariff would harm by an annual amount that is not material. It should be noted that the expected impact on 2013 results also depends on the implementation date of the reduction, if it is indeed implemented. The Company intends to file its response to the hearing. The information in this section includes forward-looking information, as defined in Securities Law, dependent on if and when the reduction takes effect. The actual results may be different than specified above if the Company's predictions are not met, and also as a result of offset effects.

Below is data on the Company's revenues in fixed-line domestic communications from subscribers in interconnect fees to the cellular network, and its expenses in respect of call completion fees to the cellular companies in 2011 - 2012 (in NIS millions):

	2012	**2011**	**2010**
Revenue / expenses	226	256	801

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20 The tariffs, which are denominated in agorot, will be revised every year on January 1st and linked to the CPI (the base index being the average CPI for 2009), plus both VAT and the rate of royalties applicable to cellular operators under the Royalties Regulations multiplied by the indexed interconnect tariff. The tariffs in the table do not include VAT.

In the cellular segment (Pelephone) – Pelephone pays the other cellular operators interconnect fees for calls originating in the Pelephone network and terminating in their cellular networks (expense side), while the other operators (cellular, domestic and international) pay Pelephone interconnect fees for call terminating in its cellular network (income side).

Below is data for Pelephone's revenues from interconnect fees received from other communications networks in respect of incoming text messages (SMS) to the Pelephone network, and its expenses in respect of interconnect fees to the other cellular networks in 2010 – 2012 (in NIS millions).

	2012	2011	2010
Revenue	363	343	1,054
Expenses	300	265	813

In the international calls segment (Bezeq International) – Bezeq International pays interconnect fees to the cellular operators for calls terminating in their cellular networks.

Connectivity for VOB operators - on December 16, 2012, the Company reapplied to the Ministry with a request to immediately reduce the interconnect fee for VOB operators. The Company contends that this reduction is necessary when several years have passed from the effective date for removing "infancy protection" which these enterprises received based on a policy document issued by the Ministry on this subject (As part of this protection, a symmetrical interconnect fee was set although the VOB operators benefit from the "infancy protection of at least 0.7 agorot per minute), and certainly when the Ministry is reviewing the interconnect fees for all the domestic carrier networks

D. Limitation of the exit penalty a license-holder can collect from a subscriber

On August 8, 2011, an amendment to the Communications Law came into force, and applies to holders of Domestic Carrier and international communications and broadcasts licenses. Under the amendment, exit fees cannot be collected from a subscriber whose average monthly bill is less than NIS 5,000 who entered into an agreement after application of the amendment to the law and cancelled it, nor can he be denied a benefit that he would have received had he not ended the agreement.[21] The amendment to the law applies also, commencing November 8, 2011, to a subscriber who entered into an agreement before the amendment took force and subsequently cancelled it, but payment can be collected for cancellation of the agreement which is limited to 8% of the average monthly bill of the subscriber up to the date of cancellation, multiplied by the number of months remaining to the end of the term of the commitment. In addition, a license-holder is also forbidden to demand immediate payment of the balance of the subscriber's payments for the terminal equipment in the event of cancellation of the agreement. This amendment brought about an increase in the churn rate and certain changes in the agreement conditions with subscribers.

Cellular license-holders were governed by orders limiting the exit fee that may be collected from subscribers (to a certain scope of handsets) who terminate their agreement before the end of the commitment period to 8% of the subscriber's average monthly bill at the cancellation date. On April 1, 2012, an amendment was published to the law, eliminating entirely disconnect fees for customers who hold up to 100 phone lines who entered into agreement with the cellular operator from November 1, 2011. Calculation of exit fees for customers who entered into agreement with an operator before this date was included in the law prior to the amendment, as noted above. Likewise, according to the amendment, from January 1, 2013, a license holder will not make a subscriber's commitment to receive cellular services dependent on that subscriber's agreement with it or with any other license holder to purchase, rent, borrow or lease terminal equipment (see Section 3.6.2.D).

21 With reference to this provision, on May 9, 2012 the Ministry of Communications published its decision in a hearing noting that denial of the right to a benefit granted to a subscriber for purchasing a product that is not part of the service, due to termination of the engagement with the license-holder, is not in keeping with this provision in the Communications Law. With regard to the operators' claims in the hearing that the discounts or benefits, which are prescribed in the conditions that the subscribers are required to comply with, do not violate the provisions, the Ministry decided that in any case it will examine whether the conditions are real and relevant also when the subscriber remains as the operators' subscriber.

For a description of other regulatory developments in the reporting period and of the main limitations applicable to the areas of operation of the Group, see Sections 2.16, 3.15, 4.14 and 5.17.

E. Consumer legislation

Changes in consumer legislation affect the operations of the Group's companies on a regular basis.

During the course of their activity, the Group's companies are subject, inter alia, to the Consumer Protection Law. Various amendments have been made in recent years to the Consumer Protection Law and regulations, inter alia, concerning the cancelling of transactions even after service has begun, disconnecting from on-going services, and the need for the customer to give his express consent to continue transactions after the end of the specified period. Provisions concerning a refund of charges collected from the subscribers which are not in accordance with an agreement plus fixed handing charges are prescribed by law, as well as a maximum waiting time for a human response. Likewise, a variety of bills have been tabled in the Knesset introducing further amendments in the Consumer Protection Law which may, inter alia, affect the terms of the agreement, and the conduct of the Group's companies towards their subscribers.

F. Enforcement and financial sanctions

In January 2011, an amendment was published to the Securities Law. The amendment empowers the ISA to impose a fine and administrative enforcement measures for the violation of certain orders of the Securities Law. Subsequently, on February 16, 2012, the Company's board of directors approved an internal enforcement procedure on the subject of securities that addresses internal enforcement of the orders of the law, mainly on the following subjects: prohibition on the use of inside information, obligation to publish periodic and immediate reports, and agreement with related parties.

Over the last year, the Communications Law and the Antitrust Law were amended with regard to enforcement and the imposition of graded monetary penalties for violation of these laws and/or regulations and their provisions by the regulator. Bills which are similar to the amendment to the Consumer Protection Law and Protection of Privacy Law, are in the advanced stages of legislation. Likewise, the Law to Increase the Enforcement of Labor Laws, 5772-2011, was legislated. This legislation is expected to affect the way in which the Group's companies manage their affairs, in part with respect to the imposition of sanctions, their ability to protect themselves, etc.

G. GBE connection (Gigabit Ethernet) for ISPs ("gigabits")

On June 26, 2012, the Ministry of Communications published an invitation to a hearing asking for operators' comments on changes in the existing regulations for connecting ISPs to the Company's network and to the Hot Telecom network, whereby the "high-speed access by means of internet providers" (the Company's XDSL) portfolio, and Hot Telecom's "broadband access for ISPs" portfolio, will be amended so that these services will include all the necessary components for providing those buying the service with surfing speed, including conveying traffic on the core and access networks, the payments imposed on the ISPs for gigabits will be eliminated, and infrastructure owners will price the internet access services for the end customer to include the gigabit segments. According to the hearing, the infrastructure owners will be obligated to provide gigabit connections at a speed to be derived from the "load ratio" (a percentage of the aggregate speeds ordered by all the supplier's subscribers) as the Ministry determines from time to time. At present, the Ministry is of the opinion that the appropriate load ratio is 5%. The Company objected to this change and believes it is not generally accepted in the telecommunications industry, and expressed its opinion that the hearing and the proposed arrangement contain administrative flaws and are unreasonable. The Company published new tariffs for these services.

1.7.4 Limitations on creating charges on the assets of Group companies

For convenience, below are referrals to sections in the 2012 Periodic report that relate to the limitations applicable to Group companies in placing charges on their assets, and the main limitations:

1. Regulatory limitations – The Communications Law, the Communications Order (which applies to the Company) and some of the communications licenses of Group companies, contain limitations on the grant of rights to a third party in assets used to provide the essential service or in the assets of the license,[22] as the case may be, including the need to obtain regulatory approval to create charges on these assets. In some cases, such as Pelephone's cellular operator's license, and Bezeq International's ITS license, there are exceptions permitting the creation of charges in favor of banks without the need to obtain the regulator's approval in advance, provided that the charge agreement includes orders to ensure that the services rendered according to the license will not be affected if the bank exercises the charge. In addition, under the orders of the law and the communications licenses, the license and the resulting rights are not transferrable and they cannot be pledged or confiscated (with certain exceptions). See also Sections 2.16.3.G, 3.15.2.A and 5.17.11.

2. Contractual Restrictions - the Company and Pelephone have made undertakings towards certain financing entities that they will not pledge their assets without simultaneously creating a charge of the same class, rank and amount (negative charge) in favor of those financing entities. See also Sections3.12.2.A and 3.12.2.C. and Note 13 to the 2012 Financials. DBS created current charges on all its assets and fixed charges on several of its assets, whose conditions include, inter alia, restrictions on the creation of additional charges without obtaining the agreement of the financing entities. See also Section 5.15, and Note 12 to the 2012 Financials.

1.7.5 Level of economic activity in Israel

The activities of the Group are influenced by the level of economic activity in Israel, and accordingly, a change for the better or worse in that level can be expected to affect the Group's business.

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22 The assets required to secure the provision of service by the license-holder.

2. Bezeq – Domestic fixed-line communications

2.1 General information about the segment of operation

2.1.1 The segment of operation and changes occurring in it

The Company holds a general license for providing domestic fixed-line communication services and provides a range of such services as described in Section 2.2, mainly these: domestic fixed-line telephony (landline telephony), Internet access infrastructure services, and transmission and data communication services.

2.1.2 Legislative limitations and standards and special constraints

A. Communications laws and the Company's Domestic Carrier license

The operations are subject to government regulations and extensive oversight, stemming from its position as a general license holder under the Communications Law, which is subject to the provisions of that Law, of the subsequent instructions, regulations, orders and rules and the provisions of the Domestic Carrier License as well as other laws. Regarding this, and the restrictions on the Company's activity with respect to price setting, structural separation, permits for new services and service bundles, see Section 2.16 and Section 1.7.2. Concerning the document on extending competition, including alleviations and supervision on the obligation to provide services and the possibility of other license holders using the Company's infrastructure, see Section 1.7.3.

In addition, the Company was declared a provider of essential telecommunication services under the Communications Order. Pursuant to that declaration, the Company is obliged to provide a number of basic services under the Domestic Carrier license, and may not terminate them or narrow them without approval. The order also lays down limitations on the transfer and acquisition of means of control in the Company, and certain limitations on the activities of the Company. For details, see Section 2.16.3.

B. Antitrust laws

The Company was declared a monopoly in the main areas of its activities,, and is also subject to supervision and to limitations under the Antitrust Law (see Section 2.16.8).

C. Environmental laws and planning and construction laws

Some of the activities of the Company involve the use of wireless frequencies and the use of facilities that emit electromagnetic radiation, which are subject, respectively, to the Telegraph Ordinance (see Section 2.16.9), the Non-Ionizing Radiation Law (see Section 2.15), and to UBP 36 and UBP 56 (see Section 2.16.10).

2.1.3 Changes in the scope of operation in the segment and its profitability, market developments and customer traits

For the main data about the scope of operation in domestic fixed-line communications and its profitability in 2011 and 2012, see Section 1.5.4A. Below is a description of the main changes in the scope of operation in the segment in the reporting period.[23]

A. Fixed-line telephony - in recent years has been characterized by a decline in demand and in prices. The decline in demand is reflected in the gradual erosion of the number of calls originating in the fixed-line networks. The Company believes that this trend stems primarily from the rise in the number of cellular subscribers and the volume of use of cellular telephones in the comprehensive call minute package which the cellular companies have marketed extensively over the last year (the Company estimates that 75% of all calls originate on the cellular network) and from voice-over-internet calls (see Section 2.1.4 below) as well as from competition from other domestic operators. In 2012, the number of lines declined by about 4% (compared with stability in the number of lines in 2011), in part due to the elimination of the NDSL service and falling cellular prices. Likewise, the number of call minutes (incoming and outgoing) declined by 7% on the Company's fixed telephone lines compared with 2011. Average monthly revenue per phone line declined by approximately 4%.

23 For detailed data and definitions of subscriber and average income, see the notes to the table in Section 1.5.4A.

In addition, in recent years the volume of calls over the Internet has been increasing, which also reduces the number of calls made in fixed-line networks.

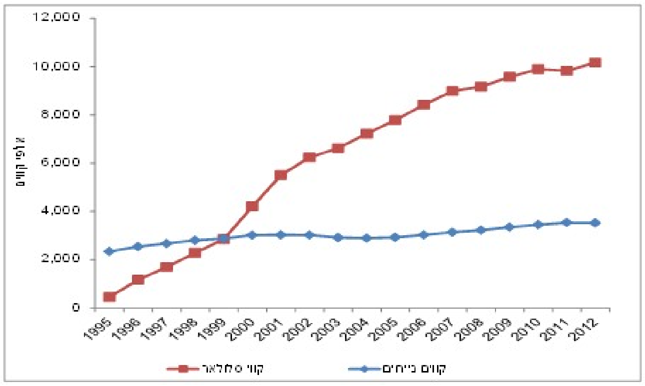
B. Internet access infrastructure services

In the Internet segment, while growth has been recorded in recent years in terms of the number of customers, the rate of that growth is slowing over time as a result of the high Internet penetration rate in Israel. Nevertheless, the Internet segment is characterized by a rise in surfing speeds and by the adoption of advanced services and value added applications. In 2012, the number of Company internet subscribers rose 5%, in part due to the elimination of the NDSL service, and average monthly revenue per internet subscriber rose by about 1% compared with 2011. The increased revenues in this area can be attributed to an increase in bandwidths of the surfing packages (see Section 2.2.3 and the adoption of advanced services and added value applications

In 2009, the Company launched its NGN (Next Generation Network) and HOT launched its UFI network. These networks enable surfing at considerably higher speed than were available until then. It is noted that a considerable number of Company customers who are connected to NGN are upgrading their surfing speeds to these new levels. For details, see Section 2.2.3.

On the possible establishment of a competing fixed-line network on the Company's infrastructure, on the electricity grid, see Section 2.6.4B.

Diagram 1 - changes in the number of fixed telephone lines compared with the number of cellular phone lines in Israel 1995-2012[24]



24 The figures are based on a Ministry of Communications publication on cellular lines, the reports of HOT to the public and assessment about the other operators. Accordingly, some of the data in the figure are based on estimates and the actual data might be different. Furthermore, commencing from the 2008 data, the calculation of fixed lines includes IP Centrex lines (lines in a virtual private exchange in a public network – see section 2.2.5D. For this purpose, the number of IP Centrex lines is measured by the maximum number of calls that can be made simultaneously).

Diagram 2 - changes in the number of call minutes from fixed telephone lines compared with the number of call minutes from cellular phone lines in Israel 1995-2012[25]

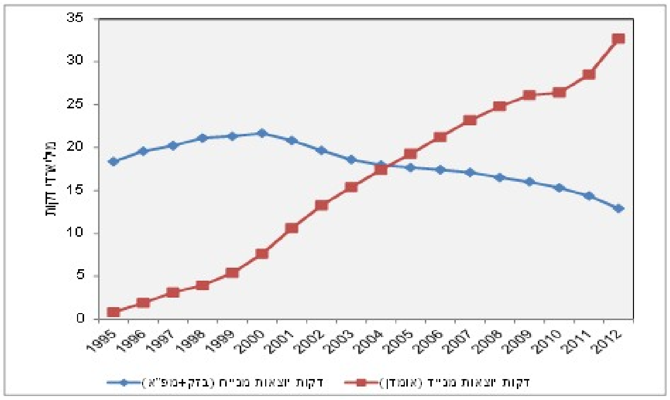
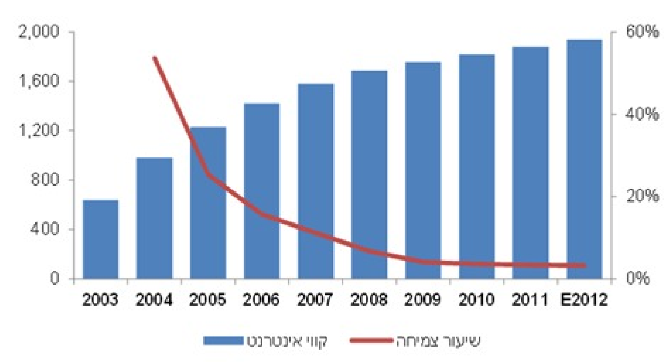


Diagram 3 - Changes in the number of internet lines and rate of growth in the internet segment 2003-2012[26]



[25] The data is based on the Company's traffic data and assessments of the traffic of other operators in the market. Accordingly, some of the data in the figure is based on estimates and the actual data might be different.

[26] The data for 2003-2011 is based on Company data and Hot reports to the public. The data for 2012 is based on Company data and assessments as to the volume of active lines of HOT, which has not yet published its financial statements Therefore, some of the data is based on estimates and the actual data might be different.

C. Transmission and data communication services

The transmission and data communications segment for business customers and communications providers is characterized by a rapid increase in the customers' broadband consumption, but in general by lower prices per given volume of traffic. This stems both from development of the technology allowing greater bandwidth at lower prices than in the past, and from competition in this area (see Section 2.6.3).

D. Service bundles

On the increase in consumption of service bundles and large-scale bundles, see Section 1.7.1.

Regarding the policy document on the development of competition, see Section 1.7.3.

2.1.4 Technological changes that can materially influence the segment of operation

A. The ongoing trend of increasing bandwidth and the availability of technologies based on IP protocol, allow the customer a broader range of applications and services on IP-based infrastructures, such as telephony services, video transfer services and network services with organizational applications on the Internet infrastructure (ERP, CRM, etc.).These developments are leading to an increase in the demand for bandwidth by Company customers of Internet infrastructure, transmission and data communication. The Company is deploying its NGN in a way that enables it to provide its customers with greater bandwidths (see Sections 2.6.6 and 2.7.2). Conversely, these developments that enable IP-based telephony services are one of the factors that have led to the decline in the consumption of the Group's fixed-line telephony services (on competition in telephony by providing services over the Company's Internet infrastructure (VoB), see Section 2.6.1. The increase in the capacity of the cellular network along with technological improvements, including future integration of 4-G networks, allow the cellular operators to compete with the Company's telephony and internet services, and to market larger bandwidths to their customers at lower prices. In the past year the trend of growing numbers of cellular Internet users has continued (see Section 2.6.2). At the date of this report, the Company estimates the increase in the number of customers surfing the cellular internet has not materially affected the volume of its Internet usage. Nevertheless, the growth potential of the cellular networks at the expense of the Company's market share is a real one.

B. Technological developments and falling prices of the equipment could enable other operators to provide services similar to those provided by the Company at much lower costs.

C. It is possible that a communications company will be established with a fixed-line infrastructure that competes with that of the Company, based on the IEC's electricity grid (see Section 2.6.4B.).

2.1.5 Critical success factors in the segment and the changes in them

A. The ability to offer reliable communications systems at a competitive price based on a cost structure suited to the frequent changes in the Company's business environment.

B. Regulatory decisions.

C. The ability to maintain innovation and technological leadership and to translate them into advanced and reliable applications of value to the customer at short response times, and marketing primacy.

D. Preservation of brand values and their adaptation to the conditions of the changing competitive environment, including the wholesale market.

E. Effectiveness of the sales arrays and service.

F. Managing an intelligent price policy, subject to regulatory limitations.

2.1.6 Main entry and exit barriers of the segment of operation, and changes occurring in them

Operating in the domestic fixed-line communications segment requires receipt of the appropriate Domestic Carrier licenses.

Traditionally, the main entry barrier to this segment stemmed from the need for heavy investment in technological infrastructure and in surrounding systems until obtaining economies of scale, and from high costs involving the establishment of marketing, sales, collection and customer support systems and the building of a brand. In recent years, these traditional carriers to the Company's segments of operation have lessened considerably as a result of the following factors: technological improvements, lower infrastructure and equipment prices, easing of regulation granted to new competitors, the mandatory obligation to allow the use of the Company's (and Hot's) infrastructures and services, and the ability to use existing set-ups, including the Company's network, by competing communications carriers or those destined to compete with the Company.

The regulation of competition in VoB-based telephony, which enables telephony services to be provided on a broadband infrastructure of another operator without need for an independent line telephony infrastructure (and in the future, if it becomes possible, competition based on dividing the network into sections and wholesale sale of services – see Section 1.7.3), significantly reduces the size of investment required from those competing with the Company, thereby making entry barriers to the segment much lower.

The main exit barriers stem from the commitment of the Company laid down in its license to provide its services to a defined quality and universally (to the entire public in Israel), its subordination to the provisions of the Communications Order, the regulations accompanying the Communications Law, and the provisions by power of Section 13A of the Communications law relating to emergency operation, its commitment to those of its employees who are employed under collective agreements, long-term agreements with infrastructure suppliers, the large investments requiring time before seeing a return, and the commitment to the repayment of long-term loans taken to finance the investments.

2.1.7 Substitutes for segment products and changes occurring in them

Cellular communications services are a substitute product for the Company's services, both in telephony and in Internet (see Sections 2.6.1 and 2.6.2).

IP technology such as VoB (see Section 2.6.1) and the Internet are also substitutes for the Company's services. In Internet services, transmission and data communications, technological developments (e.g. G4 in cellular, infrastructure based on optical fibers, including by means of the electricity grid and advanced cable Internet protocols), enable the provision of new services at high speeds and competitive prices.

2.1.8 The structure of competition in the segment and changes occurring in it

Domestic fixed-line telephony is regulated and controlled by the Ministry of Communications, inter alia by means of granting licenses to entities operating in the segment.

Fixed-line telephony is characterized by a lively competitive dynamic. The Company's competitors are HOT Telecom, VoB service providers which have operated for several years under license with no obligation to provide universal service, and without their own independent access infrastructure, and they are entities related to providers of Internet access services (ISP) and international communications services Some of them have been competing with the Company over the last year as part of telecommunications groups (see Section 1.7.1), and the Company believes that the cellular companies are also its competitors in the telephony segment (see Section 2.6.1).

The Internet segment is typified by high penetration rates, which are attributed to the deployment of a nationwide access infrastructure (HOT Telecom started operation in its area in 2002). Here, the Company is also exposed to competition from the cellular companies (see Section 2.1.4).

Hot Telecom, Cellcom, and Partner are the main operators in the transmission and data communications sector. Since 2011, new communications groups belonging to Partner have been formed - Smile and Cellcom-Netvision. These mergers enable the companies to offer customers comprehensive communications solutions.

Competition in the industry depends on a number of factors, such as regulatory decisions, possible changes in the terms of the licenses of the Company and the subsidiaries and the terms of the licenses of their competitors, mergers and joint ventures between companies that compete with the Group companies, the development of a wholesale market, and the lack of symmetry between competitor's ability to provide comprehensive service, the new services that the Company has been permitted to provide, tariff policy, and the extent of flexibility allowed to the Company when offering service bundles, including with the subsidiaries and technological developments.

For a description of the development of competition, see Section 1.7 and 2.6.

2.2 Products and services

2.2.1 General

The Company provides a wide range of communications services for its business and private customers, as described below.

2.2.2 Telephony

The Company's telephony services include mainly the basic telephony service on the domestic telephone line, plus associated services such as voice mail, caller ID, music on-hold, and Bphone.

The Company also provides its customers with a national numbering services for businesses (1-800, 1-700), for full or partial payment for the calls by the business.

The Company currently operates about 12,500 public telephones around the country, which are operated by various types of cards.

The Company's telephony services have declined, mainly due to competition from other telephony fixed-line service providers and the cellular companies. For details about the changes in the number of active lines and average monthly revenue per line, see Section1.5.4.A. For details about the Company's market share in this segment, see Section 2.6.1.

The Company operates a unified telephone directory[27] on a code (1344) determined by the Ministry of Communications for fixed-line and cellular telephony operators, as well as a unified website which is free of charge, in addition to the Company's 144 service. The Knesset approved the first reading of a bill under which, inter alia, information services provided under a Ministry of Communications license, will obligate the operators to transfer their databases to such a licensee for reasonable payment, and cancel allocation of the number 144 to the.

As part of its marketing strategy, the Company is working on the development and penetration of new services, both in the private sector and in the business sector (Bcloud, Free WiFi). The Company plans to continue to launch more products on the basis of market trends and customer needs.

2.2.3 Internet access infrastructure services

The Company provides broadband Internet access infrastructure services in xDSL technology.

As at December 31, 2012 the Company has almost completed full deployment of the NGN network and the percentage of subscribers using NGN services (those with packages of 10 mbps or higher) was 62% of all Internet subscribers (about 60% of the Company's internet subscribers).

For details about changes in the number of the Company's Internet subscribers and average monthly revenue per Internet subscriber, see Section 1.5.4A. For details about the Company's market share in this segment, see Section 2.6.2.

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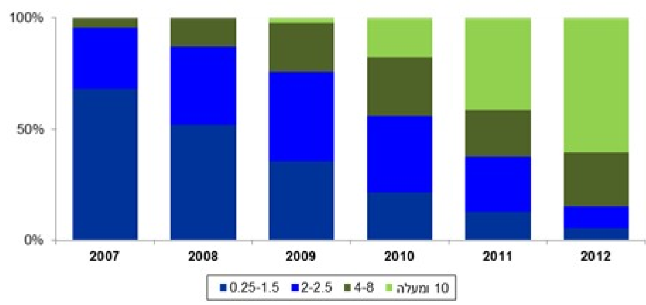
[27] A "unified" directory service is an information service containing data on the subscribers of all the operators. Fixed-line and cellular telephony operators are obliged, under the terms of their licenses, to provide unified information services. The operation is exempted from the need for approval of a cartel until July 27, 2014.

The Internet market has been one of the fastest growing markets of recent years (although a slower pace of growth has been seen compared with a rise in requested bandwidth – see Section 2.1.3B), and this service has become one of the main occupations of the Company and a central channel for its investments in technology, marketing, advertising and customer acquisition and upgrades.

The average surfing speed of the Company's Internet subscribers at the end of 2012 was 9.6 mbps, compared with 6.7 mbps at the end of 2011. Over the past year, the minimum speed provided for new customers is 5 mbps.

Figure 4 – Changes in the surfing speeds of the Company's Internet subscribers 2006-2012 (in Mbps at the end of each year)



Furthermore, the Internet market is characterized by lively competition with HOT, and with the cellular companies, which offer cellular surfing services (see Section 2.6.2).

2.2.4 Transmission and data communication services

Data communication services are network services for transferring data from point to point, transferring data between computers and between various communications networks, services connecting communications networks to the Internet, and remote access services.

The Company offers transmission services, including high speeds, to communications operators and its business customers in a range of interfaces (see Section 2.6.3). For details about the Ministry's provisions in connection with providing transmission services to competitors (Domestic Carriers Cellcom and Partner), see Section 2.6.2.

For information pertaining to the development of competition policy document, including the matter of providing services and enabling use of the Company's infrastructures by other license-holders – see Section 1.7.3.

2.2.5 Other services

A. Services to communications operators

The Company provides services for other communications operators, such as cellular operators, international call operators, HOT, NEP operators, ISPs, Domestic Carriers, and Palestinian communications providers.

Among the services provided by the Company are infrastructure services, infrastructure upgrades, connection to the Company's network, transmission services, billing services, leasing of space, services in leased premises.

For information pertaining to the development of competition policy docuement, see Section 1.7.3.

B. Broadcasting services

The Company operates and maintains radio transmitters which are operated, inter alia, by Israel Broadcasting Corporation, Israel Army Radio (Galei Zahal), and the broadcasts of a number of regional radio stations. It also operates the DTT transmitters for the Second Authority. The Company is responsible only for operating and maintaining the transmitters, and not for the content of the broadcasts – see also Section 2.15.

C. Contract works

The Company carries out set-up and operation works of networks or sub-networks for various customers (e.g. the Ministry of Defense, HOT, radio and television broadcasting companies, cellular operators, international call operators, local authorities, municipalities, and government bodies).

The Company has agreements with HOT Telecom for providing installation, maintenance and hosting of networks using the Company's infrastructures, from the exit point of the operation of the license-holders to the delivery point at the entrance to the homes of the subscribers (the connection and maintenance from these points to the subscribers' homes themselves are not the responsibility of the Company).

D. IP Centrex – IP Centrex service is a private and virtual exchange service in a public network.

E. Data Center – A service enabling a backup and survivability solution for the customer.

F. 144 Internet site (B144) – A search engine for finding the telephone numbers of businesses and private persons, including a classified search.

G. Free WiFi service – allows the Company’s customers to share part of their wireless bandwidth in return for browsing outside of their homes as well.

2.3 Breakdown of product and service revenues

The table below shows data for the breakdown of the Company's revenues by main product and service in its segment of operation, 2010-2012 (in NIS millions).

	2012	2011	2010
Revenues from line telephony	2,254	2,393	3,160
Percentage out of total Company revenues	48.68%	51.49%	60.04%
Revenues from Internet infrastructure services	1,166	1,092	977
Percentage out of total Company revenues	25.18%	23.49%	18.56%
Revenues from transmission and data communication services	976	931	882
Percentage out of total Company revenues	21.07%	20.03%	16.76%
Revenues from other services	234	232	244
Percentage out of total Company revenues	5.07%	4.99%	4.64%
Total revenues from domestic fixed-line communications services segment	4,630	4,648	5,263

2.4 Customers

The Company is not dependent on a single customer or small number of customers, the loss of which would materially affect the segment of operation, and there is no customer who accounts for 10% or more of the Company's total revenue.

The Company's sales are divided into two main customer types – private (about 59%), and business (about 41%). The division is by revenues in NIS millions, as shown in the following table:

	2012	2011	2010
Revenue from private customers	2,716	2,777	3,128
Revenue from business customers	1,914	1,871	2,134
Total revenue	**4,630**	**4,648**	**5,263**[28]

2.5 Marketing, distribution and service

The Company has marketing, sales and service systems for its business and private customers, which include customer managers for the business sector, combined sales and service centers (including Moked 199) around the country, technical support centers for private and business customers, 15 points of sale and service (Bezeqstores) at various locations, as well as a virtual online shop.

28 It is noted that the difference between the cumulative amount of revenue from private customers and revenue from business customers, and total revenue shown in the table, stems from rounding the amounts.

The Company markets its services mainly through advertising in the mass media and telephone sales centers, customer managers and an array of independent dealers which are mainly ISPs, and sales centers that operate by the outsourcing method.

2.6 Competition

Below is a description of the development of competition in the domestic fixed-line communications segment.

2.6.1 Telephony

The Company believes that at the end of 2012, its market share in the fixed-line telephony market was approximately 59% of the private sector and 75% of the business sector, compared with 63% in the private sector and 76% in the business sector, at the end of 2011.[29]

The competition in the fixed-line communications segment is lively:

A. Competition from other Domestic Carrier license-holders

The Company and HOT Telecom both own nationally-deployed fixed-line telephony infrastructures and they are in lively competition which is reflected, inter alia, in the marketing of service bundles combining Hot Internet infrastructure, telephony and cable television, and possibly cellular services as well, aimed mainly at households (for the marketing of service bundles of Bezeq Group, see Section 1.7.2). In addition, HOT markets telephony services to business customers.

The Company also has competition from license-holders for domestic fixed-line communications services, including VoB (see Section 2.1.8). Implementation of a wholesale market is expected to increase competition, based on the Company's infrastructure, and this taking into account the agreements which may be reached and the arrangements to be determined for its implementation.

B. Competition in telephony from the cellular companies

The penetration rate of cellular telephony in Israel is among the highest in the world (see Section 3.1.4). In the opinion of the Company, this penetration rate combined with low airtime rates on an international scale and large-scale bundles of minutes at fixed monthly prices have made the cellular telephone a product that largely substitutes for the landline telephone. The Company believes that a deepening of this substitution of the fixed line is one of the causes of the growing removal rate of telephone lines (see Section 2.1.3).

2012 signified another phase in competition in the cellular communications market in Israel. The launching of the activity of Golan Telecom Ltd. (as a new infrastructure operator) and the launching of Hot Mobile's UMTS network, and to a lesser degree the launching of other virtual cellular operators, led to a drop in prices and more customer switching between the companies. These developments aggravated the tendency toward lower average traffic per line and the growing rate of removal fixed telephone lines.

Partner and Cellcom also provide fixed-domestic fixed-line services through corporations they own, and they sell service bundles that combine fixed-line and cellular telephony and Internet services.

C. Regulation of VoC services

On November 21, 2012, the Ministry gave its decision on the hearing according to which VOB or VOC telephony services are telephony services which use IP technology over another entity's internet services, irrespective of whether this network is mobile or fixed, and it is therefore a single fixed service the provision of which will be regulated in a general Domestic Carrier license or special license, as applicable. The Ministry announced that it will publish an amendment to the general and special Domestic Carrier licenses which currently provide VOB services. The Company believes that the marketing of VoC services as part of the aforementioned Domestic Carrier license in telephony will increase competition, and will enable telephony services to be provided at fixed-line call prices on the cellular network.

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[29] These market shares are in terms of lines, based on the Company's assessment. According to Ministry of Communications publications, these methods showed that in March 2012 the Company's market share was 68.7% in the private sector and 76.3% in the business sector in terms of revenue using the normative measurement method, and 67.6% in individual lines and 68.4% in PRI trunks in terms of revenue using the normative measurement method.

D. NDSL Service

On April 5, 2012, the decision of the Ministry of Communications to cancel NDSL services came into effect. Accordingly, the Company will not be able to apply differential ADSL pricing for subscribers who use the service together with telephony service and subscribers who only use the ADSL service. Cancellation of the tariff led to a decline in the Company's revenues from internet infrastructure services, and indirectly to the loss of fixed telephone lines as well as an improvement in the pace of customer recruitment to the internet infrastructure.

2.6.2 Internet infrastructure segment

The Company believes that at the end of 2012, its market share in the Internet infrastructure market was approximately 60%, compared with 59% at the end of 2011.[30]

The competition in this field is also lively:

A. Competition from HOT Group – HOT's Internet infrastructure is deployed nationwide, in which a range of communications services and interactive applications can be provided. The network is currently the main alternative to competition with the Company in the private sector., The upgrading of the infrastructure and grant of an ISP license to HOT-Net in December 2010, the service bundles marketed by Hot Group (see Section 1.7.1C), and the Ministry of Communication’s decision regarding the cancellation of NDSL services, increased the level of competition .

B. Competition from cellular operators – The cellular companies have deepened their Internet activities on the cellular range both in the private sector and in the business sector. Unlike the fixed-line communications segment (where the provision of access infrastructure services – by HOT, is separate from provision of Internet access services – by the ISP), the cellular Internet service is provided as one unit. Surfing services are provided both from the cellular handset and through a cellular modem that connects laptop and desktop computers in combination with Internet access services.

2.6.3 Transmission and data communications

In addition to the Company, other companies operating in this field are Cellcom, Partner (which acquired the Med-1 operation), HOT, and Internet companies that also use leased infrastructures.

To the best of the Company's knowledge, Cellcom has deployed and set up a transmission network which it uses both for its own needs (instead of transmission provided for it in the past by the Company) and for competition with the Company in the transmission and data communications market. Cellcom offers its customers a complete package of solutions that includes domestic telephony, data communication and cellular communication, using its own infrastructure and its own sales array. Partner provides transmission and data communication services combined with telephony, for business customers.

Under the terms of its license, the Company is obliged to provide some of its communications services to all. According to the Ministry of Communications, interpretation of this and other provisions in the Domestic Carrier license in the matter of providing infrastructure services to license-holders, the Company is also obliged to provide infrastructure and transmission services to competing communications operators for providing services which compete with those of the Company. The Company is acting in accordance with the Ministry's decision. On this matter, see also Section 2.16.8.

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30 The Company's assessment of its market share in Internet infrastructure services at the end of 2012 is based on the number of its subscribers and an assessment of the number of HOT subscribers at the same date, based on the data published by HOT in its financial statements for the third quarter of 2012. The data for the Company's market share at the end of 2011 is based on the number of Company subscribers and the number of HOT subscribers at that date according to 2011 annual financial statements.

2.6.4 Additional factors that could influence competition

A. Narrowing of transition barriers among companies

Numbering and number portability – number portability exists in the fixed-line and cellular telephony market, enabling customers to immediately switch between various communication operators without changing their telephone number. The Company believes that it has significantly increased the churn rate in its fixed-line telephony services.

Limitation on the exit penalty that a license-holder can demand of a subscriber – See Section 1.7.3D.

B. Other potentially competing infrastructures

In addition to HOT's cable and optical fiber network and the optical fiber infrastructures of Cellcom and Partner, there are in Israel today a number of infrastructures with the potential to serve as communications infrastructures, which are based on optical fibers and are mostly owned by government companies and bodies. Among these are Israel Electric Corporation ("IEC"), Israel Railways, Mekorot (water grid), Oil Infrastructures, and the Cross Israel Highway company. Some municipalities are also trying to create an alternative to pipes being laid by communications license-holders by deploying their own infrastructures.

The State engaged in a process to choose an investor for a communications venture that will control the establishment of a third communications infrastructure company in Israel, which will use and operate the fixed-line communications infrastructure on the electricity grid, where IEC will hold 40% of the share capital in the venture. According to various publications, on December 26, 2012, a group of investors headed by "Viva Europa" submitted an offer to the selection committee. Further to the selection process, the selection committee will review the economic, technology, and legal aspects of the offer submitted by the Group. If the offer is found to meet the conditions of the selection process, a winning investor will be declared.

In the Company's estimation, if such a communications company is established, which would compete with the Company in infrastructure, and particularly if that new company is permitted to provide services to operators and business customers while easing the obligation for universal deployment of an FTTH network or before completing deployment of a significant portion of the network, this could adversely affect the Company's operations and results.

The Company's assessments of how the establishment of a communications company with a competing infrastructure would affect the Company and its results are forward-looking information as defined in the Securities Law. It is not certain that a competing communications company will be established, what limitations will be imposed on its activities and what breaks it might be granted. These assessments might not be realized, depending, inter alia, on the question of whether such a company will be established, what restrictions will apply to its activities, and if any changes will be made to the structure of competition in the communications market.

C. Technological developments

In this matter, see also Section 2.1.4.

On October 16, 2012, the Ministry of Communications published a hearing according to which as a means of improving the possibility of providing the public with fixed-line communications services, it is considering granting permission to the domestic carrier license holder to offer the use of WLAN (Wireless Local Access Network) technology by installing access points everywhere and under any law, and removing the connection restriction on "delineated premises". At the date of the report, the Ministry of Communications had not yet published a final decision.

2.6.5 The Company's preparation and ways of coping with the intensifying competition

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

A. The Company launches new communications services, value added applications and product packages, and services, in order to broaden the scope of use of subscriber lines, to respond to customer needs and to strengthen its image of technological innovation. The Company invests in enhancement and modernization of its infrastructure so as to enable it to provide advanced services and products for its subscribers. In 2010, upon receipt of the requisite permit (see Section 1.7.2), the Company started marketing joint products packages in the private sector and in May 2012 in the business sector, while broadening the supply of the services it offers and offering packages that correspond to some of those offered by its competitors.

B. The Company works on the penetration of a high-speed internet infrastructure service and on increasing the number of its customers for the service, including by offering applications for businesses. NGN enables advanced telephony applications to be provided, customer upgrades to higher speeds, and the creation of added value for the customer by means of broader consumption of content, leisure and entertainment applications (see also Sections 2.2.3 and 2.7.2).

C. The Company works constantly to improve the quality of its services and to maintain its customers.

D. The Company has simplified its tariff structure and offers its customers alternative payment packages (see Section 2.16.1), tracks and campaigns.

E. The Company offers bundles which combine the services of the Group's subsidiaries (excluding DBS - see Section 5.17.13).

F. The Company utilizes use-based packages and service tracks to in order to promote subscriptions to telephony services.

G. The Company makes adjustments on the expenses side for the purpose of focusing investments on fixed assets in growth activities and in projects for cutting operating costs. Nevertheless, the Company's ability to make adjustments in its expenses in the short and medium term is limited due to the structure of its costs, which are mainly rigid in the short and medium term. These costs include mainly depreciation expenses and expenses related to wages and wage incidentals. In addition, the Company has operating expenses such as infrastructure maintenance and the leasing and upkeep of buildings, which are also rigid in the short term.

H. In selling services to its customers, the Company also sells terminal equipment (home networks), laptop computers, streamers, etc., as well as telephony terminal equipment, as a tool for competitive differentiation and increasing its revenues.

2.6.6 Positive and negative factors that affect the competitive status of the Company

A. Positive factors

1. Nationally deployed, quality infrastructure through which a range of services are provided.

2. Presence in most businesses and households.

3. Strong and familiar brand.

4. Technological innovation.

5. Strong capital structure and positive cash flows.

6 Broad service infrastructure and varied customer interfaces.

7. Professional, experienced and skilled human resources.

B. Negative factors

The Company believes that various limitations imposed upon it by existing regulation, impede its ability to compete in its areas of operation. The main limitations in this context are the following:

1. Absence of tariff flexibility

The Company is limited in its ability to grant discounts on its main services and to offer differential tariffs. On this matter, see Section 2.16.1.

For information on the development of competition policy document, including in the matter of tariff control, see Section 1.7.3.

2. Structural separation

See Section 1.7.2A. for the Hayek Commission's recommendations including the matter of cancellation of structural separation and the conditions for doing so, see Section 1.7.3.

3. Duty to provide universal service

The Company operates under an obligation to provide service to the entire public in Israel (universal service). Due to this obligation, the Company could be required to provide services also in circumstances which are not financially viable (subject to the possibility of obtaining an exemption from an exemptions committee in extraordinary circumstances following the recommendations of the advisory committee and the Minister of Communications decision on this matter). This obligation is not imposed on the holders of special Domestic Carrier licenses, which can offer their services to the most profitable of the Company's customers (mainly business customers), which are a material source of the Company's income.

4. "Access deficit"

The Company's telephony tariffs are determined in regulations by the Minister of Communications in consultation with the Minister of Finance. As a result of a deliberate regulatory policy, the monthly usage tariff for a telephone line is set at a level that does not cover the cost involved in providing it (a situation known as the "'access deficit"). This deficit has been reduced over the years but still exists. It is emphasized that in a competition format that relies on the Company's infrastructure and uses the access deficit (such as VoB service), the negative effects of this factor increases.

5. Limitations in marketing joint service bundles of the Company and other Group companies

See Section 1.7.2B.

6. The nature of fixed-line telephony terminal equipment

Fixed-line terminal equipment is technologically less advanced that the cellular terminal equipment, and the supply of advanced services that can be consumed with it is limited.

7. Wholesale market

See the development of competition policy document in section 1.7.3. (Despite this, the possibility that the structural separation will be cancelled when the whole market opens could have a positive influence on the Company's competitive position.

2.7 Property, plant and equipment, and facilities

2.7.1 General

The Company's property, plant and equipment consists mainly of domestic communications infrastructure, real estate assets (land and buildings), computer systems, vehicles, and office equipment.

2.7.2 Domestic fixed-line communications infrastructure

NGN

The demand for communications services in Israel and worldwide includes a demand for ever-increasing bandwidths and an advanced IP platform. In order to meet this demand, at the end of 2009 the Company started the gradual set-up of an NGN based on a core IP network and deployment of an optical fiber network to street cabinet (known as fiber to the curb - FTTC).

The NGN network is also based on an access network (a system which connects NEPs on the subscriber's premises with the network and engineering systems. The connection from the home to the access network is based on copper cables and optical cables connecting the access systems to the backbone (in a special conduit or over-ground network), and in (negligible) part via wireless systems). Terminal equipment (equipment which is installed on the subscriber's premises, e.g. the actual telephone, private exchanges, fax machines, modems, routers, etc.) via which the subscriber receives the service.

In this network and using VDSL2[31] technology, bandwidth of up to 100 Mbps download speed can be provided, as well as innovative added value services. Other advantages of the new technology are simplification of the network structure and better management ability. The Company launched the NGN in September 2009.For data about the number of subscribers connected to the NGN, changes in the volume of customers who consume NGN services and average bandwidths in 2011 and 2012, see Sections 1.5.4A and 2.2.3.

At the end of 2012, the Company had completed deployment of the network almost everywhere.

The Company is extending its infrastructure, including distribution of fiber optics so as to further enlarge bandwidth for its customers. On August 29, 2012, the Board of Directors resolved to approve extension of the Company's optical fiber deployment so that the fibers will be as close as possible to the customer's premises (FTTH/FTTB), as a basis for future provision of more advanced and broader-band communications services than those currently provided. In this context, a detailed planning of the project, pilots, and the purchase of optical fibers and advanced optical technologies is to be prepared. The project will be modular and the Company will review the scope and outline of the project, as well as the need for adjustments, on a regular basis, in part in view of the advancement of relevant technologies and development of customer needs. The Company intends to accelerate the distribution of optical fibers to the customer's home and residential buildings (FTTB/H), so that during the course of the coming year, the Company will already have a significant fiber optic distribution, which will further increase in forthcoming years.

2.7.3 Computerization

The computerization system in the Company supports four main areas:

A. Marketing and customer management

The system supports management of a database of the Company's customers, service order management, management of follow-up of customer complaints, management of the sales and service process, application of the number portability plan, and billing. The billing system includes the production of phone bills to the Company's customers for services provided by the Company and for the services of other communications operators. The system also includes the management of accounting with communications operators.

B. Information systems for the engineering infrastructures of the telecommunications networks

These support the planning, management, control and maintenance of engineering resources for the provision and assurance of the services. Inter alia, the systems manage stocks of numbers and support massive changes of numbers and equipment (when necessary).

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31 Very High Bit Rate Digital Subscriber Line – A Digital Subscriber Line (DSL) at very high speed. One of the fastest technologies currently available for data transfer on high bandwidth in standard telephone lines.

C. Information systems for management of the Company's resources

These support the management, control and maintenance of the expense side in the Company, the financial information (including budget and control), purchasing and stock processes, property, real estate, human resources and salary control, fleet of vehicles, Company projects, and the like.

2.7.4 Company-wide systems

The Company's computerization system is large and complex, and supports critical work processes and handles very large volumes of data. The system consists of a large number of systems, some old, which were developed many years ago and operate on mainframe computers, others modern, developed and applies more recently and operating in open computerization environments.

The systems support decision-making processes by means of a data warehouse operated by the Company. The Company also operates a website which provides information about the Company's services and enables the display of information about the telephone bill, payment of the telephone bill and other services. There are also computerized office systems (e-mail, decision follow-up, etc.), and knowledge management systems.

2.7.5 Real estate

A. General

The Company's real estate assets delivered from two sources: assets transferred to the Company by the State in 1984 under the Asset Transfer Agreement (see Section 2.17.2A), and assets in which the rights were purchased or received by the Company after that date, including assets that it leases from third parties.

At the date of publication of this Periodic Report, the Company owns, leases or has right of lease in about 395 real estate properties all over the country. The total area in which the Company has full ownership rights or capitalized lease rights (including joint lease rights as described below) is 1,060,000 sq.m. of land on which the built-up area is about 270,000 sq.m. Six of these properties, with a total area of 6,000 sq.m. and 500 sq.m. built- up, are in Israeli towns in the Administered Territories (of the above total, about 380 properties with an area of 980,000 sq.m. of land and 220,000 sq.m. built up, are for communications needs, while the rest are for administrative needs).

In addition, the Company has the right to receive a net area of about 70 dunam in Sakia (near Mesubim Junction), for warehouses and offices. The Company is in advanced negotiations with the Israel Lands Administration ("ILA") to obtain a contract for preparing plans for the area.

At the date of publication of this report, of the abovementioned properties, 40 are jointly owned with the Ministry of Communications and/or Israel Postal Co. Ltd. with whom an agreement was signed for defining and regulating the rights of the parties in these properties (see Section 2.17.2C). The parties operate as required by the orders of the agreement, and inter alia, they separate joint debits and systems.

In addition to the 395 properties referred to above, the Company holds, at the date of publication of this report, about 60 properties in Israeli towns in the Administered Territories, covering a total area of 9,300 sq.m. of land and about 1,500 sq.m. built up (all for communications needs). There is no written regulation of the contractual rights for these properties, but in the Company's opinion this does not create material exposure.

The real estate assets are used by the Company for communications activities (exchanges, control rooms, broadcasting sites, etc.) and for other activities (offices, storage areas, etc.). Some of them are undeveloped or partially developed, and can be used for other purposes.

At the date of publication of this report, the Company leases about 290 properties from various landlords, in a total area of about 63,000 sq.m. (about 280 of these properties have a built-up area of 9,400 sq.m. and are for communications purposes, while the rest are for administrative uses).

The Company has an interest (transition rights, etc.) in other real estate (such as for the erection of offices and for laying cables) .Also at the Company's disposal are about 550 neighborhood rooms (for cables and installations used for neighborhood communications), in a total area of 8,310 sq.m. (all for communications purposes).for most of which there is no written regulation of rights with their owners (e.g. the Administration, settlement entities, the entrepreneurs of project in which the properties are located, and house committees).

B. Registration

At the date of publication of this Periodic Report, the Company's rights in a considerable number of its real estate assets are not registered in the Lands Registry, and therefore they correspond to contractual rights. The Company is in the process of registering in its name those properties which can be registered in the Lands Registry.

C. Real estate settlement agreement

On March 10, 2004, a settlement agreement between the Company and the Administration and the State ("the Settlement Agreement") was validated as a court decision. The Agreement concerns most of the real estate that was transferred to the Company in the asset transfer agreement signed prior to the start of the business operations of the Company. The Settlement Agreement states that the assets remaining in the Company's possession have the status of a capitalized lease and are subject to the execution of individual lease contacts (at the date of this report, such contracts have been signed for about 90 of the 205 properties for which they are required), the Company would be able to make any transaction in the properties and to enhance them. The Agreement sets out a mechanism for payment to the Administration for enhancement actions in the properties (if undertaken), beyond the rights according to plans approved by 1993 as set out in the Agreement, at the rate of 51% of the increase in value of the property following the enhancement (and less part of amounts paid for a betterment levy, if paid). The Settlement Agreement also states that 17 assets must be returned to the State, through the Administration, on various dates (up to 2010), and on the terms laid down in the Settlement Agreement.

At the date of publication of this Periodic Report, the Company has returned 15 assets to the ILA, Two others will be returned after the Company receives substitute properties, as provided in the Settlement Agreement.

D. Sale of real estate assets

Following a new review by the Company's Management concerning the sale of the Company's real estate assets, the Board of Directors approved further sales of assets which are not active and/or which can be relatively easily vacated without incurring significant expenses, in accordance with a list presented to it from time to time. The transition to the NGN allows the Company to increase the efficiency of the network and to sell some of the real estate assets that will be vacated as a result of the transition. During 2012, the Company sold 13 such properties, in a total area of 40,000 sq.m. of land and 22,700 sq.m. built up, for a total sum of approximately NIS 118 million.

According to Company estimates, the sale of real estate assets that are not active and/or that can easily be vacated without incurring significant expenses and for which the Company has no use after they are vacated, including real-estate assets that may be vacated and will become redundant following the transition to the NGN network, insofar as such assets are sold, may generate capital gains for the Company which may, in aggregate over the coming years, reach significant amounts estimated at hundreds of millions of shekels (before tax). It should be emphasized that this estimate also relates to real estate assets where no concrete decision has yet been made to sell them, and there is no certainty regarding the timing of their sale (insofar as they are sold); the estimate is based on appraisals prepared for some of the assets, some of which are not final or current, as well as to internal estimates prepared by the Company (including with respect to assets that were not appraised at all); likewise, the sale of some of the assets may involve difficulties, including if there is no demand or there are various planning limitations, and at this stage the Company is unable to foresee what consideration will be received when any of these real estate assets are actually sold or when they will be sold.

In view of the foregoing, it should be emphasized that the Company's above-mentioned estimates are forward-looking information, as defined in the Securities Law. These estimates are based, inter alia, on the Company's estimates with respect to the value of the real estate assets that it owns regarding their carrying value, subject to the aforementioned regarding the fact that the Company has no appraisals for some of the assets, or the appraisals in the Company's possession are out of date and the valuations are therefore based on the Company's internal estimates; and regarding the Company's inability to predict the consideration that may actually be paid for any assets sold (if and when they are sold); and on the Company's estimates regarding the volume of the real estate assets that may be vacated and become obsolete in coming years, making it possible to sell them based on Company policy, subject to the aforementioned concerning the fact that no concrete decision has yet been made to sell the assets that were taken into account in estimating the above amount, the list of relevant assets may change from time to time and the timing of their sale (if a decision is made to sell them) is uncertain. Consequently, the Company's estimates concerning capital gains (in aggregate and before tax) that may be generated in coming years from the disposal of real estate assets as noted above, may not materialize or may materialize in a materially different way from that foreseen, including should any of the Company's assumptions and estimates listed above in this clause fail to materialize or if they materialize only partially.

2.8 Intangible assets

2.8.1 The Company's Domestic Carrier license

The Company operates under its Domestic Carrier license, which forms the basis for its activities in domestic fixed-line communications (for a description of the main points of the license, see Section 2.16.2).

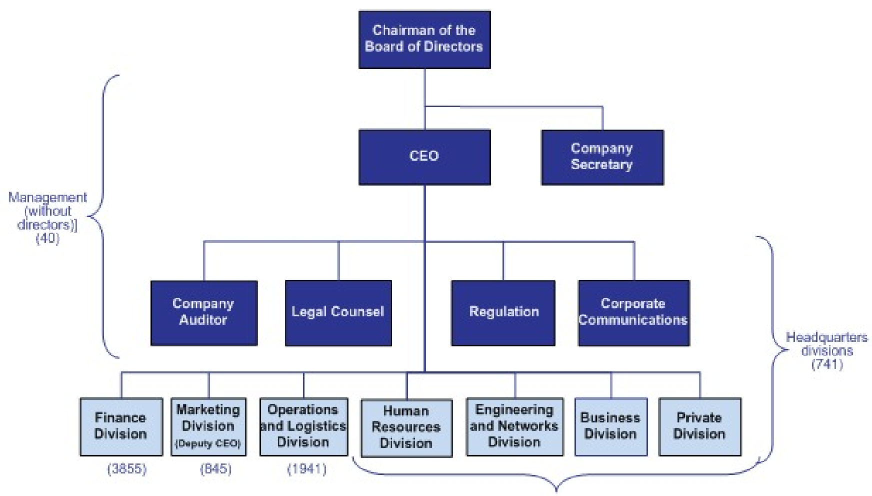
2.8.2 Trademarks

The Company uses trademarks that characterize its services and products. At the date of publication of this Periodic Report, there are about 200 trademarks registered or in the process of being registered in the Company's name with the Registrar of Trademarks. The main trademarks of the Company are "Bezeq" – the name of the Company, and "B" – the Company's logo. The investment in advertising the trademarks is intended to raise the level of exposure and awareness of the public to the trademarks and to build differentiation and uniqueness for the Company, which will influence the customers' purchasing considerations and preference.

2.9 Human resources

2.9.1 Organizational structure and headcount

The chart shows the general organizational structure of the Company:



On September 4, 2007, the Board of Directors of the Company resolved, pursuant to Section 50(a) of the Companies Law and Sections 119 and 121.1 of the Company's Articles of Association, that the authority of the CEO in all matters relating to corporations held directly or indirectly by the Company (Pelephone, Bezeq International, DBS, Walla, Bezeq on Line and Bezeq Zahav Holdings), would transfer to the Board of Directors, and the Board adopted resolutions accordingly. As a result, on matters relating to the subsidiaries the Deputy CEO and CFO report to the Board of Directors, while on the Company's activities as Domestic Carrier they report to the CEO of the Company.

2.9.2 Headcount by employment framework

Description of employment framework	Number of employees At December 31, 2012	Number of employees At December 31, 2011
Senior managers excluded from application of the Company's collective bargaining agreements. The terms of their employment are set in personal agreements.	61	63
Permanent employees employed under collective agreements (without new permanent employees)	2,742	2,847
Permanent employees employed under collective agreements (new permanent employees[32])	596	437
Employees employed under personal agreements that are not part of the collective agreements.	635	666
Employees employed under individual agreements on the terms of the collective agreement ("Rank Rating Contracts").	26	44
Employees employed in accordance with the special collective agreement of December 2006, on an hourly basis ("Hourly Collective Agreement".	2,288	1,948
Employees employed under the special collective agreement of December 2006, on a monthly basis ("Monthly Collective Agreement").	1,074	1,071
Total	7,422	7,076

Notes:

The **Hourly Collective Agreement** applies to every "former Generation 2000" worker (see Section 2.17.4D) and former temporary hourly agreement workers, as well as to new workers hired on hourly employment. The **Monthly Collective Agreement** applies to "former Generation 2000" workers who were hired in occupations for which employment is monthly in essence, former global salary contract workers, and monthly workers hired for monthly employment.

[32] Concerning new permanent employees, see section 2.9.5.

The increase in the number of employees in 2012, in comparison to 2011, is primarily the result of hiring service representatives and customer service technicians in order to improve the level of customer service.

For details about the special collective agreement of December 2006 and its amendment in December 2010, see Section 2.9.5.

2.9.3 Early retirement plans

On December 4, 2011, the Company's Board of Directors approved the early retirement of 91 employees at a total cost of NIS 80 million. This retirement completed the early retirement plan for 2011 as well as early retirement on account of an option for employee retirement in 2012, based on the terms of the special collective agreement from December 2006 and amended in December 2010. On November 7, 2012, the Board of Directors of the Company approved an additional budget of NIS 16 million for the early retirement of 19 employees during 2012. This supplement is in addition to an expense of NIS 16 million which was recognized for updating the provision in 2012.

During the course of 2012, 122 tenured employees retired from the Company, based on the early retirement plan.

On this matter, see also Note 16 to the 2012 Financials.

2.9.4 Company investments in further study, training, employee certification and university studies

The Company conducts in-house training (including through a communications college) by company employees who are professional experts, at times with outside assistance, in all areas of its operations. The training activities include professional certification in technology, sales, management, service and other areas.

The Company also participates in funding university studies and courses at outside facilities for its employees.

2.9.5 The nature of employee agreements in the Company

Labor relations in the Company are regulated in collective agreements between the Company and the representatives of Company employees and the New General Federation of Workers ("Histadrut"), and in personal agreements. Company employees are also subject to expansion orders to certain general collective agreements such as cost-of-living increment agreements.

In December 2006, a special collective agreement was signed between the Company, the employee union and the Histadrut, regulating labor relations in the Company following transfer of control in the Company from the State to Ap.Sb.Ar. Holdings Ltd. and set a new organizational structure for the Company (see Section 2.9.1).

Under the agreement, all the agreements, arrangements and traditional behavior in the Company prior to execution of the agreement, including the mechanism for linkage of wages to the public sector, would continue to apply only to the veteran permanent employees of the Company to which the agreement would apply, subject to changes inserted specifically in the agreement. The hiring of existing and future temporary workers would be on the basis of monthly/hourly wage agreements based on a wage model according to occupation, with high managerial flexibility. The agreement sets out limitations on certain kinds of future organizational changes, and a mechanism of notification, negotiation and arbitration with the union in the event of organizational changes. The agreement also states that the Company can, at its discretion, terminate the employment of 245 permanent employees in each of the years 2009 – 2013.

Under the agreement, during the term of the agreement, two employee-directors will serve on the Board of Directors of the Company, who would be proposed by the union (subject to their election by the general meeting). The employee-directors are not entitled to payment for their service as directors, and will not participate in Board discussions of the terms of employment of senior employees.

On December 19, 2010, an amendment was made to the collective agreement, dating it to December 31, 2015 (with an option for extension to December 31, 2017). The main points of the amendment are the following:

Extension of the retirement arrangements under the collective agreement to December 31, 2016. Under these retirement arrangements, the Company may, at its discretion, terminate the employment of up to 245 permanent employees in each of the years 2010 – 2016.[33]

The agreement also defines the "New Permanent Employee", the terms of whose employment differ from those of a veteran permanent employee of the Company (under the collective agreement): his wage model is according to the Company's wage policy and market wages; at the end of his employment in the Company he is entitled to increased severance pay only (depending on the number of years of employment).

For details of other material agreements concerning labor relations, see Section 2.17.4.

2.9.6 Employee reward plans

Details regarding options plans for employees. See Note 26 to the 2012 Financials.

2.9.7 Officers and senior management in the Company

On the date of publication of this Periodic Report, the Company has 12 directors, of whom three are external directors, two are employee-directors and two are independent directors pursuant to Section 249B of the Companies Law. In addition, senior management has 12 members.

Commencing January 1, 2011, Mr. Shaul Elovitch, the controlling shareholder (indirectly) in the Company serves as Chairman of the Board of Directors of the Company. On January 17, 2013 the Company CEO announced that he was terminating his term of office, and on March 6, 2013 the Company's Board of Directors approved the appointment of Ms. Stella Hendler as CEO of the Company, as of April 14, 2013 (when Mr. Avi Gabbay's term ends).

The external directors and independent directors serving on the Board of Directors receive compensation in accordance with the Companies (Rules for compensation and expenses of an external director) Regulations, 2000. The other directors do not receive any compensation or other pay from the Company in respect of their service as directors (The two employee-directors receive a salary for their work in the Company and not for their service as directors).

The members of the senior management are employed under personal agreements which include, *inter alia*, pension coverage, payment of bonuses based on targets, and advance notice months before retirement. The Company also allots options for Company shares to the members of senior management, at its discretion (see Section 2.9.6).

For further information pertaining to the remuneration of officers see section 3 of the Board of Directors Report and Section 7 of Chapter 4 and Note 29 in the 2012 Financials.

2.10 Equipment and suppliers

2.10.1 Equipment

The main equipment used by the Company is exchanges, copper cables, optical cables, transmission equipment, data communication systems and equipment, servers, Internet modems and routers. The Company purchases most of the equipment needed for its communications infrastructure from Israeli companies affiliated with international communications equipment manufacturers. Hardware and software are purchased from a number of suppliers.

33 The Company may complete the retirement process also in 2017, if it is not completed during the above period.

2.10.2 Percentage of purchases from main suppliers and form of agreement with them

With respect to Section 23 of the First Annex to the Securities (Details of a Prospectus and Draft Prospectus - Structure and Form) Regulations, 5729-1969, the Company considers a "main supplier" to be a supplier that accounts for more than 5% of the volume of the Company's annual purchases, or that accounts for more than 10% of the volume of all the Company's purchases in a particular operating segment.

During 2012, the Company did not have suppliers from which the volume of purchases exceeded 5% of the Group's total annual purchasing, or suppliers from which the volume of purchases exceeded 10% of total purchasing in a particular segment of operation.

2.10.3 Dependence on suppliers

Most of the equipment purchased for data communication, switching, transmission and radio systems is unique, and over its years of operation the possibility of obtaining support other than through the manufacturer, is limited.

In the opinion of the Company, in view of the importance of manufacturer support for certain systems used by the Company, it could become dependent, in the areas of public switching and metro transmission, on Alcatel Group, represented in Israel by Alcatel Telecom Israel Ltd., Dialogic Networks (Israel) Ltd. which supplies the Company with migration exchanges for linking operators to the Company's switching network, Comverse which supplies the Company with switching exchanges for end customers on the NGN network, in the area of access systems on the NGN of Adtran Holdings Ltd., in the area of databases on Oracle, on EMC which supplies the Company with hardware solutions for back-up, recovery and archiving of systems and infrastructures, on vmware which supplies the Company with infrastructure for the entire virtualization of its servers, and on ECI which supplies the Company with systems for the transmission network for connecting the Company's network and business customers.

Agreements with suppliers on which the Company may be dependent, as noted in this section, generally include a warranty period for a certain period of time and conditions specified in the agreements, followed by another period of maintenance or support. Where necessary, the Company may enter into an agreement with the supplier for the supply of support and/or maintenance services for a further period. These agreements usually contain various forms of relief for the Company should the supplier breach the agreement. Such agreements with suppliers are usually long term.

2.11 Working capital

The working capital of the Company as per the 2012 Financials (solo) consists of current assets totalling approximately NIS 2,762 million less current obligations of approximately NIS 3,552 million (for the components of the current assets and current obligations, see the separate financial information as at December 31, 2012).

As a result of the above, the Company has a deficit of working capital totalling approximately NIS 790 million in its 2012 Financials (solo). Note that in the consolidated 2012 Financials of the Company, there is an excess of working capital totalling NIS 491 million.

On March 13, 2013, the Board of Directors of the Company determined that the Company does not have a liquidity problem. For policy regarding treating this deficit, see Section 1.5 of the Board of Directors Report.

2.12 Investments

For information on investments in affiliates, see Note 12 to the 2012 Financials, and see also Sections 3 and 4 in Chapter D of this Periodic Report.

2.13 Finance

2.13.1 Average and effective interest rates on loans

At 31 December 2012, the Company is not financed by any short-term credit (less than one year). The table shows the distribution of long-term loans (including current maturities):

Loan term	Source of finance	Amount (NIS millions)	Currency or linkage	Type of interest and change mechanism	Average interest rate	Effective interest rate	Interest range in 2012
Long-term loans	Banks	2,306	Unlinked NIS	Variable, based on prime rate*	3.20%	3.22%	3.20%-4.20%
	Banks	2,340	Unlinked NIS	Fixed	5.67%	5.69%	5%-6.85%
	Non-bank	425	Unlinked NIS	Variable, based on annual STL rate**	3.26%	3.41%	3.26%-4.08%
	Non-bank	1,729	Unlinked NIS	Fixed	5.92%	6.11%	5.70%-6.65%
	Non-bank***	2,334	CPI-linked NIS	Fixed	3.86%	3.95%	3.70%-5.95%

* Prime interest rate in March 2013 – 3.25%.

** STL yield per year (1113) – 1.858% (average last 5 trading days of November 2012 for the interest period that ended on March 1, 2013.

*** Not including Debentures (Series 5) held by a wholly-owned subsidiary.

It is noted that Company loans in the total amount of NIS 7.8 billion include a cross-default mechanism that under certain conditions allows immediate recall of the debt should a third party demand immediate repayment of Company debts towards it due to a breach of contract.

2.13.2 Limitations on borrowings

A. Limitations included in the Company's loans

See Note 13 to the 2012 Financials. At the date of the financial statements and the date of publication of this Periodic Report, the Company is in compliance with all the limitations applicable to it.

B. Bank of Israel restrictions on a single borrower and group of borrowers

Directives of the Supervisor of Banks include restrictions on liability of a single borrower and of a group of borrowers towards the banks. Concerning these directives, the Company could be seen as part of one "group of borrowers" with B Communications Group and its controlling shareholders. The directives of the Supervisor of Banks could from time to time affect the ability of banks to grant further credit to the Company.

2.13.3 Credit received during the reporting period

A. Raising of bank debt

Between November 15, 2011 and October 29, 2012, the Company completed the raising of unlinked shekel debt bearing fixed interest for a period of 4.3 years, in the total amount of NIS 650 million

In connection with this raising of debt, the Company made the following commitments towards the banks 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.

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 a commitment towards any lending entity ("additional lender") in connection with financial criteria, the financing entities may (under certain conditions) ask the Company to sign an identical undertaking towards them.

On this matter, see Note 12 to the 2012 Financials.

2.13.4 Credit received after December 31, 2012

The Company has taken no loans after December 31, 2012.

2.13.5 Company debentures

For details of Debentures Series 5 and Series 6-8 that were issued by the Company and are traded on the Stock Exchange, see Section 2.17.1 below. The Company also issued debentures in a private placement which were not listed for trading on the Stock Exchange, the balance of which in the Company's books at December 31, 2012, was approximately NIS 436 million.

2.13.6 Credit rating

The Company is rated by two rating agencies. Below are details of the rating of each of the agencies at the date of publication of this Periodic Report (including the latest updates):

Rating agency	Rating	Changes in rating	Type of credit rated
S&P Maalot	ilAA +	February 6, 2011 – Ratification of the Company's rating of ilAA+ (removal from CreditWatch) The rating outlook is negative. June 29, 2011 – Rating set at ilAA+[1] for new Company debentures (Series 6-8) of up to NIS 3 billion. July 4, 2012 – Ratification of the current rating without change. February 21, 2013 – Rating of the Company and its debentures was lowered to ilAA with a stable outlook.[2]	The Company and Debentures Series 5 – 8
Midroog	Aa2	January 2, 2011 – Transfer of rating of Company debentures to Watch List with negative outlook, following the Company's notice of distribution of a dividend that does not pass the profit test, of NIS 3 billion in 2011-2013. April 3, 2011 – Removal of above debentures from Watch List with rating un changed (Aa1), and setting negative forecast, following capital reduction outline and distribution of a dividend of NIS 3 billion as decided by the Company and approved by the District Court. June 29, 2011 – Rating set at Aa1 with negative outlook for NIS 3 billion of Debentures (Series 6-8) that will be issued by the Company, and the same rating for Company debentures in circulation. July 19, 2012 – Lowering of the rating of the Company’s Debentures (Series 5, 6, 7, 8) from Aa1/Negative Outlook to Aa2/Stable Outlook)	Debentures Series 5 – 8

2.13.7 Company assessment for raising financing and possible sources in 2013

During 2013, the Company expects to repay approximately NIS 1,350 million on account of loan principal and interest (including debentures). The Company raises debt from time to time to manage its cash flows and it may also raise debt during 2013.

The Company's financing options are to raise debt by means of new bank loans and/or by means of private or negotiable debt.

34 Company rating ilAA+/Negative Outlook.

35 The Company’s rating is ilAA/Stable. The rating of the debentures is ilAA. For the lowering of Pelephone's rating , see Section 3.12.5.

2.13.8 Charges and guarantees

For information about charges and guarantees of the Company, see Notes 13 and 19 to the 2012 Financials.

2.13.9 For additional information regarding loans taken by the Company, including disclosure of a reportable credit event, see Note 13 to the 2012 Financials**.**

2.14 Taxation

For information on the subject of taxation, see Note 8 to the 2012 Financials.

2.15 Environmental risks and their management

2.15.1 General

Some of the Company's facilities, such as broadcasting facilities and wireless communications facilities, are sources of electromagnetic radiation which are included in the definition of "Sources of Radiation" in the Non-Ionizing Radiation Law.

2.15.2 Non-Ionizing Radiation Law

The law regulates the handling of Sources of Radiation, their erection, operation and supervision. The law provides, inter alia, that the erection and operation of a Source of Radiation and the provision of a radiation measurement service require a permit; sets penal provisions and severe responsibility of a company, employees and officers; imposes recording and reporting obligations on a permit-holder, and grants supervisory powers mainly to the Supervisor of Non-ionizing Radiation at the Ministry for Protection of the Environment ("the Supervisor"), including for the matter of the terms of the permit, cancellation of the permit and removal of a Source of Radiation.

The Company obtained operating permits from the Supervisor for the communication facilities and broadcasting sites it operates.

It is noted that the Commissioner may require building permits as a condition for the continued validity of the operating permits for communications facilities (including broadcasting facilities) he granted, as well as the fulfillment of additional conditions, inter alia, concerning wireless access installations which have category approval granted to the Company by the Supervisor. See also Section 2.16.10.

The law includes a punitive chapter which prescribes, inter alia, that the erection or operation of a source of radiation in contravention of any of the permit conditions and the erection or operation of a source of radiation without a permit, after receiving a written warning from the Supervisor, is a strict liability criminal offense.

2.15.3 Permits

On the permits for broadcasting facilities required under the Planning and Construction Law, see Section 2.16.10.

2.15.4 Claims

On claims in the matter of ostensible radiation from the Hillel broadcasting station, see Section 2.18.2. It is noted that the Company's third party liability insurance does not currently cover damages in respect of electromagnetic radiation.

2.15.5 Company policy for radiation risk management

The Company applies a work procedure for the erection, operation and measurement of sources of non-ionizing radiation, and an appropriate compliance procedure that was approved by its Board of Directors. The Company has assigned an officer to oversee implementation of the compliance procedure. Periodic reports on the status of Sources of Radiation are submitted to the CEO and to the Board of Directors.

2.16 Restrictions and control of the Company's operations

The Company is subject to systems of laws that regulate and limit its business activities. The main body overseeing the Company's activities as a communications company is the Ministry of Communication.

2.16.1 Control of Company tariffs

Arrangements in Sections 15 to 17 of the Communications Law and the terms of the Company's license, apply to the Company's tariffs.

A. Tariffs fixed in regulations - The tariffs for the Company's controlled services (telephony and others) which are fixed in regulations promulgated by power of the aforementioned Section 15, were updated in accordance with a linkage formula less an efficiency factor consisting of linkage to the CPI plus an efficiency factor, as provided in the regulations, so that on average, the Company's controlled tariffs erode in real terms.

The Gronau Commission's report on the rules of competition in the communications industry, and a letter from the Minister of Communications dated August 13, 2008 adopting the report (with some changes ("Gronau Report") and documents on competition policy stipulated that as long as the Group's market share remains higher than 60%, control of the Company's prices will continue in the format of mandatory price fixing. In light of the rulings in the Competition Policy Documents (see Section 1.7.3) there may be changes in aforementioned price fixing and revision mechanism.

B. Alternative payment packages – Under Section 15A of the Communications Law, if tariffs are fixed for the services controlled under the aforementioned Section 15, the Minister may, with the consent of the Minister of Finance, approve the request made by the licensee for an alternative payment package for a service package. The Company can offer an alternative payment package after the period defined in the law unless the Minister of Communications or the Minister of Finance announces his objection. The Gronau report states that an alternative payment package will be approved only if it is worthwhile for 30% or more of consumers subscribers who consume the services offered in the package, and the smaller the market share of the Group in fixed-line telephony, the higher the maximum discount rate permitted in an alternative payment package can be.[36]

C. Duty to set reasonable tariffs for services – Under Section 17 of the Communications Law, "a license-holder can demand reasonable payment for a telecommunications service for which payment is not fixed in Section 15." For these of its services, the Company sets the tariffs.

The control of the Company's tariffs has a number of implications: once every few years, the Company's controlled tariffs are reviewed by a public committee, and the Company is exposed to material changes in its tariff structure and tariff levels. The review mechanism for the controlled tariffs, as defined in the regulations, results in a real average erosion of the tariffs over the years. With regard to possible changes in the monitoring mechanisms see section 1.7.3. Control of the tariffs creates or could create difficulties for the Company in providing an appropriate and competitive response to changes in the market and in offers of competitive prices at short notice. Furthermore, the restrictions on granting discounts on tariffs limit the Company in participation in certain tenders.

D. On May 31, 2012, the Communications (Telecommunications and Broadcasts) (Calculation and Linkage of Bezeq Payments) (Amendment) Regulations, 2012, were published which include a Temporary Provision according to which the payments will not be updated on June 1, 2012, and that the update of tariffs to be made in June 2013, will include an aggregate update for the last two years.

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36 A maximum discount rate of 25% when the Group's market share is between 75% and 85%, and 40% when the market share is between 60% and75%.

2.16.2 The Company's Domestic Carrier license

The Company operates, inter alia, under the Domestic Carrier license.[37] The main topics covered in the license are these:

A. Scope of license, the services the Company must provide, and the duty of universal service

The Company is required to provide its services to all on equal terms for each type of service, irrespective of the location or unique cost. The license is unlimited in time; the Minister may modify or cancel the license or make it contingent; the license and any part of it cannot be transferred, no charge can be imposed on it, nor can it be subject to attachment.

B. Principles of structural separation

For a general description of the structural separation applicable to the Company, see Section 1.7.2. The Company employs various means of compliance with these principles among its employees, including training sessions and periodic refresher courses on the relevant procedures.

C. Tariffs

The Company provides a service or package of services for which no tariff is set under Section 15 of the Communications Law, at a reasonable price and offers them to all, without discrimination and at a uniform tariff. See also Section 2.16.1.

D. Marketing joint service bundles

On amendment of the Domestic Carrier license in a way that enables the Company to request to market joint service bundles subject to limitations, and a draft amendment to the licenses of the Group concerning the marketing of joint bundles to the business sector, see Section 1.7.2B.

E. Operations of Company networks and service standards

The Company is required to maintain and operate the network and provide its services at all times, including at times of emergency, in an orderly and proper manner commensurate with the technical requirements and the nature of the service, and to work towards improving its services. The license includes an appendix, "Service Standards for the Subscriber", which is to be amended after the Company provides the Ministry with data. The Company submitted to the Ministry its proposal for amendment of the appendix, adapting it to the current state of affairs and the licenses of other operators, but the amendment has not yet been made.

F. Interconnect and use

Provisions are stated for the duty of interconnect to another public switching network and the option of use by another license-holder; a duty to provide infrastructure services to another license-holder on reasonable and equal terms is also provided, as well as refraining from preferring a license-holder that is a company with an interest.

G. Security arrangements

Provisions have been made for operation of the Company's network in times of emergency. The Company is required to set up and operate its network in a way that prevents its collapse in an emergency and enables a reduction of activity in certain sectors.

The Company is required to provide telecommunications services and set up and maintain the terminal equipment infrastructure for the security forces in Israel and abroad, as provided in its agreements with the security forces. Furthermore, the Company provides special services to the security forces. The Company will take action to ensure that each purchase and installation of hardware in its telecommunications installations, except for terminal equipment, will be made in full compliance with instructions given to the Company according to Section 13 of the Communications Law.

The Company is required to appoint a security officer and to comply fully with the security instructions contained in the appendix to the license.

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[37] A copy of the Domestic Carrier license appears on the Ministry of Communications website at www.moc.gov.il.

H. Supervision and reporting

Extensive reporting duties are imposed on the Company, such as filing the reports specified in the license and information and reports on-demand on various matters. In addition, the Director General at the Ministry of Communications is granted the authority to enter facilities and offices used by the Company and to seize documents.

I. Miscellaneous

1. The Domestic Carrier license includes limitations on the acquisition, maintenance and transfer of means of control pursuant to the Communications Order (see Section 2.16.3), as well as on cross-ownership, which are mainly a ban on cross-holding by entities in which those with an interest in a another material Domestic Carrier[38] as noted in the license, and limitations on a cross-holding by entities with Domestic Carrier licenses or general licenses in the same segment of operation.

2. The Company is required to prepare the text of the agreement it plans to offer to subscribers, and to submit it to the Director General upon his demand. The Director General has the authority to instruct that changes be made. The Company is in an ongoing process of preparing such an agreement.

3. The Company is required to submit to the Director General a bank guarantee for securing fulfillment of the terms of the license and for indemnifying the State for any loss it incurs due to their violation, in a sum equal to USD 10 million. The Company provided such a guarantee. The Minister may render the guarantee or part of it forfeit on terms set out in the license.

4. The Director General at the Ministry of Communications is authorized to impose a monetary sanction for violation of any of the terms of the license (on this matter, see also Section 1.7.3F).

5. During a calendar year, the Company may invest up to 25% of its annual income in activities not intended for providing its services (the incomes of the subsidiaries are not considered Company income for this purpose). The Minister of Communications is authorized to permit deviation from that percentage.

With regard to the development of competition policy document, see Section 1.7.3.

2.16.3 The Communications Order

The Company was declared a provider of telecommunications services under the Communications Order. By power of that declaration, the Company is required to provide certain types of services and may not cease them or narrow them. Among these services are basic telephone service, infrastructure service, transmission service and data communication service including interconnect, and other services listed in the schedule to the Order.

The main provisions of the Communications Order are these:

A. Limitations on the transfer and acquisition of means of control in a company, which include a ban on holding 5% or more of means of control of a certain kind without the prior written approval of the Prime Minister and the Minister of Communications ("the Ministers").

B. Transfer or acquisition of control in a company requires the approval of the Ministers ("Control Permit"). The Control Permit will lay down the minimum holding percentage in each of the means of control in the Company by the holder of the Control Permit,[39] where a transfer of shares or an issuance of shares by a company, as a result of which the percentage of the holding of the Control Permit holder will fall below the minimum percentage, is prohibited without the prior approval of the Ministers, subject to permitted exceptions (among them – an issuance to the public under a prospectus, or sale or private placement to institutional investors).

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38 A Domestic Carrier with a market share of 25% or more.

39 As noted in Section 1.3.1, at the date of publication of this Periodic Report the minimum rate of holding in the Control Permit of B Communications Group is 30%. For the matter of a time-restricted approval for falling below the Minimum Percentage to 29% due to exercise of options, see Footnote 9.

C. Holdings not approved as aforesaid will be considered "exceptional holdings", and the Order states that exercise of a right by power of exceptional holdings will not be valid. The Order also contains provisions authorizing the Ministers and the company to apply to the courts with an application for the enforced sale of exceptional holdings.

D. A duty to report to the Ministers upon demand is imposed on the Company, on any information on matters relating to provision of an essential service.

E. 75% of the members of the Board of Directors of the Company must be Israeli citizens and residents who have security clearance and security compatibility as determined by the General Security Service. The Chairman of the Board, the external directors, the CEO, the Deputy CEO and other office-holders in the Company as listed in the Order, must be Israeli citizens and residents and have security clearance appropriate to their functions.

F. "Israeli" requirements are laid down for the controlling shareholder in the Company: for an individual – he is an Israeli Entity (as defined in the Order); for a corporation – it is incorporated in Israel, the center of its business is in Israel, and an Israeli Entity holds at least 19% of the means of control in it.

G. The approval of the Ministers is required for granting rights in certain assets of the Company (switches, cable network, transmission network and data bases and banks). In addition, grant of rights in means of control in subsidiaries of the Company, including allotment of more than 25% of the shares in the subsidiary, requires the approval of the Ministers.

H. Provisions are laid down for the matter of protection of computerized systems and the purchasing of hardware and software.

I. Certain actions of the Company require the approval of the Minister of Communications, among them voluntary liquidation, a settlement or arrangement between the Company and its creditors, a change or reorganization of the structure of the Company, a merger and split of the Company.

2.16.4 Royalties

For details about the duty to pay royalties applicable to license-holders pursuant to the Communications Law, see Section1.7.3B.

The Company's royalties' expense in respect of 2012 is approximately NIS 52 million, compared with NIS 56 million in 2011. The royalties rate for 2012 and 2011 was 1.75% of taxable income (as defined in the regulations).

2.16.5 Authority with respect to real estate

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

The law distinguishes between land owned by the State, the Development Authority, the Jewish National Fund, a local authority or a corporation lawfully established and owned by one of them, and a road ("Public Land"), and other land ("Private Land"). With regard to Public Land, the Company and any person authorized by it, can enter and perform work there, provided that approval for deployment of the network has been granted by the local Planning and Construction Committee in the manner prescribed in the law. In most cases, the occupier must be given 21 days' notice and the latter may appeal to the Court.

Under the provisions of the Telecommunications (Installation, operation and maintenance) Regulations, 1985, if the Company is of the opinion that providing a telecommunications service to an applicant requires the installation of a telecommunications device for transmission or switching on the applicant's premises (or in shared premises or common property), the Company is permitted to request that the applicant, as a prerequisite for providing the requested service, allocate a suitable place on the premises for installation of the device, for the sole use of the Company, and it may use the device to provide service to other applicants also.

Deployment of a network on Private Land requires the consent of the landowner, the lessee in perpetuity or the protected tenant, as the case may be. In a condominium, the consent of a majority of the apartment owners is required. Nevertheless, the law contains provisions concerning deployment of a network in a condominium at the request of an apartment-owner, even in the absence of the consent of the majority of the apartment-owners, and grants authority to the "house committee" and the Supervisor of Condominiums.

In September 2010 the Planning and Construction (Application for a permit and its terms and fees) Regulations, 2010, came into force, which impose on the applicant for a permit to erect a residential building, a duty to install infrastructures for telephone, radio, television and Internet services so that the customer can choose whichever provider it prefers. In commercial buildings, if preparations for communications are installed, an underground infrastructure must be laid. At the same time, the Company's license was amended (as were the licenses of HOT Telecom and DBS) so that if the Company uses the internal wiring for providing its services, it is obliged to provide maintenance services for that wiring in apartments where it was requested by the permit applicant, without this granting it any proprietary rights in the internal wiring.

2.16.6 Immunities and exceptions to liability

The Minister of Communications granted the Company certain immunities from liability for from damages listed in Chapter Nine of the Communications Law, in accordance with his authority to grant immunity to a general license-holder.

In addition, Section 13 of the law contains exceptions to criminal and civil liability for an act done in fulfillment of a directive to provide services to the security forces in that section.

2.16.7 Regulations and rules under the Communications Law

At the date of publication of this Periodic Report, regulations in three additional and important areas apply to the Company: (1) cessation, delay or limitation of telecommunications actions and services; (2) installation, operation and maintenance; (3) ways of overseeing the actions of the license-holder. In addition to these, the Company, with the approval of the Minister, has set rules for the matter of its services to subscribers.

2.16.8 Antitrust laws

A. The Antitrust Commissioner (in this section – **"the Commissioner**") declared the Company a monopoly in the following areas:

1. Basic telephone services, provision of communications infrastructure services, and transfer and transmission of broadcasting services to the public.[40]

2. Provision of high-speed access services through the access network to the subscriber.[41]

3. Provision of high-speed access services for ISPs through a central public telecommunications network.

The Commissioner's declaration of the Company as a monopoly constitutes prima facie evidence of its content in any legal proceeding, including criminal proceedings.

B. The Company has adopted an internal compliance procedure containing internal rules, guidelines and an internal reporting and control system, the purpose of which is to ensure that the activities of the Company and its employees are carried out in accordance with the provisions of the Antitrust Law.

C. In its decision on August 20, 2009, the Supreme Court allowed the appeal of the Antitrust Commissioner against the decision of the Antitrust Tribunal in February that year, which allowed the merger of the Company with DBS, and decided not to allow the merger, See Section 1.1.2.

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40 Declaration on July 30, 1995.

41 On November 10, 2004, the Commissioner split the declaration of December 11, 2000 on Internet access infrastructure into two separate declarations (Declarations 2 and 3).

D. On March 31, 2010, a merger of B Communications and the Company was approved, following the acquisition of core control in the Company by B Communications (see Section 1.3.1).

E. As part of the approval of the merger of the Company and Pelephone on August 26, 2004, restrictive terms were imposed, mainly prohibiting discrimination in favor of Pelephone in the supply of a product in which the Company is a monopoly, prohibiting the bundling of the supply of certain products by either of the companies when purchasing products or services from the other, and limitations on certain joint activities. On October 10, 2010, these terms were amended, removing some of those relating to joint marketing.

F. On September 12, 2010, the merger of Walla and the Company was approved following the Company's acquisition of Walla shares, on terms that restrict discrimination in favor of Walla vis-à-vis its competitors.

G. On October 11, 2011, the Antitrust Authority informed the Company that the Commissioner was considering issuing a ruling in accordance with his powers under Section 43(A)(5) of the Antitrust Law, that the Company had abused its position in contravention of the provisions of Section 29A of the Antitrust Law. The notice stated that the Commissioner is considering stipulating that:

a. The Company refused to supply transmission services used to provide domestic carrier telephony and internet services to Cellcom Israel Ltd. ("Cellcom") and Partner Communications Ltd. ("Partner");

b. The Company's refusal is based on its position that it is not obligated and has no interest in supplying these services to its competitors;

c. The Company sells these transmission services to other customers and also sells transmission services to provide mobile radio telephone (MRT) services to Cellcom and Partner.

d. By refusing to sell these services, the Company abuses its status in contravention of the provisions of Section 29A of the Law.

The Commissioner's notice further states that before making his decision, the Company is given the opportunity to present its case in writing. It should be noted that as described in Section 2.6.3, commencing October 2010, in accordance with the decision of the Ministry of Communications, the Company also supplies infrastructure and transmission services to competing telecommunications operators (including owners of infrastructures).

H. On June 30, 2011, the Antitrust Authority asked the Company for information as part of its review of the Company's conduct on the supply of services (on this matter, see also Section 2.16.2).

I. On February 11, 2013, the Antitrust Authority informed the Company that the Commissioner was considering issuing a ruling under his powers pursuant to Section 43 (A)(5) of the Antitrust Law, to the effect that the Company had abused its position in contravention of the provisions of Section 29A of the Antitrust Law in that it had adopted a prohibited practice of margin squeeze or price squeeze in connection with a campaign in which it had offered new subscribers a fixed telephone line plus 200 minutes of free calls to fixed line destinations for NIS 19.90 a month. The Commissioner contends that given that the internet access infrastructure service is a critical input for the supply of internet-based telephony services, then the price set by the Company places competitors who wish to offer this service at a disadvantage, as the price of the critical input for supply of the service (NIS 25 for an NDSL internet line only) is higher than the price of the final service which the Company offered its customers. Given that the Company believes that it acted lawfully and with Ministry of Communications approval, it intends to exercise its right to a hearing.

2.16.9 The Telegraph Ordinance

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

The Government deals with the shortage of radio frequencies for public use in Israel (among other reasons, due to the allocation of a large number of frequencies for security purposes), by limiting the number of licenses granted for the use of frequencies on the one hand, and increasing the fees payable for allocation of frequencies, on the other.

2.16.10 Setting up communications facilities

A. General

The National Outline Plan for communications, NOP 36 (within the Green Line) and NOP 56 (in the Administered Territories), were designed to regulate the deployment and manner of set-up of communication facilities in a way that would ensure coverage for transmitting and receiving radio, television and wireless communications, while avoiding radiation hazards and minimizing the damage to the environment and the landscape, and also to simplify and increase the efficiency of the processes involved in setting up the facilities.

The classification of the facilities according to their technical variables and physical dimensions, which affect the determination of safety ranges for protection against the effects of radiation and the extent to which they protrude on the landscape, determine which facilities will be included in Part A of the Plan and which in Part B of the Plan.

The Company has erected and is erecting broadcasting facilities and wireless communication facilities for providing broadcasting services to the Company's customers, mainly for providing services to area which are not connected to the fixed-line communications infrastructure (remote areas or new towns).

B. NOP 36A

1. Part A of NOP 36 deals with guidelines for erecting small and miniature broadcasting installations.

2. The Company has obtained building permits for most of the small broadcasting installations in accordance with NOP 36A. From time to time, a need arises to add broadcasting installations which require that building permits be obtained in accordance with NOP 36A.

3. Given the exemption granted under the orders of the Planning and Construction Law and of the Communications Law, the Company believes that it is not obliged to obtain building permits for miniature broadcasting installations, which are "wireless access facilities" under those laws.

   There are a number of initiatives to cancel this exemption, and its cancellation could have materially adverse implications, including difficulty in providing universal service as required by the provisions of the Company's license, and which the Company is unable to assess at this stage.

   For possible implications of cancellation of the exemption for Pelephone – see Section 3.15.4.

4. In January 2008, the Planning Administration issued a draft amendment to NOP 36A (NOP 36/A/1), with the aim of changing the guidelines for the licensing of small and miniature broadcasting installations. The draft cancels the definition of a miniature broadcasting installation and changes the definition of a small broadcasting installation. In addition, different licensing tracks are defined (fast and standard), depending on the location and the public safety range of each installation. In these tracks, indemnification arrangements (of differing amounts) are set for claims for compensation under Section 197 of the Planning and Construction Law.

   The change of definition of small broadcasting installations and large broadcasting installations, presents practical difficulties which could impede the Company's ability to provide the public with some of the services it is required by law to provide.

NOP 36/A/1 has not yet been approved by the government, and there is no certainty as to the final text that will be approved. If changes are made in the final text compared with the present draft, they could materially affect the Company.

C. NOP 36B

Part B of NOP 36 contains guidelines for setting up large broadcasting facilities. In the January 2008 draft plan (which was presented to the government for approval in August 2010), the definition of a large broadcasting facility was changed so that the licensing of broadcasting facilities which prior to the proposed amendment were classified as large, would be according to NOP 36/A/1 (if and when approved), which does not include transition provisions for an abridged licensing proceeding. The change in definition for small and large broadcasting facilities presents practical difficulties which could impede the Company's ability to provide the public with the services it is required by law to provide.

The January 2008 draft contains a transition provision which is expected to allow grant of a license for existing broadcasting installations even if they do not meet the requirements of NOP 36B, subject to certain terms and restrictions, provided that they are in compliance with the safety restrictions described in the Plan. The January 2008 draft also proposes to include a provision requiring the license applicant (including for existing sites) to provide the local committee with a deed of indemnity for compensation under Section 197 of the Planning and Construction Law, if a court rules against the committee.

NOP 36B has not yet been approved by the government and there is no certainty as to the final text that will be approved. If changes are made in the final text compared with the present draft, they could materially affect the Company.

The Companies assessments concerning the effect of the amendments to NOP 36 (Parts A and B) on the Group's operations and performance are forward-looking information. These assessments may not materialize, or they may materialize differently than foreseen, in part depending on the final text of the relevant NOP 36. As mentioned above, at this stage, before publication of the final text of the NOP, the Company is unable to estimate the full impact of the amendments on the Group.

D. On radiation permits for communications and broadcasting facilities, see Section 2.15.

E. NOP 56 – Communications facilities in the Administered Territories

NOP 56 came into force in June 2008, and regulates the manner of erection and licensing of communications facilities in the Administered Territories. The Plan contains transition provisions for facilities erected with a permit for small installations.

The Plan also includes a requirement for production of a communications license and receipt of the consent of the Commissioner of Government Property at the Civil Administration.

The Company has arranged the licensing for 72 installations in the Administered Territories and is in the process of licensing an additional 9 installations in the Administered Territories.

2.17 Substantial agreements

Below is a brief description of substantial agreements outside the normal course of the Company's business which were signed in the reporting period and/or which are in force.

2.17.1 Agreements concerning debentures

A. Deed of trust for Debentures (Series 5), dated May 24, 2004

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

An addendum to the deed of trust for the debentures in this series relates to the issue of an additional 1,500,000,000 debentures by the Company to Bezeq Zahav Holdings on the same terms and listed for trading on the Stock Exchange (subject to lock-up restrictions).

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

On March 21, 2012, the appointment of Hermetic Trust Services (1975) Ltd. ("Hermetic") was approved as the trustee for Debentures (Series 5) of the Company, replacing Mizrahi-Tefahot Trust Company Ltd., and accordingly from that date Hermetic serves as the trustee for the aforementioned debentures.

B. Deeds of trust for Debentures (Series 6-8) from May 31, 2011 and an amendment to the deeds from June 21, 2011

Deeds of trust signed with Reznik Paz Nevo Trust Ltd. (Series 6-7and with Strauss Lazar Trust Company (1992) Ltd. (Series 8) for series of up to 3,000,000,000 debentures each to be issued according to a shelf prospectus.

For further details concerning the debentures from the aforementioned series, see Note 13.2 to the 2012 Financials.

2.17.2 Real estate

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

An agreement between the State and the Company, under which the Company was granted the State's rights in assets which the Ministry of Communications used for providing telecommunication services, and the Company assumes the rights of the State in those assets and for the obligations and liabilities relating to those rights immediately prior to implementation of the agreement. Moreover, under this agreement, the State's rights, powers, obligations and duties, as well as the contracts and transactions that were in force for telecommunications services immediately prior to application of the agreement, were transferred to the Company.

B. <u>Settlement agreement dated May 15, 2003</u> between the Company and the State and Israel Lands Administration, in the matter of rights relating to real estate

See Section 2.7.5C.

C. Agreement between the Company and the Postal Authority, June 30, 2004

An agreement between the Company and the Postal Authority to define and regulate the rights of the Company and the Postal Authority in their joint assets. The agreement listed the joint assets and defined the part of each party in them. It was determined that each of the parties shall have exclusive rights in its parts, except for the matter of rights in common property, building rights or rights for which there is an explicit other determination. The agreement determines, among other things, a mechanism of right of refusal if a party wishes to make a sale transaction and a priority right for a rental transaction. For a number of additional properties, the party with exclusive rights in them, in whole, will be one named party.

2.17.3 Sundry agreements with DBS and its other shareholders

See Section 5.18.4.

2.17.4 Employment agreements

A. A comprehensive pension agreement dated September 21, 1989, between the Company, the Histadrut and the joint representation of workers committees, and Makefet Fund – Center for Pension and Compensation Cooperative Association Ltd, provides a full and autonomous arrangement in everything relating to the pension insurance of Company employees. The agreement applies to all transferred employees (who were transferred from the Ministry of Communications to the Company), to all of the members of the cumulative pension fund who are employed by the Company on the date of execution of the pension agreement, and to all of the permanent and temporary employees of the Company, with the exception of special employee groups (students, employees under personal contracts or employees working according to another, alternative arrangement).

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

A collective agreement for early retirement of employees in a pension track and an increased compensation track, under which Company employees retired in the past and which was renewed in December 2006. Sub-section F below is based, inter alia, on this agreement. For information on this matter and on the matter of early retirement, see Note 16 to the 2012 Financials,

C. Agreement to affirm rights dated September 4, 2000 between the Company, the Histadrut and the Union

A special collective agreement relating, inter alia, to affirmation of the rights of the transferred employees (who were transferred from the Ministry of Communications to the Company). This agreement affirms the rights of the transferred employees to any pension right to which they were entitled by power of their being former civil servants, under the Company's pension agreement, adopted by the Company as part of its pension agreement. Under this agreement, these rights become "personal rights" which cannot be cancelled except by a waiver of personal rights under law (in other words, by personal waiver by the employee himself or herself).

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

Following an amendment in July 2000 to the Hiring of Workers by Human Resource Contractors (Amendment) Law, 2000, a special collective bargaining agreement was signed on January 11, 2001 for hiring new employees and stipulating the terms of their salaries. The agreement applies to new employees and to employees who were previously employed at the Company through human resource companies, in positions listed in the appendix to the agreement (customer service representatives at call centers, administrative workers, typists, warehouse employees, secretaries, mail sorters and distributors etc., and similar administrative workers such as porters, drivers, forklift operators and others). Under the special collective agreement of December 2006, it was agreed that the Generation 2000 agreement would not apply to such employees who were hired by the Company after July 1, 2006. It was also agreed to insert minor amendments into the terms of employment of workers hired under the Generation 2000 agreement.

E. Agreement dated April 17, 2005 with the entity that replaced Makefet Fund in everything relating to early retirement arrangements of Company employees

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

Subsequently, on June 28, 2005, an agreement was signed between Harel Insurance Company Ltd. ("**Harel**") and the Company ("**the June 2005 Agreement**"), regulating pension payments in respect of early retirement and provisions for old-age and survivor pensions, stemming from legislative amendments which were part of the Israeli Economy Recovery Program Law, for employees who retired from the Company from the end of 2003 / beginning of 2004 and/or who will retire from the Company in accordance with the September 2000 special collective agreement for retirement as amended on March 18, 2004 and April 17, 2005. Following execution of the agreement with Harel, the special collective agreement referred to above between the Company, the Union and the Histadrut, was amended on the same date (June 28, 2005).

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

F. Special collective agreement from December 2006 and its amendment in December 2010

See Section 2.9.5.

2.17.5 Management agreement

On June 10, 2010, the general meeting of the shareholders of the Company approved (after approval by the Audit Committee and the Board of Directors), a new agreement with Eurocom Communications Ltd., under which the Company is granted regular management and advisory services in consideration of USD 1.2 million per year. The term of the agreement is three years commencing June 1, 2010. For more details about this agreement, see the transaction report and notice of convening a special general meeting of the Company, dated June 1, 2010, which is cited by way of reference.

2.18 Legal proceedings

The Company's reporting policy is based on considerations of quality and of amount. The Company decided that the bar of amount materiality would be events affecting the Company's net profit by 5% or more according to the latest annual consolidated financial statements. Accordingly, this section describes legal proceedings involving NIS 120 million or more,[42] which account for approximately 5% of pretax profit according to the 2012 Financials (approximately NIS 90 million of the net profit), and legal proceedings in which the amount claimed is not stated in the statement of claim, except in the case of a claim which prima facie does not reach the above amount bar (and all unless the Company believes the claim has other aspects and/or implications beyond its monetary amount).

Proceedings which are pending at the date of publication of this report

2.18.1 A number of claims are pending against the Company which concern recognition of various wage components for determining various payments to the Company's employees, as follows:

A. In February 2002, a notice of a party to a collective dispute ("the Party Notice") was filed in the Jerusalem District Labor Court by the Histadrut in the name of all Company employees. The applicant alleged that payments for grossing up of tax, the administrative on-call duty component and clothing allowances which were and are paid to Company employees, are regular pay which form part of the determining salary of each employee, for calculation of various payments. In April 2006, the court gave its decision, denying all parts of the Party Notice. which was procedurally void. Subsequently, the Party Notice was struck out and it was agreed that a new party notice would be filed, and that the question of the limitation date would be decided when the party notice was being heard. On February 10, 2010 a party notice was filed, which relates only to the on-call fee component. Under the party notice the Court was requested to determine that the on-call fee component be included in the hour value for calculating overtime pay and for calculating redemption of annual vacation pay.

On November 27, 2012, a judgment was given in the case in which the court ruled that an hourly rate for administrative on-call fees should be included when calculating overtime and redemption of statutory vacation days paid to Company employees who receive this supplement. The Company and the State appealed this ruling of the court. The Histadrut appealed the fact that the court had dismissed its request that the prescription period should be defined according to the date of the filing of the party notice from 2002 (i.e. commencing in 1995), and not according to the date of submission of the current party notice, and the Company filed a counter appeal on the issue of the statute of limitations alleging that the counting of the limitation period does not stop the filing of the two party notices.

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42 For reviewing claim amounts vis-à-vis this bar, the amounts were linked to the CPI. The amounts noted in this section are the original amounts (without linkage differentials). On the matter of the bar, where similar proceedings take place against a number of companies in the Group, the amount of the claim might be reviewed cumulatively in respect of all the proceedings together. In addition, it is clarified that if certain proceedings relate largely to the same legal or factual issues, or it is known that such issues are reviewed or considered together, then for setting the bar of quantitative materiality as noted in these sections, the amount involved was examined in all those proceedings together.

B. In September 2000, a claim was filed against the Company in the Jerusalem District Labor Court by 2,423 pensioners of the Company who had been employees of the Ministry of Communications and were reassigned to the Company when it was established[43]. The plaintiffs petitioned for declaratory relief to the effect that payments grossed up for tax purposes, clothing supplements and wage incentives are ordinary wages which should be considered part of their effective wage for pension purposes and for the purpose of payments given upon retirement, and should therefore be included in the hourly calculation and when calculating percentage supplements. The plaintiffs also petitioned for declaratory relief to the effect that their last effective wage for pension should be calculated based on their last wage (and not based on the average ranking). Subsequently, the claim was amended so that all the relief relating to the plaintiff's pension rights was deleted from the statement of claim. The plaintiffs also reduced their claim to the wage incentive component and retracted their claim to the grossed up tax and clothing components. On December 16, 2008, the court dismissed the claim and determined that the premium paid to the plaintiffs is a real contingent supplement and that the premium component should not be included in the hourly value for the purpose of calculating compensation for overtime or when redeeming annual vacation which is paid as part of post-employment benefits**.** On March 3, 2009, an appeal was filed in the National Labor Court which was dismissed on December 21, 2011. On July 25, 2012, the Company received a petition to the High Court of Justice for the issue of an order nisi against the National Labor Court and the Company, in which the plaintiffs are petitioning to revoke the ruling and decisions of the National Labor Court. In accordance with HCJ's decision, the company filed a preliminary response to the petition.

C. Several additional individual claims by employees and former employees are pending against the Company, concerning, inter alia, recognition of various wage components as components for the purpose of calculating various payments, and claims in respect of overtime and other time

2.18.2 Four claims were pending against the Company which were filed by various plaintiffs in the years 2003 to 2005 against the Company, the Broadcasting Authority and the State of Israel, for compensation for physical injury and damage to property, caused, according to the plaintiffs as a result of prohibited radiation from the Hillel broadcasting station.

Three of the claims were for bodily damages to person and they were heard in the Central District Court (the amounts of the claims were - one for more than NIS 15 million, in another there is no estimated amount, and the third for NIS 46 million). The plaintiffs in these three claims filed an application for consolidation of the hearings of the claims. The court ordered a stay of proceedings and resumption of the claims, as necessary, only after the plaintiffs comply with the Court's decision concerning the submittal of documents and affidavits. On November 25, 2012, the court dismissed the plaintiffs' application to resume proceedings and stated that a new claim must be filed. Subsequently, on December 12, 2012, a new claim was filed in the Central District Court against the State of Israel, the Broadcasting Authority, and the Company, based on the three aforementioned claims for alleged damage to person for 31 people, 27 of which are against the Company) in connection with the Hallel station.

The fourth claim is being heard in the Tel Aviv District Court and is for alleged damage to property and financial loss. The amount of the original claim was NIS 141 million, but following the failure to pay the court fees by some of the plaintiffs and the dismissal of their application for exemption from the fees, some of the plaintiffs were deleted from the claim so that the revised amount is NIS 23 million.

It should be noted that on December 31, 2003, the Company discontinued its broadcasts from the station as requested by the State and the Broadcasting Authority, and from that date the site is no longer used for broadcasting.

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43 This claim was consolidated with another suit filed in January 2007 by 85 pensioners who had been transferred to the Company from the Ministry of Communications, claiming declaratory relief to the effect that payment of grossed up tax clothing and wage incentives should be included in the effective wage with respect to rights under the Work Hours and Rest Law and the Annual Vacation Law.

2.18.3 In November 2006, a claim was filed against the Company in the Tel Aviv District Court together with an application for its recognition as a class action, in the amount of NIS 189 million, on the grounds of unlawful collection of money is disconnection due to non-payment. Moreover, in February 2011, the plaintiff filed an additional claim together with an application for its recognition as a class action in the amount of NIS 44 million, in the Central District Court concerning a refund of payment for "related services" for the period after the line had been disconnected. The second claim from February 2011, and the application for its recognition as a class action were dismissed *in limine* on March 28, 2012. On May 8, 2012, an appeal was filed against the decision.

2.18.4 In July 2010, an action was filed against the Company in the Central District Court, together with an application for its certification as a class action, alleging that the Company offers its customers to join call plans with a fixed monthly payment, which results in a financial loss to customers for whom the track is not worthwhile, thus misleading them. The plaintiff is claiming restitution of the difference between the amount paid by customers on the new track and the amount they would have paid on the ordinary track, which he estimates is "tens of millions of shekels", as well as compensation of NIS 1,500 per customer for an ostensible infringement of privacy.

In June 2012 the court approved publication of a compromise settlement reached by the parties at a cost of NIS 6.5 million to the Company, and instructed that the settlement be sent to the relevant parties before it hands down the verdict. Subsequently, an inspector was appointed to estimate the damage and the amount of the compensation.

2.18.5 On November 10, 2011, a person who claims to own 1,162 shares of the Company ("the Applicant") petitioned the Economic Department of the Tel Aviv-Jaffa District Court to approve the submission of a derivative action ("the Application") and a derivative action which was included in the Application. As part of the Application, the Court was asked to approve the submission of a derivative action in the amount of NIS 900 million against the Company's incumbent directors and against a former director. The Application argues, inter alia, that the Board members were in breach of their duty of caution and fiduciary obligations towards the Company (and with respect to the controlling shareholder, his duty of fairness as well) by approving loans worth billions of shekels taken by the Company, which as alleged in the Application, were not used for the Company's benefit and were designated for the distribution of dividends for the purpose of reducing the financing costs of the Company's controlling shareholder, and were therefore in a conflict of interests between their own personal benefit and that of the Company. Consequently, as argued by the Plaintiff, the Company suffered losses in the form of heavy financing expenses in respect of those loans. Alternatively, the Plaintiff alleges that the resolutions passed by the Board of Directors with respect to the aforementioned loans, created a tax exposure for the Company due to the fact that the financing expenses are not recognized for tax purposes. On January 26, 2012, the Company and the Board of Directors submitted their response to the Application, requesting a dismissal of the Application.

On June 14, 2012, the court resolved to dismiss the application *in limine* after ruling that the applicant in this procedure is not a "shareholder" of the Company and he is therefore not entitled to file a derivative claim in the Company's name. Subsequently, on July 15, 2012, a new application to approve a derivate claim was filed in the Tel Aviv District Court (Economic Department) by the father of the applicant whose application had been dismissed *in limine*, (against directors of the Company, the CEO, Deputy CEO, and the CFO of the Company) on the same subject ("the Amended Application").

On November 26, 2011, an additional application was filed for certification as a derivative claim ("the Additional Application") together with a derivative action in the Economic Department of the Tel Aviv-Jaffa District Court by a shareholder of the Company who holds 1,500 shares ("the Additional Applicant"). The Additional Application (which is essentially similar to the Amended Application) was filed against the Company's incumbent directors, directors who no longer serve the Company and against the previous controlling shareholder of the Company (F.SAB.R. Holdings Ltd. (hereinafter together: "the Defendants"). The Additional Application alleges, inter alia, that the Defendants approved the distribution of dividends and took loans with the purpose of serving the interests of the controlling shareholders, were in a conflict of interests between their own personal benefit and that of the Company. Consequently, the decision making process and the disclosure given by the Company regarding these decisions was flawed. The Additional Application therefore contends that the Defendants were in breach of their duty of caution towards the Company, and some of there were also in breach of their fiduciary obligations, and with respect to the former and present controlling shareholder, it was alleged that they were also in breach of their duty of fairness. Consequently, the Additional Applicant alleges that the Company suffered losses of NIS 3.4 billion (gross) or NIS 2.64 billion (net). The Additional Applicant is petitioning, inter alia, for declarative relief concerning nullification of extraordinary loans taken by the Company from the date of the change of control therein and concerning nullification of the Company's outstanding payments to its shareholders originating in a capital write-down, as well as the restitution of dividends by the Company's controlling shareholder. During February and March 2013, responses to the request were filed by the Company and claimants, asking to reject the request.

On January 17, 2013, the court instructed the consolidation of these two applications.

2.18.6 In 2003, the Company filed a claim in the Tel Aviv District labor Court against the Makefet Fund for compensation in respect of breach of agreement between the Company and Makefet in the matter of calculation of the cost of early retirement of employees who were transferred to the Company from the Ministry of Communications. The amount claimed by the Company was NIS 280 million. On this matter, see also Note 16.7 to the 2012 Financials.

2.18.7 In October 2011, an action was filed at the Tel Aviv District Court, together with an application for its certification as a class action, alleging that the Company unlawfully broadcasts its own advertising on the Music on Hold (MOH) platform about subscribing to the service. The plaintiffs estimate the total amount of the claim for all members of the group at NIS 200 million, for restitution of the service fees and compensation for prohibited advertising (for callers to subscribers to the service), and all from the date on which the Company commenced this service.

2.18.8 In February 2012, an action was filed at the Jerusalem District Court, together with an application for its certification as a class action, against the Company, against the subsidiary Pelephone Communications Ltd. ("Pelephone"), and against two other cellular companies (all together: "the Respondents"). The plaintiffs allege that the Respondents do not offer the handicapped members of the public accessible handsets and services in a fitting manner, and that they are therefore in breach of the law and the regulations. The plaintiffs are requesting certification of the claim as a class action in the name of a group of handicapped people and are claiming monetary compensation of NIS 361 million against all the Respondents for the losses they allege (monetary loss, non-monetary loss, and infringement of autonomy) as well as other relief. In this matter, see also Section 3.17.1G.

2.18.9 In September 2012, a claim was filed against the Company in the Tel Aviv District Court together with an application for its certification as a class action, alleging that in contravention of the law, the Company does not include a call details record in the phone bills which it sends to its subscribers. The application estimates the amount of the class action at NIS 154 million. It should be noted that in April 2011, another claim was filed against the Company in the Tel Aviv District Court together with an application for its certification as a class action in the same matter, and the plaintiff estimates the amount of the claim at NIS 127 million. In view of the similarity between the two claims, the attorney for the plaintiff in the claim from September 2012, expressed his agreement in principle to abandon the proceeding. For a similar claim which was filed against Pelephone on the same subject, see the Section3.17.1I.

<u>Legal proceedings which ended in the reporting period or by the date of publication of the report</u>

2.18.10 In October 2011 a former employee of the Company filed a claim against the Company at the Tel Aviv Regional Labor Court that includes an application for its certification as a class action in the total amount of NIS 150 million in the name of some the Company's employees and pensioners. The main purpose of the claim is a request to refund wage differences stemming, according to the claimant, from a failure to include two wage supplements, on-call fees and an hourly value premium for calculating overtime and the redemption of vacation days. On April 29, 2012, a ruling was given whereby the claim and the application for certification as a class action were struck out, upon the plaintiff's request and further to the court's recommendation.

2.18.11 In November 2006, a claim was filed at the Tel Aviv District Court against the Company, Pelephone, HOT, Cellcom, and Partner, together with an application for its certification as a class action, in the total amount of NIS 158 million. The plaintiffs allege that when completing a call made from a cellular line to a fixed line, the Company and HOT delay sending the disconnection signal, and as a result they incur a loss which is reflected in airtime costs and interconnect fees. On October 28, 2010, a ruling was given dismissing the application. On October 17, 2012, the Supreme Court resolved to strike out (without ordering costs) an appeal which had been filed against the Company on December 16, 2010 in respect of a dismissal of the application for certification as a class action.

2.18.12 In September 2010, the Ministry of Communications, the IDF Commander in the Administered Territories and the Civil Administration in the Administered Territories filed a claim against the Company in the Jerusalem District Court in the matter of payment of fees of approximately NIS 74 million for erecting and operating microwave trunks in the Administered Territories. On April 2, 2012, a compromise settlement between the parties to the procedure was validated as a court ruling, in which the Company will pay the plaintiffs the total amount of NIS 26 million (plus CPI linkage from February 11, 2010).

2.18.13 In January 2011, four claims were filed against the Company at different courts, together with applications to certify them as class actions concerning a malfunction of the Company's network on January 25, 2011. Subsequently, all four claims were transferred to the Tel Aviv District Court and on November 27, 2011, the court decided to consolidate the hearing of the last two applications (nos. 3 and 4 above) and to delete the first two applications (nos. 1 and 2 above). on October 9, 2012, the court approved the applicants' request to abandon their applications for certification as a class action, based on the court's recommendation and in view of the difficulties encountered by the application for certification.

2.18.14 In the matter of an application to approve a distribution that does not pass the profit test, which was filed in the Tel Aviv-Jaffa District Court (Economics Department) on January 26, 2011, see Section1.4.2.

2.19 Business Objectives and Strategy

2.19.1 Forward-looking information

The following review of Company strategy includes forward-looking information as defined in the Securities Law, and involves assessments about future developments relating to customer behavior and needs, the pace of adoption of new services, technological changes, regulatory policy, marketing strategies of competitors, and the effectiveness of the marketing strategy of the Company.

The Company's strategy and the business objectives stemming from it are based on internal research, secondary sources of information, and primarily – the reports of research companies, publications about the activities undertaken by similar communications operators in Israel and around the world, and the work of consultants who assist the Company.

Nevertheless, it is far from certain that the strategy and the main activities described here will actually be implemented or implemented in the way described. The circumstances that could lead to non-implementation of the strategy or even its failure, lie in frequent technological changes, regulatory constraints, the formation of a sustainable business model for new services that the Company intends to provide, and a superior marketing strategy by competitors. In addition, a change in ownership of the Company could result in a change in its strategy and its business objectives.

2.19.2 Strategy summary and intentions for the future

A. Vision and purpose

The Company's objective is to be a market leader in the domestic and business arena and to provide the customer with a total communications solution. In the private sector the Company provides such solutions for the home; in the business sector the Company provides a smart network on which a range of advanced services operate.

The objective: to maintain the Company’s competitive position and continue being the customer’s first choice in telephony, internet and telecommunications.

To attain this goal, the Company has set itself a number of challenges:

1. Preservation of leader status in an environment of intensifying competition (leader in service and strengthening of perceived values – innovative products, reliability, proximity to the customer);

2. Encouraging the recruitment of new customers and fidelity motivators among existing customers;

3. Creation of new sources of income by launching new services and products;

4. Ongoing adaptation of the organization to the competitive environment and operational excellence.

B. Means

To implement this strategy and attain these objectives, the Company uses and will continue to use the following means:

<u>Business customers</u>

Diverse bundles of products and services that meets the business needs of the customer;

Total solution according to customer needs, while applying a strategy of commitment to service quality and availability;

Encouragement of customer to migrate from basic services to managed solutions for organizational and inter-organizational connectedness;

<u>Private customers</u>

Wider bandwidth of customers and sale of advanced products and services on the new NGN;

Supply of differential debit tracks to suit customer needs;

Strengthening the positioning of the Company's telephony services, with emphasis on advanced applications and the penetration of advanced terminal handsets.

Levering Group assets for the purpose of providing the customer with a comprehensive communications solution.

<u>Network</u>

In order to attain its strategic objectives, the Company is working on improving the existing network and adapting it to its business goals, including by the deployment of optical fibers and by investing in the heart of the network. See also Sections 2.6.5 and 2.7.2, on the NGN.

2.19.3 Development trends in the company's business

A. The Company is working to increase data transfer speeds in the services it provides for its customers, and its marketing initiatives aim to transfer customers to faster Internet surfing speeds. For its business customers, the Company is also launching transmission and data communication services at high speeds and in a range of interfaces.

B. The Company is working to integrate itself into Internet protocol (IP) applications. To achieve this, it has established an IP network company to serve as a platform for the services it provides today and those it intends to provide in the future.

C. The Company markets fixed-line and wireless home network services for surfing from a number of computers simultaneously, as well as additional services (Bphone, Bcloud, Free WiFi).

D. The Company has launched a range of debit tracks for telephony services alongside its basic tariff structure, so as to increase the extent of use of its services.

E. The Company markets bundles that include additional services to those of the Company (see Section 1.7.2).

2.19.4 Main projects – planned and in progress

As at the end of 2012 the Company has completed deployment of the NGN almost everywhere. With regard to the Company’s deployment of an optic network as close as possible to the customer’s premises, see section 2.7.2.

The Company is also developing and assimilating advanced computer systems, among them a network engineering management system, and a service order and delivery management system.

2.20 Expectations for development in the coming year

The Company intends to accelerate the distribution of optical fibers to the customer's home and residential buildings (FTTB/H), so that during the course of the coming year, the Company will already have a significant fiber optic distribution, which will further increase in forthcoming years. In this matter, see also Section 1.6.

2.21 Risk factors

The Israeli market in which the Company operates is essentially stable. Nevertheless, there are risk factors stemming from the macroeconomic environment, from the unique characteristics of the industry in which the Company operators, and risk factors that are unique to the Company, as described in the following sub-sections:

2.21.1 Competition

Competition in domestic fixed-line communications has intensified in the past few years, both from other domestic operators, headed by Hot (which holds a general license), and from cellular and other communications operators (which hold special licenses). There is also a possibility of competition from other infrastructure owners (see Section 2.6).

This has led to the churn of some of the Company's customers and lowering of prices for part of the Company’s services and to a rise in the costs of acquiring new customers and retaining existing ones.

The entities competing with the Company at present or those that might compete with it in the future, benefit from greater business flexibility than the Company, including the ability to cooperate with subsidiaries and affiliates for marketing joint packages of services (see Section 1.7.2). The ability of HOT to offer such packages ("Triple Play" and even more) with tariff flexibility compared with the limitations that prevent the Company from doing the same, harms the Company's ability to compete.

2.21.2 Government control and regulation

The Company is subject to government control and regulation relating, among other things, to the licensing of operations, setting permitted areas of operation, setting tariffs, operation, competition, payment of royalties, providing universal service, holding its shares, relations between the Company and its subsidiaries and a ban on ceasing or limiting its services (which could oblige the Company to provide services even in circumstances which are not economically worthwhile) – for details, see Section 2.16. This control and regulation result at times in government intervention that the Company believes impedes its business activities. Within this framework the Company is exposed to the imposition of various sanctions by the Ministry of Communications, including financial sanctions (see Section 1.7.3F).

In addition, the Minister of Communications has the authority to change the Company's license. Significant changes in the regulatory principles applicable to communications as a whole and to the Company in particular, could oblige the Company to make changes in its strategic plans, and harm its ability to plan its business activities for the long term. On possible changes following the Hayek Commission, see Section 1.7.3.

2.21.3 Tariff control

The Company’s tariffs for its main services (including interconnect fees) are subject to government control and intervention. Some of these tariffs are determined in regulations, which also set a formula for updating them (see Section 2.16.1). The practical significance of this mechanism is on average real erosion of the Company's controlled tariffs. Significant changes in controlled tariffs, if implemented, could have a materially adverse effect on the Company's business and results. Regarding the uncertainty about continuing the updating arrangement for the Company's controlled tariffs – see Sections 1.7.3 and 2.16.1. Furthermore, the limitations applicable to the Company in marketing alternative tariff packages could create difficulties for the Company in offering an appropriate competitive response to changes in the market. In the context of the application of a wholesale market, the Ministry of Communications has the power to set the price for which the Company will sell its services to license holders. The application of low prices may adversely affect the Company's revenues and profits.

2.21.4 Labor relations

The Company's implementation of human resources and organization plans (including retirement plans and restructuring), involves coordination with the workers and significant costs, including compensation for early retirement. The processes of implementation of such plans are liable to cause unrest in labor relations and to be damaging to the Company regular activities – see also Sections 2.9.3 and 2.17.4.

2.21.5 Restrictions on relations between the Company and companies in the Bezeq Group

Structural separation - The Company's general license obliges it to ensure that its relations with its main investees in the Group do not result in preferring them over their competitors. Separation is required between the managements of the Company and those companies, as is separation between the business, financial and marketing systems, assets and employees, which causes duplication and high administration overheads. In addition, the Company is limited in its ability to offer joint service bundles with those companies (see Section 1.7.2). In view of the entry of communication companies into direct competition with the Company in most of its areas of operation based on the provision of a bundle of services to the customer and the option of providing wholesale services for offering customers end-to-end services, the risk that this factor will affect the Company's operations has increased. Nonetheless, on the matter of the possibility that in the future the Group will be granted a permit to provide non-divisible bundles of services and cancellation of the structural separation, see Section 1.7.3A. On possible changes following the development of a competition policy document, see Section 1.7.3.

2.21.6 Legal proceedings

The Company is a party to legal proceedings, including class actions, which could result in it being ordered to pay significant sums, most of which cannot be estimated, and therefore, no provisions have been made in the Company's financial statements for most of them. In addition, the Company's insurance policies are confined to cover limits and to certain causes, and might not cover claims for certain types of damages.

Class actions against large commercial companies have become more numerous of late, notably since the Class Actions Law came into force and expanded the causes for which a class action can be filed. Class actions can reach large amounts, as virtually all residents of the country are consumers of the Company's services, and a claim that relates to a minor loss for a single consumer can become a material claim for the Company if it is certified as a class action applicable to all consumers or a significant portion of them. In addition, since the Company provides communications infrastructures as well as billing services to other licensees, parties suing those licensees in other class actions are also likely to try to involve the Company as a party to such proceedings. For a description of legal proceedings, see Section 2.18.

2.21.7 Exposure to changes in currency exchange rates, inflation and interest

The Company measures exposure to changes in exchange rates and inflation by the surplus or deficit of assets against liabilities, based on the type of linkage. The Company's exposure to changes in currency exchange rates against the shekel is low. The Company's exposure to inflation rates is high, and therefore the Company takes steps to cover part of the inflation exposure. In addition, the Company has exposure to changes in the interest rates in relation to its borrowings. For further information on this subject, see Note 30 to the 2012 Financials.

2.21.8 Electromagnetic radiation and licensing of broadcasting facilities

The subject of the electromagnetic radiation emitted from broadcast facilities is regulated mainly in the Non-Ionizing Radiation Law (see Sections 2.15 and 2.16). The Company is working to obtain permits to set up and operate its various broadcasting installations; however, the difficulties it faces in this area, including difficulties stemming from the change in policy by relevant entities and amendments to statutes and standards, could impact adversely on the infrastructure of these installations and on the regularity of provision of services using them, and as a result, on the Company's revenues from these services. The Company's third-party liability policy does not currently cover liability for electromagnetic radiation.

2.21.9 Frequent technological changes

Communications is a field characterized by frequent technological changes and a shortening of the economic life of new technologies – see Section 2.1.4. The significance of these trends creates a need to invest numerous resources in technology upgrades, especially the Company's infrastructures, a lowering of entry barriers for new competitors, an increase in depreciation rates, and in certain cases, redundancy of technologies and networks owned by the Company, the cost of investment in which is still recorded on its balance sheets.

2.21.10 Dependence on macro-factors and on levels of business activity in the economy

Stability in the financial market and the strength of economies in countries around the world, have recently been subjected to high volatility. So far, the Israeli economy has displayed economic resilience, reflected in further economic expansion, maintaining low levels of unemployment and inflation rates within government targets. Nevertheless, the growth of the national deficit, rising housing prices and uncertainty in the political and defense arenas cast doubt over a continuation of these trends. The Company estimates that if the local market slides once again – following external or internal events – into a slow-down and a worsening of business activity, then its business results will be harmed, inter alia, as consequence of poorer revenues (including revenues from affiliates) and the difficulty in selling its real estate assets or due to an increase in the Group's finance costs.

2.21.11 Failure in the Company's systems

The Company provides services using various infrastructure systems that include, among others, exchanges, transmission, data communication and access systems, cables, computerized systems and others. Some of the Company's systems have backups, but nevertheless, damage to some or all of these systems, whether due to a technical fault or natural disaster (earthquake, catastrophe, fire), whether due to malicious damage, could cause extreme difficulties in providing service, including if the Company is unable to repair the systems.

It is noted that a significant part of the Company's activities (consolidated) are in its subsidiaries / affiliates. The risk factors of these companies and the assessments of their managements as to the risk factors, are described in Sections 3.20, 4.18 and 5.21.

The table below rates the effects of the risk factors described above on the Company's activities, in the estimation of its management. It is noted that this assessment of the extent of the impact of a risk factor reflects its extent assuming it is realized, and does not assess or give weight to the likelihood of its realization. The order in which the risk factors appear above and below is not necessarily according to the rate of risk.

Table of risk factors[44]

	Extent of risk factor's impact on Company activities		
	Major impact	**Medium impact**	**Minor impact**
Macro-risks			
Exposure to changes in exchange, inflation and interest rates			X
Industry risks			
Intensifying competition	X		
Government control and regulation	X		
Tariff control	X		
Electromagnetic radiation / Licensing of broadcasting facilities		X	
Frequent technological changes		X	
Risks unique to the Company			
Exposure in legal proceedings		X	
Difficult labor relations		X	
Limitations on relations between the Company and companies in Bezeq Group	X		
Dependence on macro-factors and on levels of business activity in the economy		X	
Failure of Company systems	X		

The information in this Section 2.21 and the Company's assessments of the risk factors on its activities and business, are forward-looking information as defined in the Securities Law, The information and assessments rely on data published by the Ministry of Communications, the Company's assessments as to the market situation and the structure of competition in it, and as to possible developments in that market and in the Israeli economy. Actual results might differ significantly from these assessments if a change occurs in one or more of the factors taken into account in making them.

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44 It is clarified that the Group companies' assessments of the impact of the risk factors in the table (in this section and in sections 3.24, 4.22 and 5.22) did not estimate the probability of the realization of the risk factor but rather, the impact of the risk factor on the relevant company should it be realized. It is also noted that some of the Group companies make estimates of the probability of the scenarios of some of the risk factors mentioned in these sections for certain internal needs of their own, but no orderly estimate is made at the Group level of all the risks listed in the tables in this and the aforementioned sections.

3. Pelephone – Mobile radio-telephone (cellular telephony)

3.1 General information about the segment of operation

3.1.1 Pelephone's segment of operation

Pelephone provides cellular communications services and sells and services terminal equipment. Pelephone's services are described more fully in Section 3.2. Pelephone is wholly owned by the Company.

3.1.2 Legislative and regulatory limitations applicable to Pelephone

A. Communications laws and the cellular license

Pelephone's operation is subject to regulation and control by power of the Communications Law and its regulations, the Telegraph Ordinance, and the cellular license ("**the Cellular License**"). The Cellular License lays down conditions and principles that apply to Pelephone's activities, (for details, see Section 3.15.2.).

B. Tariff control

The interconnect fees (call and text message (SMS) completion fees collected by Pelephone from other operators) are fixed in the Interconnect Regulations.

The other tariffs collected by Pelephone from its customers are not controlled, but the types of payments it can collect from its subscribers and the mechanisms for setting regulated tariffs, are regulated in the license (see Section 3.15.2).

C. Royalties

In 2012 Pelephone was obliged to pay royalties to the state out of its revenues from the provision of telecommunications services, in accordance with its license and under the Royalties Regulations. Over the years the rate of royalties has decreased and as of 2013 Pelephone is no longer required to pay royalties from its revenues (see Sections 1.7.3B and 3.15.2B).

D. Environmental laws and planning and construction laws

The set-up and operation of a wireless communication infrastructure, including cellular communications, is subject to the provisions of the Non-Ionizing Radiation Law and the permits from the Ministry for Protection of the Environment that are required by it, and to the provisions of planning and construction laws (see Section 3.14.1).

3.1.3 Changes in the volume of operation in the segment

For the financial data about the volume of operations of Pelephone, see Section 3.3.

Revenues from mobile radio telephony

In view of the more intense competition (see Section 3.1.1), during the course of 2012 the manner of costing services in the cellular market changed significantly. Instead of charging their customers according to actual use or selling communications packages which are limited to a certain use with an additional charge for extra use companies moved to offering unlimited packages. The increased competition and change in the format of the communication packages has led to a significant decline in average revenue per subscriber and higher churn rates. Average monthly income per subscriber during the reporting period dropped by 11.2%, and this alongside an increase in the use of services reflected in an increase in the average monthly usage of minutes per subscriber, an increase in the number of messages (SMS) sent and a significant increase in the use of data communications(DATA). The more intense competition also led to an increase in the movement of subscribers between the cellular operators.

Revenue from sale of terminal equipment

The new operators that own infrastructure, the reform in the import of handsets and regulatory changes have led to lower demand for handsets and the amount of cellular terminal equipment which is sold by the cellular operators. In 2012, Pelephone's revenues from terminal equipment amounted to NIS 1,207 million, accounting for 27% of total revenues, as against NIS 1,911 million, accounting for 34.4% of revenues in 2011. The decline in sales of terminal equipment led to a drop in the balance of customers, in parallel to a decline in the volume of payments to suppliers of terminal equipment.

3.1.4 Market developments and changes in customer characteristics

The cellular market has been characterized by lower growth rates due to saturation of penetration rates.

Penetration rate as at December 31, 2012 is 126%

3.1.5 Technological changes than can affect the segment of operation

The cellular communications market is a dynamic area characterized by frequent technological changes in all its areas of operation (handsets, network technology and value added services). These changes impact the segment of operation ion a number of levels:

A. Erection of cellular networks in advanced technologies

Technological developments in terminal equipment and the desire to widen the range and quality of the services offered to the customer oblige the cellular operator to periodically upgrade its network technologies, mostly on Generation 3.5 UMTS/HSPA technology. In addition to the UMTS/HSPA network, Pelephone continues to operate an old network on CDMA technology which supports limited activity by subscribers (see Section 3.7.1).

Pelephone constantly reviews new technologies that come onto the market and the need to upgrade its existing network technologies, depending on the competition situation and the economic viability of the investment.

LTE technology (Long Term Evolution) – Data transfer technology, based on an Internet Protocol that can transfer data at higher speeds than the existing Generation 3.5 technology. This technology is applied by tens of operators around the world. In 2012, smartphones which support this technology were launched on the market, including the iPhone 5. In March 2012, the Ministry of Communications published a work plan on this subject. As at reporting date there is no certainty as to the allocation of a frequency range for use of LTE technology. Such a policy, as well as technological developments in this area, could have a significant effect on Pelephone.

This assessment is forward-looking information as defined in the Securities Law, and might not be realized or be realized differently than foreseen, inter alia in the event of formulation of a policy for designation and allocation of a suitable frequency range by the Ministry of Communications and depending on such policy and technological developments in cellular networks and their suitability to the frequency ranges in Israel.

B. Smartphones

The penetration of Smartphones – cellular phones with integrated operating systems allowing the use of advanced applications – has led to a rise in the consumption of data transfer services while increasing the supply of alternative applications and services to the Pelephone products and services provided by other entities.

C. Alternative technologies

Technologies that enable voice telephony and Internet (data) services in an IP over the cellular network (VoC) (see Section 3.1.8), could compete with Pelephone's services and materially affect its operations.

3.1.6 Critical success factors and the changes occurring in them

A. Addressing the strong competition in this sector and streamlining its operations, to enable Pelephone to confront the more intense competition

B. Nationwide deployment of an advanced and high-quality network, regular maintenance of the network to a high standard, and significant and regular investments in the cellular infrastructure, both for quality coverage of the whole country, which is a basic condition for providing Pelephone's services, and in order to provide customers with the most advanced services by means of the most advanced infrastructure and technology. See also Section 3.7.1.

C. The provision of high-quality communications.

D. Nationwide deployment of sales and service centers that provide the best efficient customer support and service, for coping successfully in a competitive market.

3.1.7 Main entry and exit barriers

A. Main entry barriers

1. The high penetration rate (see Section 3.1.4).
2. The need for a cellular license, the allocation of frequencies, which involves high costs and a resource in short supply (see Section 1.15.3B), and subjection of operations to the regulatory supervision that applies to the market (see Section 3.15.2).
3. The need for significant financial resources for making heavy and ongoing investments in infrastructures, which are affected by frequent technological changes.
4. The difficulty in erecting radio sites due to regulatory limitations and public opposition.

It is important to note that the main entry barriers do not apply to virtual operators and new cellular operators that own infrastructure which benefit from considerable easements enabling entry into the segment (see Section 3.6.2).

B. Main exit barriers

1. The large investments and the time required to recoup them.
2. The commitment to provide services for customers stems from the terms of the cellular license and agreements made in accordance with those terms.

3.1.8 Alternatives to Pelephone products

The products and services that could become an alternative to some of those provided by Pelephone are these:

A. Domestic fixed-line telephone and Internet services..

B. Telephony services based on VoB/ViOP/VoC technologies.

C. Wireless Internet in public places (hotspots) by means of wireless technologies (WiFi), which could be an alternative to cellular Internet.

3.1.9 The structure of competition in the field and changes occurring in it

A. General

Until the end of 2011, four companies with a general license for providing cellular services operated in Israel's cellular communications market. During 2012, a number of other cellular operators began to operate. The entry of the new operators has led to fierce competition, resulting in higher churn rates among the existing operators, an extremely significant erosion of tariffs, and erosion of profits (for more information, see Section 3.6.2A

B. Entry of additional operators that own infrastructure

In 2011, Hot-Mobile and and Golan Telecom Ltd. won the right to a frequency allocation and a license for cellular operators that own infrastructure. These operators began to operate during the course of 2012 (see Section 3.6.2A).

C. Virtual operators

MVNO - following the government's decision to encourage competition in the cellular market, nine MVNO licenses have been granted to date to virtual operators (cellular operators that do not own their own infrastructure and provide their services using the networks of the existing operators). To the best of Pelephone's knowledge, only 3 of the MVNO license holders actually provide services: Rami Levy Cellular Communications Ltd. ("Rami Levy"), Hot Cellular Ltd., and Alon Cellular Ltd. On an agreement between Pelephone and Rami Levy, see Section 3.6.2C.

D. Marketing service bundles by the competing cellular companies

Pelephone's main competitors – Cellcom and Partner – also operate in Internet access (ISPs), international telephony services, and domestic communications, and they market diverse joint service bundles (see Section 1.7.1).

E. Ministry of Communications policy concerning WiFi

In October 2012, a Ministry of Communications hearing was published on the exemption from a license to establish and operate access points which operate on WLAN (WiFi) technology frequencies. The hearing document includes, inter alia, an option to allow Domestic Carrier operators, but not cellular operators, to provide services on the aforementioned technology as part of existing licenses and on a best efforts basis.

Pelephone submitted its comments on the hearing in which it objected to the exclusion of the cellular operators from the arrangement, in part given that use of the WiFi technology is critical for cellular operators, as this technology is currently an important instrument in regulating loads on the mobile radio telephony (cellular) networks. Additionally, Cellcom and Partner have Domestic Carrier licenses, allowing them to use WiFi technology according to the proposed arrangement, and this created unreasonable discrimination for Pelephone against its competitors.

After submitting their comments on the hearing and at the date of the report, no decision or response has been received from the Ministry of Communications on this hearing.

F. Changes in legislation for increasing competition

Under the Arrangements Law for 2011 and 2012, a number of legislative amendments were adopted, the purpose of which was to remove transition barriers among the cellular operators and to increase competition. Among these was reform in the exit penalties from commitment that the operators can collect from the subscriber (See Section 3.6.2D).

For additional information about the structure of competition, see Section 3.6.

3.2 Products and services

3.2.1 Services

Pelephone provides its subscribers with comprehensive services of voice transmission, transmission of text messages, data communications and advanced multimedia services. Pelephone also offers its customers, inter alia, various packages and tracks that combine various services.

The following describes the services that Pelephone provides for its customers:

Basic telephone services (voice) –basic call services, call completion services and auxiliary services such as call waiting, call forwarding, voice mail, voice conference call and caller ID. For details about changes in the number of customer usage minutes, see Section 1.5.4B.

Browsing and data communications services –Internet browsing using a mobile device with maximum download speeds of 42 mbps. Pelephone also offers its customers internet browsing by means of a cellular modem.

Messaging service – a service for sending and receiving SMS text messages and multimedia MMS messages.

Content services - Pelephone offers its customers content services such as information and entertainment services on Pelephone's internet portal, navigating services, Super TV and musix which makes it possible to listen to a variety of music via cellphone and PC.

Roaming services – Pelephone provides roaming services based on agreements it has with cellular operators abroad, enabling it to use their networks.

Pelephone is able to offer its customers with handsets in that technology, roaming services using their personal handsets to countries all over the world, and also provides these customers with roaming coverage in 212 countries. Pelephone also provides incoming roaming services for the customers of foreign operators staying in Israel.

Servicing and repair services – Pelephone offers its customers a repair service for a monthly payment entitling the customer to a warranty for the cellular handset, or for a one-time payment at the time of repair.

Pelephone provides its customers with these services, and in addition, it provides, as part of hosting agreements , basic telephone (Voice) services, surfing and data communications services, sending and receiving text messages, and roaming services to other cellular operators (Hot Mobile and Rami Levy Cellular Communications Ltd.), see Sections 3.6.2B and 3.6.2C.

3.2.2 Products

Handsets – Pelephone offers its customers various types of cellular telephone, on-board telephones and hands-free devices, as well as support for its range of services.

Pelephone also supplies its customers with modems, laptop computers and tablets for surfing the Internet through the Pelephone network,

3.3 Segmentation of revenues from products and services

The table shows data on Pelephone's revenues from its products and services (in NIS millions):

Products and services	2012	2011	2010
Revenue from services[45]	3,261	3,637	4,550
Percentage of total revenue	73.0%	65.6%	79.4%
Revenue from terminal equipment	1,207	1,911	1,182
Percentage of total revenue	27.0%	34.4%	20.6%
Total revenue*	**4,468**	**5,548**	**5,732**

* For the impact of lower interconnect fees – see section 1.7.3C.

3.4 Customers

Segmentation of revenues from customers:

NIS millions	2012	2011	2010
Revenue from private customers	2,461	2,985	2,899
Revenue from business customers*	2,007	2,563	2,833
Total revenue**	**4,468**	**5,548**	**5,732**

* Revenues from business customers include revenue from hosting agreements which amounted to NIS 129 million in 2012.

** For the impact of lower interconnect fees – see section 1.7.3C.

At the end of 2012 the number of Pelephone subscribers totals 2.8 million. It is noted that some of Pelephone's customers are pre-paid customers (who pay for communications in advance). Revenues from these customers are not material to the Company's total revenue.

In addition to Pelephone's aforementioned subscribers, who are the end customers who actually use Pelephone's network, Pelephone provides services subject to hosting agreements to other cellular operators that use Pelephone's network to provide services to their customers (see Section 3.6.2B and3.6.2C.

3.5 Marketing, distribution and service

Pelephone’s distribution system includes 40 service and sales centers located around the country, which deal in service, customer sales, dealing with malfunctions or provision of a substitute handset while sending the malfunctioning handset for repair to a central laboratory owned by Pelephone, installation of handsets, and customer retention. The distribution system is reinforced with stores and stands at 90 points of sale (some of which are operated by Pelephone employees, and others by authorized dealers). In addition, Pelephone operates through dealers who run a door to door system, and service and sales representatives for the business sector. As a rule, payment to the dealers is in the form of a commission on sales.

45 Revenue from services includes revenues from cellular services (airtime, usage fees, call completion fees, roaming fees, value added services and others), and revenues from repair services and warranty.

Pelephone’s subscriber service system includes the company's website and 17 designated telephone call centers that provide information, service on various matters and in three languages, technical support, data on customer billing, value added services, sales and general information.

Pelephone's sales and service network is reviewed from time to time and changes are made therein where necessary.

3.6 Competition

3.6.1 General

Until the end of 2011, four companies with a general license for providing cellular services operated in Israel's cellular communications market ("the Existing Operators"). In recent years, the Ministry of Communications has introduced numerous regulatory measures in an effort to make the cellular telephony market more competitive by removing barriers to the movement of customers between cellular operators, by giving licenses to additional operators and creating conditions which encourage competition. During 2012, a number of cellular operators began to operate. The entry of the new operators has led to fierce competition, resulting in higher churn rates among the existing operators, to a price war which has greatly eroded prices and profits (for more information, see Section3.6.2A).

The table shows, to the best of Pelephone's knowledge, the numbers of subscribers of Pelephone and its competitors in 2011 and 2012 in millions of subscribers. The numbers are approximate.

		Pelephone	Partner	Cellcom	Mirs(1)	Hot Mobile	Total in market
At Dec. 31, 2011	No. of subscribers(2)	2,847	3,176	3,349	-	444	9,816
	Market share	29.0%	32.4%	34.1%	-	4.5%	
At Sep. 30, 2012	No. of subscribers(2)	2,839	3,042	3,338	110	687	10,016
	Market share	28.3%	30.4%	33.3%	1.1%	6.9%	

(1) Since Golan Telecom is a private company, it does not publish data about numbers of subscribers. The numbers in the table are an assessment.

(2) The numbers of subscribers (see section 1.5.4.B) are as at September 30, 2012 and December 31, 2011, based on the reports of Cellcom, Partner and Hot Mobile to the public. (As at December 31, 2012 Hot Mobile is a private company and therefore its figures are based on estimates).

(3) The number of subscribers of the virtual operators (MVNO) is not presented in the table and is estimated to be approximately 100,000 subscribers as at December 31, 2012. These figures are based on estimates.

3.6.2 Regulatory moves and legislative amendments that increased competition in the segment

Over the past few years, the Ministry of Communications has promoted various regulatory measures for increasing competition in the cellular market, which have impacted strongly on the structure of the market and competition. Below is a description of the matters promoted by the Ministry in order to increase competition in the industry:

A. Entry of other operators with infrastructure and sharing infrastructures

During 2011, a tender was issued for grant of frequencies and a license for cellular operators that own infrastructure. The tender was awarded to Mirs Communications Ltd. (part of the HOT-Mirs Group), and Golan Telecom Ltd. Under the tender conditions, the winners will be able to launch their activity after they have deployed a cellular network that initially covers 10% of the population of the State of Israel. Following this deployment, the new operators will be able to utilize the existing operator networks for a period of up to 7 years (with a possible extension based on approval for three more years), and based on the national roaming model.

According to the tender, Mirs Communications Ltd. will pay NIS 710 million and Golan Telecom Ltd. will pay NIS 360 million in license fees (**"the Maximum License Fees"**) at the end of 5 years. The maximum license fees will be reduced by one seventh (1/7) (about 14.3%) for every percent (1%) market share accumulated in the private sector over a five-year period from the date of granting the license, so that if a New Operator manages to gain 7% of the private market, it will not pay any license fees.

To guarantee payment of the license fee, the New Operators provided bank guarantees in favor of the Ministry of Communications for the amount of the maximum license fees.

In May 2012, Golan Telecom Ltd. and Hot Mobile (which was one of the four existing operators prior to the launch and operated a cellular network based on IDEN technology) launched their activity ("the New Operators"). The entry of the New Operators immediately caused much stronger competition in the cellular market between all the cellular operators. After launching their operations, the New Operators offered customers cellular communication packages which are significantly cheaper than the packages offered by the cellular operators who were in the market prior to the launch. Like the other cellular operators, Pelephone responded to this new competition by launching new packages which reflect a substantial decline in income per subscriber.

As part of the competitive measures, Partner launched a discount brand called 012mobile, and Cellcom launched a communications package offering a combination of cellular communications, fixed-line communications internet and international calls.

As part of the competition, during the second quarter of 2012 "unlimited" communication packages were offered for the first time. In these packages, the subscriber pays fixed usage fees and is entitled to make unlimited use of the services in accordance with the terms of the plan. These packages are the principal packages currently being offered on the cellular market, alongside the basic packages which include low usage fees, if any, allowing customers to use the services up to a certain amount, and beyond this limit they are charged according to their excess consumption. The stronger competition, alongside the removal of regulatory barriers to the movement of customers (see Section D) led to a trend for communications packages without a device (SIM only).

This more intense competition has led to a higher churn rate, a price war, and significantly lower prices for communications packages for hundreds of thousands of subscribers.

Pelephone expects these trends to continue in 2013, leading to a significant erosion of revenues and profitability. Pelephone is introducing streamlining measures in an effort to reduce the impact on profit.

Pelephone's aforementioned estimates are forward-looking information, as defined in the Securities Law. These estimates may not materialize, may materialize in part or may materialize in a manner materially different from that forecast.

In July 2011, the Ministry of Communications issued a press release listing the main recommendations of the inter-ministerial committee on "the sharing of infrastructures in the cellular market". These are the key recommendations:

1. A model of forced sharing of sites will be defined, giving preference to the possibility of involving the new operators.

2. Obtaining a permit to set up a site will be conditional on a proposal for cooperation for all operators.

3. The operators will be obligated to erect sites that facilitate sharing with up to four participants.

4. All the components and infrastructures used for broadcasting from the facility will be shared, excluding active designated equipment (radio equipment).

5. With respect to sharing on a new site, all the costs of the site (recurring and non-recurring) will be divided equally among all the participants, and regarding an existing site, the on-going costs will be divided equally among the participants, and in addition non-recurring costs in respect of adjustment only, arising from the new participants' involvement in the site, will be divided among them.

6. All license holders will be encouraged and obligated to reduce the number of unshared sites each year.

Implementation of the recommendations requires them to be legislated. Implementation of the recommendations imposes significant restrictions on Pelephone's ability to expand its network, but may lead to savings in expenses and investments.

Pelephone has written to the State Attorney, submitting its reservations to the aforesaid recommendations. These reservations focus on the requirement to reduce the number of existing sites that are not shared and the economic model for the sharing of costs, whereby new participants in existing sites will only be required to bear their share of the "adjustment costs" and not the full costs of erecting the site.

B. Domestic roaming agreements

In November 2011, Pelephone signed an agreement with Hot Mobile in which Hot Mobile will acquire from Pelephone (exclusively), for its subscribers, domestic roaming services on Pelephone's UMTS/HSPA network and the parties will cooperate on the sites. The agreement is until December 31, 2014. Following a malfunction on Pelephone's network in February 2013, which lasted less than four hours, Hot Mobile sent a letter to Pelephone demanding compensation for the malfunction, and noting that it considers itself entitled to enter into national roaming agreements with other operators, despite the exclusivity agreement with Pelephone. Pelephone rejected this attempt by Hot Mobile outright in a detailed reply.

In October 2011, Cellcom announced that it had signed a domestic roaming services agreement and agreement to share infrastructures with Golan Telecom Ltd

C. Mobile Virtual Network Operator – MVNO

The Ministry of Communications has currently completed its policy on MVNO and granted licenses to nine companies. Additional applications were for licenses submitted to the Ministry by various entities.

At the date of this report, there are three virtual operators including Rami Levy , utilizing Pelephone's network, based on the agreement between the companies.

D. Increased competition and the removal of barriers to switching among operators

Reform of exit penalties – until 2011, the cellular operators marketed communications packages which included a commitment period for a time period defined in the agreement (between 18 and 36 months). The agreements included exit fees if the customer terminated the agreement before the end of the commitment period. In 2011, the amount which can be collected from a cellular subscriber for terminating an agreement before the end of the commitment period was severely restricted, and in March 2012, customer exit penalties were completely eliminated for customers that hold up to 100 phone lines.

Severing the connection between the sales of terminal equipment and the sale of cellular services – in March 2012, the Knesset approved an amendment to the Communications law so that: a license holder will not make a subscriber's commitment to receive cellular services dependent on that subscriber's agreement with it or with any other license holder to purchase, rent, borrow or lease terminal equipment, either in one agreement or in separate agreements, including by way of providing a discount or any other benefit in one agreement that is dependent on the other agreement. The amendment entered into force on January 1, 2013. In the past, the principal sales method was to offer discounts on the price of the services that are dependent on the terminal equipment in the customer's possession. From the entering into force of this amendment, it will no longer be possible to offer such benefits. The severing of this connection has a negative effect on the sale of terminal equipment.

Other legislative amendments – in September 2012, a reform of the importing of cellular handsets entered into force. The reform includes two alleviations which are exemption from obtaining a trade license and exemption from the need to obtain type approval for the import of cellular devices that comply with accepted European and American standards. Pelephone believes that implementation of the reform may intensify competition in the terminal equipment market.

3.6.3 Positive and negative factors that affect Pelephone's competitive status

A. Positive factors

1. A high quality cellular network with extensive deployment.
2. A high-speed, advanced cellular network.
3. A service array and diverse service interfaces for the customer, enabling a high grade of customer service.
4. A wide distribution array that is skilled in providing appropriate solutions for every type of customer, with a skilled staff.
5. Strong capital structure and positive cash flow.
6. Pelephone has agreements with cellular operators which utilize Pelephone’s network.

B. Negative factors

1. As a subsidiary of Bezeq, Pelephone is subject to regulatory restrictions for entering other areas of operation and expanding its service bundle for customers – regulations that do not apply to its competitors.
2. Limitations of joint activities with Bezeq, including in the marketing of joint service bundles – see Section 1.7.2.
3. The frequencies available to Pelephone might not be suitable, in certain cases, to the application of technologies being developed in cellular technology. In view of these developments, this factor could impede Pelephone in applying new technologies, and could also impact adversely on its competitive status, taking into account other license-holders who might have different frequencies, some of which are likely to be suitable to those technologies, and difficulties involved in new frequency allocations (see Section 3.15.1.B).
4. Inferiority to competing networks in the pre-paid market (use of terminal equipment at lower cost), stemming, *inter alia*, from the absence of a range of low-cost terminal equipment that operates in the UMTS/HSPA network.

3.7 Property, plant and equipment, and facilities

Pelephone's property, plant and equipment include infrastructure equipment of the core network, radio sites, electronic equipment, computers, vehicles, terminal equipment, office furniture and equipment, and improvements to leased premises.

3.7.1 Infrastructure

A. Pelephone currently operates communications networks in two main technologies:

1. UMTS/HSPA, a digital technology based on the GSM standard. This technology is globally widespread, and enables subscriber identification and the provision of service by means of a SIM card, which can be transferred from one handset to another. Among the advantages of this technology are its support for download speeds of up to 42 Mbps and upload speeds of up to 5.7 Mbps. This cellular communications network is Pelephone’s primary network..

   CDMA digital technology, which is less widespread than UMTS/HSPA and in which subscriber identification is by the identification of details burned onto his terminal equipment rather than by means of a SIM card. Until 2009 the CDMA network was the Pelephone's only network and it operates nationwide. This network serves a limited number of subscribers who seldom use the network.

2. Since the UMTS/HSAP network was launched, Pelephone is working to transfer existing subscribers from CDMA to UMTS/HSPA, and offers them an upgrade of their handsets to the new network. It is not increasing its investments in the CDMA network beyond the needs of current maintenance.

B. At the date of publication of this report, Pelephone's UMTS/HSPA infrastructure is based mainly on two switch farms, connected to more than 2,100 sites.

C. In the years after the launch of the UMTS/HSPA network, Pelephone also expanded the network, gradually upgrading it to support a higher data communication capacity on HSPA+ technology and significantly expanded the capacity of the network center for voice and data traffic and the capacity of the network's sites in areas of heavy use. Investments in 2013 are projected to be current, including further significant enlargement of network capacity, in an amount not materially different from 2012.

Pelephone's assessment of investments in the network are forward-looking information as defined in the Securities Law, based on the company's work plans and its assessments of network investment needs. This forecast might not be realized, inter alia in circumstances of changes in the market situation in Israel and in demand for Pelephone's services, material changes in the costs of investing in the network.

3.7.2 Space used by Pelephone

Pelephone does not own spaces, and leases from others, including the Company, the areas it uses for its operations. Below is a description of the main areas used by Pelephone.

A. The areas referred to in Section 3.7.1 and used by Pelephone for setting up communications sites and network centers, are located all over the country and are leased for various periods (in many cases, for 5 years with an option to extend for another 5 years). Concerning the licensing of the sites, see Section 3.15.4

B. Some of the leased communications sites (see Section 3.15.4) are in Israel Lands Administration ("the Administration") areas. Pelephone entered into an agreement with the Administration to use land in those areas for the erection and operation of communications sites. Among other things, the agreement regulates payments to which the Administration is entitled for the period to December 31, 2008. At the end of the term of the agreement and in the event of its cancellation for causes listed in it, Pelephone must vacate the site. To the best of Pelephone's knowledge, the other cellular operators have a similar agreement with the Administration. The agreement was extended to December 31, 2010. Since 2010 negotiations have been held with the Administration to conclude the terms for further use of the sites in the Administration areas.

In October 2012, the Council of the Lands Administration passed a resolution concerning the conditions of umbrella agreements with the cellular operators for the purpose of erecting small broadcasting sites. The decision stipulated, inter alia, that the umbrella agreement will be signed for the period from January 1, 2011 (termination of the previous agreement) until December 31, 2019, and that the Council empowers the ILA administration to define rules in the umbrella agreement concerning the settlement of debts and absence of claims.

C. Pelephone's head office, which has been in Givatayim since 1997, covers an area of 17,800 sq.m. In January 2010, Pelephone signed an agreement for the extension of the term of the lease to December 31, 2015, which includes an option for a further extension to November 2020.

D. For sales and services, Pelephone leases 58 service centers and points of sale all over the country.

E. Pelephone has other lease agreements for its warehouses (including a main logistics center where the central laboratory for repairing customer devices is located), offices, call centers, and two switch farms that it uses for its activity.

3.8 Intangible assets

3.8.1 Licenses

For details about Pelephone's cellular license and its license to operate in the Administered Territories, see Section 3.15.2.

3.8.2 Right to use frequencies

Pelephone is entitled to use frequencies by power of the cellular license and the Telegraph Ordinance, in the 850 MHz range for the CDMA network, and in the 850 MHz and 2100 MHz ranges for the UMTS/HSPA network. For details about the scarcity of frequencies in Israel, see Section 3.15.1B. For details about exposure to disturbances in the frequency ranges used by Pelephone, see Section 3.20.3.

3.8.3 Trademarks

Pelephone has a number of registered trademarks, the main one being "Pelephone".

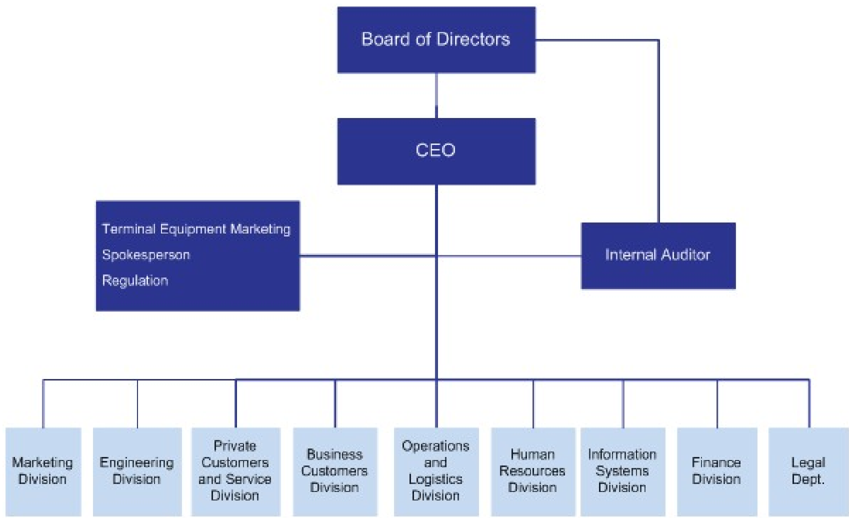
3.8.4 Software, computerized systems and data banks

Pelephone uses software and computerized systems, some of which are under purchased licenses and of which were developed by Pelephone's information systems department. Many of these licenses are limited in time, and are periodically renewed. The main systems used by Pelephone are an Oracle Application ERP system and an Amdocs billing system.

3.9 Human resources

3.9.1 Organizational structure

The organizations structure of Pelephone is shown in the diagram below:



3.9.2 Negotiating a collective labor agreement

After Pelephone received notice from the New Labor Federation (Histadrut) in September 2012, that it constitutes a representative workers union of Pelephone employees, Pelephone informed the Histadrut that rejected the notice of representation. In January 2013, Pelephone withdrew this notice, and the parties therefore began to negotiate a collective labor agreement.

3.9.3 Inventory of positions

The table shows the number of positions[46] at Pelephone, by organizational structure.

Department	Number of positions December 31, 2012	Number of positions December 31, 2011
Management and HQ	223	279
Content and product marketing	57	96
Service – Private customers	1,592	2,206
Business customers	463	533
Operation and logistics	347	344
Engineering and information systems	505	583
Total	**3,187**	4,041

3.9.4 Training

Pelephone invests resources in professional training for the various types of employees and the areas in which they work. Training is mainly in sales and service, especially for the Service Department and private customers.. The employee population serving as sales and service representatives and as telephone service attendants has a high turnover that necessitates constant investment in training new workers.

3.9.5 Reward plans for employees and managers

Pelephone customarily gives its employees and managers bonuses and incentive pay on a monthly, quarterly or annual basis, depending on the attainment of defined targets and on the type of work done by the employee. On the officers' remuneration plans in the Group see section 2.9.6.

3.9.6 Employment contracts

All Pelephone employees are employed under standard personal agreements according to the professions and roles in which they are employed (regarding negotiations for a collective agreement see section 3.9.2).

Most of Pelephone's employees are employed under monthly or hourly wage agreements. Most of the service and sales employees are shift workers who work part time and are employed on an hourly basis. Pelephone's other employees are employed under monthly agreements, and some of them are employed under global agreements. The advance notice period applicable to Pelephone employees is generally overlaps the period defined by law. A longer advance notice period applies to employees in management positions and positions of trust. The employment agreements include restrictions concerning confidentiality, non-competition, and intellectual property.

3.10 Suppliers

3.10.1 Suppliers of terminal equipment

Pelephone purchases some of the terminal equipment and accessories from importers in Israel, and some it imports independently. The agreements with most of the suppliers are based on framework agreements that set out, among other things, the supplier's technical support for the terminal equipment it supplies, the availability of spare parts and the repair cycle time, and the supplier's liability for the products as required by law. Most of these agreements do not include an undertaking to purchase, which is made on a regular basis by means of purchase orders according to Pelephone's needs.

If an agreement with a particular supplier of terminal equipment is cancelled, Pelephone can increase the quantity purchased from other suppliers or purchase from a new supplier.Pelephone has an agreement with Apple Distribution International for the purchase and distribution of iPhone handsets in Israel, which is in force until March 2013. Pelephone is negotiating to extend the agreement, which will probably include an undertaking to purchase a minimum quantity of handsets. These handsets account for a substantial share of the handsets which are sold by Pelephone. In 2012, Pelephone's purchases from Apple accounted for less than 10% of its purchases from all its suppliers. Other than Apple, the distribution of the purchase of terminal equipment among the suppliers is such that it does not create any significant dependence on a particular equipment supplier or model.

46 The number of positions at Pelephone is the total work hours divided by the standard monthly work hours.

An agreement between Pelephone and Eurocom Cellular Communications Ltd, the Israeli distributor of Nokia and ZTE terminal equipment,[47] regulates the purchasing and supply relations of Nokia and ZTE products to Pelephone and the maintenance service for those products, through December 31, 2015. The agreement was approved by the general meetings of Pelephone and of the Company, as a transaction in which the controlling shareholder in the Company has a personal interest. For details, see the transaction report and notice of convening a special general meeting, dated October 11, 2012, which is cited here by way of reference,

3.10.2 Infrastructure suppliers

The infrastructure equipment needed for the UMTS/HSPA network is made by Ericsson, and for the CDMA network by Nortel and Motorola. Pelephone has long-term agreements for the maintenance, support and upgrading of software for the UMTS/HSPA network with Ericsson. In the opinion of Pelephone, it could become dependent on Ericsson in connection with support for this network. Pelephone maintains the Motorola and Nortel equipment independently, In addition, the cellular network uses transmission, for which the Company is Pelephone's main supplier.

3.11 Working capital

3.11.1 Working capital according to GAAP

Pelephone's working capital for 2012 includes current assets such as: cash and cash equivalents, trade payables, accounts receivable and inventory totaling NIS 2,169 million less current liabilities such as: current maturities of loans from banks and debentures, loans from a principal shareholder, suppliers and service providers, creditors and accounts payable, current tax liabilities, totaling approximately NIS 1,054 million.

3.11.2 Credit policy

Credit in handset sales transactions – Pelephone grants most of its customers who purchase cellular handsets an option to divide the payments of up to 36 equal installments.

To reduce exposure that may result from extending credit to its customers, Pelephone examines the financial reliability of customers (based on parameters defined by Pelephone) and determines limits to the level of credit given to customers.

During 2012, Pelephone began to discount customers' debts arising from the sale of terminal equipment in transactions paid in installments by credit card. The discounting transactions are carried out on a no-recourse basis. During the period ended December 31, 2012, Pelephone discounted a total of NIS 165 million (the gross amount is not capitalized).

Credit by monthly debit for cellular services – Pelephone customers are debited once a month in debit cycles made on various days in the month, for use of the services provided in the previous month.

From most of its suppliers, Pelephone receives credit for a period ranging from 30 days to ECM + 92 days.

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[47] Eurocom Cellular Communications is a company indirectly controlled by Mr. Shaul Elovitch, the controlling shareholder (indirectly) in the Company.

Average customer and supplier credit in 2012:

	Credit in NIS millions	Average credit days
Customers – sales of terminal equipment*	2,316	**599**
Customers – services*	678	**65**
Suppliers	520	**46**

* Net of doubtful debts.

3.12 Financing

3.12.1 General

Pelephone's operations are financed out of cash flow from operating activities. It has long-term loans from banks, private (non-tradable) debentures, and loans received from the Company.

The average effective interest rate in 2012 for Pelephone's loans:

Source of finance	Amount at Dec. 31, 2012 (NIS millions)	Currency or linkage	Average interest rate	Effective interest rate
Banks	97	CPI-linked NIS	4.50%	4.55%
Non-bank	353	CPI-linked NIS	4.62%	4.67%
Loan from parent company	549	Fixed interest NIS	5.75%	5.75%

In 2012, a new long-term loan of NIS 440 million was received from the Company, and loans from the Company in the total amount of NIS 646 million were repaid. Likewise, repayment of loans and debentures amounted to NIS 177 million.

3.12.2 Restrictions

A. Undertakings towards banks

As part of the arrangements in connection with banks in Israel providing it with credit, Pelephone made an irrevocable undertaking to those banks to comply with financial covenants, mainly these:

1. Pelephone's total debt will not exceed three times its equity.

2. If its debt exceeds 2.5 times its equity and for as long as they do so, Pelephone will not distribute dividends and will not pay management fees to the shareholders. If Pelephone violates this undertaking, it must pay the bank, within 120 days from the demand, the entire credit facility provided at that date by the bank, or alternatively, it must remedy the violation by increasing its equity or repaying its debt so that the ratio is maintained.

3. Total debt (including guarantees and less cash and cash equivalents) should not exceed NIS 3.8 billion (linked to the known CPI in January 2002). The amount of the debt will be reviewed once every quarter as appears in the reviewed financial statements.

4. No fixed or floating charge can be imposed in any shape or form and of any type or rank, on Pelephone's assets unless it obtains the banks' prior written consent.

5. No security or charge on Pelephone's assets or guarantee to secure credit for the shareholders, can be provided for Pelephone's shareholders or any third party, without the prior written consent of the banks.

6. No loans or credit can be provided for Pelephone's shareholders, except for the parent – Bezeq, without the prior written consent of the bank, and provided that the ratio of its debts does not exceed 2.5 times its equity.

7. Undertaking to a particular bank – In addition to these covenants, Pelephone undertook to ensure that the cumulative amount of all its debts and liabilities towards a particular bank does not exceed at any time a sum equal to 40% of all its debts to financial entities, including debenture-holders.

Pursuant to legal position 104-15 of the Securities Authority from October 30, 2011, hereunder are further disclosures concerning compliance with financial covenants of reportable credit:

Binding financial covenants	At December 31, 2011	At December 31, 2010	Maximum ratio required
Total debts not to exceed equity x 3	0.56	0.70	3.00
Total debts not to exceed NIS 3.8 billion (linked to CPI known in January 2002. On Dec. 31, 2012, debt is NIS 4.88 billion.	1.66	2.22	4.88
Undertaking to a certain bank that debts to it will not exceed 40% of Pelephone's total cumulative debts to financial entities, including debenture holders	13.6%	13.6%	40%

B. Immediate repayment of a loan

The bank financing agreements include standard causes for immediate repayment of the loan, among them cases of insolvency proceedings, merger or change of control without the lender's approval, or a cross-default event.

C. Issuance of debentures

In 2004-2005, Pelephone issued three series of CPI-linked debentures by way of a private placement to institutional investors, in a total amount of NIS 1,133 million par value, in consideration of their par value.

Clal Finance Trusts 2007 Ltd. currently serves as the trustee. The debentures are not secured by a charge, and the terms of the negative pledge and Pelephone's financial covenants towards the banking system in Israel apply also to the debenture-holders (see sub-section A above). The deed of trust includes standard causes for immediate repayment of the debentures, including insolvency proceedings or violation.

D. At December 31, 2012, Pelephone is in compliance with its undertakings towards the banks and the debenture-holders.

For additional information about the composition of the loans and debentures, their terms and maturity dates, in the reporting period, see Note 13 to the 2012 Financials.

3.12.3 Credit facilities

As at December 31, 2012, Pelephone has no approved credit facilities at banks.

3.12.4 Guarantees and charges

See Note 19 to the 2012 Financials.

3.12.5 Credit rating

For issuances of debentures (see Section 3.12.2C), Pelephone was rated AA- by Midroog.

In February 2013, Standard & Poor’s Maalot, which rates Pelephone's debentures, announced that it was lowering the rating for Pelephone’s local debentures to AA with a stable outlook, from AA+/negative outlook.

3.12.6 Pelephone' assessment for raising capital and its sources

Pelephone expects to repay approximately NIS 400 million of its loans during 2013, of which NIS 222 million was received from the Company, and plans further (current) investments in property, plant and equipment (see Section 3.7.1 Pelephone expects that it will not need to raise capital in 2013 for its current operations.

3.13 Taxation

See Note 8 to the 2012 Financials.

3.14 Environmental risks and their management

3.14.1 Statutory provisions relating to the environment and applicable to Pelephone's operations

The broadcasting sites used by Pelephone are "sources of radiation" as defined in the Non-Ionizing Radiation Law. The erection and operation of these sites, excluding those listed in the Schedule to the law, requires a radiation permit.

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

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

With regard to the Operation Permit, by law, grant of the permit is contingent on implementation of the Limiting Measures and to measuring the exposure levels of human beings and the environment to the radiation generated when operating the source of radiation, and the levels not exceeding the maximum exposure levels set by the Commissioner in the law. Furthermore, by law, grant of the Operation Permit is contingent on presentation of a license under the Communications Law and presentation of a permit pursuant to the Planning and Construction Law except when a building permit is not required, in which case the law directs that the applicant submit a statement to the local committee specifying the reasons that a building permit is not required for the source of radiation. If the local council engineer or district planner does not object to granting the Operation Permit within 21 days from the day the statement is submitted, the applicant must submit an additional statement stating that the aforementioned period has passed and no such objection has been made.

The law includes a punitive chapter under which, inter alia, the construction or operation of a source of radiation in contravention of the provisions of the permit and the construction or operation of a source of radiation without a permit, after having been warned in writing by the Commissioner, are strict liability offenses.

A small number of city engineers have acted according to the mechanism provided in the law and have announced that in their option, a particular access facility requires a building permit, and have objected to the grant of an Operation Permit for that facility.

The Minister for Protection of the Environment also promulgated regulations pursuant to the Non-Ionizing Radiation Law ("**the Regulations**") that address issues such as fees for permits, the method of measuring radiation, etc.

It should be noted that regulation of the maximum permissible human exposure levels to radiation from a source of radiation and the safety ranges from communication broadcasting installations, including a limit on the placing of radiation masts on roof terraces, is still making its way through the Knesset’s interior Committee for Environmental Quality, as part of a proposed amendment to the regulations which was accompanied by disagreements between the government ministries.

In January 2009, the Radiation Supervisor at the Ministry for Protection of the Environment published guidelines regarding safety ranges and maximum permitted exposure levels with respect to radio frequency radiation, including from cellular aerials.

A discussion by the Interior Committee for Environmental Quality on May 4, 2011 resolved to ask the Minister for Protection of the Environment to delete from the wording of the proposed amendment to 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. The Minister for Protection of the Environment replied to the committee chair that his ministry cannot agree to the request. In view of the above, promulgation of the amendment has been delayed.

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).

In this instance, it should be noted that from time to time, various documents are published on the website of the Ministry for Protection of the Environment at www.sviva.gov.il, and on the website of the World Health Organization www.who.int.

It is further noted that the Ministry of the Environment continuously monitors and supervises the broadcasting sites, operating a system which allows the use of computerized recordings from the control system in the broadcasting sites, to check and verify that the broadcasting sites are in compliance with the Ministry's requirements.

Cellular services are provided by means of a cellular phone which emits non-ionizing radiation (also known as electromagnetic radiation). Consumer Protection Regulations (Information regarding Non-Ionizing Radiation from a Cellular Telephone) 5762-2002, specify the maximum permitted radiation level for a cellular phone measured in units of Specific Absorption Rate (SAR) and informing Pelephone's customers accordingly. As far as Pelephone is aware, all the cellular phones that it markets comply with the relevant SAR standards. See also Section 3.20.2.E.

3.14.2 Legal proceedings

For details of material legal proceedings allegedly relating, according to a claim made by the plaintiffs, to topics linked with electromagnetic radiation, see Section 3.17.1.B. It should be noted that Pelephone’s existing insurance policies do not cover electromagnetic radiation damage. In view of an explicit exclusion in the terms of the policy resulting from a global trend, it is difficult to buy significant insurance cover at a reasonable cost for this matter.

3.14.3 Pelephone's policy for environmental risk management

Pelephone conducts periodic radiation tests in order to ascertain its compliance with permitted operation standards and the standards of the International Radiation Protection Agency. These tests are outsourced and performed by companies authorized by the Ministry for Protection of the Environment.

Pelephone has an internal enforcement procedure for supervision of implementation of the provisions of the Non-Ionizing Radiation Law whereby a senior manager is responsible for this implementation. The purpose of the procedure is to assimilate the provisions of the law and limit the possibility of violation thereof.

Transparency for consumers

Pelephone is subject to relevant laws that define obligations to publicize and inform customers about the sources of the radiation that it operates and the mobile handsets that it supplies.

The Radiation Supervisor at the Ministry for Protection of the Environment publishes information on the ministry's website about active cellular broadcasting facilities and those that are under construction. The Ministry for Protection of the Environment continuously monitors the cellular broadcasting facilities that Pelephone erects and operates, as it does to the other operators.

On its website, Pelephone publishes information about radiation emitted from cellular phones and Ministry of Health regulations regarding preventive caution when using cellular phones.

3.15 Restrictions on and control of Pelephone's operations

3.15.1 Statutory limitations

A. Communications Law and the cellular license

Pelephone's provision of cellular services is subject to the provisions of the Communications Law and its regulations. For details of the cellular permit granted to Pelephone by power of the Communications Law, see Section 3.15.2.

The law qualifies the Director-General of the Ministry of Communications to impose financial sanctions for various breaches of the provisions of the law and ordinances and provisions by virtue thereof, and for breaches of the terms of the permit. On the government law memorandum from 2011 – amendment to the Communications Law on the subject of financial sanctions, see Section 1.7.3F.

B. Wireless Telegraph Ordinance

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

For several years, the Government has been coping with the existing shortage of radio frequencies for public use in Israel (inter alia, due to the allocation of a great many frequencies for security uses), by limiting the number of licenses issued for the use of frequencies, on the one hand, while increasing fees payable in respect of the allocation of frequencies on the other. The shortage of frequencies is also liable to cause difficulties in implementing certain technologies (e.g. advanced technological infrastructures such as LTE – see Section 3.1.5A).

For the allocation of radio frequencies to Pelephone, see Section 3.8.2.

C. Installations emitting electromagnetic radiation – See Section 3.14.

D. Consumer Protection Law

During the course of its operations, Pelephone is subject to the Consumer Protection Law which regulates the obligations of an operator vis-à-vis consumers.

E. Change in interconnect fees (call completion fees)

For details of a significant reduction in the interconnect fees paid to the cellular operator, see Section 1.7.3C.

3.15.2 Pelephone's cellular licenses

A. General

Pelephone's general license is valid until September 8, 2022.[48]

Likewise, in April 2001, the Civil Administration for the Administered Territories granted Pelephone a general license for the provision of cellular services in the Administered Territories. The license is valid until September 2022 and the provisions of the general license granted to Pelephone by the Ministry of Communications are applicable to it.

The following are the main provisions of Pelephone's cellular license:

1. Under certain circumstances, the Minister is entitled to modify, restrict or suspend the terms of the license, and in certain instances to even revoke it.
2. The license is non-transferable, and it contains restrictions on the acquisition or transfer (including by way of a charge), directly or indirectly, of control or of 10% or more of any means of control in Pelephone, including an encumbrance on said means of control, unless the Minister has given his consent beforehand.

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48 The text of Pelephone's cellular license is published on the website of the Ministry of Communications www.moc.gov.il.

3. Pelephone is obliged to provide an interconnect service under equal terms to all other operators and it shall refrain from any discrimination in the implementation thereof.

4. Pelephone must refrain from preference in the provision of infrastructure services to a licensee a company with an interest (as defined in the license) over another licensee.

5. Pelephone is not entitled to sell, lease or mortgage any of the assets used for the implementation of the license without the consent of the Minister of Communications, except for certain deviations stipulated in the license (see also Note 19.7 to the 2012 Financials):

6. In times of emergency, whoever is statutorily competent shall have the authority to issue Pelephone with certain instructions on its mode of operation and/or manner of provision of services (see section 3.20.2.H).

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

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

9. To secure Pelephone's undertakings and to compensate and indemnify the State of Israel for any damage caused by acts committed by Pelephone, Pelephone is required to furnish a bank guarantee for USD 10 million. The license determines the instances in which such guarantee may be forfeited.

B. Changes in Pelephone's license

As mentioned, the Minister is empowered to change the terms of the license, add to or subtract from them. In January 2013, the Ministry of Communications published a hearing on "Charges for roaming services abroad," of which the principal points are:

1. Blocking of new and existing subscribers browsing services abroad by default.

2. Sending an alert via text message (SMS) to subscribers who have purchased an overseas roaming package and reached a utilization rate for each component of the package purchased.

3. Blocking subscribers from using roaming services abroad after they have fully utilized the package they purchased.

4. Blocking subscribers who use overseas roaming services only occasionally when their bill reaches approximately NIS 100.

Pelephone's revenues from roaming services could be adversely affected depending on the results of this hearing. Pelephone submitted a detailed response to Communications Ministry hearing and asked that a frontal hearing be held before making a decision.

3.15.3 Royalties

For information about the royalties and their elimination commencing in 2013, see Section 1.7.3.B.

Pelephone paid about NIS 32 million in royalties for 2012 for its current operations this year, the rate of the royalties for 2012 was 1.3% of revenues liable for royalties. For 2011, Pelephone paid approximately NIS 48 million as royalties on its current operations in that year. That same year it paid 1.75% of its liable revenues as royalties.

3.15.4 Site construction licensing

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

Pelephone uses two main types of broadcasting sites and in two tracks: macro sites that require a building permit from planning and construction committees (see reference to NOP 36) and wireless access devices ("**access devices**"), which are exempt from a building permit in accordance with Section 27 of the Communications Law and Section 266(C) of the Planning and Construction Law ("**the Exemption Provision**").

Building permits by power of NOP 36

Licensing the construction of cellular broadcasting sites that require building permits is governed by NOP 36, which came into force in 2002.

The NOP 36 licensing process requires, inter alia, obtaining a number of approvals from government authorities and regulators, including: (a) approval for construction and operation from the Ministry for Protection of the Environment (see Section 3.17.1); (b) approval of the Civil Aviation Administration in some cases; and (c) approval of the Israel Defense Forces.

In addition, under the law, a condition for licensing the construction of a cellular broadcasting facility is that entities requesting permits submit an indemnity note to the local council relating to claims for compensation in respect of impairment of value pursuant to Section 197 of the Planning and Construction Law, and the indemnity will be a full indemnity (100%). At the date of this update, Pelephone has deposited 234 indemnity notes with various local councils in accordance with the law.

Despite NOP 36 in its existing format, Pelephone (and its competitors) encounter difficulties in obtaining some of the required approvals, and in particular approvals from planning and construction authorities.

At the same time, criticism has been leveled at NOP 36 by various entities (including the argument that it is not applicable to 3G frequencies), which has led to a proposal to amend NOP 36 in a number of rounds ("**the Proposed New NOP 36A**").

If it takes effect, the wording of the Proposed New NOP 36A/1 will replace the current NOP 36. The new version is stringent and burdensome compared to the current version, and will complicate and impede the process of obtaining building permits for cellular sites. The amended NOP 36 is currently pending government approval.

At the date of preparing the report, Pelephone is aware of an initiative to appoint a joint technical consultant to the Ministry of the Interior and the Ministry of Communications to help review the issue of the new NOP 36/A proposal and the possible deployment of broadcasting facilities.

Access devices exempt from building permits

The second track under which Pelephone sets up broadcasting sites is the access device track. Access devices require specific radiation permits according to the Radiation Law but are exempt from a building permit if they are constructed pursuant to the conditions provided in the Exemption Provision.

Some local authorities have disputed the applicability of the Exemption Order to access devices of a cellular network and its use. Pelephone's position on the applicability of the exemption was accepted in a number of rulings and decisions by local affairs courts and the use of such facilities and the supporting equipment was approved. One decision in the same instance gave an opposite ruling. Appeals have been filed for some of these rulings and decisions, some of which are still pending before the Supreme Court.

On September 9, 2009, the Attorney General summarized his position on the legal issue of access devices whereby the frequencies regulations for access devices which contain the exemption from a building permit for wireless access devices as prescribed in Section 266C of the Building and Planning Law, were duly promulgated by authority and by law. Nevertheless, the Attorney General determined that in view of the legal and factual changes which have taken place over the years since the regulations were promulgated, and in view of their importance, which were discussed and clarified during the team's deliberations and in its report, the arrangement in its present format does not properly balance the interest of efficiency and competition with the interests embodied in the Building and Planning Law. The Attorney General further stipulated that the Ministries of the Interior and Communications shall, by the end of October 2009, file amendments which will prescribe conditions limiting and restricting the applicability of the exemption from a building permit and use of that facility.

On June 16, 2009, the Forum for Cellular Sanity and others filed a petition (this petition was preceded by another petition to local government from July 2008 which centered on the issue of access devices) to the High Court of Justice ("HCJ") for an order nisito instructing the Attorney General to explain, inter alia, why the State Prosecutor's response regarding Pelephone's application for permission to appeal must not be withdrawn, and to explain why the enforcement instructions issued to the urban claimants by the Attorney General should not be cancelled, whereby indictments are not to be filed or administrative demolition orders to be issued in respect of the erection and operation of cellular access devices without building permits.

On September 9, 2010, an update notice was sent by the State to the HCJ whereby on September 7, 2010 the Minister of the Interior sent a draft of the Planning and Construction (Installation of a Cellular Wireless Communication Access Device) Regulations, 2010 ("**the Access Device Regulations"**) for approval to the Knesset Economics Committee. The proposed Access Device Regulations determine highly restrictive conditions for application of the exemption from a building permit for a wireless access device.

In a later update notice sent by the State to the HCJ on September 15, 2010, the State announced that the Attorney General believes, inter alia, that due to the delay in presenting the Access Device Regulations for additional discussion and approval by the Economics Committee, instead of an interim order, a temporary order should be granted for the petitions which will ban the construction, with an exemption from a building permit, of additional wireless access devices used by the cellular licensees to provide cellular services, until the promulgation of access device regulations and until the validation of the basic arrangement stipulated therein. The Attorney General also clarified that the basic arrangement in the access device regulations reflects the desired balance between all the various considerations relevant to the matter and in light of this, if the access device regulations are approved and promulgated and the basic arrangement determined therein takes effect, he believes the HCJ will have no grounds for intervention to include the cellular frequency sector in the access device frequency regulations.

In view of the aforesaid, on September 16, 2010 the HCJ handed down a temporary injunction as requested in the notice of the Attorney General to the government dated September 15, 2010, and it was stipulated that the injunction would be valid until validation of the arrangement determined in the draft access device regulations or until otherwise decided. On February 16, 2011 the HCJ qualified the temporary injunction so as to permit the cellular companies to exchange access devices which were no longer used or which were not in working order, subject to the terms laid down in the HCJ ruling. The temporary order remains in place.

On April 13, 2011, the State submitted a further announcement to HCJ whereby on April 11, 2011, the Tendering Committee announced the two winners of the tender for new cellular operators in Israel. On August 30, 2011, the State submitted a further revised announcement to HCJ, according to which, inter alia, the Attorney General is of the opinion that a decision should be made that the temporary injunction should be restricted under certain conditions to a pre-defined period, until July 31, 2012, with respect to the new operators only. In view of the foregoing, on September 6, 2011, HCJ qualified the temporary injunction it had issued consistent with the conditions put forward by the Attorney General in his response from August 30, 2011.Other HCJ rulings determined that the temporary injunctions will remain in effect until September 30, 2013.

Pelephone believes that if the access device regulations are approved as proposed, the option of using the exemption from the building permit track in order to erect cellular access devices will be restricted to a very significant degree. A restriction of this track, together with the proposed tightening of the terms for construction of base sites in the parallel Proposed New NOP 36A track is likely to lead to noticeable tightening at the level of the obstacles restricting the construction of new broadcasting sites and access devices and even to have an adverse effect on the quality of the cellular network.

Pelephone uses access devices to provide coverage and capacity to highly populated areas. Reducing or preventing use of the access devices track in a given geographical area may have an adverse effect on service in those areas. If it is legally required that sites in a given geographic area be simultaneously demolished, service in that area is liable to deteriorate until substitute broadcasting sites can be built. As at the date of this report, Pelephone operates 499 wireless access devices.

Summary: Pelephone’s ability to maintain and preserve the quality of its cellular services as well as its coverage is based partly on its ability to construct cellular sites and install information equipment, including broadcasting sites. The difficulties encountered by Pelephone in obtaining the licenses and approvals required may have an adverse effect on the existing infrastructure, network performance and on the construction of the additional cellular sites required by the network.

Inability to resolve these issues in a timely manner is liable to prevent the achievement of the service quality targets laid down in the cellular license.

A few sites constructed years ago still lack approvals from the Civil Airport Administration and the IDF, even though applications for the approvals were submitted a long time ago. Furthermore, there are administrative or other delays in some of the building and planning committees in issuing building permits to sites. Pelephone is consequently operating a number of broadcasting sites before obtaining the requisite building permits. Applications for the building permits were submitted by Pelephone to the building and planning authorities and are at various stages of discussion or approval.

Construction of a broadcasting site without a building permit constitutes a breach of the law and in some cases it has led to the issuing of demolition orders of sites or the filing of indictments or instigation of civil proceedings against Pelephone and some of its officers.

At the reporting date Pelephone has succeeded in most of the above cases in refraining from demolition or delaying implementation of the demolition orders as part of arrangements made with the planning and building authorities in order to attempt to regulate the missing licensing. These arrangements did not require an admission of guilt and/or conviction of Pelephone's officers. Notwithstanding, there is no certainty that this situation will continue in future, or that there will be no further cases where demolition orders will be issued and indictments will be filed because of building permits, including against officers.

Like other cellular operators in Israel, Pelephone might be required to dismantle broadcasting sites before the requisite approvals and permits have been obtained, on the dates stipulated in the law. If it is legally required that sites in a given geographic area be simultaneously demolished, service in that area is liable to deteriorate until substitute broadcasting sites can be built

3.15.5 Antitrust

The document setting out the terms of the merger between Pelephone and the Company includes various restrictions as to cooperation between the companies which were updated in 2010 (see Section 2.16.8E).

3.15.6 Standards

Pelephone conducts routine durability and quality control tests of its facilities. The quality control and supervision do not detract from Pelephone’s responsibility towards its customers for the quality of the services it provides.

Pelephone complies with the requirements of Israeli Standard ISO 9001, 2008 version for mobile radio telephone (cellular) services and it undergoes periodic inspections by the Standards Institute of Israel to confirm compliance with the standard. The IQC, control and quality certifications are valid until December 2013.

Once a year, an inspection is conducted to ensure that Pelephone's operations comply with the requirements of the standard. The last inspection was carried out in December 2012, and was successful.

3.16 Substantial agreements

The Company has an agreement with the Accountant General in the Ministry of Finance to supply mobile telephone services to government ministries through February 2014 with an option for two additional years. As of December 31, 2012 the Company is supplying end equipment and mobile telephone service to 106,000 subscribers in the framework of this agreement.

For undertakings to banks, see Section 3.12.2.A.

For trust deeds signed with Union Bank Trust Co. Ltd. at the time of issue of debentures, see Section 3.12.2.C.

For an agreement with Israel Lands Administration, which expired in December 2010, and Pelephone is negotiating its renewal, see Section 3.7.2.B.

For agreements with Apple and with Eurocom Cellular Communications, see Section 3.10.1.

For agreements with Ericsson, see section 3.10.2

For agreements with cellular operators (Hot Mobile and Rami Levi Cellular Communications), see Section 3.6.2.

3.17 Legal proceedings[49]

As part of its normal course of business legal claims have been filed against Pelephone, including applications for certification as a class action.

3.17.1 Pending legal proceedings

Following are details of the claims whose claimed amounts are material and claims which could have material implications for Pelephone's operations:

A. In July 2008, a claim was filed in the Tel Aviv District Court together with a motion to certify it as a class action.The total amount of the claim is NIS 240 million. The claim is for the refund of amounts which the plaintiffs allege was over-collected from Pelephone's subscribers, as follows:

The defendant (Pelephone) collects interest in arrears from a subscriber who is late in paying Pelephone, as well as "rescheduling" interest where payments are rescheduled, in ostensible violation of Pelephone's license. Also, Pelephone collects payment in respect of a standing order, handling fees for the voucher and commission for payment of a voucher at a service center, ostensibly in contravention of its license.

B. In May 2010 a claim was filed in the Tel Aviv District Court together with a motion to certify it as a class action. The claim was filed against the four cellular companies (Pelephone, Partner, Cellcom and Mirs) where the amount of the claim against each of Pelephone, Partner and Cellcom is NIS 3.68 billion and the total amount of the claim (against the four companies) is more than NIS 12 billion. The applicants argue that the cellular companies are in breach of the following duties: (1) to erect cellular antenna sites of the required scope, proportion and deployment; (2) to check, correct and provide information about the non-ionizing radiation values in cellular handsets after repair, etc.; (3) to warn against the risks involved in how the cellular handset is held. The application includes numerous other declaratory reliefs and applications for writs of mandamus relating to the above matter. In January 2013, Pelephone signed a compromise settlement with the plaintiffs to settle the claim in return for Pelephone verifying and ascertaining certain matters relating to the claim and in return for the sale of earphones to customers at a reduced price for a period. This arrangement has been submitted to the court and is awaiting approval.

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

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49 With regard to reporting policies and materiality see section 2.18.

D. In December 2010, a claim was filed in the Central District Court together with an application for its certification as a class action. The amount of the claim is not specified. The applicant alleges that Pelephone withholds from its subscribers one or more monthly benefits due to the fact that the date of the first invoice is not necessarily the same as the actual date of joining the plan. In May 2012, the court dismissed the application for certification, and in June 2012 the decision was appealed in the Supreme Court.

E. In March 2011, a claim was filed in the Petach Tikva District Court (Central Region) together with an application for its certification as a class action. The amount of the action is NIS 122 million. The applicants allege that Pelephone intentionally conceals significant limitations pertaining to benefits on selected destinations and even acts in contravention of the communications agreement with respect to these destinations

F. In August 2011, a motion was filed at the Petach Tikva District Court against Pelephone, Cellcom, and Partner, together with an application for its certification as a class action. The amount of the action against the respondents is not specified. The action addresses the charge for calls made overseas when the call time is rounded up to a whole minute, and this, as alleged by the claimant, is contrary to the provisions of the license and in contravention of the law.

In September 2012 the court dismissed the claim and the motion for certification as a class action. In November 2012, the applicants filed an appeal against the ruling in the Supreme Court.

G. In February 2012, a claim was filed in the Jerusalem District Court against Pelephone, Cellcom, Partner and the Company, together with an application for its certification as a class action. The amount of the action is NIS 361 million. The claim relates to a failure to comply with the provisions of the law with respect to handicapped customers when rendering telecommunication services. In this matter, see also Section 2.18.8.

H. In March 2012, a claim was filed against Pelephone in the Tel Aviv District Court, together with an application for its certification as a class action. The grounds for the claim are that Pelephone makes false representations to the public according to which it provides a surfing experience on its network at extremely high speeds. According to the plaintiffs, they conducted dozens of measurements showing that the surfing speed on the respondent's cellular network is lower than specified. According to the claim, this state of affairs caused and causes cumulative personal loss of NIS 560. The amount of the application is estimated in the total amount of about NIS 242 million, subject to data to be produced by Pelephone as part of the proceeding.

I. In May 2012, a claim was filed against Pelephone in the Tel Aviv District Court, together with an application for its certification as a class action. The amount of the action is NIS 124 million. According to the applicant, Pelephone does not inform customers who wish to join its services with a handset which was not purchased from the Company, that insofar as the handset does not support a frequency of 850 MHz, they will only have partial reception on one frequency rather than two.

J. In August 2012, a claim was filed against Pelephone in the Tel Aviv District Court together with a motion for its certification as a class action. The action was filed against three cellular companies - Pelephone, Partner, and Cellcom. The amount of the claim is estimated at NIS 120 million for each of the defendants. Additionally, orders for mandamus and declaratory relief were requested. The applicants allege that as part of the repair services which the defendants provide for payment (payment for the repair or a monthly payment for the repair service), if a certain part in the handset must be replaced, the defendants do not provide the customer with the spare part, and this in contravention of the law. Additionally, the defendants use the replaced part in future when providing repair services for other customers, thus ostensibly enriching themselves twice.

K. In February 2013, a claim was filed against Pelephone in the Nazareth District Court together with a motion for its certification as a class action. The applicant alleges that due to a nation-wide malfunction on Pelephone's network on February 3, 2012, from 19:00, the applicant as well as other Pelephone customers were disconnected from Pelephone's services for several hours and were unable to use their cellular handsets to receive or make calls and for SMSs. As a result, they incurred losses. The total amount of the class action is NIS 450 million.

In March 2013, another claim against Pelephone was filed in the Jerusalem District Court, with a petition for certification as a class action suit, for an amount estimated at about 160 million. According to the applicant, the plaintiff group members are all cellular telephone customers, including customers of companies hosted on the network (Rami Levi and Hot Mobile).

3.17.2 Legal proceedings that ended during the Reporting Period

A. In December 2000, the State of Israel filed a claim with the District Court in respect of royalties allegedly owed for the period from January 1994 until February 1996. The amount being claimed is NIS 260 million, including principal, linkage differences and interest. In September 2010, a ruling was issued against Pelephone and accepting some of the State's arguments. The amount the Company was obligated to pay amounted to approximately NIS 150 million, (including principal, linkage differences and interest), and it was paid in October 2010. In October 2010, Pelephone appealed the decision in the Supreme Court. The appeal was dismissed in August 2012.

B. In December 2007, a claim was filed in the Tel Aviv District Court against Pelephone, Cellcom and Partner, together with a motion to approve it as a class action in the amount of NIS 1 billion. The claim relates to radiation damage from cellular antennae which were ostensibly erected unlawfully. In June 2012, the court approved the plaintiff's abandonment of the action.

C. In March 2010, a claim was filed in the Tel Aviv District Court together with a motion application for its certification as a class action. The total amount of the claim is about NIS 4.2 billion, the amount of the claim against Pelephone is NIS 2.1 billion. The applicants allege that the Company operates in contravention of its license and the law as it does not purchase liability insurance for injury to person arising from the exposure to cellular radiation. The application also includes requested relief for an order instructing the Company to take out such insurance. In November 2012, the applicants' abandonment of the motion to certify the action as a class action was approved, and their personal claim was dismissed.

D. In June 2010, a claim was filed in the Central District Court together with a motion to certify it as a class action. The amount of the personal claim is NIS 958 (plus linkage differences and interest). The total amount of the action is not specified, however the application notes that it is estimated to be hundreds of millions of shekels. According to the applicant, Pelephone collects payment from its customers for services to which the customers have not requested to subscribe, and transfers their personal information to external suppliers without their approval, which contravenes the agreement and the law. The claim is for the restitution of this money. The application also includes relief for orders instructing Pelephone, inter alia, to desist from collecting these amounts and from transferring the information to suppliers. In March 2012 the motion and claim were dismissed further to the plaintiff's request.

E. In November 2011, a claim was filed in the Haifa District Court together with a motion for its certification as a class action. The amount of the action is NIS 285 million. The grounds for the claim are the recording of service conversations by Pelephone customers at the service stations without their knowledge and without terminating the recording when the representative was not with them. Pelephone therefore infringed on their right to privacy. In April 2012 the court resolved to approve abandonment of the claim and the motion for its certification as a class action.

F. In January 2012, a claim was filed in the Tel Aviv District Court together with a motion for its certification as a class action. The amount of the action is NIS 381 million. The grounds for the claim are the unlawful updating of service tariffs for business customers. In February 2013, the Tel Aviv District Court dismissed the suit and the application for recognition as a class action.

G. In June 2012, a claim was filed against Pelephone in the Tel Aviv District Court together with an application for its certification as a class action. The applicants allege that the Pelephone is in violation of Section 30A of the Communications Law, by sending marketing messages (spam), despite the applicants' failure to agree to receive them. The amount of the application is estimated in the total amount of NIS 455 million. In September 2012 the court resolved to approve abandonment of the claim and the motion for its certification as a class action.

H. In August 2012, a claim was filed against Pelephone in the Tel Aviv District Court together with a motion for its certification as a class action. The plaintiffs contend that Pelephone unlawfully collects a monthly fee from its customers for payment by standing order. The amount of the application is estimated in the total amount of NIS 161 million. In February 2013 the court resolved to approve abandonment of the claim and the motion for its certification as a class action.

I. In September 2012, a claim was filed against Pelephone in the Tel Aviv District Court together with an application for its certification as a class action. The applicant alleges that Pelephone does not include a call details record in its phone bill, and this contrary to Ministry of Communication instructions and Pelephone's license. The total amount of the class action is about NIS 109 million. In February 2013, the request for approving a class action suit was erased by the court for inaction. For similar suits that have been filed, see Section 2.18.9.

J. In September 2012, a claim was filed against Pelephone in the Tel Aviv District Court together with a motion for its certification as a class action. The plaintiff contends that Pelephone unlawfully collected money for: the cost of a cellular handset, a cancelled phone line, surfing services, various services, as well as for collection expenses and voucher fees. The amount of the application is estimated at NIS 57 million for the causes claimed plus NIS 1,000 for distress for each member of the group. It should be noted that a class action is currently being conducted against Pelephone, in which some of the grounds for the claim are similar to those in this claim (see Section3.17)

3.18 Business objectives and strategy

Pelephone’s main strategic objectives are these:

3.18.1 Growth and continued dominance of data services

A. Increasing revenues from data services by focusing on a target audience, increased marketing of mobile devices, cellular modems (NetStick) and smartphones.

B. Marketing of supplementary value-added services to surfing such as anti-virus, backup and data storage, Musix and video services

C. Increasing data transfer speeds and maintaining the leading image as the company with the fastest network in Israel.

3.18.2 Continued recruitment and retention of quality customers.

3.18.3 Increase customer satisfaction

3.18.4 Constant improvement of network infrastructures

3.18.5 Streamlining of operations.

3.19 Outlook for development in the coming year

In 2013, a number of factors are expected to affect Pelephone’s activities, the main ones being:

3.19.1 The continuing fierce competition and price wars

Pelephone expects that the price wars between the operators will continue in 2013 as well.

3.19.2 Cellular network innovations

In 2013, Pelephone expects to continue to invest in the cellular network and solidify its position as the owner of the fastest, highest quality and most advanced network. Together with the investment in the network, Pelephone expects to launch and promote several services which will help increase its revenues and improve its image compared with competitors. These services include anti-virus, data storage and backup, music and video services and surfing packages for tablets and cellular modems (Netstick).

3.19.3 Increase in use of services by Pelephone subscribers

Pelephone expects that as a result of the erosion of tariffs and the increase in the number of subscribers using smartphones, there will greater use of data communications and the average number of minutes used per subscriber will increase.

3.19.4 Collective agreement negotiations

Pelephone expects that during 2013 the negotiations for a collective agreement will continue.

3.19.5 Allocation of LTE frequencies

Pelephone expects that during 2013, the Ministry of Communications will make progress on the tender for allocating LTA frequencies and will actually allocate the frequencies.

Pelephone's above assessments of developments in the year to come are forward-looking information as defined in the Securities Law. These assessments are based, inter alia, on the state of competition in the cellular sector, the existing regulatory situation and the manner in which innovative changes are implemented in regulation. These assessments might not be realized or might be realized in a materially different manner from the one already described, depending, inter alia, on the structure of the competition in the market, changes in the consumption habits of cellular customers and regulatory developments in the segment.

3.20 Risk factors

Risk factors deriving from the macro-economic environment, the unique qualities of the sector in which Pelephone operates, and risk factors that are unique to the Company.

3.20.1 Macroeconomic risks

Exposure to changes in exchange rates, interest rates and rates of inflation – Pelephone is exposed to risks due to changes in the exchange rates, as most of its terminal equipment, accessories, spare parts and infrastructure are purchased in US dollars, whereas Pelephone's revenues are in shekels. An erosion of the shekel against the dollar may affect Pelephone's profitability if it is unable to adjust the sale price in the short term. Pelephone's loans and debentures which are linked to the CPI bear fixed interest so that any change in the interest rate will affect their fair value but not their book value.

3.20.2 Sector risks

A. Investments in infrastructure and technological changes – The cellular market in Israel and in other countries is characterized by material capital investments in the deployment of infrastructure and in subscriber equipment. The frequent technological changes in infrastructure and terminal equipment and the fierce competition in various market segments impose a heavy financial burden on the companies operating in the market, requiring them to update their infrastructure technology from time to time or to introduce new devices into the market at heavy costs.

B. Customer credit – Pelephone’s sales to its customers are mostly credit-based. Most of this credit, which is not covered by either insurance or sureties, is exposed to risk. It is noted that the credit is spread among a large number of customers and Pelephone's collection mechanisms are efficient and competent.

C. Regulatory developments – In the area of Pelephone’s operations, there is a trend to legislate and impose standards on issues such as the environment, increased competition, tariffs, product liability and the methods used for repairing products. These regulations might, *inter alia*, make it much more difficult to construct cellular sites, impairing network quality, and increasing the costs of services and marketing, which could erode Pelephone's profits. Furthermore, regulatory intervention and the uncertainty it entails may have an adverse effect on Pelephone’s ability to plan its business activity.

D. Competition – The cellular market in Israel is characterized by a high degree of saturation, by competition that is likely to intensify as a result of the entry of additional operators, and is exposed to influences due to technological and regulatory developments (see Section 3.6).

E. Electromagnetic radiation – Pelephone operates hundreds of transmission facilities and sells terminal equipment that emits electromagnetic radiation (see Section 3.14). Pelephone is taking steps to ensure that the levels of radiation emitted by these transmission facilities and terminal equipment do not exceed the levels of radiation permitted in the directives of the Ministry of Environment Protection (levels adopted in accordance with international standards). Even though Pelephone acts according to the directives of the Ministry of Environment, if health risks are found to exist or if the transmission sites or terminal equipment are found to emit more radiation than that allowed in radiation standards, constituting a risk to health, this could have a negative effect caused by a reduction in the use of Pelephone's services, difficulty in renting sites, compensation claims for physical and property damages in substantial amounts and attempts to exercise the deeds of indemnity that were deposited with the planning authorities with respect to section 197 of the Planning and Construction Law. Pelephone's third-party liability policies do not currently cover electromagnetic radiation.

F. Site licensing – The establishment and operation of cellular antennas are subject to building permits from the various planning and building committees, a process that involves, inter alia, a number of approvals from State entities and regulatory bodies. For details of the difficulties encountered by Pelephone in the establishment and licensing of sites, see Sections3.14. These difficulties may impair the quality of the existing network and even more the deployment of the new network.

G. Serious malfunctions in the information and engineering systems - Pelephone's information systems are networked throughout the country through designated communications lines and through the internet. Pelephone's business is highly dependent on these systems. Wide scale malicious damage (e.g.: viruses and cyber-attacks) or malfunction may adversely affect Pelephone's business and its results.

H. Economic emergency - during a state of emergency, legislative provisions and certain other provisions of the Mobile Radio Telephony Law invest in the competent authorities powers to take the necessary measures to guarantee the security of the state and/or the public wellbeing, including: an obligation for Pelephone (as a cellular license holder) to provide services to the defense forces, the appropriation of engineering equipment and facilities which belong to Pelephone, and even to take control of the system.

3.20.3 Pelephone's risk factors:

A. Property risks and liabilities – Pelephone is exposed to various property risks and liabilities. Pelephone employs the services of expert professional external insurance consultant in this field. Pelephone has insurance policies which cover the usual risks which Pelephone is exposed to within the limits of the conditions of such policies, including various forms of property insurance and liability insurance, loss of profits, third party liability insurance and officers' insurance. However, its policies do not cover some types of risk, including certain faults arising from negligence or human error, radiation risks, terror, etc.

B. Serious malfunctions in the communications network – Pelephone's communications network is deployed around the country through network core sites, antenna sites and other systems. Pelephone's business is totally dependent upon these systems. Wide scale malicious harm or malfunction might adversely affect Pelephone's business and results.

C. Damage by natural disasters, war, catastrophe - damage to the switching farm and/or servers used by Pelephone for its core activities could have an adverse effect on Pelephone's business and its results.

D. Legal proceedings – Pelephone is a party in legal proceedings, including class actions, which will possibly result in it being charged for material amounts that cannot presently be estimated and generally no provision has been made in Pelephone's financial statements for these proceedings. Class actions may reach high amounts, since approximately one third of the residents of Israel are Pelephone consumers, and a claim relating to a small amount of damage to a single consumer may grow into a material claim against Pelephone if certified as a class action applicable to all or a large proportion of those consumers.

E. Labor relations and collective bargaining – Pelephone is currently negotiating with the Histadrut workers' committee to formulate a collective labor agreement. The negotiating process may cause some labor unrest and harm Pelephone's on-going activity. Likewise, the collective labor agreement may limit management flexibility and impose additional costs on Pelephone. (See Section 3.9.2).

F. Frequency ranges: 850 MHz and 2100 MHz. In certain situations Pelephone's frequency inventories might not be suited to the implementation of new technologies emerging in the cellular communication sector in a manner which could make it difficult for Pelephone to implement them. This would have having an adverse effect on Pelephone's competitive status, since the other licensees have a different frequency inventory, some of which might suit those technologies and on the difficulties entailed by the allocation of new frequencies (see Section 3.15.1B). Furthermore, the frequencies are exposed to interference and could impair service quality of networks operated by Pelephone. The factors that could cause interference include the fact that the 850 MHz frequency is also used for terrestrial television broadcasts by television stations in the Middle East on the same frequency, causing interference in Pelephone's 850 MHz UMTS/HSPA network. Furthermore, the Jordanian networks use the same frequency range of 2100 MHZ that Pelephone may use and in view of the limited cooperation between the operators in Jordan and Pelephone, this could have an effect.

Below is a chart grading the effect of the above-mentioned risk factors on Pelephone's operations, as assessed by Pelephone's management. It should be noted that Pelephone's assessments of the effect of a risk factor reflect its effect based on the assumption that the risk factor will be realized. Nothing in the aforesaid expresses an assessment or gives weight to the chances of such a realization. The order in which the risk factors appear above and below is not necessarily in accordance with the extent of the risk.[50]

Effect of risk factor on Pelephone's activities as a whole			
Risk factors	**Major**	**Moderate**	**Minor**
Macro-economic risks			
Exposure to changes in the exchange rates, interest rates and inflation			X
Sector risk			
Investments in infrastructures and technological changes	X		
Customer credit		X	
Regulatory developments		X	
Competition	X		
Electromagnetic radiation	X		
Site licensing	X		
Severe malfunctions in information systems	X		
Emergency situation in the economy	X		
Pelephone's risk factors:			
Property risks and liabilities			X
Severe malfunctions in the communications network	X		
Natural disasters	X		
Legal proceedings		X	
Difficulties in work relations and human resource issues		X	
Frequency ranges		X	

The information contained in Section 3.20 and Pelephone's assessments of the effect of risk factors on its operations and businesses is forward-looking information as defined in the Securities Law. The information and assessments rely on data published by the Ministry of Communications, Pelephone's assessments of the market situation and its competitive structure. With regard to possible developments in the market and in the Israeli economy, the actual results are likely to be materially different from the above assessments if there is a change in one of the factors taken into account in making them.

50 See footnote 47.

4. Bezeq International – international communication and internet services

4.1 General

4.1.1 Structure and changes to area of operations

Bezeq International operates in a number of key areas: supply of ISP services; supply of international telephony services; domestic internal telephony services, based on a VoB infrastructure; supply of NEP services; supply of ICT (infrastructure and communication systems) and data services.

The international telephony services of Bezeq International, similar to those of the international operators which are its competitors, are supplied mainly via the Company's domestic network and that of HOT, and the cellular networks, for connecting the subscriber to the international exchange.

4.1.2 Legislative and statutory restrictions applicable to Bezeq International

The areas of operation of Bezeq International are primarily regulated by the Communications Law and its regulations, and the communications licenses awarded to Bezeq International (see Sections 4.14.1 and 4.14.2). Moreover, Bezeq International is subject to consumer legislation.

For the key regulatory developments applicable to Bezeq International, see Section 4.14.6.

4.1.3 Changes in the sector's volume of operations and profitability

For information regarding changes in the scope and profitability of Bezeq International's operations, see Section 1.5.4C.

4.1.4 Market developments and customer characteristics

The international call market in Israel has in recent years been characterized by a decline in call volume – in 2012 the volume of call minutes (incoming and outgoing) declined by 0.7% and an average decline of 4.4% in 2011.

In the internet market in 2012, there was a continuation of the trend toward a slowdown in the growth rate in light of the high penetration percentage (approximately 68% of Israeli households are connected to the internet), alongside a rise in surfing rates used. As a rule, an increase in demand for higher surfing speeds requires an increase from time to time in the capacity operated by Bezeq International on the submarine cable that it owns (Jonah cable) and the international capacity in which it acquired usage rights (for details of other infrastructure providers of Bezeq International, see Section 4.10.2).

4.1.5 Main entry and exit barriers

A. The main entry barrier in the international call market is the requirement for a license under the Communications Law and investments in infrastructure (the volume of investments in infrastructure is lower than the volume of investments in a domestic carrier or cellular infrastructure), which is affected by frequent technological changes. However, change in the licensing policy, as set forth below, and expansion of the use of VoIP technology in this field, significantly reduces the effect of these barriers.

B. The main entry barrier into the data and internet services market stems from investments in infrastructure (international capacity, access to the internet network and broad service network).

C. The main exit barriers for these markets stem from long-term agreements with infrastructure suppliers and from investments that require long periods of time to provide returns. Furthermore, Bezeq International is committed to providing service to its customers throughout the period of their contract.

4.1.6 Substitutes for Bezeq International products

In the international call market, the use of VoIP technology enables transfer of international calls over the internet, for other users of this technology, as well as for TDM network users, through the use of software products (such as Skype) and services of overseas communication providers, and the attractive cost of using these services leads to a steady growth in the number of users, and as a result – a decline in the revenues of Bezeq International. Furthermore, some service providers operating in the international call market do not have a license (illegal operators) and therefore are not subject to the debts imposed on Bezeq International by power of the license and the provisions of the law.

4.1.7 Structure of competition and changes in the sector

A. At the date of this report, eight international carriers operate in the international telephony arena (including two cellular companies that won the most recent frequency tender: Golan Telecom International Ltd. and Hot Mobile International Communications Ltd.).To date, about 40 companies have received licenses to provide internet access, five of which have international operator (ITS) licenses.

On February 15, 2012 Hot Net began providing internet access services under the special license to provide ISP services that it received.

During 2012 the sale of international direct dial services began as part of the unlimited packages offered by the cellular operators.

4.2 Products and Services

Below are details of the main products and services provided by Bezeq International.

4.2.1 Internet services

In the internet services sector, Bezeq International provides internet access services for private and business customers, including terminal equipment and support, with an emphasis on broadband internet based on ADSL, transmission or cable infrastructures; hosting services – site storage and server services in a designated installation, including value-added services (such as monitoring and control); information security services, services securing internet connections and LAN networks using the required terminal equipment or software, including monitoring; data services with IP-based international data communication solutions for business customers, including global deployment; and high-speed wireless (WIFI) access, including in public locations (hotspots).

4.2.2 Voice (telephony) services

In the voice services sector, Bezeq International provides international direct dialing (IDD) services to business and private customers; toll-free number services for business customers overseas; international call routing and completion services (hubbing) – transfer of international calls between foreign communication providers (worldwide), telephone card services enabling prepaid and postpaid dialing from Israel; and the 1809 service for dialing from Israel to other countries. Bezeq International also provides domestic telephony services by means of VoB (Voice over Broadband) access using BIP.

4.2.3 International data services

Supply of international data communication solutions for business customers includes customized global deployment.

The customer is able to choose from a range of the most advanced data communication methods through the submarine cable deployed by Bezeq International (on this, see Section 4.6.4) and the optic cables deployed from Israel to Europe for which Bezeq International has long-term usage rights and through its business partnerships with leading global telecom providers such as BT, which make available to their customers their sophisticated global network services.

4.2.4 ICT solutions for business customers

Bezeq also provides ICT (Information and Communication Technology) solutions for business customers; as part of the customer's overall ICT solution Bezeq International provides broad communications services, including international data and communication services, server and site hosting services, technical support and maintenance services, network and system services, outsourcing and out-tasking services, security and risk management solutions, managed IP services, advanced, unique cloud computing services and online backup services.

4.2.5 PBX services

Bezeq International markets and maintains communication systems in the Israeli market, exchanges, telephony networks and IP communications. As part of the service contracts, Bezeq International supplies direct maintenance of a range of exchange manufacturers. The services are given to gateways, exchanges and network end points (NEP) designated for use with both internal and external lines.

4.3 Revenue

Bezeq International's revenue (in NIS millions):

	2012	2011	2010
Revenue from international carrier services	383	413	501
% of total revenue	28.58%	30.51%	36.30%
Revenue from internet and communication services for businesses (ISP, ICT, data)	957	941	879
% of total revenue	71.42%	69.49%	63.70%
Total revenue	**1,340**	**1,354**	**1,380**

4.4 Customers

Bezeq International has no customer whose revenues constitute 10% of its revenue. Below is a breakdown of revenues from private and business customers:

NIS millions	2012	2011	2010
Revenue from private customers	546	540	523
Revenue from business customers	794	813	857
Total revenue	**1,340**	**1,354**	**1,380**

4.5 Marketing, distribution and service

4.5.1 Marketing

The marketing department coordinates all the operations for a number of permanent suppliers, among them advertising companies representing Bezeq International, which are used by Bezeq International to remain in contact with the advertising media (television, internet, radio and the daily national press), production and post-production companies (this changes depending on the requirements of each campaign), design and printing companies, and sales promotion companies. Bezeq International believes that the loss of contact with any of its permanent advertising or marketing suppliers will have no significant effect on its marketing and distribution channels.

4.5.2 Private market sales channels

A. Telephone recruitment and retention centers for internet and telephony service customers.

B. National direct sales setup conducting door-to-door operations, operating points of sale and managing customers.

C. Technical support and service centers for customers by means of telephone service and support centers.

D. Distribution channel setup including external centers and field systems for resellers and dealers.

E. Sale of Bezeq International services by the Company in the form of joint service bundles (see Section 1.7.2B).

4.5.3 Business market sales channels

These channels include customer recruitment centers, business service and solution centers, and customer managers according to customer type (SMB, SME customers designated for outsourcing transactions, etc.).

4.6 Competition

The main characteristic of market competition in 2012 was the merging of communication groups and offering of comprehensive services and products – see Section 1.7.1.

Competition is characterized by a particular trend of tariff erosion.

4.6.1 International telephony services

A. At the end of 2012 there were eight competitors in the market:014 Bezeq International, 013 Netvision, 012 Smile, 018 Xfone, HILAT Telzar International Communication Services Ltd., Golan Telecom International Ltd., and NGN International Communications 015 Ltd.

Bezeq International estimates that its market share in outgoing international calls from customers is approximately 27.2% compared to a market share of approximately 30% at the end of 2011[51].

B. General characteristics of competition in 2012

1. A rise in call minute volume, in the fourth quarter, due to the sale of unlimited packages (see Section 4.1.4).
2. About 45% of households make international calls at least once a month.
3. The competition centers on various sectors of the population.
4. The product is a commodity.
5. The fierce competition and penetration of VoIP technology (such as Skype) increase competition for customers.

4.6.2 Internet access services

A. There are a number of competitors in this market, including Bezeq International, 013 Netvision which merged with Cellcom, 012 Smile, which merged with Partner, (as described in section 1.7.1B), Hot Net and two minor niche players whose share is not material.

Bezeq International believes that its market share in the internet services sector is 38.85% compared with a market share of 37.5% at the end of 2011[52].

B. General characteristics of competition in 2012

1. High penetration – approximately 68% of households in Israel are connected to the internet, according to CBS information.
2. There are two alternatives for customers in the market: the Company’s ADSL and the HOT cable infrastructure.
3. HOT frequently cooperates with Bezeq International’s direct competitors. In addition, as noted above, in February 2012, HOT entered independent internet access operations through HOT-Net

C. Developments in 2012

1. Upgrade of the internet infrastructures (the Company and HOT) and increased speeds offered to customers – the Company’s NGN network and HOT's UFI network (DOCSIS 3.0) enables internet access providers and infrastructure providers to offer a range of speeds from 10MB through 100MB.
2. Strengthening of the trend of selling service bundles.
3. Continuation of the trend toward a rise in the sale of value-added services.

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[51] Bezeq International's assessment of its share of the outgoing customer calls segment at the end of 2012, as well as its estimate that 45% of households make overseas calls at least once a month, are based on market surveys that were conducted by an outside survey center. The market segment reflects the results of studies on the percentage of callers using Bezeq International from the entire surveyed population who make overseas calls.

[52] Bezeq International's estimate of its market segment in the internet access sector is based on a calculation of the ratio between the number of subscribers it has, and the total number of ISP subscribers (based on public data for the Company and HOT).

4. In view of the market saturation, an emphasis is placed on strengthening customer loyalty.

5. In January 2012, Bezeq International launched the Power NGN network, a high-speed internet access network which relies on the advanced technology capabilities of the new submarine cable (Jonah cable) that it owns, together with new, state-of-the-art core and access systems that it operated.

4.6.3 Communication solutions for the business sector

With the aim of increasing revenues from business customers, Bezeq International continues to supply ICT (Information Communication Technology) services, providing full solutions in areas such as system, networking, IT, hosting, voice, data, ISP, wireless (wireless networks), and cloud computing.

The solution is a full solution model for the customer, which does not rely on outside suppliers and a single contact person, who bears full responsibility for the process and deals with the customer (one supplier, one responsibility).

A. ICT – In this sector Bezeq International is facing new competitors, such as Binat, Taldor, and IBM. In 2012 Bezeq International continued to establish its position in the ICT market and gained recognition and accreditation, as well as considerable admiration and prizes for its technical and business excellence and leadership from leading providers in the market.

B. NEP services - The traditional field of telephone exchanges is characterized by a large number of competitors and by fierce competition which has given rise to an erosion of service prices. The most prominent competitors are Tadiran, Eurocom, GlobeCall and Tel-Yad. Data communications and IP telephony (adapting switchboards and terminal equipment to IP technology) is characterized by the entry of new players from the IT world. These are companies such as Binat, Teldor, Malam Team and IBM. These companies are substantially different from traditional NEP companies and are on a higher technological level. Telecommunication companies are also conglomerating and new operators are entering the market with the intention of providing customers with total communications solutions such as telephony, transmission, data communications, internet, and information security.

4.6.4 International communications infrastructure

A. During December 2011 Alcatel-Lucent Submarine Networks successfully completed the laying of the sea-bed optical fiber communications cable between Israel and Italy, for Bezeq International, which has started to use it commercially.

International capacity passes through the submarine cable, of the kind consumed by Bezeq International before it was established from Med nautilus (see section 4.10.2), serves Bezeq International and its various customers, in addition to the capacity on the Med Nautilus network in which Bezeq International purchased usage rights.

B. During January 2011, TamaresLtd. announced completion of laying a sea-bed cable between Israel and Cyprus and the purchase of continuing capacity to Western Europe.

C. On November 3, 2011, the Ministry of Communications published a hearing concerning regulation of the submarine cable sector from Israel.[53] The decision of the Ministry of Communications on this matter could affect the activities of Bezeq International in sales to this market.

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53 On October 11, 2011 the Antitrust Commissioner declared Mediterranean Nautilus a monopoly in the provision of two-way international transmission over optical fibre, in segments between the landfall point in Israel and the first landfall point abroad.

4.7 Property, plant and equipment

Bezeq International has Veraz SoftSwitch switches. These switches are used to route Bezeq International's voice traffic. The value-added services, including dialing cards, are based on an intelligent network (IN) .

Bezeq International's technological infrastructures, which support voice, data and internet setups, are deployed in five sites, inside and outside Israel, inter alia, to provide services with high survivability.

Bezeq International has a long-term lease for the two main structures in which it is based, for average periods of 6 years until 2015.

For details of the submarine cable, see Section 4.6.4.

4.8 Intangible assets

For details of the communication licenses by power of which Bezeq International operates, see Section 4.14.2.

4.9 Human resources

Following are details of the number of persons employed by Bezeq International (employees of the company, outsourced employees in 2011 and 2012:

	Number of employees	
	Dec. 31, 2011	**Dec. 31, 2012**
Corporate office employees	1,209	1261
Sales and service representatives	1,053	841
Total	2,262	**2,102**

Organizational structure

Below is a chart depicting the organizational structure of Bezeq International:

All Bezeq International employees have standard personal contracts based on their professions and the positions they fill. The salary structure for some of them contains a component of performance-linked commissions and incentives.

Conditions of employment agreements vary depending on the nature of the position. Service and sales representatives are mostly paid on an hourly basis, and some of them are entitled to commissions on sales made and/or bonuses for meeting service and/or sales targets. This also includes employees (technicians) whose work hours are often difficult to supervise, and some of them are entitled to sales commissions and bonuses for meeting targets. Some of the HQ employees who receive a monthly salary are paid a global supplement for overtime. Employees receive social supplements that vary depending on their position and rank within the organization. The advance notice period is usually one month. The employment agreements include non-competition and confidentiality clauses.

Bezeq International invests resources in professional training in accordance with the type of employee and the field in which he or she operates, such as technological training and qualification, manager development courses and more.

4.10 Suppliers

4.10.1 Foreign operators

Bezeq International has cooperation agreements with 200 foreign operators for 240 destinations worldwide.

4.10.2 Capacity suppliers

Bezeq International is dependent upon the Company for domestic capacity to provide its services.

Under its agreement with Med Nautilus, Bezeq International purchased indefeasible rights of use to a particular non-specific part of the communication capacity transferred by the undersea cable system operated by Med Nautilus between Israel and Europe for a period of up to 15 years from the date on which it started using this capacity (with an option to extend the period of use). The periods of use are at least until 2017 – 2027, depending on the date of the start of use of the capacity. Bezeq International paid for these rights of use a one-time payment shortly before the date on which it started using the capacity. During 2011, Bezeq International entered into an additional agreement with Med Nautilus to extend and regulate use of its international transmission infrastructure.

4.10.3 Downstream infrastructure and maintenance of the Jonah submarine cable

In 2011, Bezeq International purchased indefeasible rights of use in a continental infrastructure which links its points of presence to its sites in Western Europe.

Upon completion of the laying of the cable, in December 2011, Bezeq International entered into agreement with the MECMA consortium for maintenance of the cable.

4.11 Working Capital

Bezeq International’s working capital in its 2012 Financials includes current assets such as: cash and cash equivalents, trade payables, accounts receivable and inventory totaling approximately NIS 456 million, less current liabilities such as: current maturities of loans from banks and debentures, loans from a principal shareholder, suppliers and service providers, creditors and accounts payable, and allowances totaling approximately NIS 256 million.

4.12 Financing

4.12.1 General

As of the date of this report, Bezeq International has no liabilities to banks and is not using its approved credit line. The source of Bezeq International's finance in recent years has been a positive cash flow from operating activities. At the beginning of December 2011, the Company signed a loan agreement with Bezeq International, according to which the Bezeq International received a loan in the amount of NIS 160 million, to be repaid in five equal, annual installments of principal and interest beginning December 2012. During 2012 another two loan agreements were signed, at the same terms, according to which Bezeq International received NIS 40 million in each agreement.

4.12.2 Bank guarantees

In accordance with the requirements of the Ministry of Communications, Bezeq International provided a bank guarantee of NIS 10 million to fulfill all of the conditions of the license for provision of international telecommunications services. As at the publication date of the statement of financial position, Bezeq International has provided additional bank guarantees in order to meet the contractual commitments it has made in bids for tenders, and legal proceedings, amounting to NIS 16 million.

In accordance with the requirements of the Ministry of Communications, Bezeq International provided a bank guarantee in the amount of NIS 11 million to fulfill all of the conditions of the exclusive general license for providing domestic fixed line telecommunication services to B I P.

4.13 Taxation

At December 31, 2012, Bezeq International has carried forward capital losses of NIS 20 million.

In addition, Bezeq International has tax assessments that are deemed final through 2008, inclusive.

See also Note 8 to the 2012 Financials.

4.14 Restrictions and supervision of Bezeq International's operations

4.14.1 Legislative restrictions

Under the Communications Law, implementation of telecommunications operations and provision of telecommunications services, including international telecommunications services and internet access services, require a license from the Minister of Communications. The Minister is authorized to amend the terms of the license, add to them or detract from them, while taking into consideration, inter alia, the government’s telecommunications policy, interests of the public, compatibility of the licensee with the provision of services, contribution of the license to competition in the telecommunications industry, and the level of service therein.

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

A recently introduced amendment to the provisions of the Communications Law permits the Minister of Communications to prescribe telecommunications services that do not require a license.

In view of these provisions of the Communications Law, all Bezeq International's telecommunications services are provided by power of the provisions of the licenses granted to it and pursuant to the terms therein, as set forth in Section 4.14.2.

4.14.2 Licenses

A. International Telecommunications Service (ITS) license[54]

In providing voice (international telephony) and data services, Bezeq International is operating in accordance with its ITS license which is valid until 2022.

B. Special general Domestic Carrier license

On February 8, 2009 the Minister of Communication granted an exclusive general license for the provisions of domestic telecommunications services to B I P, which allows it to provide domestic telephony services via broadband internet access (VoB). On August 2, 2009, Bezeq International started providing these services to private customers and on December 30, 2009 (after the Ministry of Communications determined that the company's market share in the area of domestic telephony for the business sector had dropped below 85%) this license was amended so as to permit Bezeq International to provide the services to business customers (subject to the limitation on infrastructure through which the services are provided).

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54 The text of the international carrier license is published on the Ministry of Communications website at www.moc.gov.il.

C. Special license for the provision of internet access services

On August 10, 2009 Bezeq International received a special license to provide internet access services (ISP). The services Bezeq International is permitted to provide under this license had hitherto been provided under an ITS license. The provision of an internet license puts Bezeq International on a footing level with that of all the other ISPs who operate under a similar license. The license is valid until August 29, 2014.

D. NEP license

On December 31, 2006 the Ministry of Communications confirmed the transfer of the NEP license from BezeqCall (a company subsidiary which had engaged in the provision of NEP services) to Bezeq International, following their merger. Since the merger date Bezeq International has provided NEP services by power of this license. On April 30, 2010, its NEP license was extended until April 30, 2015.

4.14.3 Interconnect payments

For interconnect fees paid to Domestic Carriers and cellular operators, including the reduction of interconnect fees to cellular operators from 2011, see Section 1.7.3C.

4.14.4 Royalties

On this issue see Section 1.7.3.B

In 2011 Bezeq International paid royalties totaling NIS 3.4 million for that year (NIS 1.6 million for closing the dialing cards dispute from 2001) and in 2012 Bezeq International paid royalties in the amount of NIS 1.3 million.

4.14.5 Standards

Bezeq International holds ISO 9001:2000 certification for quality management systems and ISO 7799 certification for information security management systems issued by the Standards Institution of Israel.

4.14.6 Key regulatory developments

A. Following the entry into the market of additional cellular operators that also hold general licenses for providing international telephony services, there have been a large number of changes in the international calls market from mobile phones. These changes affect the scope of services provided by Bezeq International in this area and its revenues from them.

B. <u>Amendment to the licenses of Bezeq International and B.I.P. – sale of service bundles</u>

Concerning the permit granted to the Group companies to market joint service bundles to private market customers, see Section 1.7.2B. In August 2010 the company began selling joint service bundles which include Bezeq International's internet access services.

In July 2012, the Ministry of Communications amended the license of the Company and the subsidiaries, allowing the Company to offer subsidized plans which combine the services of the subsidiaries to customers in the business sector. The rules for the supply of these bundles are the same as those imposed on Bezeq regarding the marketing of joint service bundles to the private sector.

On possible changes following the Hayek Commission, see Section 1.7.3.

C. Change of tariff structure for overseas calls from a cellular network

On January 1, 2011, the interconnect charges for the cellular operators were reduced, and on January 1, 2012 they were further reduced, in the format determined in the regulations (see Section .1.7.3C).

D. In November 2012 the Ministry of Communications decided that VOC/VOB services will be regulated through a domestic carrier license (general or special), accordingly and not through a MVNO license. This decision could have a positive impact on Bezeq International’s operations which can offer the services to its customers. See section 2.6.1.C.

E. Internet license amendment

On October 31, 2012 Bezeq International received the decision of the Ministry of Communications regarding the special license it had received for providing internet access services (ISP), concerning the provisions for amending the format for drawing up an agreement with subscribers, conditions for performing a remote transaction and a transaction in the presence of the parties, provisions for documenting a subscriber's application for service, provisions for a refund in respect of an overcharge or services that were not requested, conditions for discontinuing the service, provisions concerning the format and sending of bills to subscribers, provisions concerning the option to contact the ombudsman, provisions concerning the possibility of changing plans and tariffs, provisions for the collection of debts from subscribers, provisions concerning the treatment of subscribers' complaints and the obligation to document and submit documents about this treatment, and provisions concerning the obligation to publish information about plans and tariffs. The provisions of the amendment will enter into force gradually, from December 2, 2012 until May 1, 2013. Bezeq International made the necessary preparations in good time and is continuing to implement the provisions of the amendment.

F. Amendment to the Communications Law on the filtering of offensive content

In August 2012, the Ministry of Communications amended the licenses of the ISPs (fixed and mobile), adding provisions to the licenses concerning filters for offensive sites and content, as a supplementary measure to the provisions of the law on this subject. The amendment stipulates that a license holder will be required, inter alia, to inform its subscribers about offensive sites and content on the internet which are not suitable for children and teenagers, and to include details of ways of blocking access to these sites and content. Likewise, the license holder must offer its subscribers an effective service for filtering offensive sites and content, for no additional payment.

G. Change in the format of the settlement of accounts between cellular operators and the ITS companies in the prepaid calling cards market of the cellular companies

Subsequent to a hearing held by the Ministry of Communications in July 2012, the Ministry issued an administrative instruction which prescribed that commencing in September 2012, the ITS companies will be able to split the tariff so that the price of the international call will be separate from the interconnect fee payable to the cellular company. Cellular companies will not market or give preference to one international operator over another, and they will not publish the services of any particular international operator. Likewise, the commissions which the cellular companies collect from the international call companies for marketing this service will be cancelled.

H. Sending a detailed list of annual charges

Pursuant to the provisions of an amendment to the Consumer Protection Law on the subject of the sending of an annual breakdown of customer customers, which entered into force in January 2013, Bezeq International must send all subscribers an annual list of charges for all the amounts charged from January 1 to December 31 of each year.

4.15 Cooperation agreements

On January 18, 2010 Bezeq International signed an exclusive partnership agreement with British Telecom (BT) for providing global communications services to Israeli and multi-national companies operating in Israel. As part of the strategic agreement, a master agreement with no time limit, Bezeq International will operate as the exclusive partner of BT Alliance in Israel and will market IT services and products from the global British Telecom's range of services. Any service ordered in this context, is limited to a minimum service period (depending on the category of service) that can be extended. Payment varies in line with the mix of services supplied under the agreement at any time, and payment is on a monthly basis at the conditions defined in the agreement.

4.16 Legal Proceedings[55]

Pending proceedings

4.16.1 During the second quarter of 2008, four claims were filed against Bezeq International and two other holders of licenses to provide Bezeq International's services (together "the Defendants") in the Tel Aviv District Court and in the Central District (that were later consolidated to form one claim being heard in the Central District Court). The claims related to the use of international calling cards to the Philippines, Thailand and Nepal and applications for certification as class actions. The plaintiffs, who are foreign workers, claim that the calling cards provide an average of 50% of the units of time indicated to the purchasers of the cards, Bezeq International deducts the time spent when unsuccessfully attempting to call someone from the card, contrary to the declaration, not by units of round minutes as indicated, providing misleading information about the number of units on the card and formed a cartel with other international communication companies that raised the prices of calling cards. The plaintiffs seek court permission to file their claim as a class action on behalf of groups of people that include anyone who purchased the relevant calling cards for use in calls during the seven year period prior to filing the claim or during the proceedings themselves. The plaintiffs' estimate that the damages caused to all the members of the group by Bezeq International is NIS 1,101 million. The plaintiffs also petitioned the Court to order the defendants to cease its conduct as set forth above. The court accepted the application for certification as a class action on the grounds of deception on November 3, 2010. Notwithstanding, the court dismissed some of the grounds for the claimed action and ruled that the existence of deception ceased after the purchase of a number of calling cards. The application for leave to appeal filed by Bezeq International was denied on September 19, 2012 due to the settlement agreement signed between the other defendants in the proceedings and the plaintiffs.

4.16.2 On February 19, 2012, Bezeq International received another financial claim, similar to the above-mentioned claim, together with a motion for its certification as a class action, that were filed against Bezeq International and two other licensees for the supply of Bezeq International services (all together "the Respondents") in the Tel Aviv District Court. The applicant alleges that the Respondents misled customers who purchased dialing services by means of pre-paid international calling cards with respect to the number of minutes on the card. The applicant estimates the amount claimed from Bezeq International (as well as from each of the other Respondents), in the name of the entire group, at NIS 2.7 billion.

4.16.3 On May 4, 2009, Bezeq International received a claim, together with a motion to certify it as a class action, which was filed in the Tel Aviv District Court and which deals with raising of the tariffs for internet access services following the first year of operation and charging the plaintiff for services that it claims it did not order. The applicant requests reimbursement of the excess amounts it claims to have paid which amount to NIS 2,800 and for the entire group of customers, for whom the price of the services provided to them was raised after the first year, by NIS 216 million.

On June 5, 2011, a ruling was handed down in which the court dismissed the claim and the motion for certifying it as a class action, and ordered the applicant to pay expenses of NIS 50,000. Subsequently, on September 4, 2011, this ruling was appealed in the Supreme Court.

4.16.4 On December 8, 2011, Bezeq International received a claim together with a motion to certify it as a class action which had been filed against it in the Tel Aviv District Court. According to the plaintiffs, during October 2011, Bezeq International failed to provide its internet customers with the speed it had undertaken in the contact. The plaintiffs are claiming restitution of the monthly charge and compensation for distress, and they estimate the total amount of monetary compensation claimed from Bezeq International to be NIS 120 million.

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[55] Regarding the reporting policies and materiality standard see section 2.18.

4.17 Objectives, business strategy and projected development

Bezeq International set itself the goal of continuing to lead the internet services market in Israel for private and business customers, while maintaining its revenue in its traditional markets:

4.17.1 To continue its leadership in the internet access market while continuing to realize the potential inherent in the migration to the new generation of infrastructure networks.

4.17.2 To intensify and expand its cloud-based solutions.

4.17.3 To strengthen its status as one of the leading ICT players in Israel.

4.17.4 To increase customer satisfaction by intensifying and expanding service openings (automated services, social networks, etc.).

These objectives might not be realized or might be realized only partially, due to regulatory changes liable to harm Bezeq International's ability to provide solutions to existing or changing market requirements, and due to all the other risk factors described below.

4.18 Risk Factors

Below is a description of the risk factors stemming from the macro-economic environment, the unique characteristics of the sector in which Bezeq International operates, and risk factors unique to Bezeq International.

4.18.1 Changes in exchange rates

The main currency used by Bezeq International is the New Israeli shekel, which is also its reporting currency. There is a special risk in the nature of Bezeq International's international transactions: most of its operations (sales) derive from customers in Israel. In addition, Bezeq International provides its services to customers all over the world and collects payments from them in foreign currency, mostly the US dollar. On the other hand, Bezeq International consumes services from suppliers outside Israel and pays for these services in foreign currency, mostly the US dollar. The changes in the exchanges rates of the currencies in which Bezeq International operates opposite the Israeli shekel expose the company to exchange rate differences on the gap created, which could have an adverse effect on its cash flow as well as on its profitability by increasing financing expenses. To protect itself against currency exposure, Bezeq International enters into hedging transactions and purchases other financial instruments.

4.18.2 Competition

For the effect of competition on Bezeq International's businesses, see Section 4.6.

4.18.3 Frequent technological changes and investments in infrastructure

Bezeq International's areas of operation are characterized by frequent regulatory changes. The development of technologies constituting attractive alternatives to some of Bezeq International's products (such as Skype) is likely to have a materially adverse effect on its operations.

Furthermore, the technological developments require frequent investments in infrastructure. See section 4.10.

4.18.4 Government supervision and regulation

For the application of the provisions of the law and licensing policy and their effect on Bezeq International, see Section 4.14. Changes in regulation applicable to Bezeq International could have an adverse effect on its results and operations.

4.18.5 Legal proceedings

Bezeq International is a party to legal proceedings, including class actions, some of which could result in its being required to pay substantial sums which, according to the assessment of the company’s legal counsel, could require the use of Bezeq International's financial resources. A provision has been made in the financial statements of Bezeq International and the Company for the proceedings. For legal proceedings to which Bezeq International is a party, see Section 4.16.

4.18.6 Failure of Bezeq International's systems

In the event of damage to part or all of the systems used by Bezeq International to provide its services, whether because of all kinds of technical failures or whether because of natural disasters, significant difficulties could be caused to the provision of its services.

Below is a table illustrating the effects of the above risk factors on the operations of Bezeq International, as assessed by its management. It should be noted that these assessments of the extent of the effect of a risk factor reflect the extent of its effect based on the assumption that it becomes reality and nothing in the aforesaid expresses an assessment or gives weight to the chances of such an event. The order in which the risk factors appear above and below does not necessarily accord with the rating of the risk.[56]

Summary of risk factors

The information contained in section 4.18 and the assessments of Bezeq International regarding the effect of the risk factors on its operations and businesses is forward-looking information as defined in the Securities Law. The information and assessments rely on data published by the Ministry of Communications, assessments of Bezeq International regarding the market situation and the structure of competition in it, and possible developments in the market and in the Israeli economy. Actual results may differ materially from these assessments if there is a change in any of the factors taken into account in making them.

	Effect of risk factor on Bezeq International's operation		
	Major	**Moderate**	**Minor**
Macro risks			
Exposure to changes in the currency exchange rate			X
Sector risks			
Increasing competition		X	
Investments in infrastructure and technological changes		X	
Government supervision and regulation	X		
Special risks for Bezeq International			
Exposure in legal proceedings		X	
Systems failure		X	

56 See footnote 47.

5. DBS – Multi-channel television

5.1 General Information on the segment of operation

DBS, also known by its trade name YES, provides encoded and digital multi-channel broadcast services as well as other satellite services to subscribers in Israel and the Judea and Samaria region.

DBS is the only company in Israel currently operating in the satellite multi-channel television broadcasting sector, under a non-exclusivity license.

5.1.1 Structure of area of operations and changes therein

A. The area of multi-channel television broadcasts for subscribers ("**the area of broadcasts**") is provided, in addition to DBS, by HOT which provides cable television services. HOT has a monopoly declared under the Antitrust Law in the area of multi-channel television broadcasting. HOT Telecom, a fully-controlled subsidiary of HOT, has a cable network infrastructure, including terminal equipment and broadcasting centers and it provides internet infrastructure services as well as fixed-line telephone services. On the supply of ISP services by HOT-Net, which is part of the HOT Group, see Section 1.7.1

B. Since 2009, the Second Television and Radio Authority (the "**Second Authority**") has been operating a terrestrial digital radio broadcasting system which freely broadcasts the television channels of the broadcasting authority (Channel 1 and Channel 33), commercial television channels (Channel 2 and Channel 10) and the Knesset Channel (Channel 99) to the nation. This setup constitutes a partial alternative product to the multi-channel television broadcasts.

Under the amendment to the Second Authority law dated April 2012, the DTT system will be expanded by the end of 2013, so that, inter alia, the following will be added to it: a radio channel containing national and regional radio channels, the Educational TV channel, should it make such an application, another IBA channel to be broadcast using HD technology - should it make such an application, a designated channel, should it make such an application (today there are three designated channels - a Russian-language channel a designated channel for Israeli and Mediterranean music, and an Arabic designated channel). However, the broadcasting of a designated channel in addition to five designated channels is subject to free capacity available for this purpose; the inclusion of one of the aforementioned channels will be made in consideration of payment of distribution fees; after consulting with the Second Authority Board, the Minister of Communications may order the gradual inclusion of up to 3 more "special subject channels" to be selected in a tender process, so that each special subject channel will begin broadcasting one year after its predecessor commences broadcasts and for payment of distribution fees; commencing January 1, 2014, the DTT system and operation thereof will be transferred from the Second Authority for TV and Radio to a public body, statutory corporation or government company that does not broadcast and does not supervise radio or television broadcasts, to be appointed by the Minister of Communications and the Minister of Finance, with government approval.

DBS believes that an increase in the number or range of channels distributed through the distribution system will increase the number of alternatives to DBS services and may therefore have a detrimental effect on DBS's revenues.

C. The increase in the bandwidths of communication infrastructures in Israel, alongside technological improvements enabling the transmission of video content via the internet, cellular networks and additional infrastructures, and compression capabilities enable wider use of these infrastructures for the transmission of video content. This change will lead to material developments:

1. Transmission of video content over additional communication infrastructures – this development has led to an increase in the number and range of video content accessible to the public (whether with or without authorization from the holders of title to the content) via the various communication infrastructures[57], and to a change in the format in which downloaded content is used to streaming. Viewing the content is by means of various items of terminal equipment, among them computers, televisions, tablets, and mobile phones. As far as DBS is aware, some of the cellular operators have announced their intention of offering the public video content which will include DTT broadcasts together with additional content to be transmitted through the internet.

The development of this trend enables the supply of various forms of video content without the need to set up a designated infrastructure system, and as at the date of this report without any regulatory supervision, and it could have a materially adverse effect on the players in the broadcasting sector, which is currently based on designated infrastructures. This effect could be aggravated if such supply of content continues to be unregulated. (For possible regulation for broadcasting video content see section 5.17.4 below).

In 2011, Zira Ltd. commenced operations. DBS is one of the founders of Zira, together with other companies that operate in the television sector, and its purpose is to prevent the infringement of copyright on internet video content.

2. DBS's operation of VOD over the internet – Subsequent to this development DBS operates VOD services provided over the internet (see Section 5.2).

On the recommendations of the task force that reviewed the regulation of new broadcasting technologies, see Section 5.17.14.

5.1.2 Legislation, restrictions and special constraints in the area of broadcasts

A. The activity of DBS is governed by extensive legislation in the communications area, and particularly the Communications Law, and is implemented by virtue of licenses for satellite-TV broadcasts in Israel and in the West Bank.

B. The broadcasting operations of DBS and HOT are also under the ongoing supervision of the Council [a definition was added in the terminology section], which sets policy and makes rules and has supervisory authority in many areas of DBS's operations, including content of the broadcasts, the duty regarding original Israeli productions, broadcasting ethics, consumer protection and approval of the channels broadcasted. The Council is also authorized to amend the broadcasting licenses of DBS and HOT.

C. DBS's operations are also subject to licensing, supervision and policy decisions by the Ministry of Communications, from the aspects defined in the law and the communications licenses. In view of the coherence and overlap between broadcasting and other areas of communications, and the operations of HOT and related telephony and internet entities, broadcasting is materially influenced by the policy and supervision of the Ministry of Communications in various additional areas.

5.1.3 Changes in the scope and profitability of operations in this segment

For further information concerning the changes in the scope of DBS’s operations and its profitability, see section 1.5.4.D.

5.1.4 Market developments in the segment of operation

In accordance with a decision of the Council, beginning December 2012, DBS and HOT must allow customers to purchase, instead of the basic package of channels that licensees are obligated to offer to all their subscribers by law, a package of channels that includes the obligatory channels and at least four channels produced in Israel, including a sports channel and a channel for pre-schoolchildren and/or a channel for children and teens based on the conditions defined in the Council's decision ("the Limited Group of Channels"). According to the decision, DBS and HOT must offer the Limited Group of Channels until May 31, 2013, and during this period the Council will once again review its decision based on the data it receives from DBS and HOT.

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57 For the option of setting up an additional communication infrastructure on the network of Israel Electric Corporation, see Section 2.6.4B.

DBS believes that a significant movement of subscribers to the Limited Group of Channels may harm its results.

5.1.5 Technological developments that may have material effect on the area of operations

For information concerning the trend of broadcasting video content over communications infrastructure, see section 5.1.1C.

5.1.6 Critical success factors in the segment of operations and changes occurring in it

DBS regards the following factors as critical to the success of its operations:

A. Quality, differentiation, innovation and originality in the content, variety, branding and packaging of its broadcasts.

B. Provision of television services while using advanced technologies such as personal television services, and in particular, PVR decoders and VOD services (see section 5.7.4D), as well as HOT services.

C. Offers of bundles of communications services including television services and other services such as telephony services and internet services (see Section 5.7.2 and 5.7.3).

D. High level of customer service.

E. Brand strength and its identification with quality, innovation and industry-leading content and services.

5.1.7 Main entry and exit barriers for the segment of operation

A. The main entry barriers into the segment are these: (a) the need for licenses under the Communications Law; (b) the investments required of carriers in the area of operations, including the purpose of setting up an appropriate infrastructure and purchasing and producing content; (c) the limited size of the broadcasting market which reduces the size advantage characteristic of the broadcasting field around the world; (d) saturation of the broadcasting market.

B. In recent years, some of these entry barriers have started to crumble as a result of regulatory changes (such as DTT, see Section 5.1.1B) and as a result of technological developments enabling the transfer of content over existing communication infrastructures (see section 5.1.1C).

C. The main exit barriers are: (a) the regulatory barrier – termination of operations under the Broadcasting License depends on a decision of the Minister of Communications to cancel the license prior to the end of the license term, under the conditions set out in the license, including arrangements (which could be imposed on the licensee) for ensuring the continuation of broadcasts and services and minimization of harm to subscribers; (b) long-term contracts with important suppliers, and with entities which granted DBS long-term loans and subscribers.

5.1.8 Substitutes for and changes in products in the sector

In respect of multi-channel television broadcasts, DBS regards the following main services as alternatives to it products:

A. The variety of terrestrial channels broadcast to the Israeli public free of charge. (For the DTT setup - see Section 5.1.1B). In addition, many foreign channels may be received in Israel using relatively inexpensive terminal equipment.

B. Access to video content via various infrastructures, including the internet and cellular networks (see Section 5.1.1C).

5.1.9 Competition structure and changes occurring in it

The penetration rates of DBS and HOT are estimated by DBS to be approximately 62% of households in Israel. DBS believes that its chances of penetrating an additional material segment are not high for the reason that most of the remaining households are not potential customers for DBS and HOT. To the best of DBS's knowledge, in recent years there has been a decrease in the total number of subscribers of DBS and HOT, mainly due to the strengthening of alternative products in this field, while in recent years there has been a moderate decline in DBS's share of this market. An increase in the number of subscribers may be accomplished mainly by recruiting subscribers from the competition and recruiting new subscribers following the natural growth in the number of households. The broadcasting sector is characterized by fierce competition between HOT and DBS, which requires an investment of substantial resources to retain existing subscribers and recruit new ones.

For further details of competition in the segment, see Section 5.7.

5.2 Products and Services

5.2.1 Broadcasts

DBS's broadcasts include a wide variety of channels: there are approximately 140 different video channels (of which 5 are pay per view (PPV) channels, 20 are HD (High Definition) channels), in addition to radio channels, music channels and interactive services.

The broadcasts include a basic package which each subscriber is required to purchase as well as additional channels chosen by the subscriber, whether as a package or whether as single and PPV channels.

5.2.2 Advanced services

DBS markets PVR decoders which interface with DBS's electronic broadcasting schedule and enable receipt of special services, including ordering recordings in advance, recording series and pausing live broadcasts. The PVR Decoders also enable viewing of the content which is transferred from time to time to the decoder's memory which is updated from time to time by DBS (push video).

DBS provides HD broadcasts which can be received through special decoders. These broadcasts allow superior quality viewing. DBS also markets HDPVR decoders.

The majority of DBS subscribers use PVR decoders.

DBS believes that an increase in the number of subscribers using PVR decoders will contribute to an increase in its revenues from these subscribers and to their retention as subscribers, but it requires a material financial investment.

DBS provides a service enabling the viewing of certain internet content on TV screens, through the use of some types of advanced decoders (streamers).

5.2.3 VOD services

DBS provides its subscribers with VOD services via the internet. This service has limitations with regard to the types of decoders enabling service reception, and with regard to availability of services owing to constraints connected with the internet infrastructure and bandwidth installed in customer homes. These limitations have declined in recent years in view of the increase in the available bandwidth in subscribers' homes. In recent years, the number of DBS subscribers connected to VOD services and the use of VOD services has increased significantly. On the question of regulating DBS's VOD services, see Section שגיאה! מקור ההפניה לא נמצא. below.

5.3 Revenue of products and services

Following is a table containing a breakdown of DBS's revenue (in NIS millions):

	2012	2011
Revenue from broadcasts and multi-channel television services to subscribers	1,612	1,602
Percentage of revenue	99%	99%

5.4 New Products

For information regarding the launch of the limited package, see Section 5.1.4 above.

5.5 Customers

The overwhelming majority of DBS's subscribers are private customers. DBS's subscriber agreements regulate the rights and obligations of subscribers in their relations with DBS. Pursuant to the provisions of the broadcasting license, the subscriber agreement was approved by the Council and the Standard Contracts Tribunal. DBS is working to obtain the approval of the subscriber agreement from the Council and once such approval is obtained, DBS intends taking action to obtain the approval of the Standard Contracts Tribunal, which has expired.

5.6 Marketing and Distribution

5.6.1 Marketing of DBS services is by way of publication in the various media. DBS's sales operations are carried out via three main distribution channels:

A. Sales people, who are DBS employees, working to recruit subscribers.

B. Call centers operated by DBS employees that receive telephone inquiries from customers wishing to receive DBS services, as well as telemarketing campaigns to potential subscribers.

C. External resellers.

5.6.2 DBS's sales operation relating to existing subscribers is effected through the use of call centers, some of which are operated by its employees, and some by third parties.

5.7 Competition

5.7.1 Competitors in the broadcasting market

The subscriber multi-channel television market in Israel is estimated at approximately 62% of all homes in Israel.[58]

DBS's main competitor, as mentioned in section 5.1.1 above, is HOT, which also provides multi-channel television services to subscribers. DBS also regards the DTT setup and video content offered via the internet as competition for its services

Below is data relating to subscriber numbers and market shares,[59] to the best of its knowledge, at December 31, 2010, 2011 and 2012.

2012		2011		2010	
Subscribers*	Market share	Subscribers*	Market share	Subscribers*	Market share
578,404	39%	586,400	40%	577,700	39%

* Approximate numbers.

Subscriber – one household or one small business customer. In the event of a business customer with many 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.

5.7.2 Characteristics of competition today

The competition in the broadcasting arena focuses on broadcasting content, on the price for channels and packages, on service and on offering additional services such as VOD services, PVR decoders, and HD broadcasts. In recent years there has been a discernible trend toward demand and supply of personal television services which allow the customer to choose which content to view and when to view it (in contrast to viewing linear channels where the content broadcasting sequence is determined by the broadcasting entity). This trend is supported by the expansion of PVR services, VOD services and other services.

Competition is also characterized by the additional communication services offered by HOT as part of its "service bundle" (see Section 1.7.1).

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58 DBS's assessment of the percentage of penetration of the broadcasts market is based on the total number of DBS and HOT subscribers (according to HOT's reports), divided by the number of households in Israel according to data of the Central Bureau of Statistics for 2011.

59 The assessment of DBS's market share in 2010 – 2012 is based on the number of subscribers and HOT (according to HOT's reports). The figure for 2012 is based on data from the end of September 2012.

5.7.3 Positives and negatives in competition

A. DBS's management estimates that DBS has competitive advantages, the main ones being:

1. Use of some of the most advanced technology in the world in order to provide its services.
2. Quality and variety of content broadcast by DBS to its subscribers.
3. Level, quality and availability of DBS's customer service.
4. Option of receiving broadcasts even in remote or isolated areas where there is no deployment of cable infrastructure.
5. Fostering and promoting the "yes" brand as a preferred, popular brand with a high level of loyalty.

B. However, DBS's competitive operations suffer from inferiority or from adverse factors in a number of areas, the main ones being:

1. Inferiority of infrastructure – DBS's infrastructure is inferior because the satellite infrastructure does not enable bidirectional communication, it does not enable the provision of VOD services and does not enable the transmission of telephony and internet services, in contrast to the infrastructure of HOT which enables the supply of these services.
2. Regulatory restrictions:

   With regard to restrictions on marketing joint service bundles see section 5.17.13 below.

   Furthermore, DBS is subject to restrictions on its broadcasting content, one of which is a ban on broadcasting commercials (see Section 5.17.8) and restrictions on the ownership of the channels it broadcasts, including the News Channel (see Section 5.17.10). Similar restrictions are also applicable to HOT.
3. Space segments - the use of space segments involves heavy expenses. Regarding the restriction on its ability to expand supply of its broadcasts see Section 5.8.
4. Transmission of video content via additional communication infrastructures - see Section5.1.1C.

5.7.4 Main methods for coping with competition

Following are the main methods used by DBS to deal with competition in the field of broadcasting:

A. Content – DBS acts to purchase, produce and broadcast high-quality, innovative and varied content, creating differentiation of its content;

B. Branding – cultivation, promotion and differentiation of the YES brand;

C. Service – DBS places an emphasis on its customer service;

D. Technology – DBS makes investments in order to expand its technological capabilities, while placing an emphasis on technological innovation. To achieve this goal, it attaches great importance to the supply of personal television broadcasts as part of the range of services it offers its subscribers, including VOD, PVR and HD services.

5.8 Production capacity

The number of channels which DBS is capable of broadcasting to its subscribers depends on the number of space segments it is using, its compression capability and the bandwidth required for the transmission of all types of channels. At the date of this report, DBS uses all the space segments at its disposal and so an increase in the number of channels it broadcasts, particularly an increase in the number of HD channels it broadcasts (which require greater bandwidth) would require additional space segments or an improvement in the compression systems it uses. DBS leases space segments from a third party (see Section 5.18.1).

In addition, in matters arising from the provision of advanced content services to subscribers, including VOD and HD content, an increase in the penetration rates of these services depends on the supply of suitable decoders.

5.9 Property, plant and equipment

Below are the main components of DBS's property, plant and equipment:

5.9.1 Land

DBS leases a number of real estate assets which serve as its offices, broadcasting center, logistics centers and employee recruitment centers. Its main offices and its central broadcasting center are located on leased land in Kfar Saba. The lease periods for these sites expire in 2019, while the balance of the lease periods for the remaining properties leased by DBS varies from a few months to approximately 6 years (these periods are based on the assumption that DBS will exert its extension options for these leases).

5.9.2 Terminal equipment

DBS installs a receiver dish and other terminal equipment in subscriber homes, among them, decoders constitute an interface with the subscriber's television screen as well as smart cards used to decode the encrypted broadcasts. Some decoders are leased to subscribers in return for a fixed leasing fee paid during the broadcast reception period and others are lent to subscribers (some of these loans are made in return for a deposit which is reduced over the subscription period).[60] DBS capitalizes the installation costs for the terminal equipment as part of its property, plant and equipment

At the date of this report, DBS purchases decoders from two suppliers. The main agreement for the purchase of decoders (including the PVR decoders) is a framework agreement from August 2000, as amended from time to time, between it and Advanced Digital Broadcast S.A. ("**ADB**") and Eurocom Digital Communication Ltd. ("**Eurocom Digital Communication**") which is controlled (indirectly) by Mr. Shaul Elovitch, a controlling shareholder of the Company, who is also a controlling shareholder (indirectly) of Eurocom DBS, the largest shareholder in DBS[61] (the "**ADB Agreement**"). Under the ADB Agreement decoders are purchased from Eurocom Digital Communication which imports them from ADB and provides the warranty for the decoders which ADB undertook to issue under the agreement.

In 2012 DBS purchased from Eurocom Digital Communication HDPVR decoders in the total amount of NIS 89 million

and purchased HD Zapper decoders from Pace Micro Technology PLC ("Pace") in a total amount of NIS 19 million.

DBS may become dependent upon these suppliers[62].

5.9.3 Broadcasting equipment and computer and communications equipment

DBS has its central broadcasting center in Kfar Saba and a secondary broadcasting center close to Re'em Junction from where it transmits its broadcasts. Its broadcasting centers contain reception and transmission equipment and DBS's property, plant and equipment which also include computer and communication systems. The secondary broadcasting center is operated by a third party which makes available its services for operating and maintaining the secondary broadcasting center to DBS in accordance with an agreement which is valid until the end of 2018 (with an extension option available to DBS).

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60 A negligible number of decoders is sold to subscribers.

61 For details of the share trust of Eurocom DBS by power of the terms of the merger determined by the Antitrust Commissioner, see Section 1.3.1A.

62 Replacing the supplier with another supplier does not involve additional material costs, however a substantial preparatory period is required to adapt the decoders of the alternative supplier to the broadcasting and distribution systems of DBS, which could, in the event of the termination of the engagement at short notice, cause DBS to lose revenues.

5.9.4 Operating and encryption systems

DBS purchases services for the operating systems of its broadcasting and encryption setup from NDS Ltd. ("**NDS**") as well as hardware for these services. DBS is dependent on the regular supply of these services and products, including integration in connection with the types of the various decoders which it uses for the operating systems for which NDS provides services.

Under the terms of the agreement with NDS, NDS supplies development, licensing, supply, training, assimilation and maintenance services for encryption, broadcasting and ancillary software and equipment required for DBS's broadcasts and services. NDS has undertaken to adapt the equipment and services it supplies to the various decoders and systems purchased by DBS and also to supply a warranty for its products and also support services. DBS makes one-time payments and periodic payments for the services and products of NDS. These payments are based primarily on the number of decoders it uses and the number of its active subscribers. The agreement with NDS expires at the end of May 2015.

5.9.5 Computerized billing system

DBS uses computer software and systems to manage agreements with its subscribers, including its billing and collection system. In this context, DBS entered into a set of agreements with Netcracker Technology Solutions Ltd. ("Netcracker"), in which Netcracker provided DBS with a non-exclusive license to use the system, and Netcracker undertook to provide DBS with maintenance services as specified in the agreement. In respect of Netcracker's products and services, DBS undertook to pay consideration comprising, inter alia, variable costs for the user license for the system based on the number of its subscribers, and variable costs for training services, software upgrades, and support for operating the system.

DBS is dependent on Netcracker's systems and services, due to their importance for billing its subscribers. Malfunctions of the system or a suspension of DBS's services would likely cause operational difficulties until they can be repaired or the system/supplier replaced.

In 2012, DBS paid Netcracker NIS 12 million.

5.10 Intangible assets

5.10.1 Licenses

DBS owns the following main licenses:

A. Broadcasting license valid through January 2017[63] – this license is material to DBS's operations and is the main regulatory permit for its operations (for the conditions of this license, see section 5.17 below).

B. License for satellite television broadcasts in the Judea and Samaria region valid through 2016, and by power of this license whose provisions are similar to those of DBS's main broadcasting license, DBS broadcasts to the Judea and Samaria region.

C. License to perform uplink operations (transfer of broadcasts from DBS's broadcasting center to the broadcasting satellite and performance of setup and ancillary operation activities), which is valid through January 2017 or until the end of DBS's broadcasting license, the earlier of the two. This license is material to DBS's operations and is the regulatory permit for the transmission of broadcasting messages from the broadcasting center to the broadcasting satellites and from them to subscriber homes.

5.10.2 Trademarks

DBS owns registered trademarks with the main ones designed to protect its trade name (**YES**).

5.10.3 Software and licenses

See Note 9 to DBS's 2012 Financials

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63 At the end of this period the agreement may be extended for additional periods of six years each, subject to the terms of the broadcasting license.

5.11 Broadcasting rights

5.11.1 DBS has the broadcasting rights of two types of video content.

Content purchased from third parties, including content and channels, that own the broadcasting rights thereto;

Content which DBS invests in producing (wholly or partially), and in addition to the actual right to include the content in its broadcasts, DBS generally also has rights in such content, at the rates specified in agreements with the producers. In most instances, DBS is also entitled to issue authorizations to use the rights and share the revenues stemming from additional use of the content, in addition to DBS broadcasting thereof

5.11.2 The broadcasting and distribution of content by DBS on various media involves the payment of royalties to the owners of copyrights of musical works, voice records, scripts and content direction, included under the Copyright Law, 2007 and the Performers and Broadcasters Rights Law, 1984. Payment of royalties, as aforementioned, is done via a number of organizations that operate in Israel which collect the royalties for the owners of the intellectual property rights. DBS has blanket licenses with these organizations. Payments by DBS under these licenses are, at times, based on a fixed payment and at other times on various pricing methods, and with respect to some of the organizations, DBS may be required to pay additional amounts as royalties for transmitting content via certain media and for secondary broadcasting of certain content, and which are not expected to be significant. Further D.B.S. is expected to pay royalties to relevant organizations for secondary broadcasts of certain content, in amounts that in the estimation of D.B.S. are significant. This estimate by DBS is a forward-looking statement, based among other things on estimates by DBS, including regarding the amount of use of the content and the positions of the various organizations, and should any of them change, this estimate may change accordingly.

In October 2012, DBS and Association of Composers, Authors and Publishers of Music in Israel ("ACUM") signed a compromise agreement settling disputes which had emerged between them over the amount of the additional royalties owed by DBS (in addition to the advance which was paid) for the years 2003 to 2011. Concurrently, the annual rates of royalties that DBS must pay for the years 2012 - 2016 were arranged, and DBS and ACUM signed a licensing agreement in which DBS received a permit from ACUM until December 31, 2016 to use the broadcasting, copying and recording rights of ACUM's works, which as part of the broadcasting and content rights provided by DBS to other media, were defined by agreement. [

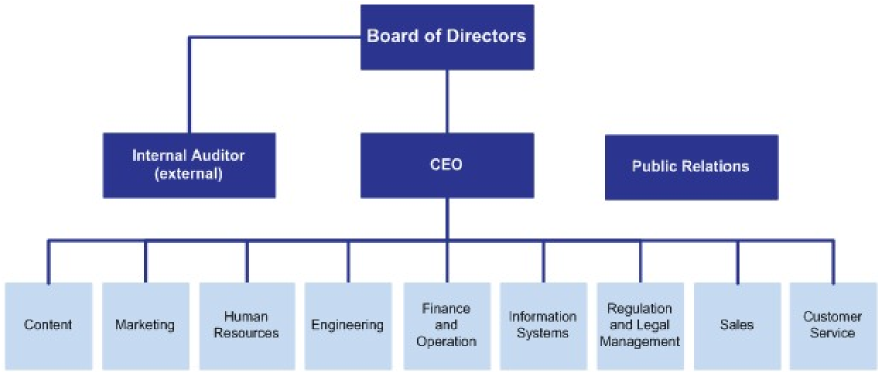
5.11.3 Given the many content providers from which DBS purchases broadcasting rights, DBS does not have a main content provider and is not materially dependent on any single content provider. However, with respect to broadcasts of Israeli sports, at the date of this report there is dependence on the purchase of the broadcasting rights of local sports channels by these providers.

5.11.4 For information regarding the broadcasting rights, see Note 7to the DBS 2012 Financials.

5.12 Human Resources

5.12.1 Organizational structure

DBS is made up of departments, each headed by a VP, who are members of DBS management.



(*) The Internal Auditor is not an employee of DBS.

5.12.2 DBS personnel by department

Department	Number of Employees At December 31, 2012	Number of Employees At December 31, 2011
Marketing	38	34
Customer Service*	1,462	1,467
Content	74	70
Engineering	101	101
Finance and Operations	118	114
Human Resources	52	50
Regulation and Legal Management	4	6
Technologies and Information	100	138
Management and Spokesperson	15	7
Sales	263	284
Total	2,227	2,276

5.12.3 Training and human resources development

DBS trains its employees on an ongoing basis, through a training center, and also carries out manager training and support on an ongoing basis.

5.12.4 Employee compensation schemes

DBS customarily awards its officers annual bonuses based on attaining targets. Furthermore, DBS also awards bonuses and other incentives to other managers and employees.

5.12.5 Benefits and the nature of employment agreements

DBS employees are employed under personal employment agreements, on the basis of a monthly salary or an hourly wage, with some of the employees also entitled to performance-based compensation. The employment agreements are generally for an undefined period, and each party may terminate the agreement by prior notice in accordance with the agreement or the law.

DBS employs people in some of its departments on the weekly day of rest and on days of rest prescribed by the State, and it has an appropriate permit for such employment.

5.13 Suppliers

For a description of the engagement with Spacecom, see Sections 5.8 and 5.18.1.

For a description of the engagement with ADB, Eurocom Digital Broadcast and Pace, see Section 5.9.2.

For a description of the engagement with NDS, see Section 5.9.4.

With respect to the purchase of the broadcasting rights to local sports channels, see Section 5.11.3.

For a description of the agreement with Netcracker, see Section 5.9.5.

5.14 Working Capital

Working capital in the financial statements of DBS for 2012 consists of current assets totaling approximately NIS 165 million less total current liabilities in the amount of approximately NIS 816 million (for the composition of current assets, see Note 6 and the composition of current liabilities see Notes 10-14 of DBS Financials for 2012). Consequently, DBS has a working capital deficit totaling approximately NIS 654 million in the Financial Statements for 2012 (see Note 5 to the DBS Financials for 2012).

5.15 Financing

5.15.1 Average interest rate on loans

	Source of financing	Amount at December 31, 2012 (NIS millions)	Currency or linkage	Average interest rate	Effective interest rate
Short-term loans	Banks	69	NIS	5.2%	5.4%
Long-term loans	Banks (1)	0	NIS	5.65%	5.72%
	Non-bank (2)	1,539	CPI-linked NIS	6.3%	6.4%
	Shareholder loans(3)	3,086	CPI-linked NIS	6.1%	6.2%

(1) Until December 31, 2010, the long-term bank loans bore 5.6% annual fixed interest. As of December 31, 2010, some of these loans began bearing fixed interest at an average rate of 6.63%, and others variable interest at an average rate of prime plus 1.8%. During July 2012, DBS paid-off all of its long-term loans from banks, totaling NIS 400 million.

(2) The non-bank credit, which is valid to December 31, 2012, consists of debentures (see Section שגיאה! מקור ההפניה לא נמצא.).

(3) Loans extended to DBS by its shareholders are linked to the CPI and are divided into three types: A. Non-interest bearing loans; B. Loans bearing annual interest of 5.5%; C. Loans bearing annual interest of 11%. See also Section 5.18.4 and Note 15 to DBS's 2012 financial statements.

5.15.2 Bank financing

DBS is party to a financing agreement with a consortium of banks from May 23, 2001, which was amended and represented in July 2012 [64] ("the Finance Agreement" or "the Bank Finance Agreement" and "the Banks", respectively).

According to the financing agreement, DBS was provided with an on-going credit facility of NIS 170 million and a hedge facility of USD 10 million up to the end of 2015 [65].

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[64] With the entering into force of the amended finance agreement, DBS repaid all the long-term bank credit provided to it up to that date, by means of a loan provided according to Debentures 2012 (as defined below) and by means of the proceeds of the expansion of Debentures (Series 2) of DBS.

[65] Utilization of these credit facilities is limited to the total working capital requirements of DBS, based on a formula set forth in the Amended Financing Agreement, which is dependent on the customer balances of DBS, the total unutilized broadcasting rights of DBS, the depreciated cost of the decoders and the total supplier balance of DBS according to its financial statements.

For additional information about the financial covenants and the compliance of DBS with them, and other key limitations which apply to DBS under the financing agreement, and for information about the collaterals which were created in favor of the banks, see Note 27 to the 2012 Financials of DBS.

5.15.3 Institutional financing

A. DBS has a debenture series issued in 2007 to institutional investors, which were listed on the TACT Institutional at TASE ("the Debentures (Series A)") in accordance with a deed of trust between DBS and Hermetic Trust (1975) Ltd. ("Trustee A" and "Deed of Trust A", respectively).

B. DBS has a debenture series issued in 2010 to institutional investors which were listed on TACT Institutional at TASE and which were expanded in 2011 and 2012 (the "Debentures (Series B)"), in accordance with a deed of trust between DBS and Hermetic Trust (1975) Ltd. ("Deed of Trust B" and "Trustee B", respectively).

C. In May 2012, DBS and several institutional entities (in this section: "the Lenders") signed a debenture whereby the Lenders provided DBS with a loan of NIS 392 million (in this section: "Debenture 2012"). The loan was provided to DBS in July 2012, after several conditions precedent defined in the 2012 Debenture were met, and it was used (together with the proceeds of the expansion of Debentures Series B, which took place out during the year) to repay the long-term bank loans which DBS had taken from the banks up to that date.

Deed of Trust A, Deed of Trust B, and the Debentures 2012 will together be called "the Institutional Finance Documents".

For additional information about the financial covenants and the compliance of DBS with them, and other key limitations which apply to DBS under the Finance Documents, and for information about the collaterals which were created according to the Institutional Finance Documents, see Note 27 to the 2012 Financials of DBS.

5.15.4 Changes in the rating of DBS and rating of the debentures by S&P Maalot in the reporting period

	Debentures (Series A) and rating	Debentures (Series B)	Debentures 2012
March 1, 2011	Rating ilA	Rating of ilA- for additional debentures of up to NIS 120 million par value, to be issued in a series expansion.	
November 8, 2011	ilA rating (i.e. rating retained) with stable rating outlook for DBS.	ilA- rating	
May 7, 2012		ilA- rating for debentures and for the expansion of the debentures in the amount of NIS 450 million par value issued under the series expansion	
October 17, 2012	ilA rating (i.e. rating retained) with stable rating outlook for DBS.	ilA- rating (rating retained) with stable rating outlook for DBS.	ilA- rating

5.15.5 Corporate credit (in NIS thousands)

Credit framework	Utilization as at Dec. 31, 2012	Utilization as at Feb. 27, 2013
170,000	73,019	76,828

5.15.6 Estimate regarding the need to raise sources of financing in 2013

According to the payment schedule of the Financing Agreement and DBS's debentures, in 2012 DBS is expected to repay NIS 241 million on account of principal and interest of its loans.

DBS management estimates the sources of financing available to it, which include, *inter alia*, the deficit in working capital and the amount of potential fund raising, will be sufficient for its operations in the coming year, and this according to the cash flow forecast that was approved by the DBS Board of Directors. Should additional sources be necessary for operations in the coming year, DBS will adjust its activity such that it will not require additional sources beyond those available to it.

In recent years DBS needed to raise external financing sources, *inter alia*, to increase its investments. As at the date of this report, a significant increase of DBS's investments would require expansion of the sources of financing available to it (for restrictions regarding additional credit, see Sections 5.15.2.and).

5.16 Taxation

For information regarding DBS taxation, see Note 8 to the 2012 Financials and Note 26 to DBS's 2012 Financials.

5.17 Restrictions on and supervision of the company

5.17.1 General

DBS's operations are regulated by and subject to an extensive system of laws that apply to the area of broadcasting, including primary legislation (and specifically the Communications Law and subsequent regulations), secondary legislation (including the Communications Rules), as well as administrative directives and Council decisions. Likewise, DBS is subject to legislation and secondary legislation in the field of consumer protection.

Additionally, DBS's operations are subject to the provisions of its licenses, and particularly the broadcasting license.[66]

5.17.2 Eligibility requirements for licensee for satellite broadcasts, restrictions on cross-ownership

The regulations of the satellite broadcasting license place various restrictions on a licensee, including eligibility requirements that relate to the holdings of the owner of the license and the interested parties, directly and indirectly, in the licensees under the Law of the Second Authority and the owners of daily newspapers.

5.17.3 Royalties

For information pertaining to Royalties Regulations (Satellite Broadcasts), see Section 1.7.3B.

For 2011, DBS paid a total of approximately NIS 17.4 in royalties and for 2012, it paid a total of approximately NIS 17 in royalties (the rate of royalties in these years averaged 1.75% of the relevant revenues).

5.17.4 Tariff regulation

The broadcasting license stipulates provisions regarding the types of payments the licensee may collect from its subscribers, and they appear in the DBS price list. The vast majority of subscribers join special offers, which offer the services of DBS, including different combinations of content packages, related services, as well as the receiving and installation of terminal equipment at prices which below the listed price for all components of the special offer and they appear in the DBS price list. The vast majority of subscribers join special offers, which offer the services of DBS, including different combinations of content packages, related services, as well as the receiving and installation of terminal equipment at prices which below the listed price for all components of the special offer..

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66 The full version of the broadcasting license is available on the Ministry of Communications website: www.moc.gov.il.

Under Section 6(49) of the Communications Law, the license may stipulate maximum prices that can be charged to subscribers. At the date of this report, no such prices had been set.

5.17.5 Requirement to invest in local productions

In accordance with the requirements of the broadcasting license and the decisions of the Council, for each of the years 2012 and 2013 DBS must invest in local productions an amount which shall not be less than 8% of its revenue from subscription charges[67], and according to the regulations and the decisions of the Council, DBS must invest different rates of these investments in various genres of local productions. DBS is also completing investment shortfalls determined by the Council in certain genres

5.17.6 Terminal equipment

In 2011, the Ministry of National Infrastructures published Draft Energy Sources (Maximum electrical output in active stand-by mode of a digital channel converter for TV broadcast reception) Regulations, 5771-2011, the purpose of which is to regulate the maximum electrical output when digital converters are on active standby mode. As far as DBS is aware, this draft has not yet been discussed by the Knesset Economic Affairs Committee. DBS estimates that should the draft regulations become binding legislation, they may adversely affect DBS's ability to continue to use some of the decoders currently used by its subscribers, and its ability to import the decoders that require a higher level of electricity capacity than the maximum output prescribed in the draft regulations. DBS has asked the Ministry of National Infrastructures to amend the wording of the draft regulations so as to minimize wherever possible these possible effects.

DBS's opinion in this instance is forward-looking information, as defined in the Securities Law, based in part on the present version of the draft regulations. There is no certainty that the draft regulations will become binding, or that the version of the regulation that is passed, if it is passed, will be the same as the draft version that has been published. This estimate may not materialize, or it may materialize in a manner that differs significantly from that foreseen, in part depending on the version of the registration that is passed, if and when it is passed.

In 2011, the Council chair informed DBS that he intends to recommend that the Council consider amending DBS's broadcasting license so that the deposit that subscribers are required to make for borrowing an HD or PVR decoder will be limited to the cost of the purchase of the decoder loaned to the subscriber (eliminating an easement that was given to DBS in the past with respect to these advanced decoders)and to recommend amending the subscription agreement so that the amount deposited when borrowing used terminal equipment, is not more than its depreciated cost. DBS has expressed its objections on this subject to the Council chair. DBS is of the opinion that insofar as these recommendations are implemented, its revenues will be severely reduced.

This opinion is forward-looking information, as defined in the Securities Law, based, in part, on the aforesaid announcements by the Council, that are still subject to a hearing with DBS. There is no certainty that these announcements will in fact be adopted and implemented by the Council. This estimate may not materialize, or it may materialize in a manner that differs significantly from that foreseen, in part depending on the decisions that are actually made, if they are made, by the Council.

5.17.7 Requirement to transmit channels

In accordance with the requirements under the law and license, DBS is required to allow the producers of channels set out in the law to use its infrastructures to transmit broadcasts to its subscribers, and this in exchange for payment ("Transmission Fee") to be determined in the agreement, and lacking agreement - in exchange for a payment to be determined by the Minister, after consulting with the Council.

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67 Including DBS revenue from terminal equipment and installation thereof.

In accordance with an amendment to the Communications Law in 2010, the dedicated channels are exempt from payment of transmission fees to HOT and DBS. In 2010, DBS filed a claim with the High Court of Justice against the validity and applicability of this amendment. This claim is still pending.

5.17.8 Content of the broadcasts and obligations with respect to subscription

The broadcasting license sets out provisions that relate to the content of DBS's broadcasts, including an obligation to obtain the Council's approval of the channels broadcasted by DBS. The Communications Law prohibits the broadcast of advertisements, subject to several exceptions (this prohibition also applies to HOT).

Additionally the broadcasting license includes conditions regarding the terms of the services to subscribers and prohibition of discrimination between subscribers as well as an obligation to have the Council and the Standard Contracts Tribunal approve the subscriber agreement.

5.17.9 Restrictions on term of commitment

Regarding restrictions concerning exit penalties collected from subscribers whose commitment period has not yet ended, see Section 1.7.3D.

5.17.10 Ownership of broadcast channels

According to the communications rules, DBS, including its associated entities which are defined in the communications rules, may own up to 30% of the local channels broadcast by DBS. (This is in contrast to the 20% applicable to HOT.) Under the Communications Law, DBS is also restricted on the ownership of news broadcasts producers.

5.17.11 General provisions regarding the broadcasting license

The Minister and the Council have parallel authority to amend the broadcasting license. The Minister was authorized to cancel or postpone the broadcasting license for causes set out in the Communications Law and the broadcasting license. The Communications Law and broadcasting license stipulate restrictions on the transfer, attachment and encumbrance of the broadcasting license and any of the assets of the broadcasting license. The broadcasting license requires receipt of the approval of the Minister for specific changes in the holding of the means of control in DBS and imposes a reporting requirement regarding the holders of the means of control; hurting competition by way of an agreement, arrangement or understanding with a third party in terms of provision of broadcasts and services is prohibited, unless approved in advance and in writing by the Council; the obligation to file reports to the Ministry of Communications was defined as well as conditions regarding the regulation of the activity of the licenses; an obligation was stipulated to provide bank guarantees that are currently NIS 40 million (principal) to the Ministry of Communications to guarantee DBS's undertakings under the license (in order to issue these guarantees, DBS shareholders provided securities to the issuing banks).

With respect to the restrictions stipulated regarding DBS as part of acquisition of control of the Company by B Communications, see Section 1.3.1.

5.17.12 Wiring in subscribers' homes

In October 2012, the Ministry of Communications announced that it would cancel the administrative order which applied until that time, and which regulates the movement of subscribers between DBS and HOT. This announcement is further to the request by DBS and HOT to institute an administrative order, the main point of which is cancellation of the obligation to give advance notice of connecting a subscriber to another service provider. In January 2013, DBS and HOT applied to the Ministry of Communications to amend this decision, so that the administrative instruction is not cancelled but will be amended as they requested.

5.17.13 Offering service bundles

According to the broadcasting license, DBS may offer joint service bundles that include service provided by the Company and service by DBS, subject to obtaining Ministry of Communications approval (and if no objections are raised within the period specified in the license, such approval will be deemed granted) and subject to conditions, the most important of which are the "unbundling" obligation, and whether a corresponding bundle is marketed by a licensee that is unrelated to the Company (see Section 1.7.2B). The joint service bundle with the Company includes infrastructure service for the Company's internet only, does not require Ministry of Communications approval and the unbundling obligation does not apply to it.

Nevertheless, in October 2012, the Antitrust Authority informed DBS that in its opinion, cooperation between DBS and the company which markets the joint service bundle, constitutes cooperation between (potential) competitors in this area of competition (this, subsequent to a ruling by the Supreme Court, see Section 2.16.8.C), which might be construed as a restrictive agreement and requires approval under the Antitrust Law (even if it complies with the conditions of the broadcasting license), and that the Commissioner does not intend to grant an exemption from the need for approval of the arrangement.

DBS believes that in view of the development of competition between the communications groups and the growing importance of the supply of comprehensive communications services (see Section 1.7.1.C), insofar as the restrictions in relation to the Company's control of DBS remain in place (see Section1.7.2.D), and regarding the Company's cooperation with it, the negative impact of these limitations on DBS's results may increase.

5.17.14 Regulation of the transmission of video content via media infrastructures

In 2011, the recommendations of the joint Ministry of Communications and Council task force were submitted to the Minister of Communications. The task force was appointed to review the question of regulating broadcasts on new technologies and platforms, with respect to the method and process of prescribing regulations for semi-TV broadcasts (audio-visual content) over the internet. The primary recommendation is to shift from regulation based on transmission and recording methods to regulation based on output, so that internet-TV broadcasts should have the same features as the broadcasts currently offered by the broadcasting entities (the criteria for determining these features were included in the task force recommendations), they shall be subject to regulation by the Council and any other relevant regulating entity. It was also recommended that a follow-up team be established, involving all the relevant entities, including the Ministry of Communications, the Council, the Israel Broadcasting Authority (IBA) and the Second Authority for Television and Radio, for the purpose of reviewing and adapting the regulations currently applicable to the present world of broadcasting to the developing world of broadcasting, in an effort to create a standard, comprehensive set of regulations for both the existing and new world of broadcasts (including a recommendation on appropriate legislative amendments). The task force noted that it must continue to take into account possible changes in the distribution of revenues between the broadcasting entities and the new entities and the expansion of the range of broadcasting entities that will be subject to the new regulations. The task force further recommended that insofar as the new broadcasting entities continue to replace the regulated broadcasting entities (the task force found that the replacement rate is still low), which will have a negative economic impact on the regulated broadcasting entities even before the recommended regulations are adopted, the regulating entities should work for the adoption of urgent, temporary regulations to include temporary alleviations for the supervised entities and/or impose obligations tailored to the web-based broadcasting entities. At the date of this report, the Minister of Communications has yet to make a decision regarding these recommendations.

DBS believes that the VOD services that it supplies are not subject to the regulations that currently apply to the multi-channel TV broadcasts and as far as it is aware, this is the position of the Ministry of Communications. Nevertheless, implementation of these conclusions by the Ministry of Communications may have repercussions for regulating VOD services provided by DBS. It may also affect the development of the transfer of video content over the internet.

DBS's estimates in this instance are forward-looking information, as defined in the Securities Law, based in part on the recommendations of the task force as published at this date. There is no certainty that the Ministry of Communications will in fact implement these recommendations. These estimates may not materialize, or they may materialize in a manner that differs significantly from that foreseen, in part depending on the actual implementation of the recommendations and the content of the implemented regulations, if they are in fact implemented, and on the way they are implemented.

5.18 Substantial agreements

Following is a brief description of the main points of the agreements likely to be considered as material agreements not in the ordinary course of DBS's business, which have been signed and/or are valid in the period of the Periodic Report:

5.18.1 Space segment lease agreements

DBS and Spacecom Communications Ltd. ("**Spacecom**")[68], have an array of agreements under which DBS uses the space segments via Amos 2 and Amos 3 satellites ("**Space Agreement**").

Pursuant to the Space Agreement, the term of use of the space segments on satellites AMOS 2 and AMOS 3 is through April 2016 or until the end of life of AMOS 2, the earlier of the two. The consideration for use of th space segments depends on the number of segments DBS utilizes.

Under the Space Agreement, if the supplied capacity becomes unusable, Spacecom shall make every effort to provide alternative capacity, and if Spacecom is not able to do so, it will work to provide such through a satellite belonging to another operator (whereby participation of Spacecom was fixed in immaterial amounts with additional costs if incurred).

A mechanism was set up for partial backup on Amos 3 in the event of non-availability of space segments on Amos 2. Additionally, Spacecom undertook to make every reasonable effort to back-up on Amos 2 in the event of non-availability of both space segments used by DBS on Amos 3.

According to a space agreement, DBS must use 13 space segments. However, DBS may temporarily suspend the use of one segment, where each party is entitled to cause a resumption of the use thereof (once a year).

At the date of this report, DBS is using 12 space segments (ten on Amos 2 and two on Amos 3), in view of its right to terminate the lease of the 13th segment, as aforementioned). Nevertheless, in February 2012, Spacecom informed DBS that DBS could resume use of the 13th segment commencing January 1, 2013. To date DBS has not yet started using the 13th segment due to the negotiations between the parties regarding continuation of the agreement.

The lease fees in 2012 amounted to approximately NIS 93 million.

On March 6, 2013, the Board of the Directors of the Company approved (after approval of the Audit Committee), and recommended that General Assembly of shareholders in the Company (which has not yet been called) to approve the manner of voting at the General Assembly of shareholders of DBS in favor of amending the existing agreement of DBS with Spacecom and extending the leases for space segments on the satellites Amos 2 and Amos 3, Amos 6 and/or another satellite to be agreed between the parties, until the end of 2028 for a totaling of approximately USD 227 million for the period. The agreement is subject to the approval of the competent bodies in Spacecom and approval of the General Assemny of shareholders in DBS.

DBS is materially dependent on Spacecom, as the exclusive holder of the rights and the sole provider of space segments used by DBS, which is also responsible for operation of the space segments. With respect to exposure to risks in the event Amos 2 or Amos experience operations failure, see Section 5.21.3.D.

In 2011, Spacecom notified DBS concerning a malfunction in the battery of the Amos 3 satellite, which could cause, during certain periods, limited activity of the satellite and took operational action to prevent harming DBS broadcasts. The failure is unlikely to affect the service that DBS receives from Spacecom.

This opinion is forward-looking information, as defined in the Securities Law, based in part on Spacecom's publications regarding the fault and its repercussions and on the materialization of Spacecom's estimates as submitted to DBS. Consequently, this opinion may not materialize, or may materialize in a manner different from that anticipated, in part depending on technical and operating conditions relating to the satellite and the malfunction, as well as on other operational or other measures, insofar as they are taken by Spacecom.

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68 The company is controlled by the controlling shareholder of Eurocom DBS, the largest shareholder in DBS.

5.18.2 Financing agreement with the Banks

For a summary of the main points of the agreement, see Section 5.15 and Note 27 to DBS's 2012 Financials.

5.18.3 Deeds of trust regarding Debentures (Series A) and Debentures (Series B) and 2012 debentures

For a summary of the main points regarding the deeds of trust and 2012 debentures, see Section5.15.3 and Note 14 to DBS's 2012 Financials.

5.18.4 Agreements with DBS shareholders[69]

A. The 1998 founders agreements between the shareholders of DBS, regulates the establishment and management of DBS as well as the relationships between the shareholders.

B. The agreements between DBS's shareholders and DBS, stipulate that the holdings of DBS's shareholders would be adjusted to the pro rata share of their investments, and prioritizes shareholders' loans granted subsequent to July 10, 2002 over earlier loans. The agreement also stipulated that these loans would bear CPI linkage differentials and an annual accrued linked interest rate of 5.5%, while loans granted after April 27, 2003 would bear CPI linkage differentials and an annual accrued linked interest rate of 11%.

5.19 Legal Proceedings

5.19.1 Pending proceedings

On March 6, 2013, a suit was filed in the Tel Aviv District Court against DBS and a request for recognition as a class action suit. According to the claimant, DBS disconnected customers from channel 5+ and reconnected them only after the said customers contacted the Company and asked to be reconnected but continued collecting fees for the channel from those customers who did not contact them and were, therefore, not reconnected. The claimant estimates the damage to himself at NIS 1,065 of which NIS 1,000 is non-monetary damage, but did not include a total amount for the suit.

5.19.2 Proceedings that came to a close

In April 2012 the Tel Aviv District Court accepted the withdrawal request filed by the parties and approved the applicant's request for leave withdraw from his petition to approve a class action against DBS. With regard to the claim that DBS violated its obligation to its customers by omitting broadcasts it is committed to air in the Basic Package, removed channels without approval, did not comply with the obligation to invest in quality genres and violated obligations regarding the broadcast of commercials, promos and marketing and commercial content. Business objectives and strategy

5.20 Business Goals and Strategies

5.20.1 DBS's goals are to increase its operating margins and to continue streamlining efforts while maintaining its business and competitive status in the broadcasting market.

5.20.2 To achieve these goals, along with efforts to reduce costs, DBS intends to invest considerable effort in marketing and sales, and in appropriate marketing strategy designed to continue attracting subscribers; and to retain existing customers; continually improve the array of services to subscribers, create differentiation and innovation in its broadcasting content which is to be expanded relative to HOT content, to increase the amount of content purchased by each subscriber and expand DBS's value-added services, and to invest in the development and integration of advanced technologies and new services. These efforts include DBS's drive to increase the rate of penetration of advanced services, including the PVR decoders and VOD and HD services among its subscribers as well as to also provide its content on additional platforms to increase DBS revenues and enhance subscriber loyalty to DBS's services.

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69 These agreements were also signed by additional shareholders, whose holdings in DBS were sold to Eurocom DBS and therefore, at the date of this report, the parties to these agreements are Eurocom DBS and the Company.

5.20.3 DBS's foregoing goals are based on forecasts by DBS's management, on the current trend in the broadcasting market and on DBS's assumptions regarding competition in the broadcasting arena and the regulation which applies and which will apply to DBS and other entities in the broadcasting segment and with regard to the transmission of content over the internet, taking into account the restrictions that apply and will apply to the Company, which affect DBS. However, the forecasts of DBS's management may not materialize, or may materialize in a manner that differs significantly, because of changes in demand in the broadcasting market, fiercer competition in this field, the entry of additional entities into the broadcasting field or alternative fields and in light of the regulatory restrictions which are imposed or will be imposed on DBS or on its partnerships with the Company.

5.21 Risk Factors

Following is a list of the threats, weaknesses and other risk factors of DBS (the "Risks") attributable to the general environment, industry and special nature of its operations.

5.21.1 Macro risks

A. Financial risks – a material part of DBS's expenses and investments are linked to fluctuations in the exchange rate of the US dollar (particularly content, satellite segments, purchase of decoders and additional logistics equipment). Therefore, sharp fluctuations in the exchange rate will have a effect on DBS's business results. In addition, the loans taken out by DBS from its shareholders and the debentures DBS issued are linked to the consumer price index and, therefore, sharp rises in inflation rates could have a material effect on DBS's business results.

B. Recession/economic downturn - A downturn in the economic, rise in unemployment and decline in disposable income may lead to a drop in the number of DBS subscribers, lower revenues for DBS and have a negative impact on its business results.

C. Security situation - An ongoing unstable security situation in large areas of Israel, which disrupts the day-to-day lives of the residents, could have an adverse effect on DBS's business results.

5.21.2 Sector risks

A. Dependence on licenses - DBS provides multi-channel television broadcasts in accordance with a broadcasting license and other licenses. A breach of the orders of the licenses as well as of the law under which the licenses are issued could bring about, subject to the license conditions, the cancellation, amendment or suspension of the licenses and consequently material harm to DBS's ability to continue operating in the field.

B. Regulation - DBS's operations and broadcasts are subject to obligations and restrictions set out in legislation and to a system of licensing, oversight and approvals from various regulatory bodies, and consequently DBS may be influenced and restricted by policy considerations dictated by these entities and by their decisions and changes in communications legislation (see Section 5.17). An extremely high degree of regulatory intervention and regulatory changes impact on DBS's operations and may have an adverse effect on its financial results. Likewise, the entry of content providers who transmit video content on additional communications networks, as noted in Section 5.1.1.C above, without the application of regulations to their operations and/or without amending the regulations which apply to broadcasting license holders, may significantly affect the performance of DBS. In addition, the operations of DBS, as a company supplying services to the public is subject to consumer protection legislation.

C. Intense competition - The field of broadcasts is characterized by intense competition with HOT (see Section 5.1.9 above), which requires DBS to constantly and continually invest in attracting and retaining customers, and dealing with high subscriber churn rates between DBS and HOT. For details about competition with HOT, see Section 5.7.

D. Technological developments and improvements - The risk in the development of new technologies is that they will render existing technology inferior, which will force DBS to male large monetary investments to retain competitive standing. The development of new technologies may also enable entry into the field of multi-channel broadcasts without making heavy financial investments, the entry barriers into the field might be lowered and constitute a threat to DBS's competitive status (see Section 5.1.1C).

E. Technological advances that have been made in recent years facilitate a high degree of accessibility to video content that may make it difficult for DBS to recruit new subscribers, retain existing subscribers and offer its services (see Section 5.1.1C above).

F. Deploying alternative multi-channel broadcast infrastructures - The DTT system activity and particularly the possibility of expanding it may negatively impact on the financial results of DBS.

G. Piracy – The area of broadcasting is exposed to viewers' attempts to use pirate connections in order to receive broadcasts without paying subscription fees and is exposed to public access to content to which the broadcasting entity has the rights.

H. Exposure to class action lawsuits - In view of the number of subscribers DBS and HOT have, there is exposure to class action lawsuits in material amounts.

5.21.3 Special risks of DBS

A. Exposure to having credit called in for immediate repayment due to non-compliance with loan agreements - Failure of DBS to comply with the orders of the agreements with its financing entities may, in accordance with and subject to their provisions, entitle the relevant lenders to a cause of action to call in all the credit provided to DBS for immediate repayment and realization of the securities given by DBS. With regard to the possibility of DBS debts being called in for immediate repayment in the event of violation of another credit term – see Section 5.15.

B. Restrictions that are the result of the ownership structure - DBS is restricted in cooperative ventures with the Company with respect to offering a basket of communications services in a manner that has a material impact on DBS's business status and is competitive ability (see Section 5.7.2).

C. Existence of sufficient cash flow - DBS is required to maintain a cash flow which is sufficient for compliance with its business plan and with repayment of the credit it used. The absence of a sufficient cash flow may impact on the ability of DBS to increase its rate of penetration of advanced services (such as PVR and HDPVR decoders) and to make it more difficult for it to face the competitive threats in view of technological developments and consumption patterns in the field.

D. Malfunction of and damage to satellite - DBS broadcasts through space segments on the Amos 2 and Amos 3 satellites stationed in identical points in space. Operational malfunction or damage to one of the satellites is liable to disrupt and reduce the scope of DBS's broadcasts, and such disruption and reductions are expected to be more significant in the event of a failure of AMOS 2. Nonetheless, the duplication of the satellites by means of which broadcasts are transmitted to subscribers enables a significant reduction of the risk entailed by damage to one of them, and improves the survival ability of the broadcast. If there is a malfunction in one of the satellites, it will be possible to broadcast most of DBS's channels via the existing space segments on the other satellite, and perhaps even via additional segments on the same satellite that might be made available to DBS, but not all the channels broadcast (for the agreement with Spacecom, see Section 5.18.1). DBS is not insured against loss of revenues caused by satellite malfunction.

DBS's estimate as aforesaid in this paragraph is forward-looking information. This estimate is based on the supply of space segments by Spacecom and on the ability to transfer broadcasts between the satellites. This estimate might not be realized or might be realized to some or other extent if Spacecom does not provide DBS with alternative segments in the event of malfunction of either of the satellites, or DBS is not permitted to carry out the above-mentioned channel transfer.

E. Dependence on holders of rights in the space segments - DBS is materially dependent on Spacecom, as the exclusive holder of the rights and the sole provider of space segments used by DBS, which is also responsible for operation of the space segments (see Section 5.18.1).

F. Dependence on providers of software, equipment, content, infrastructure and services - DBS is dependent on certain providers of software, equipment, content and services, including broadcast encryption services (see Section 5.13). Failure to receive the products or services they provide could harm DBS's ability to function and results.

G. Dependence on use of internal wiring - DBS is dependent on the use of internal wiring in some subscriber homes, which is owned by HOT (see Section 5.17.12). Denying the use of Hot infrastructure would constitute a substantial barrier to DBS's subscriber recruitment.

H. Damage to broadcasting centers - Damage to a broadcasting center might cause a significant difficulty for continued broadcasts, however, the splitting of broadcasts into two broadcasting centers (Kfar Saba and Re'em Junction) reduces the risk involved if one sustains damage and improves the possibility that some of the broadcasts will survive. In the event of damage to one of the broadcasting centers, DBS will be able to continue broadcasting only part of its channels from the other broadcasting center (the Kfar Saba center is able to broadcast a larger number of channels than the secondary center at Re'em Junction). All the broadcasting centers have identical encryption systems and therefore backup is also available for the encryption system in the event of damage to one of the broadcasting centers.

DBS's estimate as aforesaid in this paragraph is forward-looking information. This estimate is based on the provision of services from the supplier that operates the secondary broadcasting site in the event of damage to the Kfar Saba broadcasting center. This estimate might not be realized or might be realized to some or other extent if DBS is not permitted to receive the services of this supplier.

I. Malfunction of DBS's computer systems - A significant malfunction in DBS's central computer systems is liable to wreak havoc with its operational capability. DBS has a remote backup site, which is intended for activation and provision of partial computer services within a few hours in the event of malfunction, however, it will be impossible to implement significant DBS operational capacities without the proper operation of the central computer systems.

DBS's estimate with respect to its backup capability, as aforesaid in this paragraph, is forward-looking information. This estimate is based on the functioning of the remote backup site. This estimate might not be realized or might be realized to some or other extent if this functioning is not enabled.

J. Technical inferiority and the inability to offer integrated services - DBS's technology is inferior to that of Hot. This technical inferiority prevents DBS from providing telephony and Internet services, and various interactive services, including VOD, on its infrastructure; hence their supply therefore depends on third parties.

K. Defects in the encryption system - DBS's broadcasts are based on the encryption of broadcasts transmitted via satellites and encrypted via smart cards that are installed in the decoders in subscribers' homes. Defects in the encryption system or a breach thereof could make it possible to view broadcasts without payment to DBS, thereby causing a reduction in revenues and a breach of the agreements between DBS and its content suppliers.

L. Lack of exclusivity on frequencies - The spectrum of frequencies used by DBS to transmit its broadcasts from the broadcasting satellites to the satellite dishes installed in subscriber homes, and which is allocated in accordance with the license from the Ministry of Communications, is defined as a frequency spectrum with a secondary allocation, such that an Israeli party that is allowed to make authorized primary use the frequency spectrum. If the owner of the primary allocation uses the aforementioned frequency spectrum, this may cause DBS broadcasts to suffer in terms of quality and/or availability of the broadcasts to its subscribers, which may negatively impact on the financial results of DBS. At the date of this report, to the best of DBS's knowledge, the primary allocation holder did not make use of said frequencies such that it caused real and/or lengthy disruptions to DBS broadcasts.

M. Disturbances to broadcasts - Since DBS's broadcasts are wireless transmissions from broadcasting centers to broadcasting satellites and from them to the receiver dishes in subscriber homes, the broadcast of wireless signals in the same frequency spectrum, whether or not they originate in Israel, and extreme weather conditions of heavy rain, hail or snow could cause disruptions to the quality and/or availability of the broadcasts provided by DBS to its subscribers and may cause material harm to its financial results.

5.21.4 The following table sets out the risk factors by nature and ranking according to impact, as assessed by DBS management. Note that DBS's assessments below regarding the level of exposure of DBS to a risk factor reflects the level of impact of such a risk factor on the assumption that the risk factor is realized, and this does not express any assessment whatsoever not grant any weight whatsoever to the chances of the aforementioned realization. Likewise, the order of appearance of the risk factors above and below is not necessarily based on the risk inherent in each risk factor, or the probability of its occurrence.[70]

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70 Net calculation after weighting the discount received during the term of the current agreement (until 2016 or until Amos 2 ceases functioning).

	Extent of impact		
	Major	Moderate	Minor
Macro risk			
Financial risks		X	
Recession / economic downturn			X
Security situation			X
Sector risk			
Dependence on licenses	X		
Changes in regulation	X		
Intense competition	X		
Technological developments and changes		X	
Alternative infrastructures		X	
Unlawful viewing			X
Exposure to class action lawsuits		X	
Specific risk			
Exposure to bank credit being called in for immediate repayment as a result of failure to comply with the finance agreements	X		
Restrictions caused by ownership structure		X	
Need for sufficient cash flow	X		
Satellite malfunction and damage	X		
Dependence on space segment supplier	X		
Dependence on suppliers of content, equipment and infrastructure	X		
Dependence on use of internal wiring		X	
Damage to broadcasting centers	X		
Failure of computer systems	X		
Technical inferiority and inability to offer integrated services		X	
Malfunction of encryption system	X		
Lack of exclusivity on frequencies		X	
Disturbances in broadcasts	X		

The information included in this Section 5.21 and the assessments of DBS regarding the impact of the risk factors on DBS's operations and business constitute forward-looking information as defined in the Securities Law. The information and estimates are based on data published by regulatory agencies, DBS assessments of the market situation and the structure of competition, possible developments in the market and the Israeli economy, and the factors mentioned above in this section. Actual results may differ significantly from these assessments if a change occurs in one of the factors taken into account in making them.

March 13, 2013

Date

Bezeq - The Israel Telecommunication Corp. Ltd.

Names and titles of signatories:
Shaul Elovitch, Chairman of the Board of Directors
Avi Gabbay, Chief Executive Officer

Exhibit 99.2

Directors' Report on the State of the Company's Affairs
for the year ended
December 31, 2012

We respectfully present the Directors' Report on the state of affairs of "Bezeq" – The Israel Telecommunication Corp. Limited ("the Company") and consolidated Group companies (the Company and consolidated companies together: "the Group"), for the year ended December 31, 2012.

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

1) **Domestic Fixed-Line Communications**

2) **Cellular**

3) **International Communications, Internet and NEP Services**

4) **Multi-Channel Television**

It should be noted that the Company's consolidated financial statements also include an “Others” segment which consists mainly of internet services, portal operation (by means of Walla) and customer call center services (by means of Bezeq On Line). This Others segment is not material at the Group level.

The Company's profit for the year attributed to the shareholders amounted to NIS 1,858 million compared to NIS 2,066 million in the prior year, a decrease of 10.1%.

EBITDA (operating profit before depreciation and amortization) of the Group in the reporting year decreased from NIS 4,637 million in the prior year to NIS 4,471 million in the reporting year, a decrease of about 3.6%.

The results for the reporting year compared with the prior year were affected mainly by more intense competition in the communications market, primarily in the Cellular segment, which resulted in a decline in revenues. The effect of the decline in revenues was moderated by a decrease in operating and general expenses. In addition, the early retirement expense recorded in 2011 in the Domestic Fixed-Line Communications segment affected the results for the prior year compared with the reporting year.

1. Explanations of the Board of Directors for the state of the Company's affairs, the results of its operations, its equity, cash flows and other topics

1.1 Financial position

1.1.1 Assets

The Group's assets as of December 31, 2012 amounted to NIS 15.77 billion, compared to NIS 17.33 billion on December 31, 2011, of which NIS 6.08 billion (approximately 39%) are property, plant and equipment, compared to NIS 6.02 billion (35%) on December 31, 2011.

The decrease in the Group's assets stemmed primarily from the Domestic Fixed-Line Communications and the Cellular segments, as described below.

In the Domestic Fixed-Line Communications segment, total assets, without loans and investment in associates, decreased by NIS 752 million compared to December 31, 2011. The decrease stemmed mainly from a decrease in the balances of cash and cash equivalents.

In the Cellular segment, total assets decreased from NIS 5.40 billion on December 31, 2011 to NIS 4.70 billion as of December 31, 2012. The decrease stemmed primarily from a decline in the customer balance owing to a decrease in revenues from the sale of terminal equipment and deduction of non-returnable credit card instalment transactions. A decrease in the balance of property, plant and equipment, stocks and intangible assets was also recorded, and was partly offset by an increase in trade receivables and in the balance of cash and cash equivalents.

In the International Communications, Internet and NEP segment, assets decreased from NIS 1,268 million on December 31, 2011 to NIS 1,259 million as of December 31, 2012. Most of the decrease occurred in current assets, mainly cash and customer balances, and was moderated by an increase in the balance of property, plant and equipment balances following completion of the investment in setting up the sea-bed cable.

In the Multi-Channel Television segment (stated by the equity method), assets increased by approximately NIS 105 million, which stemmed mainly from an increase in property, plant and equipment, owing primarily to an increase in investment in decoders and an increase in the balance of broadcasting rights, mainly as a result of an increase in the balance of original productions.

1.1.2 Liabilities

The Group's debt to financial institutions and debenture holders at December 31, 2012 amounted to NIS 9.55 billion,[1] which is stable compared with December 31, 2011. The repayment of debentures and loans in the Domestic Fixed-Line Communications and Cellular segments was offset by bank loans taken by the Domestic Fixed-Line Communications segment.

1.2 Results of operations

1.2.1 Principal results

The Group's revenue in 2012 amounted to approximately NIS 10.278 billion, compared to NIS 11.373 billion in the prior year, a decrease of 9.6%. The decrease stemmed mainly from the Cellular segment as a result of more intense competition, which resulted in a decrease in revenues from the sale of terminal equipment and services, as described later in this document.

The Group's depreciation and amortization expenses amounted to approximately NIS 1.436 billion compared to NIS 1.395 billion in the prior year, an increase of 2.9%. The increase stemmed from the Domestic Fixed-Line Communications and the International Communications, Internet and NEP segments, as described later in this document.

[1] The Group's debt to financial institutions and to debenture-holders net of cash and cash equivalents and current investments as of December 31, 2012, amounts to approximately NIS 8 billion, compared with NIS 7.3 million on December 31, 2011.

The Group’s salary expenses amounted to NIS 1.982 billion compared to NIS 2.103 billion in the prior year, a decrease of 5.8%. The decrease stemmed from the Cellular and Domestic Fixed-Line Communications segments.

The Group’s operating and general expenses amounted to approximately NIS 3.953 billion compared to NIS 4.494 billion in the prior year, a decrease of 12%. The decrease stemmed primarily from the Cellular segment, mainly due to the decrease in the cost of selling terminal equipment.

Other operating expenses, net, amounted to approximately NIS 128 million compared to NIS 139 million in the prior year. The expense in 2011 stemmed from recording a provision of NIS 369 million for early retirement severance in the Domestic Fixed-Line Communications segment. For details, see later in this document and Note 24 to the financial statements.

The Group's finance expenses, net, amounted to approximately NIS 149 million, compared to NIS 210 million in the prior year, a decrease of 29%. Most of the decrease stemmed from the sale of the entire holding in Traffix Communication Systems Ltd. at a profit of approximately NIS 74 million in the first quarter of 2012.

Taxes on income amounted to approximately NIS 777 million, which is 26.9% of profit after net finance expenses, compared with NIS 755 million and 24.9% of profit after net finance expenses in the prior year, an increase of 2.9%.

The increase in expenses stemmed from the Domestic Fixed-Line Communications segment as a result of a rise in the segment's taxable income, which was largely offset by a decline in profitability in the Cellular segment. In addition, the corporate tax rate increased from 24% in 2011 to 25% in 2012.

1.2.2 Segments of operation

A. Data on operations by segment, according to the Group’s segments of operation:

	1-12/2012		1-12/2011	
	NIS millions	% of total revenue	NIS millions	% of total revenue
Revenue by segment				
Domestic Fixed-Line Communications	**4,630**	**45.1%**	4,648	40.9%
Cellular	**4,468**	**43.5%**	5,548	48.8%
International Communications, Internet and NEP	**1,340**	**13.0%**	1,354	11.9%
Multi-Channel Television Services	**1,636**	**15.9%**	1,619	14.2%
Other and offsets(*)	**(1,796)**	**(17.5)%**	(1,796)	(15.8)%
Total	**10,278**	**100%**	11,373	100%

	1-12/2012		1-12/2011	
	NIS millions	% of total revenue	NIS millions	% of total revenue
Operating profit by segment				
Domestic Fixed-Line Communications	**1,953**	**42.2%**	1,658	35.7%
Cellular	**892**	**20.0%**	1,360	24.5%
International Communications, Internet and NEP	**219**	**16.3%**	241	17.8%
Multi-Channel Television Services	**253**	**15.5%**	295	18.2%
Other and offsets(*)	**(282)**	**-**	(312)	-
Consolidated operating income /percentage of total Group revenue	**3,035**	**29.5%**	3,242	28.5%

* The setoffs are mainly for the Multi-Channel Television segment, which is an affiliate.

B. Domestic Fixed-Line Communications

Revenues

Revenues in the segment in 2012 amounted to NIS 4,630 million compared to NIS 4,648 million in the prior year, a decrease of 0.4%.

The decrease in the segment’s revenue stemmed mainly from a decrease in revenues from telephony, primarily due to erosion of revenue per telephone line, a decline in the number of subscribers, and a decrease in revenues from interconnect fees to the cellular networks.

The decrease in revenue was moderated by an increase in revenues from high-speed Internet, mainly the result of an increase in the number of Internet subscribers and in revenue per subscriber as a result of surfing speed upgrades. There was also an increase in revenues from data communications.

Operating expenses

Depreciation and amortization expenses in 2012 amounted to approximately NIS 730 million, compared with NIS 688 million in the prior year, an increase of 6.1%. The increase stemmed mainly from depreciation of the old network, in which operation ended, and amortization of new investments in the NGN project. The increase was moderated by the end of depreciation of other property, plant and equipment.

Salary expense in 2012 amounted to approximately NIS 1,042 million compared with NIS 1,089 million in the prior year, a decrease of 4.3%. The decrease in salary expenses stemmed mainly from a decrease in share-based payments and employee retirement, and was partly offset by wage creep, new employees hired and a decrease in salary attributed to investment.

Operating and general expenses in 2012 amounted to approximately NIS 1,033 million compared to NIS 1,074 million in the prior year, a decrease of 3.8%. The decrease stemmed mainly from a decrease in the liability for payment of frequency fees in the first quarter of 2012. There was also a decrease in interconnect expenses to the cellular networks with a corresponding decrease in revenues from interconnect fees. The decrease was moderated by a rise in expenses for terminal equipment and materials.

Other operating income, net, in 2012 amounted to approximately NIS 128 million compared to expenses of NIS 139 million in the prior year. The transition from expense to revenue in the reporting year stemmed from recording a provision of NIS 369 million on account of early retirement severance in 2011 compared with NIS 32 million in the reporting. In contrast, the Company recognized a loss of approximately NIS 54 million as a result of its decision to terminate the CRM project.

Profitability

Operating profit in the segment in 2012 amounted to approximately NIS 1,953 million, compared with NIS 1,658 million in the prior year, an increase of 17.8%. The change in operating profit stemmed from the changes described above in the revenue and expense items, and primarily from the provision for early retirement severance.

Finance expenses, net

Finance expenses, net, in the segment in 2012 amounted to approximately NIS 257 million, compared to NIS 240 million in the prior year, an increase of 7.1%. The increase in the reporting year stemmed primarily from an increase in interest expenses in respect of debentures issued during 2011, and bank credit received in the fourth quarter of the reporting year and during 2011. There was also a decrease in profit from financial assets held for trading owing to a decline in the balance of cash and cash equivalents.

The increase in finance expenses was moderated by an increase in finance income following an increase in loans made to associates and the recording of finance income from a decrease in the liability to pay frequency fees in the first quarter of 2012.

C. Cellular segment

Revenue

Segment revenue in 2012 amounted to approximately NIS 4,468 million compared to NIS 5,548 million in the prior year, a decrease of 19.5%. The decrease stemmed from significant intensification in competition in the segment (see section 3.6.2 in Chapter A of the Periodic Report for 2012).

Revenues from services in 2012 amounted to approximately NIS 3,261 million compared to NIS 3,637 million in the prior year, a decrease of 10.3%. The decrease in service revenues stemmed from the erosion of tariffs as a result of the more intense competition and the transition to unlimited packages that led to a decrease in ARPU (Average Revenue Per Subscriber), as well as a decline in the number of relatively high-usage subscribers. The fall in revenues was partly offset, commencing 2012, by revenues from cellular operators who use the segment's network.

Revenues in the segment from the sale of terminal equipment in 2012 amounted to approximately NIS 1,207 million, compared to NIS 1,911 million in 2011, a decrease of 36.8%. The decrease stemmed primarily from a decrease in the quantity of sales, inter alia as the market was opened to parallel imports and numerous stores selling terminal equipment opened for business.

Costs and expenses

Depreciation and amortization expenses in 2012 amounted to approximately NIS 531 million compared to NIS 561 million in the prior year, a decrease of 5.4%. The decrease stemmed mainly from termination of the capitalization of subscriber acquisition costs. .

The salary expense in 2012 amounted to approximately NIS 491 million compared to NIS 602 million in the prior year, a decrease of 18.4%. The decrease in salary expenses stemmed primarily from a decrease in the number of positions.

Operating and general expenses in 2012 amounted to approximately NIS 2,554 million compared to NIS 3,025 million in the prior year, a decrease of 15.6%. The decrease stemmed mainly from a decrease in the costs of selling terminal equipment, mostly the result of a decrease in the number of handsets sold and which was offset partly by a rise in the prices of the handsets and partly by a decrease in content expenses along with a decrease in revenues from content.

Profitability

Operating profit in the segment in 2012 amounted to approximately NIS 892 million compared to NIS 1,360 million in the prior year, a decrease of 34.4%. The decrease in operating profit stemmed primarily from erosion of revenues from services and a decline in sales of terminal equipment as noted above, as well as a decline in the profitability of the sale of terminal equipment.

Finance income, net

The segment's finance income, net, in 2012 amounted to approximately NIS 45 million compared to finance expenses, net, of NIS 38 million 2011, an increase of 18.4%. The increase stemmed mainly from finance income owing to an increase in the credit embodied in the sale of terminal equipment on installments in the past three years, which was partly offset by an increase in the segment's average debt.

D. International Communications, Internet and NEP

Revenue

Revenues in the segment in 2012 amounted to approximately NIS 1,340 million compared to NIS 1,354 million in the prior year, a decrease of 1%. The decrease in revenue stemmed primarily from a decrease in the revenues from outgoing and incoming calls owing a transition in the cellular market to packages that include unlimited international calls, and to a decline in sales of exchanges (PBX), offset by an increase in Internet revenues as a result of a rise in the number of customers and growth in the field of business communication solutions (ICT).

Costs and expenses

Depreciation and amortization expenses in 2012 amounted to approximately NIS 136 million compared to NIS 109 million in the prior year, an increase of 24.8%. Most of the increase stemmed from operation of the sea-bed cable and its depreciation for the first time at the beginning of the reporting year.

Salary expenses in 2012 amounted to approximately NIS 278 million compared to NIS 265 million in the prior year, an increase of 4.9%. The increase stemmed mainly from an increase in the number of workers employed in outsourcing services in ICT activities, along with termination of the capitalization of subscriber acquisition costs.

Operating and general expenses in 2012 amounted to approximately NIS 708 million compared with NIS 739 million in the prior year, a decrease of 4.2%. The decrease stemmed from a decrease in costs related to outgoing and incoming calls to PBX equipment, with a corresponding decrease in revenues, as well as more efficient maintenance of international cables after deployment of the sea-bed cable.

Profitability

Operating profit in the segment in 2012 amounted to approximately NIS 219 million compared to NIS 241 million in the prior year, a decrease of 9.1%. The decrease stemmed from the changes described above in the income and expense items.

E. Multi-channel television segment (stated by the equity method)

Revenue

Revenues in the segment in 2012 amounted to approximately NIS 1,636 million compared to NIS 1,619 million in the prior year, an increase of 1.1%. Most of the increase stemmed from a rise in revenues from the consumption of advanced converters, increased revenues from premium channels, and one-time sales of content in the first quarter of 2012.

Costs and expenses

The cost of sales in 2012 amounted to approximately NIS 1,067 million compared to NIS 1,028 million in the prior year, an increase of 3.8%. Most of the increase stemmed from an increase in content costs, and was moderated by a decrease in depreciation expenses.

Sales, marketing and administrative and general expenses in 2012 amounted to approximately NIS 316 million, compared to NIS 296 million in the prior year, an increase of 6.8%. The increase in these expenses stemmed primarily from termination of the capitalization of subscriber acquisition costs, and from an increase in advertising expenses.

Profitability

Operating profit in the segment in 2012 amounted to approximately NIS 253 million compared to NIS 295 million in the prior year, a decrease of 14%. The decrease in operating profit stemmed from the changes described above in the revenue and expense items.

1.3 Principal data from the Group's consolidated income statements (in NIS millions)

	Q1 2012	Q2 2012	Q3 2012	Q4 2012	2012	2011	Increase (decrease)	%
Revenue	2,740	2,595	2,494	2,449	10,278	11,373	(1,095)	(10)%
Operating expenses	1,890	1,849	1,827	1,677	7,243	8,131	(888)	(11)%
Operating profit	850	746	667	772	3,035	3,242	(207)	(6)%
Finance expenses, net	(44)	77	55	61	149	210	(61)	(29)%
Profit after finance expenses, net	894	669	612	711	2,886	3,032	(146)	(5)%
Equity in losses of associates	58	83	92	12	245	216	29	13%
Profit before income tax	836	586	520	699	2,641	2,816	(175)	(6)%
Income tax	245	174	178	180	777	755	22	3%
Profit for the period	591	412	342	519	1,864	2,061	(197)	(10)%
Attributable to:								
The Company's equity holders	582	415	342	519	1,858	2,066	(208)	(10)%
Non-controlling interest	9	(3)	-	-	6	(5)	11	-
Profit for the period	591	412	342	519	1,864	2,061	(197)	(10)%
Earnings per share (in NIS)								
Base and diluted earnings per share	0.21	0.15	0.13	0.19	0.68	0.76	(0.8)	(11)%

Comparison of quarterly results of 2012

Details of the material changes:

Total revenue decreased in each of the quarters of the reporting year compared with its previous quarter. The decrease stems from the Cellular and the Domestic Fixed-Line Communications segments. In the Cellular segment, revenues from services decreased in the fourth quarter compared with the third quarter, moderated by an increase in revenues from sales of terminal equipment with the launch of the iPhone5 in the fourth quarter of 2012. In the Domestic Fixed-Line Communications segment, the decrease occurred mainly in revenues from telephony.

Total operating expenses decreased in the fourth quarter by approximately NIS 150 million compared to the prior quarter. The decrease stemmed from the Domestic Fixed-Line Communications segment, mainly owing to an increase in capital gains from the sale of real estate and copper, along with a decrease in the salary and the operating and general expenses.

The Company's equity in the losses of associates decreased in the fourth quarter by approximately NIS 80 million, mainly due to a decrease in finance expenses and an improved operating profit in the Multi-Channel Television segment.

1.4 Equity

Equity attributable to the Company's owners as of December 31, 2012 amounted to approximately NIS 2.46 billion, which is 15.6% of the total balance sheet, compared to NIS 2.65 billion on December 31, 2011 which was 15.3% of the total balance sheet.

The decrease in equity is the result of the Group's profits in 2012, less a dividend of NIS 2.07 billion distributed during the year from the profits of the second half of 2011 and the first half of 2012.

On March 13, 2013, the Board of Directors of the Company resolved to recommend to the general meeting of the shareholders of the Company that a cash dividend of NIS 861 million be distributed to the shareholders (see Note 20.2.4 to the financial statements).

1.5 Cash flows

Consolidated cash flows from operating activities in 2012 amounted to approximately NIS 4,014 million, compared to NIS 3,186 million in the prior year, an increase of NIS 828 million. Most of the increase stemmed from the Cellular segment, due to a decrease in working capital net of a decrease in net profit. The decrease in working capital in the Cellular segment stemmed primarily from a decline in the volume of sales of terminal equipment on installments, which resulted in a decrease in the customer balance and also stemmed from the deduction of installment transactions paid by credit card. The increase was moderated by a decrease in the cash flow from operating activities in the Domestic Fixed-Line Communications segment, mainly owing to changes in working capital.

Cash flow from operating activities is one of the sources of financing for the Group’s investments, which in 2012 included approximately NIS 1,271 million in the development of communications infrastructures and NIS 269 million in intangible assets and deferred expenses, compared to NIS 1,548 million and NIS 355 million, respectively, in the prior year. Furthermore, approximately NIS 131 million net was invested in financial assets held for trade and others, compared to NIS 892 million in the prior year.

In addition, the Group received proceeds of approximately NIS 305 million from the sale of property, plant and equipment, as well as approximately NIS 100 million from the realization of assets and non-current loans, which includes the proceeds from the sale of assets available for sale.

In 2012, the Group repaid debts and paid interest totaling approximately NIS 1,184 million, compared with approximately NIS 1,860 million in the prior year. In contrast, the Domestic Fixed-Line Communications segment raised debt of NIS 650 million in the fourth quarter of 2012 whereas in the prior year total debt raised (by means of loans and an issuance of debentures) amounted to approximately NIS 5.29 billion. In addition, in 2012, a dividend of NIS 3.07 billion was paid, compared to NIS 3.16 billion in the prior year (see Note 20.2.3 to the financial statements).

The average of long-term liabilities (including current maturities) to financial institutions and debenture holders in 2012 amounted to NIS 9,274 million.

Average supplier credit in 2012 was NIS 851 million, and the average short-term customer credit was NIS 3,071 million, while average long-term customer credit was NIS 1,259 million.

The Group's working capital surplus as of December 31, 2012 amounted to approximately NIS 491 million, compared to a working capital surplus of NIS 1,424 million on December 31, 2011. The Company has (according to its separate financial statements) a working capital deficit of approximately NIS 790 million as of December 31, 2012, compared to a surplus of NIS 161 million on December 31, 2011.

The transition from surplus to deficit in the Company's working capital stemmed primarily from a decrease in the balance of cash and cash equivalents, which on December 31, 2011 included receipts in respect of an issuance of debentures and raising long-term loans during 2011. There was also an increase in the current liabilities of the Company, mainly due to an increase in current maturities of long-term loans.

The Board of Directors of the Company reviewed the existing and projected resources and cash flows in the foreseeable future and the investment needs of the Company, as well as the sources of finance and the potential amounts that will need to be available to the Company. On the basis of its review of all these factors, the Board of Directors concluded that despite the deficit in the Company's working capital (according to the separate financial statements), the Company does not have a liquidity problem. The Company can meet its existing cash needs and its needs for the foreseeable future by generating cash from operations, by receipt of dividends from subsidiaries and by raising debt, should it decide to do so, from banking and non-banking sources.[2]

The above information includes forward looking information based on the Company's assessments as to liquidity. The actual data might differ materially from those assessments if a change occurs in one of the factors taken into account in making them.

2 In light o the Board of Directors' determination that despite the Company's working capital deficit (according to the separate financial statements), there are no warning signs in the Company as provided in Article 10(b)(14) of the Securities (Periodic and immediate reports) Regulations, of the need to attach a projected cash flow report.

2. Explanations of the Board of Directors relating to exposure to market risks and their management (Part 4 below)

The Company operates on the basis of a financial exposure management policy adopted by the Company's Board of Directors on June 26, 2008 and updated on October 18, 2012.

Below are summaries of the sensitivity analysis tables (in NIS millions) shown in Part 4.

Sensitivity to changes in the USD/NIS exchange rate

		Gain (loss) from changes		Fair value of assets (liabilities	Gain (loss) from changes	
	Dollar exchange rate	10%	5%		5%-	10%-
2012	**3.733**	**(44)**	**(24)**	**(456)**	**24**	**44**
2011	3.821	(44)	(22)	(442)	22	44

Sensitivity to changes in the CPI

	Gain (loss) from changes			Fair value of assets (liabilities)	Gain (loss) from changes		
	1.5%	0.2%	%		0.1%-	0.2%-	1.5%-
2012	**(23)**	**(3)**	**(1)**	**(2,570)**	**1**	**3**	**25**
2011	(34)	(4)	(4)	(2,781)	4	4	34

Surplus liabilities exposed to changes in the CPI decreased by approximately NIS 211 million, primarily as a result of the Group's repayment of CPI-linked debentures, which was moderated by an increase in the balance of other liabilities.

Sensitivity to changes in real shekel interest

	Gain (loss) from changes			Fair value of assets (liabilities)	Gain (loss) from changes		
	16%	10%	5%		5%-	10%-	16% -
2012	**(73)**	**(48)**	**(24)**	**(1,483)**	**25**	**51**	**82**
2011	(68)	(43)	(22)	(1,834)	24	47	79

Surplus liabilities exposed to changes in the real shekel interest decreased by approximately NIS 351 million, primarily as a result of the Group's repayment of debentures.

Sensitivity to changes in nominal shekel interest

	Gain (loss) from changes			Fair value of assets (liabilities)	Gain (loss) from changes		
	16%	10%	5%		5% -	10%-	16%-
2012	**54**	**34**	**17**	**(3,052)**	**(17)**	**(34)**	**(55)**
2011	94	59	32	(2,763)	(32)	(61)	(100)

Surplus liabilities exposed to changes in the nominal shekel interest increased by approximately NIS 289 million, mainly as a result of raising loans during 2012 and a decrease in the balance of trade receivables, consolidated, which was moderated by a decrease in the balance of the dividend payable in respect of a distribution that does not pass the profit test.

Sensitivity to changes in the prices of commercial paper

	Gain (loss) from changes		Fair value of assets (liabilities)	Gain (loss) from changes	
	10%	5%		-5%	-10%
2012	**96**	**48**	**962**	**(48)**	**(96)**
2011	92	46	915	(46)	(92)

3. The link between the compensation awarded under Article 21 and the recipient's contribution to the Corporation

At its meetings on March 6 and March 13, 2013, the Board of Directors discussed the terms of service and compensation of the officers and interested parties in the Company, which are described in section 7 of Chapter D of the Periodic Report for 2012 ("the Periodic Report"), in accordance with Article 21 of the Periodic and Immediate Reports Regulations, 1970 ("the Periodic and Immediate Reports Regulations"). The Board discussed the connection between the compensation amounts given in 2012 to each of the senior officers and interested parties in the Company, and his activities and contribution to the Company during that year. To enable informed discussion, the members of the Board were provided in advance with the relevant data on the terms of employment of each officer and interested party.

The above discussion was preceded by extensive discussion in the Compensation Committee on March 10, 2013, of each of the officers – CEO Mr. Avraham Gabbay, former Deputy CEO and CFO Mr. Alan Gelman, Deputy CEO and VP Marketing Mr. Ran Guron, the CEO of Pelephone, Mr. Gil Sharon, and the CEO of Bezeq International, Mr. Itzhak Benbenisti ("the Managers"), his contribution and his compensation package seen as a whole.

The Board of Directors noted that the compensation given to each of the senior officers in the Group, was set, *inter alia*, while taking into account the function he filled in the Group and his contribution to the Group and its operations, and on the basis of the Company's compensation plan for 2012, which was approved in February 2012 by the Board of Directors of the Company with reference to each of the Managers.

The Board of Directors reviewed comparison data with the help of a paper prepared by Professor Moshe Zviran ("the Zviran Survey") on accepted bonus levels for CEOs and Deputy CEOs, as the case may be, among companies comparable with the Company, and discussed other parameters for considering the reasonableness and fairness of the compensation for the Company's officers, among them significant managerial goals attained in the reporting period and the occurrence of one-time events that could affect the targets defined in the officer's compensation plan.

In the assessment of the Board of Directors, the compensation of each of the Managers referred to in Article 21 in Chapter D of the Periodic Report (Additional Details about the Company), including the bonuses that are derived from the results of the Company or the subsidiaries, as the case may be, reflects the contribution of the Manager to the Group and is fair and reasonable, as described below.[3]

The five most highly paid persons in the Company

A. Avraham Gabbay – CEO of Bezeq

Approval of Mr. Gabbay's annual bonus for 2012 was based on the rate of his compliance with the targets set in advance by the Board of Directors in the 2012 bonus plan that was approved in February 2012.

In reviewing the compensation in respect of 2012 for Mr. Gabbay, the Board of Directors noted the achievements of Bezeq and in particular, the high rate of attainment of the EBITDA target (104.2%), his success this year also in meeting the Company's targets despite the fierce competition and the challenging regulatory situation.

The Board of Directors found that the amount of the compensation to Mr. Gabbay for 2012 is within the range of compensation levels presented in the Zviran Survey, in the upper section of the range.

In the opinion of the Board of Directors, the amount of the compensation and the bonus paid to the CEO of the Company in respect of 2012 is reasonable and fair in the circumstances, taking into account the size and scope of operations of the Company and the complexity of the job of its CEO, as well as his salary in relation to the size of the Company, the salaries of other senior Managers in the Group and his personal qualifications.

B. Gil Sharon – CEO of Pelephone

Approval of Mr. Sharon's annual bonus for 2012 was based on the rate of his compliance with the targets set in advance by the Board of Directors in the 2012 bonus plan that was approved in February 2012.

[3] For more information about the compensation of the senior officers, see Note 29 to the financial statements for 2012 and Article 21 (section 7) in Chapter D of the Periodic Report.

The Board's recommendation was to grant the compensation in accordance with the formula set, despite Pelephone's non-attainment of the EBITDA target – the result of a challenging budget which did not take into account in advance the intense competition in the cellular market as the new operators started operation. It was also noted that compared with the incumbent operators, Pelephone achieved the most impressive results while dealing with the changing market conditions of the cellular world.

The Board of Directors found that the amount of the compensation to Mr. Sharon is within the range of compensation levels presented in the Zviran Survey, in the upper section of the range.

In the opinion of the Board of Directors, the amount of the compensation and the bonus paid to the CEO of Pelephone in respect of 2012 is reasonable and fair under the circumstances, taking into account the size and scope of operations of Pelephone and the complexity of the job of its CEO, as well as his salary in relation to the size of the Company, the salaries of other senior Managers in the Group and his personal qualifications.

C. Itzhak Benbenisti – CEO of Bezeq International

Approval of Mr. Benbenisti's annual bonus for 2012 was based on the rate of his compliance with the targets set in advance by the Board of Directors in the 2012 bonus plan that was approved in February 2012.

In reviewing the compensation in respect of 2012 for Mr. Benbenisti, the Board of Directors noted the achievements of Bezeq International under his leadership, among them maintaining its position as the largest player in its field, the increase in the number of its customers while maintaining profitability despite the difficult market conditions and intense competition. In addition, Mr. Benbenisti successfully held together the managers and employees of the company in a period of shake-ups and incertainty in the economy as a whole and in the communications market in particular, fueling their motivation and commitment to the company and its customers.

The Board of Directors found that the amount of the bonus approved for Mr. Benbenisti is within the range of the bonus levels presented in the Zviran Survey, in the upper section of the range.

In the opinion of the Board of Directors, the amount of the compensation and the bonus paid to Mr. Benbenisti in respect of 2012 is reasonable and fair in the circumstances, in view of his achievements described above and taking into account his salary in relation to the size of the company, the salaries of other senior Managers in the Group and his personal qualifications.

D. Alan Gelman – Deputy CEO and CFO of Bezeq

Approval of Mr. Gelman's annual bonus for 2012 was based on the rate of his compliance with the targets set in advance by the Board of Directors in the 2012 bonus plan that was approved in February 2012.

The Board of Directors found that the amount of the compensation for Mr. Gelman in respect of 2012 is within the range of the compensation levels presented in the Zviran Survey, in the upper section of the range.

In the opinion of the Board of Directors, the amount of the compensation and the bonus paid to Mr. Gelman in respect of 2012 is reasonable and fair in the circumstances, in view of his achievements and taking into account his salary in relation to the size of the Company, the salaries of other senior Managers in the Group and his personal qualifications.

E. Ran Guron – Deputy CEO and VP Marketing of Bezeq

Approval of Mr. Guron's annual bonus for 2012 was based on the rate of his compliance with the targets set in advance by the Board of Directors in the 2012 bonus plan that was approved in February 2012.

In reviewing the compensation in respect of 2012 for Mr. Guron, the Board of Directors noted Bezeq's high rate of compliance with the EBITDA target, maintaining the level of the Company's revenues by means of marketing moves that resulted in a record year on Internet growth and continued progress in bandwidth, the range of services marketed to customers, and the strength of the brand. This was achieved in parallel to leading decision-making processes on important subjects such as the Fiber project, the Company's preparation for the changes expected in the communications market, and preparing the structure of the packages and products of the Company for the next stage in the competition.

The Board of Directors found that the amount of the compensation for Mr. Guron is in respect of 2012 is within the range of the bonus levels presented in the Zviran Survey, in the mid-section of the range.

In the opinion of the Board of Directors, the amount of the compensation and the bonus paid to Mr. Guron in respect of 2012 is reasonable and fair in the circumstances, in view of his achievements described above and taking into account his salary in relation to the size of the company, the salaries of other senior Managers in the Group and his personal qualifications.

Compensation interested parties in the Company

Management agreement with Eurocom Communications Ltd. ("Eurocom Communication")

Details of the management agreement with Eurocom Communications were reviewed before the Board of Directors, and also the services it has provided for the Company since the beginning of the year,[4] through Mr. Shaul Elovitch, Mr. Or Elovitch and Mr. Amikam Sorer.

In addition, the Board was shown comparison data from the paper prepared by Ernst & Young Kost Forer Gabbay & Kasierer, on management agreements in other public companies of similar size to the Company or as close as possible in size.

The Board members discussed the scope and nature of the services provided by Eurocom Communications in the reporting year, which included, inter alia, advice in various areas, mainly to the Group and on its strategy, regulation, finance and financing, and real estate taxation. The advice was provided at regular work meetings and review of various issues and discussions outside the regular meetings. Moreover, in the reporting year the Company did not pay its directors (including the Chairman of the Board) any compensation for their service as directors, except for the external directors and the independent directors.

The members of the Board found the compensation in 2012 to Eurocom Communications pursuant to the management agreement to be reasonable and fair, taking into account the contribution of the management agreement to the Company, for the following reasons:

The advice services by virtue of the management agreement were provided by experienced professional and expert entities in the communications market and in the areas of operation of the Company, including on regulation, on finance and financing and on real estate. These entities devoted considerable time and work to providing the advice in the reporting year (beyond the time devoted by some of them, as directors in the Company and in the subsidiaries).

The contribution of the advice services to the Company in preparing the Group for the regulatory changes, was significant.

In the reporting period, no compensation was paid to directors Shaul Elovitch (who serves as Chairman of the Board of the Company), Or Elovitch, Orna Elovitch-Peled, Amikam Sorer and Felix Cohen, for their service as directors in the Company and as directors in the subsidiaries and /or in companies related to the Company. The cost of these directors' compensation was saved to the Company in 2012 (calculated in terms of the compensation paid by the Company to the external and independent directors).

From the comparison data presented to the members of the Board in the E&Y survey, it transpires that compared with other companies of similar size to the Company, the compensation pursuant to the management agreement is at the average level.

Employee-directors

It is noted that the Board of Directors of the Company did not discuss Article 10(b)(4) of the Period and Immediate Reports Regulations and the reasonableness and fairness of the compensation to employee-directors Mr. Rami Nomkin and Mr. Yair David, since the compensation paid to them is by virtue of their job as Company employees and in accordance with the collective agreement, and not by virtue of their service as directors in the Company.

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4 Details of the management agreement are provided in section 7 of Chapter D in the Periodic Report. Engagement in the management agreement was approved in accordance with section 275 of the Companies Law by the general meeting of the Company on June 10, 2010.

4. Market Risks – Exposure and Management

The Company's market risk manager

The person responsible for management of the Company's market risks is Deputy CEO and CFO Dudu Mizrahi. For details of his education and experience, see Section 15 in Chapter D of the Periodic Report.
Until December 31, 2012, the market risk manager was Alan Gelman, the former Deputy CEO and CFO of the Company.

- ID No. 015704307
- Date of birth: November 5, 1955
- Term of office: February 15, 2008 – December 31, 2012
- Is he an interested party in the Company or a relative of a senior officer or of an interested party in the Company: No.
- Education and business experience in the past five years:
  Graduate in accounting, Queens College NY
  MBA, Hofstra University, NY
  CPA (Isr.)
  CPA New York
  2006-2007 – Deputy CEO and CFO at Delek Group.

Once every quarter, a presentation is made to the Financial Statements Review Committee and to the Board of Directors, of the extent and the characteristics of the financial exposures and the actions taken, if taken, to minimize them.

Market risks and the Company's risk management policy

The Company is exposed to market risks as a result of changes in interest rates, exchange rates, the CPI, inflation, and the prices of raw materials.

The Company acts in accordance with a financial exposure management policy adopted by the Board of Directors of the Company on June 26, 2008 and updated on October 18, 2012. Pursuant to that policy, the Company implements partial hedging operations depending on the circumstances and its own judgment, primarily in order to reduce its exposure to changes in the CPI, in the price of copper and in foreign currency exchange rates. The Company monitors the Group's exposure management every month, and this includes, where necessary, recommending changes in exposure management. In cases where management considers deviation from this policy, its recommendations are brought before the Company's Board of Directors.

CPI risk – The Company has a significant surplus of liabilities over CPI-linked assets, and the bulk of its financial exposure stems from the risk of a rise in inflation. The rate of inflation also affects the Company's operating income and expenses in the course of the year.

In order to minimize exposure to inflation, the Company's Board decided to implement full or partial hedging, at its discretion, in accordance with the following:

a. Hedging activity will be implemented mainly by means of CPI-shekel forward transactions, which guarantee a defined rise in the CPI over a designated period.

b. The transactions will be subject to judgment and made in accordance with market trading restrictions and reviewed in relation to the inflation expectations inherent in the debenture market and inflation forecasts, and in relation to the Bank of Israel's inflation target range.

c. The hedging position can be lowered by closing existing transactions before their final expiration date.

d. The Company will strive for hedging transactions to meet the terms required for the application of hedging accounting.

e. Hedging transactions will be made according to the repayment schedules of the CPI-linked financial debt.

f. As long as index exposure is more than NIS 500 million, the hedging rate will not be less than 40% of the exposure in respect of the CPI-linked financial debt and will not exceed 100%; where the exposure is less than NIS 500 million, the hedging rate will not exceed 50% of the exposure stemming from CPI-linked financial debt.

The Company made hedging transactions against the CPI in order to minimize the risk. The Company incurred no material costs in making these hedging transactions.

Interest risk – The Company's exposure to change in the interest rate depends largely on the nature of its financial liabilities and assets as well as on future financing needs. Some of the Company's liabilities bear fixed interest, and therefore a change in the interest rate will affect their fair value rather than their carrying value. Other liabilities bear variable interest based on the prime / STD rate.

As of the date of this report, the Company does not hedge against these exposures, but it is not inconceivable that it will do so in future market circumstances. Furthermore, the Company takes into account such influences when considering the types of loans it takes.

Currency risk – A change in the shekel exchange rate against the currency basket is an economic exposure in that it can affect the Company's profit and future cash flows.

To minimize this exposure, the Board of Directors decided that the Company should hedge its exposure against exchange rate risks, subject to the following principles and rules:

a. The unhedged equity exposure to changes in exchange rates will not exceed a sum equivalent to USD 200 million

b. The decision whether to hedge purchase and/or investment transactions will be made, if at all, on the date of the purchase and/or investment decision, or shortly thereafter as possible.

The Company made no hedging transactions against exchange rates in the reporting period.

Copper price – The Company is exposed to changes in copper prices that result in a change in the residual value of its copper cable infrastructure. In addition, the Company is withdrawing and selling copper cables while deploying the NGN network, and in view of the significant cash flows expected from sale of copper and the volatility of its price, the Board of Directors of the Company approved transactions to hedge its exposure to the value of copper assets that will be sold as part of the NGN project. On December 31, 2012, the Company had open forward transactions for 3,494 tons of copper. The total fair value of the transactions at that date is approximately NIS 1.4 million.

Risks and risk management in the subsidiaries

In accordance with a decision of the Board of Directors, each of the companies in the Group is required to manage a risk management policy and routinely monitor its implementation. The persons responsible for market risk management in the principal consolidated companies are the CFOs of those companies.

For more details about financial risk management in the Group and information on the linkage terms of the balances in the Group's balance sheet (Linkage Bases Report), see Note 30 to the financial statements.

5. Aspects of corporate governance

5.1 Community involvement and donations by Group companies

Group companies are active in the community through donations to not-for-profit associations and social organizations which promote education, welfare and other causes. Activities are expressed in money donations, contributions of communications infrastructures, and the encouragement of volunteering by employees carrying out a range of activities for the community.

The guiding principle of the Company's contribution to the community this year was support for programs aimed at narrowing social-educational gaps that exist due to non-availability of computers and the internet ("the digital divide") in the world.

In 2012, the Group donated approximately NIS 11.7 million.

5.2 Disclosure concerning the auditor's fees

Below are the fees paid to the auditors of the main companies in the Group for auditing services and audit-related services:

Company	Auditor	Details	2012		2011	
			Fees (NIS thousands)	Hours	Fees (NIS thousands)	Hours
Bezeq	Somekh Chaikin	Audit and audit-related services	3,610	17,325	3,850	16,535
		Other services[5]	170	487	157	426
Pelephone	Somekh Chaikin	Audit and audit-related services	1,414	7,837	1,510	8,450
		Other services[4]	164	433	91	269
Bezeq International	Somekh Chaikin	Audit and audit-related services	717	5,121	749	4,527
		Other services[4]	105	262	403	878

The auditors' fees were discussed by the Committee for the Examination of the Financial Statements and approved by the boards of directors of the Company and of each of the Group companies. The fees were determined on the basis of the hours worked and the hourly tariff in the prior year and with adjustment for changes and events which occurred in the reporting year.

5.3 Directors with accounting and financial expertise and independent directors

Information about directors with accounting and financial expertise and independent directors is included in sections 2 and 12 of the corporate governance questionnaire and in section 14 in Chapter D of the Periodic Report.

5.4 Disclosure regarding an internal auditor in a reporting corporation

5.4.1 The Company's internal auditor

A. Name: Lior Segal.

B. Date of commencement of office: January 24, 2011.

C. The internal auditor complies with the conditions laid down in Article 8 of the Internal Audit Law, 1992 and section 146(b) of the Companies Law.

D. Method of employment: the internal auditor is a Company employee. The Company has an audit unit which is headed by the internal auditor.

5.4.2 Method of appointment

In its discussion on January 13, 2011, the Audit Committee recommended the appointment of Lior Segal as the Company's internal auditor. The appointment was approved by the Board of Directors on January 24, 2011.

Summary of the reasons for approving the appointment

The Board of Directors approved the appointment of Lior Segal, who, prior to his appointment as internal auditor, served as manager of internal processes and controls and corporate governance compliance officer, to the post of internal auditor, following a recommendation from the Audit Committee, based on his qualifications and professional experience.

Duties, authority and tasks of the internal auditor

The authority and responsibility of the Company's internal auditor are laid down in the Company's internal audit procedure. The procedure was revised and approved by the Audit Committee on December 19, 2010.

The role of the internal auditor according to the Company's internal audit procedure

5 "Other services" provided for the principal companies in the Group in 2011 and 2012 included tax advice.

A number of roles are imposed in the internal auditor, including examination of the propriety of the actions of the Company and the activities of its officers and office-holders, examination of the integrity of the financial and operating information, review of financial and liability management and review of the Company's computerized information and its information security set-up. The internal auditor is also responsible for examining employee complaints, as required by section 117(6) of the Companies Law, 1999.

Authority of the internal auditor according to the Company’s internal audit procedure

The internal auditor is authorized to receive any information, explanation and document required for the performance of his duties: he has right of access to any ordinary or computerized data bank, database and automated or non-automated data processing work plan of the Company and its units, and to receive right of entry to any Company property. He is also entitled to be invited to all meetings of management, the Board of Directors and its committees.

5.4.3 The organizational superior of the internal auditor

The internal auditor answers to the CEO.

5.4.4 Work plan

1. The work plan in 2012 was annual. As part of the preparation for 2013, the internal auditor defined a work plan for the years 2013-15.

2. **Considerations in determining the internal audit work plan**
The guiding principle underlying the annual work plan of the internal audit is the risk inherent in the Company's processes and operations. To assess these risks, the internal audit referred to a risk survey prepared in the Company by the Deputy CEO and CFO, who serves also as operational risk manager, and to other resources that affect the risk assessment in those processes, such as speaking with management, the findings of previous audits and other relevant activities.
The considerations taken into account in compiling the work plan are reasonable coverage of most of the Company’s areas of operation based on exposure to material risks, including the controls existing in the Company's areas of operation and the findings of previous audits.

3. **Entities involved in compiling the work plan**
The internal auditor, management, the CEO, the Audit Committee, the Chairman of the Board.

4. **Entity accepting and approving the work plan**
The Audit Committee.

5. **The auditor’s discretion to deviate from the work plan**
The Chairman of the Board and the chairman of the Audit Committee can propose subjects on which an urgent need arises for audit, and may also recommend narrowing or halting an audit approved in the work plan. The internal auditor has discretion to deviate from the work plan.

6. The internal auditor attends discussions at Board meetings where material transactions are approved, and reviews the relevant material sent in preparation for those discussions. He examined transactions with related parties which were discussed in 2012 by the Audit Committee. This subject is included in the work plan for 2013 (as part of a review of managerial compliance). .

5.4.5 The audit and the corporations which are material holdings

The work plan of the internal audit unit does not include an audit in corporations which are material holdings. All the corporations that are material holdings of the Company have their own internal auditors (either as employees or outsourced). The audit reports are discussed in the audit committees and/or boards of directors of these corporations, on which directors of the Company serve. The internal auditor may, under the Company's internal audit procedure and at his discretion, obtain the audit reports of the subsidiaries’ statements and he is obligated to hold a work meeting with each of the internal auditors of the subsidiaries at least once a year, to discuss the audit plan and its implementation in the subsidiary.

For a summary about the internal audit in the material associates of the Company – Pelephone, Bezeq International and DBS, see sub-section 5.4.12 below.

5.4.6 Scope of employment

Number of hours of employment in the year

In 2012, approximately 9,300 hours were devoted to internal audit work. This includes the hours of entities from outside the organization who were hired by the internal auditor. The internal audit unit at the end of the reporting year employed four full-time internal auditors in addition to the Company's internal auditor. The scope of employment is set according to the audit work plan, which was set in accordance with the scope and complexity of the activities of the various companies.

5.4.7 Preparation of the audit

1. **Work standards**

Bezeq's internal audit is carried out in accordance with the Companies Law - 1999 and the Internal Audit Law - 1992, and implemented according to accepted professional standards.

2. **The Board's criteria for ensuring that the auditor complies with all the requirements of the standards**

The auditor briefed the Board of Directors on the standards by which he operates.

In 2012, the internal auditor made a self-assessment of the internal auditing work, from which it transpired that it is carried out in accordance with the requisite standards. An assessment is also being made by an external entity and is expected to be completed in 2013. .

5.4.8 Access to information

The internal auditor was supplied with documents and information as stipulated in Section 9 of the Internal Audit Law, and he was granted permanent and direct access to the Company's information systems, including financial data.

5.4.9 Internal Auditor's report

The internal auditor submits audit reports in writing.

The internal auditor routinely submits audit reports during the reporting year to the Chairman of the Board, the CEO, the Audit Committee chairman and members. The Audit Committee holds regular discussions of the audit reports.

The Audit Committee held 19 meetings in 2012 and discussed audit reports on the following dates: January 11, 2012, February 23, 2012, March 20, 2012, June 17, 2012, July 25, 2012, August 26, 2012, September 20, 2012, October 28, 2012 and November 28, 2012. The reports were forwarded to the above-mentioned entities in readiness for the committee's discussions (usually about three days in advance). In addition to reports, the auditor submitted to the Audit Committee surveys on various topics at the request of the committee, and briefings on the implementation of the decisions in the audit reports that were discussed by the committee.

5.4.10 The Board of Directors' assessment of the work of the Internal Auditor

The Board of Directors believes that the scope of the Company audit in 2012, the nature and continuity of the internal auditor's activities as well as the work plan, are reasonable in the circumstances and they can achieve the objectives of the audit.

5.4.11 Compensation

1. The terms of employment of the internal auditor were discussed and approved by the Audit Committee and the Board of Directors as follows: Monthly salary of NIS 40,000 and an annual target-based bonus set in advance by the Audit Committee and approved by the Board of Directors, of 25% of the annual salary excluding incidentals. On March 16, 2011, the Board of Directors of the Company approved an allotment of 41,000 options of the Company to the internal auditor, under the 2010 employee stock options plan.

2. On March 4, 2013 the Audit Committee of the Company approved the bonus for the Company's internal auditor for 2012 in the amount of NIS 102,000 (21.4% of the annual salary).

3. The Board of Directors believes that the compensation of the internal auditor did not affect his professional judgment.

5.4.12 Details of internal auditing in the Company's material associates

The table provides details of the internal auditing at Pelephone, Bezeq International and DBS. It is noted that these are private companies, not subject to the duty to employ an internal auditor under Chapter 4 of Part IV of the Companies Law, and the internal auditors are voluntary.

	Pelephone	**Bezeq International**	**DBS**
Name of internal auditor	Vered Cohen-Herschaft	Meir Kugler	Morad & Shmueli Ltd., CPA, through Uzi Shmueli
Employment format	Employee	Employee	Not a DBS employee
Date of start of term	November 2, 2011	November 2003	June 2, 2002
Answers to	The CEO of Pelephone, and she also reports to the board of directors.	CEO of Bezeq International	CEO of DBS
Hours of work in 2012	5,500	2,200	1,200
Reasons for number of hours allocated and extent of flexibility	Corresponds to scope and complexity of the company's various operations. The hours and the structure of the internal audit division are similar to those of competitors in the sector and of similar-size companies abroad. Flexibility is defined in the work procedures.	To allow for reasonable scope of audit and range of topics as per the company's risk survey. The hours include outsourcing services to enable flexibility.	DBS management believes that the scope, character and continuity of the activity and the work plan are reasonable, given the size, organizational structure and nature of the business, and that they can achieve the purposes of internal auditing.
Accepted professional standards by which the auditor carries out the audit	Companies Law, 1999, Internal Audit Law, 1992 and accepted professional standards.		
Were material transactions reviewed in the reporting year?	Material transactions were not reviewed in the reporting year.		
Compliance with the provisions of the law	The internal auditors are in compliance with the terms laid down in Sections 3(a) and 8 of the Internal Audit Law and Section 146(b) of the Companies Law.		

5.5 Provisions of the Sarbanes-Oxley Act of 2002 (SOX)

Commencing 2011, the Company ceased to apply the provisions of the Securities (Periodic and immediate reports) (Amendment) Regulations, 2009, in the matter of internal control, and applies instead the provisions of the Sarbanes-Oxley Act of 2002 (SOX), as a significant subsidiary of a company traded in the U.S. Accordingly, the Company's 2012 Periodic Report includes a management report and managers' confirmation in the SOX format.

6. Disclosure concerning the financial reporting of the corporation

6.1 Critical accounting estimates

Information about the main issues of uncertainty in critical estimates and judgments in implementation of the accounting policy is provided in Note 2.7 to the financial statements.

6.2 Disclosure of material valuations

Below are details about material valuations pursuant to Article 8B of the Securities (Periodic and immediate reports) Regulations, 1970.

Valuation of Pelephone's operation:

Subject of valuation	Value of Pelephone for test of impairment of goodwill attributed in the Company's financial statements in accordance with IAS 36.
Timing of valuation	December 31, 2012; valuation signed on 11.3.2013
Value prior to the valuation	NIS 2.886 billion carrying value of the net operating assets of Pelephone* (NIS 1.027 billion – balance of goodwill).
Value set in the valuation	Approx. NIS 8.133 billion. .Based on the value set in the valuation, the Company concluded that there is no impairment that requires amortization in the amount pf the goodwill recorded in the Company's books.
Assessor and his characteristics	Giza Singer Even Ltd. The work was done by a team headed by Eyal Shevach, a partner with more than five years' professional experience. Mr. Shevach is a graduate (B.Sc.) of The Technion in electronic engineering, and has an MBA from Tel Aviv University. The assessor has no dependence on the Company.
Assessment model	Discounted Cash Flow method (DCF).
Assumptions used in the assessment	• Discount rate – 11%. Comparison companies for setting the discount rate – Cellcom and Partner. • Permanent growth rate – 1%. • Scrap value out of total value set in assessment – 63% (model years – up to 2016).

* Net operating assets of Pelephone do not include trade receivable balances relating to the sake of terminal equipment on installments.

6.3 The auditors drew attention in their opinion on the financial statements, to the materiality of the claims filed against the Group which at this stage cannot be assessed or in respect of which the exposure cannot be calculated.

7. Details of series of liability certificates

7.1 Data for the Company's debentures in circulation, at December 31, 2012:

Debentures Series 5 – 8

		Debentures Series 5	Debentures Series 6	Debentures Series 7	Debentures Series 8
A	Issue date	June 1, 2004	July 3, 2011	July 3, 2011	July 3, 2011
B	Total par value on issue date	NIS 2,386,967,000	NIS 958,088,000	NIS 424,955,000	NIS 1,329,363,000
C	Its par value	NIS 1,591,311,333 (1)(2)	NIS 958,088,000	NIS 424,955,000	NIS 1,329,363,000
D	Par value reassessed to report date (linked to the CPI)	NIS 1,935,482,978 (3)	NIS 975,659,112	NIS 424,955,000	NIS 1,329,363,000
E	Accrued interest	NIS 59,838,682	NIS 3,008,282	NIS 1,153,753	NIS 6,314,474
F	Fair value	NIS 2,169,116,478	NIS 1,081,209,117	NIS 425,464,946	NIS 1,460,039,383
G	Stock exchange value	NIS 2,169,116,478	NIS 1,081,209,117	NIS 425,464,946	NIS 1,460,039,383
H	Interest type	Fixed at 5.3%	3.7% fixed interest	Variable – STL for one year plus margin not to exceed 1,4%	5.7% fixed interest
I	Principal payment dates	June 1 every year from 2011 through 2016	December 1 of each of the years 2018-2022	December 1 of each of the years 2018-2022	June 1 of each of the years 2015-2017
J	Interest payment dates	June 1 every year through 2016	June 1 and December 1 of each of the years 2011-2022	March 1, June 1, September 1 and December 1 of each of the years 2011-2022	June 1 and December 1 of each year from December 1, 2011 to June 1, 2017
K	Linkage	Principal and interest linked to the CPI (base index April 2004)	CPI-linked principal and interest (base index May 2011)	Unlinked	Unlinked
L	Liability in relation to Company's total liability	Material	Material	Not material	Material

(1) On June 1, 2012, NIS 397,827,833 par value was repaid.

(2) Of which NIS 586.7 million par value is held by a wholly-owned subsidiary.

(3) Of which NIS 713.6 million held is by a wholly-owned subsidiary.

Series 5

On March 23, 2012, the appointment of Hermetic Trust (1975) Ltd. ("Hermetic") was approved as trustee for the Debentures of the Company, instead of Mizrachi Tefahot Trust Co. Ltd., and accordingly, commencing that date, Hermetic is the trustee for those debentures.

Trust company – Hermetic Trust (1975) Ltd.

Contact person in the trust company – Dan Avnon, CEO

Email address – avnon@hermetic.co.il Telephone – 03-5274867

Address – Hermetic House, 113 Hayarkon Street, Tel Aviv

The liability certificates are not secured by any charge whatsoever.

Series 6 and 7

Trust company – Reznik Paz Nevo Trusts Ltd.

Contact person in the trust company – CPA Yossi Reznik and Adv. Liat Bachar-Segal

Email address – 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.

Contact person in the trust company – CPA Uri Lazar

Email address – slcpa@slcpa.co.il Telephone: 03-6237777, Fax: 03-5613824

Address – 17 Yitzchak Sadeh Street, Tel Aviv

With reference to Debentures Series 6-8, the Company undertook not to create additional charges on its assets unless it simultaneously creates a charge in favor of the debenture- holders and the lending banks (negative pledge) and subject to the exceptions noted in it, as described in Note 13.2.1 to the financial statements.

7.2 For details of the ratings of the series of liability certificates, see Section 2.13.6 in Chapter A of the Periodic Report. The ratings reports are attached as an appendix to the Directors' Report.

7.3 During and at the end of the reporting year the Company met all the conditions and commitments under the deeds of trust for series 5-8, and no conditions were met for establishing cause to present the certificates of liability for immediate repayment. No collateral was given to secure payment to the holders of the liability certificates.

8. Miscellaneous

8.1 For the forecast of Bezeq Group for 2013, see Section 1.6 in Chapter A of the Periodic Report for 2012.

8.2 For information about the liability balances of the corporation and the subsidiaries or the proportionately consolidated companies in its financial statements at December 31, 2012, see the report form filed by the Company on Magna on March 14, 2013.

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

Shaul Elovitch Chairman of the Board	Avraham Gabbay CEO

Date of signature: March 13, 2013

Exhibit 99.3

Bezeq The Israel
Telecommunication Corp. Limited

Part C

Consolidated Financial Statements
for the Year Ended
December 31, 2012

bezeq

Contents

Somekh Chaikin
8 Hartum Street, Har Hotzvim
PO Box 212, Jerusalem 91001
Israel

Telephone 972 2 531 2000
Fax 972 2 531 2044
Internet www.kpmg.co.il

Auditors' Report to the Shareholders of "Bezeq" -The Israel Telecommunication Corporation Ltd.

We have audited the accompanying consolidated statements of financial position of "Bezeq" -The Israel Telecommunication Corporation Ltd.(hereinafter- "the Company") as of December 31, 2011 and 2010 and the consolidated income statements, statements of comprehensive income, statements of changes in equity and statements of cash flows, for each of the three years, the last of which ended December 31, 2011. These financial statements are the responsibility of the Company's Board of Directors and of its Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of certain consolidated subsidiaries whose assets constitute 2.12 % and 2.6 % of the total consolidated assets as of December 31, 2011 and 2010, respectively, and whose revenues constitute 1.75 % and 1.1 % of the total consolidated revenues for the years ended December 31, 2011 and 2010, respectively. The financial statements of those companies were audited by other auditors whose reports thereon were furnished to us, and our opinion, insofar as it relates to amounts emanating from the financial statements of such companies, is based solely on the reports of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards in Israel, including standards prescribed by the Auditors Regulations (Manner of Auditor's Performance) - 1973. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the company's Board of Directors and by its Management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and on the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its consolidated subsidiaries as of December 31, 2011 and 2010 and their results of operations, changes in their equity and cash flows, for each of the three years, the last of which ended December 31, 2011, in accordance with International Financial Reporting Standards (IFRS) and in accordance with the Securities Regulations (Annual Financial Statements) - 2010.

We have also audited, in accordance with the Standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 14, 2012 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Without qualifying our abovementioned opinion, we draw attention to lawsuits filed against the Company which cannot yet be assessed or the exposure in respect thereof cannot yet be calculated, as set forth in Note 17.

Somekh Chaikin
Certified Public Accountants (Isr.)

March 14, 2012

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
"Bezeq"- The Israel Telecommunication Corporation Ltd.

We have audited "Bezeq"- The Israel Telecommunication Corporation Ltd.'s (hereinafter "The Company") internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with generally accepted auditing principles in Israel, the consolidated balance sheets of the Company and its subsidiaries as of December 31, 2011, 2010 and 2009, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2011, and our report dated March 14, 2012 expressed an unqualified opinion on those consolidated financial statements with an explanatory paragraph referring to Note 17 regarding the claims made against the Company and its subsidiaries for which at this point the exposure cannot be assessed or calculated.

Somekh Chaikin
Certified Public Accountants (Isr.)

Jerusalem, Israel
March 14, 2012

Consolidated Statements of Financial Position as at December 31

	Note	2011 NIS million	2010 NIS million
Assets			
Cash and cash equivalents	5	**1,352**	365
Investments, including derivatives	6	**946**	7
Trade receivables	7	**3,059**	2,701
Other receivables	7	**286**	227*
Inventory		**204**	178
Assets classified as held for sale		**23**	29
Total current assets		**5,870**	3,507
Investments, including derivatives	6	**119**	129
Trade and other receivables	7	**1,499**	1,114
Property, plant and equipment	9	**6,022**	5,610
Intangible assets	10	**2,257**	2,248
Deferred and other expenses	11	**282**	292
Investments in equity-accounted investees (mainly loans)	12	**1,059**	1,084
Deferred tax assets	8	**223**	254
Total non-current assets		**11,461**	10,731
Total assets		**17,331**	14,238

Consolidated Statements of Financial Position as at December 31 (Contd.)

	Note	2011 NIS million	2010 NIS million
Liabilities			
Debentures, loans and borrowings	13	**765**	949
Trade payables	14	**890**	1,061
Other payables, including derivatives	14	**792**	770
Current tax liabilities		**397**	267
Deferred income		**56**	33
Provisions	15	**186**	251
Employee benefits	16	**389**	269
Dividend payable	20	**971**	–
Total current liabilities		**4,446**	3,600
Debentures	13	**4,663**	1,967
Loans	13	**4,150**	2,801
Employee benefits	16	**229**	305
Other liabilities		**93**	43
Provisions	15	**69**	69
Deferred tax liabilities	8	**69**	83
Dividend payable	20	**924**	–
Total non-current liabilities		**10,197**	5,268
Total liabilities		**14,643**	8,868
Equity	20		
Total equity attributable to equity holders of the Company		**2,650**	5,327
Non-controlling interests		**38**	43
Total equity		**2,688**	5,370
Total liabilities and equity		**17,331**	14,238

Shaul Elovitch
Chairman of the Board of Directors

Avi Gabbay
CEO

Alan Gelman
Deputy CEO and CFO

* Reclassified See Note 2.9.

Date of approval of the financial statements: March 14, 2012

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

Consolidated Statements of Income for the Year Ended December 31

	Note	2011 NIS million	2010 NIS million	2009 NIS million
Continuing operations				
Revenues	21	**11,373**	11,987	11,519
Costs and expenses				
Depreciation and amortization	9,10,11	**1,395**	1,409	1,485
Salaries	22	**2,103**	2,024	1,990
General and operating expenses	23	**4,494**	5,026	4,871
Other operating expenses (income), net	24	**139**	(216)	201
		8,131	8,243	8,547
Operating profit		**3,242**	3,744	2,972
Financing expenses (income)	25			
Financing expenses		**599**	391	398
Financing income		**(389)**	(282)	(429)
Financing expenses (income), net		**210**	109	(31)
Profit after financing expenses (income), net		**3,032**	3,635	3,003
Share in losses of equity-accounted investees	12	**216**	261	34
Profit before income tax		**2,816**	3,374	2,969
Income tax	8	**755**	932	807
Profit for the year from continuing operations		**2,061**	2,442	2,162
Discontinued operations				
Profit for the year from discontinued operations	12.1.9	**–**	–	1,379
Profit for the year		**2,061**	2,442	3,541
Attributable to:				
Owners of the Company				
Profit for the year from continuing operations		**2,066**	2,443	2,157
Profit for the year from discontinued operations		**–**	–	1,446
		2,066	2,443	3,603
Non-controlling interests				
Profit (loss) from continuing operations		**(5)**	(1)	5
Loss for the year from discontinued operations		**–**	–	(67)
		(5)	(1)	(62)
Profit for the year		**2,061**	2,442	3,541

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

Consolidated Statements of Income for the Year Ended December 31(contd.)

	Note	2011 NIS	2010 NIS	2009 NIS
Earnings per share	27			
Basic earnings per share				
Earnings from continuing operations		**0.76**	0.91	0.82
Earnings from discontinued operations		**–**	–	0.55
		0.76	0.91	1.37
Diluted earnings per share				
Earnings from continuing operations		**0.76**	0.90	0.80
Earnings from discontinued operations		**–**	–	0.54
		0.76	0.90	1.34

Consolidated Statements of Comprehensive Income for the Year Ended December 31

	2011 NIS million	2010 NIS million	2009 NIS million
Profit for the year	**2,061**	2,442	3,541
Actuarial gains (losses) net of tax	**27**	13	(10)*
Other items of comprehensive income for the year, net of tax	**8**	–	(1)*
Total comprehensive income for the year	**2,096**	2,455	3,530
Attributable to:			
Owners of the Company			
Comprehensive income for the year from continuing operations	**2,101**	2,456	2,146
Comprehensive profit for the year from discontinued operations	**–**	–	1,446
	2,101	2,456	3,592
Non-controlling interests			
Comprehensive income (loss) for the year from continuing operations	**(5)**	(1)	5
Comprehensive loss for the year from discontinued operations	**–**	–	(67)
	(5)	(1)	(62)
Total comprehensive income for the year	**2,096**	2,455	3,530

* Reclassified, see Note 2.9.

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

Consolidated Statements of Changes in Equity for the Year Ended December 31

	Share capital	Share premium	Capital reserve for employee options	Capital reserve for a transaction between a corporation and a controlling shareholder	Other reserves	Deficit	Total	Non-controlling interests	Total equity
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
	Attributable to owners of the Company								
Balance as at January 1, 2011	6,213	378	146	390	(10)	(1,790)	5,327	43	5,370
Profit for the year	–	–	–	–	–	**2,066**	**2,066**	**(5)**	**2,061**
Other comprehensive income for the year, net of tax	–	–	–	–	**8**	**27**	**35**	–	**35**
Total comprehensive income for the year	–	–	–	–	**8**	**2,093**	**2,101**	**(5)**	**2,096**
Transactions with owners recognized directly in equity									
Dividends to Company shareholders not in compliance with the earnings test (see Note 20)	**(2,415)**	**(396)**	–	–	–	–	**(2,811)**	–	**(2,811)**
Dividends to Company shareholders	–	–	–	–	–	**(2,155)**	**(2,155)**	–	**(2,155)**
Share-based payments	–	–	**167**	–	–	–	**167**	–	**167**
Exercise of options for shares	**28**	**86**	**(93)**	–	–	–	**21**	–	**21**
Balance as at December 31, 2011	**3,826**	**68**	**220**	**390**	**(2)**	**(1,852)**	**2,650**	**38**	**2,688**

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

Consolidated Statements of Changes in Equity for the Year Ended December 31 (contd.)

	Share capital	Share premium	Capital reserve for employee options	Capital reserve for a transaction between a corporation and a controlling shareholder	Other reserves	Deficit	Total	Non-controlling interests	Total equity
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
	Attributable to owners of the Company								
Balance as at January 1, 2010	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
Transactions with owners recognized directly in equity									
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	–	–	–	–	–	–	–	2	2
Non-controlling interests in a business combination	–	–	–	–	–	–	–	57	57
Increase in the rate of holding in a subsidiary	–	–	–	–	(5)	–	(5)	(9)	(14)
Balance as at December 31, 2010	6,213	378	146	390	(10)	(1,790)	5,327	43	5,370

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

Consolidated Statements of Changes in Equity for the Year Ended December 31 (contd.)

	Share capital	Share premium	Capital reserve for employee options	Capital reserve for a transaction between a corporation and a controlling shareholder	Other reserves	Deficit	Total	Non-controlling interests	Total equity
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
	Attributable to owners of the Company								
Balance as at January 1, 2009	6,132	–	362	390	(4)	(2,165)	4,715	(471)	4,244
Profit for the year	–	–	–	–	–	3,603	3,603	(62)	3,541
Other comprehensive income for the year, net of tax	–	–	–	–	(1)	(10)	(11)	–	(11)
Total comprehensive income for the year	–	–	–	–	(1)	3,593	3,592	(62)	3,530
Transactions with owners recognized directly in equity									
Dividends to Company shareholders	–	–	–	–	–	(1,941)	(1,941)	–	(1,941)
Share-based payments	–	–	49	–	–	–	49	–	49
Exercise of options for shares	55	275	(201)	–	–	–	129	–	129
Derecognition of non-controlling interests for deconsolidation of a subsidiary	–	–	–	–	–	–	–	551	551
Dividends paid to non-controlling interests, net	–	–	–	–	–	–	–	(24)	(24)
Balance as at December 31, 2009	6,187	275	210	390	(5)	(513)	6,544	(6)	6,538

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

Consolidated Statements of Cash Flows for the Year Ended December 31

	Note	2011 NIS millions	2010 NIS millions	2009 NIS millions
Cash flows from operating activities				
Profit for the year		**2,061**	2,442	3,541
Adjustments:				
Depreciation	9	**1,080**	1,114	1,343
Amortization of intangible assets	10	**287**	269	266
Amortization of deferred and other expenses	11	**28**	26	22
Profit from deconsolidation of a subsidiary	12	**–**	–	(1,538)
Profit from gaining control in an investee		**–**	(57)	–
Share in losses of equity-accounted investees	12	**216**	261	34
Financing expenses, net	25	**293**	113	362
Capital gain, net	24	**(181)**	(171)	(64)
Share-based payments	26	**167**	35	49
Income tax expenses	8	**755**	932	807
Proceeds (payment) for derivatives, net		**(19)**	10*	11
Change in inventory		**(33)**	84	(114)
Change in trade and other receivables	7	**(756)**	(300)	(546)
Change in trade and other payables	14	**(131)**	(21)	247
Change in provisions	15	**(64)**	(136)	36
Change in broadcasting rights		**–**	–	(49)
Change in employee benefits	16	**82**	(215)	115
Change in deferred and other income		**50**	–	(41)
Net income tax paid		**(649)**	(690)	(565)
Net cash from operating activities		**3,186**	3,696	3,916
Cash flow used in investing activities				
Investment in intangible assets and deferred expenses	10,11	**(355)**	(343)	(349)
Refund from the Ministry of Communications for frequencies		**36**	–	–
Proceeds from the sale of property, plant and equipment		**230**	133*	90
Acquisition of financial assets held for trading		**(2,859)**	(113)*	(140)*
Proceeds from the sale of financial assets held for trading:		**1,967**	251*	6*
Purchase of property, plant and equipment	9	**(1,548)**	(1,279)	(1,363)
Proceeds from disposal of investments and long-term loans		**11**	11	93
Acquisition of investments and long-term loans		**(5)**	(6)	(4)
Payment for derivatives		**(5)**	(2)*	–
Business combinations less cash acquired		**–**	(145)	–
Dividends received		**3**	–	6
Interest received		**34**	9	29
Net cash used in investing activities		**(2,491)**	(1,484)	(1,632)

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

Consolidated Statements of Cash Flows for the Year Ended December 31 (contd.)

	Note	2011 NIS millions	2010 NIS millions	2009 NIS millions
Cash flows used in financing activities				
Issue of debentures	13	**3,092**	–	–
Bank loans received	13	**2,200**	2,670	400
Repayment of debentures	13	**(835)**	(697)	(682)
Repayment of loans	13	**(648)**	(448)	(109)
Net short-term borrowings	13	**(5)**	(6)	48
Dividends paid	20	**(3,155)**	(3,733)	(1,941)
Interest paid		**(377)**	(237)	(354)
Proceeds (payment) for derivatives, net		**(1)**	10	43
Net dividends paid to non-controlling interests, less transfers		**–**	2	(24)
Increase in the rate of holding in a subsidiary		**–**	(14)	–
Proceeds from exercise of options		**21**	26	129
Net cash from (used in) finance activities		**292**	(2,427)	(2,490)
Increase (decrease) in cash and cash equivalents		**987**	(215)	(206)
Cash and cash equivalents as at January 1		**365**	580	786
Cash and cash equivalents as at the end of the year	5	**1,352**	365	580

* Reclassified See Note 2.9.

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

Notes to the Financial Statements

1. <u>Reporting Entity</u>

1.1 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 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 interests in associates. The Group is a principal provider of communication services in Israel (see also Note 28, Segment Reporting).

1.2 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. As at December 31, 2011, this company held 31.1% of the Company's shares. Each of these companies is also considered as a controlling shareholder in the Company.

1.3 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 the operating segments of the Group are subject to competition. The operations of the Group are subject, in general, to government regulation and supervision.

1.4 On June 1, 2011, the Company published a shelf prospectus for the issue 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 included mainly amendments to the terms of the debentures and deed of trust. On June 29, 2011, the Company issued a shelf offering memorandum for a public offering of debentures (Series 6 to 8). See Note 13 for information about debentures, loans and borrowings.

2. <u>Basis of Preparation</u>

2.1. Definitions

In these financial statements:

<u>International Financial Reporting Standards (IFRS)</u>: Standards and interpretations that were adopted by the International Accounting Standards Board (IASB) and which include international financial reporting standards and international accounting standards (IAS), along with the interpretations to these standards of the International Financial Reporting Interpretations Committee (IFRIC) or interpretations of the Standing Interpretations Committee (SIC), respectively.

<u>The Company</u>: Bezeq The Israel Telecommunication Corporation Limited

<u>The Group</u>: Bezeq The Israel Telecommunication Corporation Limited and its subsidiaries, as listed in Note 12 – Investees

2. Basis of Preparation (Contd.)

Subsidiaries: Companies, including a partnership, the financial statements of which are fully consolidated, directly or indirectly, with the financial statements of the Company, as follows:

Pelephone Communications Ltd. ("Pelephone")

Bezeq International Ltd. ("Bezeq International")

Bezeq Online Ltd. ("Bezeq Online")

Walla! Communications Ltd. ("Walla")

Bezeq Zahav (Holdings) Ltd. ("Bezeq Zahav")

Stage-One Venture Capital Fund (Israel) LP ("Stage-One")

See also Note 12.2.

Associates: Companies, including a partnership, in which the Group's investment is included, directly or indirectly, in the consolidated financial statements on the equity basis. The Company has an investment in the associate DBS Satellite Services (1998) Ltd. The subsidiaries have investments in other associates that are not material. See also Note 12.1.

Investees: Subsidiaries, jointly-controlled companies or associates

Related party: As defined in IAS 24, Related Party Disclosures

Interested parties: As defined in paragraph (1) of the definition of an "interested party" in section 1 of the Securities Law, 1968

CPI: The consumer price index as published by the Central Bureau of Statistics

2.2. Statement of compliance

The consolidated financial statements of the group have been prepared in accordance with International Financial Reporting Standards ("IFRS") and in accordance with the Securities Regulations (Annual Financial Statements), 2010

The consolidated financial statements were approved by the Board of Directors on March 14, 2012.

2.3. Functional currency and presentation currency

The consolidated financial statements are presented in NIS, which is the Group's functional currency, and have been rounded to the nearest million. The NIS is the currency that represents the principal economic environment in which the Group operates.

2.4. Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for the following items:

* Financial instruments, including financial derivatives, at fair value through profit or loss
* Financial assets classified as available-for-sale at fair value
* Inventories measured at the lower of cost and net realizable value
* Equity-accounted investments
* Deferred tax assets and liabilities
* Provisions
* Liabilities for employee benefits
* Liabilities for cash-settled share-based payment arrangements

2. Basis of Preparation (Contd.)

2.4 Basis of measurement (contd.)

For further information regarding the measurement and these assets and liabilities see Note 3 regarding significant accounting policies. The methods used to measure fair value are described in Note 4.

The value of non-monetary assets and equity items that were measured on the historical cost basis was adjusted to changes in the CPI until December 31, 2003, since until that date the Israeli economy was considered hyperinflationary for the purpose of preparation of the financial statements.

2.5. Operating cycle

The Group's operating cycle is up to one year. As a result, the current assets and current liabilities include items the realization of which is intended and anticipated to take place within one year from the date of the financial statements.

2.6. Classification of expenses recognized in the statement of income

The classification of costs and expenses recognized in the statement of income is based on the function of the expenses. The classification is compatible with the understanding of the Group's businesses, which address a wide range of services using common infrastructure. All of the costs and expenses are used to provide services.

2.7. Use of estimates and judgment

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

The preparation of accounting estimates used in the preparation of the Group's financial statements requires management to make assumptions regarding circumstances and events that involve considerable uncertainty. Management of the Company prepares the estimates on the basis of past experience. In exercising its judgment when making the estimates, management relies on experience, various facts, external circumstances, and reasonable assumptions according to the relevant circumstances of each estimate.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Significant estimates made when applying accounting policies and changes in these estimates and assumptions that could potentially have a material effect on the financial statements are as follows:

Estimates in respect of depreciation of property, plant and equipment

Estimated useful life of property, plant and equipment

The estimated useful life of property plant and equipment serves to determine depreciation expenses that will be recognized in the reporting year. The main part of the communications infrastructure is managed according to asset groups. The depreciation rates are based on the average useful life of an asset group and not of each individual asset. The useful life of an asset group is assessed annually and is based on past experience, taking into consideration expected technological changes, Company plans or other changes. If such changes take place earlier than foreseen or differently than expectations, the remaining useful life of such assets may be shortened. This results in an increase in future depreciation expenses. If the changes take place later than expected, the remaining useful life may be extended, and this results in a decrease in the depreciation expenses. Given the significant amounts of the Group's depreciation expenses, these changes can have a material effect on the operating results and the financial position of the Group.

2. Basis of Preparation (Contd.)

2.7. Use of estimates and judgment (contd.)

Estimated residual value

The residual value of the Company's copper cables was determined on the basis of the Company's assessment. The Company is exposed to changes in copper prices which lead to a change in the residual value of the copper infrastructure.

The use of estimates and valuations affects the items of property, plant and equipment and the depreciation expense. See Note 9.

Measurement of employee benefit liabilities

These liabilities are based on actuarial calculations that include material assumptions which might be different from actual results. The assumptions relate, inter alia, to interest rates for capitalization, mortality tables, wage creep and churn rates. For further information see Note 16.

Deferred taxes

Deferred taxes are calculated at the tax rate expected to be in effect on their date of utilization. The tax benefit is included in the financial statements where, according to the Company's assumptions and business plans, realization of the tax benefit is foreseeable. By nature, actual business results may differ from the business plans, and this can affect the future realization of the tax benefit. For further information see Note 8.

Provisions and contingent liabilities

The Group's companies have contingent liabilities in amounts for which the possible maximum exposure is considerable Among these, class actions of extremely significant amounts are pending against Group companies. The Company makes estimates of the potential liabilities associated with every claim and action in each reporting period. It is naturally very difficult to determine the outcomes of the claims. The Company uses its best judgment and the assessments of its legal advisers to determine whether it is likely to bear the costs of settling claims and whether they can be reliably estimated.

Taking into consideration the inherent uncertainty included in legal claims, it is possible that all or some of them will be concluded with the Company being ordered to pay amounts materially different from the provisions included in the financial statements, if any. For details of provisions and contingent liabilities, see Notes 15 and 17.

Measurement of recoverable amounts of cash-generating units

Recoverable amounts of cash-generating units are measured in order to assess the need for recognizing impairment of the unit's assets (including goodwill). The measurement involves various estimates and assumptions, including the cash flows expected from the units and the discount rates. See also Note 10.

Share-based payments

Calculation of share-based payments is based on an economic model that includes estimates in respect of various parameters. See Note 26.

Provision for doubtful debts

The financial statements include provisions for doubtful debts, which reflect the potential loss inherent in receivables for which collection is in doubt. The provision for doubtful debts is partially based on the risk assessment of the debt according to the information available to the Group regarding the period of the overdue payment, its classification according to collection status, customer payment patterns, assessment of the collateral received from the debtors, and the experience accumulated in collecting debts.

Doubtful debts are derecognized when the management of the Group companies and the legal advisors believe that they are uncollectible.

These assumptions may change due to a change in the composition of trade receivables, economic changes and other changes related to the Group's activities. For further information see Note 7.

2. Basis of Preparation (Contd.)

2.7. Use of estimates and judgment (contd.)

Investment in investees at fair value

Upon deconsolidation of DBS and as of that date, the Company recorded the investment at fair value and attributed the fair value to tangible and intangible assets. Fair value is based on the estimates and assessments of an independent appraiser and attributed accordingly. See also Note 12.1.9.

2.8. Changes in accounting policies – Initial implementation of new accounting standards

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. The Standard was applied retrospectively.

For the purpose of applying the Standard for the first time, the Group mapped its related parties. According to the new definition and following the mapping, new related parties were identified. The Group had no transactions with these new related parties in the reporting period and in corresponding periods.

2.9. Certain insignificant comparative amounts were reclassified to the relevant items in the financial statements for the current year.

3. Significant Accounting Policies

The accounting policies set out below have been applied consistently by Group entities for all periods presented in these consolidated financial statements, except as explained in Note 2.8 Initial implementation of new accounting standards.

3.1. Basis of consolidation

3.1.1 Business combinations

Business combinations are accounted for by applying the acquisition method. According to this method, the identifiable assets and liabilities of the acquired business are recognized and recorded at fair value on the acquisition date.

The acquisition date is the date on which the acquirer obtains control over the acquiree. Control exists when the Company is able to govern the financial and operating policies of the entity so as to obtain benefits from its activities. In assessing control, potential voting rights were taken into account if they confer effective control.

The cost of the acquisition is the aggregate fair value of the assets transferred, liabilities incurred and equity interests issued by the acquirer on the date of acquisition. In addition, the consideration transferred includes the fair value of any contingent consideration. After the acquisition date, the Group recognizes changes in fair value of the contingent consideration in the statement of income. Contingent consideration is stated as a financial liability in the statement of financial position.

On the acquisition date the acquirer recognizes a contingent liability assumed in a business combination if there is a present obligation resulting from past events and its fair value can be reliably measured.

In a step acquisition, the difference between the fair value at the acquisition date of the Group's pre-existing equity rights in the acquiree and the carrying amount at that date is recognized in the statement of income under other operating revenue.

3. Significant Accounting Policies (Contd.)

3.1. Basis of consolidation (contd.)

3.1.1 Business combinations (contd.)

The Group recognizes goodwill at acquisition according to the fair value of the consideration transferred, including the fair value at the acquisition date of any pre-existing equity right of the acquirer in the acquiree, less the net amount of the identifiable assets acquired and the liabilities assumed. After initial recognition, goodwill is measured at cost less any accumulated impairment losses and is not systematically amortized. For assessment of impairment of goodwill, see section 3.9.2 below.

Costs associated with the acquisition that were incurred by the acquirer in the business combination such as finder's fees, advisory, legal, valuation and other professional or consulting fees, other than those associated with an issue of debt or equity instruments connected to the business combination, are recognized as expenses in the period the services are received

3.1.2 Subsidiaries

Subsidiaries are entities controlled by the Company. The financial statements of the subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of the subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

3.1.3 Non-controlling interests

Non-controlling interests comprise the equity of a subsidiary that cannot be attributed, directly or indirectly, to the parent company and they include additional items such as share-based payments that will be settled with equity instruments of subsidiaries and share options of subsidiaries. Non-controlling interests that are instruments that give rise to a present ownership interest and entitle the holder to a share of net assets in the event of liquidation (for example, ordinary shares), are measured at the date of the business combination at fair value or at their proportionate interest in the identifiable assets and liabilities of the acquiree, on a transaction-by-transaction basis.

Profit or loss and any part of other comprehensive income are allocated to the owners of the Company and the non-controlling interests, even when the result is a negative balance of the non-controlling interests.

Transactions with non-controlling interests, while retaining control, are accounted for as equity transactions. Any difference between the consideration paid or received for change in non-controlling interests is recognized in capital reserve for transactions with non-controlling interests.

For non-controlling interests in a business combination in 2010, the non-controlling interests were measured at the date of the business combination at their proportionate interest in the identifiable assets and liabilities of the acquiree.

3.1.4 Put option granted to non-controlling shareholders

A put option issued by the Group to non-controlling interests that is settled in cash or another financial instrument is recognized as a financial liability. In subsequent periods, changes in the value of the liability in respect of put options are recognized in the statement of income according to the effective interest method.

3. Significant Accounting Policies (Contd.)

3.1. Basis of consolidation (contd.)

3.1.5 Loss of control

Upon the loss of control, the Group derecognizes the assets and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. If the Group retains any interest, including any loans in the previous subsidiary, then such interest, including the loans, is measured at fair value at the date that control is lost. Subsequently, the retained interest is accounted for on an equity basis, depending on the level of influence retained by the Group in the subsidiary.

Loss of control of a subsidiary is accounted for as a discontinued operation, regardless of whether the Company retains a non-controlling interest in its former subsidiary (for example, when the investee becomes, after loss of control, an equity-accounted associate). The difference between the consideration and the fair value of the retained interest and the derecognized amounts are recognized in the statement of income under discontinued operations. See also Note 12.1.9.

3.1.6 Special purpose entity

A special purpose entity (SPE) is consolidated if, based on an evaluation of the substance of its relationship with the Group and the SPEs' risks and rewards, the Group concludes that it controls the SPE. The Group is exposed to the majority of the risks incident to the SPE's activity and retains the majority of the residual rights and ownership risks related to the SPE or its assets.

3.1.7 Associates (accounted for by the equity method)

Associates are those entities in which the Group has significant influence, but not control, over financial and operating policy. Associates are accounted for using the equity method and are recognized initially at cost or at their fair value at the date control is lost. The investment includes goodwill calculated at the acquisition date and is presented net of accumulated impairment losses. The consolidated financial statements include the Group's share in the income and expenses of equity-accounted investees, after adjustments to align the accounting policy with that of the Group, from the date that significant influence commences until the date that significant influence no longer exists. When the Group's share of losses exceeds its interest in an associate, the carrying amount of that interest is reduced to zero and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the associate.

When the Group holds additional long-term interests in the associate, which are a part of the Group's net investment in the associate, and when the Group's proportionate share in the additional interests is different to the Group's share in the equity of the associate, the Group recognizes its share in the additional losses of the associate at its proportionate share in the additional interests according to the percentage of the Company's participation in all the levels of the additional interests and according to the order of priority of the additional levels of interests. If, subsequently, the Group recognizes its share in the profits of the associate, the Company recognizes its share in the profits up to the amount of the cumulative profits previously recognized.

In respect of equity-accounted investments, goodwill is included in the carrying amount of the investment. For further information about recognition of impairment loss for these investments, see section 3.9.3 below.

3. Significant Accounting Policies (Contd.)

3.1. Basis of consolidation (contd.)

3.1.8 Transactions eliminated on consolidation

Intra-group balances and any unrealized income and expenses arising from intra-group transactions, are eliminated in the preparation of the consolidated financial statements. Unrealized gains arising from transactions with associates are eliminated against the investment to the extent of the Group's interest in these investments. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

3.2. Foreign currency transactions

Transactions in foreign currency are translated into the functional currency of the Group at the exchange rate on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies on the reporting date are retranslated to the functional currency at the exchange rate at that date.

3.3. Financial instruments

3.3.1 Non-derivative financial assets

Non-derivative financial assets include investments in financial funds, shares, debt instruments, trade and other receivables, and cash and cash equivalents.

A. **Initial recognition of financial assets**

The Group initially recognizes financial assets at the date the Group becomes a party to contractual provisions of the instrument, meaning the date that the Group fulfills its obligations under the contract.

B. **Derecognition of financial assets**

Financial assets are derecognized when the contractual rights of the Group to the cash flows from the asset expire, or the Group transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred.

Regular way sales of financial assets are recognized on the trade date, meaning on the date the Group undertook to sell the asset.

For information about the offset of financial assets and liabilities, see section 3.3.2(C) below.

C. **Classification of financial assets**

The Group classifies its financial assets as follows:

Cash and cash equivalents

Cash comprises cash balances available for immediate use and call deposits. Cash equivalents comprise short-term highly liquid investments (with original maturities of three months or less) that are readily convertible into known amounts of cash and are exposed to insignificant risks of change in value.

3. Significant Accounting Policies (Contd.)

3.3. Financial instruments (contd.)

Financial assets at fair value through profit or loss

A financial asset is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Upon initial recognition, attributable transaction costs are recognized in the statement of income as incurred. These financial assets are measured at fair value and changes therein are recognized in the statement of income.

The Group's investment in financial funds was presented as part of investments at fair value through profit or loss.

Available-for-sale financial assets

The Group's investments in shares and certain debt instruments are classified as available-for-sale financial assets. Subsequent to initial recognition, these investments are measured at fair value and changes therein, other than impairment losses and foreign currency differences are recognized directly in other comprehensive income and presented within equity in a reserve for available-for-sale financial assets. A dividend received for available-for-sale financial assets is recognized in the statement of income on the date the entity's right to receive the dividend is established. When an investment is derecognized, the cumulative gain or loss in the reserve for available-for-sale financial assets is transferred to profit or loss.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method, net of impairment losses.

3.3.2 Non-derivative financial liabilities

Non-derivative financial liabilities include debentures issued by the Group, loans and borrowings from banks and other credit providers, and trade and other payables.

A. **Initial recognition of financial liabilities**

The Group initially recognizes debt instruments as they are incurred.

Financial liabilities are initially recognized at fair value plus any attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest method.

B. **Derecognition of financial liabilities**

Financial liabilities are derecognized when the obligation of the Group, as specified in the agreement, expires or when it is discharged or canceled.

C. **Offsetting financial instruments**

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group currently has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

3. Significant Accounting Policies (Contd.)

3.3 Financial instruments (contd.)

3.3.3 Derivative financial instruments

The Group holds derivative financial instruments to hedge its exposure to foreign currency, the CPI and copper prices. Hedge accounting is not applied to derivative instruments that economically hedge financial assets and liabilities. Derivative instruments are recognized initially at fair value; attributable transaction costs are recognized in the statement of income as incurred. Subsequent to initial recognition, derivative financial instruments are measured at fair value and the changes in fair value are recognized in the statement of income as incurred.

Embedded derivatives are separated from the host contract and accounted for separately if: (a) the economic characteristics and risks of the host contract and the embedded derivative are not closely related; (b) a separate instrument with the same terms as the embedded derivative would meet the definition of the derivative; (c) the combined instrument is not measured at fair value through profit or loss.

Changes in the fair value of separable embedded derivatives are recognized in the statement of income as financing income or expense as incurred.

3.3.4 CPI-linked assets and liabilities that are not measured at fair value

The value of CPI-linked financial assets and liabilities, which are not measured at fair value, is revaluated in each period according to the actual increase in the CPI.

3.4. Property, plant and equipment

3.4.1 Recognition and measurement

Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to acquisition of the asset. The cost of self-constructed assets includes the cost of materials, direct labor and financing costs as well as any other cost directly attributable to bringing the asset to the condition for its use intended by the management, and the costs of dismantling and removing the items and restoring the site on which they are located when the Group has an obligation to vacate and restore the site. The cost of purchased software that is integral to the functionality of the related equipment is recognized as part of the cost of the equipment.

When major parts of the property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of the property, plant and equipment.

Changes in the obligation to dismantle the items and restore the site on which they are located, other than changes deriving from the passing of time, are added to or deducted from the cost of the asset in the period in which they occur. The amount deducted from the cost of the asset should not exceed its carrying amount, and any balance is recognized immediately in the statement of income.

Gains or losses on disposal of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of the asset, and are recognized net under “other income” in the statement of income.

3. Significant Accounting Policies (Contd.)

3.4. Property, plant and equipment (contd.)

3.4.2 Subsequent expenditure

The cost of replacing part of an item of property, plant and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefit embodied in the replaced item will flow to the Group and its cost can be measured reliably. The costs of day-to-day servicing are recognized in the statement of income as incurred.

3.4.3 Capitalization of borrowing costs

Specific and non-specific borrowing costs were capitalized to qualifying assets throughout the period required for completion and construction until they are ready for their intended use. Non-specific borrowing costs are capitalized using a rate which is the weighted-average cost of the credit sources which were not specifically capitalized. Other borrowing costs are recognized in the statement of income as incurred.

3.4.4 Depreciation

Depreciation is a systematic allocation of the depreciable amount of an asset over its useful life. The depreciable amount is the cost of the asset, or other amount substituted for cost, less its residual value.

Depreciation is recognized in the statement of income on a straight-line basis over the estimated useful life of each part of an item of property, plant and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets under finance lease agreements are depreciated over the shorter of the lease term and their useful lives. An asset is depreciated when it is ready for use, meaning when it reaches the location and condition necessary for it to be capable of operating in the manner intended by management.

Leasehold improvements are depreciated over the shorter of the lease term, including the extension option held by the Group and intended to be exercised and the expected life of the improvement.

The estimated useful lives for the current and comparative periods are as follows:

	Years	Main depreciation (%)
NGN equipment	8	13
Digital switching equipment	4-10	20
Transmission and power equipment	5-10	10
Network equipment	5-25	4
Subscriber equipment and installations	3-7	25
Motor vehicles	6-7	17
Internet equipment	4	25
Office equipment	5-14	10
Electronic equipment, computers and internal communication systems	3-7	20
Cellular network	4-10	14
Buildings	25	4

Depreciation methods, useful lives and residual values are reviewed at least at each reporting year and adjusted as required.

3. Significant Accounting Policies (Contd.)

3.5. Non-current assets held for sale

Non-current assets which are expected to be realized by way of sale rather than ongoing use, are classified as assets held for sale. These assets are presented at the lower of the carrying amount and fair value, less selling costs. Impairment losses at the time of initial classification of an asset held for sale, and subsequent gains or losses resulting from remeasurement, are recognized in the statement of income. Gains are recognized up to the cumulative amount of impairment loss recorded in the past.

3.6. Intangible assets

3.6.1 Goodwill

Goodwill that arises upon the acquisition of subsidiaries is included in intangible assets. For information about measurement of goodwill at initial recognition, see section 3.1.1 above. In subsequent periods, goodwill is measured at cost less accumulated impairment losses.

3.6.2 Software development costs

Software development costs are recognized as an intangible asset only if the development costs can be measured reliably; the software is technically and commercially applicable; and the Group has sufficient resources to complete the development and intends to use the software. The costs recognized as an intangible asset include the cost of the materials, direct labor and overhead expenses directly attributable to preparation of the asset for its intended use. Other development costs are recognized in the statement of income as incurred.

Capitalized development costs are measured at cost less amortization and accumulated impairment losses.

3.6.3 Subscriber acquisition

Direct sale commissions paid to dealers and salespersons for sales and upgrades to subscribers who have agreements with Group companies that include a commitment for a defined period and/or a penalty for early termination, are recognized as an intangible asset if the Company expects a return of those commissions from the service contracts. Subscriber acquisition amortization expenses are recognized in the statement of income over the period of the subscribers' commitments on a straight line basis. When the subscriber terminates the agreement period, the balance of the asset is amortized immediately. Sales commissions that do not comply with these terms are recognized immediately as an expense in the statement of income.

3.6.4 Software

The Group's assets include computer systems consisting of hardware and software. Software that is an integral part of the hardware, which cannot function without the programs installed on it, is classified as property, plant and equipment. However, licenses for stand-alone software, which adds functionality to the hardware, is classified (mainly) as intangible assets. Software depreciation is recognized in the statement of income using the straight-line method over the estimated useful life of the asset.

3. Significant Accounting Policies (Contd.)

3.6 Intangible assets (contd.)

3.6.5 Rights to frequencies

Rights to frequencies refer to Pelephone's rights to cellular communication frequencies according to a Ministry of Communications tender. Depreciation of the asset is recognized in the statement of income on the straight line method over the license term, which is 13 years and 7 months starting from the use of the frequencies.

3.6.6 Other intangible assets

Other intangible assets acquired by the Group, which have a definite useful life, are measured at cost less amortization and accumulated impairment losses.

3.6.7 Subsequent expenditure

Subsequent expenditure is recognized as an intangible asset only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure, including expenditure relating to generated goodwill and brands, is recognized in the statement of income as incurred.

3.6.8 Amortization

Amortization is a systematic allocation of the amortizable amount of an intangible asset over its useful life. The amortizable amount is the cost of an asset, or another amount substituted for the cost, less its residual value.

Amortization, except for goodwill, is recognized in the statement of income on a straight-line basis over the estimated useful life of the intangible assets, from the date on which the assets are available for use. Goodwill is not systematically amortized but is tested for impairment at least once a year.

Estimated useful lives for the current and comparative periods are as follows:

Type of asset	Amortization period
Development expenses	4-7 years
Other rights	3 - 10 years, depending on the useful life
Subscriber acquisition costs	Over the subscriber's commitment period (12-36 months)
Frequency usage right	Over the term of the license for 13 years starting from the use of the frequencies
Computer programs and software licenses	Over the term of the license or the estimated time of use of the program

Amortization methods and useful lives are reviewed at least at each reporting year and adjusted if appropriate.

3. Significant Accounting Policies (Contd.)

3.7. Leased assets

Leases, including leases of land from the Israel Land Administration, where the Group assumes substantially all the risks and rewards of ownership, are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to the asset.

At inception or upon reassessment of an arrangement, the Group determines whether such an arrangement is or contains a lease. A specific asset is the subject of a lease if fulfillment of the arrangement is dependent on the use of that specified asset or assets. An arrangement conveys the right to use the asset if the arrangement conveys to the Group the right to control the use of the asset. At inception or upon reassessment of the arrangement, the Group separates payments and other consideration required by such an arrangement into those for the lease and those for other elements on the basis of their relative fair values.

Transactions for acquiring an indefeasible right of use (IRU) of seabed cable capacities are accounted for as service transactions. The prepaid expense is amortized on a straight-line basis as stated in the agreement and no more than the expected estimated useful life of those capacities.

Other leases are operating leases and the leased assets are not recognized in the Group's statement of financial position.

3.8. Inventory

Inventories are measured at the lower of cost and net realizable value. The cost of inventories is based on the moving average principle. Slow-moving inventory of terminal equipment, accessories and spare parts are stated net of the provision for impairment.

The inventories of a subsidiary include terminal equipment and accessories intended for sale and service, as well as spare parts used for repairs in the repair service it provides to its customers.

3.9. Impairment

3.9.1 Non-derivative financial assets

The Group tests a financial asset for impairment when objective evidence indicates that one or more loss events have had a negative effect on the estimated future cash flows of that asset.

When testing for impairment of available-for-sale financial assets that are equity instruments, the Group also examines the difference between the fair value of the asset and its original cost, the length of time the fair value of the asset is lower than its original cost and changes in the technological, economic or legal environment or in the market environment in which the issuer of the instrument operates. In addition, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows, discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its fair value.

3. Significant Accounting Policies (Contd.)

3.9 Impairment (contd.)

3.9.1 Non-derivative financial assets (contd.)

Significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed for impairment collectively, in groups that share similar credit risk characteristics. The financial statements include specific provisions and Group provisions for doubtful debts, which properly reflect, in the estimation of the management, the loss inherent in debts for which collection is in doubt.

All impairment losses are recognized in the statement of income. Any cumulative loss in respect of an available-for-sale financial asset recognized previously in equity is transferred to the statement of income.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost and available-for-sale financial assets that are debt securities, the reversal is recognized in the statement of income. For available-for-sale financial assets that are equity securities, the reversal is recognized directly in other comprehensive income.

3.9.2 Non-financial assets

Timing of impairment testing

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the recoverable amount of the asset is estimated.

The Group assesses the recoverable amount of goodwill and of assets which are unavailable for use once a year, or more frequently if there are indications of impairment.

Measurement of recoverable amount

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Determining cash-generating units

For the purpose of impairment testing, the assets are grouped together into the smallest group of assets that generates cash from continuing use that are largely independent of other assets or groups of assets ("cash-generating unit").

Allocation of goodwill to cash-generating units

For purposes of goodwill impairment testing, cash-generating units to which goodwill has been allocated are aggregated so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes, but in any event is not larger than an operating segment. Goodwill acquired in a business combination or the purpose of impairment testing is allocated to cash-generating units that are expected to generate benefits from the synergies of the combination.

For purposes of goodwill impairment testing, when the non-controlling interests were initially measured according to their relative share of the acquiree's net identifiable assets, the carrying amount of the goodwill is adjusted according to the rate the Company holds in the cash-generating unit to which the goodwill is allocated.

3. Significant Accounting Policies (Contd.)

3.9 Impairment (contd.)

3.9.2 Non-financial assets

Recognition of impairment loss

Impairment losses are recognized if the carrying amount of an asset or cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognized in the statement of income. For cash generating units that include goodwill, an impairment loss is recognized when the carrying amount of the cash generating unit, after adjustment for goodwill, exceeds its recoverable amount.

Impairment losses recognized in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the cash-generating unit on a pro rata basis.

Allocation of impairment loss to non-controlling interests

An impairment loss is allocated between the owners of the Company and the non-controlling interests on the same basis that the profit or loss is allocated. Nevertheless, if an impairment loss allocated to non-controlling interest relates to goodwill that was not recognized in the consolidated financial statements, the impairment is not recognized as an impairment loss on goodwill. In such cases, only an impairment loss relating to goodwill that was allocated to the owners of the Company is recognized as an impairment loss on goodwill.

Reversal of impairment loss

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

3.9.3 Investments in equity-accounted investees

An investment in an associate is tested for impairment when objective evidence indicates that there has been impairment.

Goodwill that forms part of the carrying amount of an investment in an associate is not recognized separately, and therefore is not tested for impairment separately. If objective evidence indicates that the value of the investment may have been impaired, the investment is tested for impairment.

3.10. Employee benefits

3.10.1 Post-employment benefits

The Group has a number of post-employment benefit plans. The plans are usually financed by deposits with insurance companies and they are classified as defined contribution plans and defined benefit plans.

A. **Defined contribution plans**

The Group's obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense in the statement of income in the periods during which services are rendered by employees. See Note 16.1 below.

3. Significant Accounting Policies (Contd.)

3.10 Employee benefits (contd.)

3.10.1 Post-employment benefits (contd.)

B. **Defined benefit plans**

The Group's net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods. That benefit is stated at present value and the fair value of any plan assets and the cost of past service not yet recognized are deducted. The discount rate is the yield at the reporting date on government bonds denominated in the same currency that have maturity dates approximating the terms of the Group's obligation. The calculation is performed by a qualified actuary. See Note 16.2 below.

Gains or losses resulting from curtailments or settlements of a defined benefit plan are recognized in the statement of income. Such gains or losses include any resulting change in the present value of the obligation.

The Group recognizes immediately, directly in retained earnings through other comprehensive income, all actuarial gains and losses arising from defined benefit plans.

Interest costs and expected return on plan assets that were recognized in profit or loss are presented under financing income and expenses, respectively.

3.10.2 Other long-term employee benefits

The Group's net obligation in respect of long-term employee benefits other than pension plans is the amount of future benefit that employees have earned in return for their service in the current and prior periods. The amount of these benefits is stated at its present value. The discount rate is the yield at the reporting date on government bonds denominated in the same currency, that have maturity dates approximating the terms of the Group's obligations. The calculation is performed using the projected unit credit method. Any actuarial gains or losses are recognized in the statement of income in the period in which they arise.

3.10.3 Benefits for early retirement and dismissal

Employment termination benefits are recognized as an expense when the Group is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to terminate employment before the normal retirement date. Termination benefits for voluntary redundancies are recognized as an expense if the Group has made an offer of voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

3.10.4 Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognized for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably. In the statement of financial position the employee benefits are classified as current benefits or as non-current benefits according to the time the liability is due to be settled.

3. Significant Accounting Policies (Contd.)

3.10 Employee benefits (contd.)

3.10.5 Share-based payments

The fair value on the grant date of options for Company shares granted to employees is recognized as a salary expense with a corresponding increase in equity over the period during which the employee becomes entitled to the options. The amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest.

For share-based payment awards with non-vesting conditions, the fair value of the share-based payment awards is measured to reflect such conditions, and therefore the Group recognized an expense in respect of the awards whether or not the conditions have been met.

The fair value of the amount payable to employees in respect of share-based payments, which are settled in cash, is recognized as an expense with a corresponding increase in liabilities, over the period that the employees become entitled to payment. The liability is remeasured at each reporting date until the settlement date. Any changes in the fair value of the liability are recognized as salary expenses in the statement of income.

3.11. Provisions

A provision is recognized if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows. The carrying amount of the provision is adjusted each period to reflect the time that has passed and is recognized as a financing expense.

The Group recognizes a reimbursement asset if, and only if, it is virtually certain that the reimbursement will be received if the Group settles the obligation. The amount recognized in respect of the reimbursement does not exceed the amount of the provision.

3.11.1 Legal claims

Contingent liabilities are accounted for according to IAS 37 and its related provisions. Accordingly, the claims are classified by likelihood of realization of the exposure to risk, as follows:

A. More likely than not – more than 50% probability

B. Possible – probability higher than unlikely and less than 50%

C. Unlikely – probability of 10% or less

For claims which the Group has a legal or constructive obligation as a result of a past event, which are more likely than not to be realized, the financial statements include provisions which, in the opinion of the Group, based, inter alia, on the opinions of its legal advisers retained in respect of those claims, are appropriate to the circumstances of each case, despite the claims being denied by the Group companies. There are also a few legal proceedings, received recently, for which the risks cannot be assessed at this stage, therefore no provisions have been made.

Note 17 describes the amount of additional exposure due to contingent liabilities that are likely to be realized and contingent liabilities that are unlikely to be realized, however the maximum possible loss from the claim could place the continuation of the Group’s operations at risk in the current format.

3. Significant Accounting Policies (Contd.)

3.11 Provisions (contd.)

3.11.2 Onerous contracts

A provision for onerous contracts is recognized when the benefits expected to be derived by the Group from the contracts are lower than the unavoidable cost of meeting its obligations according to the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Group assesses the need for impairment on the assets associated with that contract.

3.11.3 Site dismantling and clearing costs

A provision in respect of an obligation to dismantle and clear sites is made in accordance with IAS 37. The provision is made for those rental agreements for which the Group has an undertaking to restore the rental property to its original state at the end of the rental period, after dismantling and transferring the site, and restoring it as necessary.

3.11.4 Warranty

A subsidiary recognized a provision for warranty in respect of first-year insurances for cellular handsets. The warranty is limited to technical malfunctions defined by the subsidiary, and does not include warranty as a result of customer damages. However, an asset is recognized in respect of the manufacturer's warranty for those handsets, which is limited to technical malfunctions defined by the manufacturer.

3.12. Revenues

The Group's revenues are mainly composed of revenues for fixed-line communication services, cellular services, international communication services, customer center services, communication services for other operators, sales and installation of communication equipment and internet services. Revenues are measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates.

3.12.1 Equipment sales

Revenues from sales of terminal equipment are recognized in the statement of income when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably and the Group companies have no continuing involvement with the goods.

Revenues from the sale of terminal equipment to subscribers in long-term credit arrangements are recognized upon delivery to the customer at the present value of the future cash flow expected from them, at the market interest rate for transactions of this kind. Financing income in respect of these transactions is recognized in the statement of income over the period of the installments by the effective interest method.

3. Significant Accounting Policies (Contd.)

3.12 Revenues (contd.)

3.12.2 Revenues from services

Revenues from services rendered are recognized in the statement of income proportionately over the term of the agreement or upon providing the service if the flow of the economic benefits associated with providing the service is likely. Revenues from calls, including revenues from prepaid call cards, are recognized when the call is made by the customer.

3.12.3 Multi-component sales agreements

For multi-component transactions in which terminal equipment is sold together with the customer's undertaking to receive services, the Group applies the relative fair value method. Allocation of the revenues to a supplied component is limited to the amount of the consideration that is not contingent upon the supply of additional components.

Transactions which agreements do not include commitments for a defined period and/or a penalty for early termination, and there is no legal connection between the components that are sold, are not considered as multi-component transactions for accounting, but as separate transactions for the sale of terminal equipment and services. Accordingly, the Group recognizes revenues from these transactions according to the selling price of the terminal equipment or service when they are sold separately.

3.12.4 Reporting gross or net revenues

When the Group acts as an agent or intermediary without bearing the risks and rewards deriving from the transaction, its revenues are recognized on a net basis. However, when the Group acts as a main supplier and bears the risks and rewards deriving from the transaction, its revenues are recognized on a gross basis.

3.13. Financing income and expense

Financing income comprises interest income from deposits, dividend income, income interest accrued using the effective interest method in respect of the sale of terminal equipment in installments, gains on the disposal of available-for-sale financial assets, changes in the fair value of financial assets at fair value through profit or loss, foreign currency gains and gains on derivative instruments that are recognized in the statement of income (except for gains from hedging copper prices recognized in other operating income).. Interest income is recognized as it accrues using the effective interest method. Revenues from dividends are recognized when the Group's right to receive the payment is established,

Changes in the fair value of financial assets at fair value through the statement of income also include income from dividends and interest.

Financing expenses comprise interest expense on borrowings, debentures issued, changes in time value of provisions and liabilities, changes in the fair value of financial assets at fair value through the statement of income, impairment losses recognized on financial assets (except for a provision for doubtful debts, which is recognized under operating and general expenses), financing expenses for provisions arising from legal claims and losses on hedging instruments that are recognized in the statement of income.

Foreign currency gains and losses are reported on a net basis as either financing income or financing expenses depending on whether foreign currency movements are in a net gain or net loss position.

3. Significant Accounting Policies (Contd.)

3.14. Income tax expense

Income tax expense comprises current and deferred tax Income tax expenses are recognized in the statement of income except to the extent that it relates to a business combination, or are recognized directly in equity or in other comprehensive income to the extent they relate to items recognized directly in equity or in other comprehensive income.

Current taxes

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date. Current taxes also include taxes in respect of prior years.

Uncertain tax positions

A provision for uncertain tax positions, including additional tax and interest expenses, is recognized when it is more probable than not that the Group will have to use its economic resources to pay the obligation.

Deferred taxes

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The Group does not recognize deferred taxes for the following temporary differences:

- Initial recognition of goodwill
- Initial recognition of assets and liabilities in the transaction that is not a business combination and that affects neither accounting nor taxable profit.
- Carry-forward losses that are not expected to be utilized in the foreseeable future
- Differences arising from investment in subsidiaries and associates, if it is probable that they will not reverse in the foreseeable future and if the Group controls the date of reversal.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognized for carry-forward losses, tax benefits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Offsetting deferred tax assets and liabilities

The Group sets off deferred tax assets and liabilities if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

3.15. Discontinued operations

A discontinued operation is presented for a previously consolidated associate in which the Group no longer retains control. When an operation is classified as a discontinued operation, the comparative income statement is restated as if the operation had been discontinued from the start of the earliest comparative period. See also Note 12.1.9.

3. Significant Accounting Policies (Contd.)

3.16. Earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the year. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise warrants and share options granted to employees.

3.17. Segment reporting

An operating segment is a component of the Group that meets three conditions as follows:

A. It engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components.

B. Its operating results are reviewed regularly by the Group's chief operating decision maker, in order to make decisions about resources to be allocated to the segment and assess its performance.

C. Separate financial information is available in its respect.

3.18. Transactions with a controlling shareholder

Assets and liabilities included in a transaction with a controlling shareholder are measured at fair value on the date of the transaction.. As the transaction is on the equity level, the Company includes the difference between the fair value and the consideration from the transaction in its equity.

3.19. Dividends declared subsequent to the reporting date

An obligation relating to a dividend proposed or declared after the reporting date is recognized only in the period in which the declaration was made.

3.20. New standards and interpretations not yet adopted

3.20.1 IFRS 9 (2010), *Financial Instruments* ("the Standard")

This Standard is one of the stages in a comprehensive project to replace IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39") and it replaces the requirements included in IAS 39 regarding the classification and measurement of financial assets and financial liabilities.

In accordance with the Standard, there are two principal categories for measuring financial assets: amortized cost and fair value, with the basis of classification for debt instruments being the entity's business model for managing financial assets and the contractual cash flow characteristics of the financial asset. The Standard generally preserves the instructions regarding classification and measurement of financial liabilities that are provided in IAS 39.

The Standard is effective for annual periods beginning on or after January 1, 2015. Early application is permitted, subject to disclosure and subject to parallel adoption of other IFRSs set out in the appendix to the Standard. The Standard is to be applied retrospectively other than in a number of exceptions. The Group is examining the effects of adopting the Standard on the financial statements.

3. Significant Accounting Policies (Contd.)

3.20 New standards and interpretations yet to be adopted (contd.)

3.20.2 A new suite of accounting standards on consolidation of financial statements, joint arrangements and disclosure of involvement with other entities.

In May 2011, the IASB published a new suite of accounting standards for consolidation of financial statements and related issues. The Group is examining the effect of adopting the standards on the financial statements. The standards are to be applied retrospectively for annual periods commencing on or after January 1, 2013. Early adoption is permitted, subject to the conditions that were determined. New standards published:

A. IFRS 10, Consolidated Financial Statements

B. IFRS 11, Joint Arrangements

C. IFRS12, Disclosure of Interests in Other Entities

3.20.3 IFRS 13, *Fair Value Measurement* ("the Standard")

The Standard supersedes the guidelines for fair value measurement in other IFRSs. 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 adoption is permitted, subject to the conditions that were determined. The Group is examining the effects of adopting the Standard on the financial statements.

3.20.4 The amendment to IAS 19, *Employee Benefits* ("the Amendment")

The Amendment includes a number of revisions to accounting guidelines for employee benefits. The Amendment is effective retrospectively for annual periods commencing on or after January 1, 2013. Early adoption is permitted provided that disclosure is provided. The Group is examining the effect of adopting the Amendment on the financial statements.

3.20.5 Amendment to IAS 32, Financial Instruments: Presentation, and Amendment to IFRS 7 Financial Instruments: Disclosure, Regarding Transfers of Financial Assets and Liabilities ("the Amendments").

The amendment to IAS 32 clarifies conditions that can offset financial assets and liabilities in the statement of financial position and determines that an entity has an immediate enforceable legal right to offset the amounts recognized, if this right is not conditional on a future event and is enforceable during the normal course of business as well as in the event of insolvency or bankruptcy. The amendment to IFRS 7 introduces new disclosure requirements for financial assets and liabilities that were offset in the statement of financial position.

The amendment to IAS 32 will be applied retrospectively for annual periods beginning on or after January 1, 2014. Early adoption is permitted, subject to the conditions that were determined.

The amendment to IFRS 7 will be applied retrospectively for annual periods beginning on or after January 1, 2013. The Group is examining the effect of adopting the Amendments on the financial statements.

4. Determination of Fair Value

A number of the Group's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and / or disclosure purposes based on the methods described below. Further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

4.1. Investment in securities

The fair value of investments in financial funds, shares and debentures (at fair value through profit or loss or available for sale) is determined by reference to their quoted closing bid price at the reporting date. If there is no available quote, the fair value is measured with the utmost consideration of available market information (such as the use of an interest curve), and by means of an appropriate valuation technique.

4.2. Trade receivables

The fair value of trade receivables for sales in installments is measured at initial recognition based on the present value of the future cash flows, discounted at the market interest rate on the transaction date. Subsequent to initial recognition, the fair value of trade and other receivables, for disclosure purposes only, is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. See also Note 7.

4.3. Derivatives

The fair value of forward exchange contracts, the CPI or copper prices and foreign currency options is based on their quoted price, if available. If a quoted price is not available, then fair value is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity of the contract, using an appropriate interest rate.

4.4. Intangible assets

The fair value of a brand acquired in a business combination is based on the relief from royalty methodology, according to which the brand value is estimated by discounting the appropriate amount of the royalty payments, which the user of the asset would pay for the use of the asset had it not owned the asset. The fair value of customer relations, order backlog and technology knowhow acquired in a business combination is determined using the multi-period excess earnings methodology.

4.5. Non-derivative financial liabilities

The fair value of the non-derivative financial liabilities, which is determined for disclosure purposes, is determined by reference to the quoted closing asking price at the reporting date. If such a quoted price is not available, fair value is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

4.6. Share-based payments

The fair value of employee share options and of cash-settled share based payments is measured using the Black-Scholes model. The assumptions of the model include the share price on the date of measurement, the exercise price of the instrument, expected volatility (based on the weighted average of historical volatility, adjusted for changes expected due to publicly available information), the projected useful life of the instruments (based on past experience and the general behavior of the option-holders), expected dividends, and the risk-free interest rate (based on government bonds). See also Note 26.

5. Cash and cash equivalents

	December 31 2011 NIS million	December 31 2010 NIS million
Bank balances	**58**	55
Call deposits	**1,294**	310
	1,352	365

In 2011, the effective interest rate for call deposits was 3.12%-2.7%

in 2010: 1.59% - 1.5%). For deposits, the average maturity period was 3-9 days (in 2010: 4-7 days) See also Note 30.

6. Investments, including derivatives

6.1. Categories of financial assets

	December 31 2011 NIS million	December 31 2010 NIS million
Current investments		
Financial assets held for trading (monetary reserves)	**915**	–
Derivatives and other investments	**31**	7
	946	7
Non-current investments		
Bank deposit for providing loans to employees *	**76**	83
Available-for-sale financial assets	**39**	31
Derivatives and other investments	**4**	15
	119	129
	1,065	136

* The deposit serves as a security for providing bank loans to Company employees. The deposit is unlinked and the effective interest rate of the deposit at December 31, 2011 is 2.29% (in 2010, 2.15%). The Company is liable for the loans to employees. The deposit is stated at its present value, taking into account the loan repayment schedule, based on a weighted average discount rate of 3.19% (in 2010, 3.28%).

6.2. Analysis of forecasted maturity dates

	2012 NIS million	TBD NIS million	Total NIS million
Financial assets held for trading (monetary reserves)	915	–	915
Available-for-sale financial assets	–	39	39
Bank deposit for providing loans to employees	–	76	76
Derivatives and other investments	31	4	35
	946	119	1,065

7. Trade and other receivables

Composition of trade and other receivables

	December 31 2011 NIS million	December 31 2010 NIS million
Trade receivables *		
Open accounts	**827**	719
Credit cards and checks receivable	**418**	554
Revenues receivable	**307**	413
Current maturities of long-term receivables	**1,439**	992
Related and interested parties	**68**	23
	3,059	2,701
Other receivables and current tax assets		
Prepaid expenses	**70**	119
Other receivables (mainly from real estate sales)	**212**	105
Current tax assets	**4**	3
	286	227
Long-term trade and other receivables		
Trade receivables – open debts **	**1,439**	954
Trade receivables - associate	**12**	44
Other receivables (mainly from real estate sales)	**48**	116
	1,499	1,114
	4,844	4,042

* The amount of trade receivables is stated net of the provision for doubtful debts

** Capitalized interest is based on the total average cost of unlinked credit provided by the seven large banks, as published by the Bank of Israel once a month. The interest rates used by the Company for capitalization in 2011 are 5.04%-6.28% (in 2010: 4.24% - 5.06%).

Trade and other receivables include NIS 40 million for trade and other receivables denominated in the US dollar (in 2010: NIS 38 million).

Expected payment dates for long-term trade and other receivables:

Expected payment dates	December 31, 2011 NIS million
2013	**1,065**
2014	**422**
2015	**9**
2016	**3**
	1,499

7. Trade and other receivables (Contd.)

Aging of trade receivables at the reporting date:

	December 31, 2011		December 31, 2010	
	Trade receivables (gross)	Provision for doubtful debts	Trade receivables (gross)	Provision for doubtful debts
	NIS million	NIS million	NIS million	NIS million
Not past due	**4,256**	**(40)**	3,423	(39)
Past due up to one year	**267**	**(78)**	294	(80)
Past due one to two years	**134**	**(79)**	127	(73)
Past due more than two years	**195**	**(145)**	176	(129)
	4,852	**(342)**	4,020	(321)

Change in provision for doubtful debts during the year:

	2011	2010
	NIS million	NIS million
Balance as at January 1	**321**	282
Impairment loss recognized	**68**	62
Bad debts	**(47)**	(28)
Additions in respect of a business combination	**–**	5
	342	321

8. Income tax expenses

8.1. General

Current tax expense			
For the current period	**747**	823	671
Adjustments for prior years, net	**2**	–	(30)
	749	823	641
Deferred tax expense			
Creation and reversal of temporary differences	**31**	114	136
Effect of change in tax rates	**(25)**	(5)	30
	6	109	166
Income tax expenses	**755**	932	807

8.2. Reconciliation between the theoretical tax on the pre-tax profit and the tax expense

	Year ended December 31		
	2011 NIS million	**2010 NIS million**	**2009 NIS million**
Profit before income tax	**2,816**	3,374	2,969
Statutory tax rate	**24%**	25%	26%
Income tax at the statutory tax rate	**676**	844	772
Differences in the tax rate	**(23)**	(8)	60
Expenses (revenues) not recognized for tax purposes	**48**	31	(4)
Adjusted tax calculated for the Company's share in the losses of equity-accounted investees	**52**	65	9
Taxes for previous years	**2**	–	(30)
	755	932	807

8.3. Unrecognized deferred tax assets and liabilities

8.3.1 The calculation of deferred taxes does not take into account the taxes that would be applicable in the case of disposal of investments in subsidiaries and associates, since the Group intends to retain the investment. Deferred taxes in respect of a distribution of profit in subsidiaries and associates were also not taken into account since the dividends are not taxable.

8.3.2 Deferred tax assets have not been recognized in respect of carry-forward capital losses for tax purposes as at December 31, 2010, in the amount of NIS 19 million.

8.3.3 Deferred tax assets relating to carry-forward losses and tax benefits were not recognized because their utilization in the foreseeable future is not likely. The deductible temporary differences and tax losses do not expire under current tax legislation. Deferred tax assets have not been recognized in respect of these items since it is not probable that future taxable profit will be available against which the Group can utilize the benefits.

8. Income tax expenses (contd.)

8.3 Unrecognized deferred tax assets and liabilities (contd.)

8.3.4 DBS (an equity-accounted associate, see also Note 12.1 below) has carry-forward losses and deductions for inflation for tax purposes amounting to NIS 4.8 billion at the reporting date (as at December 31, 2010 – NIS 4.6 billion).

8.3.5 DBS does not create deferred tax assets since it is not probable that future taxable profit will be available against which the Group can utilize the benefits.

8.4. Recognized tax assets and deferred tax liabilities

Deferred tax assets and tax liabilities are attributed to the following items:

	Assets		Liabilities		Net	
	2011 NIS million	**2010 NIS million**	**2011 NIS million**	**2010 NIS million**	**2011 NIS million**	**2010 NIS million**
Property, plant and equipment	**–**	–	**209**	149	**(209)**	(149)
Doubtful debts	**61**	54	**–**	–	**61**	54
Employee benefit plan	**298**	264	**–**	–	**298**	264
Share-based payments	**16**	20	**–**	–	**16**	20
Provisions	**26**	29	**–**	–	**26**	29
Other assets and carry-forward losses	**12**	8	**50**	55	**(38)**	(47)
	413	375	**259**	204	**154**	171

8.5. Changes in temporary differences during the year

	Balance at January 1, 2010 NIS million	**Changes recognized in profit or loss NIS million**	**Changes recognized in capital NIS million**	**Business combinations NIS million**	**Balance at December 31, 2010 NIS million**	**Changes recognized in profit or loss NIS million**	**Changes recognized in capital NIS million**	**Balance at December 31, 2011 NIS million**
Property, plant and equipment	(130)	(19)	–	–	(149)	(60)	–	(209)
Doubtful debts	47	7	–	–	54	7	–	61
Employee benefit plans	338	(70)	(4)	–	264	44	(10)	298
Share-based payments	33	(13)	–	–	20	(4)	–	16
Provisions	38	(9)	–	–	29	(3)	–	26
Other assets and carry-forward losses	(4)	(5)	(1)	(37)	(47)	11	(2)	(38)
	322	(109)	(5)	(37)	171	(5)	(12)	154
Deferred tax assets in the statement of financial position					254			223
Deferred tax liabilities in the statement of financial position					(83)			(69)
					171			154

8. Income tax expenses (contd.)

8.6. Amendments to the Income Tax Ordinance

On December 5, 2011, the Knesset approved the Law for Change in the Tax Burden (Legislative Amendments), 2011. According to the law, from 2012 onwards, the corporate tax rate will be 25%. The deferred tax balances as at December 31, 2011 were based on the new tax rate set out in this law, according to the expected tax rate at the reversal date. The effect of the change in the tax rate on the financial statements as at December 31, 2011 is reflected in an increase in deferred tax assets and a decrease of NIS 25 million in tax expenses.

8.7. Non-applicability of IFRS for tax purposes

Under the Amendment to the Income Tax Ordinance (Amendment 174 and Amendment 188), Israel Accounting Standard No. 29 - Adoption of International Financial Reporting Standards (IFRS) will not apply to determining taxable income in 2007-2011, other than for the preparation of the financial statements.

8.8. Final tax assessments

8.8.1 The Company has final tax assessments up to and including 2004.

8.8.2 Pelephone has received final tax assessments up to and including the year ended December 31, 2006.

In addition, in the tax assessment that Pelephone received for the 2007 tax year, the tax assessor determined that Pelephone had taxable income of NIS 151 million in 2007 instead of a carry-forward loss to 2008 of NIS 337 million, as Pelephone had reported in its tax returns. Accordingly, Pelephone was required to pay NIS 33 million beyond the amount included under current taxes for 2007. All issues raised by the tax assessor are for the timing of recognition of certain income and expenses for tax purposes. Pelephone rejects the demands of the Tax Authority, and appealed this assessment.

8.8.3 Bezeq International has received final tax assessments up to and including 2005.

8.8.4 Bezeq Online has received final tax assessments up to and including 2007.

8.8.5 Walla has received final tax assessments up to and including 2006.

9. Property, plant and equipment

	Land and buildings	Switching, transmission, power, cellular equipment	Network equipment	Subscriber equipment	Vehicles	Office equipment and computers	Total
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Cost or deemed cost							
Balance as at January 1, 2010	2,033	4,720	12,790	606	97	1,261	21,507
Additions	64	471	525	106	78	84	1,328
Disposals (9.2 below)	(92)	(223)	(367)	(256)	(5)	(9)	(952)
Transfer from assets held for sale	40	–	–	–	–	–	40
Addition in respect of a business combination	10	–	–	–	–	57	67
Balance as at December 31, 2010	2,055	4,968	12,948	456	170	1,393	21,990
Additions	**86**	**533**	**634**	**155**	**82**	**95**	**1,585**
Disposals (9.2 below)	**(14)**	**(177)**	**(580)**	**(110)**	**(5)**	**(74)**	**(960)**
Transfer to assets held for sale	**(71)**	**–**	**–**	**–**	**–**	**–**	**(71)**
Balance as at December 31, 2011	**2,056**	**5,324**	**13,002**	**501**	**247**	**1,414**	**22,544**
Depreciation and impairment losses							
Balance as at January 1, 2010	1,479	2,592	10,504	448	44	1,012	16,079
Depreciation for the year	59	607	235*	96*	14	103	1,114
Disposals (9.2 below)	(73)	(222)	(343)	(246)	(4)	(9)	(897)
Transfer from assets held for sale	30	–	–	–	–	–	30
Additions in respect of a business combination	7	–	–	–	–	47	54
Balance as at December 31, 2010	1,502	2,977	10,396	298	54	1,153	16,380
Depreciation for the year	**60**	**570**	**236**	**92**	**30**	**92**	**1,080**
Disposals (9.2 below)	**(5)**	**(175)**	**(520)**	**(101)**	**(5)**	**(74)**	**(880)**
Transfer to assets held for sale	**(58)**	**–**	**–**	**–**	**–**	**–**	**(58)**
Balance as at December 31, 2011	**1,499**	**3,372**	**10,112**	**289**	**79**	**1,171**	**16,522**
Carrying amount							
As at January 1, 2010	554	2,128	2,286	158	53	249	5,428
As at December 31, 2010	553	1,991	2,552	158	116	240	5,610
As at December 31, 2011	**557**	**1,952**	**2,890**	**212**	**168**	**243**	**6,022**

* Reclassified, see Note 2.9.

9.1 **Residual value**

The residual value of the Group's copper cables is assessed at the end of each reporting year. The residual value is NIS 469 million and NIS 689 million as at December 31, 2011 and December 31, 2010, respectively. The change in the residual value is not expected to have a material impact on the depreciation expenses in the future.

9.2 Property, plant and equipment in the Group is derecognized at the end of each year upon reaching full depreciation, except for land, buildings, vehicles and copper cables, which are derecognized upon their sale. In 2011, the Group derecognized fully depreciated property at a cost of NIS 348 million (in 2010 NIS 847 million).

9.3 In July 2008, the Company launched the NGN project to replace the existing network. In 2011, most of the network had been deployed.

9. PROPERTY, PLANT AND EQUIPMENT (CONTD.)

9.4 The Group companies reviewed the useful life of the property, plant and equipment through the depreciation committee, in order to determine the estimated useful life of their equipment. Following the findings of the committees, minor changes were made in the estimated useful life of certain assets.

9.5 Most of the real estate assets used by the Company were transferred to it by the State of Israel, according to the provisions in the asset transfer agreement signed between the Company and the State on January 31, 1984. Some of these assets were leased for 49 years, with an option for an extension for another 49 years, and others were rented for two years, renewable each time for another two years. The rights are amortized over the term of the lease period.

9.6 As at December 31, 2011, trade payables for credit acquisitions of property, plant and equipment amounted to NIS 99 million. In addition, at December 31, 2011, payables for the sale of property, plant and equipment amounted to NIS 211 million.

9.7 At the reporting date, there are agreements to purchase property, plant and equipment amounting to NIS 387 million (in 2010, NIS 300 million).

9.8 See Note 19 for liens.

10. Intangible assets

	Goodwill	Computer software and licenses and discounted development costs	Subscriber acquisition	Right of use in communication and cellular frequencies	Others	Total
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Cost						
Balance as at January 1, 2010	1,039	1,367	231	424	64	3,125
Acquisitions or additions from independent development	–	218	81	–	–	299
Disposals *	–	(309)	(160)	–	–	(469)
Additions in respect of a business combination	194	–	–	–	187	381
Balance as at December 31, 2010	1,233	1,276	152	424	251	3,336
Acquisitions or additions from independent development	**3**	**247**	**79**	**–**	**4**	**333**
Disposals	**–**	**–**	**(73)***	**(36)**	**–**	**(109)**
Balance as at December 31, 2011	**1,236**	**1,523**	**158**	**388**	**255**	**3,560**
Amortization and impairment losses						
Balance as at January 1, 2010	6	989	166	29	50	1,240
Amortization for the year	–	137	82	31	19	269
Disposals *	–	(309)	(160)	–	–	(469)
Addition in respect of a business combination	47	–	–	–	1	48
Balance as at December 31, 2010	53	817	88	60	70	1,088
Amortization for the year	**–**	**144**	**83**	**30**	**30**	**287**
Disposals *	**–**	**–**	**(72)**	**–**	**–**	**(72)**
Balance as at December 31, 2011	**53**	**961**	**99**	**90**	**100**	**1,303**
Carrying amount						
As at January 1, 2010	1,033	378	65	395	14	1,885
As at December 31, 2010	1,180	459	64	364	181	2,248
As at December 31, 2011	**1,183**	**562**	**59**	**298**	**155**	**2,257**

* Fully amortized intangible assets

10. Intangible assets (contd.)

Total value of goodwill attributable to each cash-generating unit:

	2011	2010
	NIS million	NIS million
Cellular communication – Pelephone Communications Ltd. (1)	**1,027**	1,027
Others (2)	**156**	153
	1,183	1,180

(1) Goodwill impairment testing - Pelephone

The value of the use of cellular communications – Pelephone, was calculated using the discounted cash flow (DCF) method, based on the expected cash flow for the next five years. The expected cash flow is based on Pelephone's results in 2011 and future growth and market shares are affected by the intensifying competition, regulation and new operators (MVNOs and a fifth cellular operator). In addition, it is assumed that Pelephone's new network will contribute to its marketing position and contribute to ARPU following the increase in revenues from roaming services and content/added value services.

The five-year revenue forecast is based on the forecast of the number of subscribers and average income and sales of terminal equipment, with reference to the effect of the entry of MVNO, the entry of a fifth operator and increased competition as well as reduction of interconnect prices. Some impairment of revenues from cellular services was assumed, which was partially offset by an increase in revenues from the sale of terminal equipment.

The operating, sales and marketing expenses were adjusted for Pelephone's volume of operations. The investments were estimated according the assumptions of an independent assessor regarding Pelephone's investments, which includes investment in the LTE network (including acquisition of frequencies) in 2013-2014 (which have not yet been approved by the management of Pelephone), and ongoing investments.

The cost of capital used is 11%. In addition, it was assumed that the permanent growth of Pelephone will be 1%.

This valuation was made by an independent appraiser. Based on this valuation, the Group was not required to record an impairment of Pelephone's cellular cash-generating unit.

(2) The need for a provision for impairment in another subsidiary, which is not material, was assessed, and following the assessment, a provision for impairment was not recognized.

11. Deferred and other expenses

	December 31, 2011	December 31, 2010
	NIS million	NIS million
Long-term prepaid expenses in respect of use of capacities *	**278**	288
Other prepaid expenses	**4**	4
	282	292

* See Note 3.7 above. In addition, in October 2011, Bezeq International entered into an agreement with Mediterranean Nautilus to expand and change the existing user rights in the international optic network that it operates, which will be used as a backup for Bezeq International's cable between Israel and Italy. This agreement is not expected to have a material impact on the Company's results.

The amount of amortization recognized in the statement of income in 2011 is NIS 28 million (in 2010, NIS 26 million; in 2009, NIS 22 million).

12. Investees

12.1. Equity-accounted associates

Below is a summary of the major associate, DBS Satellite Services (1998) Ltd. ("DBS"), without adjustment for ownership percentage held by the Group:

Condensed statement of financial position	December 31, 2011 NIS million	December 31, 2010 NIS million
Current assets	**181**	180
Non-current assets	**1,101**	1,063
Total assets	**1,282**	1,243
Current liabilities	**771**	802
Non-current liabilities	**4,161**	3,863
Total liabilities	**4,932**	4,665
Capital deficit	**(3,650)**	(3,422)

Condensed statement of income	2011 NIS million	2010 NIS million
Revenues	**1,619**	1,583
Gross profit	**591**	454
Operating profit	**295**	178
Loss for the year	**(230)**	(314)

The Company holds 49.78% of the share capital of DBS In addition, at the reporting date, the Company has warrants that confer the right to 8.6% in DBS shares. In view of the 2009 ruling of the Supreme Court not to approve the Company's merger with DBS, the warrants are not exercisable by the Company at the approval date of the financial statements. See also Note 12.1.9 below.

The Group attaches the financial statements of DBS to these financial statements

12.1.1 As at December 31, 2011 and December 31, 2010, the Company's investment in DBS includes the Company's investments in shares, share options and loans. The loans are presented at fair value as at August 21, 2009 (the date of deconsolidation) plus interest and linkage differences and less the Company's share in the losses at that date. For details of deconsolidation of DBS in 2009, see section 12.1.9 below.

12.1.2 Composition of investments in DBS:

	2011 NIS million	2010 NIS million
Balance as at January 1	**1,084**	1,184
Interest and linkage differences	**189**	159
Company's share in capital reserves	**1**	4
Company's share in losses	**(217)**	(263)
Balance as at December 31	**1,057**	1,084

The Company's subsidiaries have investments in other associates amounting to NIS 2 million as at December 31, 2011.

12. Investees (contd.)

12.1 Equity-accounted associates (contd.)

12.1.3 Details of the Company's loans to DBS, according to the terms of the loans and details of the carrying amount of the loans as stated in the financial statements:

	Balance at December 31, 2011		December 31, 2010	
	Carrying amount	Value according to the terms of the loans **	Carrying amount	Value according to the terms of the loans **
	NIS million	NIS million	NIS million	NIS million
CPI-linked loans (1)	**59**	**1,173**	44	1,145
CPI-linked loans, bearing interest at a rate of 5.5% (2)	**214**	**309**	172	286
CPI-linked loans, bearing interest at a rate of 11% (2)	**1,276**	**1,266**	1,135	1,112
	1,549	**2,748**	1,351	2,543

* The fair value at the deconsolidation date, including interest and linkage differences accumulated from the deconsolidation date through to December 31, 2011 and December 31, 2010, respectively.

** Balance of the loans plus interest and linkage differences according to the terms of the loans

(1) The loans extended to DBS by the Company until July 10, 2002 ("the Old Shareholders' Loans") are linked to the known CPI, do not have a repayment date and do not bear interest.

(2) In accordance with the agreement between DBS and the shareholders as at December 30, 2002, it was decided that the loans extended by some of the shareholders (including the Company) to DBS as from July 10, 2002 ("the New Shareholders Loans"), will have preference over the Old Shareholders Loans. In accordance with the agreement, the New Shareholders Loans will be eligible for full settlement by DBS before any dividend is distributed by DBS and/or the repayment of the Old Shareholders Loans extended to DBS by the shareholders, and subject to the cash flows and liabilities of DBS under the agreements with the banks. No repayment dates were set for the new loans as well.

12.1.4 Financial position of DBS

Since commencing its operations, DBS has accumulated considerable losses. The losses in 2011 and 2010 amounted to NIS 230 million and NIS 314 million, respectively. As a result of these losses, the capital deficit and working capital deficit of DBS as at December 31, 2011 amounted to NIS 3,650 million and NIS 590 million, respectively.

The management of DBS believes that the financial resources available to it will be sufficient for its operating needs in the coming year based on the forecasted cash flow approved by DBS's board of directors. If additional resources are required to meet its operational requirements for the coming year, DBS will adapt its operations to preclude the need for additional resources beyond those available to it. In recent years, DBS has raised external financing to expand its investments. At the reporting date, any significant increase in the investments of DBS will require an expansion of the financing sources at its disposal.

12. Investees (contd.)

12.1 Equity-accounted associates (contd.)

12.1.5 Financial covenants and stipulations applicable to DBS

The terms of loans and credit facility that DBS received from banks (NIS 535 million as at December 31, 2011) impose the following restrictions: the lien or sale of certain assets, receipt of credit from other banks (without the prior approval of the lending bank), distribution of a dividend, repayment of shareholder loans, transactions with interested parties, changes in the shareholding ratio of shareholders, the Company's compliance with various licenses granted to it, purchase of securities by the Company and the establishment of a subsidiary, and the issuance of shares or other securities of the Company.

According to the financing agreement, DBS is required to comply with the minimum debt coverage ratio between its cash balance (cash, deposits and available for sale securities plus the unused balance of the short-term bank credit), plus the excess before its financing (the total net cash arising from operating activities in the preceding four quarters, less the total cash arising from investing activities in those four quarters according to the statement of cash flow) and the total capital and interest payments (the total repayable amount in the four quarters subsequent to the assessed quarter, on account of long-term bank credit and Debentures (Series A) and (Series B). The covenant targets rise gradually until 2013, when the covenant targets for December 31, 2011 were equal to a minimum debt coverage ratio of 1.05. As at December 31, 2011, DBS is in compliance with this covenant (the debt coverage ratio was 1.55).

DBS is also in compliance with the minimum and maximum suppliers credit. This covenant is measured according to the balance of the liabilities to suppliers and service providers for the period commencing at the beginning of that calendar year and ending at the end of the measured quarter. The covenant target is that suppliers' credit will be no less than NIS 300 million and no more than NIS 500 million (the maximum target does not include credit of up to NIS 100 million from suppliers that are interested parties, provided the credit from suppliers that are not interested parties does not exceed NIS 500 million. As at December 31, 2011, DBS is in compliance with this covenant (suppliers' credit was NIS 428 million).

In addition, the trust deed for Debentures (Series B) issued by DBS stipulates that DBS is required to meet a maximum debt-EBITDA ratio of 5.7 every quarter. As at December 31, 2011, DBS is in compliance with this covenant (the debt-EBITDA ratio was 2.86).

12.1.6 As collateral for the guarantees and liabilities (for bank credit and Debentures (Series A) and (Series B)) amounting to NIS 1.6 billion, DBS recognized current liens on all its assets and fixed liens on some of its assets (subject to restrictions set out in the Communications Law).

12.1.7 DBS has a current debt to the Group companies. The balance of DBS's current debt to the Group companies amounts to NIS 65 million, of which NIS 53 million is to the Company.

12.1.8 For the guarantees that the Company provided to DBS, see Note 19.4 and 19.6.

12. Investees (contd.)

12.1 Equity-accounted associates (contd.)

12.1.9 Deconsolidation of DBS in 2009

On August 20, 2009, the Supreme Court accepted the appeal of the Antitrust Commissioner against the merger notice filed by the Company and DBS regarding exercise of options for DBS shares by the Company, and ruled against the merger. The ruling of the Supreme Court is a peremptory ruling. Until the ruling of the Supreme Court, the Company consolidated the financial statements of DBS in its financial statements (the Company held 49.78% of the share capital of DBS), even though it did not have legal control of DBS, as in view of all the circumstances, including the Company's additional potential voting rights by virtue of the options, in the opinion of the Company, it was able to direct the financial and operational policy of DBS.

The Company estimates that the ruling of the Supreme Court, which is final and irrevocable, constitutes an external legal barrier to the Company's ability to obtain more than 50% of the voting rights in DBS, will lead to a material change in the operations between the Company and YES and its shareholders, following which the Company will no longer be able to direct the financial and operational policy of DBS. Therefore, the Company cannot be regarded as controlling DBS (neither legally nor effectively). Accordingly, as from August 21, 2009, the Company no longer consolidates the reports of DBS in its financial statements and the investment in DBS shares is stated according to the equity method commencing from that date.

At the deconsolidation date, the Company presented its investment in shares, share options and loans to DBS according to the equity method based on a valuation by an independent assessor. According to the opinion, the value of the Company's investment in shares, share options and loans to DBS is estimated at between NIS 1.234 billion and NIS 1.145 billion.

This included valuation of the fair value of DBS's tangible assets, intangible assets (except for goodwill) and liabilities. It is noted that In February 2011, the Company received an adjusted valuation from the assessor, according to which the value of the investment is between NIS 1.138 billion and 1.234 billion, including an adjustment to the allocation of the value to various equity and debt components. The adjustment has no material effect on the financial statements.

The difference between the fair value of the remaining investment in DBS at the deconsolidation date and the Company's share in the identifiable assets and liabilities of DBS at that date constitute the goodwill included in the calculation of the Company's investment in DBS at the deconsolidation date. At the deconsolidation date and as at December 31, 2011 and December 31, 2010, goodwill that was included as part of the investment amounts to NIS 814 million. On August 21, 2009, the Company stated the investment at NIS 1.175 billion and recognized a profit of NIS 1.538 billion under profit from discontinued operations.

The Company was informed, in the context of the approval given to the controlling shareholder of the Company (who indirectly holds shares in DBS) to acquire core control in the Company, that the controlling shareholder was required to sell his holdings in DBS and until completion of the sale, to transfer his shares in DBS to a trustee. To the best of the Company's knowledge, the Antitrust Commissioner is discussing these conditions.

12. Investees (contd.)

12.1 Equity-accounted associates (contd.)

12.1.9 Deconsolidation of DBS in 2009 (contd.)

Results of discontinued operations as stated in the financial statements for 2009:

	From January 1 to August 20 2009 NIS million
Revenues	970
Cost of revenues	663
Gross profit	307
Selling and marketing expenses	79
General and administrative expenses	74
	153
Operating profit	154
Financing expenses, net	313
Loss after financing expenses	(159)
Profit from deconsolidation of a subsidiary	1,538
Profit from discontinued operations	1,379

12.2. Subsidiaries held directly by the Company

12.2.1 General

	Country of incorporation	Company's rights in capital	Amounts provided by the Company to subsidiaries NIS million	Investment in equity-accounted subsidiaries NIS million
2011				
Pelephone Communications Ltd.	Israel	100%	**732**	**4,169**
Bezeq International Ltd.*	Israel	100%	**160**	**830**
Bezeq Online Ltd.	Israel	100%	**17**	**41**
Bezeq Zahav (Holdings) Ltd.	Israel	100%	**893**	**–**
Walla! Communications Ltd.**	Israel	71.55%	**–**	**174**
Stage One Venture Capital Fund	Israel	71.8%	**–**	**42**
			1,802	**5,256**
2010				
Pelephone Communications Ltd.	Israel	100%	–	3,983
Bezeq International Ltd.*	Israel	100%	–	743
Bezeq Online Ltd.	Israel	100%	5	30
Bezeq Zahav (Holdings) Ltd.	Israel	100%	1,049	–
Walla! Communications Ltd.**	Israel	71.55%	–	188
Stage One Venture Capital Fund	Israel	71.8%	–	40
			1,054	4,984

* The Company provided a guarantee in favor of banks in connection with credit of up to NIS 70 million granted to Bezeq International

** Walla has investments in other subsidiaries that are not material.

12. Investees (contd.)

12.2 Subsidiaries held directly by the Company (contd.)

12.2.2 Dividend received or receivable from subsidiaries

	Year ended December 31	
	2011	2010
	NIS million	NIS million
From Pelephone Communications Ltd.	**869**	625
From Bezeq International Ltd.	**92**	216
From Stage One Venture Capital Fund	**3**	10
	964	851

12.2.3 Details of Group entities

A. **Pelephone Communications Ltd.**

Pelephone Communications Ltd. ("Pelephone") is a wholly-owned subsidiary of the Company. Pelephone provides cellular communication services and value added services and markets and repairs terminal equipment.

B. **Bezeq International Ltd.**

Bezeq International Ltd. ("Bezeq International") is a wholly-owned subsidiary of the Company. Bezeq International provides internet access (ISP) services, international communications services and network end point (NEP) services.

C. **Bezeq Online Ltd.**

Bezeq Online Ltd. ("Bezeq Online") is a wholly-owned subsidiary of the Company. providing call center outsourcing services.

D. **Bezeq Zahav (Holdings) Ltd.**

Bezeq Zahav (Holdings) Ltd. ("Bezeq Zahav") is wholly-owned subsidiary of the Company. Bezeq Zahav holds debentures (Series 5) issued by the Company. See Note 13.2.4.

E. **Walla! Communications Ltd.**

Walla! Communications Ltd. ("Walla") is controlled by the Company and the Company holds 71.55% of Walla shares. Walla is a public company and its shares are traded on the Tel Aviv Stock Exchange. The market value of the Walla shares held by the Company as at December 31, 2011 is NIS 137 million. Walla provides internet management and media services for a range of populations. For information about publication of the complete tender offer by the Company to acquire the entire shares of Walla held by the public, subsequent to the reporting date, see Note 32.3.

F. **Stage One Venture Capital Fund (Israel) L.P.**

This is a venture capital fund in which the management rights are held by the general partner (Stage One Capital Investments LP) and the Company has rights to profits. See Note 3.1.6 above.

Subsequent to the reporting date, the fund signed an agreement to sell the shares of one of the companies in which the fund invested. Following the agreement, in the first quarter of 2012, the Group is expected to recognize financing revenues of USD 18 million from the disposal of available-for-sale assets.

13. Debentures, loans and borrowings

13.1. Composition:

	December 31, 2011 NIS million	December 31, 2010 NIS million
Current liabilities		
Short-term credit	**3**	7
Current maturities of debentures	**507**	895
Current maturities of bank loans	**255**	47
	765	949
Non-current liabilities		
Debentures	**4,663**	1,967
Bank loans	**4,150**	2,801
	8,813	4,768
	9,578	5,717

13.2. Terms and debt repayment schedule

		December 31, 2011		December 31, 2010		
		Carrying amount Balance NIS million	Nominal value NIS million	Carrying amount Balance NIS million	Nominal value NIS million	Interest rate range
Short-term credit		**3**	**3**	7	7	
Total unlinked loans at variable interest	See 13.2.1 and 13.2.2	**2,470**	**2,470**	1,370	1,370	Prime -0.33% to +0.2%
Total unlinked loans at fixed interest	See 13.2.1 and 13.2.2	**1,800**	**1,800**	1,300	1,300	6.85% - 5%
CPI-linked loans at fixed interest	See 13.2.3.	**135**	**113**	178	153	4.45%-5.2%
Total loans		**4,405**	**4,383**	2,848	2,823	
Debentures issued to the public						
CPI-linked debentures at fixed interest - Series 4		**–**	**–**	351	300	4.8%
CPI-linked debentures at fixed interest - Series 5	See 13.2.4.	**1,520**	**1,256**	1,812	1,507	5.3%
CPI-linked debentures at fixed interest - Series 6	See 13.2.5.	**962**	**958**	–	–	3.7%
Unlinked debentures at variable interest - Series 7	See 13.2.5.	**425**	**425**	–	–	Makam for one year +1.4%
Unlinked debentures at fixed interest - Series 8	See 13.2.5.	**1,329**	**1,329**	–	–	5.7%
Total debentures issued to the public		**4,236**	**3,968**	2,163	1,807	
Debentures issued to financial institutes						
CPI-linked debentures at fixed interest		**58**	**44**	102	81	5.95%
CPI-linked debentures at fixed interest	See 13.2.3.	**476**	**398**	597	512	4.4%-5.2%
Unlinked debentures at fixed interest	See 13.2.2.	**400**	**400**	–	–	6.65%
Total debentures issued to financial institutions		**934**	**842**	699	593	
Total debentures		**5,170**	**4,810**	2,862	2,400	
Total interest-bearing liabilities		**9,578**	**9,196**	5,717	5,230	

13. Debentures, loans and borrowings (contd.)

13.2 Terms and debt repayment schedule

13.2.1 In 2010, the Company completed debt financing amounting to NIS 2.6 billion, through loans from banks in Israel. The Company created a negative pledge for the loan.

which includes exceptions, inter alia, for the matter of a lien on assets that are purchased or expanded by the Company, if the undertakings for which the charge serves as security is created for the purchase or expansion of those assets and for the matter of a token charge.

There is a cross-default mechanism for the loans that allows, under certain conditions, immediate recall of the debt should a third party call for immediate repayment of the Company’s debts towards it due to breach of contract.

As at December 31, 2011 and the approval date of the financial statements, there were no grounds to call for immediate repayment of the loans.

13.2.2 In 2011, the Company completed debt financing from banks amounting to NIS 1.6 billion and issued private debentures to an institute (group) amounting to NIS 400 million. The Company has provided the following undertakings to each of the credit providers (“the Credit Providers”):

A. 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 13.2.1 above.

B. 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.

C. The Company undertook that if it makes a commitment 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.

D. At December 31, 2011 and the approval date of the financial statements, the Company was in compliance with all its liabilities in respect of this debt, there were no grounds to call for immediate repayment and financial covenants were not set out as described above.

13.2.3 The bank loans and debentures of Pelephone (NIS 135 million and NIS 476 million as at December 31, 2011, respectively) are secured by an irrevocable undertaking by Pelephone to the credit providers not to encumber its assets without their consent (a negative pledge). The undertaking includes:

A. A declaration that Pelephone will not encumber its assets (as may be from time to time), in whole or in part, in any manner including by means of a floating lien or a fixed lien of any type or rank, in favor of any third party, without the prior written consent of the credit providers

B. Compliance with the following financial covenants:

1. An undertaking that Pelephone’s debt will not exceed three times its equity and an undertaking that as long as that ratio exceeds 2.5, dividends will not be distributed and management fees will not be paid to the shareholders.

2. Pelephone undertook that the amount of its debts will not exceed NIS 3.8 billion (linked to the CPI known in January 2002). As at December 31, 2011, the estimated amount is NIS 4.8 billion.

3. An undertaking towards a certain bank that its total debt to it will not exceed 40% of its total debts to all the financial entities.

As at the date of the financial statements, Pelephone is in compliance with the financial covenants and with its undertakings to the banks and the debenture holders. Non-compliance with these undertakings would allow the banks and the debenture holders to call for immediate repayment of the loans it received from the banks and the debentures.

13. Debentures, loans and borrowings (contd.)

13.2 Terms and debt repayment schedule (contd.)

13.2.4 The par value of Debentures (Series 5) is 1,989,139,167 of NIS 1 par value each, of which 1,255,722,500 debentures were issued to the public and to institutional investors (partially through Bezeq Zahav, a wholly-owned subsidiary) and the balance of 733,416,667 debentures was issued to Bezeq Zahav. The debentures are repayable in six equal annual payments in each of the years 2011 to 2016.

13.2.5 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 Note 1.4 above. Subsequently, on July 3, 2011, the Company issued debentures according to the shelf offering memorandum, as follows:

A. 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 in 2018 to 2022. The interest is payable twice a year as from December 1, 2011.

B. 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 payments in 2018 to 2022. The interest is payable four times a year as from September 1, 2011.

C. 1,329,363,000 Debentures (Series 8) of record, 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 in 2015 to 2017. The interest is payable twice a year as from December 1, 2011.

13.2.6 The total gross consideration for the debentures amounted to NIS 2,712,406,000. The consideration less issuance fees amounted to NIS 2,694,283,579.

13.2.7 The Company undertook the following for the debentures that were issued:

A. 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 section 13.2.1 above.

B. The Company will take steps so that, to the extent under its control, debentures of the relevant series will rated by at least one rating company, so long as there are debentures of the relevant series in circulation.

C. 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).

D. Standard grounds were included for immediate repayment of the debentures, including breach events, insolvency, dissolution procedures or receivership. In addition, a right was determined 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.

13.2.8 As at December 31, 2011 and the approval date of the financial statements, the Company was in compliance with all its liabilities in respect of these debentures, there were no grounds to call for immediate repayment of the credit and financial covenants were not set out as aforesaid.

14. Trade and other payables

	December 31, 2011 NIS million	December 31, 2010 NIS million
Trade payables (open accounts)*	**890**	1,061
Other payables, including derivatives		
Liabilities to employees and other liabilities for salaries	**346**	348
Institutions	**187**	183
Expenses due	**109**	112
Accrued interest	**107**	93
Other payables, including derivatives	**43**	34
Total other payables	**792**	770

* Of which, the carrying amount of suppliers that are related parties and interested parties at December 31, 2011 amounts to NIS 18 million (as at December 31, 2010 – NIS 46 million).

Amounts payable denominated in a currency other than the functional currency include NIS 140 million for trade payables denominated in US dollars (in 2010, NIS 174 million).

15. Note provisions

	Employee claims*	Customer claims*	Supplier and communication provider claims*	Punitive claims *	Enterprise and company claims *	State and Authorities claims *	Dismantling and clearing of sites **	Liability, onerous contracts and others	Total
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Balance as at January 1, 2011	96	56	5	2	10	65	64	22	320
Provisions during the period	**8**	**11**	**4**	**–**	**1**	**6**	**1**	**4**	**35**
Provisions used during the period	**–**	**(21)**	**–**	**(1)**	**–**	**(12)**	**–**	**(1)**	**(35)**
Provisions canceled during the period	**(31)**	**(20)**	**–**	**–**	**–**	**(12)**	**(1)**	**(1)**	**(65)**
Balance as at December 31, 2011	**73**	**26**	**9**	**1**	**11**	**47**	**64**	**24**	**255**
Current	**73**	**26**	**9**	**1**	**11**	**47**	**–**	**19**	**186**
Non-current	**–**	**–**	**–**	**–**	**–**	**–**	**64**	**5**	**69**

*** Claims**

For details regarding legal claims, see Note 17.

**** Dismantling and clearing of sites**

The provision is in respect of Pelephone’s obligation to clear the sites that it leases.

16. Employee benefits

Employee benefits include post-employment benefits, other long-term benefits, termination benefits, short-term benefits and share-based payments. For details of share-based payments, see Note 26 below.

16.1. Defined contribution plans

16.1.1 The pension rights of Company employees for the period of their employment in the civil service through January 31, 1985, are covered by a pension fund ("the Makefet Fund"), which assumed the State's obligation following an agreement between the Government of Israel, the Company, the Histadrut and the Makefet Fund.

16.1.2 Liabilities for employee benefits at retirement age in respect of the period of their service in the Company and its subsidiaries are covered in full by regular payments to pension funds and insurance companies.

16.1.3 The severance obligation to employees who leave their employment on terms entitling them to compensation is covered, for the period from February 1, 1985, by regular contributions to such pension funds and insurance companies (in accordance with Section 14 of the Severance Pay Law). Severance pay for the period of employment in the civil service through January 31, 1985, is paid by the Company, and the monies accumulated in the Makefet Fund for that period are kept in a fund that will be used for the employees' rights. For certain employees, the Company has an obligation to pay severance in excess of the amount accumulated in the compensation fund which is in the employees' names. See section 16.2.1 below.

16.2. Defined benefit plans

16.2.1 The severance obligation included in the statement of financial position represents the balance of the obligation not covered by contributions and/or insurance policies in accordance with the existing labor agreements, the Severance Pay Law, and the salary components which the managements of the companies believe entitle the employees to receive compensation. For this part of the obligation, there are deposits in the name of Group companies in a recognized compensation fund. The reserves in compensation funds include accrued linkage differentials and interest deposited in compensation funds, in banks and in insurance companies. Withdrawal of the reserve monies is contingent upon fulfillment of the provisions in the Severance Pay Law.

16.2.2 The collective agreement of December 2006 (see section 16.4 below), provides, among others, that employees who transferred from the civil service to the Company and are due to end their employment due to retirement after December 31, 2016, are entitled to a supplement to close the gap between the Civil Service Law and the regulations governing the Makefet Fund. The financial statements of the Company include the obligation for this benefit.

16.2.3 According to some of the personal employment agreements, a number of senior employees are entitled to early retirement terms (pension and retirement grants) which are not dependent on the existing retirement agreements for all employees. Accordingly, a liability is included in the financial statements.

16.2.4 According to the employment agreements of some of the senior employees in the Group, they will be paid a benefit for notice upon severance. Accordingly, a liability is included in the financial statements in accordance with employment agreements and an actuarial calculation.

16. Employee benefits (contd.)

16.2 Defined benefit plans (contd.)

16.2.5 Company retirees receive, in addition to the pension payments, benefits which consist mainly of a holiday gift (linked to the dollar exchange rate), financing the upkeep of retiree clubs, and social activities. The Company's liability for these costs accumulates during the employment period. The Company's financial statements include the liabilities for expected costs in the post-employment period, based on an actuarial calculation.

16.3. Other long-term employee benefits

The financial statements include a provision in respect of redemption and use of sick leave. The right to accumulate sick leave was taken into account for all employees in the Group. Only employees eligible under the terms of the employment agreement may redeem sick leave. The provision was computed on the basis of an actuarial calculation, including the assumption of positive accumulation of days by most of the employees and use of days by the last in first out (LIFO) method.

16.4. Benefits for early retirement and dismissal

The Company has a number of collective agreements that include terms for early retirement. According to the collective agreement of December 2006, between the Company and the employees union and the New Histadrut, and according to the amendment to the agreement of December 2010, the Company may, at its discretion, terminate the employment of 245 permanent employees in one or more of the years 2010-2016. The retirement terms that will be offered to the retirees will be largely the same as the retirement terms prevailing in the Company up to that date. The term of the agreement (after the amendment made in 2010) is from the date the agreement is signed through December 31, 2015. The Company has an option to extend it for another two years, through December 31, 2017. The term of the retirement section in the agreement will be through December 31, 2016.

On January 24, 2011, the Board of Directors of the Company approved a plan for early retirement of up to 260 employees at a maximum cost of NIS 281.5 million. In addition, on December 4, 2011, the Board of Directors of the Company approved the retirement of another 91 employees at a total cost of NIS 80 million. This approval constitutes the completion of the early retirement plan for 2011 and early retirement on account of the option for retirement in 2012.

The Company recognizes expenses for early retirement when the Company is committed demonstrably, without realistic possibility of withdrawal, to a defined plan to terminate employment before the defined date, according to a defined plan. The collective agreement allows the Company to dismiss employees, but does not create a demonstrable commitment without realistic possibility of withdrawal.

The expense of NIS 281.5 million and NIS 80 million for these decisions was recognized in the Company's financial statements in the first and fourth quarters of 2011, respectively, since only after the approval of the Board of Directors and publication of the decision, does the Company have a demonstrable commitment without realistic possibility of withdrawal.

16. Employee benefits (contd.)

16.5. Liabilities for employee benefits

	December 31, 2011	December 31, 2010
	NIS million	NIS million
Unfunded obligations (1)	**185**	225
Funded obligations (2)	**203**	213
Total present value of obligations	**388**	438
Fair value of plan assets	**(144)**	(152)
Liability for defined benefit plans (post-employment plans)	**244**	286
Obligation for a special bonus	**–**	26
Obligation for holiday pay	**91**	89
Obligation for sick leave	**118**	126
Obligation for early retirement	**165**	47
Total employee benefits	**618**	574
Stated in the statement of financial position as:		
Short term	**389**	269
Long term	**229**	305
	618	574

(1) Unfunded obligations are those obligations for which the Company did not deposit a reserve to finance its liabilities and they include a provision for notice, an obligation to the Company's pensioners, an obligation for early retirement of senior employees in the Company and an obligation for employees transferred from the civil service.

(2) Obligations for which the Group companies deposited a reserve to finance its obligations (severance obligation).

16. Employee benefits (contd.)

16.6. Defined benefit plans (post-employment plans)

	2011 NIS million	2010 NIS million
1. Change in an obligation in respect of a defined benefit plan		
Obligation in respect of a defined benefit plan as at January 1	**438**	453
Benefits paid according to the plans	**(39)**	(32)
Costs of current service, interest and exchange rate differences (see section 3 below)	**50**	34
Retirement and curtailment of benefits (see section 3 below)	**(21)**	(9)
Actuarial gains charged to equity (see section 5 below)	**(40)**	(17)
Additions in respect of a business combination	**–**	9
Defined benefit obligation as at December 31	**388**	438
2. Change in plan assets and cost of past service		
Fair value as at January 1	**152**	148
Deposits	**9**	10
Withdrawals	**(12)**	(9)
Expected proceeds from plan assets (see section 3 below)	**6**	5
Actuarial losses charged to equity (see section 5 below)	**(3)**	(2)
Amortization of past service cost (see section 3 below)	**(8)**	(7)
Additions in respect of a business combination	**–**	7
Fair value as at December 31	**144**	152

	2011 NIS million	2010 NIS million	2009 NIS million
3. Expense recognized in the statement of income			
Cost of current service	**25**	14	37
Interest on the obligation	**21**	24	29
Other	**(15)**	(11)	(12)
	31	27	54
These expenses are included in the following items in the statement of income			
Salary expenses	**8**	12	31
Other expenses	**5**	–	–
Financing expenses	**18**	15	23
	31	27	54
4. Actual return on plan assets	**2**	3	15
5. Actuarial losses (gains) recognized directly in other comprehensive income (before tax)			
Amount accrued as at January 1	**(2)**	13	–
Amount recognized in the period	**(37)**	(15)	13
	(39)	(2)	13

16. Employee benefits (contd.)

16.6 Defined benefit plans (post-employment plans) (contd.)

	December 31				
	2011	2010	2009	2008	2007
	NIS million	NIS million	NIS million	NIS million	NIS million
6. Historical information					
Adjustments for liabilities arising from past experience	–	(17)	(13)	(21)	(15)
Adjustments for assets arising from past experience	(1)	(1)	20	13	(1)

In 2012, the Group expects to pay NIS 18 million as a contribution to a defined benefit plan.

16.7. Actuarial assumptions

Principal actuarial assumptions for defined benefit plans and for other long-term benefit obligations at the reporting date are as follows:

A. Mortality rates are based on the rates published in Insurance Circulars 6-3-2007 of the Ministry of Finance, except for early retirement, which was calculated according to the agreement with the insurance company, including future changes in the mortality rate.

B. Churn rates were determined on the basis of the past experience of the Company and the subsidiaries, distinguishing between different employee populations and taking into account the number of years of employment. The churn rates include a distinction between severance with entitlement to full severance compensation and severance without entitlement to this right.

In respect of calculation of the liabilities as at December 31, 2011, the main assumptions regarding the churn rate were determined with a distinction made between permanent employees (0.1% per year), employees with a personal agreement (9% per year), senior employees (10% per year), new employees (between 23% in the first year to 4% above four years) and hourly employees (between 21%-47% in the first to fifth year and 16% for those employed for more than six years).

For calculation of the liabilities as at December 31, 2010 and December 31, 2009, the main assumptions regarding the churn rate were determined with a distinction made between permanent employees (between 3.5% in the first year to 0.5% over 10 years), personal contract employees (5.5% per year), senior employees (20% per year), and temporary employees (between 34% in the first year and 25% for more than 7 years).

The change in assumptions in 20011 did not have a material effect on the Group's financial statements.

16. Employee benefits (contd.)

16.7 Actuarial assumptions (contd.)

C. The real discounted rate is based on yield on government bonds at a fixed interest rate with a life equal to that of the gross liability.

	December 31,		
	2011	2010	2009
	Average capitalization rate	Average capitalization rate	Average capitalization rate
	%	%	%
Sick leave	2.3	1.9	1.8
Compensation	2.1	2.0	1.4
Retirement benefit – holiday gift *	4.5	4.3	4.9
Retirement benefit – clubs and activities	2.8	2.9	2.7
Early notice to senior employees	1.78	1.5	1.4

* In 2011, based on the risk-free dollar interest curve of Israeli government bonds, in 2010 and 2009 according to the capitalization rate based on US corporate bonds The change in capitalized interest did not have a material effect on the Group's financial statements.

D. Assumptions regarding salary increments for calculation of the liabilities as at December 31, 2011 were made on the basis of the management's assessments, distinguishing between the groups of employees. The main assumptions (in real terms) regarding salary increases are as follows:

For permanent employees, the average annual salary increment is 7.6% for young employees, with a gradual decrease to 1% per year up to age 66. For new employees, the average annual salary increment is 1.5%, for employees with a personal agreement and employees with a monthly and hourly collective agreement, the average annual salary increment is 0.5% and for senior employees, the average annual increment is 2%.

Assumptions regarding salary increments for calculation of liabilities as at December 31, 2010 were made on the basis of past experience and the management's assessments as follows.

For permanent employees, the average salary increment is 3% for young employees, with a linear decrease to 1.5% per year up to age 60. For employees in a monthly collective agreement, the average salary increment is 3% per year. For employees in a personal collective hourly employment agreement, the average salary increment is 7% per year. For employees in a personal employment agreement, the average salary increment is between 4% and 0.5%, depending on the age of the employee, and for senior employees, the average salary increment is 6% per year

The change in assumptions regarding salary updates did not have a material impact on the financial statements.

E. The forecasted growth rate of the assets accumulated in all Group companies is 2% in real terms for old pension funds in the administration and 5.57% in real terms for old pension funds that are not part of the arrangement. For new, subsidized pension funds, a guarantee of 4.86% is assumed for 30% of the assets. For officers' insurance where the severance interest is not transferred to compensation and their start date is prior to 1989, guaranteed interest is 4.25% in real terms. The growth rate in other plans is the discount interest.

F. An obligation for voluntary early retirement includes an obligation for pension and grants. The obligation for pension is calculated according to the terms of the agreement of December 2006 (see section 16.4 above) and in accordance with the agreement with the insurance company. The obligation is affected by changes in the interest rates of debentures until the purchase of the policy and payment to the insurance company.

16. Employee benefits (contd.)

16.8. Other

According to the collective agreements applicable to labor relations in the Company, and in accordance with agreements with the Makefet Fund, an option is reserved for Company employees who are transferred employees, to retire under one of two retirement tracks. The method for calculating the cost of early retirement for the transferred employees was laid down in the provisions of a number of agreements and documents drawn up between the Company and the Makefet Fund between 1990 and 1996. The Company contends that the Makefet Fund violated the provisions of the agreements, and therefore, in 2003, the Company filed a claim against the Makefet Fund at the district labor court in Tel Aviv, in the amount of NIS 280 million. The Makefet Fund filed defense documents, in which it rejects the allegations of the Company and contends that it acted in accordance with the agreements between it and the Company. The case is in the stage of summary statements.

17. Contingent liabilities

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

In the opinion of the managements of the Group companies, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements (Note 15 above) include appropriate provisions, 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 as at December 31, 2011, due to claims filed against Group companies on various matters and which are unlikely to be realized, amounts to NIS 13.1 billion (of which NIS 1.06 billion is for claims, which at this stage cannot be assessed, as set out in sections 17.1 and 17.2 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 updates subsequent to the reporting date, see section 17.2 below.

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 17.2 and 17.4 below.

Following is a detailed description of the Group’s contingent liabilities at December 31, 2011, classified into groups with similar characteristics.

17.1. Employee claims

During the normal course of business, employees and former employees filed collective and individual claims against the Company. These are mainly claims concerning the recognition of various salary components as components for calculation of payments to Company employees. In addition, employees and former employees also filed various individual claims against the other Group companies. As at December 31, 2011, the additional exposure (beyond the provisions included in these financial statements) for employee claims amounts to NIS 253 million and relates mainly to claims filed by groups of employees or individual claims with wide ramifications. Of these claims, there is a claim amounting to NIS 25 million, which, at this stage, cannot be estimated. 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 73 million, where provisions are required to cover the exposure resulting from such claims.

17. Contingent liabilities (contd.)

17.2. Customer claims

During the normal course of business, customers of the Group companies filed claims against the Group companies. These are mainly motions for certification of class actions concerning contentions of unlawful collection of payment and impairment of the service provided by the Group companies. As at December 31, 2011, the amount of the additional exposure for customer claims amounts to NIS 6.5 billion (beyond the provisions included in these financial statements). Of these claims, there are claims amounting to NIS 1.03 billion, which, at this stage, cannot be estimated. There are other claims for which the Group has additional exposure beyond the aforesaid, which cannot be quantified, as the exact amount of the claims is not stated in the claim. In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 26 million, where provisions are required to cover the exposure arising from such claims.

Subsequent to the reporting date, customer claims amounting to NIS 3.2 billion were filed against Group companies (of which an amount of NIS 361 million is also against other communications companies that do not belong to the Group, without details regarding the amount claimed from each defendant). At the approval date of the financial statements, the exposure for these claims cannot be assessed. In addition, customer claims with exposure of NIS 561 million came to an end.

In the second quarter of 2008, four claims (which were subsequently combined into one claim at the Central District Court), were filed against Bezeq International in the Tel Aviv and Central District Courts, concerning the use of international calling cards for destinations in the Philippines, Thailand and Nepal, together with motions for certification of class actions. The plaintiffs have applied for their claims to be certified as class actions on behalf of a group that includes every person who, during the seven years prior to filing the claim and during the claim’s proceeding, purchased phone cards of the type referred to in the claims. The plaintiffs estimate the loss sustained by all the members of the group at NIS 1.1 billion. After the parties filed their summary arguments, the court accepted the application for certification as a class action on the grounds of misleading information and the other grounds were dismissed. In the opinion of the management of Bezeq International, based, inter alia, on the opinion of its legal counsel, the maximum amount of the exposure (included in the aforementioned exposure), for all these claims is negligible.

17.3 Supplier and communication provider claims

During the normal course of business, suppliers of goods and/or services and communications providers that the Group companies supply goods and/or services to or receive goods and/or services from filed various claims against the Group companies. These claims are usually for compensation for alleged damage as a result of the supply of the service and/or the product. As at December 31, 2011, the amount of the additional exposure for these claims amounts to NIS 999 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.

17.4 Claims for punitive damages

During the normal course of business, claims were filed against Group companies for alleged physical damage or damage to property caused by Group companies (including in relation to environmental quality and radiation). As at December 31, 2011, 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. In addition, there are other claims for which the Group has additional exposure beyond the aforesaid, which cannot be quantified, as the exact amount of the claim is not stated in the claim. In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions of NIS 1 million, where provisions are required to cover the exposure arising from such claims.

17. Contingent liabilities (contd.)

17.5 Claims by developers and companies

During the normal course of business, claims were filed against some of the Group companies, claiming liability of the Group companies in respect of their activities and/or the investments made in various projects. As at December 31, 2011, the additional exposure for these claims amounts to NIS 83 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.

17.6 Claims by the State and authorities

During the normal course of business, various claims are pending against the Group companies by the State of Israel, government institutions and authorities ("the Authorities"). These are mainly procedures related to regulations relevant to the Group companies and financial disputes concerning monies paid by the Group companies to the authorities (including property taxes) or by the authorities to the Group companies. As at December 31, 2011, the additional exposure for these claims amounts to NIS 210 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 47 million, where provisions are required to cover the exposure arising from such claims.

In December 2000, the government filed a claim against Pelephone for royalties allegedly due from January 1994 to February 1996. The amount in the claim is NIS 260 million at the date of the claim, including principal, linkage differences and interest. In September 2010, the court ruled against Pelephone, accepting some of the government's claims. Pelephone was required to pay NIS 150 million, including principal linkage differences and interest. This amount was paid in October 2010. In October 2010, Pelephone appealed the ruling at the Supreme Court.

17.7 Contingent claims referring to the associate DBS Satellite Services (1998) Ltd.

During the normal course of business, legal claims were filed or are pending against DBS. In the opinion of the management of DBS, which is based, inter alia, on legal opinions as to the likelihood of success of the claims, the financial statements include appropriate provisions, where provisions are required to cover the exposure resulting from such claims. In the opinion of the management of DBS, as at December 31, 2011, the exposure for claims against DBS for various matters and which are likely to be realized amounts to NIS 955 (before linkage and interest) Of these claims, there are claims amounting to NIS 14 million, which, at this stage, cannot be estimated.

Of these claims, on December 13, 2010, a motion for certification as a class action suit against DBS was filed at the Tel Aviv-Jaffa district court, amounting to NIS 600 million. The plaintiff alleges that DBS violated its liability towards its customers by canceling broadcasts that were supposed to be included in the basic package, removed channels without permission, did not fulfill the required investment obligation and breached the liabilities regarding broadcasting of commercials, trailers and marketing and commercial content. On October 30, 2011, an application for approval of a settlement was filed at the court. On January 9, 2012, the parties filed a motion for a ruling of the claim. On February 26, 2012, the Attorney General submitted his position and announced that the settlement cannot be approved as it contains flaws that establish a concern that the settlement is not appropriate, fair and in favor of the group members, and that it is in breach of the provisions of the Class Actions Law, including warning of violation of the law and providing appropriate relief to the victims of the violation. On February 27, 2012, the court ruled that the parties are required to respond to the position of the Attorney General within 15 days. A hearing of the petition to approve the settlement has been set for April 4, 2012.

In addition, subsequent to the reporting date, the settlement for two class actions was given the validity of a ruling, in a total amount of NIS 172 million.

18. Agreements

18.1 The Group companies have rental agreements. Contractual rental payments during the next five years, calculated according to the rental agreements in effect as at December 31, 2011 are as follows:

Year ended December 31	NIS million
2012	**193**
2013	**198**
2014	**148**
2015	**109**
2016	**47**
2017 and thereafter	**109**
	804

18.2 The Group companies have a number of operating lease agreements for periods of up to three years in respect of vehicles they use. The contractual annual lease payments, calculated according to the lease agreements in effect as at December 31, 2011 are as follows:

Year ended December 31	NIS million
2012	**62**
2013	**48**
2014	**29**
	139

18.3 Most of the Group companies are required to pay royalties to the State of Israel. The rate of royalties paid was 1.75% in 2011, 1% in 2010 and 1.5% in 2009.

In January 2011, an amendment to the Communications Regulations (Royalties) was issued. According to the amendment, the rate of royalties will increase to 2.5% in 2012.

18.4 Pelephone leases some of the sites from the Israel Lands Administration ("the ILA"). Pelephone has an agreement with the ILA for use of the land to establish and operate communication sites. The agreement regulates payments to which the ILA is entitled for the period through December 31, 2008. According to the agreement, at the end of the agreement period, and in the event of its annulment due to reasons set out in the agreement, Pelephone will evacuate the land. To the best of Pelephone's knowledge, the other cellular operators have the same agreement with the ILA. The agreement was extended to December 31, 2009 and was extended again until December 31, 2010. At the reporting date, Pelephone and, to the best of its knowledge, the other cellular operators as well, are in advanced stages of negotiations to extend the agreement, however the agreement has not yet been renewed. If, for any reason, the agreement is not renewed or extended, this could have a material negative effect on Pelephone, inter alia because Pelephone will be restricted in establishing sites on ILA land.

18.5 Pelephone uses Ericsson UMTS/HSPA infrastructure equipment and Nortel and Motorola CDMA infrastructure equipment. Pelephone has multi-annual agreements for maintenance, support and upgrade of software for the UMTS/HSPA network and a maintenance agreement for the Nortel network with Ericsson.

18.6 Pelephone has obligations to acquire terminal equipment amounting to NIS 91 million (as at December 31, 2010, NIS 455 million).

18.7 For agreements for the purchase of property, plant and equipment, see Note 9.7 above.

19. Securities, liens and guarantees

19.1 The Group companies have guarantees of NIS 97 million in favor of the Ministry of Communications to secure the terms of their licenses (mostly linked to the USD exchange rate).

19.2 The Group companies have bank guarantees of NIS 118 million in favor of third parties.

19.3 The Company has received a demand for the forfeiture of a guarantee in the amount of approximately USD 5.5 million related to a project (HBTL) in a basic telephony tender in 1995 in India, in which the Company participated together with others. The Company (together with other parties that deposited a guarantee) applied to the court in India for release of the bank guarantees it provided. Subsequent to the reporting date, the court ruled that the guarantees are not valid and that the bank holding the guarantees should consider the guarantees as released by virtue of the court ruling. At the approval date of the financial statements, the guarantees have not been released.

19.4 On June 6, 2011, the Company signed an extension to the bank guarantee for DBS, which DBS had provided in favor of the State of Israel, according to the terms of DBS's license. The guarantee is in accordance with the proportionate rate of the Company's holdings in DBS. As at December 31, 2011, the balance of the Company's share in the guarantee is NIS 23.6 million.

19.5 In accordance with its general license for cellular services, Pelephone is not permitted to sell, lease or pledge any of its assets used for the implementation of the license, without the consent of the Minister of Communications, except for:

A pledge on one of the license assets in favor of a bank operating lawfully in Israel, for receipt of bank credit, provided that it submitted notice to the Ministry of Communications regarding the pledge it intends to register, noting that the pledge agreement includes a clause ensuring that in any case, exercise of the rights by the bank will not impair in any way the provision of the services pursuant to the license.

Sale of items of equipment when implementing an upgrade, including sale of equipment by the trade-in method.

19.6 The other shareholder in DBS has pledged its shares in favor of the banks. In view of a negative pledge of the Company, the Company provided the banks with a perpetual guarantee for payment of the debts of DBS. The guarantee is up to a maximum amount equal to the percentage of the Company's holding in DBS, multiplied by the value of DBS as derived from realization of the pledged shares of the other shareholders. If the Company joins the sale when realizing the pledged shares of the other shareholders, the amount of the guarantee will not exceed the amount of the proceeds the Company will receive from realization of its shares in DBS. The note of guarantee includes numerous restrictions on the Company in realizing the shares it holds, and lists events of violation which, if committed, will enable the banks to call in the guarantee. Furthermore, the Company undertook to put its shares up for sale if the shares pledged to the bank are sold, and agreed that in the event of realization of collateral provided by the other shareholders, the Company would forgo repayment of shareholder loans provided for DBS and that the guarantee would also apply, with the required changes, to warrants which the Company will receive from DBS and to the right to receive them.

The shareholders in DBS have made a commitment to the banks not to oppose the sale or other realization of their shares in DBS, which were pledged or for which a guarantee was provided (by the Company), in a way that will enable the banks to accomplish a friendly liquidation.

The Company also undertook that if a negative pledge the Company gave in favor of its creditors is released, the Company will pledge its shares in DBS in favor of the banks as a first lien.

19.7 For securities, liens and stipulations given by the Company and subsidiaries in connection with loan covenants and borrowings, see Note 13.

19.8 For the Company's guarantee to Bezeq International in respect of bank credit, see Note 12.2.1.

19.9 For the securities, liens and stipulations of DBS, see Note 12.1 about equity-accounted investees.

20. Equity and Capital Reserves

20.1. Share capital

	Registered		Issued and paid up	
	December 31, 2011	December 31, 2010	December 31, 2011	December 31, 2010
	Number of shares	Number of shares	NIS million	NIS million
Ordinary shares of NIS 1 par value	**2,825,000,000**	2,825,000,000	**2,713,627,744**	2,685,917,052

20.2. Dividends

20.2.1 Dividend Distribution Policy

In August 2009, the Board of Directors resolved to distribute a dividend to the shareholders of 100% of the semi-annual profit ("profit for the period attributable to the shareholders of the Company"), in accordance with the consolidated financial statements of the Company. Application of the policy to distribute a dividend is subject to the provisions of the law, including the distribution criteria prescribed in the Companies Law, and the estimation of the Board of Directors of the Company regarding the Company's ability to meet its existing and anticipated liabilities, taking into consideration the projected cash flow, the Company's operations and liabilities, the cash balance, its plans and position as will be from time to time and subject to the approval of the general meeting of the Company's shareholders regarding any specific distribution, as set out in the articles of association of the Company. Since the date of the resolution, the Company's dividend policy has not been changed.

20.2.2 Distribution not in compliance with the earnings test

On December 30, 2010, the Company's Board of Directors resolved to approve and to recommend that the general meeting of the Company's shareholders approve a distribution to the Company's shareholders ("the special distribution") in the total amount of NIS 3 billion, a sum not in compliance with the earnings test. as defined in Section 302 of the Companies Law. The amount of the special distribution will be distributed to the Company's shareholders in six equal semi-annual payments, from -2013 to 2011 (without interest or linkage payments), together with the Company's regular dividend distribution.

On January 24, 2011, the general meeting of the Company's shareholders approved the special distribution and on March 31, 2011, the economic division of the district court approved the special distribution. Accordingly, in 2011, the first two payments of the special distribution were paid in a total amount of NIS 500 million each, as set out in section 20.2.3 below.

20. Equity and Capital Reserves (Contd.)

20.2 Dividends (contd.)

20.2.2 Distribution not in compliance with the earnings test (contd.)

The balance of 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% to 5.05% (calculated on the basis of the risk-free interest rate at the recognition date of a liability, plus an appropriate fixed credit margin for the Company).

The dividend for payment is stated as follows:

	December 31, 2011	
	Dividend payable, undiscounted	**Presented in the statement of financial position ***
	NIS million	**NIS million**
Current liabilities	**1,000**	**971**
Non-current liabilities	**1,000**	**924**
	2,000	**1,895**

* Dividend payable for the special distribution presented in the statement of financial position at present value plus financing expenses accumulated from March 31, 2011 to December 31, 2011

On July 3, 2011, a holder of the Company's Debentures (Series 5) petitioned the economic division of the Tel Aviv district court to order the Company to submit a revised opinion and to permit submission of responses/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, immediately and the downgrade of the Company's rating to negative outlook by "Midroog"). On August 18, 2011, another holder of the Company's Debentures (Series 5) petitioned the court to join the procedure. On July 10, 2011, the Company submitted its response to the petition, according to which the petition should be rejected since there have been no changes to the circumstances as alleged and/or which justify reexamination of the decision and since this is a final and absolute decision. In the hearing of these petitions held on September 19, 2011, the parties agreed to accept the position of the court, according to which the court's approval of the distribution under section 303 of the Companies Law does not derogate in any way from the obligations of the Company's officers under any law. The court validated the consent and ruled that in view of the consent, discussion of the other issues that arose in the petition is unnecessary. The court noted that the aforesaid does not prevent a creditor that is able to demonstrate a material adverse change in the Company's solvency from applying to the court. Further to this decision, the Company clarified that the decision does not affect the continuation of payment of the special distribution and the Company's regular dividend policy and does not require reapplication to the court before payment. On March 4, 2012, the applicants filed "a petition to set a date for a hearing" at the economic division of the Tel Aviv district court, to hear the objections "that will be filed" (according to wording of the petition) in respect of distribution of a dividend not in compliance with the earnings test. The applicants seek to set a date for a hearing and ruling "before the Company distributes the next dividend of NIS 0.5 billion, which is planned sometime in May 2012".

20. Equity and Capital Reserves (Contd.)

20.2 Dividends (contd.)

20.2.3 In 2010 and 2011, the Company declared and paid the following dividends in cash:

	2011	2010
	NIS million	NIS million
Distribution of a regular dividend, see section 20.2.1 above		
May 2011 (NIS 0.4306 per share)	**1,163**	–
October 2011 (NIS 0.366 per share)	**992**	–
May 2010(NIS 0.917 per share)	**–**	2,453
October 2010 (NIS 0.478 per share)	**–**	1,280
	2,155	3,733
Distribution not in compliance with the earnings test (see section 20.2.2 above)		
May 2011(NIS 0.1851 per share)	**500**	–
October 2011 (NIS 0.1846 per share)	**500**	–
	1,000	–
	3,155	3,733

20.2.4 On March 14, 2012, the Board of Directors of the Company resolved to recommend to the general meeting the distribution of a cash dividend to the shareholders in the amount of NIS 1.074 billion. At the approval date of the financial statements, the dividend has not yet been approved by the general meeting. The record date for the distribution is May 4, 2012 and the payment date is May 21, 2012. As well as this distribution (to the extent that it will be approved), the third portion of the special dividend amounting to NIS 500 million will be distributed as set out in section 20.2.2 above and the distribution dates of the regular dividend (the record date, the ex-day and the payment day) will be relevant for this distribution as well.

20.3. The Company also issued share options to employees, managers and senior employees in the Group (see Note 26).

20.4. Description of the reserves

Capital reserve for activities between the Company and a controlling shareholder
This reserve relates to benefits granted by the State as a controlling shareholder in the Company, to employees, in cash and in equity instruments of the Company.

Capital reserve for employee share options
This reserve relates to a benefit granted to employees by means of share-based payments. See also Note 26.

Composition of other reserves:

Translation reserve
A translation reserve includes all the foreign currency differences arising from translation of financial statements of a consolidated partnership whose functional currency is a foreign currency.

Capital reserve for assets classified as available for sale
The capital reserve for assets classified as available-for-sale includes the net cumulative change in the fair value of available-for-sale financial assets, up to the date of derecognition or impairment of the investment.

Reserve for transactions with non-controlling interests
The reserve for transactions with non-controlling interests, while retaining control, include differences between the consideration paid or received for changes in non-controlling interests.

21. Revenues

	Year ended December 31		
	2011	2010	2009
	NIS million	NIS million	NIS million
Domestic fixed-line communication			
Fixed-line telephony	**2,320**	3,074	3,247
Internet - infrastructure	**1,092**	977	862
Transmission and data communication	**749**	713	703
Other services	**215**	226	237
	4,376	4,990	5,049
Cellular			
Cellular services and terminal equipment	**2,346**	3,286	3,231
Value added services	**1,201**	1,014	782
Sale of terminal equipment	**1,911**	1,176	1,119
	5,458	5,476	5,132
International communications, internet and NEP services	**1,289**	1,334	1,276
Other	**250**	187	62
	11,373	11,987	11,519

22. Salaries

	Year ended December 31		
	2011	**2010**	**2009**
	NIS million	**NIS million**	**NIS million**
Salaries and incidentals - operating	**1,747**	1,764	1,670
General and administrative	**725**	692	655
Share-based payments	**173**	35	45
Total salaries and incidentals	**2,645**	2,491	2,370
Less – salaries recognized in investments in property, plant and equipment and intangible assets *	**542**	467	380
	2,103	2,024	1,990

* The increase in salary recognized in investments in property, plant and equipment and intangible assets in 2009-2011 is mainly due to an increase in the number of hours invested in the NGN project, which started in the middle of 2008 and an increase in the value of an hour due to the allotment of options and the special bonus granted to employees and from the addition of units defined as recoverable, as well as due to the change in the salary capitalization mechanism for investment in Pelephone that included adding units and calculation of the value of an hour on the level of the smallest unit.

23. Operating and general expenses *

	Year ended December 31		
	2011	**2010**	**2009**
	NIS million	**NIS million**	**NIS million**
Terminal equipment and materials	**1,693**	1,225	1,163
Interconnectivity and payments to domestic and international operators	**910**	1,876	1,762
Maintenance of buildings and sites	**641**	640	647
Sales and marketing expenses	**655**	622	626
Services and maintenance by sub-contractors	**170**	189	218
Vehicle maintenance expenses	**142**	188	177
Content services expenses	**123**	156	151
Royalties and collection fees	**160**	130	127
	4,494	5,026	4,871

* Less expenses of NIS 58 million recognized in 2011 for investments in property, plant and equipment and intangible assets (in 2010, NIS 52 million and in 2009, NIS 44 million),

** Certain expenses were reclassified to present all expenses according to their nature.

24. Other operating expenses (income), net

	Year ended December 31		
	2011	2010	2009
	NIS million	NIS million	NIS million
Provision for severance pay in early retirement	**369**	36	267
Capital gain from sale of property, plant and equipment (mainly real estate)	**(119)**	(140)	(62)
Profit from gaining control in an investee	**–**	(57)	–
Profit from sales of copper	**(62)**	(31)	(2)
Provision for contingent liabilities, net	**(29)**	(35)	(2)
Loss (profit) from forward contracts on copper and others	**(20)**	11	–
	139	(216)	201

25. Financing expenses (income), net

	Year ended December 31		
	2011	2010	2009
	NIS million	NIS million	NIS million
Interest expenses for financial liabilities	**380**	217	185
Financing expenses for dividends payable, see Note 20	**83**	–	–
Linkage and exchange rate differences, net	**75**	64	140
Financing expenses for employee benefits, net	**24**	20	24
Other financing expenses	**37**	90	49
Total financing expenses	**599**	391	398
Interest and linkage differences from loans to an associate	**189**	159	198
Interest revenues from bank deposits, investments and others	**25**	7	16
Net change in fair value of financial assets held for trading and derivatives	**31**	2	61
Income in respect of credit in sales, net of discount commission	**102**	87	83
Revenues from financial assets classified as available for sale	**–**	–	23
Other financing income	**42**	27	48
Total financing income	**389**	282	429
Financing expenses (income), net (1)	**210**	109	(31)
(1) Less discounted amounts	**10**	3	6

26. **Share-based payments**

26.1 In February 2007, the Board of Directors of the Company approved an employee share options plan for 3% of the issued and paid up capital of the Company, under the collective agreement with the employees of December 2006 ("the 2007 Employee Plan"). Under the 2007 Employee Plan, 78 million options were allotted. According to this plan, the last date for exercising the options is March 24, 2012. At the approval date of the financial statements, 3,742,204 options are yet to be exercised.

26.2 On November 20, 2007, the Board of Directors of the Company resolved to adopt a new share options plan for managers and senior employees in the Company and/or in associates ("the 2007 Senior Employees Plan"), which would allocate up to 65,000,000 unmarketable options exercisable for up to 65,000,000 shares of the Company and representing, at the date of the resolution, 2.5% of the issued capital of the Company, and at full dilution, 2.37% of the share capital. The options vest in three equal annual lots. The vesting dates of each lot fall at the end of each of the first, second and third years after the allotment date, respectively, and the expense for each lot is spread over its vesting period. The options are exercised using a cashless exercise mechanism. In 2007-2010, 65,250,000 options have actually been allocated according to this plan (of this amount, 6,199,999 options have been forfeited and returned to the quantity of options).

At the approval date of the financial statements, 10,786,420 options are yet to be exercised of the allotted options. The options are exercisable for eight years from the date of the allotment.

26.3 On December 19, 2010, the Board of Directors of the Company approved the amendment to the collective agreement with the employees (see Note 16.4) and resolved to adopt an options plan for employees ("the 2010 Employees Plan"). According to the 2010 Employees Plan, the Company will allocate 70,000,000 unmarketable options exercisable for up to 70,000,000 Company shares, NIS 1 par value each, representing at the date of the resolution, 2.61% of the issued capital of the Company (2.5% at full dilution). In 2011, 68,874,577 options have actually been allocated according to this plan (of this amount, 1,291,080 options have been forfeited and returned to the quantity of options for allotment).

The options vest in three equal annual lots. The vesting dates of each lot fall at the end of each of the first, second and third years after the grant date, respectively, and the expense for each lot is spread over its vesting period. In addition, the plan sets terms which, if met, accelerate the vesting date. The options are exercised using a cashless exercise mechanism. The options are exercisable for eight years from the date of the allotment.

The grant date was set as the later of the approval date of the plan by the general meeting and the date of the notice to the employees. The theoretic economic value is partially based on the share price at the grant date.

The date for recording the expense for the options granted in January 2011 was set at December 19, 2010, the date the plan was approved by the Company's Board of Directors, and a commitment was made to the employees at this date, including the terms of the bonus.

26. Equity and share-based payments (contd.)

Below are details of the actual grants according to this plan in 2010-2011:

Approval date of the Board of Directors	grant date	No. of options granted thousands	Theoretic economic value on grant date NIS thousands
Granted up to December 31, 2011			
Granted to Company employees and retirees - December 19, 2010	January 11, 2011	67,465	284,290
Granted to two employee-directors - December 19, 2010	January 25, 2011	87	385
Granted to Company employees - March 16, 2011	April 7, 2011	1,322	5,732
		68,874	290,407
Options forfeited and returned to the quantity of options for allotment		(1,291)	
Unexercised options at the date of the financial statements		67,583	
Allotment subsequent to the date of the financial statements			
Granted to Company employees - December 29, 2011	January 23, 2012 and February 29, 2012	646	1,060

Measurement of fair value at the grant date of the options is based on the following parameters:

	Grant from April 7, 2011	Grant from January 25, 2011	Grant from January 11, 2011
Number of options granted (thousands)	1,322	87	67,465
Theoretical economic value at the grant date (NIS thousands)	5,732	385	284,290
Weighted average of the fair value at the grant date	4.39	4.39	4.21
Share price	10.47	10.62	10.45
Exercise price	7.457	7.457	7.457
Expected fluctuations	25.7%-25.9%	25.8%-26.2%	25.8%-26.3%
Contractual life of the option (in years)	3-4	3-4	2.5-4
Risk-free interest rate (based on government bonds)	4.4%-4.7%	3.6%-3.9%	3.2%-3.9%

Due to the method for adjusting exercise increment to distribution of a dividend, an expected dividend percentage of 0% was assumed when calculating fair value.

The restriction described above by virtue of the Telecommunications Order was taken into account in calculating the theoretical economic value of the options, assuming that the restriction can be resolved.

26. Equity and share-based payments (contd.)

26.4 Change in the number of options and weighted average of the exercise price

	No. of options Year ended December 31		
	2011	**2010**	**2009**
	thousands	**thousands**	**thousands**
Balance as at January 1	**47,027**	82,077	223,399
Options granted during the year	**68,874**	1,000	2,700
Options forfeited during the year	**(1,324)**	(933)	(1,267)
Options exercised during the year	**(32,516)**	(35,117)	(142,278)
Options expired during the year	**–**	–	(477)
Balance as at the end of the year	**82,061**	47,027	82,077
Exercisable at the end of the period	**18,874**	27,741	43,777

The average share price in 2011, 2010 and 2009 is NIS 8.71 per share, 9.38 per share and NIS 7.47 per share, respectively.

Below are details of the average exercise price and projected term of the options in circulation as at December 31, 2011:

Name of plan	No. of options thousands	Weighted average of exercise price NIS	Weighted average of remaining contractual useful life Years
2007 Employee Plan (section 26.1 above)	3,742	0	0.23
Senior employees plan for 2007 (section 26.2 above)	10,786	2.35	4.56
2010 Employee Plan (section 26.3 above)	67,533	6.29	4.07

Salary expenses for equity-settled share-based payments

	Year ended December 31		
	2011	**2010**	**2009**
	NIS million	**NIS million**	**NIS million**
Equity-settled share options (1)	**167**	35	45

(1) Calculation of the salary expense assumed 5% for forfeiture, for each year, for the options plan set out in section 26.2 above, and 1% for the options plan for employees in 2010, described in section 26.3 above.

26.5 Subsequent to reporting date and until March 13, 2012, the employees exercised an additional 1,996,000 options.

26. Equity and share-based payments (contd.)

26.6 Cash-settled share-based payments

On December 30, 2010, the Company's Board of Directors adopted a plan for allocation of phantom options to senior managers in the Company and its subsidiaries. According to the terms of the plan, the options were granted at no cost, and are exercisable into a cash grant. The exercise price of the option is based on the average adjusted share price in the 30 trading days preceding the date of approval by the Board of Directors. The exercise price is nominal and amounts to NIS 10.206 at the grant date (due to the mechanism for adjusting the additional exercise for distribution of a dividend the exercise price as at December 31, 2011 amounts to NIS 9.04). According to the plan, the options vest in three equal annual lots, and the contractual life of the options is five years. The expense is spread for each lot in accordance with its vesting period.

According to the plan, 16,400,000 options were allocated, with a theoretical economic value of NIS 48 million, based on the Black and Scholes model at the grant date (of which 8,000,000 options with a theoretical economic value of NIS 24 million were allocated to senior officers who serve in key positions in the Company). The value of the benefit is measured in each quarter and any change in the fair value of the vested phantom options is recognized in the statement of income. The theoretical economic value of the allotted options as at December 31, 2011 amounts to NIS 11 million. The carrying amount of the liabilities and salary expenses for phantom options in 2011 amounts to NIS 6 million.

27. Earnings per share

Basic and diluted earnings per share

The calculation of basic earnings per share was based on the profit attributable to ordinary shareholders, and on a weighted average number of ordinary shares outstanding , calculated as follows:

	2011	2010	2009
	NIS million	NIS million	NIS million
Profit attributable to ordinary shareholders			
Profit attributable to ordinary shares from continuing operations	**2,066**	2,443	2,157
Profit attributable to ordinary shares from discontinued operations	**–**	–	1,446
Basic and diluted earnings for the year	**2,066**	2,443	3,603
Weighted average number of ordinary shares			
Weighted average number of ordinary shares (basic)	**2,701**	2,675	2,635
Effect of share options exercised	**24**	42	49
Weighted average number of ordinary shares (diluted)	**2,725**	2,717	2,684

The average market value of the Company's shares for purposes of calculating the dilutive effect of share options was based on quoted market prices for the period that the options were outstanding.

28. Segment reporting

The Group operates in various segments in the communications sector, so that every company in the Group operates in one separate business segment. The primary reporting format, by business segments, is based on the Group's management and internal reporting structure.

Each company provides services in the segment in which it operates, using the property, plant and equipment and the infrastructure it owns. The infrastructure of each company is used only for providing its services. Each of the companies in the Group is exposed to different risks and yield expectations, mainly in the matter of the technology and competition in the segment in which it operates. Accordingly, the separable component in the Group is each company in the Group. As from August 21, 2009, the Company no longer consolidates the reports of DBS in its financial statements and the investment in DBS is stated according to the equity method as from that date. The Group continues to report multichannel television as an operating segment without adjustment to ownership rates.

As from April 2010, the Company started to report the operations of Walla as an additional segment under Other Segments, after Walla achieved control as from that date.

Based on the above, the business segments of the Group are as follows:

- Bezeq The Israel Telecommunication Corp. Ltd.: fixed line domestic communications
- Pelephone Communications Ltd.: cellular communications
- Bezeq International Ltd.: international communications, internet services and network end point
- DBS Satellite Services (1998) Ltd.: multichannel television

The other companies in the Group are presented under the "Other" item. Other operations include call center services (Bezeq Online), portal operations and content sites and online trading sites (Walla). These operations are not recognized as reporting segments as they do not fulfill the quantitative thresholds The Group's investment in the Stage One venture capital fund is presented under adjustments.

Inter-segment pricing is set at the price determined in a transaction between unrelated parties.

The results, assets and liabilities of a segment include items directly attributable to that segment, as well as those that can be allocated on a reasonable basis.

Segment capital expenditure is the total cost incurred during the period for acquisition of property, plant and equipment and intangible assets.

28. Segment Reporting (contd.)

28.1. Operating segments

	Year ended December 31, 2011						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	4,371	5,454	1,288	1,619	236	(1,619)	11,349
Inter-segment revenues	277	94	66	–	41	(454)	24
Total revenues	4,648	5,548	1,354	1,619	277	(2,073)	11,373
Depreciation and amortization	688	561	109	276	21	(260)	1,395
Segment results – operating profit	1,658	1,360	241	295	3	(315)	3,242
Financing expenses	531	67	11	547	5	(562)	599
Financing income	(291)	(105)	(9)	(23)	–	39	(389)
Total financing expenses (income), net	240	(38)	2	524	5	(523)	210
Segment profit (loss) after financing expenses, net	1,418	1,398	239	(229)	(2)	208	3,032
Share in earnings (losses) of equity accounted investees	–	–	1	–	–	(217)	(216)
Segment profit (loss) before income tax	1,418	1,398	240	(229)	(2)	(9)	2,816
Income tax	353	342	58	1	4	(3)	755
Segment results – net profit (loss)	1,065	1,056	182	(230)	(6)	(6)	2,061
Additional information:							
Segment assets	9,202	5,404	1,260	1,282	314	(2,373)	15,089
Investment in associates	–	–	2	–	–	1,057	1,059
Goodwill	–	–	6	–	87	1,090	1,183
Segment liabilities	13,566	2,255	439	4,932	272	(6,821)	14,643
Capital expenses/contractual investments in property, plant and equipment and intangible assets	1,174	442	285	–	38	–	1,939

28. Segment Reporting (contd.)

28.1. Operating segments (Contd.)

	Year ended December 31, 2010						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
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 income	192	100	6	9	–	(25)	282
Financing expenses	(282)	(111)	(11)	(500)	(3)	516	(391)
Total financing income (expenses), 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 earnings (losses) of equity accounted investees	–	–	3	–	–	(264)	(261)
Segment profit (loss) before income tax	1,953	1,372	318	(313)	11	33	3,374
Income tax	527	339	65	1	4	(4)	932
Segment results – net profit (loss)	1,426	1,033	253	(314)	7	37	2,442
Additional information:							
Segment assets	6,352	4,892	1,032	1,243	291	(1,836)	11,974
Goodwill	–	–	6	–	84	1,090	1,180
Investment in associates	–	–	–	–	–	1,084	1,084
Segment liabilities	7,964	1,930	304	4,665	241	(6,236)	8,868
Capital expenses/contractual investments in property, plant and equipment and intangible assets	1,041	431	160	295	13	(295)	1,645

28. Segment Reporting (contd.)

28.1. Operating segments (Contd.)

	Year ended December 31, 2009						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	5,039	5,130	1,273	1,529	54	(1,529)	11,496
Inter-segment revenues	264	246	45	1	20	(553)	23
Total revenues	5,303	5,376	1,318	1,530	74	(2,082)	11,519
Depreciation and amortization	794	603	84	234	4	(234)	1,485
Segment results – operating profit	1,523	1,190	261	248	4	(254)	2,972
Financing income	310	90	15	8	23	(17)	429
Financing expenses	(295)	(100)	(12)	(478)	–	487	(398)
Total financing income (expenses), net	15	(10)	3	(470)	23	470	31
Segment profit (loss) after financing expenses, net	1,538	1,180	264	(222)	27	216	3,003
Share in earnings (losses) of equity accounted investees	–	–	7	–	–	(41)	(34)
Segment profit (loss) before income tax	1,538	1,180	271	(222)	27	175	2,969
Profit from discontinued operations	–	–	–	–	–	1,379	1,379
Income tax	431	305	71	1	2	(3)	807
Segment results – net profit (loss)	1,107	875	200	(223)	25	1,557	3,541
Additional information:							
Segment assets	6,368	4,990	1,066	1,206	85	(2,026)	11,689
Goodwill	–	–	6	–	–	1,027	1,033
Investment in associates	–	–	34	–	–	1,185	1,219
Segment liabilities	6,390	2,440	404	4,314	22	(6,167)	7,403
Capital expenses/contractual investments in property, plant and equipment and intangible assets	838	508	151	270	3	(102)	1,668

28. Segment Reporting (contd.)

28.2. Adjustments for segment reporting of revenue, profit or loss, assets and liabilities

	Year ended December 31		
	2011	2010	2009
	NIS million	NIS million	NIS million
Revenues			
Revenues from reporting segments	**13,169**	13,958	13,527
Revenues from other segments	**277**	210	74
Cancellation of revenues from inter-segment sales except for revenues from sales to an associate reporting as a segment	**(454)**	(603)	(553)
Cancellation of revenues for a segment reporting as an associate (up to August 20, 2009 - discontinued operations)	**(1,619)**	(1,578)	(1,529)
Consolidated revenues	**11,373**	11,987	11,519
Profit or loss			
Operating profit for reporting segments	**3,554**	3,924	3,216
Cancellation of results of a segment reporting as an associate (up to August 20, 2009 - discontinued operations)	**(295)**	(178)	(248)
Other financing income (expenses), net	**(210)**	(109)	31
Share in losses of equity-accounted investees	**(216)**	(261)	(34)
Profit for operations classified in other categories	**3**	14	4
Other adjustments	**(20)**	(16)	–
Consolidated profit before income tax	**2,816**	3,374	2,969

	December 31, 2011	December 31, 2010
	NIS million	NIS million
Assets		
Assets from reporting segments	**17,156**	13,525
Assets attributable to operations in other categories	**401**	375
Goodwill not attributable to an operating segment	**1,090**	1,090
Investment in an equity-accounted investee (mainly loans) reported as a segment	**1,057**	1,084
Cancellation of assets for a segment classified as an associate	**(1,282)**	(1,243)
Less inter-segment assets	**(1,091)**	(593)
Consolidated assets	**17,331**	14,238
Liabilities		
Liabilities from reporting segments	**21,192**	14,863
Liabilities attributable to operations in other categories	**272**	241
Cancellation of liabilities for a segment classified as an associate	**(4,932)**	(4,665)
Less inter-segment liabilities	**(1,889)**	(1,571)
Consolidated liabilities	**14,643**	8,868

29. Transactions with interested and related parties

29.1. Identity of interested and related parties

The Company's interested and related parties are as defined in the Securities Law and in IAS 24 – Related Party Disclosures and include mainly B Communications, related parties of B Communications, jointly-controlled entities, associates, directors and key management personnel in the Company or the parent company and a person who is close to a family member of any of these individuals.

29.2. Balances with interested and related parties

	December 31	
	2011	2010
	NIS million	NIS million
Payables – associates, net	**71**	58
Loan to an associate, see section 29.3 below.	**1,549**	1,351
Liabilities to related parties, net *	**(80)**	(105)

* The amounts are for B Communications, the controlling shareholder of the Company as from April 14, 2010, and its related parties.

29.3. Loans provided to an associate

For the loans provided by the Company to the associate DBS, see Note 12.1. DBS also received loans from Eurocom DBS Ltd. The balance of the loans according to the loan terms at December 31, 2011 is NIS 1,408 million (as at December 31, 2010, NIS 1,351 million). DBS recognizes the loans in its financial statements at fair value when received. The balance of the loans at December 31, 2011 in the financial statements of DBS is NIS 737 million (as at December 31, 2010, NIS 627 million).

29.4. Transactions with interested and related parties

	Year ended December 31		
	2011	2010	2009
	NIS million	NIS million	NIS million
Revenues			
From associates	**217**	172	224
From related parties *	**8**	6	–
Expenses			
To related parties *	**138**	180	–
Associate to related parties *	**146**	106	–
To associates	**1**	5	3
Investments			
Related parties *	**97**	78	–

* The amounts are for B Communications, the controlling shareholder of the Company as from April 14, 2010, and its related parties.

29. Transactions with interested and related parties (contd.)

29.5. Transactions with interested and related parties

29.5.1 Negligible transactions

On March 7, 2011, the Company's Board of Directors resolved to adopt guidelines and regulations to classify a transaction of the Company, its subsidiary or associate with an interested party as a negligible transaction, which is not an extraordinary transaction, as set out in Article 41(A)(6) of the Securities Regulations (Annual Financial Statements), 2010 ("the Annual Financial Statements Regulations"). These guidelines and regulations are also used to assess the scope of disclosure in the periodic report and prospectus (including shelf offering reports) regarding a transaction of the Company, a company under its control and a subsidiary or associate with a controlling shareholder or in which the controlling shareholder has a personal interest as set out in Article 22 of the Securities Law (Periodic and Immediate Reports), 1970 ("the Periodic Reports Regulations") and Article 54 of the Securities Regulations (Prospectus Details and Draft Prospectus – Structure and Form), 1969, and to assess the need to submit an immediate report for the transaction of the Company, as set out in Article 37 (A)(6) of the periodic reports regulations (types of transactions determined in the financial statements regulations) and the prospectus details regulations referred to above ("the Interested Party Transactions").

From time to time, the Company and its subsidiaries or associates carry out negligible transactions, which are not extraordinary transactions, with an interested party in the Company or with related parties, of the types and nature detailed below:

A. Sales of communications services and products by Group companies, including: basic communication services (telephony, transmission and PRI) and hosting at server farms; cellular services, value added services and sales and upgrading of cellular end equipment; web browsing services, international telephony services, hosting services and data communication services; multichannel television services

B. Purchase of devices from Eurocom Group companies (companies owned by the controlling shareholder of the Company or companies controlled by the controlling shareholder at the approval date of the agreement), including electronic equipment (such as monitors, telephones, televisions and cameras) from Eurocom Digital Communication for the requirements of the Group companies (including for marketing campaigns), through purchase orders and subject to the conditions prescribed, and purchase of terminal equipment (office telephones and fax machines) for customers of Group companies; acquisition of communication equipment (such as PLC devices and power supplies) from Eurocom Digital Communication; purchase of converters for IP Centrex; acquisition of pit covers.

C. Acquisition of maintenance and development services from companies in the Eurocom Group, including maintenance, development and upgrading services for systems used in the Group companies, including maintenance, upgrade and development of the testing system and maintenance of the Company's billing mediation systems (interconnect); maintenance and spare parts for exchanges; content development services and communication applications.

D. Sales of maintenance, upgrading and development services by Group companies, including: maintenance of equipment (including converters) in the Company's BezeqTech unit; maintenance of exchanges; content development services and communication applications.

E. Sale of user rights in communication infrastructure, call transfer, including sale of user rights in international communication infrastructure and supply of a local segment in Israel, hosting services at server farms, and mutual call transfer and completion agreements with Eurocom Group companies.

29. Transactions with interested and related parties (contd.)

29.5 Transactions with interested and related parties (contd.)

29.5.1 Negligible transactions (contd.)

F. Placement and outsourcing services, including outsourcing of call center services and other outsourcing services.

G. Rental, management and real estate acquisition agreements, including rental of areas used for communication facilities and wireless communication, rental or acquisition of communication rooms in buildings owned by Eurocom Group companies (for example, to provide communication services in the building), and warehouses; and rental of areas to Eurocom Group companies in properties owned by the Company.

H. Acquisition of advertising and content services, including agreements to acquire media slots (web and radio advertising) from media companies in the Eurocom Group; agreement for to use content on Pelephone’s cellular portal; acquisition of portals from Eurocom Group companies; media content management services by Eurocom Group companies.

I. Transactions relating to joint marketing, advertising, discounts and sponsorship with Eurocom Group companies or related to products of Eurocom Group companies, including distribution agreements (dealer) for marketing Company services (such as PRI and IPVPN) and joint marketing campaigns for the sale of PRI lines together with an exchange; consignment agreements for the sale of Eurocom Digital Communications equipment in private chain stores and the Company’s virtual stores, for a commission to the Company; technological sponsorship at exhibitions organized by the Company.

J. Contribution to the community together with Eurocom Group companies and contribution to organizations/projects in which the controlling shareholder of the Company or his relative volunteers as an officer. These contributions are part of the Company’s contribution policy. Each specific contribution is approved and the controlling shareholder or his relative gain no financial benefit from this connection. In the reporting period, these contributions were insignificant compared to the total contributions of the Company.

In the absence of special qualitative considerations all the circumstances, a transaction that is in the Company’s regular course of business, is carried out in market conditions and has no material effect on the Company, shall be deemed negligible if all the following parameters exist:

K. The amount of the transaction does not exceed NIS 10 million.

L. The Company is not required to issue an immediate report for the transaction under Article 36 of the periodic reports regulations or any other law.

M. The transaction does not address the conditions of office and employment (as defined in the Companies Law) of an interested party or his relative, or a transaction as set out in section 270(4) of the Companies Law (transaction of a public company with a holder of control therein, directly or indirectly, including through a company he controls, in respect of receiving services from it by the Company and if such person is also an officer - as to the conditions of his office and employment, and if he is an employee of the Company but not an officer, as to his employment by the Company).

29. Transactions with interested and related parties (contd.)

29.5 Transactions with interested and related parties (contd.)

29.5.1 Negligible transactions (contd.)

According to the provisions of the Companies Law, 1999, as amended from time to time, once a year, before publication of the annual financial statements, the audit committee will review the parameters set out above, and whether they require updating. In general, each transaction will be tested separately for negligibility. Notwithstanding the aforesaid, separate transactions that are part of the same continuing transaction or very similar transactions that are carried out routinely and repeatedly, will be tested as one transaction on an annual basis for negligibility, provided the scope of the transaction does not exceed NIS 10 million, as set out above.

The Board of directors may, from time to time and at its discretion, amend the parameters for a negligible transaction. This amendment will be duly reported.

For details of transactions that are not within the above definition of negligible, see sections 29.5.2 and 29.5.3 below.

29.5.2 Transactions with controlling shareholders or in which the controlling shareholder has a personal interest, pursuant to section 270(4) of the Companies Law, 1999 (“the Companies Law”).

A. **Agreements for acquisition of converters and power supplies**

1. On April 13, 2011, the general meeting approved (after the approval of the audit committee and Board of Directors) the Company’s vote in the general meeting of DBS in favor of the agreement between DBS and Advanced Digital Broadcast SA (“ADB”) and Eurocom Digital Communications Ltd. in the following transactions: (a) Acquisition of yesMaxHD converters according to the framework agreement and upgrade (partial or full, at the discretion of DBS) of the converter’s hard-drive, at a total cost of USD 10.3 million. This price is for sea shipment. If the Company requires earlier delivery, by air, DBS will pay Eurocom the extra cost for air freight. (b) Receipt of dollar credit from Eurocom Digital Communications for an additional 60 days (“the Additional Credit Period”) for purchase of the converters. The payment terms set out in the framework agreement is EOM + 35 days and 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 11 million and payment of the annual interest is estimated at NIS 578,000. (c) Purchase of power supplies for yesMaxHD converters from Eurocom and ADB for the period up to May 31, 2012 at a total cost of USD 131,000. The investment in the converters amounts in NIS 87 million in 2011 and was recognized in the financial statements of DBS under property, plant and equipment.

2. On August 4, 2011, the general meeting approved (after the approval of the audit committee and Board of Directors) the Company’s vote in the general meeting of DBS in favor of the engagement of DBS in the following transactions:

29. <u>Transactions with interested and related parties (contd.)</u>

29.5 Transactions with interested and related parties (contd.)

29.5.2 <u>Transactions with controlling shareholders or in which the controlling shareholder has a personal interest, pursuant to section 270(4) of the Companies Law, 1999 (“the Companies Law”) (contd.).</u>

A. Agreements for purchase of converters and power supplies (contd.)

An additional order, further to the order in section 29.5.2(A)(1) above, of yesMaxHD converters from Eurocom Digital Communications and ADB, according to the framework agreement and any upgrade (partial or full, at the discretion of DBS) of the converter’s hard-drive, at a total cost of USD 20.7 million. This price is for sea shipment. Should the Company require earlier delivery that requires air shipment, DBS will pay Eurocom the difference between sea shipment and airfreight and receipt of dollar credit from Eurocom for an additional 60 days (“the additional credit period”) for 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.

3. On February 16, 2012, the Board of Directors approved, after the approval of the audit committee, the amendment to the agreement between DBS and Eurocom Digital Communications Ltd. and ADB, which was approved at the general meeting on August 4, 2011 (“the Original Agreement”) as set out in section 29.5.2 A (3) above. Accordingly, a proposal was made to amend the agreement for some of the converters (50% of the original amount) so that the additional maximum total cost of the Original Agreement (due to the increase in prices of hard drives as set out in this report) will be up to USD 1.953 million. The approval requires the approval of the general meeting of the Company’s shareholders of which was convened for March 27, 2012.

4. On March 14, 2012, the Company’s Board of Directors approved the engagement of DBS in the following transactions (after approval of the audit committee):

(a) An additional order of new yesMaxTotal 3 converters from Eurocom Digital Communications and ADB, further to the order in section 29.5.2(A)(2) , according to the framework agreement and upgrade (partial or full, at the discretion of DBS) of the converter’s hard-drive, at a total cost of USD 9.8 million (this price is for sea shipment; If DBS requires earlier delivery, by air, DBS will pay Eurocom the extra cost for airfreight) DBS will also be entitled, without consideration, to development days equivalent to USD 105,000 for future updates of the converter. DBS will also have the option, at its sole discretion, to acquire services for handling production stages, holding inventory in Israel, storage and supply to DBS’s warehouses. If DBS decides to exercise this option for all the converters, the additional payment will be up to USD 250,000 for the entire quantity submitted for approval in accordance with this agreement. The approval includes approval for DBS to exercise the option at its discretion.

(b) Receipt of dollar credit from Eurocom Digital Communications for an additional 60 days (“the Additional Credit Period”) for 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 15 million and accordingly, payment of the annual interest is estimated as NIS 437,000.

29. Transactions with interested and related parties (contd.)

29.5 Transactions with interested and related parties (contd.)

29.5.2 Transactions with controlling shareholders or in which the controlling shareholder has a personal interest, pursuant to section 270(4) of the Companies Law, 1999 (“the Companies Law”) (contd.).

A. **Agreements for purchase of converters and power supplies (contd.)**

(c) An order of power supplies for yesMaxHD converters from Eurocom Digital Communications and from ADB, until December 31, 2012, at a total cost of USD 131,000.

The agreements in sub clause (a) and (b) will be presented for approval at the general meeting under section 275 of the Companies Law, in view of the terms set out in the Ministry of Communications’ approval, as a transaction for acquisition of control in the Company by B Communications.

B. **Management services**

On June 10, 2010, the general meeting of the Company’s shareholders approved an agreement between the Company and Eurocom Communications Ltd., the controlling shareholder (indirect) of the Company. Under the agreement, Eurocom will provide the Company with ongoing management and consultation services for an annual fee of USD 1.2 million over three years, commencing from June 1, 2010 through to May 31, 2013, unless one of the parties announces its intention to terminate the agreement with three months notice. The main services provided by the management company are consultation services for the Company’s operations, including strategy, business development, regulation, marketing and any other consultation that the Company requires as a communications company and as a group of companies, and ongoing management services.

The services will be supplied from June 1, 2010 and for the term of the agreement by managers and/or employees and/or consultants of the management company and/or its shareholders and anyone that the management company deems suitable to supply the services. The management company will provide professional and skilled human resources and other resources that are required to supply the services, including managers and consultants with a background in communications and with international experience, in order to provide the Group professional and high-quality service. In addition, according to the consultation agreement, until otherwise decided, the Company’s directors, except for outside directors, independent directors and the chairman of the Board of Directors, will not receive directors’ compensation from the Company or the subsidiaries. The Company recognized expenses of NIS 4.306 million for the management services in 2011 and paid them in full. The Company believes that the remuneration paid according to the management agreement is below the average standard remuneration in similar companies, however is within the range of fair value.

29. Transactions with interested and related parties (contd.)

29.5 Transactions with interested and related parties (contd.)

29.5.2 Transactions with controlling shareholders or in which the controlling shareholder has a personal interest, pursuant to section 270(4) of the Companies Law, 1999 ("the Companies Law") (contd.).

C. **Undertaking to indemnify in advance for new directors in the Company**

On October 26, 2011, following the enactment of the Streamlining of Enforcement Procedures within the Israel Securities Authority (Amendments to Legislation), 2011, the general meeting of the Company approved the amendment to the deeds of indemnity granted to officers serving in the Company, including directors or officers who are controlling shareholders in the Company or their relatives, so that the amended deed of indemnity will also allow indemnification of an officer for payment to a person affected by the breach (in accordance with section 52BBB(a)(1(a) of the Securities Law) or for expenses expended by an officer in respect of a procedure in accordance with section H(3), H(4) or I(1) of the Securities Law or in accordance with Article D in Chapter Four of Part IX of the Companies Law, including reasonable litigation expenses, including attorneys fees In addition, on October 11, 2011, the general meeting of Walla Communications Ltd. approved an undertaking to indemnify, dated July 6, 2010 and January 25, 2011, in favor of Or Elovitch, Amikam Shorer and Shaul Elovitch, respectively, by virtue of their positions as directors in Walla, under the same conditions as the undertaking to indemnify directors in Walla, in an amount (cumulative, for all Walla officers) equal to the lower of: A) 25% of the equity of Walla as at December 31, 2006 (linked to the CPI up to the indemnity date); or B) USD 10 million.

D. **Framework transaction for D&O liability insurance**

In April, 2011, the general meeting of the Company's shareholders approved, after approval of the Company's Board of Directors and the audit committee, a framework transaction, subject to approval of the general meeting of the Company's shareholders, for three years, from April 14, 2011 through to April 13, 2014, for the Company's engagement, during the normal course of business, in future insurance policies to cover the liability of directors and officers as may be from time to time, including directors and officers who are or who are likely to be considered controlling shareholders in the Company, and all by way of a "framework transaction" as defined in the Companies Regulations (Reliefs in Transactions with an Interested Party), 2000 ("the Relief Regulations"). The Company will acquire a policy with a liability limit of USD 100 million per claim and in total for each insurance year, and up to USD 20 million per claim and in total for the insurance period for legal expenses in Israel only. In addition, the liability limit for subsidiaries is the aggregate of half of this amount (as part of the above liability limits). The amount of the annual premium that the Company pays will not exceed USD 185,000 plus a sum constituting up to 20% of that amount. At the aforesaid date, the general meeting of the Company approved the Company's engagement in a D&O liability insurance policy for one year, from April 14, 2011 to April 13, 2012, under the terms set out above.

The Company may purchase insurance with a liability limit exceeding USD 100 million, provided that the amount of the annual premium that the Company pays does not exceed USD 185,000 plus a sum constituting up to 20% of that amount. Any purchase of a new insurance policy in the future as mentioned above will be approved by the Company's audit committee and the Board of Directors, which will determine whether it complies with the terms of the framework transaction.

29. <u>Transactions with interested and related parties (contd.)</u>

29.5 Transactions with interested and related parties (contd.)

29.5.2 <u>Transactions with controlling shareholders or in which the controlling shareholder has a personal interest, pursuant to section 270(4) of the Companies Law, 1999 ("the Companies Law") (contd.).</u>

E. **D&O liability insurance policies**

In March 2012, the Board of Directors resolved, after receiving the approval of the audit committee and after determining that it meets the terms of the framework transaction, to approve the Company's engagement in the D&O liability insurance policy for one year, from April 14, 2011 to April 13, 2012. The Company will pay an annual premium of up to USD 220,000. The liability limit is USD 100 million per claim and in total for each insurance year, and up to USD 20 million per claim and in total for the insurance period for legal expenses in Israel only. In accordance with the Relief Regulations, the transaction does not require the approval of the general meeting (unless objections are submitted as set out in these regulations and below). For directors who are controlling shareholders, or their relatives, the engagement was approved pursuant to article 1B(5) of the Relief Regulations. Accordingly, if an objection is submitted as set out in article 1(C)(a) of the Relief Regulations, for the scope of the policy in respect of directors who are controlling shareholders or their relatives, and/or in respect of its approval in the context of the framework agreement, the engagement is subject to the approval of the general meeting with a majority as set out in section 275 of the Companies Law.

29.5.3 <u>Transactions not included in section 270(4) of the Companies Law and are not negligible</u>

A. **Raising of debt by DBS**

On March 7, 2011, the Company's Board of Directors resolved (after the approval of the audit committee) to vote in favor of DBS's transaction to raise debt of up to NIS 120 million at the general meeting of the shareholders of DBS.

B. **Liability in advance to acquire Debentures (Series 6-8)**

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. (a company indirectly controlled by Eurocom Communications Ltd., the indirect controlling owner of the Company), in the planned tender for classified investors for a public offering of Debentures (Series 6 to 8) ("the Institutional Tender"). In the Company's institutional tender of June 28, 2011, preliminary commitments were received from Eurocom Capital Underwriting amounting to 5% of the total debentures relevant to the preliminary commitments from classified investors for each of the Debentures Series (6 to 8). At the reporting date, Eurocom Capital Underwriting no longer holds Debentures (Series 6 to 8) as set out above.

29. Transactions with interested and related parties (contd.)

29.5 Transactions with interested and related parties (contd.)

29.5.4 Transactions with the controlling shareholder or companies under his control

The transactions in which the Group engaged with the controlling shareholder or in which the controlling shareholder has a personal interest in the reporting period reflect fair value. This determination is based, inter alia, on one or more of the following characteristics in relation to transactions (as the case may be, and according to the type of transaction and the relevance of the characteristic in respect thereof). The transaction is in similar conditions to those offered to the Company by unrelated parties (as the case may be), in similar transactions, and / or the transaction is carried out at prices that were set in the period prior to transfer of control in the Company (when the parties to the transaction unrelated parties), and / or terms of the transaction that the Company believes reflect market conditions.

29.6. Benefits for key officers

Benefits for employment of key managers, including:

	Year ended December 31					
	2011		2010		2009	
	No. of persons	NIS thousands	No. of persons	NIS thousands	No. of persons	NIS thousands
Salary (29.6.2)	**3**	**7,643**	4	7,701	4	9,544
Bonus (29.6.3)	**3**	**6,292**	4	13,366	4	8,713
Share-based payments (see Note 26)	**3**	**2,931**	4	7,141	4	15,712
		16,866		28,208		33,969

29.6.1 Key officers in the Group in 2011 include the chairman of the Board of Directors (who did not receive compensation for his office in the reporting year) and the CEO of the Company, as well as the CEOs of Pelephone and Bezeq International.

29.6.2 In 2011, changes in other provisions (which are included in total salary) are not material. In 2010, the changes in other provisions (which are included in total salary) were not significant, except for a decrease in the provisions for early notice and leave for the former chairman of the Board of Directors, in the amount of NIS 1.8 million. In 2009, the changes in the other provisions were not significant.

29.6.3 The bonus for 2010 to the former chairman of the board, amounting to NIS 3.507 million, required the approval of the general meeting of the shareholders of the Company, and received approval in April 2011. In addition, the bonus includes a retention grant for the CEO’s of the Company, Bezeq International and Pelephone, amounting to nine months salary, and was approved by the Company’s Board of Directors on December 31, 2009.

29. Transactions with interested and related parties (contd.)

29.7. Benefits for directors

	Year ended December 31		
	2011	2010	2009
	NIS thousands	NIS thousands	NIS thousands
Remuneration for directors who are not employed by the Company, see section 29.7.1	**1,427**	966	705
Number of directors receiving remuneration	**4**	5	2
Salary of employee-directors, see 29.7.2	**1,269**	1,332	1,450
Number of directors receiving the salary	**2**	2	2
Management fees to the controlling shareholder up to April 14, 2010	**–**	1,285	4,692
Management fees to the controlling shareholder from April 14, 2010, see section 29.5.2(C)	**4,306**	2,541	–

29.7.1 The directors serving on the Company's Board of directors, except for the outside directors and the independent directors, do not receive remuneration from the Company.

29.7.2 The salary is paid to employee-directors in respect of their work in the Company and they do not receive any additional pay in respect of their service as directors in the Company. For details of the additional allocation of options for employee-directors on January 25, 2011, see Note 26.

29.7.3 In May 2005, the general meeting of the Company's shareholders approved the exercise of an option to purchase a run-off policy for liability for officers who served in the Company up to transfer of control to Ap. Sb. Ar., meaning until October 11, 2005, for seven years from that date

29.7.4 In March, 2010, the general meeting of the Company's shareholders approved (after approval of the audit committee and the Board of directors) the conversion of the directors' and officers' liability insurance policy to a run-off policy, commencing from the date of transfer of control from Ap.Sb.Ar. Holdings Ltd. to B Communications for seven years from this date. The limit of liability is up to USD 50 million for claims and in total for the insurance period. In addition, the liability limit is up to USD 10 million per claim and in total for the insurance period for legal expenses in Israel only. The liability limit for subsidiaries is half of this amount (as part of the above liability limit). The annual premium for the policy is USD 380,500. The policy will also cover directors who were controlling shareholders in the Company until control was transferred to B Communications, or their relatives.

29.7.5 See section 29.5.2 (D) above for the approval of the general meeting held on April 2011 in respect of the Company's engagement, in the normal course of business, in future insurance policies to cover D&O liability, as amended from time to time, including directors and officers who are or may be considered as controlling shareholders in the Company, by way of a framework transaction" as defined in the Relief Regulations.

29.7.6 For the approval of the general meeting held in April 2011 of the Company's engagement in a D&O liability insurance policy for one year from April 14, 2011 to April 13, 2012, including directors and officers who are or may be considered as controlling shareholders in the Company, see section 29.5.2 (D) above.

29. Transactions with interested and related parties (contd.)

29.7 Benefits for directors (contd.)

29.7.7 For the approval of the audit committee and Board of Directors in March 2012 in respect of the Company's engagement in a D&O liability insurance policy, see section 29.5.2 (E) above.

29.7.8 In January 2007, the general meeting of the Company's shareholders approved an undertaking to indemnify according to a deed of indemnity for all of the Company's officers for any liability or expense imposed on the officers due to their actions in their capacity as an officer in the Company (including their actions in subsidiaries), within the limitations provided in the Companies Law. The amount of the indemnity was limited to a ceiling of 25% of the Company's equity at the time the indemnity is paid. The deed of indemnity will apply to events listed in the deed of indemnity, which is attached to the immediate report regarding notice of a general meeting to approve the undertaking to indemnify. In 2008-2010 and up to the publication date of this report, an undertaking to indemnify was approved for new officers who joined the Company.

See section 29.5.2 (C) above for the approval of the general meeting held on October 2011 in respect of the amendment to the deed of indemnification granted to officers serving in the Company (including directors or officers who are controlling shareholders in the Company or their relatives).

In the past seven years, the Company has granted indemnity to officers for the following issues:

A. The undertaking to indemnify of April 6, 2005 for a financial liability that would be imposed on officers of the Company and in respect of reasonable litigation expenses which they would incur, relating directly or indirectly to the sale of the State's holdings in the Company.

B. The undertaking to indemnify of May 16, 2005, for officers who served in the seven years preceding the completion date of the sale of core control in the Company to Ap.Sb.Ar.

29.8. For guarantees to related parties, see Note 19.

29.9. For the allocation of phantom options to the CEOs of the Company, Pelephone and Bezeq International, see Note 26.

30. Financial instruments:

30.1. General

The Group is exposed to the following risks, arising from the use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk (which includes currency, interest, CPI risks and other price risks)

This Note provides information about the Group's exposure to each of the above risks, an explanation as to how the risks are managed, and the measurement processes. . Other quantitative disclosure is included in the other Notes to the financial statements.

30.2. Framework for financial risk management

The Board of Directors has overall responsibility for the Group's financial risk management. The purpose of financial risk management in the Group is to define and monitor those risks constantly, and to minimize their possible effects arising from the exposure on the basis of assessments and expectations for parameters that affect the risks. The Group's policy is to hedge, in part and where required, exposure arising from fluctuations in foreign exchange rates, copper prices, the CPI and interest rates.

30.3. Credit risk

Credit risk is the risk of financial loss to the Group if a customer or the other party to a financial instrument fails to meet its contractual obligations, and it is derived mainly from debit balances of customers and other receivables and from investments in deposits and in securities. Management monitors the Group's exposure to credit risks on a regular basis. Cash and investments in deposits and securities are deposited in highly-rated banks and credit assessments are made on material customer balances.

Trade and other receivables

The Group's management regularly monitors customer debts, and the financial statements include provisions for doubtful debts which properly reflect, in the management's estimation, the loss inherent in doubtful debts. In addition, the balances of the trade receivables are widely spread.

Investments in financial assets

Any investments in securities are made in liquid, marketable and low-risk securities. Transactions involving derivatives are made with entities that have a high credit rating.

Guarantees

The Group's policy is to provide tender, performance and legal guarantees. In addition, the Company provides bank guarantees, where necessary, for banking obligations of subsidiaries and associates. As at December 31, 2011, the Group has the guarantees described in Note 19.

30. Financial instruments (Contd.)

30.3 Credit risks (contd.)

At the reporting date, there is no material concentration of credit risks. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivatives, in the statement of financial position, as follows:

	December 31, 2011	December 31, 2010
	NIS million	NIS million
Cash and cash equivalents	**1,352**	365
Monetary reserves	**915**	–
Available-for-sale financial assets	**39**	31
Trade and other receivables	**4,770**	3,920
Bank deposit for providing loans to employees	**76**	83
Assets and other investments	**10**	7
Derivatives	**25**	15
	7,187	4,421

See Note 7 for the matter of maximum exposure to credit risk for trade receivables.

30.4. Liquidity risk

Liquidity risk is the risk that the Group will be unable to honor its financial obligations on time. The Group's policy for liquidity management is to ensure, as far as possible, sufficient liquidity to honor those liabilities on time, without incurring undesirable losses. The Group estimates that the risk is low.

For information about the terms of the debentures issued by Group companies and the loans received, see Note 13 above.

The following are the contractual maturities of financial liabilities, including estimated interest payments (based on known CPI and interest rates on December 31, 2011):

	Balance at December 31, 2011						
	Carrying amount	Contractual cash flow	First half of 2012	Second half of 2012	2013	2014-2016	2017 and thereafter
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Non-derivative financial liabilities							
Trade payables	**890**	**890**	**890**	**–**	**–**	**–**	**–**
Other payables	**792**	**792**	**773**	**19**	**–**	**–**	**–**
Bank loans	**4,408**	**5,346**	**163**	**249**	**761**	**2,171**	**2,002**
Debentures issued to the public	**4,236**	**5,199**	**384**	**64**	**494**	**2,203**	**2,054**
Debentures issued to financial institutions	**934**	**1,175**	**153**	**90**	**177**	**295**	**460**
Dividend payable	**1,895**	**2,000**	**500**	**500**	**1,000**	**–**	**–**
	13,155	**15,402**	**2,863**	**922**	**2,432**	**4,669**	**4,516**

It is not expected that the cash flows included in the analysis of the repayment dates will be materially earlier, or in amounts that are materially different.

30. Financial instruments (Contd.)

30.4 Liquidity risk (contd.)

	Balance at December 31, 2010						
	Carrying amount	Contractual cash flow	First half of 2012	Second half of 2012	2013	2014-2016	2017 and thereafter
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Non-derivative financial liabilities							
Trade payables	1,061	1,061	1,061	–	–	–	–
Other payables	760	760	748	12	–	–	–
Bank loans	2,855	3,320	69	83	310	1,778	1,080
Debentures issued to the public	2,163	2,391	690	–	371	1,021	309
Debentures issued to financial institutions	699	756	169	79	152	356	–
	7,538	8,288	2,737	174	833	3,155	1,389
Financial liabilities - derivative instruments							
Forward contracts on copper prices	10	10	10	–	–	–	–

30.5. Market risks

Market risk is the risk that changes in market prices, such as foreign currency exchange rates, interest rates and the prices of securities, raw materials and other items, will influence the Group's results or the value of its holdings in financial instruments. The purpose of market risk management is to manage and oversee the exposure to market risks within accepted parameters to prevent significant exposures to market risks that will influence the Group's results, liabilities and cash flow.

During the normal course of its business, the Group takes full or partial hedging action and takes into account the effects of the exposure in its considerations for determining the type of loans it takes and in managing its investment portfolio.

The Group is currently assessing its financial risk management policy.

30.5.1 Exposure to CPI and foreign currency risks

CPI risk
Changes in the rate of inflation affect the Group's profitability and its future cash flows, mainly due to its CPI-linked liabilities. In applying a policy of minimizing the exposure to the CPI, the Group makes forward transactions against the CPI. The duration of the forward transactions is the same as or shorter than the duration of the hedged exposures. A considerable part of these cash balances is invested in shekel deposits / monetary reserves which are exposed to changes in their real value as a result of a change in the rate of the CPI.

Foreign currency risk
The Group is exposed to foreign currency risks mainly due to payments for purchases of terminal equipment and property, plant and equipment, some of which are denominated in or linked to the dollar or euro. In addition, the Group provides services for customers and receives services from suppliers worldwide for which it is paid and it pays in foreign currency, mainly the dollar. In applying a policy of minimizing foreign currency exposure, the Group makes forward transactions and purchases options against the dollar. The duration of the hedging transactions is the same as or shorter than the duration of the hedged exposures.

30. Financial instruments (Contd.)

30.5 Market risks (contd.)

30.5.1 Exposure to CPI and foreign currency risks (contd.)

	Balance at December 31, 2011				
	Unlinked	CPI-linked	Foreign currency or linked thereto (mainly dollar)	Non-monetary balance	Total
	NIS million	NIS million	NIS million	NIS million	NIS million
Current assets					
Cash and cash equivalents	1,331	–	21	–	1,352
Trade receivables	2,986	37	36	–	3,059
Other receivables	49	167	–	70	286
Investments, including derivatives	921	9	16	–	946
Inventory	–	–	–	204	204
Assets classified as held for sale	–	–	–	23	23
Non-current assets					
Trade and other receivables	1,397	98	4	–	1,499
Investments, including derivatives	80	–	38	1	119
Property, plant and equipment	–	–	–	6,022	6,022
Intangible assets	–	–	–	2,257	2,257
Deferred and other expenses	–	–	–	282	282
Equity-accounted investments	–	1,549	–	(490)	1,059
Deferred tax assets	–	–	–	223	223
Total assets	6,764	1,860	115	8,592	17,331
Current liabilities					
Debentures, loans and borrowings	219	546	–	–	765
Employee benefits (not within the scope of IFRS 7)	389	–	–	–	389
Trade payables	750	–	140	–	890
Other payables, including derivatives	722	69	1	–	792
Current tax liabilities	–	397	–	–	397
Deferred income	3	–	–	53	56
Provisions	49	134	–	3	186
Dividend payable	971	–	–	–	971
Non-current liabilities					
Debentures	2,154	2,509	–	–	4,663
Loans	4,055	95	–	–	4,150
Provisions and other liabilities	126	–	–	36	162
Deferred tax liabilities	–	–	–	69	69
Employee benefits (not within the scope of IFRS 7)	166	13	50	–	229
Dividend payable	924	–	–	–	924
Total liabilities	10,528	3,763	191	161	14,643
Total exposure in the statement of financial position	(3,764)	(1,903)	(76)	8,431	2,688
Details of forward transactions					
Forward contracts on CPI	(600)	600	–	–	–

30. Financial instruments (Contd.)

30.5 Market risks (contd.)

30.5.1 Exposure to CPI and foreign currency risks (contd.)

	Balance at December 31, 2010				
	Unlinked	CPI-linked	Foreign currency or linked thereto (mainly dollar)	Non-monetary balance	Total
	NIS million	NIS million	NIS million	NIS million	NIS million
Current assets					
Cash and cash equivalents	339	–	26	–	365
Trade receivables	2,629	34	38	–	2,701
Other receivables	51	52	–	124	227
Other investments, including derivatives	2	2	3	–	7
Inventory	–	–	–	178	178
Assets classified as held for sale	–	–	–	29	29
Non-current assets					
Long-term trade and other receivables	949	161	4	–	1,114
Investments, including derivatives	87	10	30	2	129
Property, plant and equipment	–	–	–	5,610	5,610
Intangible assets	–	–	–	2,248	2,248
Deferred and other expenses	–	–	–	292	292
Equity-accounted investments	–	1,351	–	(267)	1,084
Deferred tax assets	–	–	–	254	254
Total assets	4,057	1,610	101	8,470	14,238
Current liabilities					
Debentures, loans and borrowings	7	942	–	–	949
Employee benefits (not within the scope of IFRS 7)	269	–	–	–	269
Trade payables	887	–	174	–	1,061
Other payables, including derivatives	675	85	10	–	770
Current tax liabilities	–	267	–	–	267
Deferred income	4	–	–	29	33
Provisions	31	216	–	4	251
Non-current liabilities					
Debentures	–	1,967	–	–	1,967
Loans	2,670	131	–	–	2,801
Provisions and other liabilities	103	–	1	8	112
Deferred tax liabilities	–	–	–	83	83
Employee benefits (not within the scope of IFRS 7)	202	56	47	–	305
Total liabilities	4,848	3,664	232	124	8,868
Total exposure in the statement of financial position	(791)	(2,054)	(131)	8,346	5,370
Details of forward transactions					
Forward contracts on CPI	(390)	390	–	–	–

30. Financial instruments (Contd.)

30.5 Market risks (contd.)

30.5.2 The Group has CPI forward contracts

	Currency/ linkage receivable	Currency/ linkage payable	Expiry date	Par value (currency)	Fair value
	NIS million	NIS million	NIS million	NIS million	NIS million
December 31, 2011					
Instruments not used for hedge accounting – contract on CPI	**CPI**	**Unlinked**	**2012**	**600**	**8**
December 31, 2010					
Instruments not used for hedge accounting – contract on CPI	CPI	Unlinked	2011-2012	390	12

30.5.3 Data in NIS for exchange rates and CPI

	December 31 2011	December 31 2010	December 31 2009	Change (%) December 31 2011	Change (%) December 31 2010	Change (%) December 31 2009
CPI in points (*)	**136.79**	133.89	130.42	**2.17**	2.66	3.91
1 USD (in NIS)	**3.821**	3.549	3.775	**7.66**	(5.99)	(0.71)
1 EUR (in NIS)	**4.938**	4.738	5.442	**4.22**	(12.94)	2.73

(*) CPI for the month at average base of 100=1998

30.5.4 Interest risks

Group is exposed to interest rate risk due to its holding of debt instruments bearing variable interest.

A. **Type of interest**

The interest rate for the Group's interest-bearing financial instruments at the reporting date is as follows:

	Carrying amount 2011	Carrying amount 2010
	NIS million	NIS million
Fixed-interest instruments		
Financial assets (mainly deposits and trade receivables)	**4,450**	2,551
Financial liabilities (loans and debentures)	**(6,683)**	(4,347)
	(2,233)	(1,796)
Variable-interest instruments		
Financial liabilities (loans and debentures)	**(2,895)**	(1,370)

B. Fair value sensitivity analysis for fixed rate instruments

The Group's assets and liabilities at fixed interest are not measured at fair value through profit or loss, nor does the Group designate derivatives (interest swap contracts) as hedging instruments according to a hedge accounting model of fair value. Accordingly, a change in interest rates at the reporting date will not affect profit or loss.

30. Financial instruments (Contd.)

30.5 Market risks (contd.)

30.5.4 Interest risk (contd.)

C. Sensitivity analysis of cash flow for instruments at variable interest

An increase of 100 basis points in the interest rate at the reporting date would decrease shareholders' equity and profit or loss by approximately NIS 22.00 million (2010-approximately NIS 10.28 million). This analysis assumes that all other variables, especially foreign currency rates, remain stable.

30.6. Fair value

30.6.1 Fair value compared to carrying amounts

The table below shows the differences between the carrying amount and the fair value of groups of financial liabilities The carrying amount of financial assets does not differ significantly from their fair value.

	December 31, 2011		December 31, 2010	
	Carrying amount	Fair value	Carrying amount	Fair value
	NIS million	NIS million	NIS million	NIS million
Short-term credit	**3**	**3**	7	7
Loans from banks and others, CPI-linked	**136**	**139**	180	192
Loans from banks and others, unlinked	**1,815**	**1,873**	1,310	1,310
Debentures issued to the public, CPI-linked	**3,894**	**4,083**	2,249	2,387
Debentures issued to financial and other institutions, CPI-linked	**544**	**564**	712	760
Debentures issued to financial institutions, unlinked	**403**	**422**	–	–
Dividend payable	**1,895**	**1,920**	–	–
	8,690	**9,004**	4,458	4,656

The methods used to estimate the fair values of financial instruments are described in Note 4.

30.6.2 Average interest rates used to determine fair value

	2011	2010
	%	%
Long-term trade receivables	**6.14**	5.0
Unlinked loans	**5.12**	5.42
Linked loans	**1.66**	1.39
Unlinked debentures	**6.9**	–
Linked debentures	**2.13**	1.3

30. Financial instruments (Contd.)

30.6 Fair value (contd.)

30.6.3 Fair value hierarchy

The table below presents an analysis of the financial instruments measured at fair value, using the evaluation method.

The levels are defined as follows:

A. Level 1: Quoted prices (unadjusted) in an active market for identical instruments.

B. Level 2: Observable market inputs, direct or indirect, other than Level 1 inputs.

C. Level 3: Inputs not based on observable market data.

	Balance at December 31, 2011			
	Level 1	Level 2	Level 3	Total
	NIS million	NIS million	NIS million	NIS million
Financial assets held for trading:				
Monetary reserves	915	–	–	915
Derivatives not used for hedging				
Forward contracts on CPI	–	15	–	15
Forward contracts on copper prices	–	8	–	8
Available-for-sale financial assets:				
Unmarketable shares	–	–	38	38
	915	23	38	976

30.6.4 Financial instruments measured at fair value on level 3

The table below reconciles the opening and closing balances in respect of financial instruments measured at fair value on level 3 in the fair-value hierarchy:

	2011	2010
	Available-for-sale financial assets Non-marketable shares	Available-for-sale financial assets Non-marketable shares
	NIS million	NIS million
Balance as at January 1	29	31
Total losses recognized in the statement of income	(1)	–
Acquisitions	6	5
Disposal consideration	(3)	(10)
Profits recognized in other comprehensive income	7	3
Balance as at December 31	38	29

31. Selected condensed data from the financial statements of Pelephone Communications Ltd. and Bezeq International Ltd.

31.1. Pelephone Communications Ltd.

Statement of financial position:

	December 31, 2011	December 31, 2010
	NIS million	NIS million
Current assets	**2,280**	2,071
Non-current assets	**3,124**	2,821
	5,404	4,892
Current liabilities	**1,263**	1,198
Non-current liabilities	**992**	732
Total liabilities	**2,255**	1,930
Equity	**3,149**	2,962
	5,404	4,892

Statement of income:

	Year ended December 31		
	2011	2010	2009
	NIS million	NIS million	NIS million
Revenues from services	**2,436**	3,536	3,474
Value added services	**1,201**	1,014	782
Revenues from sales of terminal equipment	**1,911**	1,182	1,120
Total revenues from services and sales	**5,548**	5,732	5,376
Cost of services and sales	**3,587**	3,754	3,592
Gross profit	**1,961**	1,978	1,784
Selling and marketing expenses	**480**	468	461
General and administrative expenses	**121**	127	133
Operating profit	**1,360**	1,383	1,190
Financing expenses (income)			
Financing expenses	**67**	111	100
Financing income	**(105)**	(100)	(90)
Financing expenses (income), net	**(38)**	11	10
Profit before income tax	**1,398**	1,372	1,180
Taxes on income	**342**	339	305
Profit for the year	**1,056**	1,033	875

31. Selected condensed data from the financial statements of Pelephone Communications Ltd. and Bezeq International Ltd. (contd.)

31.2. Bezeq International Ltd.

Statement of financial position

	December 31, 2011	December 31, 2010
	NIS million	NIS million
Current assets	**500**	447
Non-current assets	**768**	591
	1,268	1,038
Current liabilities	**292**	279
Non-current liabilities	**147**	24
Total liabilities	**439**	303
Equity	**829**	735
	1,268	1,038

Statement of income

	Year ended December 31		
	2011	2010	2009
	NIS million	NIS million	NIS million
Revenues	**1,354**	1,380	1,318
Operating expenses	**788**	822	777
Gross profit	**566**	558	541
Selling and marketing expenses	**209**	192	175
General and administrative expenses	**116**	109	105
Other revenue, net	**–**	(63)	–
Operating profit	**241**	320	261
Financing expenses (income)			
Financing expenses	**11**	11	12
Financing income	**(9)**	(6)	(15)
Financing expenses (income), net	**2**	5	(3)
Share in the profits of equity-accounted investees	**1**	3	7
Profit before income tax	**240**	318	271
Income tax expense	**58**	65	71
Profit for the year from continuing operations	**182**	253	200
Profit for the year from discontinued operations	**–**	1	–
Profit for the year	**182**	254	200

32. **Subsequent Events**

32.1 For claims filed against Group companies subsequent to the date of the financial statements, see Notes 17.2 and 17.7.

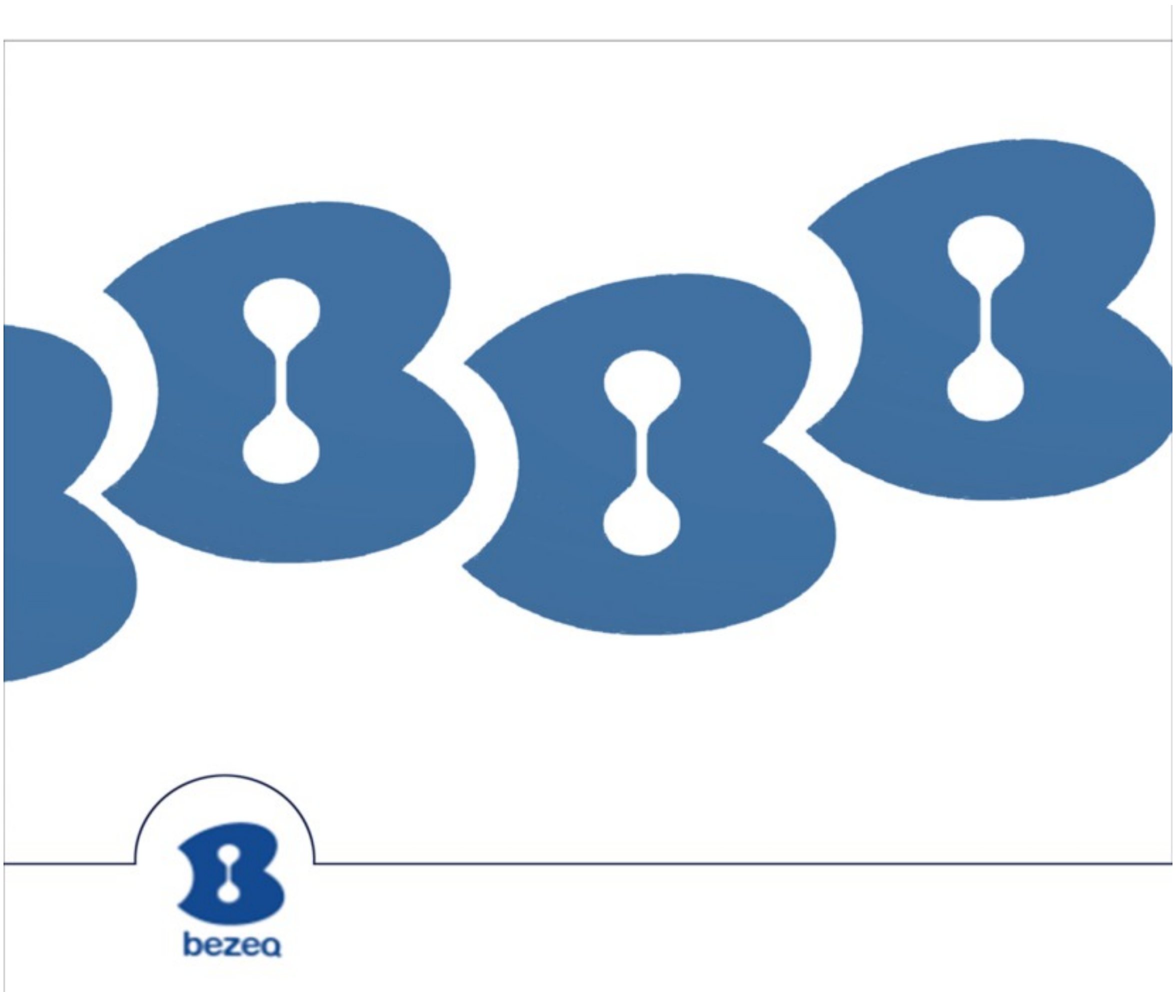
32.2 For the resolution of the Board of Directors, subsequent to the date of the financial statements, to recommend to the general meeting to distribute a cash dividend to the shareholders, see Note 20.2.3.

32.3 On March 14, 2012, the Company issued a complete tender offer to purchase all the shares of Walla held by the public (12,980,972 shares representing 28.45% of Walla's issued and paid up share capital) at a price of NIS 5.25 per share and for NIS 68 million (if employee options in Walla are exercised up to the last date for acceptance under the tender, the amount of purchased shares increase, and the total consideration will increase accordingly to NIS 77 million). The tender offer is subject to acceptance by offerees, in the majority set out in the Companies Law, to allow the purchase of all Walla shares held by the public, Walla will become a private company and its shares will be delisted from the TASE. The final date for submitting notices of acceptance was set for April 5, 2012.

Exhibit 99.4

Bezeq The Israel Telecommunication Corporation Ltd.

Separate Financial Information for year ended December 31, 2012



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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Somekh Chaikin
8 Hartum Street, Har Hotzvim
PO Box 212, Jerusalem 91001
Israel

Telephone 972 2 531 2000
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Internet www.kpmg.co.il

To:
The Shareholders of "Bezeq" the Israeli Telecommunication Corporation Ltd.

Dear Sirs,

Subject: Special auditors' report on separate financial data according to Regulation 9C of the Securities Regulations (Periodic and Immediate Reports) – 1970

We have audited the separate financial data presented in accordance with Regulation 9C of the Securities Regulations (Periodic and Immediate Reports) – 1970 of "Bezeq" the Israeli Telecommunication Corporation Ltd. (hereinafter – "the Company") as of December 31, 2012 and 2011 and for each of the three years, the last of which ended December 31, 2012, which are included in the Company's periodic report. The separate financial data are the responsibility of the Company's Board of Directors and of its Management. Our responsibility is to express an opinion on the separate financial data based on our audit.

We did not audit the financial statements of investees accounted for in the equity method in which the investment as of December 31, 2012 and 2011 amounted to approximately NIS 223 million and NIS 216 million, respectively, and the Company's share in their profits (losses) amounted to approximately NIS 59 million, NIS (7) million and NIS (6) million for each of the three years, the last of which ended December 31, 2012. The financial statements of these investees were audited by other auditors whose reports thereon were furnished to us, and our opinion, insofar as it relates to amounts emanating from the financial statements of such investees, is based solely on the reports of the other auditors.

We conducted our audit in accordance with generally accepted auditing standards in Israel. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial data are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the separate financial data. An audit also includes assessing the accounting principles that were used in preparing the separate financial data and the significant estimates made by the Board of Directors and by Management of the Company, as well as evaluating the separate financial data presentation. We believe that our audit and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and on the reports of the other auditors, the separate financial data is prepared, in all material respects, in accordance with Regulation 9C of the Securities Regulations (Periodic and Immediate Reports) - 1970.

Without qualifying our abovementioned opinion, we draw attention to lawsuits filed against the Company which cannot yet be assessed or the exposure in respect thereof cannot yet be calculated, as set forth in Note 9.

Somekh Chaikin

Certified Public Accountants (Isr.)
March 13, 2013

Data pertaining to the Financial Position as at December 31

	Note	2012 NIS million	2011 NIS million
Assets			
Cash and cash equivalents		**221**	1,096
Investments, including derivatives	3	**1,071**	940
Trade receivables	3	**740**	731
Other receivables	3	**208**	212
Inventories		**13**	13
Loans extended to investees	8	**465**	546
Assets classified as held for sale		**44**	23
Total current assets		**2,762**	3,561
Investments, including derivatives	3	**67**	77
Trade and other receivables	3	**128**	116
Property, plant and equipment	5	**4,403**	4,319
Intangible assets		**355**	368
Investment in investees		**6,061**	6,303
Loans extended to investees	8	**1,016**	1,256
Deferred tax assets	4	**109**	216
Total non-current assets		**12,139**	12,655
Total assets		**14,90**	16,216

	Note	2012 NIS million	2011 NIS million
Liabilities			
Debentures, loans and credit	3	**1,132**	757
Trade payables	3	**149**	177
Other payables, including derivatives	3	**493**	620
Current tax liabilities		**447**	361
Provisions	9	**139**	163
Employee benefits		**223**	351
Dividend payable		**969**	971
Total current liabilities		**3,552**	3,400
Debentures	3	**4,581**	5,034
Bank loans	3	**4,049**	3,996
Employee benefits		**205**	182
Deferred and other income		**54**	30
Dividend payable		**-**	924
Total non-current liabilities		**8,889**	10,166
Total liabilities		**12,441**	13,566
Equity			
Share capital		**3,837**	3,826
Share premium		**100**	68
Reserves		**608**	608
Deficit		**(2,085)**	(1,852)
Total equity		**2,460**	2,650
Total equity and liabilities		**14,901**	16,216

Shaul Elovitch
Chairman of the Board of Directors

Avi Gabbay
CEO

Dudu Mizrahi
Deputy CEO and CFO

Date of approval of the financial statements: March 13, 2013

The attached notes are an integral part of this separate financial information.

Data pertaining to the Profit and Loss for the year ended December 31

	Note	2012 NIS million	2011 NIS million	2010 NIS million
Revenue	6	**4,630**	4,648	5,263
Cost of Activities				
Depreciation and amortization		**730**	688	690
Salaries		**1,042**	1,089	1,079
General and operating expenses	7	**1,033**	1,074	1,609
Other operating expenses (income), net		**(128)**	139	(158)
		2,677	2,990	3,220
Operating profit		**1,953**	1,658	2,043
Financing expenses (income)				
Financing expenses		**579**	531	282
Finance revenues		**(322)**	(291)	(192)
Financing expenses (income), net		**257**	240	90
Profit after financing expenses, net		**1,696**	1,418	1,953
Share in earnings of investees, net		**654**	1,001	1,017
Profit before income tax		**2,350**	2,419	2,970
Income tax	4	**492**	353	527
Profit for the year		**1,858**	2,066	2,443

Data pertaining to the Comprehensive Income for the year ended December 31

	Note	2012 NIS million	2011 NIS million	2010 NIS million
Profit for the year		**1,858**	2,066	2,443
Items of other comprehensive income				
Actuarial gains (losses), net of tax		**(15)**	28	8
Other items of other comprehensive income (loss), net of tax		**(3)**	3	-
Other comprehensive income (loss), net of tax for Investees		**(9)**	4	5
Other comprehensive income (loss), net of tax		**(27)**	35	13
Total comprehensive income for the year		**1,831**	2,101	2,456

The attached notes are an integral part of this separate financial information.

Data pertaining to the Cash Flows for the year ended December 31

	2012	2011	2010
	NIS million	NIS million	NIS million
Cash flows from operating activities			
Profit for the year	**1,858**	2,066	2,443
Adjustments:			
Depreciation	**635**	613	618
Amortization of intangible assets	**95**	75	72
Share in profit of equity accounted investees, net	**(654)**	(1,001)	(1,017)
Financing expenses, net	**309**	243	69
Capital gain, net	**(150)**	(181)	(171)
Share-based payment transactions	**73**	165	26
Income tax expenses	**492**	353	527
Expenses (income) for derivatives, net	**-**	(21)	10
Change in inventory	**-**	2	(6)
Change in trade and other receivables	**(61)**	95	29
Change in trade and other payables	**(133)**	(80)	55
Change in provisions	**(24)**	(67)	(45)
Change in employee benefits	**(127)**	79	(213)
Change in deferred income	**25**	27	1
Net cash from financing activities (used for activities) for transactions with investees	**(18)**	(34)	2
Net income tax paid	**(311)**	(228)	(260)
Net cash from operating activities	**2,009**	2,106	2,140
Cash flows from investing activities			
Investment in intangible assets	**(136)**	(167)	(156)
Proceeds from the sale of property, plant and equipment	**300**	228	132
Acquisition of financial assets held for trading	**(2,457)**	(2,850)	-
Proceeds from disposal of financial assets held for trading	**2,329**	1,961	-
Purchase of property, plant and equipment	**(822)**	(998)	(876)
(Payment) receipt for derivatives	**14**	(5)	(2)*
Proceeds from disposal of investments and non-current loans	**7**	7	2*
Interest and dividends received	**9**	33	8
Acquisition of a subsidiary from an investee	**-**	-	(196)
Increase in holding of consolidated company	**(77)**	-	-
Net cash flows from current operations regarding transactions with investees	**1,323**	507	1,097
Net cash from (used in) financing investing activities	**490**	(1,284)	9

The attached notes are an integral part of this separate financial information.

Data pertaining to the Cash Flows for the year ended December 31 (cont'd)

	2012	2011	2010
	NIS million	NIS million	NIS million
Cash flow from financing activities			
Bank loans received	**650**	2,200	2,600
Issue of debentures	-	3,092	-
Repayment of bank loans	**(204)**	(600)	(400)
Repayment of debentures	**(327)**	(702)	(567)
Dividend paid	**(3,071)**	(3,155)	(3,733)
Interest paid	**(436)**	(346)	(196)
Net proceeds (payment) for derivatives	**7**	(1)	10
Proceeds from exercise of options for shares	**7**	21	26
Net cash from financing ongoing activities (used for activities) Financing for transactions with investees	-	(433)	(51)
Net cash from (used in) financing activities	**(3,374)**	76	(2,311)
Increase (decrease) in cash and cash equivalents	**(875)**	898	(162)
Cash and cash equivalents at January 1	**1,096**	198	360
Cash and cash equivalents as at the end of the year	**221**	1,096	198

The attached notes are an integral part of this separate financial information.

Notes to the separate financial information as of December 31, 2012

1. General

Below is a breakdown of financial information from the Group's consolidated financial statements as of December 31, 2012 ("the Consolidated Statements") published as part of the periodic reports, pertaining to the Company itself ("the Separate Financial Information"), presented pursuant to Regulation 9C ("the Regulation") and the Tenth Addendum of the Securities Regulations (Periodic and Immediate Reports),5730-1970 (hereinafter "the Tenth Addendum") with respect to the separate financial information of the corporation.

This Separate Financial Information should be read in conjunction with the Consolidated Statements.

In this Separate Financial Information -

The Company – "Bezeq" The Israel Telecommunication Corporation Ltd.

"Investee", the "Group", "Subsidiary", "Interested Party" - as these terms are defined in the Group's Consolidated Statements for 2012.

2. Significant accounting standards that were applied in these Separate Financial Information,

The accounting policies specified in the Consolidated Statements were consistently applied by the Company to all periods presented in this Separate Financial Information, including the method for classifying the financial information under the consolidated statements, with the required changes:

2.1. **Presentation of the financial information**

The statements of financial position, statements of income, comprehensive income and cash flows include data contained in the consolidated statements attributable to the Company itself. The investments and operating results of investees are equity accounted. Cash flows pertaining to ongoing, investment and financing activities with regard to transactions with investees are presented separately as net figures, as part of the given activities, based on the nature of the transaction.

2.2. **Transactions between the Company and investees**

2.2.1 Presentation

Intra-group balances and any unrealized income and expenses arising from intra-group transactions, which were derecognized in the preparation of the consolidated financial statements, are presented separately from the balance for investees and the profit with respect to investees, together with similar balances with third parties.

2.2.2 Measurement

Transactions carried out between the Company and its subsidiaries are measured in accordance with the recognition and measurement principles set in International Financial Reporting Standards ("IFRS"). These principles outline the accounting treatment for transactions carried out with third parties.

3. Financial Investments

3.1. Investments including derivatives

	December 31, 2012	December 31, 2011
	NIS million	NIS million
Capital notes	**962**	-
Money market funds	**-**	915
Bank deposits	**105**	-
Derivatives and other investments	**4**	25
	1,071	940

Investments in capital notes and money market funds are investments designated for trade and are presented at fair value at the date of the financial statements. The maturity dates for the investments in capital notes are during 2013. The maturity date of a bank deposit is April 2013.

Non-current investments as at December 31, 2012 and December 31, 2011 primarily include bank deposits for providing loans for employees. Their maturity dates have not yet been fixed.

3.2. Trade and other receivables

	Maturity dates	Unlinked	Israeli CPI linked	Total
		NIS million	NIS million	NIS million
December 31, 2012				
Current assets				
Trade receivables	**2013**	**740**	**-**	**740**
Other receivables	**2013**	**51**	**157**	**208**
Total current assets		**791**	**157**	**948**
Non-current assets				
Trade and other receivables	**2014-2015**	**82**	**46**	**128**
December 31, 2011				
Current assets				
Trade receivables	2012	731	-	731
Other receivables	2012	14	198	212
Total current assets		745	198	943
Non-current assets				
Trade and other receivables	2013-2014	70	46	116

3.3. **Suppliers and other payables, including derivatives**

	Unlinked	Israeli CPI linked	In foreign currency or linked thereto (primarily USD)	Total
	NIS million	NIS million	NIS million	NIS million
December 31, 2012				
Trade payables	**127**	**-**	**22**	**149**
Other payables, including derivatives	**424**	**66**	**3**	**493**
	551	**66**	**25**	**642**
December 31, 2011				
Trade payables	**149**	**-**	**28**	**177**
Other payables, including derivatives	**534**	**86**	**-**	**620**
	683	**86**	**28**	**797**

3.4. **Debentures and Loans**

3.4.1 Composition:

	December 31, 2012	December 31, 2011
	NIS million	NIS million
Current liabilities		
Current maturities of debentures (1)	**535**	553
Current maturities of bank loans	**597**	204
	1,132	757
Non-current liabilities		
Debentures (2)	**4,581**	5,034
Bank loans	**4,049**	3,996
	8,630	9,030
	9,762	9,787

(1) Of this amount, NIS 183 million (NIS 181 million in 2011) is for current maturities of debentures held by Bezeq Zahav (Holdings) Ltd. ("Bezeq Zahav").

(2) Of this amount, NIS 540 million (NIS 712 million in 2011) is for debentures held by Bezeq Zahav.

3.4.2 Terms and debt repayment schedule

	December 31, 2012		December 31, 2011	
	Carrying amount balance	Nominal value	Carrying amount balance	Nominal value
	NIS million	NIS million	NIS million	NIS million
Total unlinked loans bearing variable interest	**2,306**	**2,306**	2,400	2,400
Total unlinked loans bearing fixed interest	**2,340**	**2,340**	1,800	1,800
Total loans	**4,646**	**4,646**	4,200	4,200
Debentures issued to the public				
CPI linked Debentures, bearing fixed interest - Series 5	**1,950**	**1,591**	2,413	1,989
Debentures, Series 6-8	**2,730**	**2,712**	2,716	2,712
Total debentures issued to the public	**4,680**	**4,303**	5,129	4,701
Debentures issued to financial institutes				
CPI linked Debentures, bearing fixed interest	**36**	**27**	58	44
Unlinked debentures bearing fixed interest	**400**	**400**	400	400
Total debentures issued to financial institutions	**436**	**427**	458	444
Total debentures	**5,116**	**4,730**	5,587	5,145
Total interest-bearing liabilities	**9,762**	**9,376**	9,787	9,345

For further information see Note 13 to the consolidated statements, Debentures, Loans and Credit

3.5. **Liquidity risk**

Below are the contractual maturities of financial liabilities, including estimated interest payments (based on known CPI and interest data as of December 31, 2012):

	December 31, 2012						
	Carrying amount	Projected cash flows	First half of 2013	Latter half of 2013	2014	2015-2017	2018 and thereafter
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Non-derivative financial liabilities							
Trade payables	**149**	**149**	**149**	**-**	**-**	**-**	**-**
Other payables	**440**	**440**	**428**	**12**	**-**	**-**	**-**
Bank loans	**4,646**	**5,522**	**51**	**718**	**779**	**2,494**	**1,480**
Debentures issued to the public	**4,680**	**5,517**	**580**	**63**	**686**	**2,638**	**1,550**
Debentures issued to financial institutes and others	**436**	**602**	**49**	**13**	**27**	**178**	**335**
Dividend payable	**969**	**1,000**	**500**	**500**	**-**	**-**	**-**
Non-derivative financial liabilities							
Forward contract on the consumer price index	**16**	**16**	**8**	**-**	**6**	**2**	**-**
	11,336	**13,246**	**1,765**	**1,306**	**1,498**	**5,312**	**3,365**

3.6. Currency and CPI Risks

For details pertaining to CPI hedging transactions carried out by the Company during 2012, see Note 30.6 to the consolidated financial statements. These transactions are recognized as cash flow hedging.

For details regarding hedging transactions on the price of copper carried out by the Company during 2012, see Note 30.5.2 to the consolidated financial statements. These transactions are not used as accounting hedges.

4. Income tax

4.1. General

	For year ended December 31		
	2012	2011	2010
	NIS million	NIS million	NIS million
Current tax expense	**379**	332	396
Deferred tax expense			
Creation and reversal of temporary differences	**113**	53	131
Effect of change in tax rates	**-**	(32)	-
	113	21	131
Income tax expenses	**492**	353	527

4.2. Recognized deferred tax assets and deferred tax liabilities

Breakdown and changes applicable during the year on deferred tax assets and deferred tax liabilities:

	Balance at January 01, 2011	Recognized in profit or loss	Recognized in equity	Balance at December 31, 2011	Recognized in profit or loss	Recognized in equity	Balance at December 31, 2012
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Employee benefits plans	245	41	(10)	276	**(62)**	**5**	**219**
Share-based payments	16	(4)	-	12	**(12)**	**-**	**-**
Property, plant and equipment	(42)	(57)	-	(99)	**(35)**	**-**	**(134)**
Provisions and others	29	-	(2)	27	**(4)**	**1**	**24**
	248	(20)	(12)	216	**(113)**	**6**	**109**

5. Property, plant and equipment

	2012	2011
	NIS million	NIS million
Cost or deemed cost		
Balance as at January 1	**16,820**	16,817
Additions	**809**	1,006
Disposals	**(1,203)**	(932)
Transfer to assets held for sale	**(226)**	(71)
Balance as at December 31	**16,200**	16,820
Depreciation and loss from impairment of assets		
Balance as at January 1	**12,501**	12,811
Depreciation for the year	**635**	613
Disposals	**(1,149)**	(865)
Transfer to assets held for sale	**(190)**	(58)
Balance as at December 31	**11,797**	12,501
Amortized cost as at December 31	**4,403**	4,319

6. Revenue

	For year ended December 31		
	2012	2011	2010
	NIS million	NIS million	NIS million
Fixed-line telephony	**2,254**	2,393	3,160
Internet - Infrastructure	**1,166**	1,092	977
Transmission and data communication	**976**	931	882
Other services	**234**	232	244
	4,630	4,648	5,263

7. Operating and general expenses

	For year ended December 31		
	2012	2011	2010
	NIS million	NIS million	NIS million
Interconnect and payments to communication operators	**281**	314	855
Sales and marketing expenses	**159**	194	196
Terminal equipment and materials	**111**	89	88
Maintenance of buildings and sites	**245**	247	240
Services and maintenance by sub-contractors	**73**	76	76
Vehicle maintenance expenses	**83**	78	101
Royalties and others	**81**	76	53
	1,033	1,074	1,609

8. Substantial Agreements and Transactions with Investees

For a list of entities directly held by the Company, and details pertaining to directly and indirectly held investees, and information pertaining to equity accounted investees, see Note 12 to the consolidated financial statements.

8.1. Financial Guarantees

8.1.1 The Company has given guarantees to banks for credit granted to Bezeq International up to a total amount of NIS 70 million and to Teletel Communication Channels Ltd (fully owned subsidiary of Walla) up to a total amount of NIS 66 million.

8.1.2 For information pertaining to guarantees and liens provided by the Company to various entities with respect to DBS, see Note 19 to the consolidated statements, Securities, Liens and Guarantees

8.2. Loans

Loans from investees

8.2.1 In 2004 Bezeq Zahav purchased Series 5 debentures of the Company. The par value balance held by Bezeq Zahav as of December 31, 2012 amounted to NIS 587 million. The debentures are repayable in six equal annual installments in each of the years 2011 to 2016. The interest rate fixed for these debentures is 5.3% per annum. The purchase was made through a loan from the Company which is at the same terms as those of the debentures.

Loans to investees

8.2.2 Breakdown of loans extended to investees:

	December 31 2012	December 31 2011
	NIS millions	NIS millions
Short term loans and current maturities		
Bezeq Zahav	**183**	181
Pelephone	**222**	327
Bezeq International	**48**	32
Bezeq Online	**12**	6
	465	546
Non-current loans		
Bezeq Zahav	**540**	712
Pelephone	**308**	405
Bezeq International	**160**	128
Bezeq Online	**8**	11
	1,016	1,256
	1,481	1,802

Breakdown of the terms of the loans extended to investees (as presented in the statement of financial position):

	Loan Balance NIS million	Maturity dates	No. of installments	Interest rates
Bezeq Zahav (*)	723	2011-2016	6	5.3%
Pelephone				
	90	2013	1	6%
	440	2013-2020	10	5.7%
Bezeq International				
	128	2012-2016	5	5.1%
	80	2013-2017	5	4.68%-4.7%
Bezeq Online				
	11	2012-2014	3	4%
	9	2013-2015	3	4.2%-4.68%
	1,481			

(*) This loan is linked to the CPI. For information pertaining to the loan provided by the Company to Bezeq Zahav relating to debentures Series 5, see section 8.2.1 above.

8.2.3 For information relating to the loans provided by the Company to DBS, see Note 12 to the consolidated statements, Investees.

8.3. **Agreements for the provision of services**

As the Company and its investees are communications providers, they are engaged in agreements and arrangements for providing and receiving various services in the communications sector, such as:

Transmission agreements, interconnectivity arrangements, billing agreements, various agreements regulating the telecommunications services provided jointly by two companies, maintenance of communications equipment, marketing agreements, purchase agreements for communications equipment and leasing agreements (mainly for communication facilities), partnership agreements and website advertising of subsidiaries, management service agreement, etc.

The terms of the foregoing service agreements are fixed according to accepted market prices for similar type of services.

In addition to the foregoing agreements, Bezeq International has a debt to the Company for its share in the Group’s managers’ remuneration plan.

Breakdown of the transactions and balances included in the Company's books:

	For year ended December 31		
	2012	**2011**	**2010**
	NIS million	**NIS million**	**NIS million**
Transactions			
Revenue			
Pelephone	**162**	158	160
Bezeq International	**120**	113	110
D.B.S.	**6**	3	1
Other	**3**	3	2
Total	**291**	277	273

	For year ended December 31		
	2012	2011	2010
	NIS million	NIS million	NIS million
Expenses			
Pelephone	**80**	82	241
Bezeq International	**13**	21	11
D.B.S.	**-**	-	5
Other	**10**	13	6
Total	**103**	116	263

	December 31	December 31
	2012	2011
	NIS million	NIS million
Balance		
Pelephone	**19**	14
Bezeq International	**7**	16
D.B.S.	**31**	53
Other	**(2)**	(4)
Total	**55**	79

For more information, see Note 29 to the consolidated statements, Transactions with interested and related parties

8.4. **Dividends**

For further information relating to dividends that the Company received from its investees see Note 12.2 to the consolidated financial statements.

9. <u>Contingent Liabilities</u>

During the normal course of business, various lawsuits were filed against the Company and it faces various pending proceedings (in this section: "Litigations").

In the opinion of the Company, based on, *inter alia*, the legal opinions concerning the chances of the litigations succeeding, appropriate provisions are included in the financial statements in the amount of NIS 139 million, where required to cover the exposure resulting from these litigations.

The Company's management believes that amount of additional exposure (beyond the foregoing amount) as at December 31, 2012 for claims filed against the Company on various issues and which are not expected to succeed amounted to a total of NIS 2.2 billion. Out of this amount, an amount of NIS 361 million are for claims filed against the Company and other related companies, without specifying the proportion of the amount claimed from each defendant. In addition, there is further exposure in the amount of NIS 41 million for a claim, the success of which, at this stage, cannot be assessed. All the foregoing amounts are linked to the CPI and are before the addition of interest.

Furthermore, petitions to recognize claims as class actions have also been filed against Group companies, for which the Group has additional exposure, beyond the foregoing, due to the fact that no exact amount is noted in these claims.

Subsequent to the reporting date, exposures for claims amounting to NIS 94 million have ended.

For further information concerning contingent liabilities, see Note 17 to the consolidated financial statements, Contingent Liabilities

10. <u>Subsequent events</u>

1. On March 3, 2013 the board of directors of Pelephone decided on the distribution of a dividend in the amount of NIS 287 million in May 2013.

2. On March 5, 2013 the board of directors of Bezeq International decided on the distribution of a dividend in the amount of NIS 84 million in May 2013.

Exhibit 99.5

DBS Satellite Services (1998) Ltd.

Financial Statements

For The Year Ended December 31, 2012

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.

Contents

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Auditors' Report to the Shareholders of
D.B.S Satellite Services (1998) Ltd.

We have audited the accompanying statements of financial position of D.B.S Satellite Services (1998) Ltd. (hereinafter "the Company") as of December 31, 2012 and 2011 and the statement of operations, statements of comprehensive loss, statements of changes in deficit and statements of cash flows, for each of the three years, the last of which ended December 31, 2012. These financial statements are the responsibility of the Company's Board of Directors and of its Management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in Israel, including standards prescribed by the Auditors Regulations (Manner of Auditor's Performance) - 1973. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors and by Management of the Company, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2012 and 2011 and its results of operations, statements of comprehensive loss ,changes in its deficit and its cash flows, for each of the three years, the last of which ended December 31, 2012, in accordance with International Financial Reporting Standards (IFRS) and in accordance with the Securities Regulations (Annual Financial Statements) - 2010.

Without qualifying our opinion, we draw attention to Note 5 with respect to the financial position of the Company.

Somekh Chaikin
Certified Public Accountants (Isr.)

March 5, 2013

Statement of Financial Position at December 31

	Note	2012 NIS thousands	2011 NIS thousands
Assets			
Cash and cash equivalents		-	13,325
Trade receivables	6	**163,043**	159,596
Other receivables	6	**1,674**	8,020
Total current assets		**164,717**	180,941
Broadcasting rights, net of rights exercised	7	**377,349**	330,572
Property, plant and equipment, net	8	**745,365**	675,954
Intangible assets, net	9	**99,864**	94,227
Total non-current assets		**1,222,578**	1,100,753
Total assets		**1,387,295**	1,281,694

The attached notes are an integral part of these financial statements

Statement of Financial Position at December 31

	Note	2012 NIS thousands	2011 NIS thousands
Liabilities			
Borrowings from banks	10	**69,322**	85,998
Current maturities for debentures	14	**174,305**	57,494
Trade payables and service providers	11	**396,572**	409,298
Other payables	12	**172,412**	167,060*
Provisions	13	**6,200**	40,647*
Total current liabilities		**818,811**	760,497
Debentures	14	**1,364,840**	1,120,806
Bank loans	10	**-**	337,679
Loans from shareholders	15	**3,085,742**	2,677,916
Long-term trade payables	16	**73,899**	28,907*
Employee benefits	17	**5,837**	6,171
Total non-current liabilities		**4,530,318**	4,171,479
Total liabilities		**5,349,129**	4,931,976
Capital deficit			
Share capital	21	**29**	29
Share premium		**85,557**	85,557
Option warrants		**48,219**	48,219
Capital reserves		**1,537,271**	1,537,271
Capital reserve for share-based payments		**10,280**	10,280
Retained loss		**(5,643,190)**	(5,331,638)
Total capital deficit		**(3,961,834)**	(3,650,282)
Total liabilities and capital		**1,387,295**	1,281,694

David Efrati	**Ron Eilon**	**Micky Neiman**
Authorized to sign on behalf of the chairman of the board	CEO	CFO

(See Note 31).

Date of approval of the financial statements: March 5, 2013

* Reclassified – see Note 2.G regarding a change in classification.

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

Statements of Income for the Year Ended December 31

	Note	2012 NIS thousands	2011 NIS thousands	2010 NIS thousands
Revenues		**1,635,994**	1,618,809	1,582,930
Cost of revenues	22	**1,067,087**	1,028,168	1,128,848
Gross profit		**568,907**	590,641	454,082
Sales and marketing expenses	23	**166,274**	152,737	143,202
General administrative expenses	24	**149,884**	143,036	132,561
Operating profit		**252,749**	294,868	178,319
Financing expenses		**155,431**	168,991	181,584
Financing income		**(1,859)**	(23,163)	(9,313)
Financing expenses for shareholder loans		**407,826**	377,529	318,499
Financing expenses, net	25	**561,398**	523,357	490,770
Loss before income tax		**(308,649)**	(228,489)	(312,451)
Income tax	26	**1,668**	1,128	1,188
Loss for the period		**(310,317)**	(229,617)	(313,639)
Basic and diluted loss per share (in NIS)		**10,380**	7,681	10,491

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

Statements of Comprehensive Income for the Year Ended December 31

	Note	2012 NIS thousands	2011 NIS thousands	2010 NIS thousands
Loss for the period		**(310,317)**	(229,617)	(313,639)
Other items of comprehensive income:				
Actuarial gains (losses) from a defined benefit plan	17	**(1,235)**	(80)	(1,535)
Other comprehensive profit (loss) for the year		**(1,235)**	(80)	(1,535)
Total comprehensive loss for the year		**(311,552)**	(229,697)	(315,174)

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

Statements of Changes in Equity for the Year Ended December 31

	Note	Share capital NIS thousands	Share premium NIS thousands	Option warrants NIS thousands	Capital reserve NIS thousands	Capital reserve for share-based payments NIS thousands	Accrued deficit NIS thousands	Total NIS thousands
Balance at January 1, 2012		29	85,557	48,219	1,537,271	10,280	5,331,638))	(3,650,282)
Total comprehensive loss for the year								
Loss for the year		-	-	-	-	-	**(310,317)**	**(310,317)**
Other comprehensive loss for the year		-	-	-	-	-	**(1,235)**	**(1,235)**
Total comprehensive loss for the year		-	-	-	-	-	**(311,552)**	**(311,552)**
Balance at December 31, 2012		**29**	**85,557**	**48,219**	**1,537,271**	**10,280**	**(5,643,190)**	**(3,961,834)**
Balance at January 1, 2011		29	85,557	48,219	1,537,271	9,391	(5,101,941)	(3,421,474)
Total comprehensive loss for the year								
Loss for year		-	-	-	-	-	(229,617)	(229,617)
Other comprehensive loss for the year		-	-	-	-	-	(80)	(80)
Total comprehensive loss for the year		-	-	-	-	-	(229,697)	(229,697)
Transactions with owners recognized directly in equity								
Share-based payments	18	-	-	-	-	889	-	889
Balance at December 31, 2011		29	85,557	48,219	1,537,271	10,280	(5,331,638)	(3,650,282)

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

Statements of Changes in Equity for the Year Ended December 31

	Note	Share capital	Share premium	Option warrants	Capital reserve	Capital reserve for share-based payments	Accrued deficit	Total
		NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Balance at January 1, 2010		29	85,557	48,219	1,537,271	6,931	(4,786,767)	(3,108,760)
Total comprehensive loss for the year								
Loss for the year		-	-	-	-	-	(313,639)	(313,639)
Other comprehensive loss for the year		-	-	-	-	-	(1,535)	(1,535)
Total comprehensive loss for the year		-	-	-	-	-	(315,174)	(315,174)
Transactions with owners recognized directly in equity								
Share-based payments	18	-	-	-	-	2,460	-	2,460
Balance at December 31, 2010		29	85,557	48,219	1,537,271	9,391	(5,101,941)	(3,421,474)

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

Statements of Cash Flows for the Year Ended December 31

	2012	2011	2010
	NIS thousands	NIS thousands	NIS thousands
Cash flows from operating activities			
Loss for the period	**(310,317)**	(229,617)	(313,639)
Adjustments:			
Depreciation and amortization	**248,250**	276,393	284,732
Financing expenses, net	**548,997**	519,716	465,562
Loss (profit) from sale of property, plant and equipment	**504**	(515)	(35)
Share-based payments		889	2,460
Income tax expenses	**1,668**	1,128	1,188
Change in trade receivables	**(3,447)**	9,251	(8,695)
Change in other receivables	**6,346**	3,130	363
Change in broadcasting rights, net of rights exercised	**(46,777)**	(26,082)	(19,724)
Change in payables and other liabilities	**(24,271)**	(39,411)	80,928
Change in employee benefits	**(1,569)**	(605)	(438)
	729,701	743,894	806,341
Income tax paid	**(1,337)**	(1,128)	(1,188)
Net cash from operating activities	**418,047**	513,149	491,514
Cash flows from investment activities			
Proceeds from sale of property, plant and equipment	**471**	**747**	1,589
Purchase of property, plant and equipment	**(240,686)**	**(207,741)**	(226,728)
Payments for programs and licenses	**(43,531)**	**(32,181)**	(14,897)
Payments for subscriber acquisition	**-**	**(24,414)**	(36,756)
Net cash used for investment activities	**(283,746)**	**(263,589)**	(276,792)

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

Statements of Cash Flows for the Year Ended December 31 (contd.)

	2012	2011	2010
	NIS thousands	NIS thousands	NIS thousands
Cash flows from finance activities			
Repayment of loans from institutions	-	-	(115,731)
Bank loans received	-	-	255,000
Repayment of bank loans	**(423,235)**	(97,277)	(580,718)
Repayment of debentures	**(58,211)**	(57,271)	(55,020)
Short-term bank credit, net	**66,046**	(85,294)	41,232
Payment for finance lease obligation	**(1,554)**	(768)	-
Interest paid	**(125,674)**	(114,178)	(203,444)
Issue of debentures, net	**395,002**	118,553	443,959
Net cash used for finance activities	**(147,626)**	(236,235)	(214,722)
Decrease in cash and cash equivalents	**(13,325)**	13,325	-
Cash and cash equivalents at beginning of period	**13,325**	-	-
Cash and cash equivalents at end of period	-	13,325	-

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

NOTE 1 – GENERAL

A. Reporting entity

DBS Satellite Services (1998) Ltd. ("the Company") was incorporated in Israel on December 2, 1998 The Company holds 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 to, *inter alia*, the Communications (Telecommunications and Broadcasts) Law 1982 ("the Communications Law") and the regulations and rules promulgated thereunder, and to the terms of the License.

Pursuant to its license Bezeq The Israel Telecommunication Corporation Limited ("Bezeq"), is required to maintain structural separation between it and its subsidiaries, and between it and the Company. In addition, the licenses of the Company and Bezeq impose restrictions on joint marketing of services (service bundles).

In 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, 1988) between the Company and Bezeq by exercising the options held by Bezeq in the Company, subject to certain conditions, and ruled against the merger.

In October 2012 the Antitrust Authority notified the Company that in its opinion cooperation between the Company and between Bezeq in the marketing of a joint service bundle constitutes cooperation between (potential) competitors in a competitive arena (as a result of the above-mentioned ruling handed down by the Supreme Court) verging on a cartel arrangement (even if it complies with the terms of the broadcasting license) requiring exemption or approval under the Antitrust Law, and the Commissioner does not intend to grant an exemption from the need to obtain approval for such an arrangement.

The Company believes that as a result of the development of competition between the telecommunications groups and the increasing importance of providing comprehensive communications services, if the restrictions on Bezeq's control of the Company and on Bezeq's cooperation with it remain intact, the adverse effect of these restrictions on the Company's expenses is liable to increase.

NOTE 2 - BASIS OF PREPARATION

A. Definitions

In these financial statements -

(1) The Company: DBS Satellite Services (1998) Ltd.

(2) Related party: As defined in IAS 24, *Related Party Disclosures*

(3) Interested parties: As defined in paragraph (1) of the definition of an "interested party" in section 1 of the Securities Law, 1968

B. Statement of compliance

These financial statements have been prepared in conformity with International Financial Reporting Standards (IFRS) and with the provisions of the Israeli Securities Regulations (Annual Financial Statements), 2010.

NOTE 2 - BASIS OF PREPARATION (CONTD.)

The Company adopted IFRS for the first time in 2006 and so the date for the transition to IFRS was set as January 1, 2005 (“the IFRS Transition Date”).

The financial statements were approved by the Board of Directors on March 5, 2013.

C. Functional and presentation currency

These financial statements are presented in NIS, which is the Company’s functional currency, and have been rounded to the nearest thousand. The NIS is the currency that represents the principal economic environment in which the Company operates.

D. Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for the following assets and liabilities: derivative financial instruments, shareholder loans, provisions and liabilities for employee benefits. For further information regarding the way in which these assets and liabilities are measured, see Note 3 - *Significant Accounting Policies*. The methods used to measure fair value are described in Note 4 – *Determination of Fair Value*.

The value of non-monetary assets and equity items that were measured on the historical cost basis was adjusted to changes in the CPI until December 31, 2003, since until that date Israel was considered a hyperinflationary economy.

E. Operating cycle

The Company's operating cycle is no more than one year. Therefore, current assets and current liabilities include items intended and expected to be realized within one year from the date of the financial statements.

F. Use of estimates and judgment

The preparation of the 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 preparation of accounting estimates used in the preparation of the Company’s financial statements requires management to make assumptions regarding circumstances and events that involve considerable uncertainty. The Company’s management prepares the estimates on the basis of past experience, various facts, external circumstances, and reasonable assumptions according to the pertinent circumstances of each estimate. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future affected period.

NOTE 2 - BASIS OF PREPARATION (CONTD.)

Following is information about significant estimates and judgments made by management while implementing accounting policies and which have a material effect on the financial statements:

Estimates	Principal assumptions	Possible consequences	Reference
Useful life	The useful life of groups of property plant and equipment, intangible assets and broadcasting rights	Recording depreciation expenses in the ledgers.	Note 3 (B); Note 3 (C); Note 3 (D).
Provisions and contingent liabilities	Assessment of the changes of actions against the Company and measurement of the potential liabilities for the actions.	Cancellation or creation of a provision for an action and recognition of revenues/expenses respectively.	Note 13 and Note 20.

G. Reclassification

Insignificant amounts in the comparative figures have been reclassified in the relevant item in the financial statements.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

A. Foreign currency transactions

Transactions in foreign currency are translated into the functional currency of the Company at the exchange rate on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies on the reporting date are retranslated to the functional currency of the exchange rate on that date.

B. Broadcasting rights

Broadcasting rights are stated at cost, net of rights exercised.
The cost of broadcasting rights includes the amounts paid to the content provider plus direct costs incurred for adjustment of the rights to the broadcast. Broadcasting rights are amortized on the basis of actual broadcasts from the total number of expected broadcasts in accordance with management estimates, or permitted under the agreement (the part that has not been amortized by the end of the agreement is amortized in full upon termination of the agreement), or in a straight line according to the period of the rights agreement or its economic life, the shorter of the two. The net adjustment of the broadcasting rights is presented as an adjustment of earnings as part of ongoing operations in the statement of cash flows.

C. Property, plant and equipment

(1) Recognition and measurement

The Company has opted to measure items of property, plant and equipment at cost less accumulated depreciation and accumulated impairment losses.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

The cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labor, and any other costs directly attributable to bringing the assets to the site and condition as intended by management. The cost of software that is integral to the functionality of the related equipment is recognized as part of the cost of that equipment.

When major parts of items of property, plant and equipment (including costs of major periodic inspections) have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

(2) Subsequent costs

The cost of replacing part of an item of property, plant and equipment is recognized as part of the carrying amount of said item if it is probable that the future economic benefits embodied in the item will flow to the Company and the cost of the item can be reliably measured. The carrying amount of the replaced part is derecognized. Ongoing maintenance costs are recognized in the statement of income when they are created.

(3) Depreciation

Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment.

	Years
Broadcasting and receiving equipment	6.67;5
Installation costs *	1-3,15
Digital satellite decoders	4,5,6,8
Office furniture and equipment	6.67-14.2
Computers	3, 5

* The costs of installation in apartments are depreciated over the period of enjoyment expected from the benefits claimed for the installation.

Leasehold improvements are depreciated over the shorter of the rental period or the expected useful life of the improvements.

D. Intangible assets

(1) Acquisition of subscribers

The Company discounts the direct sale commissions paid to marketers and salespersons for sales of services to subscribers who have signed long-term commitments with the Company and recognizes these costs as an intangible asset. When the subscriber terminates the agreement period, the balance of the asset is amortized immediately. For customers who are out of contract the Company immediately amortizes the subscriber acquisition costs on the income statement. The Company stopped discounting the sales commissions at the end of 2011 when the agreement period was canceled by legislation.

(2) Software

Standalone software that adds functionality to the hardware is classified as an intangible asset.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(3) Development

Development activities involve a plan for the production of products for new processes in order to bring about substantial improvements in existing products or processes. Development expenditure is capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable and the Company intends to and has sufficient resources to complete development and to use or sell the asset. The costs recognized as an intangible asset include the cost of materials, direct labor and overhead costs that are directly attributable to preparing the asset for its intended use and capitalized credit costs. Other development expenditure is recognized in profit or loss as incurred.

In later periods capitalized development expenditure is measured at cost less accumulated amortization and accumulated impairment losses.

(4) Amortization

Amortization of intangible assets is recognized in the statement of income on a straight-line basis over the estimated useful life of the intangible assets, from the date on which the assets are available for use.

Estimated useful lives for the current and comparative periods are as follows:

	Years
Software	3,5
Subscriber acquisition costs*	1-3
Capitalized development costs	1-5

* Pursuant to the terms and conditions of contracts with the subscribers.

E. Financial instruments

(1) Non-derivative financial assets

Non-derivative financial assets comprise trade and other receivables, cash and cash equivalents.

(A) **Initial recognition of non-derivative financial assets**

A financial asset is recognized when the Company accepts the contractual terms of the instrument, in other words on the date on which the Company fulfilled its obligations under the contract.

Financial instruments are derecognized when the contractual rights of the Company to the cash flows from the asset expire, or the Company transfers the rights to receive the cash flows arising from the financial asset in a transaction where all the risks and benefits of ownership of the financial asset are transferred. Financial assets are sold in regular way sales on the trade date, meaning on the date on which the Company undertook to sell the asset.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(C) **Classification of financial assets**

The Company classifies financial assets as follows:

Cash and cash equivalents

Cash includes immediately usable cash balances and on-demand deposits. Cash equivalents include short-term investments (where the period between the original deposit date and the redemption date is up to 3 months) of a high level of liquidity which can easily be converted into known amounts of cash and which are exposed to insignificant risk of changes in value.

Trade receivables

Trade receivables are financial assets with payments which are fixed or which can be determined that are not traded on an active market.

(2) Non-derivative financial liabilities

Non-derivative financial instruments include bank overdrafts, bank loans and credit, loans from shareholders and other credit providers, finance lease liabilities, trade payables and other payables.

(A) **Initial recognition of financial liabilities**

Debt instruments are recognized initially on the date that they are created. Financial liabilities are initially recognized at fair value plus all the attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest method.

(B) **De-recognition of financial instruments**

Financial liabilities are derecognized when the obligation of the Company, as specified in the agreement, expires or when it is discharged or canceled.

(C) **Change in terms of debt instruments**

An exchange of debt instruments having substantially different terms, between an existing borrower and lender are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability at fair value. Furthermore, a substantial modification of the terms of the existing financial liability or part of it, is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(C) **Change in terms of debt instruments** (contd.)

The terms are substantially different if the discounted present value of the cash flows according to the new terms, including any commissions paid, less any commissions received and discounted using the original effective interest rate, is different by at least ten percent from the discounted present value of the remaining cash flows of the original financial liability.

In addition to the aforesaid quantitative criterion, the Company examines, inter alia, whether there have been changes also in various economic parameters inherent in the exchanged debt instruments, therefore exchanges of CPI-linked debt instruments with unlinked instruments are considered exchanges with substantially different terms even if they do not meet the aforementioned quantitative criterion.

(D) **Offsetting financial instruments**

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when the Company currently has a legally enforceable right to offset the recognized amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

(3) Derivative financial instruments

The Company holds derivative financial instruments to hedge its foreign currency risk exposure. The financial instruments comprise mainly forward transactions.

Derivative financial instruments are recognized initially at fair value; attributable transaction costs are recognized in profit or loss as incurred. Subsequent to initial recognition, derivatives are measured at fair value. Hedge accounting is not applied to derivative instruments that economically hedge financial assets and liabilities denominated in foreign currencies. Changes in the fair value of these derivatives are recognized in profit or loss, as part of the profits or losses from foreign currency.

(4) CPI-linked assets and liabilities that are not measured at fair value

The value of CPI-linked financial assets and liabilities, which are not measured at fair value, is re-measured every period in accordance with the actual increase in the CPI.

F. Impairment

(1) Financial assets

A financial asset is tested for impairment when objective evidence indicates that one or more events had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. All impairment losses are recognized in profit or loss.

(2) Non-monetary assets

The carrying amounts of the Company’s non-monetary assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the recoverable amount of the asset is estimated. The Company estimates the recoverable amount if there are indications of impairment.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

For the purpose of impairment testing, the assets are grouped together into the smallest group of assets that generates cash from continuing use that are largely independent of other assets or groups of assets ("cash-generating unit").

An impairment loss is recognized if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount and is recognized in profit or loss.

G. Employee benefits

(1) Post-employment benefits

The Company has a number of post-employment benefit plans. The plans are usually financed by deposits with insurance companies and they are classified as defined contribution plans and defined benefit plans.

(A) Defined contribution plans

The Company's obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense in the statement of income in the periods during which services are rendered by employees.

(B) Defined benefit plans

The Company's net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods. That benefit is presented at its present value less the fair value of any plan assets. The discount rate is the yield at the reporting date on government bonds denominated in the same currency that have maturity dates approximating the terms of the Company's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

When the calculation results in an asset for the Company, an asset is recognized up to the net present value of economic benefits available in the form of a refund from the plan or a reduction in future contributions to the plan. An economic benefit in the form of refunds or reduction in future payments will be considered to be available when it can be exercised during the life of the plan or after settlement of the obligation.

When the minimum contribution requirement includes an obligation to pay additional amounts for services that were provided in the past, the Company recognizes an additional obligation (increases the net liability or decreases the net asset), if such amounts are not available as an economic benefit in the form of a refund from the plan or the reduction of future contributions.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognized as an expense in profit or loss on a straight-line basis over the average period until the benefits vest. If the benefits vest immediately, the expense is recognized immediately in profit or loss.

The Company has decided to recognize immediately, directly in retained earnings through other comprehensive income, all actuarial gains and losses arising from defined benefit plans.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

The Company offsets an asset relating to one benefit plan from the liability relating to another benefit plan only when there is a legally enforceable right to use the surplus of one plan to settle the obligation in respect of the other plans, and there is intent to settle the obligation on a net basis or to simultaneously realize the surplus of one plan and settle the obligation in the other plan.

(2) Short-term employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided or upon the actual absence of the employee when the benefit is not accumulated (such as maternity leave).

A liability is recognized for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Company has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably. In the statement of financial position the employee benefits are classified as current benefits or as non-current benefits according to the time the liability is due to be settled.

(3) Other long-term employee benefits

The Company's net obligation in respect of long-term employee benefits other than post-employment plans is the amount of future benefit that employees have earned in return for their service in the current and prior periods. The benefit is discounted to its present value. The discount rate is the yield at the reporting date on government bonds denominated in the same currency that have maturity dates approximating the terms of the Company's obligations. The calculation is performed using the projected unit credit method. Any actuarial gains or losses are recognized in the statement of income in the period in which they arise.

(4) Share-based payments

The grant date fair value of share-based payment awards granted to employees is recognized as a salary expense, with a corresponding increase in equity, over the period that the employees become unconditionally entitled to the awards. The Company has decided to present the increase in capital in a capital fund for share-based payments. The amount recognized as an expense in respect of share-based payment awards that are conditional upon meeting service and non-market performance conditions is adjusted to reflect the number of awards that are expected to vest.

Share-based payment arrangements in which the parent company grants to the employees of the Company rights to its equity instruments are accounted for by the Company as equity-settled share-based payment transactions, meaning that the fair value of the grant is recognized directly in equity, as set out above.

H. Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

Legal claims

A provision for claims is recognized if, as a result of a past event, the Company has a present legal or constructive obligation and it is more likely than not that an outflow of economic benefits will be required to settle the obligation and the amount of obligation can be estimated reliably.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

I. Revenues

(1) Revenues from services rendered are recognized in the statement of income proportionately over the term of the agreement or upon providing the service.

(2) Income from rental of digital satellite decoders is attributed proportionately over the term of the agreement.

(3) Receipts from customers for the installation of terminal equipment which do not provide the customers with separate value are recognized as income in the statement of income over the period of enjoyment of the economic benefits.

(4) The Company charges a deposit for the digital satellite decoders rented by its customers. The customers are entitled to receive a proportional refund of the deposit upon termination of the agreement, according to the terms in the agreement. The revenues from deposit deductions are attributed to the statement of income, according to the terms of the agreements with the customers.

(5) Commissions: When the Company acts in the capacity of an agent rather than as the principal in a transaction, the income recognized is the net amount of commission.

J. Income tax expenses

Income tax expense comprises current and deferred taxes. Current and deferred taxes are recognized in the statement of income, or are recognized in other comprehensive income if they relate to items recognized in other comprehensive income.

Current tax is the expected tax payable (or receivable) on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date.

K. Leased assets

Leases where the Company bears most of the risks and rewards are classified as financing leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of future minimum lease payments. After initial recognition, the asset is treated in accordance with the accounting policies used for the asset. Other leases are classified as operating leases; the leased assets are not recognized in the Company's Statement of Financial Position.

Payments made under operating leases are recognized in the statements of income on a straight-line basis over the term of the lease. Minimum lease payments made under financing leases are apportioned between financing expenses and amortization of the outstanding liability.

At the start of the arrangement or upon re-examination, the Company determines whether an arrangement is a lease or if it contains a lease. A specific asset is subject to a lease if the existence of the arrangement depends on the use of a specific asset or assets. An arrangement transfers the right to use the asset if it transfers the right to control the use of the asset. Payments and other considerations required under the arrangement are separated at the beginning of the arrangement or upon the re-examination for the lease payments and other elements based on their relative fair values.

L. Loss per share

Basic loss per share is calculated by dividing the loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the year.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

M. Financing income and expenses

Financing income comprises interest income on funds invested, foreign currency gains and gains on derivative instruments that are recognized in the statement of income. Interest income is recognized as accrued using the effective interest method.

Financing expenses comprise interest expense and linkage differentials on borrowings, impairment losses of financial assets and losses on derivative instruments recognized in the statement of income. All borrowing costs are recognized in profit or loss using the effective interest method.

The statements of cash flows present interest paid as cash flows from financing operations.

N. Transactions with a controlling shareholder

Assets and liabilities included in a transaction with a controlling shareholder are measured at fair value on the date of the transaction.

As this is a capital transaction, the differences between the fair value and the proceeds from the transaction are attributed to equity.

O. New standards and interpretations not yet adopted

(1) The Company will apply the following standards and amendments to the standards (“the New Standards”) from January 1, 2013. The Company believes that the first application of these standards will not have a material effect on its financial statements:

IFRS 13 - *Fair Value Measurement*.

IAS 19 - *Employee Benefits*.

An amendment to IFRS 7 - *Financial Instruments: Disclosures* regarding rules for offsetting assets and liabilities.

(2) IFRS 9 (2010), *Financial Instruments* (“the Standard”)

The Standard will be applied for annual periods beginning on or after January 1, 2015. It may be applied earlier, subject to conditions to be determined. The Company is examining the effects of adopting the Standard on the financial statements.

(3) Amendment to IAS 32 *Financial Instruments: Presentation* (“the Amendment”)

The Amendment to IAS 32 will be implemented retrospectively in respect of annual periods commencing January 1, 2014 or thereafter. Early implementation is possible subject to conditions determined. The Company is examining the effects of adopting the Amendments on the financial statements.

NOTE 4 – DETERMINATION OF FAIR VALUE

A number of the Company's accounting policies and disclosures require the determination of fair value for both monetary and non-monetary assets and liabilities. Fair values have been determined for measurement and / or disclosure purposes based on the following methods. Further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

A. Derivatives

The fair value of forward exchange contracts is based on their quoted price.

B. Non-derivative financial liabilities

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted by the market interest rate at the reporting date.

NOTE 5 – THE FINANCIAL POSITION OF THE COMPANY

A. Since commencing its operations, the Company has accumulated considerable losses. The Company's losses for 2012 and 2011 amounted to NIS 310 million and NIS 230 million, respectively. As a result of these losses, the Company's capital deficit and working capital deficit at December 31, 2012 amounted to NIS 3,962 million and NIS 654 million, respectively.

B. 1. In May 2012 a bond was signed by the Company and a number of institutional entities ("the Lenders") whereby the Lenders would extend a loan to the Company in the sum of NIS 392 million ("the Bond"). The entire proceeds of the funds raised would be used to repay the long-term bank credit which the Company had obtained from the banks. The Company received the loan in July 2012 after compliance with the conditions precedent determined in the debentures.

In July 2012 the Company issued another series of debentures (Series B) by way of expansion of the series, in the sum of NIS 10 million, the proceeds of which, together with the funds from the loan for the Bond, were used in full repayment of the long-term bank credit. For details of the debentures, see Note 14.

2. In October 2012, Standard & Poor's Maalot confirmed a rating of ilA- for the Company and for all its debentures with stable outlook.

3. At December 31, 2012, the Company is in compliance with the financial covenants under the financing agreement and the debentures. See Note 27 for information about compliance with the covenants.

4. The Company's management believes that the financial resources available to it, which include the working capital deficit and the scope of potential capital to be raised, will be sufficient for the Company's operating needs in the coming year based on the forecasted cash flow 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.

NOTE 6 – TRADE AND OTHER RECEIVABLES

	December 31, 2012	December 31, 2011
	NIS thousands	NIS thousands
Trade receivables (1)		
Outstanding debts	**36,185**	34,395
Credit companies	**134,368**	132,576
Less provision for doubtful debts	**(7,510)**	(7,375)
	163,043	159,596
Other receivables (1)		
Prepaid expenses	**420**	853
Pledged deposits	**1,254**	7,167
Others	**1,674**	8,020
(1)Including trade and other receivables that are related and interested parties	**2,326**	**1,944**

For further information about related and interested parties, see Note 30 – *Related and interested parties*. For the Company's exposure to currency and liquidity risks, see Note 29 – *Financial instruments*.

NOTE 7 –BROADCASTING RIGHTS, NET OF RIGHTS EXERCISED

	December 31, 2012	December 31, 2011
	NIS thousands	NIS thousands
Cost	**758,847**	621,199
Less - rights exercised	**381,498**	290,627
	377,349	330,572

NOTE 8 – PROPERTY, PLANT AND EQUIPMENT, NET

A. Composition

	Broadcasting and reception equipment	Discounted installation costs	Digital satellite converters	Office furniture and equipment (including computers)	Leasehold improvements	Total
	NIS thousands					
Cost						
Balance at January 1, 2011	237,123	1,554,996*	1,643,899*	94,642	45,644	3,576,304
Additions during the year	6,980	77,449	127,461	13,731	1,338	226,959
Disposals during the year	-	(158)	(502)	(839)	-	(1,499)
Balance at December 31, 2011	244,103	1,632,287*	1,770,858*	107,534	46,982	3,801,764
Additions during the year	**9,862**	**89,458**	**158,280**	**15,653**	**3,151**	**276,404**
Disposals during the year	**-**	**(428)**	**(203,250)**	**(184)**	**-**	**(203,862)**
Balance at December 31, 2011	**253,965**	**1,721,317**	**1,725,888**	**123,003**	**50,133**	**3,874,306**
Accumulated depreciation						
Balance at January 1, 2011	198,287	1,301,187*	1,303,673*	64,785	32,484	2,900,416
Additions during the year	13,468	91,505	109,460	10,156	2,072	226,661
Disposals during the year	-	(158)	(291)	(818)	-	(1,267)
Balance at December 31, 2011	211,754	1,392,534*	1,412,842*	74,123	34,557	3,125,810
Additions during the year	**12,053**	**83,644**	**97,826**	**10,448**	**2,047**	**206,018**
Disposals during the year	**-**	**(428)**	**(202,399)**	**(60)**	**-**	**(202,887)**
Balance at December 31, 2012	**223,807**	**1,475,750**	**1,308,269**	**84,511**	**36,604**	**3,128,941**
Carrying amount						
At January 1, 2011	38,836	253,809*	340,226*	29,857	13,160	675,888
At December 31, 2011	32,349	239,753*	350,016*	33,411	12,425	675,954
At December 31, 2012	**30,158**	**245,567**	**417,619**	**38,492**	**13,529**	**745,365**

B. Collateral

See Note 27.

C. Credit acquisitions of property, plant and equipment

In the year ended December 31, 2012, credit for acquisitions of property, plant and equipment increased by NIS 35,718,000 (2011: NIS 19,218,000).

* Reclassified – see Note 2.G regarding a change in classification.

NOTE 9 – INTANGIBLE ASSETS, NET

	Costs of acquisition of subscribers	Software licenses	Total
		NIS thousands	
Cost			
Balance at January 1, 2011	253,754	180,629	434,383
Additions during the year	21,240	39,950	61,190
Balance at December 31, 2011	274,994	220,579	495,573
Additions during the year	**-**	**47,869**	**47,869**
Disposals during the year	**(119,707)**	**-**	**(119,707)**
Balance at December 31, 2012	**155,287**	**268,448**	**423,735**
Accumulated depreciation			
Balance at January 1, 2011	219,436	132,178	351,614
Additions during the year	34,692	15,040	49,732
Balance at December 31, 2011	254,128	147,218	401,346
Additions during the year	**18,903**	**23,329**	**42,232**
Disposals during the year	**(119,707)**		**(119,707)**
Balance at December 31, 2012	**153,324**	**170,547**	**323,871**
Carrying amount			
At January 1, 2011	34,318	48,451	82,769
At January 1, 2012	20,866	73,361	94,227
At December 31, 2012	**1,963**	**97,901**	**99,864**

In the year ended December 31, 2012, credit for intangible asset acquisitions increased by NIS 4,338,000 (2011: NIS 4,595,000).

NOTE 10 - BANK CREDIT

Additional information about the Company's exposure to interest, currency CPI and liquidity risks appears in Note 29.

With respect to collateral and restrictions pertaining to credit and to financial covenants, see Note 27.

	December 31, 2012	December 31, 2011
	NIS thousands	NIS thousands
Short-term credit	**69,322**	441
Current maturities of bank loans	**-**	85,557
Long-term loans from banks	**-**	337,679
	69,322	423,677

NOTE 11 – SUPPLIERS AND SERVICE PROVIDERS

	December 31, 2012	December 31, 2011
	NIS thousands	NIS thousands
Open accounts	**335,436**	363,312
Notes and checks for repayment	**61,136**	45,986
	396,572	409,298
Including related and interested parties suppliers	**89,441**	119,055

For further information about related and interested parties suppliers, see Note 30 – *Related and interested parties*.

For the Company's exposure to currency and liquidity risks for part of the trade balances, see Note 29 – *Financial Instruments*

NOTE 12 – OTHER PAYABLES

	December 31, 2012 NIS thousands	December 31, 2011 NIS thousands
Employees and institutions with respect to wages	**30,366**	30,743
Provisions for vacation and convalescence pay	**10,732**	10,952
Interest payable for debentures	**33,800**	29,839
Deposits from customers, net	**2,411**	4,283
Institutions	**40,227**	39,061
Prepaid income	**23,305**	17,009
Others	**31,571**	35,173
	172,412	167,060

For information about the Company's exposure to currency and liquidity risks for part of the payables balances, see Note 29 – *Financial Instruments*

* Reclassified – see Note 2.G regarding a change in classification.

NOTE 13 - PROVISIONS

	December 31, 2012 NIS thousands
Balance at January 1, 2012	**40,647***
Provisions during the period	**4,301**
Provisions realized during the period	**(31,889)**
Provisions eliminated during the period	**(6,884)**
Effect of time lapse (linkage differentials)	**25**
Balance at December 31, 2012	**6,200**

During the normal course of business, various lawsuits were filed against the Company.

For information about the lawsuits and amounts of the exposure, see Note 20.

* Reclassified – see Note 2.G regarding a change in classification.

NOTE 14 – DEBENTURES

December 31, 2012					
	% of nominal interest and linkage*	Redemption year	Redemption of original par value	Par value	Accounting value
				NIS thousands	
Debenture A	Linked + 8.4%	2012 – 2013 2014 – 2017	8% 17%	471,428	552,006
Debenture B	Linked + 5.85%	2013 – 2017 2018 – 2019	14% 15%	576,621	596,313
2012 Bond	Linked + 6.4%	2013 – 2017 2018 - 2022	8% 12%	392,000	390,826

* Each of the debentures contains a mechanism for reducing and increasing the interest in the event of occurrences stipulated in the deeds of trust and in the debentures.

A. The Company has a series of bonds which were issued to institutional investors in 2007 and were listed on the TACT-institutional system of the Tel Aviv Stock Exchange ("the Debentures (Series A")) pursuant to a deed of trust between the Company and Hermetic Trust (1975) Ltd. ("Trustee A" and "Deed of Trust A"), respectively).

Deed of Trust A stipulates that the Company may register first liens in favor of holders of additional debentures which it might issue and/or add them to liens in favor of the trustee without agreement from the trustee, provided that the ratio between the Company's total debt (after issue of the above debentures and including the proceeds thereof) at the end of the quarter preceding the issue, and its EBITDA in the 12 months ending at the end of the last calendar quarter does not exceed 6.5. Deed of Trust A defines total debt as the Company's debts which are secured by a first lien, unlimited in amount, on all the Company's assets pari passu with the collateral created by the Company in favor of the holders of Debentures (Series A).

Moreover, Deed of Trust A defines various events (such as insolvency proceedings, breach and exercise of liens on most of the Company's assets), which, should they occur after the warning period stipulated in the deed, will allow immediate call for repayment, pursuant to the provisions in the Deed of Trust, and the right to immediate repayment of the bank collateral, or immediate repayment of another series of debentures issued by the Company, if its balance for settlement exceeds the amount set out in the deed.

In order to enable the rating of the Debentures (Series A) the Company undertook to S&P Maalot (and only to it) that it would not make repayment on account of the shareholder loans before the end of the life of the Debentures (Series A).

B. The Company has a series of bonds which were issued to institutional investors in 2010 and were listed on the TACT-institutional system of the Tel Aviv Stock Exchange and expanded in 2011 and in 2012 ("the Debentures (Series B")) pursuant to a deed of trust between the Company and Hermetic Trust (1975) Ltd. ("Trustee B" and "Deed of Trust B"), respectively).

NOTE 14 – DEBENTURES (CONTD.)

B. (contd.)

Deed of Trust B stipulates that the Company may register first liens in favor of holders of additional debentures which it might issue and/or add them to liens in favor of the trustee without agreement from the trustee, provided that the rating does not drop below the rating of the Debentures (Series B) at that time (if their rating does not exceed their start rating) and that the ratio between the Company's total debt (the Company's debts which are secured by a first lien, unlimited in amount, on all the Company's assets pari passu with the collateral created by the Company in favor of the holders of Debentures (Series A), less the sums of cash and monetary deposits at the disposal of the Company) after issue of the above debentures and including the proceeds thereof) at the end of the quarter preceding the issue, and its EBITDA (the Company's total operating profit from ordinary operations, excluding financing expenses and taxes, plus depreciation and amortization and plus exceptional non-recurring provisions and expenses) in the 12 months ending at the end of the last calendar quarter does not exceed 5.7.

At December 31, 2012, the Company was in compliance with the debt/EBITDA ratio set out in Deed of Trust B (the Company's debt/EBITDA ratio at December 31, 2012 was 3.3).

Moreover, Deed of Trust B defines various events (subject to the extension periods set out in the deed), which, should they occur, will allow a call for immediate repayment of the debentures, subject to the provisions in the deed. These events include the events included for this purpose in Deed of Trust A, with certain changes, as well as additional events, among them failure to deliver the financial statements to the trustee on the dates set out in the deed, a decrease in Bezeq’s holding in the Company below the minimum rate stipulated in the deed (provided that the Company remains a private company), a merger with another company (except for with Bezeq or one of its subsidiaries), or the sale of most of its assets under conditions stipulated in the deed, cancellation of the broadcasting license or termination of communications activities, as well as non-compliance with the financial covenants set out in Deed of Trust B whereby the Company's maximum debt/EBITDA ratio should remain 5.7, as defined above.

The Company’s right to distribute dividends and repay them at the expense of shareholder loans is contingent on compliance with the financial covenants, based on the ratio between the total secured debt and its EBITDA (as these are defined in Deed of Trust B, and subject to the amendment period set out in the deed). In respect of repayment of shareholder loans, there is a further restriction whereby the repayment amount will not exceed the Company’s cumulative net profit from the beginning of 2011 onwards, less the Company's financing expenses for shareholder loans and less repayments or distributions.

In July 2012 the Company issued another series of Debentures (Series B) by way of expansion of the series, in the amount of NIS 10 million, the proceeds of which, together with the funds from the loan for the Bond, were used to repay the long-term bank credit in full.

NOTE 14 – DEBENTURES (CONTD.)

C. In May 2012 a bond was signed by the Company and a number of institutional entities ("the Lenders") whereby the Lenders extended a loan to the Company in the sum of NIS 392 million ("the 2012 Bond"). The loan was extended to the Company in July 2012, after compliance with the conditions precedent set out in the 2012 Bond and was used (together with the proceeds of the expansion of the Debentures (Series B) which was implemented in that year) to repay the long-term bank credit which the Company had received from the banks up to that date.

The Bond determines various events (similar to those described in Deed of Trust B), the occurrence of which (sometimes after an extension period) could give rise to a call for immediate repayment of the loan, subject to the provisions of the Bond, including immediate repayment (not initiated by the Company) of another series of debentures issued and/or which might be issued by the Company and/or of debts owed by the Company to a financial institution, subject to the conditions set out in the Bond.

Pursuant to the provisions of the Bond, every quarter the Company shall comply with two financial covenants identical to the financial covenants determined in the amended financing agreement (subject to the cure periods and cure conditions set out in the 2012 Bond) and they are: (A) compliance with the maximum debt/EBITDA ratio which is the ratio between the total debt (the Company's debts to financial institutions, as defined in the Bond), as it is at the end of the relevant quarter, and the Company's EBITDA (which is defined in the 2012 Bond as the Company's total operating profit from ordinary operations (excluding financing expenses and taxes), plus depreciation and amortization and plus expenses which are included in the Investments item in the Company's financial statements at December 31, 2010 (whose classification was changed to expenses because of accounting policy or a directive from an authority) and plus provisions and extraordinary non-recurring expenses in the 12 months ending in the relevant quarter; (B) compliance with the maximum debt/E-C ratio which is the ratio between the total debt, as it is at the end of the relevant quarter and the Company's E-C (which according to the 2012 Bond, is the Company's EBITDA in the 12 months ending at the end of said quarter, less the Company's capex at that time). Capex is the sum of the additions to property, plant and equipment, excluding decreases and depreciation, in the 12-month period ending at the end of said quarter.

At December 31, 2012, the maximum debt/EBITDA ratio pursuant to the 2012 Bond was 5. The Company was in compliance with this covenant (at December 31, 2012 the debt/EBITDA ratio was 3). At December 31, 2012 the maximum debt/(E-C ratio pursuant to the 2012 Bond was 9.5. The Company was in compliance with this covenant (at December 31, 2012 the debt/(E-C ratio was 8.9).

The Bond also stipulated restrictions relating to the distribution of dividends and repayment of shareholder loans similar to the restrictions applicable under Deed of Trust B.

For details of the collateral created by the debentures see Note 27.

Repayment dates of the CPI-linked principal

	December 31, 2012
	NIS thousands
2013	174,305
2014	239,916
2015	239,916
2016	239,916
2017	239,916
2018 and onwards	418,308
	1,552,277

NOTE 15 – LOANS FROM SHAREHOLDERS

A.

		December 31, 2012 NIS thousands	December 31, 2011 NIS thousands
Balance of the loans based on their nominal terms:			
Old shareholder loans (1)	**Linked**	**2,340,213**	2,306,939
New shareholder loans (2)			
Loans granted until April 27, 2003	**Linked and bearing 5.5% interest**	**439,974**	411,047
Loans granted after April 27, 2003	**Linked and bearing 11% interest**	**1,620,177**	1,438,455
		4,400,364	4,156,441
Less – excess of amounts of loans over their fair value upon receipt, after cumulative reduction (at the effective interest rate) (3)		**(1,314,622)**	(1,478,525)
		3,085,742	2,677,916

(1) The loans do not have a repayment date.

(2) The loans extended by some of the Company's shareholders from July 10, 2002 ("the New Shareholder Loans"), have preference over the Old Shareholder Loans. In accordance with the agreement, the New Shareholder Loans will be eligible for full settlement by the Company before any dividend is distributed by the Company and/or the repayment of the Old Shareholder Loans extended to the Company by the shareholders, and subject to the Company's cash flows and liabilities under the agreements with the banks and with some debenture holders. The new loans also have no repayment dates.

(3) The shareholder loans are presented in the financial statements at their fair value when they are received. The fair value of the loans is determined according to the current value of the expected cash flows for repayment of the loans, taking into consideration the dates on which the shareholders may make a first demand for repayment of the loans (in accordance with the restrictions in the agreements with the banks and debenture holders), and the interest rates applicable to loans with similar risks upon receipt of the loans.

In 2007, during the process of rating the Debentures (Series A) with the rating company, the Company undertook to the rating company (and only to it) that it would not make repayment on account of the shareholder loans before the end of the life of the Debentures (Series A).

When a change in the terms of the loans results in a difference of over 10% in the discounted cash flows, the difference between the expected cash flows prior to the change when they are discounted at the interest rate on the date on which the loans are provided, and their discounted value at the interest rate on the date of the change, is recognized in the financing item.

NOTE 15 – LOANS FROM SHAREHOLDERS (CONTD.)

A. (contd.)

The difference between the current value of the new cash flows, when they are discounted at the interest rate on the date of the change, and the old cash flows when they are discounted at the interest rate on the date of the change, is recognized in the capital reserve under equity.

The interest rate on the date of the change is determined in accordance with a professional opinion received by the Company from an external consultant, stating that the interest rate for discounting the interest-free shareholder loans is 15.63%, and the interest rate for discounting the shareholder loans bearing interest at a rate of 5.5% is 15.58%.

When the Debentures (Series B) and the 2012 Bond were issued a restriction was imposed on the Company's right to distribute dividends and repay shareholder loans. . See Note 14. This is not a material change in the terms as set out above, therefore it had no effect on the Company's financial statements.

B. In accordance with the agreement between the Company and its shareholders, the shareholders that provided the new shareholder loans were awarded rights to receive additional shares in the Company or options exercisable into Company shares pro rata to their contributions.

Accordingly, these shareholders were allocated additional shares in the Company and options exercisable into Company's shares. The options are exercisable at any time and at no additional consideration, and they are transferable as though they were shares, subject to the approval of the banks according to the financing agreements.

Exercise of the options allocated to Bezeq and changes in certain holdings in the Company are contingent on regulatory approvals. For the ruling regarding non-approval of the merger between Bezeq and the Company, see Note 1.

NOTE 16 – OTHER LONG-TERM TRADE PAYABLES

	December 31, 2012 NIS thousands	December 31, 2011 NIS thousands
Open debts	**56,900**	18,767
Advance revenues	**16,999**	10,140
Total other long-term trade payables	**73,899**	28,907
Open debts with related parties	**36,923**	16,681

In September 2012 agreements were approved to defer part of the payments owed by the Company to Bezeq and Bezeq International by virtue of the previous debt restructuring arrangements between the Company and between them (NIS 27 million and NIS 6 million, respectively). Under the agreements the payments will be deferred for 18 months and in this period the payments will bear interest of prime + 4%.

* Reclassified – see Note 2.G regarding a change in classification.

NOTE 17 – EMPLOYEE BENEFITS

Employee benefits include post-employment benefits, termination benefits and short-term benefits.

The Company has defined benefit plans for post-employment benefits and it makes contributions to central severance pay funds and appropriate insurance policies.

The Company also has a defined contribution plan for some of its employees who are subject to Section 14 of the Severance Pay Law, 1963.

	December 31, 2012 NIS thousands	December 31, 2011 NIS thousands
Current value of obligations	**10,210**	11,797
Fair value of plan assets	**(4,373)**	(5,626)
Liability recognized for a defined benefit plan	**5,837**	6,171
Other liabilities	**11,962**	14,869
Total employee benefits	**17,799**	21,040
Presented under the following items:		
Other payables	**11,962**	14,869
Long-term employee benefits	**5,837**	6,171
	17,799	21,040

Post-employment benefit plans – defined benefit plan

A. Change in the current value of the defined benefit obligations

	2012 NIS thousands	2011 NIS thousands
Balance of obligation in respect of a defined benefit plan at January 1	**11,797**	11,891
Current service cost	**947**	1,300
Financing expenses with respect to obligations	**420**	544
Actuarial losses (gains) recognized in other comprehensive income	**2,276**	(307)
Benefits paid according to the plan	**(5,230)**	(1,631)
Balance of obligation at end of year	**10,210**	11,797

NOTE 17 – EMPLOYEE BENEFITS (CONTD.)

B. Change in plan assets

	2012	2011
	NIS thousands	NIS thousands
Fair value of plan assets at January 1	**5,626**	5,195
Amounts deposited in the plan	**945**	649
Expected return on plan assets	**193**	256
Actuarial gains (losses) recognized in other comprehensive income	**1,041**	(387)
Benefits paid according to the plan	**(3,432)**	(87)
Fair value of plan assets at end of year	**4,373**	5,626

C. Expense recognized in profit or loss

	2012	2011	2010
	NIS thousands	NIS thousands	NIS thousands
Current service cost	**947**	1,300	1,346
Interest for obligation	**420**	544	650
Expected return on plan assets	**(193)**	(256)	(353)
	1,174	1,588	1,643

The expense is included in the following items in the statement of income:

	2012	2011	2010
	NIS thousands	NIS thousands	NIS thousands
Cost of sales	**520**	715	738
Sales and marketing expenses	**324**	442	460
General and administrative expenses	**103**	143	148
	947	1,300	1,346

NOTE 17 – EMPLOYEE BENEFITS (CONTD.)

D. Actuarial gains and losses recognized directly in other comprehensive income

	2012	2011	2010
	NIS thousands	NIS thousands	NIS thousands
Amount accrued at January 1	**4,123**	4,043	2,508
Amount recognized in the period	**1,235**	80	1,535
Amount accrued at December 31	**5,358**	4,123	4,043

E. Main actuarial assumptions

	2012	2011	2010
	%	%	%
Discount rate at December 31	0.6	1.85	1.7
Future salary increases	2	2	2

Assumptions regarding future mortality rate are based on published statistics and mortality tables.

The expected long-term yield rate on the assets is 1.85%. This rate is based on the asset portfolio as a whole and not on the yield of the separate asset groups. The return is based exclusively on historical returns, without adjustments.

F. Historical information

	2012	2011	2010
	NIS thousands	NIS thousands	NIS thousands
Present value of the defined benefit obligation	**10,210**	11,797	11,891
Fair value of plan assets	**(4,373)**	(5,626)	(5,195)
Deficit in the plan	**5,837**	6,171	6,696

G. Post-employment benefit plans – defined contribution plan

	Year ended December 31,		
	2012	2011	2010
	NIS thousands	NIS thousands	NIS thousands
Amount recognized as an expense in respect of a defined deposit plan	**12,349**	11,771	9,526

NOTE 18 – SHARE-BASED PAYMENTS

In September 2008, 4,250,000 options of Bezeq were allocated to the CEO of the Company. The options are exercisable into Bezeq shares at an exercise price of NIS 5.24 per option (the exercise price at the allocation date, adjusted to distribution of dividends by Bezeq as from the allocation date). The fair value of all the options on the allocation date was NIS 10,280,000. The options will vest in three equal annual lots. Up to the reporting date, all three lots have vested.

NOTE 19 – COMMITMENTS

1. At December 31, 2012, the Company has agreements for the acquisition of broadcasting rights. In the year ended December 31, 2012, acquisition of these rights amounted to NIS 192 million.

2. At December 31, 2012, the Company has agreements for the acquisition of channels. In the year ended December 31, 2012, expenses for use of channels acquired by the Company amounted to NIS 286 million.

3. The Company has operational leasing contracts for the buildings it occupies. The primary lease expires in 2014, with an option to extend the lease for another five years. The rental fees are linked to the CPI. The Company also has several other leasing contracts for various periods.

The expected rent for the forthcoming years, calculated according to the rent on December 31, 2012, is as follows:

	NIS thousands
2013	10,735
2014 to 2016	11,727

4. **Operating lease**

The Company has a number of operating lease agreements for periods of up to 36 months for the vehicles it uses. The balance of the contractual annual lease payments, calculated according to the payments in effect at December 31, 2012, is NIS 16 million.

5. Royalties

In accordance with the terms of the license, the Company has a liability to pay royalties to the State of Israel, calculated on the basis of income from broadcasting services as defined in the relevant regulations.

In accordance with the Communications Regulations 2006, the rates of applicable royalties are as follows: 2011 – 1%, 2011 – 1.75%, 2012 – 1.75%. From 2013, the rate of royalties is 0%.

6. Agreement with NDS Limited ("NDS"): The Company entered into several agreements with NDS to acquire services in respect of the Company's encoding, broadcasting and receiving systems and hardware for these services. In 2012 and 2011, the Company's payments to NDS amounted to NIS 38 million and NIS 35 million, respectively.

NOTE 19 – COMMITMENTS (CONTD.)

7. In August 2000, the Company entered into in a three-way contract to purchase decoders from Eurocom Marketing (1986) Ltd. ("Eurocom") and Advanced Digital Broadcast Ltd ("ADB"). Eurocom is an interested party of the Company.

In 2012 and 2011, the Company's payments to Eurocom for the purchase of decoders amounted to NIS 89 and NIS 102 million, respectively.

The Company purchases HD Zapper decoders from another supplier under an agreement from August 2011. In 2012 the Company’s payments to this supplier totaled NIS 19 million while the Company has not yet paid this supplier for 2011.

8. The Company entered into an agreement with Space Communications Ltd. to receive space segment capacity. The agreements are not dependent on the use of specific space segments and Space’s ability to supply the service by means of other segments which meet the Company's requirements. The transaction is therefore presented as a transaction for the receipt of services. Space is an interested party of the Company.

In 2012 and 2011, the Company's payments to Space amounted to NIS 108 million and NIS 100 million, respectively.

9. In October 2012 the Company signed a settlement agreement with the Union of Composers, Songwriters and Publishers of Israeli Music Ltd. ("ACUM"), regulating the disputes which had arisen between ACUM and the Company in relation to the sum of additional royalties owed by the Company (over and above the advance payment already made) for the years 2003 to 2011. The annual royalty rates to be billed to the Company for the years 2012 to 2016 were also regulated.

NOTE 20 – CONTINGENT LIABILITIES

1. Guarantees

To assure its obligations, the Company has made available collateral in the amount of NIS 42 million (including guarantees to the State of Israel in the amount of NIS 40 million).

2. Legal claims

Various legal claims have been filed or are pending against the Company (in this section: *Legal claims*").

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 (Note 13) include appropriate provisions, where provisions are required to cover the exposure resulting from such claims.

The additional exposure at December 31, 2012, owing to legal claims filed against the Company amounts to NIS 201,535,000. These amounts and all the amounts of the claims in this Note are before the addition of interest and linkage.

Below are details of the material contingent claims against the Company at December 31, 2012, classified into groups with similar characteristics.

A. Employee claims

During the normal course of business, collective and individual claims were filed against the Company by employees and former employees of the Company. These are claims which are primarily allegations of non-payment of salary components and delay in salary payment. At December 31, 2012, the total amount of these claims amounted to NIS 54,980,000. 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, appropriate provisions amounting to NIS 1,550,000 have been included in the financial statements, where provisions are required to cover the exposure resulting from such claims.

B. Customer claims

During the normal course of business, claims were filed against the Company by its customers. These are mainly motions for certification of class actions and the ensuing claims concerning the alleged unlawful collection of payment and impairment of the services provided by the Company. At December 31, 2012, these claims amount to NIS 146,155,000. 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 3,038,000, where provisions are required to cover the exposure resulting from such claims.

After the balance sheet date, a settlement agreement for two class actions whose claims totaled NIS 32,608,000 was given the force of a court judgment.

NOTE 20 – CONTINGENT LIABILITIES (CONTD.)

2. Legal claims (contd.)

C. Supplier and communication provider claims

During the normal course of business, various legal claims have been filed against the Company by suppliers who supply the Company with goods and/or services. The main claim was filed for alleged damage caused to a supplier as a result of the Company's negligence.

At December 31, 2012, these claims amounted to NIS 400,000. The Company's lawyers believe that financial resources will not be needed to dismiss these claims.

NOTE 21 – EQUITY

A. Share capital

The equity consists of ordinary shares of NIS 1 par value each, as follows:

	December 31, 2012	December 31, 2011
	Number of shares and amount in NIS thousands	
Issued and paid up share capital	**29**	29
Registered capital	**39**	39

B. Option warrants for shareholders

See Note 15(B).

NOTE 22 – COST OF REVENUES

	Year ended December 31		
	2012	2011	2010
	NIS thousands	NIS thousands	NIS thousands
Wages, salaries and incidentals	**145,811**	148,746	148,545
Content costs	**317,301**	277,505	350,688
Utilized broadcasting rights	**153,959**	147,116	168,799
Use of space segments	**92,348**	85,278	89,990
Depreciation and amortization	**201,541**	220,180	237,260
Car allowance	**21,406**	26,601	25,409
Royalties	**16,948**	17,438	10,944
Other	**117,773**	105,304	97,213
	1,067,087	1,028,168	1,128,848

NOTE 23 – SALES AND MARKETING EXPENSES

	Year ended December 31		
	2012	2011	2010
	NIS thousands	NIS thousands	NIS thousands
Wages, salaries and incidentals	**61,665**	41,662	29,805
Advertising	**70,435**	61,846	67,624
Marketing consultation	**1,728**	1,662	1,729
Car allowance	**9,180**	8,561	8,786
Depreciation and amortization	**19,181**	34,829	32,165
Other	**4,085**	4,177	3,093
	166,274	152,737	143,202

NOTE 24 – GENERAL AND ADMINISTRATIVE EXPENSES

	Year ended December 31		
	2012	2011	2010
	NIS thousands	NIS thousands	NIS thousands
Wages, salaries and incidentals	**61,103**	57,073	54,347
Share-based payment	**-**	889	2,460
Professional consultation and fees	**11,196**	11,107	10,100
Rental and maintenance fees	**15,734**	13,983	13,181
Depreciation and amortization	**27,528**	21,384	15,307
Provisions for doubtful and bad debts	**1,116**	1,933	805
Subcontractors (mainly for system maintenance)	**17,534**	20,661	20,462
Other	**15,673**	16,006	15,899
	149,884	143,036	132,561

NOTE 25 - FINANCING EXPENSES, NET

Recognized in profit or loss

	Year ended December 31		
	2012	2011	2010
	NIS thousands	NIS thousands	NIS thousands
Income from interest on bank deposits	**(817)**	(981)	(316)
Change in fair value of financial assets at fair value through profit and loss	**(140)**	(5,378)	(351)
Other financing income	**(902)**	(16,804)	(8,646)
Financing income recognized in profit and loss	**(1,859)**	(23,163)	(9,313)
Expenses for shareholder loans	**243,923**	263,263	228,464
Expenses for discounting of shareholder loans	**163,904**	114,266	90,035
Change in fair value of financial assets at fair value through profit and loss	**361**	4,250	7,244
Interest expenses for financial liabilities measured at reduced cost	**110,250**	114,649	127,544
Expenses for linkage differences	**21,887**	31,283	19,449
Expenses from exchange rate changes	**6,021**	6,221	277
Other financing expenses	**16,911**	12,588	27,070
Financing income recognized in profit and loss	**563,257**	546,520	500,083
Net financing expenses recognized in profit and loss	**561,398**	523,357	490,770

NOTE 26 – INCOME TAX

A. Deferred tax assets and liabilities

At the balance sheet date, the Company has losses and deductions for inflation of NIS 5 billion for tax purposes carried forward to the next year (in 2011, NIS 4.8 billion).

Loss balances and deductions carried forward to the next year are linked to the CPI until the end of 2007.

The deductible temporary differences and tax losses do not expire under current tax legislation. The Company does not create deferred tax assets since it is not probable that future taxable profit will be available against which it can utilize the benefits.

B. Tax assessments

The Company has received final tax assessments up to and including 2008.

C. Theoretical tax note

The main reconciling item between the Company's statutory tax rate and the effective tax rate is the difference arising from non-recognition of tax benefits for losses accrued by the Company. The above losses are not recognized because of the Company's uncertainty regarding realization of these tax benefits.

NOTE 27 – LIABILITIES SECURED BY LIENS AND RESTRICTIONS IMPOSED WITH RESPECT TO LIABILITIES

A. The Company's secured liabilities and collateral are as follows:

	December 31, 2012	December 31, 2011
	NIS thousands	NIS thousands
Debentures	**1,539,145**	1,178,300
Borrowings from banks (1)	**69,322**	423,677
Guarantees	**41,709**	41,302

1. The Company is a party to a financing agreement with a bank consortium from May 23, 2001, which was amended and re-expressed in July 2012 (respectively: "the Bank Financing Agreement" or "the Financing Agreement" or "the Banks"). When the amended Financing Agreement took effect, the Company repaid all the long-term bank credit granted to it until that date, (see Note 14).

   Under the Financing Agreement a credit facility of NIS 170 million was granted to the Company until the end of 2015 as well as a hedging facility of USD 10 million. Use of these frameworks is restricted to the Company's total working capital requirements calculated on the basis of the formula determined in the amended Financing Agreement which is dependent on the balance of the Company's receivables, its unused broadcasting rights, the depreciated cost of the decoders and its balance of payables pursuant to the financial statements.

   Under the amended Financing Agreement, the Company has to comply with two financial covenants similar to the 2012 Bond every quarter – see Note 14 (C).

NOTE 27 – LIABILITIES SECURED BY LIENS AND RESTRICTIONS IMPOSED WITH RESPECT TO LIABILITIES (CONTD.)

Under the amended Financing Agreement there are restrictions relating to repayment of shareholder loans and distributions which are set out in the 2012 Bond (as described in Note 14), This is instead of the restrictions which had been applicable until now in relation to repayment of shareholder loans and the prohibition on distributions.

The amended Financing Agreement also sets out grounds for immediate repayment, including various breaches of the Financing Agreement, engaging in non-communications activity, liquidation and receivership proceedings against the Company, cancellation or suspension of the broadcasting license, unauthorized changes of ownership, breach of material agreements defined in the Financing Agreement, immediate recall or the existence of grounds for immediate recall of amounts owed by the Company to debenture holders, other banks or financial institutions as well as non-compliance with the financial covenants set forth in the Financing Agreement. The amended Financing Agreement also stipulates that the creation of liens and raising of debt secured by liens (excluding exceptional instances) is conditional upon the receipt of consent from the banks.

The Financing Agreement also determines mechanisms for the raising and lowering of interest rates.

B. 1. The Company created the following liens in favor of each one of Trustee A, Trustee B and the Lenders pursuant to the 2012 Bond (“the Institutional Lenders”):

1.1 Floating first liens, unlimited in amount, on all the Company's assets (excluding exceptions arising from the Communications Law), which contain a condition limiting the creation of additional liens (subject to the exceptions stipulated in the Financing Agreements);

1.2 Fixed first liens, unlimited in amount, on the Company's rights and assets including its rights under material agreements to which it is party, its unissued registered capital, its goodwill, certain intellectual property rights and insurance rights to which it is entitled under the insurance policy issued for it. These fixed liens will not apply to the exceptions arising from the provisions of the Communications Law.

In this section, jointly: “the Collateral”:

2. The Collateral is in the form of first liens equal (pari passu) to each other. The creation by the Company of additional liens in favor of the banks is subject to consent from the Institutional Lenders unless these liens are also recorded in favor of the Institutional Lenders. In the event that the Collateral is realized and/or the assets secured by the Collateral are realized, including by holders of other securities who receive a lien on those assets, the receipts from the exercise will be distributed pro rata among all the holders of the Collateral, whereby each holder will receive a proportionate share of the receipts equal to the proportionate share of the debt owed to it (as defined in the Financing and Debenture Agreements) divided by the total debt secured by said assets.

C. Under the provisions of Deed of Trust B, if Bezeq gives Trustee B a guarantee for the Company's liabilities to the holders of Debentures (Series B), and as long as Bezeq's rating does not drop below its rating or its equivalent in another rating company (the higher of the two), then, henceforth the Collateral created by the Company in favor of Trustee B will be canceled, the **restriction** on the expansion of the series and the issue of additional securities secured by the same Collateral will be canceled, the restriction on the repayment of shareholder loans and distribution of dividends will be canceled, and some of the grounds for immediate repayment available to Trustee B under Deed of Trust B will also be canceled. Moreover, increases in interest caused by a rating downgrade, if any, will also be canceled.

NOTE 28 - FINANCIAL RISK MANAGEMENT

A. General

The Company is exposed to the following risks arising from the use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk

This Note describes the Company’s exposure to each of the above risks, and the Company’s objectives, policies and processes in respect of risk management and measurement.

B. Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises mainly from debt balances of trade receivables.

Management has a credit policy and the Company's exposure to credit risks is monitored on a regular basis.
The Company regularly monitors trade receivables and the financial statements include provisions for doubtful debts which properly reflect, in management’s estimation, the loss inherent in debts for which collection is uncertain.

C. Liquidity risk

Liquidity risk is the risk of the Company being unable to meet its financial liabilities repayable by cash or other financial asset. The Company’s approach to managing liquidity risk is to ensure, as far as possible, the degree of liquidity that is sufficient to meet its liabilities on time, under normal conditions and stressful conditions, without causing it unexpected losses or harming its goodwill.

D. Market risk

Market risk is the risk that changes to market prices such as exchange rates and interest rates will impact the Company's revenues or the value of its holdings in financial instruments. The objective of market risk management is to manage and supervise the exposure to market risks under standard parameters, by maximizing the risk yield.

NOTE 29 - FINANCIAL INSTRUMENTS

A. Credit risk

(1) Exposure to credit risk

The carrying amount of the financial assets represents the maximum credit exposure. The maximum exposure to credit loss at the reporting date is described in the table below:

	December 31, 2012	December 31, 2011
	NIS thousands	
Trade receivables	**163,043**	159,596
Other receivables	**1,254**	7,167
	164,297	166,763

(2) Aging of debts and impairment losses

	December 31, 2012	December 31, 2011
	NIS thousands	
Not past due	**154,240**	154,211
Past due up to one year	**8,984**	8,749
Past due one to two years	**2,106**	4,788
Past due more than two years	**6,477**	6,390
	171,807	174,138
Less provision for doubtful debts	**(7,510)**	(7,375)
Total	**164,297**	166,763

(3) Changes in provision for doubtful and bad debts:

	December 31, 2012	December 31, 2011
	NIS thousands	
Balance at January 1	**7,375**	7,700
Decrease	**135**	(325)
Balance at December 31	**7,510**	7,375

NOTE 29 - FINANCIAL INSTRUMENTS (CONTD.)

B. Liquidity risk

Below are the contractual repayment dates of financial liabilities, including interest payments. This aging does not include amounts where offset agreements exist.

	December 31, 2012						
	Carrying amount	Contractual cash flows	6 months or less	6-12 months	1-2 years	2-5 years	More than five years
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Non-derivative financial liabilities:							
Credit from banks at variable interest - overdraft	69,322	69,322	69,322				
Debentures, including accrued interest	1,572,945	1,987,962	85,754	194,999	334,506	900,536	472,168
Loans from shareholders	3,085,742	4,400,364	-	-	-	-	4,400,364
	4,728,009	6,457,648	155,076	194,999	334,506	900,356	4,872,532

NOTE 29 - FINANCIAL INSTRUMENTS (CONTD.)

B. Liquidity risk (contd.)

	December 31, 2011						
	Carrying amount	Contractual cash flows	6 months or less	6-12 months	1-2 years	2-5 years	More than five years
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Non-derivative financial liabilities:							
Credit from banks at variable interest – on call	441	441	441	-	-	-	-
Credit from banks at variable interest – long-term loan	86,334	97,392	12,558	13,123	25,220	46,491	-
Credit from banks at fixed interest	343,017	393,446	36,062	55,655	106,607	195,122	-
Debentures, including accrued interest	1,208,140	1,556,143	42,633	99,850	219,217	776,955	417,488
Loans from shareholders	2,677,916	4,156,469	-	-	-	-	4,156,469
	4,315,848	6,203,891	91,694	168,628	351,044	1,018,568	4,573,957

NOTE 29 - FINANCIAL INSTRUMENTS (CONTD.)

C. CPI and foreign currency risks

(1) Foreign currency and CPI risk for the Company's financial instruments are as follows:

	December 31, 2012				
	Unlinked	CPI-linked	In foreign currency or foreign currency linked (mainly USD)	Non-monetary items	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Current assets					
Trade receivables	161,722	-	1,321	-	163,043
Other receivables	1,252	2	-	420	1,674
Total current assets	162,974	2	1,321	420	164,717
Current liabilities					
Borrowings from banks	69,322	-	-	-	69,322
Current maturities for debentures	-	174,305	-	-	174,305
Suppliers and service providers	252,250	1,404	142,918	-	396,572
Other payables	112,897	36,210	-	23,305	172,412
Provisions	1,299	4,901	-	-	6,200
Total current liabilities	435,768	216,820	142,918	23,305	818,811
Non-current liabilities					
Debentures	-	1,364,840	-	-	1,364,840
Shareholder loans	-	3,085,742	-	-	3,085,742
Long-term payables	56,159	741	-	16,999	73,899
Total non-current liabilities	56,159	4,451,323	-	16,999	4,524,481
Surplus liabilities over assets	328,953	4,668,141	141,597	39,884	5,178,575

NOTE 29 - FINANCIAL INSTRUMENTS (CONTD.)

C. CPI and foreign currency risks (contd.)

(1) Foreign currency and CPI risk for the Company's financial instruments are as follows: (contd.)

	December 31, 2011*				
	Unlinked	CPI-linked	In foreign currency or foreign currency linked (mainly USD)	Non-monetary items	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Current assets					
Cash and cash equivalents	13,325	-	-	-	13,325
Trade receivables	159,128	-	468	-	159,596
Receivables and debt balances	7,165	2	-	853	8,020
Total current assets	179,618	2	468	853	180,941
Current liabilities					
Borrowings from banks	85,998	-	-	-	85,998
Current maturities for debentures	-	57,494	-	-	57,494
Suppliers and service providers	277,987	7,004	124,307	-	409,298
Other payables	93,759	40,238	16,054	17,009	167,060
Provisions	34,690	5,957	-	-	40,647
Total current liabilities	492,434	110,693	140,361	17,009	760,497
Non-current liabilities					
Debentures	-	1,120,806	-	-	1,120,806
Bank loans	337,679	-	-	-	337,679
Shareholder loans	-	2,677,916	-	-	2,677,916
Long-term payables	16,681	2,085	-	10,141	28,907
Total non-current liabilities	354,360	3,800,807	-	10,141	4,165,308
Surplus liabilities over assets	667,176	3,911,498	139,893	26,297	4,744,864

* Reclassified – see Note 2.G regarding a change in classification.

(2) CPI and material currencies:

	December 31, 2012	December 31, 2011	Change (%) 2012	Change (%) 2011
CPI in points	**117.87**	115.97	1.64	2.16
USD exchange rate per 1 USD	**3.733**	3.821	(2.3)	7.7
Euro exchange rate per 1 Euro	**4.921**	4.938	(0.34)	4.2

NOTE 29 - FINANCIAL INSTRUMENTS (CONTD.)

D. Interest rate risk

Types of interest of the Company's interest-bearing financial instruments:

	Carrying amount 2012 NIS thousands	Carrying amount 2011 NIS thousands
Fixed-interest instruments		
Other receivables	**271**	-
Financial liabilities	**3,678,513**	4,199,234
Total	**3,678,242**	4,199,234
Variable-interest instruments		
Financial liabilities	**36,923**	86,775

E. Fair value compared to carrying amount

The carrying amount of assets and liabilities correspond with or are close to their fair values.

Fair value of financial assets and liabilities which are not stated at fair value are as follows:

	2012		2011	
	Carrying amount NIS thousands	Fair value NIS thousands	Carrying amount NIS thousands	Fair value NIS thousands
Bank loans	**69,322**	**69,322**	423,235	405,664
Debentures, including accrued interest	**1,572,945**	**1,706,884**	1,208,140	1,138,728
	1,642,267	**1,776,206**	1,631,375	1,544,392

See Note 4 regarding the basis for determining fair value.

The interest rates used to discount estimated cash flows, where applicable, are based on the government yield curve similar to that of the Company.

F. Derivative financial instruments

The Company has limited involvement in derivative financial instruments. The Company contracts such transactions to hedge its cash flows.

NOTE 29 - FINANCIAL INSTRUMENTS (CONTD.)

G. Sensitivity analysis

Below are sensitivity analyses for changes in the main market risks where changes will alter the values of assets and liabilities and affect the Company's net profit and equity.

(1) Sensitivity to changes in the CPI

The Company has financial instruments that are sensitive to changes in the CPI such as debentures and customer deposits. The sensitivity analysis of 5% and 10% refers to the rate of deviation from an inflation assessment of 2% per year, based on the Inflation Target Center at the Bank of Israel.

Sensitivity analysis at December 31, 2012

Deviation rate from inflationary target	**10%**	**5%**	**(5%)**	**(10%)**
	NIS thousands	**NIS thousands**	**NIS thousands**	**NIS thousands**
Effect on equity and net profit	**(9,600)**	**(4,800)**	**4,800**	**9,600**

Sensitivity analysis at December 31, 2011

Deviation rate from inflationary goal	**10%**	**5%**	**(5%)**	**(10%)**
	NIS thousands	**NIS thousands**	**NIS thousands**	**NIS thousands**
Effect on equity and net profit	(7,680)	(3,840)	3,840	7,680

(2) Sensitivity analysis of changes in exchange rates

The Company has financial instruments that are sensitive to changes in the exchange rates of the US dollar and/or the euro against the shekel. The sensitivity analysis of 5% and 10% refers to the rate of change in the exchange rate.

Sensitivity analysis at December 31, 2012

Change in NIS/USD exchange rate (in NIS)	**10%**	**5%**	**(5%)**	**(10%)**
	NIS thousands	**NIS thousands**	**NIS thousands**	**NIS thousands**
Effect on equity and net profit	**(13,876)**	**(6,938)**	**6,938**	**13,876**

Sensitivity analysis at December 31, 2011

Change in NIS/USD exchange rate (in NIS)	**10%**	**5%**	**(5%)**	**(10%)**
	NIS thousands	**NIS thousands**	**NIS thousands**	**NIS thousands**
Effect on equity and net profit	(13,990)	(6,995)	6,995	13,990

NOTE 30 – TRANSACTIONS AND BALANCES WITH INTERESTED AND RELATED PARTIES

A. Transactions with interested and related parties

	December 31,		
	2012	**2011**	**2010**
	NIS thousands	**NIS thousands**	**NIS thousands**
Revenues	**376**	1,446	1,165
Cost of revenues (1)	**104,129**	98,729	101,251
Administrative and general expenses	**4,015**	2,075	2,376
Financing expenses	**412,495**	384,074	320,032
Salary and benefits for interested parties employed by the Company	**2,815**	3,682	5,802

(1) The expenses consist primarily of space leasing costs from an interested party, (see Note 19).

B. Balances with related parties

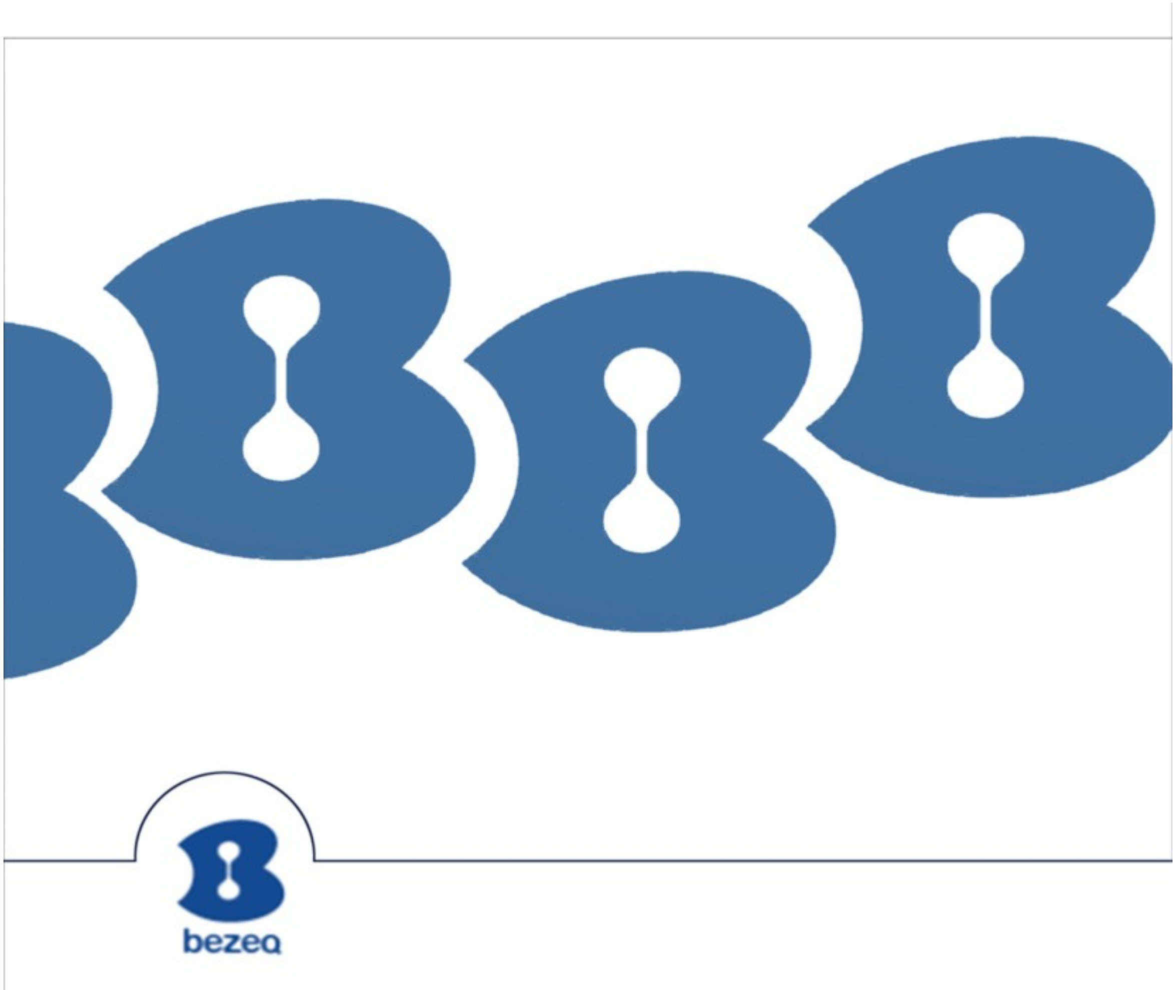
	December 31, 2012	**December 31, 2011**
	NIS thousands	**NIS thousands**
Shareholder loans (see Note 15)	**3,085,742**	2,677,916
Current liabilities	**89,441**	119,055
Non-current liabilities	**36,923**	16,681
Receivables and debt balances	**2,326**	1,944

NOTE 31 – APPOINTMENT OF THE CHAIRMAN OF THE BOARD FOR THE FINANCIAL STATEMENTS APPROVAL MEETING

On the date of approval of the financial statements, the Company's board of directors does not have an incumbent chairman. Consequently, on March 5, 2013, 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 and to sign the Company's financial statements at December 31, 2012.

Exhibit 99.6

Chapter D
(Additional Information about the Company)
Periodic Report for 2012



1. **Regulation 10A: Summary of the Company's consolidated statements of income for each of the quarters in the year ended December 31, 2012 (in NIS millions).**

The quarterly statements were prepared in compliance with International Financial Reporting Standards (IFRS)

	Q1 2012	Q2 2012	Q3 2012	Q4 2012	2012	2011
Revenue	2,740	2,595	2,494	2,449	10,278	11,373
Costs and expenses	1,890	1,849	1,827	1,677	7,243	8,131
Operating profit	850	746	667	772	3,035	3,242
Financing expenses (income) - net	(44)	77	55	61	149	210
Earnings before Group's equity in affiliates	894	669	612	711	2,886	3,032
Share in losses of affiliates	58	83	92	12	245	216
Profit before income tax	836	586	520	699	2,641	2,816
Income tax	245	174	178	180	777	755
Profit for the period	591	412	342	519	1,864	2,061
Other comprehensive income (loss), net for the period	(6)	(2)	3	(22)	(27)	35
Total comprehensive income for the period	585	410	345	497	1,837	2,096
Attributable to:						
Shareholders of the Company	576	413	345	497	1,831	2,101
Non-controlling interests	9	(3)	-	-	6	(5)
Total comprehensive income for the period	585	410	345	497	1,837	2,096
Earnings per share						
Basic and diluted earnings per share	0.21	0.15	0.13	0.19	0.68	0.76

2. **Regulation 10C: Use of proceeds for securities with special reference to the application of proceeds based on the prospectus**

On July 3, 2011 the Company issued debentures (Series 6 through 8) based on a shelf offering memorandum dated June 29, 2011 published under the shelf prospectus.

For further information relating to this matter see the Company's shelf offering memorandum dated June 29, 2011 and the announcement of the results of the issuance under the Company's shelf offering memorandum dated June 30, 2011, included here by reference. Furthermore, see Note 13.2 to Chapter C of the Company's financial statements for 2012.

The purposes of the proceeds from the issuance, as published in the announcement of the results of the issuance under the Company's shelf offering memorandum date June 30, 2011, are as follows: "The Company intends to use the proceeds from the issuance for the ongoing business operations of the Company, and this includes the option of using the proceeds, *inter alia*, to repay loans, carry out investments in infrastructures and other investments, to pay dividends, or for other needs as the Company may decide, as the Capex may be from time to time. The Company used the proceeds for its ongoing business operations in accordance with the goals that were set.

3. Regulation 11: Breakdown of material investments in subsidiaries and related companies as of the date of the financial statements [1]

Company name:	Name of holder	Class of share	Number of shares	Total par value	Rate of holding in issued equity and in voting rights	Rate of holdings in rights to appoint directors	Company's separate balance sheet value[2]
Pelephone Communications Ltd. ("Pelephone")	The Company	Ordinary NIS 1	302,460,000	302,460,000	100%	100%	4,519
Bezeq International Ltd. ("Bezeq International")	The Company	Ordinary NIS 0.1 shares	1,136,990,000	113,699,000	100%	100%	1,031
D.B.S. Satellite Services (1998) Ltd.[3] ("DBS")	The Company	Ordinary NIS 1 shares	14,881	14,881	49.78%	45.45%[4]	1,003
Bezeq Online Ltd.	The Company	Ordinary NIS 1	1,170,000	1,170,000	100%	100%	64
Bezeq Zahav (Holdings) Ltd.[5]	The Company	Ordinary NIS 1 shares	1,000,000	1,000,000	100%	100%	723
Walla! Communications Ltd. ("Walla")	The Company	Ordinary NIS 1	47,340,970	47,340,970	100%	100%	200
Coral-Tell Ltd.	Walla	Ordinary NIS 1	22,650	22,650	75%	75%	140
Teletel Communications Channels Ltd.	Walla	Ordinary NIS 1	200	200	100%	100%	(45)

1 The Company's investees have immaterial investments in other investees..

2 These amounts include extended loans as follows: Pelephone - NIS 530 million; Bezeq International - NIS 208 million; Bezeq Zahav - NIS 723 million and Bezeq Online - NIS 20 million. For further information regarding dates on which the loans were extended, their terms and repayment dates, see Note 8.2 to the Separate Financial Information attached to the periodic report.

3 The investment in DBS, in the amount of NIS 1,742 million, was carried out through loans, of which NIS 73 million are CPI linked loans, NIS 240 million are CPI linked loans bearing 5.5% interest and NIS 1,429 million are CPI linked loans bearing interest of 11%.

4 In accordance with DBS articles of association, based on the current holdings in DBS, the Company is eligible to appoint 5 out of the 11 directors that can be appointed by DBS shareholders. Furthermore, according to DBS articles of association, voting rights of all the board members will be equivalent to the total voting rights of the shareholder who appointed the director divided by the number of directors appointed on behalf of the appointing shareholder. Thus, the voting rights of the directors appointed by the Company are 49.78% of the voting rights on the board of directors of DBS. The Company has options that, as at the date of publication of the periodic report, grants it 8.6% rights in DBS shares.

5 Loans were extended to the subsidiary, Bezeq Zahav (Holdings) Ltd. for financing the acquisition of debentures Series 5 of the Company.

4. **Regulation 12: Material changes in investments in subsidiaries and related companies in the reporting period:**

Date of change	Nature of the change	Company name:	Reported amounts (NIS millions)
May 17, 2012	Dividend payment	Pelephone	466
October 9, 2012	Dividend payment	Pelephone	410
May 17, 2012	Dividend payment	Bezeq International	90
October 9, 2012	Dividend payment	Bezeq International	74
1-12, 2012	Reduced premium	Bezeq Zahav Holdings Ltd.	(5)
1-12, 2012	Estimate	Bezeq Zahav Holdings Ltd.	12
June 1, 2012	Debenture repayment	Bezeq Zahav Holdings Ltd.	(178)
1-12, 2012	Linkage and interest differentials	DBS	193
April 5, 2012	Increase to 100% control in Walla	Walla[6]	77

6 Loans were extended to the subsidiary, Bezeq Zahav (Holdings) Ltd. for financing the acquisition of debentures Series 5 of the Company.

5. Regulation 13: Revenues of subsidiaries and related companies and the revenues of the Company from them as of the reporting date (in NIS millions)[7]

Company name:	Profit (loss) for the period	Comprehensive income(loss) for the period	Dividends	Management fees	Interest income
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Pelephone	698	697	876	6	43
Bezeq International	160	157	164	1.5	10
D.B.S.	(310)	(312)	-	-	175
Bezeq Online Ltd.	(6)	(6)	-	-	1
Bezeq Zahav Holdings Ltd.	-	-	-	-	37
Walla	(17)	(17)	-	-	-

6. Regulation 20: Trading the Company's securities on the TASE –dates and reasons for interruption of trade – update

In 2012, 11,126,932 ordinary NIS 1 par value shares of the Company were listed for trading subsequent to options exercised from the employee options plan, under the outline dated March 25, 2007 and subsequent to exercise of options from the executive employee options plan dated December 20, 2010.

Dates and reasons for interruption of trade:

Start of interruption	End of interruption	Reason for interruption of trade
August 2, 2012 9:00 AM	August 2, 2012 9:48 AM	Publication of the Q2 financial statements

7 Furthermore, subsequent to reporting date, the consolidated companies announced dividends as follows: 1. On March 3, 2013 the board of directors of Pelephone decided on a dividend distribution in the amount of NIS 287 in May 2012. 2. On March 5, 2013 the board of directors of Bezeq International decided on a dividend distribution in the amount of NIS 84 million in May 2013. 3. During February and March Walla received a dividend that was announced by its investees, in a total amount of NIS 8 million.

7. **Regulation 21: Remuneration of interested parties and executive officers**

Below is a breakdown of the remuneration for 2012, as recognized in the financial statements for 2012, to each of the five highest-paid senior officers in the Company or in a corporation under its control, and which were paid to them in lieu of their service in the Company or a corporation under its control, (employer's cost on annual basis):

Recipient			Total (in NIS thousands)					
Name	**Position**	**Scope of position**	**Salary**[8]	**Bonus**[9]	**Share-based payment**	**Phantom options**[10]	**Other**	**Total**[11]
Avraham Gabbay	CEO Bezeq	Full-time	2,750	2,222	-	(665)		4,307
Gil Sharon	CEO of Pelephone	Full-time	2,732	2,011	-	(665)		4,078
Yitzhak Benbenisti	CEO, Bezeq International Ltd.	Full-time	2,012	1,630	-	(443)		3,199
Alan Gelman[12]	Bezeq Deputy CEO and CFO	Full-time	1,948	1,341	-	0		3,289
Ran Guron	Deputy CEO and VP Marketing	Full-time	1,564	512	-	(89)		1,987

8 Salaries include the cost of salaries and the ancillary salary costs including benefits (as specified in the notes below) and social benefits, as well as changes in provisions set aside in the 2012 financial statements for severance compensation, prior notice and leave pay.

9 The bonus is for 2012 (as of reporting date, not yet paid to the senior officers). During 2012 bonuses for 2011 were paid to these officers, the amounts of which are included in the corresponding table in the Company's annual report for 2011 published on March 14, 2012.

10 The value based on the Black & Scholes formula at reporting date. This amount is the relative value for share-based remuneration for phantom options that were recognized in the financial statements for the reporting year.

11 The total amount takes into account the amounts reduced in the phantom options section. These amounts were reduced due to cancellation of the provisions set aside in the reporting year for the phantom options.

12 Alan Gelman was paid prior notice, however it is not presented in this report since the expense was recognized in the Company’s financial statements for 2007.

Breakdown of information pertaining to the terms of employment of the executive officers appearing in the foregoing table:

A. Avraham Gabbay

On January 17, 2013, the Company's CEO announced his resignation from his position and is expected to terminate his position on April 14, 2013

Employed by the Company as the Company's CEO, under a personal employment agreement dated July 19, 2007. Under the agreement, the CEO is entitled to receive a monthly salary (gross) of NIS 175,000, linked to the CPI (during the reporting year his monthly salary (gross) amounted to NIS 178,000).

On December 30, 2010 the Company's CEO was granted 3,000,000 phantom options at exercise price of NIS 10.206.

The CEO is entitled to an annual bonus of up to 100% of his annual salary (without ancillary benefits), for full compliance with the preset goals for each year. In addition, a bonus formula was fixed for performance exceeding these goals of up to 125% of his annual salary.

On March 14, 2012 the Company's board of directors (upon approval of the Company's audit committee) approved the bonus for the Company's CEO for 2011 in an amount equivalent to 120% of the CEO's annual salary, in the amount of NIS 2,517,000. This amount, which is for 2011, is not included in the above remuneration table.

The goals for the CEO's bonus for 2012 were preset by the board of directors in February 2012, based on the Company's annual work schedule for 2012 and included three parameters: (a) EBITDA[13] [14]goal for the Company (solo), which constitutes 70% of the bonus calculation; (b) growth parameters in the areas of operation and revenues, constituting 15% of the bonus calculation; (c) a goal relating to customer service in the private and business markets, which constitutes 15% of the bonus calculation. The CEO's compliance with all the bonus goals set for him for 2012 was 103.7%. On March 13, 2013, the Company's board of directors approved (after receiving approval of the Company's remunerations committee) a bonus for the Company's CEO for 2012, at a rate of 103.7% of the CEO's annual salary, in the amount of NIS 2,222,000.

B. Gil Sharon

Employed as CEO of the subsidiary, Pelephone, under a personal employment agreement dated January 19, 2006. The agreement is for an unlimited period, and it may be terminated by either party at any time and for any reason with 12 months prior notice (by Pelephone) and 3 months prior notice (by Pelephone's CEO). His monthly salary is NIS 175,000 (gross), linked to the CPI (during the reporting year his monthly salary (gross) amounted to NIS 178,000).

On December 30, 2010 the CEO of Pelephone was granted 3,000,000 phantom options at exercise price of NIS 10.206.

The CEO of Pelephone is eligible for an annual bonus of up to 100% of his annual salary (without ancillary benefits), for full compliance with the preset goals for each year. In addition, a bonus formula was fixed for performance exceeding these goals of up to 125% of his annual salary[15].

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13 Levels were set, with regard to each of the criteria, for bonus calculation based on compliance rates whereby the EBITDA goal was set in such a way that compliance below 95% of the EBITDA goal would not grant the CEO any bonus for this criterion, compliance rate of 95% - 100% of the EBITDA goal would grant the CEO an amount equivalent to 60% - 100% for this criterion, pro-rata, and compliance beyond 100% of the goals would grant the CEO an amount equivalent to 100% - 125% for this criterion, pro rata.

13 In accordance with the remuneration plan, the goal was amended, eliminating accounting changes and according to the decision of the remuneration committee and the board of March 10, 2013 and March 13, 2013, respectively, the goal was amended to eliminate the effect of changes in the NAKED ADSL prices.

15 (a) Bezeq's remunerations committee and board of directors may decide, by the date of the approval of the financial statements for the relevant year, that there are extenuating circumstances justifying nonpayment of a bonus or part thereof, despite compliance with the set goals; (b) full compliance with the EBITDA goal will constitute 40% of the bonus that will be paid according to the following distribution: 1. 60% of the bonus eligibility for compliance with the EBITDA for 2013 will be paid following the date of approval of the financial statements for this year. 2. The balance of the bonus eligibility for 2013, i.e. 40%, will be paid in 2014 and only if the minimum EBITDA goal set by the Company's board of directors, compared with the 2014 budget, is achieved. (c) eligibility for a bonus is contingent upon the manager being a Company employee at the end of the calendar year for which the goals were preset. If such manager is not a Group employee at the end of that calendar year, his eligibility to receive a bonus, if at all, will be based on the board of directors' assessment and not on the preset goals. (d) If it comes to light that any bonus paid to a manager on the bases of data that afterwards are found to be misleading and are reclassified in the Company's financial statements, the manager will be required to refund to the Company the difference between the amount received and the amount of the bonus as calculated based on the updated figures

On March 14, 2012 the Pelephone's board of directors approved the bonus for the CEO of Pelephone for 2011, in an amount equivalent to 90% of the annual salary of the CEO of Pelephone for 2011, in the amount of NIS 1,900,000. This amount, which is for 2011, is not included in the above remunerations table.

The bonus goals for the CEO of Pelephone were preset by the Company's board of directors in February 2012, following approval of the Company's audit committee and of the board of directors of Pelephone, based on Pelephone's work schedule for 2012, including: EBITDA[16] goals (based on Pelephone's financial statements (solo)) which constitute 25% of the bonus calculation, a managerial goal relating to cash flows from Pelephone's ongoing operations, constituting 25% of the annual bonus calculation for the CEO of Pelephone for 2012 and a goal made up of components relating to Pelephone's competitive position in the market, constituting 50% of the bonus calculation. The compliance of the CEO of Pelephone with all the bonus goals set for him for 2012 was 93.8%. On March 13, 2013, the Company's board of directors approved (after approval of the audit committee and board of directors of Pelephone and of the Company's audit committee) a bonus for the CEO of Pelephone for 2012, at a rate of 93.8% of the Pelephone CEO's annual salary, in the amount of NIS 2,011,000.

C. Yitzhak Benbenisti

Employed as CEO of the subsidiary Bezeq International since November 6, 2007, under a personal employment agreement dated July 1, 2007. The agreement is for an unlimited period, and it may be terminated by either party at any time and for any reason with 6 months prior notice. His monthly salary is NIS 125,000 (gross), linked to the CPI (during the reporting year his gross monthly salary amounted to NIS 128,000).

On December 30, 2010 the CEO of Bezeq International was granted 2,000,000 phantom options at exercise price of NIS 10.206.

The CEO of Bezeq International is eligible to an annual bonus of up to 100% of his annual salary (without ancillary benefits), for full compliance with the preset goals for each year. In addition, a bonus formula was fixed for performance exceeding these goals of up to 125% of his annual salary[17].

On March 14, 2012 the Company's board of directors approved the bonus for the CEO of Bezeq International for 2011 in an amount equivalent to 125% of the annual salary of the CEO of Bezeq International, in the amount of NIS 1,875,000. This amount which is for 2011, is not included in the foregoing remuneration table.

The bonus goals for the CEO of Bezeq International were preset by the Company's board of directors in February 2012, based on Bezeq International's work schedule for 2012, including: An EBITDA[18] goal (based on the financial statements (solo) of Bezeq International) which constitutes 80% of the bonus calculation, and a managerial goal relating to Bezeq International's operating cash flows, constituting 20% of the bonus calculation for the annual bonus of the CEO of Bezeq International for 2012. The rate of compliance of the CEO of Bezeq International with all the bonus goals set for him for 2012 was 106.4%. On March 13, 2013 the Company's board of directors (upon approval of the board of directors of Bezeq International and of the Company's remunerations committee) approved the bonus for the CEO of Bezeq International for 2012, in an amount equivalent to 106.4% of the annual salary of the CEO of Bezeq International for 2012, in the amount of NIS 1,630,000.

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16 See footnote 13 above.

17 See Footnote 15 above.

18 See Footnote 13 above. In addition, pursuant to the decision of the Company's remuneration committee and board of directors on March 10, 2013 and March 13, 2013, respectively, the EBITDA was amended so that the effects of the cancellation of the acquisition were neutralized.

D. Alan Gelman

Employed as deputy CEO and CFO of the Company under a personal employment agreement since November 29, 2007. Alan Gelman's gross monthly salary during the reporting year was NIS 147,000.

Alan Gelman's bonus was restricted to 80% of his annual salary for 100% compliance with the Company's goals set for him. On March 14, 2012, the Company's board of directors approved (after approval of the Company's audit committee) a bonus for Alan Gelman for 2011 in the amount of NIS 1,371,000. This amount is not presented in the foregoing remuneration table.

Mr. Gelman's bonus goals were set by the Company's board in February 2012 based on the Company's annual work program for 2012 and included several criteria: (a) EBITDA[19] goals (Group), constituting 40% of the bonus calculation; (b) personal managerial goals that constitute together 35% of the bonus calculation; (c) the Chairman's assessment that constitutes 25% of the bonus calculation. The compliance of Mr. Gelman with all the bonus goals set for him for 2012 was 92.4%. On March 13, 2013 the Company's board of directors approved (after approval of the Company's remuneration committee) a bonus for Alan Gelman for 2012, of 74% of his annual salary in the amount of NIS 1,341,000.

E. Ran Guron:

Employed as VP marketing in the Company since December 18, 2005, under a personal employment agreement dated December 14, 2005. On March 16, 2011, the Company's board of directors approved his appointment as deputy CEO of the Company in addition to his role as VP marketing of the Company. The agreement is for an unlimited period, and it may be terminated by either party at any time and for any reason with 6 months prior notice. The monthly salary of the deputy CEO and VP marketing in 2011 is NIS 90,000 (from date of appointment as deputy CEO), and this amount is linked to the CPI (in the reporting year his gross monthly salary amounted to NIS 93,000).

On December 30, 2010 the Company's board of directors approved a bonus plan for executive officers in the Group, including the deputy CEO and VP marketing, under which Mr. Guron was allotted 400,000 phantom options at an exercise price of NIS 10.206.

The deputy CEO and VP marketing is eligible for an annual bonus of up to 50% of his annual salary (without ancillary benefits), for full compliance with preset goals for each year. In addition, a bonus formula was fixed for performance exceeding these goals of up to 62.5% of his annual salary[20].

On March 14, 2012 the Company's board of directors (upon receipt of the approval of the Company's audit committee) approved a bonus for the deputy CEO and VP marketing for 2011 in an amount of NIS 590,000. This amount which is for 2011 is not included in the foregoing remuneration table.

The bonus goals for the deputy CEO and VP marketing were preset by the Company's board of directors in February 2012 based on the Company's annual work schedule for 2012 and included: (a) an EBITDA[21] [22] goal for the Company (solo), which constitutes 30% of the bonus calculation; (b) growth parameters in the areas of operation and revenues that constitutes 10% of the bonus calculation; (c) a goal relating to customer services in the private and business markets constituting 10% of the bonus calculation; (d) personal-managerial goals that constitute 40% of the bonus calculation; and (e) a manager's assessment goal constituting 10% of the bonus calculation. The rate of compliance of the deputy CEO and VP marketing with all the bonus goals set for 2012 was 92.8%. On March 13, 2013 the Company's board of directors (upon approval of the Company's remunerations committee) approved the bonus for the Company's deputy CEO and VP marketing for 2012 in an amount equivalent to 46% of his annual salary, in the amount of NIS 512,000.

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19 See footnote 14 above.

20 See Footnote 15 above.

21 See Footnote 13 above.

22 See Footnote 14 above.

Other interested parties who receive remuneration from the Company

F. **Rami Nomkin**, an employee director employed with the Company, dealing with employee volunteer work, transferred from the Ministry of Communications, since 1966. All the remuneration paid to Mr. Nomkin is due to his being an employee of the Company and not for his service as a Company director. Mr. Nomkin's total salary for 2012 amounted to NIS 526,000 and is linked to the professional salary tables. This salary does not include a bonus for 2012 in the amount of NIS 20,000 which as at reporting date has not yet been paid and which was set in accordance with the criteria for all the Company's employees, based on the Company's EBITDA results and two criteria relating to growth and service.

On January 25, 2011 the Company's general meeting approved allotting 47,774 options to Mr. Nomkin, at an exercise price of NIS 7.457 (subject to adjustments for the distribution of dividend), under a material private placement report for an employee director dated December 20, 2010. The Black and Scholes value of all the options allotted to Mr. Nomkin is NIS 182,000[23]. The options were allotted to Mr. Nomkin as an employee of the Company and not for his service as a Company director.

G. **Yair David**, an employee director, (elected to serve as a director by the Company's general assembly on September 11, 2012), is employed as acting head of contractor supervision in the work execution section of the Company's Technologies and Network Division. He transferred from the Ministry of Communications in 1982. The entire remuneration paid to Mr. David is for his being a Company employee and not for his service as a Company director. Mr. David's total salary in the amount of NIS 500,000 is for 2012 and is linked to the professional salary tables. This salary does not include a bonus for 2012 in the amount of NIS 17,000, which as at reporting date has not yet been paid as of reporting date and which is set in accordance with criteria prescribed for all the Company's employees and is based on the Company's EBITDA and two growth and service criteria.

On January 23, 2011 as part of the allotment of options for the Company's employees, Mr. David was allotted 34,516 options under the employees' options plan at an exercise price of NIS 7.457 (subject to adjustments for the distribution of dividend). The B&S value of all the number of options allotted to Mr. David is approximately NIS 131,000.[24] The options were allotted to Mr. David as an employee of the Company prior to his appointment as a Company director.

H. **Remuneration of two external directors** is based on the maximum tariffs prescribed in the Companies Regulations (Rules Concerning Remuneration and Expenses for an External Director), 2000 (for external expert directors) linked to the CPI as set in said regulations and which was updated under an amendment which took effect on March 6, 2008 and which was approved by the general meeting on June 1, 2008. The remuneration for 2012 for Mr. Mordechai Keret is NIS 392,472 and for Mr. Yitzhak Edelman is NIS 391,933 (including the reimbursement of travel expenses, pursuant to the approval of the general meeting).

I. **Remuneration for two independent directors** is based on the maximum tariff (for an expert external director) as prescribed in the Companies Regulations (Rules Concerning Remuneration and Expenses for an External Director), 2000, linked to the CPI as set in said regulations and which was updated under the foregoing amendment. The remuneration in 2012 for Mr. Eldad Ben Moshe is NIS 351,671 and for Mr. Yehoshua Rosenzweig is NIS 370,902 (including the reimbursement of travel expenses, pursuant to the approval of the general meeting).

J. Eurocom Communications Ltd. management fees On June 10, 2010 the Company's general meeting approved signing an agreement with Eurocom Communications Ltd. ("Eurocom Communications"), the controlling shareholder (indirectly) of the Company, for consultancy and management services for a period of three years as of June 1, 2010 through to May 30, 2013 in return for an annual fee of USD 1.2 million (for a description of the main points of the agreement, see section 29.5.2b to the Notes to the financial statements). For the period January 1, 2012 through to December 31, 2012, the amount of NIS 4,601,100 (before VAT) was paid to the consultancy company for the services.

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23 One-third of the options vest one calendar year after the grant date, another third of the options vest after two calendar years from the grant date and the final third of the options vest after three calendar years from the grant date. The options are exercisable from the end of the vesting period of each tranche of options until five years have elapsed from the vesting date of the third tranche of options. As at the date of publication of this report 2/3 of the options have vested.

24 See foregoing footnote 23.

8. Regulation 21A: The controlling shareholder of a company

A. Controlling Shareholder at Reporting Date

To the best of the Company's knowledge, the ultimate controlling shareholder of the Company is Mr. Shaul Elovitch, through his holdings in Eurocom Holdings (1979) Ltd. ("Eurocom Holdings"), Eurocom Assets Holdings Ltd., Eurocom Assets Ltd., Eurocom Technologies Management (2005) Ltd., Eurcom Communications Holdings 2005 Ltd., and his holdings (direct or indirect) in Eurocom Communications Ltd. ("Eurocom Communications")[25]. Eurocom Communications is the controlling shareholder in Internet Gold-Golden Lines Ltd., ("Internet Gold"), which controls B Communications Ltd. ("B Communications"), the controlling shareholder (wholly owned) of B Communications (S.P. 1) Ltd. ("B Communications 1") and its wholly owned subsidiary, B Communications (S.P. 2) Ltd. ("B Communications 2"), which holds 843,873,713 of the Company's shares. Each of the aforesaid companies is also considered to be a controlling shareholder in the Company under the Securities Law. Furthermore, pursuant to the Law, the Company deems Mr. Yosef Elovitch[26], the brother of Mr. Shaul Elovitch, as a joint shareholder with Mr. Shaul Elovitch, and therefore as a controlling shareholder in the Company.

It should be noted that Ms Iris Elovitch, the wife of Mr. Shaul Elovitch holds a negligible amount of Bezeq shares amd Mr. Shaul Elovitch and his brother, Mr. Yosef Elovitch, the controlling shareholders (indirectly) of the Company, jointly hold a negligible amount of Bezeq shares (see description of Mr. Shaul Elovitch's holdings as set forth in section 10 below and footnote 27). In addition, Ms. Elovitch and other family members of Mr. Shaul Elovitch hold shares of Internet Gold and BComm in negligible amounts of their issued and paid-up share capital.

It is noted that B Communications 2 is the holder of 814,211,545 Bezeq shares. These shares are held in trust by Poalim (Romema) Trustees Ltd., as trustee for B Communications (S.P. 2) Ltd as the owners on the one hand, and for entities who provided finance for the acquisition of the shares under a financing agreement dated February 11, 2010, as holders of a first ranking lien on the shares, on the other hand.

Furthermore, and in addition to the foregoing, B Communications is the owner and holder of 29,662,168 Bezeq shares which were owned by B Communications 2, and were transferred to B Communications on December 27, 2012. It is noted that, the forgoing transferred shares are not subject to the current trust arrangement under which the rest of B Communications shares are held in trust by Poalim (Romema) Trust Ltd.

9. Regulation 22: Transactions with the controlling shareholder

Below are particulars, to the best of the Company's knowledge, concerning all transactions with the controlling shareholders of the Company, or in which the controlling shareholders have a personal interest ("transaction with the controlling shareholders"), which the Company, its subsidiaries or its related companies (together - "the Group") engaged in during the reporting year or subsequent to the end of the reporting year and until the date on which this report is submitted, or which is still valid at the reporting date. For further information concerning the transactions specified in this chapter, see Note 29 to the financial statements: Negligible Procedures

For further information concerning negligible procedures and negligible transactions carried out during the reporting year, see Note 29 to Chapter C of the financial statements.

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25 To the best of the Company's knowledge, the controlling shareholders in Eurocom Communications are as follows: (a). Eurocom Holdings (1979) Ltd., which holds 50.33% of the issued and paid up share capital of Eurocom Communications; Eurocom Holdings (1979) is a private company held by Mr. Shaul Elovitch, who holds 80% of its ordinary shares and 75% of its management shares, and his brother Mr. Yosef Elovitch, who holds 20% of its ordinary shares and 25% of its management shares; (b) The four private companies owned by Mr. Shaul Elovitch and his brother, Mr. Yosef Elovitch (at rates of 80% and 20%, respectively), hold 49% of the issued and paid up share capital of Eurocom Communications (Eurocom Asset Holdings Ltd., Eurocom Assets Ltd., Eurocom Technology Management (2005) Ltd., Eurocom Communications Holdings (2005) Ltd.); (c) Mr. Shaul Elovitch, who holds 0.67% of the issued and paid up share capital of Eurocom Communications.

26 See footnote 25 above.

Transactions that are not negligible:

1. **Agreements to purchase satellite terminal equipment**[27]

A. On March 27, 2012, the general meeting of the shareholders of the Company [28] approved the Company's vote at the general meeting of DBS in favor of the amendment to DBS's engagement with Eurocom and ADB, , in such a way that, with regard to some of the decoders (approximately 50% of the original quantity approved), the maximum overall increase of cost to the original engagement (due to the rise in hard drive prices) will be up to USD 1,953,000[29].

B. On April 24, 2012 the general meeting of the Company's shareholders approved the Company's vote in the general meeting of DBS, in favor of DBS engaging with Eurocom and ADB in the following transactions: (1) the acquisition of power supply packs for yesMaxHD decoders from Eurocom and from ADB, for the period through to December 31, 2012 and at an overall cost of up to USD 131,000. (2) the acquisition of yesMaxTotal3 decoders from Eurocom and ADB, under the existing framework contract, at a total price of USD 9.8 million, for the period through to December 31, 2014. (3) to obtain supplier credit in USD for an additional period of 60 days from Eurocom, with regard to the foregoing acquisition of decoders[30].

B. On July 25, 2012 the general meeting of the Company's shareholders approved the Company's vote in the general meeting of DBS, in favor of DBS engaging with Eurocom and ADB in the following transactions: (1) an amendment to DBS agreement with Eurocom and ADB, with regard to some of the decoders (approximately 42% of the original quantity approved), the maximum overall increase in cost for the original engagement (due to the rise in hard drive prices) will be up to USD 1,336,940 and with regard to 16% of the original quantity approved, to approve extending delivery date until September 30, 2013. (2) DBS acquisition of YesMaxTotal decoders from Eurocom and ADB, under the existing framework contract, at a total price of USD 20.7 million, for the period through to March 31, 2014. Furthermore, if the global hard disk market requires a further price increase, an additional cost was approved for the foregoing acquisition of up to USD 3.245 million; (3) to obtain supplier credit in USD for an additional period of 60 days to the period set in the framework agreement, from Eurocom, with regard to the foregoing acquisition of decoders[31].

D. On January 1, 2013 the general meeting of the Company's shareholders approved the Company's vote in the general meeting of DBS, in favor of DBS engagement with Eurocom and ADB, which was approved by the shareholders general meeting on April 24, 2012, and which relates to DBS's acquisition of power supply packs for yesMaxHD decoders from Eurocom and ADB at a cost of up to USD 131,000 and for a period up to December 31, 2012, and the amendment to the foregoing engagement for the delivery of power supply packs at a cost of up to USD 78,600[32].

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27 For the sake of caution, the agreements specified in this section were brought or will be brought, as the case may be, for approval by the general meeting of the shareholders of the Company in accordance with section 275 of the Companies Law, pursuant to the conditions prescribed in the Ministry of Communications approval for the transaction for the acquisition of control in the Company by B Communications (see section 1.1.3.A.1 of Chapter A of the periodic report).

28 The date of approval of the general meeting follows approval by the Company’s Audit Committee and Board of Directors.

29 For further information, including with regard to controlling shareholders who have a personal interest, see transaction report and notice of convening of the extraordinary general meeting which the Company issued on February 19, 2012, noted here by way of reference.

30 For further information, including pertaining to the matter of controlling shareholders who have a personal interest, see transaction report and notice of convening of an extraordinary general meeting published by the Company on March 14, 2012, noted here by way of reference.

31 For further information, including pertaining to the matter of controlling shareholders who have a personal interest, see transaction report and notice of convening of an extraordinary general meeting published by the Company on June 20, 2012, noted here by way of reference.

32 For further information, including pertaining to the matter of controlling shareholders who have a personal interest, see transaction report and notice of convening of an extraordinary general meeting published by the Company on December 11, 2012, noted here by way of reference.

2. Debt arrangements between the Company and Bezeq International and DBS

On September 6, 2012 the general meeting of the Company's shareholders approved manner of voting at the general shareholders meeting of DBS, in favor of the engagement between the Company and Bezeq International with DBS in the following transactions: (1) Debt arrangement between the Company and DBS - the Company engaged in a new debt arrangement agreement according to which all the payments under earlier debt arrangements, which were due to be paid as of August 1, 2012 through to June 10, 2013 will be postponed, each for a period of 18 months from their expected repayment date, and during this postponement period each instalment will bear interest of prime + 4%, with the addition of VAT as required by law. The total principal of these deferred payments amounts to NIS 26,663,027. (2) The debt arrangement between Bezeq International and DBS - an agreement with regard to a new debt arrangement according to which the payments under the general meeting's resolution dated October 14, 2010 and the debt arrangement of June 10, 2010, the original due dates of which were as of August 1, 2012 through December 31, 2013, will be deferred for a period of 18 months from the expected repayment date, and during this postponement period, each installment will bear interest of prime + 4%, with the addition of VAT as required by law. The total principal of these deferred payments amounts to NIS 5,928,750[33].

3. Agreement (extension and amendment) to acquire Nokia and ZTE products

On October 11, 2012 the general meeting of the Company's shareholders approved the Company's vote in the general meeting of Pelephone, in favor of amending Pelephone's engagement with Eurocom Cellular Communications Ltd. , which was approved by the general meeting of the shareholders on June 10, 2010 and which deals with the acquisition and supply of Nokia products to Pelephone. Under the amendment, this engagement will be expanded to also include products manufactured by the Chinese electronics company, ZTE, which is expected to market cellular terminal equipment in Israel through its new official representative, Eurocom Communications. The period of the engagement will be extended by three years from the date of the termination of the existing agreement period (i.e. until December 31, 2015). The annual volume of purchase under the engagement will not exceed the accumulative amount of NIS 300 million (before VAT) per calendar year[34].

4. Debt raising by DBS

On May 8, 2012 the Company’s board of directors approved (after approval by the audit committee)_that the Company would vote at the general meeting of shareholders of DBS in favor of debt raising by DBS in a total amount of up to NIS 450 million.

5. Engagement in an officers liability insurance policy for one year

On March 13, 2013 the Company's board of directors, subsequent to approval of the audit committee and the remunerations committee and after determining that it complies with the terms of the foregoing framework transaction, decided to approve the Company engaging in a directors and officers liability insurance policy for one year from April 14, 2013 through April 13, 2014. The Company will pay an annual premium of up to USD 210,000. The liability limit is USD 100 million per claim and in total for each insurance year, and USD 20 million per claim and in total for the insurance period for legal expenses in Israel only. The agreement was approved, including with regard to directors who are controlling shareholders or their relatives, in accordance with the Relief Regulations. Accordingly, in the event that an objection is lodged as stipulated in Regulation 1C(a) of the Relief Regulations, the policy will require the approval of the general meeting by majority vote as set forth in section 275 of the Companies Law.

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33 For further information, including pertaining to the matter of controlling shareholders who have a personal interest, see transaction report and notice of convening of an extraordinary general meeting published by the Company on August 2, 2012, noted here by way of reference.

34 For further information, including pertaining to the matter of controlling shareholders who have a personal interest, see transaction report and notice of convening of an extraordinary general meeting published by the Company on August 29, 2012, noted here by way of reference.

6. **<u>Agreement for acquiring satellite broadcast space segments</u>**

On March 6 2013, the Company decided to approve (subsequent to the approval of the audit committee) and recommend to the general meeting of the Company shareholders, with regard to the Company's vote in the general meeting of the shareholders of DBA, to vote in favor of DBS engaging with Space Communication Ltd in an agreement for the lease of space segments. For further information see section 5.18.1 in the chapter on Description of the Company's Businesses.

10. Regulation 24: Holdings of interested parties and senior officers in shares and other securities of the Company, a subsidiary or related company, as close as possible to the reporting date.

A. Company shares and securities convertible into shares of the Company

The holdings of the Company's interested parties and executive officers are presented in this report by way of reference to the report on the holdings of interested parties and executive officers dated March 7, 2013.

B. The Company's other securities

As at the date of the periodic report, 733,416,725 Debentures (Series 5) of the Company are held by the subsidiary, Bezeq Zahav (Holdings) Ltd.

C. Securities of a related company

As at the date of the periodic report, 15,015 DBS shares, constituting 50.22% of the issued equity are held by Eurocom DBS Ltd., a company indirectly controlled by Mr. Shaul Elovitch (the indirect controlling shareholder of the Company). For further information pertaining to trusteeship of the rights to shares pursuant to the conditions of the regulatory approvals for the acquisition of control of the Company by B Communications, see section 1.3.1 of Chapter A of the periodic report - Description of the Company's Businesses.

11. Regulation 24 A: Registered capital, issued capital, and convertible securities

A. Registered capital and issued capital

The Company's registered equity as at the date of the periodic report is 2,825,000,000 ordinary shares of NIS 1 par value each.

The Company's issued and paid-up share capital as of the date of the periodic report is 2,724,988,010 ordinary shares of NIS 1 par value each.

B. The 2007 Options Plan for Managers and Senior Employees Under the options plan for managers and senior employees, which includes up to 65,000,000 options earmarked for exercise into up to 65,000,000 Company shares (less disposals), as at the date of the periodic report 59,016,667 options, exercisable into ordinary shares of NIS 1 par value each of the Company, have been allotted, at weighted exercise price of NIS 2.84. As at the publication date of the periodic report, 56,160,781 of these options have been exercised into shares and the balance of unexercised options is 2,855,886. The plan will be valid until December 31, 2018.

C. 2010 Employee Options Plan: In accordance with the employee options plan, which includes up to 70,000,000 shares of the Company of NIS 1 par value each (which includes 87,455 options allotted to two employee directors, on January 25, 2011 under a private placement report dated December 20, 2010), 67,045,771 options are exercisable into ordinary shares of NIS 1 par value each were allotted under an outline dated December 20, 2010, at weighted exercise price of NIS 5.16. As at the publication date of the periodic report, 132,271 of these options have been exercised into shares and the balance of unexercised options is 66,718,296. The plan will be valid until December 31, 2017.

D. Treasury shares The issued equity of the Company does not include treasury shares.

12. Regulation 24B: Register of Shareholders

The Company's Register of Shareholders is presented in this report by way of reference to the Company's statement of equity and from the registered securities of the Company and adjustments made on March 28, 2012.

13. Regulation 25A Registered Address of the Company

Address: 132 Menachem Begin Avenue, Azrieli Center, (Triangle Tower), 27th Floor, Tel Aviv

Telephone 1: 03-626-2200; Telephone 2: 03-626-2201; Fax: 03-626-2209

Email: linoryo@bezeq.co.il (Company Secretary).

14. **Regulation 26: Directors of the company**

Name I.D.: Date of birth: Citizenship:	Address for delivery of court notices:	Membership on Board of Directors Committees: Serves as an external or independent director	Employee of the Company, a subsidiary, related company or interested party:	Date of commencement of term of office:	Education and employment during the past five years and details of the companies in which he serves as a director:	Related to other interested parties in the Company:	Does the Company consider the director as having accounting and financial expertise
Shaul Elovitch 042089367 Jan 4, 1948 Israeli	2 Dov Friedman Street, Ramat Gan, 52503	Chairman of the board of directors, member of the security committee The director is not an external director.	No	April 14, 10	Occupation during past five years: Chairman and owner of Eurocom Group. The companies in which he serves as a director: Chair of the board of the following companies: Pelephone Communications Ltd. – Chairman; Bezeq International Ltd. – Chairman; Bezeq Zahav (Holdings) Ltd. – Chairman; Walla! Communications Ltd; Bezeq Online Ltd.; Eurocom Holdings (1979) Ltd.; Eurocom Communications Ltd.; Eurocom Cellular Communications Ltd.; Eurocom Industries (1986) Ltd.; Eurocom Digital Communications Ltd.; Trans-Global Industries PTE Ltd.; Internet Gold – Golden Lines Ltd.; B Communications Ltd.; Eurocom DBS Ltd.; B. Communications Ltd. Director of Eurocom Communications Holdings 2005 Ltd; D.B.S. Satellite Services (1998) Ltd; Eurocom Technologies Management (2005) Ltd.; Eurocom Assets Ltd.; Eurocom Assets Holdings Ltd; Eurocom General Management Ltd.; D.M. 3000) Engineering Ltd.; Space Communication Ltd.; Satcom Systems Ltd.; Gilat Satcom Ltd.; Gaya Com Ltd.; IP Planet Network Ltd.; Satlink Communication Ltd.; E.G.R.E Ltd.; B Communication (S.P. 1) Ltd.; B Communication (S.P. 2) Ltd.; Eurocom Media-Net Holdings Ltd.; Eurocom Networks 21 Ltd.; Eurocom Networks and Technologies Ltd; Eurocom Holdings and Investment Ltd.; Eurocom Management and Investment Ltd.; Eurocom Investment Management 2005 Ltd.; Eurocom Real Estate Ltd.; Mivnei Dolinger Construction and Investment Ltd.; Mivnei Dolinger (City Gate) Construction and Investment Ltd.; R.F. Investments and Promotion 1988 Ltd.; Continental – Construction & Investment Company – D.A. Ltd.; Eurocom Project Management (1990) Ltd.; MNB Tulip Trustees (2002) Ltd.; Shem VeTehila Assets and Investments Ltd.	Father of Or Elovitch and father-inlaw of Orna Elovitch Peled who, inter alia, serve as officers in Bezeq and its subsidiaries and/or related companies. Brother of Yosef Elovitch, controlling shareholder (indirect) of Bezeq	Yes

Name I.D.: Date of birth: Citizenship:	Address for delivery of court notices:	Membership on Board of Directors Committees: Serves as an external or independent director	Employee of the Company, a subsidiary, related company or interested party:	Date of commencement of term of office:	Education and employment during the past five years and details of the companies in which he serves as a director:	Related to other interested parties in the Company:	Does the Company consider the director as having accounting and financial expertise
Yitzhak Edelman: 50066174 July 1, 1950 Israeli	9 Rahel Hmeshoreret St., Herzliya	Audit committee, committee for reviewing financial statements, remuneration committee The director is an external director.	No.	February 1, 2008 (term of office extended by a further 3 years as of February 1, 2011)	Education: BA Accounting and Economics from Tel Aviv University; Advanced Business Management course at Harvard; Coordinator of Financial Management course for MA Accounting and Economics at Bar Ilan University The companies in which he serves as a director: Bank of Israel; AVT; Love Foundation (Beit Issie Shapiro); Beit Zvi - School of Performing Arts; Swiftnet Co. Ltd. (external director)	No	Yes. The Company considers the director as having accounting and financial expertise and as an external expert director
Orna Elovitch Peled 028735587 June 8, 1971 Israeli	2 Dov Friedman Street, Ramat Gan, 52503	No The director is not an external director.	No	April 14, 10	Education: B.Sc. majoring in Finance and Economics, New York Institute of Technology. Occupation during past five years: CEO , McCann Boutique; 2005-2009 The companies in which she serves as a director – D.B.S. Satellite Services (1998) Ltd. and Bezeq International Ltd.; Walla Communications Ltd.	Wife of Mr. Or Elovitch, a director at the Company and daughter-in-law of Mr. Shaul Elovitch, the controlling shareholder (through holdings).	No
Or Elovitch 038475117 May 24, 1976 Israeli	2 Dov Friedman Street, Ramat Gan, 52503	No The director is not an external director.	Yes, see details of employment during past five years	April 14, 10	Education: BA in Business Administration, College of Management; MBA majoring in Finance, City University of New York Occupation during past five years: CEO of Eurocom Communications Ltd. as of 2011, Executive VP Business Development and Investments in Eurocom Communications Ltd. until 2011; The companies in which he serves as a director: Chair of the board of the following companies: Space-Communications; board of directors of Eurocom Capital Finances Ltd.; board of directors of Enlight Renewable Energy Solutions Ltd. Director of Satcom Systems Ltd.; B Communications Ltd.; Pelephone Communications Ltd.; DBS Satellite Services (1998) Ltd.; Bezeq Online Ltd.; Bezeq Zahav Holdings Ltd.; Walla! Communications Ltd. (and other private Walla Group companies - Coral Tel Ltd., Kama Price Comparison, Shopmind Ltd.); B Communications (S.P.1); B Communications (S.P.2); Gilat Satcom Ltd.; Gaya Com, Ltd.; I.P. Planet Network Ltd.; Telserve Limited (owned by Stacom Group); Satlink Communications Ltd.; E.G.R.E, Ltd.; Eitag Ltd.; E.G.R.E. (USA) Ltd.; Pilat Media Global PLC Ltd. and The Time Innovations Ltd.	Son of Shaul Elovitch, the controlling shareholder of the Company and husband of Orna Elovitch-Peled who serves as a director of the Company, and nephew of Yosef Elovitch (brother of Shaul Elovitch), a controlling shareholder (through holdings) of Bezeq	Yes

Name I.D.: Date of birth: Citizenship:	Address for delivery of court notices:	Membership on Board of Directors Committees: Serves as an external or independent director	Employee of the Company, a subsidiary, related company or interested party:	Date of commencement of term of office:	Education and employment during the past five years and details of the companies in which he serves as a director:	Related to other interested parties in the Company:	Does the Company consider the director as having accounting and financial expertise
Eldad Ben-Moshe 058774290 June 8, 1964 Israeli	17 Bazelet Street, Shoham, 60850	Audit committee. The director is not an external director. The director is an independent director.	No.	April 14, 10	Education: B.A. in Accounting and Economics, Tel Aviv University; MBA, Tel-Aviv University and Certified Public Accountant Occupation during past five years: CEO of Inrom Industries Ltd. The companies in which he serves as a director: Chair of the board of the following companies: Ytong, Ltd.; Carmit Mister Fix Ltd.; Alony Corporation, Ltd.; Orlite (Millennium) Ltd.; Ordan Metal Casting Industries, Ltd.; Nirlat Paints, Ltd.; Anan Dvash Ltd. Director of HM-Let (Israel-Canada)	No	Yes
Felix Jan Co, n: 26809806 Dec 14, 53 Israeli	2 Dov Friedman Street, Ramat Gan, 52503	No The director is not an external director.	Yes, see details of employment during past five years	April 14, 10	Education: High School Occupation during past five years: CFO of Eurocom Group. The companies in which he serves as a director during past five years: until 2011 director of E.G.R.E, Ltd.; The companies in which he serves as a director: Internet Gold – Golden Lines Ltd.; D.M. (3000) Engineering Ltd.; Enlight Renewable Energy Ltd.; Bezeq International Ltd.; Bezeq Online; Space Communications Ltd.	No	Yes
Rami Nomkin: 042642306 Jan 14, 49 Israeli	126 Mohaliver Street, Yahud	No The director is not an external director.	Yes, see details of employment during past five years	Jan 17, 07	Education: High School Occupation during past five years: From 2009, manager of Bezeq's sales department; from 2011 – employee of Bezeq spokesperson division; The director is an employee director.	No	No

Name I.D.: Date of birth: Citizenship:	Address for delivery of court notices:	Membership on Board of Directors Committees: Serves as an external or independent director	Employee of the Company, a subsidiary, related company or interested party:	Date of commencement of term of office:	Education and employment during the past five years and details of the companies in which he serves as a director:	Related to other interested parties in the Company:	Does the Company consider the director as having accounting and financial expertise
Mordechai Keret 054759915 May 7, 57 Israeli	12 Hanurit Street, Tel Mond	Audit committee - Chair; Remuneration committee - Chair; committee for reviewing of financial statements; security committee and internal enforcement committee The director is an external director.	No.	Feb 4, 10	Education: CPA - BA in Accounting and Finance, Tel Aviv University Occupation during past five years: CEO and owner of Keret Management and Holdings from 2002 to present; The companies in which he serves as a director during past five years: Chair of board of directors of Gmul Investment Company, 12/2007-7/2008; Director, Gmul Investment Company, 12/2007-7/2009; deputy Chair and CEO Gmul Investment Co. Ltd. 9/2008-12/2008; Chair of board of directors of Multimatrix, Ltd., 1/2007-3/2008; director of Gmul Real Estate, Ltd., 12/2007-7/2009; The companies in which he serves as a director: TIA Investments – external director, Priortech Ltd.; ISSTA Lines, Ltd.; ISSTA Israel Ltd.; Histour Eltive Ltd; Shirliad Sea City Ltd.; Shirliad Holdings Ltd.; Keret Managment an Holdings Ltd.	No	Yes. The Company considers the director as having accounting and financial expertise and as an external expert director

Name I.D.: Date of birth: Citizenship:	Address for delivery of court notices:	Membership on Board of Directors Committees: Serves as an external or independent director	Employee of the Company, a subsidiary, related company or interested party:	Date of commencement of term of office:	Education and employment during the past five years and details of the companies in which he serves as a director:	Related to other interested parties in the Company:	Does the Company consider the director as having accounting and financial expertise
Amikam Shorer 059821983 July 27, 67 Israeli	2 Dov Friedman Street, Ramat Gan, 52503	Security committee, internal enforcement committee The director is not an external director.	No.	April 14, 10	Education: BA LLB, Bar Ilan University Occupation during past five years: Executive VP Business Affairs at Eurocom - Communications Ltd. 2005 - 2011; CEO Enlight Renewable Energy Ltd. 2008-2010; former CEO of Satcom Systems Ltd. 2007-2008; The companies in which he serves as a director: Chair of the board of the following companies: Satcom Systems Ltd.; Eurocom - Communications Ltd.; board of directors of E.G.R.E. Ltd.; director of Enlight Renewable Energy Ltd.; Pelephone Communications Ltd.; Bezeq International Ltd.; DBS Satellite Services (1998) Ltd.; Walla! Communications Ltd.; Bezeq Online Ltd.; Bezeq Zahav (Holdings) Ltd.; Space Communications Ltd.; Satcom Systems Ltd.; Gilat Satcom Ltd.; Gaya Com, Ltd.; I.P. Planet Network Ltd.; Satlink Communications Ltd.; Internet Gold – Golden Lines Ltd.; Phoenix Data Pty. Ltd.; B Communications (SP 1); B Communications (SP 2); Eurocom Capital Underwriting Ltd.; Eurocom Capital Finances Ltd.; Enlight Renewable Engergy Ltd.; E.G. R.E. Ltd.; Eitag Ltd.; E.G.R.E. (USA) Ltd.; Ranitech Yezum 2007 Ltd.; IP Planet Network; TCL Teleserve Communications Ltd.; TNL Teleserve Network Ltd.; Teleserve Limited	No	No

Name I.D.: Date of birth: Citizenship:	Address for delivery of court notices:	Membership on Board of Directors Committees: Serves as an external or independent director	Employee of the Company, a subsidiary, related company or interested party:	Date of commencement of term of office:	Education and employment during the past five years and details of the companies in which he serves as a director:	Related to other interested parties in the Company:	Does the Company consider the director as having accounting and financial expertise
Yehoshua Rosenzweig 013841069 Aug 17, 52 Israeli	c/o Agmon - Electra Building, 98 Yigal Alon Street, 46-47th floor, Tel Aviv 6789141	Internal enforcement committee - Chair; audit committee; committee for reviewing financial statements; remuneration committee The director is not an external director. The director is an independent director.	No (other than as a director in subsidiaries)	Nov 22, 10	Education: LL.B, Bar Ilan University; LL.M and LL.D, New York University. Occupation during past five years: (a) Law firms: from 2005 Attorney at Rosenzweig & Aviram Law firm; from 2012 Attorney at Agmon & Co. , Rosenzweig HaCohen & Co. law firms. (b) Business / public: Chair of Bar Ilan University Executive Committee (since 2009); Chair of advisory committee to the Government Companies Authority (since 2011). The companies in which he serves as a director: Waterfall Solutions Ltd. - Chair; Gita Technologies Ltd. – Chair; Rosenram Development Co. Ltd.; Pelephone Communications Ltd.; Bezeq International Ltd.; Bezeq Zahav (Holdings) Ltd.; Rosenram Trust Co. Ltd.; Rosenzweig Legal Services Ltd.; Rosetta Green Ltd.; Rosetta Genomics Ltd.; Solarpower Systems Ltd.; Alrov Real Estate & Hotels Ltd.; Tzohar Simulation Investments Ltd., Babua Advanced Sciences Ltd., Babua Simulation Investments (1996) Ltd.	No	Yes
Yair David 058418401 April 23, 64 Israeli	7/8 Oranim, Afula	No The director is not an external director.	Yes, see details of employment during past five years	Oct 11, 12	Education: BA Business Administration - Ruppin Academic Center, Diploma Industrial and Management Engineering in Marketing - Bezeq College Occupation during past five years: Infrastructure Maintenance Dept. of North Execution Division 2007-2009; Narrow band Dept. of North Execution Div. 2009-2011; Contractor Supervision of North Execution Div. 2011-2012 The director is an employee director.	No	No

Name I.D.: Date of birth: Citizenship:	**Address for delivery of court notices:**	**Membership on Board of Directors Committees: Serves as an external or independent director**	**Employee of the Company, a subsidiary, related company or interested party:**	**Date of commencement of term of office:**	**Education and employment during the past five years and details of the companies in which he serves as a director:**	**Related to other interested parties in the Company:**	**Does the Company consider the director as having accounting and financial expertise**
Tali Simon 024017006 Mar 7, 69 Israeli	26 Meir Ya'ari St., Tel Aviv	Audit committee; remuneration committee; committee for reviewing financial statements The director is an external director.	No.	Jan 21, 13	Education: CPA, BA Economics and Accounting, Ben Gurion University Occupation during past five years: CFO at Gazit Globe Israel (Development) Ltd. The companies in which she serves as a director during past five years: External director at Fungaya Real Estate Ltd. 8/2010 - 5/2011 The companies in which she serves as a director – Acad Construction and Investments Ltd.; Acad Equipment (1979) Ltd. G BULGARIA EAD PLOVDIV RETAIL CENTER (EAD TRIDENT AD) G MACEDONIA AD Horev Center Management Company Ltd.	No	Yes. The Company considers the director as having accounting and financial expertise and as an external expert director

15. Regulation 26A Senior officers

Name	I.D.:	Date of birth:	Date of commencement of term of office:	The office he holds in the Company:	Is he and interested party in the Company or a family member of another senior officer or of an interested party:	Education and business experience over the past five years:
Avi Gabbay	59777920	Feb 22, 67	Nov 14, 07	CEO (expected to teminate term as CEO of Company on April 14, 2013).	Yes. Interested party in the Corporation by virtue of his service as Company CEO.	BA Economics, Hebrew University MBA, Hebrew University
Ran Guron	024113268	Dec 25, 68	Jan 9, 06	Deputy CEO and VP Marketing	No.	BA Economics and Business Administration, Hebrew University MBA, Hebrew University
Dudu Mizrachi	024810368	Jan 28, 70	Jun 28, 07	Deputy CEO and CFO	No.	BA Economics, Hebrew University in Jerusalem 2007-2012 VP Economics and Budgets at Bezeq
Guy Hadas	029654472	Sept 8, 72	Dec 9, 07	VP Corporate Communications	No	BA in Economics and Media, Tel Aviv University MBA, Tel Aviv University
Itamar Harel	028054666	Oct 18, 70	Oct 25, 07	VP, Manager of Private Division	No	MBA in Marketing and Accounting, Hebrew University
Linor Yochelman	032037939	Feb 11, 75	Aug 19, 07	In charge of internal enforcement and Company Secretary Company secretary of subsidiaries: Bezeq International Ltd.; Bezeq Online Ltd.; Bezeq Zahav Holdings Ltd.; Walla Communications Ltd. and Company Secretary of Walla Communications Ltd. subsidiaries: Coral Tel Ltd.; Shopmind Ltd., Yoram Limudim Ltd., Jobciti Ltd., Kama Price Comparison Ltd., Yad 2 Car Pricelist Ltd.	No	Education and business experience over the past five years: BA Business Administration, Interdisciplinary Center, Herzliya LL.B, Interdisciplinary Center, Herzliya
Ehud Mezuman:	052176336	Feb 17, 54	Oct 25, 07	VP Human Resources	No	3 years studies at Tel Aviv University – Social Sciences (no degree) 2005-2007 – Deputy VP Human Resources and Director of Management Development Department
Amir Nachlieli	23012313	May 30, 67	Jan 1, 09	VP, Legal Counsel	No	MBA (expanded major in Finance), Tel Aviv University BA Economics, Hebrew University LL.B, Hebrew University 2007 – 2008 – Legal adviser to Colmobil Ltd.

Name	I.D.:	Date of birth:	Date of commencement of term of office:	The office he holds in the Company:	Is he and interested party in the Company or a family member of another senior officer or of an interested party:	Education and business experience over the past five years:
Danny Oz:	054299953	Jun 16, 56	Sept 1, 98	Accountant and deputy CFO	No	BA Economics & Accounting, Hebrew University, Certified Public Accountant's License EMBA – Integrative Administration, Hebrew University Since September 1998 – Company Accountant
Yaakov Paz	058610999	Oct 21, 63	Nov 1, 07	VP, Manager of Business Division	No	Since 2006 – Chairman of board of directors of Alcatel Telecom Israel Ltd.
Sharon Fleischer Ben Yehuda	028531648	Apr 25, 71	June 1, 06	VP Regulation	No	BA Political Science, , Hebrew University in Jerusalem MA Public Policy and Administration, Hebrew University
Yuval Keinan	032089245	Feb 23, 75	Aug 1, 07	VP IT and Network	No	BA Computer Science, Merci College
Eyal Kamil:	057248999	Aug 30, 61	Dec 5, 06	VP Operations & Logistics	No	BA, Industrial Engineering & Management, Tel Aviv University MBA, Tel Aviv University
Lior Segal:	025695701	Sept 9, 73	Jan 24, 11	Internal Auditor	No	MBA, LLB, BA Accounting and Diploma in Accounting- all from the Tel Aviv University; Diploma in internal and public auditing on behalf of the IMC Israel Bar Association license and Israel CPA license Head of Internal Procedures and Control since 2009; Corporate Governance Officer since 2010; both at Bezeq, until appointment as internal auditor; Accountant at Alut Communications Ltd. 2007-2008;
Gil Sharon	058381351	Sept 12, 63	Oct 11, 05	CEO of subsidiary, Pelephone Communications Ltd.	No	BA Economics and Business Administration, Hebrew University; MBA Business Administration, Tel Aviv University
Yitzhak Benbenisti	059146415	Jan 21, 65	Nov 1, 07	CEO of the subsidiary, Bezeq International Ltd.	No	BA Economics, Hebrew University MBA (expanded major in Finance and Marketing), Hebrew University

<u>Below are the names of the senior officers who completed their term of service during the course of 2011 and by the date of publication of the periodic report for 2010:</u>

Eliyahu Frank – ceased serving as a VP Technologies and Network on March 14, 2012

Alan Gelman - ceased serving as deputy CEO and CFO of the Company on December 31, 2011.

Yehuda Porath - ceased serving as a director of the Company on April 4, 2012.

Arieh Saban – ceased serving as a director of the Company on December 25, 2012.

16. Regulation 26B: Independent authorized signatories:

The Company has no independent authorized signatories.

17. Regulation 27: The Auditors of the Company

Somekh Chaikin, Certified Public Accountants

Address: 17 Ha'arba'a St.

Millennium Tower KPMG

Tel Aviv, 64739

Tel: 03-684-8000

18. Regulation 28: Changes in the Memorandum or Articles of Association

During the reporting year, no changes were made to the Memorandum or Articles of Association

19. Regulation 29 (A) Recommendations and Resolutions of the Board of Directors before the General Meeting and their Resolutions which are not subject to the approval of the General Meeting in the issues specified in Regulation 29(A)

A. Resolution dated March 14, 2012 – (a) to recommend to the General Meeting of shareholders of the Company (a) to distribute to the shareholders of the Company a cash dividend in the total sum of NIS 1,074 million (b) a bonus for Mr. Yehuda Porat for 2011 in the amount of NIS 95,000, for compliance with goals and based on administrative recommendation.

B. Resolution dated August 8, 2012 – to recommend to the General Meeting of shareholders of the Company to pay the shareholders of the Company a cash dividend in the total sum of NIS 997 million.

C. With regard to extraordinary transactions see sections 9 above and 21 below.

D. Resolution dated March 13, 2012 – (a) to recommend to the General Meeting of shareholders of the Company to pay the shareholders of the Company a cash dividend in the total sum of NIS 861 million; The resolution pertaining to distribution is subject to the approval of the general meeting of the Company's shareholders.

20. Regulation 29 (C) Resolutions adopted at an Extraordinary General Meeting (EGM)

A. Approval of voting in the general meeting of DBS shareholders in favor of amendment to DBS's engagement with Digital Broadcast S.A. and Eurocom Digital Communications Ltd., see section 9.C.1 above (Resolutions dated March 27, 2012 and July 25,2012).

B. Approval of the appointment of Somekh Chaikin &Co. accounting firm as the Company's auditors for 2012 and the board of directors authority to determine their fee (Resolution dated April 24, 2012).

C. Electing the following directors to an additional term of office in the Company: Or Elovitch, Orna Elovitch-Peled, Arieh Saban, Eldad Ben Moshe, Amikam Shorer, Felix Cohen, Rami Nomkin (employee director), Yehoshua Rosenzweig and Shaul Elovitch (Resolution dated April 24, 2012).

D. Approval of the distribution of a cash dividend to the Company's shareholders in the amount of NIS 1,074 million. (Resolution dated April 24, 20102).

E. Approval for granting a bonus for 2011, in the amount of NIS 95,000, to former director, Mr. Yehuda Porat, in his position as head of the Security and Safety department of the Company (Resolution dated April 24, 2012).

F. Approval of voting in the shareholders general meeting of DBS in favor of DBS engagement with Advanced Digital Broadcast S.A. and Eurocom Digital Communications Ltd. see section 9.C.1 above (Resolution dated April 24, 2012 and July 25, 2012).

G. Approval of the distribution of a cash dividend to the Company's shareholders in the amount of NIS 997 million. (Resolution dated September 6, 2012).

H. Approval of Bezeq International engagement in an agreement with DBS - see section 9 (Resolution dated September 6, 2012).

I. Approval of the appointment of Mr. Yair David as a director, from among the employees, in the Company and providing him with a letter of indemnification (Resolution dated October 11, 2012).

J. Approval of voting in the general meeting of Pelephone shareholders in favor of the amendment to the engagement of Pelephone with Eurocom Cellular Communications Ltd. - see section 9 (Resolution dated October 11, 2012).

21. Regulation 29A(1) - (3): Transactions requiring extraordinary approvals (extraordinary transactions)

1. On March 13, 2013 the board of directors decided to recommend to the general meeting of the Company’s shareholders to approve amending and extending the DBS engagement with Space Communications Ltd. in an agreement to acquire satellite segments until 2028 (the original agreement is expected to expire in 2016) and for an amount of USD 227 million.

2. The board of directors decided on March 13, 2013 to grant bonuses for 2012 to the Company's CEO of Pelephone, the CEO and deputy CEO and former CFO of Bezeq International as set forth in section 7 above. These transactions were classified as extraordinary transaction based on the criteria for classification of an extraordinary transaction set in March 2012 by the audit committee. (The board of directors assesses the compliance with preset goals of each of the foregoing managers).

22. Regulation 29A (4): Directors and Officers Liability Insurance and Undertakings to Indemnify Officers

A. Insurance

1. The Company's board of directors decided on January 28, 2010 as approved by the general meeting of the Company's shareholders on March 8, 2010, to convert the existing directors and officers current liability insurance policy to a run-off policy.[35].

2. The resolution of the Company's Board of Directors dated March 7, 2011, which has not yet been approved by the general meeting of the shareholders of the Company on April 13, 2011, pertaining to the Company purchasing, during the regular course of business, future insurance policies to cover liability of directors and officers, as they may be from time to time, including directors and officers who are and who may be considered to be controlling shareholders in the Company, and all by way of a framework transaction, as this is defined in the Companies Regulations (Relief in Transactions with Interested Parties), 2000[36].

3. The Company's board of directors resolution of March 7, 2012, in accordance with the resolution approved by the general meeting of the Company's shareholders on April 13, 2011, pertaining to the Company's engagement in a directors and officers liability insurance policy for the year commencing April 14, 2012 through April 13, 2013. The annual premium that the Company will pay is USD 185,000. The liability limit is USD 100 million per claim and in total for each insurance year, and up to USD 20 million per claim or in total for the insurance period for legal expenses in Israel only Furthermore, the accumulative liability limit for subsidiaries is half of this amount (as part of the above liability limit).

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35 For further information see the report on the outcome of the general meeting published by the Company on March 3, 2011, noted here by way of reference.

36 For further information see the report on the outcome of the general meeting published by the Company on April 13, 2011, noted here by way of reference.

4. The resolution adopted by the Company's board of directors on March 13, 2013 pertaining to the Company engaging in a directors and officers liability insurance policy. See section 9 above.

B. Indemnification Undertaking

Resolution dated January 17. 2007 pertaining to the approval for granting an undertaking to indemnify according to a deed of indemnity for all of the Company's.[37]

The resolution dated October 26, 2011, to approve an amendment to the letters of indemnification granted to officers currently employed in the Company (including for directors or officers who are controlling shareholders of the Company, or their relatives[38].

March 13, 2013	
Date	Bezeq – The Israel Telecommunication Corp Ltd.

Signatories and their positions:
Shaul Elovitch (Chairman of Board of Directors)
Avi Gabbay, CEO

37 For further information see the report on the outcome of the general meeting published by the Company on January 17, 2007, noted here by way of reference.

38 For further information, including with regard to the controlling shareholders who have a personal interest, see Transaction Report and notice for convening an extraordinary general meeting issued by the Company on September 12, 2011, noted here by way of reference.
further information see the report on the outcome of the general meeting published by the Company on March 3, 2011, noted here by way of reference.

CORPORATE GOVERNANCE QUESTIONNAIRE

In this Questionnaire please note that -

(1) **The format of the questionnaire is prepared in a way that the response "True" to any of the questions is an indication of proper corporate governance, and vice versa A "True" response is marked √ in the appropriate box and a "False" response is marked X; to dispel any doubt, it is hereby clarified that the questionnaire does not cover all aspects of corporate governance relevant to the Company, rather it deals with only a few aspects; the Company's ongoing reports should be reviewed for further information regarding any issue (in accordance with the issue).**

(2) **The "reporting year" means from January 1, 2012 through December 31, 2012 preceding the date of the periodic report; nonetheless, the "reporting year" with regard to a company that chooses to apply the questionnaire retrospectively will refer to (at least) October 1, 2011 through September 30, 2012 (with regard to retrospective application in the quarterly report as at September 30, 2012). With regard to a company that chooses to apply the questionnaire in an immediate report (in Form T-121), the "reporting year" will refer to one full year ending close to the date on which the questionnaire is published:**

(3) **Norms are indicated alongside each question. If the question is mandatory, it is explicitly indicated;**

(4) **If a company wishes to add information relating to its response in the questionnaire that may be significant to a reasonable investor, it can do so under concluding notes in the questionnaire, with a reference to the relevant question.**

BOARD OF DIRECTORS AUTONOMY					
			True	**False**	**Guideline**
1.		Did two or more external directors hold office in the Company during each reporting year? This question can be answered True, if the period during which two external directors did not hold office does not exceed 90 days, as provided in section 363a (B) (10) of the Companies Law, nonetheless for any (True/False) answer, the period (in days) during which two or more external directors did not hold office in any reporting year, should be indicated (including a term of office approved retrospectively, while differentiating between the various external directors): **Director A: Mordechai Keret** **Director B: Yitzhak Edelman:** The number of external directors who held office in the Company at the publication date of this questionnaire: 3	√		**Mandatory Guideline** Section 239 of the Companies Law.

2.	A.	The number of independent directors who held office in the Company at publication date of this questionnaire: 5 (including 3 external directors)	√	_____.	Companies Law - section 1 of the first Addendum (Recommended Corporate Governance Guidelines) and Regulation 10(B) (9A) and 48(c) (9A) of the Reporting Regulations.
	B.	At date of publication of this questionnaire - - In a company that has a controlling shareholder or a shareholder who holds a controlling bloc (in this section - Controlling Shareholder) - at least one third of the board members are independent. - In a company that has no controlling shareholder - the majority of the board members are independent.	√		
	C.	The Company prescribed in its Articles of Association that a minimum rate[1]/number of independent directors will hold office. If your answer is True, please indicate - The rate/number of independent directors prescribed in the Articles of Association: _____. In practice, the Company complied with the provisions of the Articles of Association during the reporting year (with respect to the office of independent directors): ☒ Yes ☐ No (Mark an X in the appropriate box).		☒	
3.		A survey conducted among the external directors (and the independent directors) during the reporting year found that they are in compliance of the provisions of sections 240 (b) and (f) of the Companies Law regarding the absence of relationship between the external directors (and independent directors) who held office in the Company and they are in compliance with the conditions required for holding office as an external director (or independent director). If your answer is True - please indicate the entity that conducted such survey: In charge of internal enforcement and Company Secretary	√		Sections 240(b), 241, 245A and 246 of the Companies Law

1 In this questionnaire the term “rates" - a certain number out of all the directors. Thus, for example, a company that prescribed a rate of one third independent directors will indicate 1/3.

4.		None of the directors who held office in the Company during the reporting year are subordinate[2] to the CEO, directly or indirectly, (other than a director who represents the employees, if the Company has employee representation) If your answer is False (i.e. a director is subordinate to the CEO as aforesaid) - please indicate the number of directors who do not comply with the foregoing restriction: _____.	√		Companies Law - section 3 of the first Addendum (Recommended Corporate Governance Guidelines).
5.		Prior to commencing any board meeting, the Company asked each director participating in the discussion and/or in the vote for disclosure concerning his/her having a personal interest and/or conflict of interest in the topic on the agenda for that meeting, accordingly.[3] In addition, please indicate whether the directors who informed of the existence of personal interest and/or conflict of interest participated in said discussion and/or vote (other than a discussion and/or vote in which a majority of the directors had such personal interest, as set forth in section 278 (b) of the Companies Law): ☐ Yes The number of such directors who participated in the discussion and/or vote: _____. (Please insert additional lines according to the number of discussions/votes that took place in the reporting year). ☐ No			Sections 255, 269 and 278 of the Companies Law
6.		During the reporting year the board of directors did not refuse to provide professional consultation services at the expense of the Company, at the request of a director, pursuant to section 266 (a) of the Companies Law, if required. If your response is False (i.e. the board of directors refused as aforesaid) - the director's reasons for submitting such request and the board's reasons for rejecting the request must be specified, or alternatively, a reference must be given to an immediate report in which these are disclosed: _____. ☒ not applicable (the board did not receive such request)	√		Section 266 (a) of the Companies Law.

2 Holding office as a director in an investee will not be deemed as being "subordinate" in the matter of this question.
3 In a year of initial implementation, the company may refrain from answering this question.

7.		The controlling shareholder (including a relative and/or representative acting on his/her behalf), who is not a director or other executive officer in the Company, did not participate in the board meetings held during the reporting year. If your answer is False (i.e. a controlling shareholder and/or his/her relative and/or representative who is not a board member and/or executive officer in the Company participated in board meetings, as aforesaid) - please note the following details concerning the participation of the additional person in the board meetings, as aforesaid: Identity: _____. Position: _____. Details of the relationship to the controlling shareholder (if the individual who participated is not the controlling shareholder): _____. Was this due to the presentation of a specific topic: ☐ Yes ☐ No (Mark an X in the appropriate box). The extent of his/her participation in board meetings held during the reporting year: _____. Not applicable (the Company has no controlling shareholders).	√		Section 106 of the Companies Law.

DIRECTORS' QUALIFICATIONS AND SKILLS						
				True	**False**	**Guideline**
8.		The Company's Articles of Association do not include a provision restricting the option of immediately terminating the office of all the Company's directors who are not external directors (in this matter - an ordinary majority decision is not considered a restriction). If your response is False (i.e., there is such restriction), please indicate -			☒	Sections 85 and 222 of the Companies Law, section 46B of the Securities Law
		A.	The term of office set in the Articles of Association for a director: with regard to a director who is not an external director - from date of appointment until the date of the following general meeting, with regard to an external director - pursuant to the provisions of the Companies Law.	-		

		B.	The majority required as prescribed in the Articles of Association for terminating the terms of office of the directors: Extraordinary majority (65%)	-		
		C.	The requisite quorum prescribed in the Articles of Association for a general meeting convened to terminate the term of office of directors: Ordinary quorum - two members holding together at least 51% of the company's issued share capital.	-		
		D.	The majority required to change these provisions in the Articles of Association: Extraordinary majority (65%)	-		
9.		All the directors who held office in the Company during the reporting year declared, prior to the date for the convening of the general meeting at which their appointment was on the agenda, that they have the required qualifications (with details) and the ability to devote appropriate time for carrying out their duties and that the restrictions envisaged in sections 226 and 227 of the Companies Law are not applicable to them; and with respect to independent directors, they are also in compliance with the provisions of paragraphs (1) and (2) of the definition of an "independent director", in section 1 of the Companies Law. If your response is False - please note the names of the directors who are not in compliance with the foregoing: _____.		√		**Mandatory Guideline** section 224A and 224B of the Companies Law
10.		The Company has a training program for new directors, regarding the Company's area of business and the laws applicable to the Company and its directors, as well as a plan for further training of directors in office, which is adapted, inter alia, to the director's position in the Company. If your response is True - please indicate whether the program was implemented during the reporting year: ☒ Yes ☐ No (Mark an X in the appropriate box).		√		Companies Law - section 4 (a) of the first Addendum (Recommended Corporate Governance Guidelines).
11.		The chairman of the board of directors (or another person so appointed by the board) is responsible for integrating the corporate governance guidelines applicable to the Company and informs the directors of issues relating to corporate governance during the reporting year. If the board of directors appointed another person to the position of responsibility (in place of the chairman of the board), please indicate his/her name and position: **In charge of internal enforcement and Company Secretary, Attorney Linor Yochelman.**		√		Companies Law - section 4 (b) of the first Addendum (Recommended Corporate Governance Guidelines).

12.		A.	The company set a minimum number of directors for the board of directors who are required to have accounting and financial expertise. If your response is True - please indicate the minimum number set: **four directors (including one external director).**	√		**Mandatory Guideline** Section 92[A] (12) of the Companies Law.
		B.	During each reporting year, in addition to the external director with accounting and financial expertise, other directors with accounting and financial expertise served on the board of directors. The number of such directors was determined by the board of directors. *You may answer True for this question if the period during which no other directors with accounting and financial expertise held office on the board did not exceed 60 days, nonetheless if your answer is (True/False), please indicate the period (in days) during which no such directors served on the board: _____.*	√		**Mandatory Guideline** Section 219 [D] of the Companies Law.
		C.	The number of directors who held office during the reporting year was: Directors with accounting and financial expertise: 7. Directors with professional qualifications: *If there were such changes in the number of directors during the reporting year, please provide information of the lowest number (other than during a period of 60 days from the change) of each class of directors who held office during the reporting year.*	_____.	_____.	Sections 92(A)(12), 219(D), 240(1a) of the Companies Law and Regulations 10 (B)(9)(a) and 48(C) (9) of the Reporting Regulations.
13.		A.	On the date of appointment of an external director during the reporting year, the Company was in compliance with the provisions of section 239(D) of the Companies Law concerning the composition of the board of directors, with regard to representation of both men and women. X Not applicable (no external director was appointed during the reporting year)	_____.	_____.	**Mandatory Guideline** Section 239 [D] of the Companies Law.
		B.	Throughout the reporting year the board of directors was composed of both men and women. If your answer is False - please indicate the period (in days) during which this did not occur: _____. *You may answer True for this question if the period during which the board did not include both men and women did not exceed 60 days, nonetheless if your answer is (True/False), please indicate the period (in days) during which the board did not include both men and women: _____.*	√		Companies Law - section 2 of the first Addendum (Recommended Corporate Governance Guidelines).
		C.	The number of men and of women serving on the Company's board of directors at the date of publication of this questionnaire: Men: 10; Women; 2.	_____.	_____.	

<table>
<tr><td colspan="5">BOARD MEETINGS (AND CONVENING OF GENERAL MEETINGS)</td><td></td></tr>
<tr><td colspan="3"></td><td>True</td><td>False</td><td>Guideline</td></tr>
<tr><td rowspan="2">14.</td><td>A.</td><td>The number of board meetings held during each quarter in the reporting year:

Q1 2012 6.
Q2 2.
Q3 5.
Q4 8.</td><td>_____.</td><td>_____.</td><td rowspan="2">Sections 97, 98 and 224A of the Companies Law</td></tr>
<tr><td>B.</td><td>Please indicate, alongside the names of the Company's directors who held office during the reporting year, their participation rate in board meetings (in this subsection - including meetings of the board of directors committees to which they belong, as noted below) held during the reporting year (and with regard to their term of office):

(Please insert additional lines according to the number of directors)</td><td>_____.</td><td>_____.</td></tr>
</table>

Director's Name:	Participation in board meetings:	Participation in audit committee meetings (with regard to a company director serving on this committee)	Participation in meetings of the committee for reviewing of financial statements (with regard to a company director serving on this committee)	Participation in meetings of other board of directors committees on which he/she serves (by indicating the name of the committee)
Shaul Elovitch - Chairman of the board	100%	-	-	Security committee - 100%
Yitzhak Edelman:	100%	100%	100%	-

			Yehoshua Rosenzweig	90%	95%	80%	Internal enforcement committee 100%			
			Mordechai Keret	100%	100%	100%	Internal enforcement committee 100% Security committee - 100%			
			Eldad Ben Moshe	95%	90%	75%	-			
			Amikam Shorer	81%	-	-	Internal enforcement committee 100% Security committee - 100%			
			Orna Elovitch Peled	86%	-	-	-			
			Or Elovitch	100%	-	-	-			
			Felix Cohen:	100%	-	-	-			
			Rami Nomkin:	100%	-	-	-			
			Arieh Saban	73.33%	-	-	-			

			Yair David	100%	-	-	-			
			Yehuda Porat	100%	-	-	-			
15.		During the reporting year, the board of directors held at least one discussion concerning the management of the Company's businesses by the CEO and his subordinate officers, at which they were not present, after they were given the opportunity of expressing their position.							☒	Companies Law - section 5 of the first Addendum (Recommended Corporate Governance Guidelines).
16.		An annual general meeting was convened during the reporting year (no later than fifteen months following the last annual general meeting).						√		**Mandatory Guideline** Section 60 of the Companies Law.

SEPARATION OF THE ROLES OF THE CEO AND BOARD CHAIR					
			True	False	**Guideline**
17.		Throughout the reporting year the board of directors of the Company was chaired by a chairperson. *You may answer True for this question if the period during which the board was not chaired by a chairperson did not exceed 60 days (as set forth in section 363A(2) of the Companies Law) nonetheless if your answer is (True/False), please indicate the period (in days) during which the board was not chaired by a chairperson: _____.*	√		**Mandatory Guideline** Section 94 (a) of the Companies Law.
18.		Throughout the reporting year the Company was managed by a CEO. *You may answer True for this question if the period during which the Company was not managed by a CEO did not exceed 90 days (as set forth in section 363A(6) of the Companies Law) nonetheless if your answer is (True/False), please indicate the period (in days) during which the Company was not managed by a CEO: _____.*	√		**Mandatory Guideline** Section 119 of the Companies Law.

19.		In a company where the chairperson of the board of directors also acts as the CEO and/or exercises his/her authority, the CEO/Chair duality was approved in accordance with the provisions of section 121 (C) of the Companies Law. If your answer is True - please refer here to the immediate report for the general meeting at which such duality and/or exercise of authority was approved: _____. X Not applicable (since such duality does not exist in the Company)		_____.	_____.	**Mandatory Guideline** Sections 95 and 121 of the Companies Law
20.		The CEO is not a relative of the board chair If your response is False (i.e. the CEO is related to the board chair) -		√		Sections 95 and 121 of the Companies Law
		A.	Please indicate the relationship between the parties: _____.	_____.	_____.	
		B.	The office was approved in accordance with section 121(C) of the Companies Law: ☐ Yes ☐ No (Mark an X in the appropriate box).	_____.	_____.	
21.		Controlling shareholders or their relatives do not serve as CEO or as other senior officers in the Company (other than as directors). Not applicable (the Company has no controlling shareholders).		√		Section 106 of the Companies Law.

AUDIT COMMITTEE				
		True	**False**	**Guideline**
22.	All the external directors served on the Audit Committee during the reporting year.	√		**Mandatory Guideline** Section 115 of the Companies Law.

23.	The audit committee chair will be an external director.	√		**Mandatory Guideline** Section 115 of the Companies Law.
24.	The following persons did not serve on the audit committee during the reporting year:	_____.	_____.	**Mandatory Guideline** Section 115 of the Companies Law.
	A. Controlling shareholders or their relatives Not applicable (the Company has no controlling shareholders).	√		
	B. Chair of the Board of Directors	√		
	C. A director employed by the Company or by the Company's controlling shareholders or by another company controlled by them.	√		
	D. A director who regularly provides services for the Company or the Company's controlling shareholders or a company controlled by them.	√		
	E. A director whose primary source of income is the controlling shareholder. Not applicable (the Company has no controlling shareholders).	√		
25.	Persons who are not eligible to be a member of the Audit Committee, including controlling shareholders or their relatives, did not participate in Audit Committee meetings during the reporting year, other than pursuant to the provisions of section 115 (E) of the Companies Law.	√		**Mandatory Guideline** Section 115 (e) of the Companies Law.
26.	The requisite quorum for discussion and taking decisions at all audit committee meetings held during the reporting year was a majority of the committee members, whereby the majority of the participants were independent directors and at least one was an external director. If your response is False - please indicate the number of meetings at which this requirement did not exist: _____.	√		**Mandatory Guideline** section 116A of the Companies Law

27.	The audit committee held at least one meeting during the reporting year with the participation of the internal comptroller and its auditor, accordingly, and in the absence of Company officers who are not members of the Audit Committee, concerning flaws in the management of the corporations business.	√		**Mandatory Guideline** section 117(1) of the Companies Law - section 6 of the first Addendum (Recommended Corporate Governance Guidelines)
28.	Every audit committee meeting with the participation of persons who are not eligible to serve as members of the committee, was with the approval of the committee chair and/or at the request of the committee (with respect to the company's legal counsel and secretary, who are not a controlling shareholder or relative of the controlling shareholder).	√		**Mandatory Guideline** Section 115 (a) of the Companies Law.
29.	During the reporting year, arrangements were effective, as set by the audit committee, regarding the manner in which Company employees' complaints are treated with regard to flaws in the management of its businesses and with regard to protection that will be provided for whistleblowing.	√		**Mandatory Guideline** Section 117 (6) of the Companies Law.

<table>
<tr><th colspan="5">DUTIES OF THE FINANCIAL STATEMENTS REVIEW COMMITTEE ("THE COMMITTEE") PRIOR TO THE APPROVAL OF THE FINANCIAL STATEMENTS</th><th></th></tr>
<tr><td colspan="3"></td><td>True</td><td>False</td><td>Guideline</td></tr>
<tr><td rowspan="3">30.</td><td>A.</td><td>The Committee's recommendations concerning the financial statements issued in the reporting year were brought to the board of directors within reasonable time prior to the discussion by the board and all flaws or problems discovered during the examination were reported to the board of directors.</td><td>√</td><td></td><td rowspan="3">Mandatory Guideline

Regulation 2(3) of the Financial Statement Approval Regulations, and the guideline for disclosing the procedure for approving the financial statements.</td></tr>
<tr><td>B.</td><td>Please indicate the time (in days) set by the board of directors as reasonable time for receiving the Committee's recommendations prior to the board meeting at which the periodic or quarterly statements will be approved. 3 days when approving the periodic reports and 2 days when approving quarterly reports</td><td>_____.</td><td>_____.</td></tr>
<tr><td>C.</td><td>The actual number of days that elapsed between the date on which the recommendations were sent to the board of directors and the date on which the financial statements were approved:
2011 Annual Report: 3 days
Q1 2012 2 days
Q2 2 days
Q3 2 days
2012 Annual Report: 3 days</td><td>_____.</td><td>_____.</td></tr>
<tr><td>31.</td><td colspan="2">The Company's auditor was invited to all meetings of the committee and of the board of directors, and the internal comptroller received notice of the convening of such meetings, at which the Company's financial statements for the quarters of the reporting year were discussed.</td><td>√</td><td></td><td>Mandatory Guideline

section 168 of the Companies Law, regulation 2(2) of the Financial Statement Approval Regulations.</td></tr>
<tr><td>32.</td><td colspan="2">The Committee was in compliance, throughout the reporting year, with all the conditions as set forth below:</td><td>_____.</td><td>_____.</td><td rowspan="5">Mandatory Guideline

Regulation 3 of the Financial Statement Approval Regulations</td></tr>
<tr><td></td><td>A.</td><td>The number of Committee members was not less than three (during the Committee's discussion and approval of the said reports).</td><td>√</td><td></td></tr>
<tr><td></td><td>B.</td><td>All the conditions prescribed in section 115 (b) and (c) of the Companies Law existed (with regard to the office of the members of the audit committee).</td><td>√</td><td></td></tr>
<tr><td></td><td>C.</td><td>The audit committee chair is an external director.</td><td>√</td><td></td></tr>
<tr><td></td><td>D.</td><td>All the Committee's members are directors and the majority are independent directors.</td><td>√</td><td></td></tr>
</table>

	E.	All the members of the Committee are able to read and understand financial statements and at least one of the independent directors has accounting and financial expertise.	√	
	F.	The Committee members provided declarations prior to their appointment.	√	
	G.	The requisite quorum for the Committee discussions and decisions was a majority of its members, provided that the majority of the participants were independent directors and at least one was an external director.	√	
	If your answer is False concerning one or more of the subsections to this question, please specify which of the foregoing conditions did not exist: _____.		_____.	_____.

AUDITOR				
		True	**False**	**Guideline**
33.	The audit committee (and/or the financial statements review committee) was convinced that the scope of the auditor's work regarding audit services during the reporting year and the auditor's fee for the number of auditing hours during the reporting year, are appropriate for carrying out a proper audit.	√		Section 117 (5) of the Companies Law.
34.	Prior to the appointment of the auditor, the audit committee (and/or the financial statements Review committee) sent its recommendations to the relevant organ within the Company, with regard to the scope of the auditors' work and their fee. ☐ Not applicable (An auditor was not appointed during the reporting year) If your answer is True - please indicate whether the relevant organ within the Company acted in accordance with the recommendations of the audit committee (and/or the financial statements review committee). √ Yes - the board of directors acted in accordance with the recommendations of the Company's financial statements review committee. ☐ False (if your response is False, please specify in the concluding notes to this questionnaire, how the competent organ (indicating its name) was convinced concerning the scope of the auditors' work and their fee. (Mark an X in the appropriate box).	√		Section 117 (5) of the Companies Law.

35.	The audit committee (and/or the financial statements review committee) examined whether, during the reporting year, there were any restrictions on the auditor's work.	√		The Securities Law and its Regulations (regarding "Duly Audited Statements).
36.	The audit committee (and/or the financial statements review committee) discussed, during the reporting year, the findings of the audit and their implications, with the auditors.	√		Regulation 2 of the Financial Statement Approval Regulations, the Companies Law - section 6 of the first Addendum (Recommended Corporate Governance Guidelines).
37.	The audit committee (and/or the financial statements review committee) was satisfied, prior to the appointment of the auditors, that their qualifications were appropriate for carrying out the audit of the Company, in view of the nature and complexity of the Company's operations. ☐ Not applicable (An auditor was not appointed during the reporting year)	√		The Securities Law and its Regulations (regarding "Duly Audited Statements).
38.	Please specify the number of years in office of the partner attending to the audit accounting firm (as the Company's auditor) 3.	_____.	_____.	The Securities Law and its Regulations (regarding "Duly Audited Statements).
39.	The auditors participated at all the meetings of the financial statements review committee to which they were invited.	√		section 168 (b) of the Companies Law, regulation 2 of the Financial Statement Approval Regulations.

TRANSACTIONS WITH INTERESTED PARTIES				
		True	False	Guideline
40.	The Company adopted procedures, approved by the Audit Committee, dealing with interested party transactions, in order to ensure that such transactions are duly approved.	√		Sections 117, 253, 255 and 270-278 of the Companies Law
41.	The controlling shareholder or a relative (including a company under their control) are not employed by the Company and do not provide it with management services. If your response is False (i.e. the controlling shareholder or a relative are employed by the Company or do provide it with management services) please indicate - - the number of persons employed by the Company from among the controlling shareholders and/or relatives (including companies under their control) is: Note at end of Questionnaire Where their employment contracts and/or management service agreements duly approved by the organs prescribed by law: X Yes - the controlling shareholder of the Company provides the Company with management services under an agreement approved by the general meeting on June 10, 2010. ☐ No (Mark an X in the appropriate box). ☐ Not applicable (the Company has no controlling shareholders). _____.		☒	Section 270 (4) of the Companies Law.
42.	To the best of the Company's knowledge, the controlling shareholder does not have other businesses in the Company's area of operations (in one or more area). If your response is False, please indicate whether and arrangement has been made between the Company and its controlling shareholder for the area of operations: ☐ Yes ☐No (Mark an X in the appropriate box). ☐ Not applicable (the Company has no controlling shareholders).	√		Section 254 of the Companies Law, section 36 of the Securities Law (Important Information for a Reasonable Investor)

CONCLUDING NOTES TO THE QUESTIONNAIRE:

1. **Board of directors autonomy and directors' qualifications and expertise**

   Sections 1+13 - Tali Simon was appointed as an external director of the Company as of January 21, 2013

   Section 2A - everywhere in this Questionnaire where reference is made to an independent director, the definition also refers to an external director

2. Board Meetings (and convening of General Meetings)

Section 14 A-B - It should be noted that board meetings were held on January 17, 2012, September 23, 2012 and November 21, 2012 and the agendas for these meetings included the approval of transactions with interested parties only. Consequently and pursuant to the law, the controlling shareholder and his representatives, i.e. the directors: Shaul Elovitch, Or Elovitch, Orna Elovitch-Peled, Amikam Shorer and Felix Cohen were present at the opening of these meetings after which they left the meetings. **B.** The director, Eldad Ben Moshe ceased serving as a member of the financial statements review committee on August 29, 2012. Consequently, his participation in the board meetings refers to the period during which he served on the committee. **C.** The director, Arieh Saban ceased serving as a director on December 25, 2012. **D.** The director, Yair David ceased serving as a director during the reporting year on October 11, 2012 **E.** The director, Yehuda Porat ceased serving as a director on April 24, 2012. **F.** The participation of the directors in the board and committee meetings are indicated in rounded percentages.

3. **Audit Committee**

Section 27 - with regard to the auditors, this refers to the financial statements review committee.

4. **Role of the committee for reviewing the financial statements**

Section 30C - it should be noted that the relevant material for the discussions were sent out 72 hours prior to convening of the meetings.

5. Transactions with Interested Parties

Section 41 - the corporations and companies under his control do not employ controlling shareholders or their relatives. Eurocom Communications Ltd. ("Eurocom"), which is controlled by the controlling shareholder of the Company provides the Company with management services. As part of the management services Eurocom provides the Company with the services of the board Chair, Mr. Shaul Elovitch, and the services of consultants on behalf of the management company, including Or Elovitch, a director in the Company and the son of the controlling shareholder, and Amikam Shorer, a director who is an employee of a Company controlled by the controlling shareholder.

Section 42 - The controlling shareholder does not deal directly with the Company's operations, however companies under his control provide key services, equipment and other means that the Company and its subsidiaries and an affiliate purchase for running their areas of operations. The key products and services are purchased from companies controlled by the controlling shareholder are cellular telephony and land line terminal equipment, decoders and satellite capacity for cable television services. In addition, 51% of DBS Ltd. shares are held in trust for the controlling shareholder.

March 13, 2013

Date

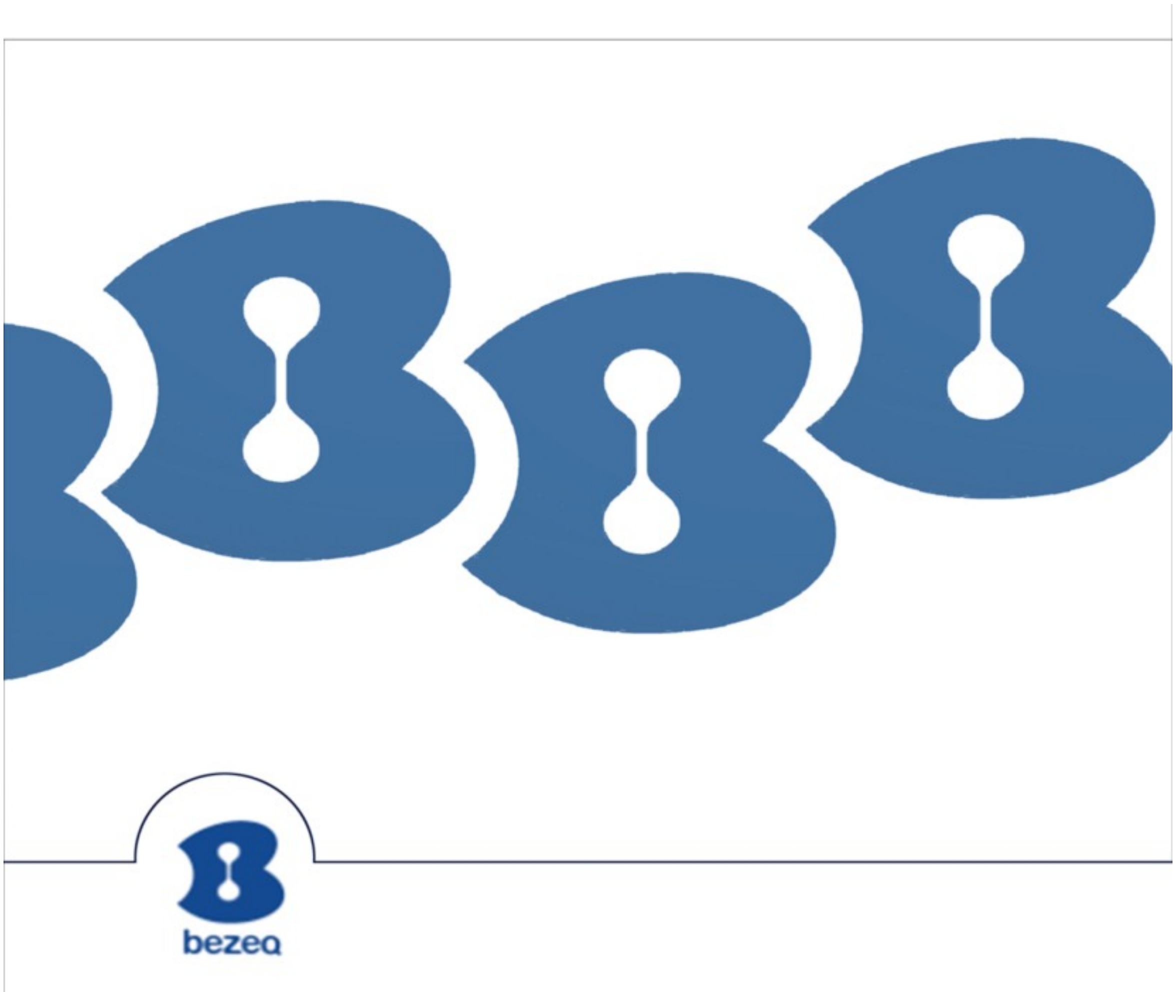
____
Bezeq – The Israel Telecommunication Corp. Ltd.

Signatories and their positions:

Shaul Elovitch, Chairman of Board of Directors
Mordechai Keret, Chair of Audit Committee
Yitzhak Edelman, Chair of Financial Statements Review Committee

Exhibit 99.7

Chapter E – Report Concerning Effectiveness of the Internal Control over Financial Reporting (SOX format)



Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our periodic report (hereinafter - "the Report") is recorded, processed, summarized and reported within the time periods specified in the law, and that such information is accumulated and communicated to our chief executive officer and chief financial officer to allow timely decisions regarding required disclosure. Our management, including our chief executive officer and chief financial officer, conducted an evaluation of our disclosure controls and procedures, as defined under United States Rule 13a-15(e) of the Exchange Act of 1934, as of December 31, 2012. Based upon that evaluation, our chief executive officer and chief financial officer have concluded that, as of such date, our disclosure controls and procedures were effective.

Management's Report on Internal Control Over Financial Reporting

Our management, including our chief executive officer and chief financial officer, is responsible for establishing and maintaining adequate internal control over financial reporting, as defined under United States Rules 13a-15(f) and 15d-15(f) of the Exchange Act of 1934. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards (IFRS). Internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets, (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with appropriate authorizations; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2012. In conducting its assessment of internal control over financial reporting, management based its evaluation on the framework in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations, or the COSO, of the Treadway Commission. Based on this assessment, our management has concluded that our internal control over financial reporting was effective as of December 31, 2012.

Auditors' Attestation Report

Our independent auditors, Somekh Chaikin, an Israeli partnership and a member firm of KPMG International, have issued an audit report on the effectiveness of our internal control over financial reporting. The report is included on page 3 of the consolidated financial statements.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the period covered by the Report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Avraham Gabbay, certify that:

1. I have reviewed this periodic report (hereinafter - "the Report") of Bezeq The Israel Telecommunication Corporation Ltd. (hereinafter - "the Company");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in United States Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in United States Exchange Act of 1934 Rules 13a-15(f) and 15d-15(f)) for the company and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards (IFRS);
   (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent function[1]):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: March 13, 2013

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Avraham Gabbay
Chief Executive Officer

* The originally executed copy of this Certification will be maintained at the Company's offices and will be made available for inspection upon request.

[1] The board of directors' committee to examine the financial statements.

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Dudu Mizrahi, certify that:

1. I have reviewed this periodic report (hereinafter - "the Report") of Bezeq The Israel Telecommunication Corporation Ltd. (hereinafter - "the Company");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in United States Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in United States Exchange Act of 1934 Rules 13a-15(f) and 15d-15(f)) for the company and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards (IFRS);
   (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent function[2]):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: March 13, 2013

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Dudu Mizrahi
Chief Financial Officer

* The originally executed copy of this Certification will be maintained at the Company's offices and will be made available for inspection upon request.

[2] The board of directors' committee to examine the financial statements.