Cellcom Israel Ltd.
Form 20-F
March 07, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 20–F

o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2011

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________________ to ________________

OR

o SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report..................................

Commission file number 001-33271

CELLCOM ISRAEL LTD.
(Exact name of Registrant as specified in its charter
and translation of Registrant's name into English)

ISRAEL
(Jurisdiction of incorporation or organization)

10 Hagavish Street, Netanya 42140, Israel
(Address of principal executive offices)

Liat Menahemi Stadler, 972-52-9989595 (phone), 972-98607986 (fax), LIATME@cellcom.co.il, 10 Hagavish Street, Netanya 42140, Israel

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class	Name of each exchange on which registered
Ordinary Shares, par value NIS 0.01 per share	New York Stock Exchange (“NYSE”)

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None
(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

As of December 31, 2011, the Registrant had outstanding 99,481,487 Ordinary Shares, par value NIS 0.01 per share.

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. [X] Yes [ ] No

If this report is an annual or transition report, indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. [ ] Yes [X] No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. [X] Yes [ ] No

Indicate by check mark whether the Registrant (1) has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) [ ] Yes [ ] No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer [ ]

Indicate by check mark which basis of accounting the Registrant has used to prepare the financial statements included in this filing:

U.S. GAAP [ ]

International Financial Reporting Standards as issued by the International Accounting Standards Board [X]

Other [ ]

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the Registrant elected to follow.

Item 17 [ ]

Item 18 [ ]

If this is an annual report, indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). [ ] Yes [X] No

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INTRODUCTION

In this annual report, “Cellcom,” the “Company,” “we,” “us” and “our” refer to Cellcom Israel Ltd. and its subsidiaries. T terms “NIS” refers to new Israeli shekel, and “dollar,” “USD” or “$” refers to U.S. dollars.

Presentation of Financial and Share Information

We prepare our consolidated financial statements in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”). Until and including our financial statements for the year ended December 31, 2007, we prepared our consolidated financial statements in accordance with Israeli GAAP. Following the Company’s adoption of IFRS, as issued by the IASB, the Company is no longer required to reconcile its financial statements prepared in accordance with IFRS to U.S. GAAP.
Unless we indicate otherwise, U.S. dollar translations of the NIS amounts presented in this annual report are translated for the convenience of the reader using the rate of NIS 3.821 to $1.00, the representative rate of exchange as of December 31, 2011 as published by the Bank of Israel. The translation is for the convenience of the reader only, and it does not represent the fair value of the translated assets and liabilities.

Trademarks

We have proprietary rights to trademarks used in this annual report which are important to our business. We have omitted the “®” and “™” designations for certain trademarks, but nonetheless reserve all rights to them. Each trademark, trade name or service mark of any other company appearing in this annual report belongs to its respective holder.

Industry and Market Data

This annual report contains information about our market share, market position and industry data. Unless otherwise indicated, this statistical and other market information is based on statistics prepared by the Ministry of Communications of Israel, the Ministry of Finance of Israel, the Central Bureau of Statistics of Israel, the Bank of Israel, Merill Lynch, , Brandman Research (survey institute), Strategy Analytics and Geocartography Group (survey institute). Industry publications generally state that the information they contain has been obtained from sources believed to be reliable, but the accuracy and completeness of such information is not guaranteed. We have not independently verified the accuracy of market data and industry forecasts contained in this annual report that were taken or derived from these industry publications.

Special Note Regarding Forward-Looking Statements

We have made statements under the captions “Item 3.D - Risk Factors,” “Item 4 – Information on the Company,” “Item 5 - Operating and Financial Review and Prospects,” and in other sections of this annual report that are forward-looking statements. In some cases, you can identify these statements by forward-looking words such as “may,” “might,” “will,” “should,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “predict,” “potential” or “continue,” the negative of these term comparable terminology. These forward-looking statements, which are subject to risks, uncertainties and assumptions about us, may include projections of our future financial performance, our anticipated growth strategies and anticipated trends in our business. These statements are only predictions based on our current

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expectations and projections about future events. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the results, level of activity, performance or achievements expressed or implied by the forward-looking statements, including those factors discussed under the caption entitled "Item 3.D - Risk Factors." You should specifically consider the numerous risks outlined under "Item 3.D - Risk Factors."

Although we believe the expectations reflected in the forward-looking statements contained in this annual report are reasonable, we cannot guarantee future results, level of activity, performance or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of any of these forward-looking statements. We assume no duty to update any of these forward-looking statements after the date of this annual report to conform our prior statements to actual results or revised expectations, except as otherwise required by law.

PART I

ITEM 1.IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable.

ITEM 2.OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3.KEY INFORMATION

A. SELECTED FINANCIAL DATA

You should read the following selected consolidated financial data in conjunction with the section of this annual report entitled "Item 5 - Operating and Financial Review and Prospects" and our consolidated financial statements and the notes thereto included elsewhere in this annual report.

The selected data presented below under the captions "Income Statement Data," and "Balance Sheet Data" for, and as of the end of, each of the years in the five-year period ended December 31, 2011, are derived from the consolidated financial statements of Cellcom Israel Ltd. and subsidiaries, which financial statements have been audited by Somekh Chaikin, an independent registered public accounting firm and a member firm of KPMG International. The consolidated financial statements as of December 31, 2009, 2010 and 2011, and for each of the years in the three-year period ended December 31, 2011, and the report thereon, are included elsewhere in this annual report. The selected data should be read in conjunction with the consolidated financial statements, the related notes, and the independent registered public accounting firm's report and the convenience translation of the consolidated financial statements as of and for the year ended December 31, 2011 into U.S. dollars solely for the convenience of the reader.

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The figures for the years 2007 and 2008 have been adjusted to give the retrospective application effect of the change in our accounting policy with respect to subscriber acquisition and retention costs, applied in June 2009, retrospectively from January 1, 2007. See note 2.H to our consolidated financial statements for the year ended December 31, 2009 (included in our annual report on Form 20-F for the year ended December 31, 2009).

On August 31, 2011, we completed the acquisition of 100% of the share capital of Netvision Ltd., or Netvision. Therefore, the consolidated results for the year ended December 31, 2011, included elsewhere in this annual report, include Netvision's results for the months of September through December 2011 only.

The information presented below under the caption "Other Data" contains information that part of it is not derived from the financial statements.

For your convenience, the following tables also contain U.S. dollar translations of the NIS amounts presented at December 31, 2011, translated using the rate of NIS 3.821 to $1.00, the representative rate of exchange on December 31, 2011 as published by the Bank of Israel.

	Year Ended December 31,					
	2007	2008	2009	2010	2011(1)	2011(1) (In US$ millions)
	(In NIS millions, except per share data)					
Income Statement Data:						
Revenues	6,050	6,417	6,483	6,662	6,506	1,703
Cost of revenues	3,315	3,396	3,333	3,322	3,408	892
Selling and marketing expenses	685	701	716	756	990	259
General and administrative expenses	653	659	660	641	685	179
Other (income) expenses, net	3	(29)	6	5	1	-
Operating income	1,394	1,690	1,768	1,938	1,422	373
Financing expense, net	(147)	(310)	(219)	(230)	(293)	(77)
Income tax	328	391	367	417	304	80
Net income	919	989	1,182	1,291	825	216
Basic earnings per share	9.42	10.12	12.01	13.04	8.28	2.17
Diluted earnings per share	9.34	9.96	11.90	12.98	8.28	2.17
Weighted average ordinary shares used in calculation of basic earnings per share	97,500,000	97,721,339	98,432,757	98,979,544	99,476,671	
Weighted average ordinary shares used in calculation of diluted earnings per share	98,441,260	99,279,924	99,306,714	99,480,791	99,511,433	
Other Data:						
EBITDA(2)	2,187	2,482	2,529	2,667	2,167	567
Capital expenditures	651	633	663	735	520	136
	13.90	11.23	11.91	13.85	7.88	2.06

Dividends declared per share						
Net cash provided by operating activities	1,820	1,745	2,080	2,380	1,332	349
Net cash used in investing activities	(560)	(528)	(774)	(889)	(1,656)	(433)
Net cash provided by (used in) financing activities	(405)	(1,853)	(678)	(1,861)	715	187
Cellular Subscribers (in thousands)(3)	3,073	3,187	3,292	3,394	3,349	
Cellular Period churn rate(4)	16.3%	18.9%	19.6%	20.5%	25.1%	
Cellular ARPU (in NIS)(5)	150	149	144	144	106	27.7
Balance Sheet Data:						
Cash	911	275	903	533	920	241
Working capital	716	461	1,254	924	679	178
Total assets	6,294	5,488	6,379	5,996	8,557	2,239
Total equity	881	390	374	341	187	49

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(1) The consolidated financial results for the year 2011 include the results of Netvision Ltd., or Netvision, our recently acquired wholly owned subsidiary, for the months September through December 2011. We consummated the acquisition of Netvision on August 31, 2011. For further details regarding the Netvision acquisition, see Item 4. A – "Significant Developments during 2011". For further details regarding the effect of Netvision's financial results on our consolidated financial results, see Item 5. A - "Operating and Financial Review and Prospects".

(2) EBITDA is a non-IFRS measure and is defined as income before financing income (expenses), net; other income (expenses), net; income tax; depreciation and amortization; share based payments. We present EBITDA as a supplemental performance measure because we believe that it facilitates operating performance comparisons from period to period and company to company by backing out potential differences caused by variations in capital structure (most particularly affecting our interest expense given our significant debt), tax positions (such as the impact on periods or companies of changes in effective tax rates or net operating losses) the age of, and depreciation expenses associated with fixed assets. EBITDA should not be considered in isolation or as a substitute for operating income or other statement of operations or cash flow data prepared in accordance with IFRS as a measure of our profitability or liquidity. EBITDA does not take into account our debt service requirements and other commitments, including capital expenditures, and, accordingly, is not necessarily indicative of amounts that may be available for discretionary uses. In addition, EBITDA, as presented in this annual report, may not be comparable to similarly titled measures reported by other companies due to differences in the way that these measures are calculated.

The following is a reconciliation of net income to EBITDA:

	Year Ended December 31,					
	2007	2008	2009	2010	2011	2011
	(In NIS millions)					(In US$ millions)
Net income	919	989	1,182	1,291	825	216
Financing expense (income), net	147	310	219	230	293	77
Other expenses (income), net	3	(29)	6	5	1	-
Income taxes	328	391	367	417	304	80
Depreciation and amortization	790	821	755	724	738	193
Share based payments	-	-	-	-	6	1
EBITDA	2,187	2,482	2,529	2,667	2,167	567

(3) Cellular subscriber data refers to active subscribers. We use a six-month method of calculating our cellular subscriber base, which means that we deduct subscribers from our subscriber base after six months of no revenue generation or activity on our network by or in relation to both the post-paid and pre-paid subscriber. The six-month method is, to the best of our knowledge, consistent with the methodology used by other cellular providers in Israel. During the fourth quarter of 2011, we have removed approximately 52,000 subscribers from our subscribers base, following the shutdown of our TDMA network as of December 31, 2011, since such subscribers have not requested a transfer to our other networks as of that date, and following a change to our previous policy which allowed subscribers to change from post to prepaid subscription as a result of the reduction of Early Termination Fees in the cellular market in early 2011, as we found this change to be futile since most of

these subscribers ceased using our services. These changes affected other key performance indicators. We have not restated prior subscriber data to conform with these changes.

(4) Churn rate is defined as the total number of voluntary and involuntary permanent deactivations of cellular subscribers in a given period expressed as a percentage of the number of cellular subscribers at the beginning of the period. Involuntary permanent deactivations relate to cellular subscribers who have failed to pay their arrears for the period of six consecutive months. Voluntary permanent deactivations relate to cellular subscribers who terminated their use of our cellular services.

(5) Average monthly revenue per cellular subscriber (ARPU) is calculated by dividing revenues from cellular services for the period by the average number of cellular subscribers during the period and by dividing the result by the number of months in the period. Revenues from inbound roaming services are included even though the number of cellular subscribers in the equation does not include the users of those roaming services. Inbound roaming services are included because ARPU is meant to capture all service revenues generated by a cellular network, including roaming services. Revenues from sales of extended warranties are included because they represent recurring revenues generated by cellular subscribers, but revenues from sales of handsets, repair services and other services are not. We and industry analysts treat ARPU as a key performance indicator of a cellular operator because it is the closest meaningful measure of the contribution to service revenues made by an average subscriber.

We have set out below the calculation of ARPU for each of the periods presented:

	Year Ended December 31,					
	2007	2008	2009	2010	2011	2011
	(In NIS millions, except number of subscribers and months)					(In US$ millions)
Revenues	6,050	6,417	6,483	6,662	6,506	1,703
less revenues from equipment sales	635	745	751	802	1,747	457
less other revenues*	93	135	162	124	484	127
Revenues used in cellular ARPU calculation	5,322	5,537	5,570	5,736	4,275	1,119

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Average number of cellular subscribers	2,955,855	3,105,022	3,215,492	3,322,891	3,361,803	3,361,803
Months during period	12	12	12	12	12	12
Cellular ARPU (in NIS, per month)	150	149	144	144	106	28

* Other revenues include revenues from repair services and other communication services such as ISP, transmission services and local and international landline services.

Exchange Rate Information

The following table shows, for each of the months indicated, the high and low exchange rates between the NIS and the U.S. dollar, expressed as NIS per U.S. dollar and based upon the daily representative rate of exchange as published by the Bank of Israel:

Month	High (NIS)	Low (NIS)
September 2011	3.725	3.574
October 2011	3.763	3.602
November 2011	3.800	3.650
December 2011	3.821	3.727
January 2012	3.854	3.733
February 2012	3.803	3.700

On March 2, 2012 the daily representative rate of exchange between the NIS and U.S. dollar as published by the Bank of Israel was NIS 3.791 to $1.00.

The following table shows, for periods indicated, the average exchange rate between the NIS and the U.S. dollar, expressed as NIS per U.S. dollar, calculated based on the average of the representative rates of exchange on the last day of each month during the relevant period as published by the Bank of Israel:

Year	Average (NIS)
2007	4.085
2008	3.568
2009	3.927
2010	3.732
2011	3.582

The effect of exchange rate fluctuations on our business and operations is discussed in "Item 5 - Operating and Financial Review and Prospects—Quantitative and Qualitative Disclosures about Market Risk."

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

We believe that the occurrence of any one or some combination of the following factors could have a material adverse effect on our business, financial condition or results of operations.

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Risks Related to our Business

We operate in a heavily regulated industry, which can harm our results of operations.

A substantial part of our operations is subject to the Israeli Communications Law, 1982, the Israeli Wireless Telegraph Ordinance (New Version), 1972, the regulations promulgated thereunder and the licenses for the provision of different telecommunications services that we received from the Ministry of Communications in accordance with the Communications Law. The interpretation and implementation of the Communications Law, Wireless Telegraph Ordinance and regulations and the provisions of our general licenses, as well as our other licenses, are not certain and disagreements have arisen and may arise in the future between the Ministry of Communications and us. The Communications Law and regulations thereunder grant the Ministry of Communications extensive regulatory and supervisory authority with regard to our activities, as well as the authority to impose substantial sanctions in the event of a breach of our licenses or the applicable laws and regulations. In January 2012, a bill proposing to set gradually increasing financial sanctions on communication operators, for breach of their licenses, the amount of which will be calculated as a percentage of the operator's income and based on the gravity of the breach, passed a preliminary legislative stage in the Israeli Parliament. Such bill, if adopted, is expected to substantially increase the Ministry of Communications' usage of such sanctions. Substantial sanctions would negatively affect our results of operations and reputation. Further, in the event that we materially violate the terms of our licenses, the Ministry of Communications has the authority to revoke them.

Our operations are subject to the regulatory and supervisory authority of other Israeli regulators which also includes the authority to impose criminal and administrative sanctions against us including, among others, the Ministry of Environmental Protection; the Anti Trust Commissionaire; the Ministry of Justice and the Law, Information and Technology Authority at the Ministry of Justice - in charge of issues such as data bases and privacy protection; the Ministry of Industry and Commerce (including the Fair Trade Authority) in charge of labor and consumer protection. We have witnessed increased activity by some of these regulators in recent years and expect this trend to continue. Substantial sanctions by any of these regulators would negatively affect our results of operations and our reputation. Increased supervision and regulation of our activities could limit our freedom to conduct our business and harm our results of operations.

Our general cellular license is valid until February 2022. It may be extended for additional six-year periods upon our request to the Ministry of Communications and confirmation from the Ministry of Communications that we have complied with the provisions of our license and the applicable law, have continuously invested in the improvement of our service and network and have demonstrated the ability to do so in the future. Netvision's Internet Service Provider, or ISP license and International Long Distance, or ILD license, are valid until April 2012 and May 2025, respectively and may be extended for additional five and eight year periods, respectively, on terms similar to those provided in our cellular license. Our other licenses are also limited in time. Our licenses may not be extended when necessary, or, if extended, the extensions may be granted on terms that are not favorable to us. In addition, the Ministry of Communications has modified and may modify our licenses without our consent and in a manner that could limit our freedom to conduct our business and harm our results of operations. Possible changes to our licenses and legislation which would require us to change our pricing plans and information systems frequently or on

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a timetable we cannot meet, can increase the risk of noncompliance with our licenses or violation of such legislation and our exposure to lawsuits and regulatory sanctions.

Further, our business and results of operations could be materially and adversely affected by new legislation and decisions by our regulators that:

- reduce tariffs, including roaming tariffs, or otherwise intervene in the pricing policies for our products and services, including by: completely annulling early termination fees in cellular pricing plans which include a commitment to a predefined period, or Early Termination Fees, intervening in pricing of bundles of services, intervening in our ability to offer airtime rebates or refunds for end user equipment, or the scope thereof, requiring us to offer a “limited credit” service to our post-paid customers, by requiring us to offer “data only” services and intervening in pricing and terms of such services, or by prohibiting subscription fees for certain services. The reduction of interconnect tariffs that came into force in January 1, 2011, and the reduction of Early Termination Fees in cellular pricing plans to a negligible amount as of February 1, 2011, had a material adverse effect on our results of operations and are expected to continue to adversely affect our results of operations in the future. See “Item 4. Information on the Company – B. Business Overview – Government Regulations – Tariff Supervision” and “Item 4. Information on The Company – B. Business Overview – Netvision”. for additional details;

- set unfavorable national roaming tariffs or Mobile Virtual Network Operator, or MVNO, hosting tariffs or tariffs that are lower than the tariffs that we would otherwise be willing to offer. According to the Telecommunication Law, the MOC is required to set the national roaming tariffs until February 1, 2012, however, to date, no such tariffs were set yet. See “Item 4. Information on the Company – B. Business Overview - Government Regulations - Additional UMTS Operators”;

- increase the number of competitors in the cellular market, including by awarding cellular licenses to additional MVNOs, and licenses for the use of our network by competing technologies, such as Voice over Broadband over Cellular, or VoC; awarding new competitors certain benefits and leniencies not available to existing cellular operators, including through requiring us to allow usage of our network by such competitors and on unfavorable terms to us; limit our ability to compete, including by limiting our ability to develop our network and by preferring new and/or small competitors in the allocation of frequencies, including those designated to the 4G of cellular services. See “Item 4. Information on the Company – B. Business Overview” under “Competition” and under “Government Regulations – Mobile Virtual Network Operator” and “- Additional UMTS Operators” for additional details;

- impose new safety or health-related requirements;

- impose additional restrictions or requirements with respect to the construction and operation of cell sites or the network, including as a result of MVNO hosting services, national roaming and site sharing;

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- impose restrictions on the provision of services or products we currently provide or regulate or otherwise intervene with the terms under which we advertise and market them and provide them to our subscribers, including in respect of existing agreements;

- impose restrictions on the provision of cellular internet services, including by providing customers their choice of ISP;

- limit or otherwise intervene with the services or products that we may sell;

- set higher service standards; or

- impose a stricter policy with respect to privacy protection, such as with regard to data protection, collection, amelioration or usage of data for marketing activities. An initial proposal of the Information and Technology Authority regarding cellular operators recently received, proposes imposing strict limitations on such collection and usage, including the requirement to receive a positive consent of the customer to do so (other than with regards to basic data); or

- impose structural or operational separation between our and Netvision's operations (partial or full) or between the different services within each company - see "Item 4. Information on the Company – B. Business Overview - Government Regulations – Long Distance Services; or set unfavorable regulation regarding the wireline wholesale market - see "Item 4. Information on The Company – B. Business Overview – Competition".

See "Item 4. Information on the Company – B – Business Overview – Government Regulations Our Principal License" and "Other Licenses".

If we fail to compensate for lost revenues, increased expenses or additional investments resulting from past or future legislative or regulatory changes with alternative sources of income or otherwise, our results of operations may be materially adversely affected.

We may not be able to obtain permits to construct and operate cell sites.

We depend on our network of cell sites to maintain and enhance network coverage for our subscribers. In addition, where necessary, we provide certain subscribers with bi-directional amplifiers, also known as "repeaters," to remedy weak signal reception in indoor locations. Some of these repeaters are located outdoors on rooftops. We also deploy and operate microwave sites as part of our transmission network. The construction and operation of these various facilities are highly regulated and require us to obtain various consents and permits. See "Item 4.B – Business Overview - Government Regulations - Permits for Cell Site Construction" for additional details.

We have experienced difficulties in obtaining some of these consents and permits, particularly in obtaining building permits for cell sites from local planning and building authorities. As of December 31, 2011, we operated a small portion of our cell sites without building permits or applicable exemptions. Although we are in the process of seeking to obtain building permits or to modify our cell sites in order to satisfy applicable exemptions, we may not be able to obtain all the necessary permits or make the necessary modifications.

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Approximately 32% of our cell sites operate without building permits in reliance on an exemption from the requirement to obtain a building permit, mainly for radio access devices. Our reliance on the exemption for radio access devices had been challenged and is currently awaiting ruling by the Israeli Supreme Court. Under an interim order issued by the Supreme Court in September 2010, we are unable to further construct radio access devices in cellular networks in reliance on the exemption, until regulations limiting our reliance on the exemption are enacted or a different decision by the court is made. A further decision of the Supreme Court in February 2011, states that the order will not apply to the replacement of existing radio access devices under certain conditions.

Additionally, in November 2008, the District Court of Central Region, in its capacity as court of appeals, ruled that the exemption does not apply to radio access devices, if the rooftop, on which those devices are located, is at the same level as a residence or other building that is regularly frequented by people.

Following the Attorney General's conclusion that the application of the exemption does not balance properly the different interests involved and therefore cannot continue unchanged, the Israeli Minister of Interior Affairs submitted draft regulations for approval by the Economy Committee of the Israeli Parliament in March 2010. The draft regulations include significant limitations on the ability to construct radio access devices based on the exemption, which will render the construction of radio access devices based on the exemption practically impossible.

Other appeals relating to the exemption, including as to the requirement to obtain an extraordinary usage permit, are still under consideration in the District Court and other similar challenges, as well as other claims asserting that those cell sites and other facilities do not meet other legal requirements continue.

In addition, we may be operating a significant number of our cell sites in a manner that is not fully compatible with the building permits issued for these cell sites which may, in some cases, also constitute grounds for termination of their lease agreements or claims for breach of such agreements. Our rooftop microwave sites and repeaters operate in reliance upon an exemption from the requirement to obtain a building permit. Substantially all of our outdoor microwave sites are rooftops. It is unclear whether other types of repeaters require a building permit.

An annulment of or inability to rely on or substantial limitation of the exemption could adversely affect our existing networks and networks build-out, particularly given the objection of some local planning and building authorities to grant due permits where required. This could have a negative impact on our ability to obtain environmental permits for these sites, and could negatively affect our ability to continue to market our products and services effectively. This may have a material adverse effect on our results of operations and financial condition. See "Item 4. Information on the Company – B. Business Overview - Government Regulations— Permits for Cell Site Construction" for additional details regarding the exemption.

Operation of a cell site or other facility without a building permit or not in accordance with the permit or other legal requirements may result in the issuance of a demolition order for the cell site or other facility or the bringing of criminal charges against us and our officers and directors. Certain of our cell sites have been subject to demolition orders. In addition, criminal charges have been brought against us and our officers and directors in connection

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with cell sites that were alleged to have been constructed or used without the required permits or not in accordance with the permits granted. As of December 31, 2011, 18 criminal and administrative proceedings are outstanding; a demolition order has been granted with respect to three cell sites while the remaining 15 proceedings are pending further litigation.

Pursuant to the Israeli Non-Ionizing Radiation Law, 2006, the granting or renewal of an operating permit by the Commissioner of Environmental Radiation at the Ministry of Environmental Protection of Israel for a cell site or other facility is subject to the receipt of a building permit or the facility being exempt from the requirement to obtain a building permit. Should we fail to obtain building permits for our cell sites or other facilities, including in the event that our reliance upon an exemption from the requirement to obtain building permits for these cell sites and other facilities is found invalid, the Commissioner of Environmental Radiation at the Ministry of Environmental Protection will not grant or renew our operating permits for those cell sites and other facilities. Since October 2007, the Commissioner of Environmental Protection took the position that he will not grant or renew operating permits to radio access devices, where the local planning and building committee's engineer objected to our reliance upon the said exemption for radio access devices. For reasons not related to radiation hazards, we have not received environmental permits for a few cell sites, primarily due to building and planning issues, such as objections by local planning and building committee's engineers to our reliance on the exemption from obtaining building permits for radio access devices. Operating a cell site or a facility without an operating permit could subject us and our officers and directors to criminal, administrative and civil liability.

The Non-Ionizing Radiation Law further grants the Commissioner authority to issue eviction orders if a cell site or other facility operates in conflict with its permit, and it imposes criminal sanctions on a company and its directors and officers for violations of the law. Failure to comply with the Non-Ionizing Radiation Law or the terms of a permit can lead to revocation or suspension of the permit, as well as to withholding the grant of permits to additional cell sites of that operator.

Should any of our officers or directors be found guilty of an offence, although this has not occurred to date, they may face monetary penalties and a term of imprisonment. Our cell sites may be the subject of demolition orders, we may be required to relocate cell sites to less favorable locations or stop operation of cell sites, which could negatively affect the extent, quality and capacity of our network coverage, all of which may have a material adverse effect on our results of operations and financial condition.

Certain proposed amendments to the Non-Ionizing Radiation Law and Regulations which have passed the preliminary stages of enactment, propose setting additional restrictions in relation to the operation of cell sites and other facilities, such as setting larger distance requirements between cell sites locations and residences or certain institutions). If such changes are subsequently adopted, they will, among other things, limit our ability to construct new cell sites (and if applied to existing cell sites, they will also limit our ability to renew operating permits for many of our existing cell sites), adversely affect our existing networks and networks build out, specifically in urban areas, and could adversely affect our results of operations. See "Item 4. Information on the Company – B. Business Overview - Government Regulations— Permits for Cell Site Construction" for an additional amendment proposing to cancel the requirement to obtain the Minister of Communications' approval to the Non-Ionizing Radiation Regulations, where such regulations may have a substantial and direct effect on the monetary burden imposed on the communication market.

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The Israeli National Zoning Plan 36, or the Plan, which regulates cell site construction and operation is in the process of being changed. Current proposed changes impose additional restrictions and requirements on the construction and operation of cell sites. In June 2010, the proposed changes were approved by the Israeli National Council for Planning and Building and submitted for the approval of the Government of Israel. If the proposed changes are approved by the Israeli Government they will harm our ability to construct new cell sites, make the process of obtaining building permits for the construction and operation of cell sites more cumbersome and costly, could adversely affect our existing network and may delay the future deployment of our network and could negatively affect the extent, quality and capacity of our network coverage and our ability to continue to market our products and services effectively, all of which could have a material adverse effect on our results of operations and financial condition.

Several local planning and building authorities are claiming that Israeli cellular operators may not receive building permits, in reliance on the current Plan, for cell sites operating in frequencies not specifically detailed in the frequencies charts attached to the Plan. In a number of cases, these authorities have refused to provide a building permit for such new cell sites, arguing that the Plan does not apply to such cell sites and that building permits for such cell sites should be sought through other processes (which are longer and cumbersome), such as an application for extraordinary usage or under existing local specific zoning plans. Since June 2002, following the approval of the Plan, building permits for our cell sites (where required) have been issued in reliance on the Plan. The current proposed draft amendment to the Plan covers all new cell sites requiring a building permit, independently of the frequencies in which they operate. Most of our cell sites and many cell sites operated by other operators operate in frequencies not specifically detailed in the Plan.

If we are unable to obtain or rely on exemptions from obtaining or to renew building or other consents and permits for our existing cell sites or other facilities, we will be required to demolish or relocate these cell sites and facilities. Our inability to relocate sites or other facilities in a timely manner or to construct and operate new sites or other facilities (if we are unable to obtain the necessary consents and permits or rely on the exemption from the requirement to obtain a building permit), could adversely affect our existing network, result in the loss of subscribers, prevent us from meeting the network coverage and quality requirements contained in our license (which may lead to its revocation) and adversely impact our network build-out, all of which may have a material adverse effect on our results of operations and financial condition.

In July 2011, an inter-ministry team of the Ministries of Communications, Finance, Interior, Environmental Protection and the Anti-Trust Commissionaire, published its recommendations regarding cell site sharing. The recommendations include compulsory cell sites sharing in the construction of new cell sites or for modification to existing cell sites which require a building permit (the Ministry of Communications may exempt sharing for reasons related to technological or engineering difficulties), while providing preference and leniencies to the new UMTS operators, as well as the reduction of the existing non shared cell sites quantity. These recommendations or similar recommendations, if enacted, will further burden the construction of new cell sites and modifications to existing cell sites, and may adversely affect our existing cellular network, the network build-out and our results of operations.

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We may be required to indemnify certain local planning and building committees in respect of claims against them.

Under the Israeli Planning and Building Law, 1965, by approving a building plan, local planning and building committees may be held liable to compensate for depreciation of properties included in or neighboring the approved plan.

In January 2006, the law was amended to require an applicant, as a precondition to obtaining a cell site construction permit from a planning and building committee, to provide a letter to the committee indemnifying it for possible depreciation claims. As of December 31, 2011, we have provided approximately 340 indemnification letters to local planning and building committees. Calls upon our indemnification letters may have a material adverse effect on our financial condition and results of operations. We may also decide to demolish or relocate existing cell sites to less favorable locations and to construct new cell sites in alternative, less suitable locations or not at all, due to the obligation to provide indemnification. As a result, our existing service may be impaired or the expansion of our network coverage could be limited.

In addition, local planning and building committees have sought to join cellular operators, including us, as defendants in depreciation claims made against them even though indemnification letters were not provided. We have been joined as defendants in a small number of cases.

In February 2007, the Israeli Minister of Interior Affairs extended the limitation period within which depreciation claims may be brought under the Israeli Planning and Building Law from three years from approval of a building plan, to the later of one year from receiving a building permit for a cell site under National Zoning Plan 36 and six months from the construction of a cell site. The Minister retains the general authority to extend such period further. This extension of the limitation period increases our potential exposure to depreciation claims. In addition, should the Planning and Building Law be construed or amended to allow a longer period of limitation for depreciation claims than the current limitation period set in that law, our potential exposure to depreciation claims would increase.

Alleged health risks relating to non-ionizing radiation generated from cell sites and cellular telecommunications devices may harm our prospects.

Handsets, accessories and various types of cell sites are known to be sources of non-ionizing radiation emissions and are the subject of a public debate and growing concern in Israel. While, to the best of our knowledge, the handsets that we market comply with the applicable legislation that relate to acceptable "specific absorption rate," or SAR, levels, we rely on the SAR levels published by the manufacturers of these handsets and do not perform independent inspections of the SAR levels of these handsets. As the manufacturers' approvals refer to a prototype handset, we have no information as to the actual level of SAR of the handsets throughout the lifecycle of the handsets, including in the case of handset repair. See also "Item 4. Information on the Company – B. Business Overview - Government Regulations - Handsets". In July 2008, the Israeli Ministry of Health published recommendations to take precautionary measures when using cellular handsets, which has increased the concerns of the Israeli public. In May 2011, the International Agency for Research on Cancer, an agency of the World Health Organization, or WHO, issued a press release classifying radiofrequency electromagnetic fields as possibly carcinogenic to humans (Group 2B), based on an increased risk for glioma, a malignant type of brain cancer,

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associated with wireless phone use. In June 2011, the WHO publication noted that to date, no adverse health effects have been established as being caused by mobile phone use and while an increased risk of brain tumors is not established, the increasing use of mobile phones and the lack of data for mobile phone use over time periods longer than 15 years warrant further research of mobile phone use and brain cancer risk, particularly given recent popular use by younger people with potentially longer periods of exposure. Several bills, aimed at increasing awareness of the possible risks of cellular phones usage, reducing usage thereof and introducing precautionary measures are awaiting deliberation by the Israeli Parliament.

Health concerns regarding cell sites have already caused us difficulties in obtaining permits for cell site construction and obtaining or renewing leases for cell sites and even resulted in unlawful sabotage of a small number of cell sites and have further prompted legislation aimed at increasing the minimum distance permitted between cell sites and certain institutions. See “We may not be able to obtain permits to construct and operate cell sites” above for additional details. In July 2009, the Ministries of Interior Affairs and Environmental Protection adopted a position (as part of the recommendations made by an inter-ministry committee established to examine the appropriateness of future application of the exemption from obtaining building permits for radio access devices) that, with respect to radiation safety, cell sites constructed pursuant to a building permit are preferable to radio access devices and that utilizing a cellular network to provide advanced services which can be provided through a landline network, is unjustified in light of the preventive care principle set forth in the Israeli Non-Ionizing Radiation Law. Further, in November 2011, in response to a petition to hold a public debate regarding 4G service in Israel and prevent 4G spectrum allocation until such debate is held, the State of Israel informed the Supreme Court, hearing the petition, that it is conducting an inter-Ministry (including the Ministries of Communications, Interior Affairs, Justice, Health and Environmental Protection) examination of the various aspects of the provision of 4G services in Israel to be followed by a public hearing. The State also informed the Supreme Court that such examination shall not prevent implementation of governmental procedures necessary for the provision of 4G services in Israel, provided that no irreversible steps or steps creating third party reliance upon them, shall be taken.

If health concerns regarding non-ionizing radiation increase further, or if adverse findings in studies of non-ionizing radiation are published or if non-ionizing radiation levels are found to be higher than the standards set for handsets and cell sites, consumers may be discouraged from using cellular handsets and regulators may impose additional restrictions on the construction and operation of cell sites or handset usage. As a result, we may experience increased difficulty in constructing and operating cell sites and obtaining leases for new cell site locations or renewing leases for existing locations (although so far, in total we have experienced renewal problems with approximately 7% of our cell site leases each year); we may be exposed to property depreciation claims; we may lose revenues due to decreasing usage of our services; we may be subject to increased regulatory costs; and we may be subject to health-related claims for substantial sums. We have not obtained insurance for these potential claims. See “Item 8. Financial Information - A. Consolidated Statements and Other Financial Information – Legal Proceedings—Purported class actions” for additional details on three purported class actions filed against us in that respect, and an additional purported class action filed against us for not obtaining such insurance. An adverse outcome or settlement of any health-related litigation against us or any other provider of cellular services could have a material adverse effect on our results of operations, financial condition or prospects.

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We face intense competition in all aspects of our business

The Israeli cellular telephone market is highly competitive. We compete for subscribers with three other established cellular operators and as of December 2011, with one additional MVNO operator – Rami Levy Hashikma Communications Marketing Ltd., or Rami Levy. While we enjoy the largest market share, estimated to be 33.6% as of December 31, 2011, two of our competitors, Partner and Pelephone, enjoy estimated market shares of 31.9% and 29.6% respectively, with MIRS Motorola Communications Ltd., or MIRS, estimated to have a market share of 4.8% and Rami Levy with less than 1%. The current competitive pressure in the Israeli cellular market results primarily from the highly penetrated state of the market. See also "Item 4. Information on the Company - B. Business Overview - The Telecommunications Industry in Israel". This means that market growth is limited and cellular operators compete intensely to retain their own subscribers and attract those of their competitors. The competition in our market has intensified following various regulatory and other changes in the market, specifically the compulsory reduction of Early Termination Fees to a negligible amount in the cellular market as of February 1, 2011, as it eliminated the transfer barrier between operators and led to the offering of packages at lower average revenue per minute, which resulted in accelerated price erosion, materially increased churn rate, and increased subscriber acquisition and retention costs due to materially increased gross recruitment of subscribers. The competition was also impacted by the expected entry of additional competitors, which benefit from the reduction of interconnect tariffs as well as the reduction of Early Termination Fees. Further, competition also increased following relaxation of regulatory restrictions on the ability to consummate acquisitions in the Israeli communications market, as cellular operators become part of communications groups in the Israeli communication market (as detailed below), enabling the offering of bundles of services, which entails ongoing price erosion. The annulment of Early Termination Fees in the other communications markets in November 2011, has also contributed to the increased competition in other communications services, increased churn rate and gross recruitment of subscribers and price erosion. These trends are expected to continue to affect the communications market and the level of competition. Any of the following developments in our market is expected to increase competition further and the increasing competition may result in a material increase in churn rate, loss of market share, increased subscriber acquisition and retention costs, further price erosion and ultimately reduced profitability for us:

- the launch of a UMTS network by Mirs and Golan Telecom Ltd., or Golan and additional MVNO operators commencing operations could increase competition and thus may have a material adverse effect on our revenues. Mirs and Golan were awarded UMTS licenses in April and December 2011, respectively, and were awarded certain leniencies in the deployment of their networks, including the usage of national roaming (both have signed national roaming agreements - Golan with us and Mirs with Pelephone). Mirs is expected to launch its UMTS network during the first half of 2012 and Golan during the second half of 2012. To date nine entities were granted MVNO licenses (of which five have entered into hosting agreements (including Rami Levy which, commenced operation in the market in December 2011) the others are expected to commence operations in 2012), and the Ministry of Communications may grant additional MVNO licenses. For additional details see "Item 4.

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Information on the Company - B. Business Overview – The Communications Market in Israel - Cellular Services”. See “Item 4. Information on the Company – B. Business Overview” under “Competition” and under “Government Regulations – Mobile Virtual Network Operator” and “Additional UMTS Operators” for additional details;

- the sale of bundles of services by operators, including cellular services, as it is expected to entail further price erosion, more so if offered by either the Bezeq or Hot groups (the only operators owning full landline infrastructure in Israel and offering internet infrastructure services to ISP operators, as well as to end-users) or the offering of services by the Bezeq and Hot groups at tariffs significantly lower than prevailing market tariffs, such as by cross subsidizing with other services in which they have the capacity to monopolize the market; in 2011 three additional communications groups were formed in the Israeli communications market, in addition to the Bezeq group: Partner-012 Smile, Cellcom–Netvision and Hot-Mirs. This change together with the regulatory changes relaxing the structural separation imposed on each of the Bezeq and Hot groups (Bezeq being the incumbent landline operator and Hot the incumbent multichannel television provider, both monopolies in their incumbent market), will allow each of the groups to offer a bundle of services, in some cases quadruple and even quintuple service bundles, to existing customers in each of their previously separated platforms as well to new customers. Bundles offerings are expected to blur boundaries among services and lead to price erosion with each of the groups having an interest not to erode the prices of its core business, but rather that of its competitors. Although Pelephone and Bezeq do not currently offer a bundle that includes both cellular and wireline services, such a bundle was already approved for the Bezeq group in 2010 under certain conditions, in relation to private customers and is currently being considered by the Ministry of Communications for business customers as well. The offering of a bundle of services, including cellular services by another group, will relax the conditions under which Bezeq may provide a similar bundle. Further, a public committee appointed by the Ministry of Communications recommended in October 2011 to annul structural limitations currently imposed on Bezeq and its subsidiaries when a wireline wholesale market of landline services is available to the other operators and to replace Bezeq’s regulated fixed tariffs with maximum tariffs. If such recommendations are adopted by the Ministry of Communications, they will allow Bezeq and its subsidiaries, including Pelephone, to offer bundles of services (other than multichannel television services) without limitation. Although the Hot group is also under structural separation limitations between its broadcasting landline, ISP and cellular services, the Ministry of Communications is currently considering to annul the structural separation limitations between Mirs and Hot, after already lifting certain limitations in 2011, allowing Hot and Mirs to sell and market each other’s services and transfer information. The Hot group was previously allowed to offer a bundle of multi-channel television, landline and internet infrastructure services and include ISP services in a bundle of services, under certain conditions. Both Bezeq and Hot currently offer bundles of services excluding cellular services. Bundle offerings are expected to accelerate price erosion in each of the services included. In February 2012, Hot began offering ISP services and has done so at tariffs significantly lower than prevailing market prices and Bezeq also significantly lowered its internet infrastructure services

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tariffs to end-users. See “Item 4. Information on The Company –B. Business Overview – The Communications Market in Israel - Communications Groups – Structural Separation”, “Competition”, “Nevision - ISP Business - Competition” and “Nevision - Telephony Business – Competition”.

- increased usage of competing technologies, applications and services, allowing usage of our network with or without an operator, such as VoC or voice over IP, or VoIP (including applications such as Viber, WhatsApp and free SMS among iPhone holders) or other technologies, such as WiFi, more so following the increased usage of smart phones, tablets and laptops. To date, VoC services are available under two trial licenses granted by the Ministry of Communications and using VoC based software on smart phones. The Ministry of Communications has published in December 2010, a hearing in relation to VoC license, under which cellular operators will be required to provide data only services, including at lower speed rates and price them by speed rate. Under an amendment to the Communication Law enacted in December 2010, any limitation or blocking of internet based services or applications is forbidden, including by differentiating pricing.

- the expansion of the “Open Garden” content provision offerings, as it is transforming the cellular operator, previously the provider of content to its subscribers, into one of many content providers competing to provide content to the operator’s own subscribers; The Open Garden international trend is facilitated by technological changes allowing high speed internet surfing and supporting handsets and the entry of international media providers and handsets manufacturers into the cellular content provision market. Further, expansion of arrangements such as that introduced by Apple and Android, in which subscribers can purchase content only through their handset manufacturer’s store, has and is expected to continue to adversely affect our content revenues. See “Item 4. Information on the Company – B. Business Overview” under “Competition”.

- Pursuant to an amendment to the Israeli Restrictive Trade Practices Law, 1988, if the Director General decides that the Israeli cellular market is oligopolistic, the Director General will have the authority to give instructions to all or some of the participants in our market, in order, among others, to maintain or increase the competition level among the participants, including the authority to issue orders to remove or to ease entry or transfer barriers, to cease a participant’s activity, or otherwise regulate the activities of the market.

We could be subject to legal claims due to the inability of our information systems to fully support our pricing plans.

In order to attract and retain the maximum number of subscribers in our highly competitive market, we design specific pricing plans to suit the preferences of various subscriber groups. We require sophisticated information systems to accurately record subscriber usage pursuant to the particular terms of each subscriber’s plan as well as accurate database management and operation of a very large number of pricing plans. From time to time, we have detected some discrepancies between certain pricing plans and the information processed by our internal information systems, such as applying an incorrect rebate or applying an incorrect tariff to a service resulting in a higher charge. We have invested

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substantial resources to refine and improve our information and control systems and ensure that our new pricing plans are appropriately processed by our information systems; we have also taken steps to remedy the identified discrepancies and have established reserves where the discrepancies are quantifiable. Despite our substantial investments, we may experience discrepancies in the future due to the multiplicity of our plans and the scope of the processing tasks. Further, while we invest substantial efforts in monitoring our employees and third-party distributors and dealers that market our services, it is possible that some of our employees, distributors or dealers may offer terms and make (or fail to make) representations to existing and prospective subscribers that do not fully conform to applicable law, our licenses or the terms of our pricing plans. As a result of these discrepancies, we may be subject to subscribers' claims, including class action claims, and substantial sanctions for breach of our licenses or the applicable laws and regulations that may materially adversely affect our results of operations. Further, frequent and multiple changes to our general license and relevant legislation require ongoing changes to our operations, pricing plans and supporting information systems. Such changes increase the risk that our employees, distributors and dealers and our information systems will not fully support such changes.

We are exposed to, and currently are engaged in, a variety of legal proceedings, including class action lawsuits.

We provide services to millions of subscribers on a daily basis. As a result of the scope and magnitude of our operations we are subject to the risk of a large number of lawsuits, including class action suits by consumers and consumer organizations, with respect to billing and other practices, such as customer care practices, marketing, including mass media marketing as well as sending commercial messages to customers, collecting and data collection and usage practices, offering practices of products and services, including third parties' products and services. These actions are costly to defend and could result in significant judgments against us. Recent years were characterized by a substantial increase in the number of requests for certification of class actions filed and approved in Israel. In December 2011, a class action was decided against us (we appealed the decision to the Supreme Court in January 2012 and the execution of the judgment was stayed until the appeal is decided). The number of purported class actions filed against us in the last two years amounts to approximately 45% of all purported class actions filed against us since our inception, thereby increasing our legal exposure and our legal costs in defending against such suits, which as a result may materially and adversely affect our financial results. This trend is expected to continue, encouraged also by amendments to the Consumer Protection Law, stricter policy by regulators, amendments to the Communications Law such as regulating "spam" as well as the growing tendency of adopting comprehensive and burdensome regulation for the telecommunications market. Currently, we are engaged in dozens of purported class action suits as a defendant, many of which are for substantial amounts. Should these requests to certify lawsuits against us as class actions are approved and succeed, this may have a material adverse affect on our financial results. For a summary of certain material legal proceedings against us, see "Item 8 – Financial Information - A. Consolidated Statements and Other Financial Information –Legal Proceedings".

We employ thousands of employees and are therefore subject to the risk of employee lawsuits, including class action suits by employees. Recent years were characterized by a substantial increase in the number of employment lawsuits, as well as purported class actions, filed against employers in Israel. We have also witnessed an increase in the number of lawsuits and amount claimed from us by former employees.

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We are subject to the risk of intellectual property rights claims against us, including in relation to music, music-related or other content services we purchase from third party content providers. These claims may require us to initiate or defend protracted and costly litigation, regardless of the merits of these claims. If any of these claims succeed, we may be forced to pay damages or may be required to obtain licenses for the infringing product or service. If we cannot obtain all necessary licenses on commercially reasonable terms, we may be forced to stop using or selling the products and services.

We rely on interconnecting telecommunications providers and could be adversely affected if these providers fail to provide these services without disruption and on a consistent basis.

Our ability to provide commercially viable telephone services depends upon our ability to interconnect with the telecommunications networks of landline, cellular telephone and international operators in Israel in order to complete calls between our subscribers and parties on a landline or other cellular telephone network, as well as third parties abroad. All landline, cellular telephone and international operators in Israel are required to provide interconnection to, and not to discriminate against, any other licensed telecommunications operator in Israel. We have no control over the quality and timing of the investment and maintenance activities that are necessary for these entities to provide us with interconnection to their respective telecommunications networks. The implementation of number portability requires us to rely further on other providers, since our ability to implement number portability, provide our services and our basic ability to port numbers between operators are dependent on the manner of number portability implementation by interconnecting local operators. The failure of these or other telecommunications providers to provide reliable interconnections to us on a consistent basis could have an adverse effect on our business, financial condition or results of operations.

Our operations are dependent on complex technology and information systems

Our operations are dependent on a number of complex technological systems. The occurrence of malfunctions in such complex and ever changing and expanding systems is inevitable. A malfunction in any of our systems which severely impacts our ability to provide products and services to our customers, may result in loss of revenues to us, may adversely impact our brand perception and expose us to legal claims, all of which may adversely affect our results of operations. In December 2010 we suffered a major network malfunction, following which we decided to grant our subscribers a substantial refund and were also sued for damages in nine purported class actions for substantial amounts (eight of which were dismissed during 2011 and the ninth is still pending).

Our operations are dependant on various information systems. The unauthorized entry to or disruption of operation of these information systems, including due to cyber attacks, may result in damage to us and our customers, including due to inability to provide certain services or provide them with disruptions or inability to bill for services rendered or loss of data, all of which may expose us to legal claims and liabilities.

There are certain restrictions in our license relating to the ownership of our shares.

Our license restricts ownership of our ordinary shares and who can serve as our directors as follows:

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- our founding shareholder, Discount Investment Corporation Ltd., or DIC (or its transferee or transferees, if approved in advance by the Ministry of Communications as "founding shareholders"), must own at least 26% of each of our means of control;

- Israeli citizens and residents among our founding shareholders (or their approved transferees) must own at least 20% of our outstanding share capital and each of our other means of control (DIC has agreed to comply with this requirement);

- a majority of our directors must be Israeli citizens and residents;

- at least 20% of our directors must be appointed by Israeli citizens and residents among our founding shareholders; and

- we are required to have a committee of our Board of Directors that deals with matters relating to state security, which must be comprised of at least four directors (including an external director) having the requisite security clearance by Israel's General Security Service.

If these requirements are not complied with, we could be found to be in breach of our license and our license could be changed, suspended or revoked.

In addition, our license provides that, without the approval of the Ministry of Communications, no person may acquire or dispose of shares representing 10% or more of our outstanding share capital. Further, our directors and officers and any holder of ordinary shares representing 5% or more of our outstanding share capital may not own 5% or more of Bezeq or any of our competitors or serve as a director or officer of such a company, subject to certain exceptions which require the prior approval of the Ministry of Communications.

To ensure that an unauthorized acquisition of our shares would not jeopardize our license, our articles of association provide that any shares acquired without approval required under our license will not be entitled to voting rights.

If our service is to be determined by the Israeli Government to be an "essential service", the Prime Minister and the Ministry of Communications could impose additional limitations including a heightened requirement of Israeli ownership of our ordinary shares.

Although our articles of association contain certain provisions that are aimed at reducing the risk that holdings or transfers of our ordinary shares will contravene our license, we cannot entirely control these and other matters required by our license, the violation of which could be a basis for suspending or revoking our license. Our other licenses and Netvision's licenses contain similar restrictions. See also "Item 4. Information on the Company – B. Business Overview – Government Regulations Our Principal License" and "Other Licenses" and "Item 4. Information on The Company – B. Business Overview – Netvision".

We may be adversely affected by the significant technological and other changes in the cellular communications industry.

The telecommunications market is known for rapid and significant technological changes and requires ongoing investments in advanced technologies in order to remain

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competitive. In recent years we have witnessed a growing demand for Internet, content and data through advanced third generation cellular phones, smartphones, modems, tablets and other devices using cellular data that resulted in a rapid growth of data traffic on cellular networks and required cellular operators to upgrade their networks to accord such demand. We estimate that data traffic will grow even faster in the future and some operators have taken steps aimed at reducing data usage by their subscribers, including by transferring traffic to free alternative networks. MVNO hosting services and national roaming on our network, when materialized, would further increase such demand. Our strategy to grow and develop our Internet, content and data services has proven to be successful and contributed positively to our results of operations. To answer the growing demand for cellular data traffic, we would be required, among others, to continue our investment in upgrading both our cellular and our transmission network as well as invest in advanced technologies such as 4G cellular technologies (Long Term Evolution, or LTE), which will allow larger capacity and higher data speed rates. Although we have completed a substantial portion of our networks upgrade and have been building our LTE readiness, should we decide to build an LTE network, it would require additional substantial investments and the allocation of frequencies for an LTE network. Such allocation to us is not guaranteed, when required or at all (including in light of prior preference given by the Ministry of Communications to new and small competitors in the allocation of additional UMTS frequencies at the September 2010 tender and the limited amount of available frequencies as well as the uncertainties relating to the government's position with respect to the provision of 4G services in Israel), and there is no certainty as to the cost of frequencies, if and when allocated to us. Inability to receive additional frequencies in a timely manner to meet our needs or at all and specifically if LTE frequencies are allocated to our competitors and not to us or allocated to us under less favorable terms than to our competitors could impair our ability to compete and may require us to cease offering certain products and/or services we currently offer and/or change their terms and conditions and/or make substantial unplanned investments, which may have an adverse effect on our results of operations.

If we cannot obtain or maintain favorable roaming arrangements, our services may be less attractive or less profitable.

We rely on agreements to provide roaming capability to our subscribers in many areas outside Israel. As of December 31, 2011, we had roaming arrangements with 545 cellular providers in 179 countries around the world. However, we cannot control the quality of the service that they provide and it may be inferior to the quality of service that we provide. Equally, our subscribers may not be able to use some of the advanced features that they enjoy when making calls on our network. Some of our competitors may be able to obtain lower roaming rates than we do because they may have larger call volumes. Competition is expected to intensify further, when new operators, including MVNOs or Mirs and Golan, begin providing roaming services as well. If our competitors' providers can deliver a higher quality or a more cost effective roaming service, then subscribers may migrate to those competitors and our results of operation could be adversely affected. Further, we may not be able to compel providers to participate in our technology migration and enhancement strategies. As a result, our ability to implement technological innovations could be adversely affected if these overseas providers are unable or unwilling to cooperate with the further development of our network or if they cease to provide services comparable to those we offer on our network.

Following European Union regulation of roaming tariffs, which reduced tariffs for calls made by members of the European Union among themselves, several European Union

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member operators have raised roaming tariffs for calls to and from non-European Union member operators, resulting in higher roaming tariffs for our subscribers. In addition, in August 2008, the Israeli Government adopted a resolution to negotiate a reduction of inbound and outbound roaming tariffs with the European Union and/or members of the European Union or countries frequently visited by Israelis. In January 2012 the Ministry of Communications requested us to provide information in relation to our roaming services. If roaming tariffs are reduced as a result of the proposed negotiation or otherwise and/or if additional European Union member operators raise their tariffs and/or if we are not able to raise our tariffs or otherwise compensate for the higher roaming expenses, this could adversely affect our profitability and results of operations.

Our substantial debt increases our exposure to market risks, may limit our ability to incur additional debt that may be necessary to fund our operations and could adversely affect our financial stability; Regulatory change may affect our possibilities to raise debt from institutional investors.

As of December 31, 2011, our total indebtedness was approximately NIS 6,145 million ($1,608 million). The indentures governing our debentures currently permit us to incur additional indebtedness. Our substantial debt could adversely affect our financial condition by, among other things:

- increasing our vulnerability to adverse economic, industry or business conditions, including increases in the Israeli Consumer Prices Index, or CPI;
- limiting our flexibility in planning for, or reacting to, changes in our industry and the economy in general;
- requiring us to dedicate a substantial portion of our cash flow from operations to service our debt, thus reducing the funds available for operations and future business development; and
- limiting our ability to obtain additional financing to operate, develop and expand our business or to refinance existing debt.

In October 2010, the Commissioner of Capital Markets, Insurance and Savings in the Ministry of Finance published a circular instructing institutional investors to follow certain procedures and requirements before investing in non-governmental debentures, including a requirement to verify that certain contractual provisions are included in the indentures of the invested debentures, and to establish a policy for investment in such debentures which will relate among other matters to repayment acceleration rights. These procedures and requirements may adversely affect our possibilities of raising debt from Israeli institutional investors as well as the terms and price of such debt raising and have already adversely affected the terms under which we plan to raise debt in the near future. See “Item 5. Operating and Financial Review and Prospects. – B. Liquidity and Capital resources – Shelf Prospectus” for additional details.

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See also the Centralization Committee's recommendations under "Risks Relating to Our Ordinary Shares" below, which if adopted and implemented, may adversely affect our possibilities of raising debt from Israeli institutional investors.

Our business results may be affected by currency fluctuations, by our currency hedging positions and by changes in the Israeli Consumer Price Index.

A portion of our cash payments are incurred in, or linked to, foreign currencies, mainly U.S. dollars. In particular, in 2009, 2010 and 2011, payments in U.S. dollars or linked to the U.S. dollar represented approximately 36%, 33% and 39%, respectively, of total cash outflow (including payments of principal and interest on our debentures, but excluding one time payments associated with the acquisition of Netvision). These payments included capital expenditures, some of our operating lease payments and payments to equipment suppliers including handset suppliers. As almost all of our cash receipts are in NIS, any devaluation of the NIS against those foreign currencies in which we make payments, particularly the U.S. dollar, will increase the NIS cost of our foreign currency denominated or linked expenses and capital expenditures.

Furthermore, since the principal amount of and interest that we pay on our Series A, B, C and D debentures, are linked to the Israeli CPI, any increase in the Israeli CPI will increase our financing expenses and could adversely affect our results of operations. See "Item 5. Operating and Financial Review and Prospects – B. Liquidity and Capital Resources – Debt Service – Public Debentures" for details.

We purchase derivative financial instruments in order to hedge part of the foreign currency risks, CPI risks deriving from our operations and indebtedness. Derivatives are initially recognized at fair value. Changes in the fair value are accounted for such that: Changes in the fair value of derivative hedging instruments designated as a cash flow hedge are recognized directly as a component of our shareholders' equity to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognized in our income statement as the hedged item affects earnings. The amount recognized in shareholders' equity is transferred to our income statement in the same period that the hedged item affects our earnings. Notwithstanding the above, hedge accounting is not applied to derivative instruments that economically hedge monetary assets and liabilities denominated in foreign currencies. Changes in the fair value of such derivatives are recognized through our income statement upon occurrence. These differences in the derivative instruments' designation could result in fluctuations in our reported net income on a quarterly basis.

We may not be able to fulfill our dividend policy in the future; implementation of our dividend policy will significantly reduce our future cash reserves.

In February 2006, we adopted a dividend policy targeting a payout ratio of at least 75% of our net income in each calendar year, subject to any applicable law, our license and contractual obligations and provided that such distribution would not be detrimental to our cash needs or to any plans approved by our Board of Directors. In 2009, 2010 and 2011, our Board of Directors declared dividends constituting as much as 95% of our net income and in some cases, part of our retained earnings from earlier periods as well, and may declare dividends as much as 95% of our net income, in the future. See "Item 8. Financial Information - A. Consolidated Statements and Other Financial Information - Dividend Policy". Our license requires that we and our 10% or more shareholders maintain at least $200 million of combined shareholders' equity. Dividend payments are not guaranteed and

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our Board of Directors may decide, in its absolute discretion, at any time and for any reason, not to pay dividends or to pay dividends at a ratio to net income that is less than that paid in the past.

Our dividend policy, to the extent implemented, will significantly reduce our future cash reserves and may adversely affect our ability to fund unexpected capital expenditures as well as our ability to make interest and principal repayments on our debentures. As a result, we may be required to borrow additional money or raise capital by issuing equity securities, which may not be possible on attractive terms or at all.

If we are unable to fulfill our dividend policy, or pay dividends at levels anticipated by investors in our shares, the market price of our shares may be negatively affected and the value of our investors' investment may be reduced.

We rely on a limited number of suppliers for key equipment and services.

We depend upon a small number of suppliers to provide us with key equipment and services. For example, Nokia Siemens Israel provides our network system based on GSM/GPRS/EDGE technology, our UMTS/HSPA core system, part of our radio access network and related products and services, and our landline New Generation Network system, or NGN system; LM Ericsson Israel supplies part of our radio access network and related products and services based on UMTS/HSPA technology; Amdocs Israel provides us with services with respect to the operating of, and the implementation of developments to our billing system; Alcatel Lucent provides our Carrier Ethernet network and SDH equipment for our transmission network; and Be'eri Printers provides our printing supplies and invoices as well as the distribution, packaging and delivery of invoices and other mail to the postal service distribution centers. In addition, we lease a small portion of our transmission capacity from Bezeq, the incumbent landline operator. Bezeq has experienced labor disputes, including stoppages, during the privatization process and liberalization of the landline market, and additional disruptions, stoppages and slowdowns may be experienced in the future. If these suppliers fail to provide equipment or services to us on the requisite standards of quality and on a timely basis, we may be unable to provide services to our subscribers in an optimal manner until an alternative source can be found and our license may be at risk of revocation for failure to satisfy the required service standards.

We are a member of the IDB group of companies, one of Israel's largest and highly regulated business groups. This may limit our ability to expand our business, to acquire other businesses or raise debt.

We are an indirect subsidiary of IDB, one of Israel's largest and highly regulated business groups. An adverse change to IDB's financial condition could have an adverse effect on our debentures rating and our ability to raise additional debt or the terms of such debt raise. In addition, pursuant to the "Guidelines for Sound Bank Administration" issued by the Israeli Supervisor of Banks, the amount that an Israeli bank may lend to one group of borrowers and to each of the six largest borrowers of such banking corporation is limited. Since we are a member of IDB's group of borrowers, these guidelines may limit the ability of Israeli banks to lend money to us.

Due to the limited size of the Israeli market and due to the high level of regulation of the Israeli market, in particular in the communications market, our being a member of the IDB group of companies may limit our ability to expand our business in the future, to form joint ventures and strategic alliances and conduct other strategic transactions with other participants in the Israeli communications market. See also the Centralization Committee's recommendations under "Risks Relating to Our Ordinary Shares" below, which if adopted and implemented, may have an adverse effect on our business.

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We are controlled by a single shareholder who can significantly influence matters requiring shareholders' approval.

As of December 31, 2011, DIC held, directly and indirectly, approximately 43.61% of our outstanding share capital. Pursuant to shareholders agreements among DIC and certain of our minority shareholders, who in the aggregate own approximately 3.43% of our ordinary shares, DIC has been granted the voting rights in respect of those shares. In addition to DIC's shareholdings and such additional voting rights, it has the right to appoint the 20% of our directors that we are required by our license and articles of association to have appointed by Israeli citizens and residents among our founding shareholders. Accordingly, subject to legal limitations, DIC has control (as the term "control" is defined in the Israeli Securities Law; namely the ability to direct a company's activities) over all matters requiring shareholder approval, including the election and removal of our directors and the approval of significant corporate transactions. This concentration of ownership could delay or prevent proxy contests, mergers, tender offers, open-market purchase programs or other purchases of our ordinary shares that might otherwise give our shareholders the opportunity to realize a premium over the then-prevailing market price for our ordinary shares.

Further, as a foreign private issuer, we are exempt from the application of the NYSE rules requiring the majority of the members of our Board of Directors to be independent and requiring our Board of Directors to establish independent nomination and compensation committees. Accordingly, our minority shareholders and debenture holders are denied the protection intended to be afforded by these corporate governance standards.

Risks Related to our wholly owned subsidiary Netvision

Integration of Netvision's business may cause us operating difficulties and expenditures.

The process of integrating Netvision's business into our operations may result in unforeseen operating difficulties and large expenditures and may require significant management attention that would otherwise be available for our ongoing business. These risks may be further intensified due to a number of potential factors, including, among others: changes in the regulatory environment in the Israeli telecommunications market, unanticipated costs or liabilities, multiplicity of information and engineering systems, some of which we may have to replace, loss of key employees of Netvision and unrealistic goals or projections for the Netvision business or the merged group, whether due to regulatory changes or otherwise. In addition, changes in the financial condition, business or operations of Netvision may significantly affect our financial condition and results of operations.

Changes in the regulatory environment could adversely affect Netvision's business.

Netvision is subject to regulation of its ongoing operations and could therefore be significantly impacted by decisions of regulators, changes in laws, regulations or government policy affecting its business activities. The uncertainties and risks surrounding the regulatory framework of the Israeli telecommunications market, some of which we are currently unable to foresee or assess, could negatively affect Netvision's business and prospects. Netvision's

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operations in ISP services, landline telephony and international calling services are highly regulated. A change in the competitive structure of the market or a change in the regulation on structural separation of different types of services may adversely affect Netvision’s results of operations and its ability to compete with other large players in the market, such as Bezeq and Hot. The annulment of Early Termination Fees in the other communications markets in November 2011 has increased competition as it has eliminated transfer barriers. This resulted in increased churn rate and gross recruitment of subscribers and price erosion and is expected to continue to affect Netvision’s results of operations.

The current policy of the Ministry of Communications is to encourage new entrants into the telecommunications market in order to increase competition and reduce fees and prices paid by consumers. See “Item 3. Key Information – D. Risk Factors – Risks related to our Business – We face intense competition in all aspects of our business” as well as under “Item 4. Information on the Company - Competition” regarding the recommendations of a public committee appointed by the Ministry of Communications to examine Bezeq’s tariffs structure, tariffs for wireline wholesale services and review the possible annulment of the structural limitations currently imposed on Bezeq and its subsidiaries, published in October 2011.

Opening the market to additional competition, permitting telecommunications companies to offer bundled services, the recommendations regarding the structural separation and Bezeq’s tariffs supervision may have a material adverse effect on Netvision’s results of operation by enabling increased competition in the markets in which Netvision operates. Moreover, it could specifically give competitive edge to Bezeq and Hot, whose existing infrastructure and ability to offer bundled services may significantly harm Netvision’s competitive position, to provide its customers with landline telephony, ISP services and international telephony. Bezeq and Hot have the advantage of owning their own infrastructure and the ability to offer landline, international telephony and ISP services, as well as multichannel television independently of any third party support. If they are allowed to bundle these services, they will have an advantage over other service providers such as Netvision that do not own their own infrastructure. Further, the offering of services by the Bezeq and Hot groups at tariffs significantly lower than prevailing market tariffs or at prices even lower than our costs for these services, such as by cross subsidizing with other services in which they have the capacity to monopolize the market, could also significantly harm Netvision’s competitive position as it could decrease demand for Netvision’s services or lead Netvision to offer its services at a loss. Further, as Netvision is dependant on Bezeq and Hot’s infrastructure to provide its services on the one hand, and is competing with them on the provision of ISP, ILD and landline services to end-users, on the other hand, price erosion of ISP services would lead to increased demand for greater bandwidth and would require Netvision to significantly increase the capacity it purchases, significantly increasing its expenses in purchasing capacity from Bezeq and Hot, while its revenues would be decreasing. This could also have a material adverse effect on Netvision’s results of operations. In February 2012, Hot began offering ISP services and has done so at tariffs significantly lower than prevailing market prices or at prices which would be lower than our costs and Bezeq also significantly lowered its internet infrastructure services tariffs to end-users. Netvision believes there is cause for regulatory intervention and has appealed to the regulators to intervene, but cannot predict the outcome of such appeals. See “Item 4. Information on The Company –B. Business Overview – The Communications Market in Israel - Communications Groups – Structural Separation”, “Competition” and “Nevision - ISP Business - Competition” and “Nevision - Telephony Business – Competition”.

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In addition, the Ministry of Communication has published a hearing on November 2011 in relation to proposed regulation of the underwater international telecommunications connection from Israel, proposing certain limitations on the agreements with Mediterranean Nautilus Ltd. and Mediterranean Nautilus (Israel) Ltd., or collectively Med Nautilus , Netvision's provider, which would, among others, limit the discounts and capacity Med Nautilus may provide. Further, Bezeq International, one of Netvision's main competitors in the ILD and ISP markets has recently deployed an underwater cable. Adoption of such changes and the deployment of such cable by a Netvision competitor may harm Netvision's results of operations and competitive position as it would force Netvision to purchase capacity at less favorable prices, and more so in comparison to its Bezeq affiliate competitor.

Netvision is exposed to risks relating to network infrastructure and information systems and is dependent on services it receives from its external suppliers.

Netvision does not own an independent network for providing the services it offers to its customers. Therefore, Netvision is dependent on its infrastructure providers, such as Med Nautilus, which provides underwater international telecom connections, Bezeq and Hot, which provide broadband connectivity and wireline infrastructure. In some cases, these providers are virtually the sole providers of such infrastructure and cannot be replaced. Netvision is also dependent on foreign telecommunications operators for its international ISP and telephony communications. Therefore, termination or amendment of terms of an agreement with any of the infrastructure providers or with some of the foreign operators at once, disruption in or refusal to provide such infrastructure services, as well as regulatory changes affecting the terms of infrastructure services that Netvision receives, may have a material adverse affect on Netvision's ability to provide its services to customers or the profitability of providing such services.

Netvision's operations are dependant on various information systems. The unauthorized entry to or disruption of operation of these information systems, including due to cyber attacks, may result in damage to Netvision and its customers, including due to inability to provide certain services or provide them with disruptions or inability to bill for services rendered, loss of data of Netvision or that of its customers stored with Netvision, all of which may expose Netvision to legal claims and liabilities. Further, any successful attacks on Netvisions' customers' information systems, protected by Netvision's data security products, may also expose Netvision to legal claims and liability.

Alternate technology may cause a decline in Netvision's international calling services.

In recent years there has been a decline in use of international calling services through international operators such as Netvision. This is due to, among other things, the development of alternate technologies, such as VoIP, which enable international calls without the services of an international operators. These technologies also pose an alternative to landline communications. If this trend continues and alternate technologies improve or if new ones are developed, the competition in the market will increase, which may have a material adverse effect on Netvision's results of operations.

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Risks Relating to Operating in Israel

We conduct our operations in Israel and therefore our results may be adversely affected by political, economic and military instability in Israel.

Our operations, our network and some of our suppliers are located in Israel. Accordingly, political, economic and military conditions in Israel may directly affect our business. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors. Any hostilities involving Israel or the interruption or curtailment of trade within Israel or between Israel and its trading partners could adversely affect our operations and could make it more difficult for us to raise capital. Since September 2000, there has been a high level of violence between Israel and the Palestinians. Hamas, an Islamist movement responsible for many attacks, including missile strikes, against Israelis, won the majority of the seats in the Parliament of the Palestinian Authority in January 2006 and took control of the entire Gaza Strip, by force, in June 2007. Hamas has launched hundreds of missiles from the Gaza Strip against Israeli population centers, disrupting day-to-day civilian life in southern Israel. This led to an armed conflict between Israel and the Hamas during December 2008 and January 2009 and a continued sporadic missile launching from the Gaza strip to Israel, thereafter. A substantial part of our network and information systems is located within range of missile strikes from the Gaza Strip and Lebanon. Any damage to our network and/or information systems would damage our ability to provide service, in whole or in part, in the southern or northern part of Israel or otherwise damage our operation and could have an adverse effect on our business, financial condition or results of operations.

More generally, any armed conflicts, terrorist activities or political instability in the region would likely negatively affect business conditions and could harm our results of operations, including following termination of such conflicts, due to a decrease in the number of tourists visiting Israel. At the end of 2010 and during 2011 several countries in the region, including Egypt and Syria, have been experiencing increased political instability, which led to change in government in some of these countries (including Egypt), the effects of which are currently difficult to assess.

In addition, in the event that the State of Israel relinquishes control over certain territories currently held by it to the Palestinian Authority, we will not be able to provide service from our cell sites located in Israeli populated areas and on connecting roads in these territories. This may result in the loss of subscribers and revenues and in a decrease in our market share.

Our freedom and ability to conduct our operations may be limited during periods of national emergency.

The Communications Law grants the Prime Minister of Israel the authority, for reasons of state security or public welfare, to order a telecommunications license holder to provide services to security forces, to perform telecommunication activities or to establish a telecommunications facility as may be required for the security forces to carry out their duties. Further, the Israeli Equipment Registration and IDF Mobilization Law, 1987, also permits the registration of engineering equipment and facilities and the taking thereof for the use of the Israel Defense Forces. This law further sets the payment for use and compensation for damages caused to the operator as a result of such taking. Our general license also permits the Israeli Government, during national emergencies or for reasons of national security, to

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take all necessary actions in order to ensure state security, including taking control of our network, and requires us to cooperate with such actions. If national emergency situations arise in the future and if we are to be subject during such time to any of the foregoing actions, this could adversely affect our ability to operate our business and provide services during such national emergencies and adversely affect our business operations. Our other licenses and Netvision's licenses (excluding its ISP license) contain similar restrictions. See also "Item 4. Information on the Company – B. Business Overview – Government Regulations Our Principal License" and "Other Licenses" "Item 4. Information on The Company – B. Business Overview – Netvision".

Provisions of Israeli law and our license may delay, prevent or impede an acquisition of us, which could prevent a change of control.

Israeli corporate law regulates mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to these types of transactions. For example, a merger may not be completed unless at least 50 days have passed from the date that a merger proposal was filed by each merging company with the Israel Registrar of Companies and at least 30 days from the date that the shareholders of both merging companies approved the merger. In addition, a majority of each class of securities of the target company is required to approve a merger. Further, the provisions of our license require the prior approval of the Ministry of Communications for changes of control in our Company.

Furthermore, Israeli tax considerations may make potential transactions unappealing to us or to our shareholders whose country of residence does not have a tax treaty with Israel exempting such shareholders from Israeli tax. For example, Israeli tax law does not recognize tax-free share exchanges to the same extent as U.S. tax law. With respect to mergers, Israeli tax law allows for tax deferral in certain circumstances but makes the deferral contingent on the fulfillment of numerous conditions, including a holding period of two years from the date of the transaction during which sales and dispositions of shares of the participating companies are restricted. Moreover, with respect to certain share swap transactions, the tax deferral is limited in time, and when the time expires, tax then becomes payable even if no actual disposition of the shares has occurred.

These provisions could delay, prevent or impede an acquisition of us, even if such an acquisition would be considered beneficial by some of our shareholders.

Risks Relating to Our Ordinary Shares

A substantial number of our ordinary shares could be sold into the public market, which could depress our share price.Our largest shareholder, DIC, holds approximately 43.61% of our outstanding ordinary shares, as of December 31, 2011. The market price of our ordinary shares could decline as a result of future sales by DIC or other existing shareholders or the perception that these sales could occur. DIC sold 16,385,870 ordinary shares, or approximately 16.47% of our outstanding shares in a number of transactions outside the United States in 2007, 2008 and 2011. Sales may be made pursuant to a registration statement, filed with the U.S. Securities and Exchange Commission, or the SEC pursuant to the terms of a registration rights agreement or otherwise, or in reliance on an exemption from the registration requirements of the Securities Act, including the exemptions

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provided by Rule 144 or Regulation S. Any decline in our share price could also make it difficult for us to raise additional capital by selling shares.

In addition, in February 2012, a public committee for the enhancement of competition and the maintenance of the financial stability of the Israeli economy, or Centralization Committee, nominated by the Israeli Prime Minister, published its final recommendations, including recommendations to: (1) impose limitations on the control or holding of a substantial real corporation and its controlling entities over a financial corporation; (2) impose limitations on the control over public corporations through a pyramid structure by imposing a limitation on the number of layers in such pyramid to three for existing corporations and two for new corporations; (3) strengthen the corporate governance applicable to public companies in Israel, and in particular strengthen the independence of board of directors of public companies held through pyramid structure; (4) limit the exposure of institutional bodies to issuers, borrowers groups and the largest borrowers and issuers groups; and (5) require the entities responsible for the allocation of rights and public assets in certain cases to consider competitive and control centralization considerations regarding essential infrastructure. In relation to certain recommendations the committee recommended transition periods of between one and four years from their adoption. The adoption of such recommendations, if implemented, could have a material effect on us, given our being held as a fourth layer company in the IDB group.

In addition, under our option plan, options are subject to vesting schedules but vesting will be accelerated upon certain events including any sale or other disposition, of all or substantially all, of the outstanding shares of us. As of December 31, 2011 we have 1,056,896 shares reserved for issuance upon the exercise of options. See "Item 6. Directors, Senior Management and Employment – E. Share Ownership – 2006 Share Incentive Plan".

ITEM 4.INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

Our History

Cellcom Israel Ltd. was incorporated in 1994 in Israel. Our principal executive offices are located at 10 Hagavish Street, Netanya 41240, Israel and our telephone number is (972)–52–999–0052. Our authorized U.S. representative, Puglisi & Associates, is located at 850 Library Avenue, Suite 204 Newark, Delaware 19711 and our agent for service of process in the United States, CT Corporation System, is located at 111 Eighth Avenue, New York, NY 10011.

We hold one of the five general licenses to provide cellular telephone services in Israel, one of the five cellular services providers has not commenced operations yet and is expected to do so in the second half of 2012. To date, nine MVNO licenses have been awarded, one of which was returned to the Ministry of Communications, and one MVNO operator commenced operation in December 2011. Our cellular license was granted by the Ministry of Communications in 1994 and is valid until 2022.

In February 2007 we listed our shares on the NYSE and in July 2007 we dual listed our shares on the Tel Aviv Stock Exchange, or TASE and began applying the reporting leniencies afforded under the Israeli Securities Law to companies' whose securities are listed both on the NYSE and the TASE.

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DIC, a subsidiary of IDB, currently directly and indirectly holds approximately 43.61% of our share capital and the voting rights in respect of an additional approximately 3.43% of our share capital.

As of the date of this Annual Report on Form 20-F, there has been no indication of any public takeover offer by any third party, in respect to our ordinary shares, or by us, with respect to another company's shares, other than as detailed under " - Significant Developments During 2011".

Significant Developments During 2011

Acquisition of Netvision Ltd.

On August 31, 2011, we completed the acquisition of 100% of the share capital of Netvision for a total consideration of approximately NIS 1.57 billion ($411 million) pursuant to a merger agreement dated June 15, 2011, by and among our Company, Netvision and a wholly owned subsidiary of our Company, which we formed solely for effecting the merger transaction. Following the consummation of the merger transaction, Netvision became a wholly owned subsidiary of our Company.

Prior to being acquired by us, Netvision was a public company traded on the TASE, indirectly controlled by the IDB Group through direct holdings in Netvision by: (1) DIC, (approximately 38%), and (2) Clal Industries and Investments Ltd., or Clal (approximately 29.7%). DIC is also our direct controlling shareholder. DIC and Clal are direct subsidiaries controlled by IDB Development, which is a wholly owned subsidiary of IDB, a public company traded on the TASE.

Since prior to the merger transaction, the IDB Group controled both Netvision and us, the merger transaction was approved as a related party transaction under Israeli law. For further details, see Item 7. B "Related Party Transactions".

Netvision is a leading company in the Israeli telecommunications market and is engaged in two primary businesses: provision of internet connectivity and related services (ISP); and provision of telephony services consisting mainly of international calling services, operator services, teleconferencing services and landline telephony services). Netvision's ISP and ILD licenses were granted by the Ministry of Communications in 2002 and 1997, respectively and are valid until 2012 and 2025, respectively. In addition, Netvision is engaged in other areas such as internet content services and custom internet applications. For further details, see Item 4.B - "Business Overview - Netvision".

Netvision has several subsidiaries, some are wholly owned, some are controlled or jointly held by Netvision, and also holds minority stakes in certain other entities. We refer to Netvision and its subsidiaries as "Netvision".

We funded the acquisition of Netvision through a combination of available cash and issuance of additional debentures from our existing Series D and Series E debenture series on the TASE. The offerings described above were made in Israel to residents of Israel only. For further details, see "Item 5. B – Operating and Financial Review and Prospects – Liquidity and Capital Resources".

Principal Capital Expenditures

Our accrual capital expenditure in 2009, 2010 and 2011 amounted to NIS 663 million, NIS 735 million and NIS 520 million, respectively. Accrual capital expenditure is defined as

investment in fixed assets and intangible assets, such as spectrum licenses, rights of use of communication lines, UMTS networks' enhancement and expansion and development of new products and services during a given period. The amount of capital expenditure for 2010 includes NIS 108 million for the acquisition of assets and operations of Dynamica, one of our major dealers.

B. BUSINESS OVERVIEW

General

We are the largest provider of cellular communications services in Israel with approximately 3.349 million cellular subscribers for the year ended December 31, 2011. Upon launch of our services in 1994, we offered significantly lower prices for cellular communications services than the incumbent provider and transformed the nature of cellular telephone usage in Israel, turning it into a mass market consumption item. We surpassed the incumbent cellular operator and became the market leader in terms of number of subscribers in 1998 and, despite the entry of additional competitors, we have continued since then to have the highest number of subscribers. As of December 31, 2011, we provided services to approximately 3.349 million subscribers in Israel with an estimated of 33.6%. Our closest competitors have estimated market shares of 31.9% and 29.6 %, respectively. In the year ended December 31, 2011, we generated revenues of NIS 6,506 million ($1,703 million), EBITDA of NIS 2,167 million ($567 million), and operating income of NIS 1,422 million ($373 million). See note 2 to the table in "Item 3. Key Information – A. Selected Financial Data" for a definition of EBITDA. In 2011, our results of operations were adversely affected by regulatory changes, mainly the reduction of interconnect fees and the reduction of Early Termination Fees to a negligible amount in the cellular market and the intensified competition leading to accelerated price erosion and we estimate that the intensified competition will continue to adversely affect our results in the future . See "Item 5. A. – Operational Review".

We offer a broad range of cellular services through our cellular networks covering substantially all of the populated territory of Israel. These services include basic and advanced cellular telephone services, text and multimedia messaging services and advanced cellular content and data services. We also offer international roaming services in 179 countries as of December 31, 2011. We offer our subscribers a wide selection of handsets from various leading global manufacturers, as well as extended warranty and repair and replacement services to most handsets we offer. We also offer landline transmission and data services to business customers and telecommunications operators and, since July 2006, we offer landline telephony services and since 2009 ISP services to selected businesses, using our advanced inland fiber-optic infrastructure.

Following the completion of the acquisition of Netvision in 2011, we expanded the range of our telecommunications services and we now also offer, through Netvision, ISP services to private and business customers and additional telephony services, such as international calling services, landline telephony services to the business and the private sectors and teleconferencing services. We also provide through Netvision additional services such as internet content services, design of software and internet applications. For further details on Netvision's business and operations, see "NETVISION" in this Item 4.B below.

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The following table presents our number of cellular subscribers and revenues for each of the last five years:

	Year Ended December 31,				
	2007	2008	2009	2010	2011
Cellular subscribers (end of period) (in thousands)(1)	3,073	3,187	3,292	3,394	3,349
Revenues (in NIS millions)	6,050	6,417	6,483	6,662	6,506

(1) Subscriber data refers to active cellular subscribers. We use a six-month method of calculating our cellular subscriber base, which means that we deduct subscribers from our cellular subscriber base after six months of no revenue generation or activity on our network by or in relation to both the post-paid and pre-paid subscriber. The six-month method is, to the best of our knowledge, consistent with the methodology used by other cellular providers in Israel. During the fourth quarter of 2011, we have removed approximately 52,000 subscribers from our subscribers base, following the shutdown of our TDMA network as of December 31, 2011, since such subscribers have not requested a transfer to our other networks as of that date, and following a change to our previous policy which allowed subscribers to change from post to prepaid subscription as a result of the reduction of Early Termination Fees in the cellular market in early 2011, as we found this change to be futile since most of those customers ceased using our services. These changes affected other key performance indicators. We have not restated prior subscriber data to conform with these changes.

The Telecommunications Industry in Israel

The following table sets forth selected macro statistics about Israel at and for the year ended December 31, 2011:

Population (millions, at end of year)	7.8
GDP ($ billions) (1)	239
GDP per capita ($ 000) (1)	31
Exports of goods & services ($ billions) (1)	88
CPI change	2.2%
Long-term local currency sovereign credit rating by S&P	A+(Stable)
Unemployment rate (average for nine months ending September 2011)	5.7%

(1) 2011 forecast, translated to USD based on the average representative rate of exchange for the year

Source: Central Bureau of Statistics, and Ministry of Finance of Israel, , Bank of Israel.

The size of Israeli telecommunications services revenues in 2010 was approximately NIS 30 billion. Telecommunications services consist of several segments, which are highly competitive. Of the total telecommunications services revenues in 2010, approximately 57% was comprised of cellular services, approximately 25% was local landline voice and Internet access services, approximately 5% was international voice services, approximately 13% was multichannel television services, and approximately 1% was Network Ending Point. These figures have changed substantially in 2011, reflecting a downsizing of the overall revenues in the cellular market, as a result of the reduction of interconnect tariff. For additional details, see "Item 4. Information on the Company – B. Business Overview – Government Regulations – Tariff Supervision". Cellular spending in 2011 was approximately 1.4% of GDP, in line with developed European economies and the United States.

Israel has high penetration rates across all telecommunications services that are in line with developed economies such as in the European Union and the United States. These levels of penetration can be attributed to the rapid adoption rate of new technologies, high expenditures on telecommunications services by consumers and businesses and a relatively young population.

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Communications Groups – Structural Separation

Since 2009, the Israeli telecommunications market underwent several ownership changes. Recent acquisitions resulted in the creation of three additional communications groups in the Israeli communications market, in addition to the Bezeq group: Partner-012 Smile, Cellcom–Netvision and Hot-Mirs. See "Cellular Services" below for additional details. Each of the Bezeq and Hot groups are subject to certain structural separation requirements as a result of being the incumbent and monopoly in their respective core business – landline and multichannel television services. That structural separation was relaxed in 2010, allowing Bezeq and its subsidiaries to offer a bundle of services under certain conditions to private customers (including the condition that each of the services in the Bezeq bundle will be available for sale separately under the same terms as in the bundle; and the requirement that Bezeq allows its competitors to participate in a similar bundle - if includes ISP, VOB or ILD services - under the same terms and equally markets such bundles as its own bundle – the second requirement does not apply to the sale of the bundle by a subsidiary of Bezeq), and is currently being considered by the Ministry of Communications with respect to business customers as well. The offering of a bundle of services, including cellular services by another group, will relax the conditions under which Bezeq may provide a similar bundle. Further, a public committee appointed by the Ministry of Communications recommended in October 2011 to annul the structural limitations currently imposed on Bezeq and its subsidiaries when a wholesale market of wireline services becomes available to other operators, and to replace Bezeq's regulated fixed tariffs with maximum tariffs. If such recommendations are adopted by the Ministry of communications, they will allow Bezeq and its subsidiaries (including Pelephone), to offer bundles of services (other than multichannel television services) without limitation. Although the Hot group is also subject to structural separation limitations between its multi-channel television, ISP, cellular and landline services, it was allowed to offer a bundle of landline, multichannel television and internet infrastructure services and the Ministry of Communications is currently considering whether to annul the structural separation limitations between Mirs and Hot, after already lifting certain limitations in 2011, allowing Hot and Mirs to sell and market each other's services and transfer information. The Hot group was previously allowed to sell a bundle including ISP services under certain conditions (similar to the ones imposed on the Bezeq bundle of services, in relation to the ISP component only) . Both Bezeq and Hot offer bundles of services excluding cellular services. Bundle offerings by Hot and Bezeq are expected to accelerate price erosion in each of the services included. See "Item 4. Information on The Company – B. Business Overview – Competition" and "Nevision - ISP Business - Competition" and "Nevision - Telephony Business - Competition".

Cellular Services

Cellular telephone services were first introduced in Israel in 1986. For the first nine years of cellular operations there was only one operator, Pelephone, a subsidiary of Bezeq, and growth of cellular telephone services, as well as penetration rates, were limited. After the commercial launch of Cellcom in December 1994, cellular penetration rates and cellular phone usage increased significantly. This is mainly due to the fact that our license was awarded to us based upon, among other things, our commitment to offer our services at low prices during the first five years of our operation.

The Israeli cellular market is highly penetrated. The market reached an estimated penetration rate (the ratio of cellular subscribers to the Israeli population) at December 31, 2011, of approximately 128%, representing approximately 10 million cellular subscribers.

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The following table sets forth the growth in the total number of cellular subscribers in Israel and the penetration rate over the last five years:

	December 31,				
	2007	2008	2009	2010	2011
Total subscribers (millions)	9.0	9.2	9.5	9.8	10
Cellular penetration (%)	124%	124%	127%	128%	128%

Source: Reported by Cellcom, Partner and Pelephone. Mirs data as reported by Hot on July 25, 2011 in the valuation of Mirs performed by TASC , an Israeli consulting firm.

There are currently four active cellular operators in Israel: Cellcom, Partner, Pelephone, and MIRS and one active MVNO operator: Rami Levy. We estimate that the distribution of cellular subscribers among these operators as of December 31, 2011 was: Cellcom 33.6%, Partner 31.9%, Pelephone 29.6%, MIRS 4.8% and Rami Levy with less than 1% . Subscriber data is based on public information as of September 30, 2011, other than MIRS, which is based on its estimate for year end, as published by Hot in its valuation for Mirs and except for Rami Levy, which is based on our estimate. However, there is no uniform method of counting subscribers. Mirs and Golan were granted a UMTS license in April and December 2011 respectively and are expected to commence their UMTS operation in the first half of 2012 and second half of 2012, respectively. An additional eight entities have received MVNO licenses during 2010 and 2011 and to date have not commenced operating: Free Telecom Ltd., or Free Telecom, Ituran Cellular Communications Ltd., or Ituran, Bynet Semech Outsourcing Ltd., or Bynet, Home Cellular Ltd., or Home Cellular, T2T Communications Ltd., or T2T, Gali Phone Ltd., or Gali Phone, and Alon Cellular Ltd., or Alon Cellular. The ninth MVNO licensee has returned its license. Free Telecom, Ituran, Alon Cellular and Home Cellular are expected to commence operations in the first half of 2012.

We are controlled by DIC, a subsidiary of IDB, and started operations at the end of 1994. In August 2011, we completed the purchase of all outstanding shares of Netvision. Until 2009, Partner was majority-owned by Hutchinson Whampoa Ltd. and started operations in 1998. In October 2009, Scailex Corporation Ltd., or Scailex, an Israeli company listed on the TASE and indirectly controlled by Israeli businessman Mr. Ilan Ben-Dov, purchased the controlling stake in Partner. Scailex is also the official importer of Samsung cellular phones to Israel. Pelephone is a wholly-owned subsidiary of Bezeq, the landline incumbent operator and started operations in 1986. The major controlling shareholder of Bezeq following its privatization in 2005 was F.Sab.Ar Holdings Ltd. (controlled by Saban Capital Group (controlled by the media entrepreneur Haim Saban), Apax Partners (the international private equity firm) and Arkin Communications (controlled by the Israeli businessman Mori Arkin)). In April 2010, Bezeq announced that F.Sab.Ar Holdings Ltd. completed the sale of its holdings in Bezeq to B Communications Ltd., or B Communications, (formerly named 012 Smile Communication Ltd., or Smile). B Communications is an Israeli company traded on the NASDAQ and the TASE and controlled by Internet Gold Golden Lines Ltd., or Internet Gold. Both B Communications and Internet Gold form part of the Eurocom Communication Group, or Eurocom, which includes Eurocom Cellular Communication Ltd. - the official representative of Nokia cellular phones in Israel. In January 2010, Ampal-American Israel Corporation, or Ampal, a company traded on the NASDAQ and TASE completed the purchase of Smile's on-going business, through its indirect wholly owned subsidiary – 012 Smile Telecom Ltd, or Smile Telecom. In March 2011, Partner announced the completion of the purchase of all outstanding shares of Smile Telecom. MIRS, previously wholly owned by Motorola, had its license upgraded from push-to-talk to a cellular license in February 2001. In

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2010, Motorola completed the sale of its holding in MIRS to Altice Securities S.A.R.L, owned by the French businessman Mr. Patrick Derhy. Mr. Derhy has also purchased the controlling stake in Hot Telecom, or Hot, which provides multichannel pay-TV services and Internet, data and landline telephony services. In September 2011, Hot acquired all the outstanding shares of MIRS.

Golan is owned by Xavier Niel, founder and controlling shareholder of the French telecom company Iliad- Free, Patrick and Gerard Pariente, founders and former owners of Naf Naf, a European fashion brand and Michael Golan, the CEO of Golan and former CEO of the French telecom company Iliad – Free.

Free Telecom (also in possession of a VoC trial license) is controlled by Shlomo Shmeltzer, who also controls Tadiran Telecom, a telecom integrator, and Shlomo Sixt, a car rental and leasing company; Ituran sold its mobile business in 2011 to the CEO of its mobile business, Yehiel Ben-Shoshan; Rami Levy is a subsidiary of a major Israeli discount supermarket chain; Bynet belongs to the Rad Bynet group, a leading Israeli manufacturer and integrator of communications products and services; Home Cellular is a subsidiary of a leading ‘do it yourself’ stores chain; T2T is owned by three private entrepreneurs ; Alon Cellular is owned by Alon holdings which also controls a leading retail chain and a gas stations chain and Ellomay Capital, an investment company and Gali Phone is owned by Avigdor Tamir, who also owns Sipme, one of the companies conducting a VoC services trial.

The following listing sets forth the key milestones in the history of the Israeli cellular services:

1986	Bezeq and Motorola create a joint venture called “Pelephone”, which becomes Israel’s first cellular operator. Pelephone launches N-AMPS services
1994	Cellcom awarded a license and launches TDMA services
1997	Cellcom introduces first pre-paid plan to the market
1998	Partner awarded a license and launches GSM services
1998	Pelephone launches CDMA services
2001	Ministry of Communications allocates additional 2G and 3G cellular frequencies for existing cellular operators and for the licensing of a new operator
2001	MIRS becomes Israel’s fourth cellular operator with iDEN services
2002	Cellcom launches GSM/GPRS services
2003	Cellcom launches EDGE services
2004	Partner launches UMTS services Pelephone launches EVDO services
2006	Cellcom launches full scale UMTS/HSDPA services
2007	Partner launches HSDPA services
2008	Cellcom launches HSUPA services
2009	Pelephone launches UMTS/HSPA services
2010	Ministry of Communications provides MVNO licenses; Cellcom and Pelephone launch HSPA+ services
2011	Mirs and Golan awarded UMTS operator licenses Rami Levy , MVNO operator, commences operations Cellcom stops operating its TDMA network

Key characteristics of the Israeli cellular services market

The following paragraphs describe the key characteristics of the Israeli cellular services market:

High cellular telephone penetration. The estimated penetration rate in Israel as of December 31, 2011 was 128%. Penetration rate is calculated by dividing the total number of

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subscribers by the Israeli population. The Israeli population does not include foreign workers and Palestinian subscribers who are included in the number of subscribers. The number of subscribers also includes subscribers with more than one subscription to a cellular network (including data only subscriptions alongside a cellular subscription) and may also include subscribers to more than one network including those in the process of switching networks. As a result, the effective penetration rate after adjustment for these factors is likely to be lower than 128%. The regulatory reduction of Early Termination Fees to a negligible amount in the cellular market, has reduced the number of subscribers with more than one subscription.

Favorable demographics. Population growth is generally high and the population is relatively younger than in other developed economies.

Favorable geography and high population density around a few urban centers. Israel covers a small area of territory of approximately 8,000 square miles (20,700 square kilometers). In addition, Israel is relatively flat and dry. Moreover, the population tends to be concentrated in a small number of geographical locations. These characteristics facilitate efficient network roll out and maintenance.

High cellular voice usage. The average cellular voice usage per subscriber in Israel is well over 300 minutes per month, which is higher than the average cellular voice usage per subscriber in most developed economies using the pricing model of “calling party pays”.

Low average voice revenue per minute. Cellular operators in Israel have lower average voice revenues per minute than in most developed calling party pay economies. This is a consequence, among other things, of the strong competition and a heavily regulated environment. Following the reduction of Early Termination Fees in the cellular market and the intensified competition, the average voice revenue per minute further declined in 2011 as a result of the offering of packages which led to further price erosion (together with higher MOU).

High percent of Postpaid customers. The Israeli cellular market has a high percent of Postpaid customers (71%) compared to other developed countries.

High potential for mobile data. The contribution of non-voice revenues to total revenues in the Israeli cellular market is below the level of other developed markets. This characteristic is attributable in part to the relatively late launch of advanced data services and smartphones in Israel. We believe that there is a potential for narrowing this gap by increasing marketing efforts of new data devices (such as tablets and laptops) to increase usage of data together with the growth in our existing 3G subscriber base.

Calling party pays. In Israel, as in most of the world, the party originating the call pays for the airtime. Cellular telephone network operators do not charge subscribers for calls received on their handsets, except while roaming abroad.

Annual churn rates. The average annual churn rate in Israel in 2011 is estimated to be approximately 25%, which is in line with the churn rates in other developed economies. This churn rate reflects a material increase in churn rate attributed to the regulatory changes implemented in 2011 such as the regulatory reduction of Early Termination Fees to a negligible amount in the cellular market in February 2011.

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Wireline Services

Landline Services

Bezeq operates approximately 2.3 million lines (at the end of September 2011) and provides local services. The second largest competitor in landline telephony services is Hot, a provider of cable TV services, which started landline operations in late 2003. Hot's network has been upgraded to offer Internet, data and voice services.

In recent years, Bezeq has experienced a significant drop in its traffic volume. Bezeq is a monopoly and thus subject to enhanced regulatory scrutiny, including supervision of tariffs.

We, Netvision (our wholly owned subsidiary) and Hot entered this market in 2006. Partner entered this market in 2007, Smile Telecom entered this market in 2008 and Bezeq International (VOB only) entered this market in 2009, bringing to a total of seven players. Following the acquisition of Smile Telecom by Partner in March 2011, Partner announced it will transfer its landline telephony business to Smile Telecom.

Broadband and Internet services

The Israeli broadband market is characterized by a regulatory structural separation between the providers of the internet infrastructure and the internet access service. Based on Bezeq and Hot reports, at the end of September 2011, there were approximately 1.864 million subscribers, and the household penetration rate was approximately 85%. The only providers of infrastructure in the market are Bezeq through ADSL technology and Hot through cable. ADSL services were launched by Bezeq in 2000 and currently represent a 59% share of broadband connections. Cable modems, which account for the rest of the market, have been available since 2002.

Hot announced in 2010 it has completed the upgrade of its network to UFI (Ultra Fast Internet) network and Bezeq announced it will complete upgrading its network to high speed NGN in 2012. In December 2011, Bezeq announced it will start a limited trial to test a Fiber to the Building (FTTB) and Fiber to the home (FTTH) network. In February 2010, the Ministry of Communications provided a trial license to the Israeli Electric Company, allowing it to use its fiber optic infrastructure to provide transmission services to other operators. In March 2011, the Israeli government approved the establishment of a new communications company that will be granted the exclusive right to use the Israeli Electric Company's optic fiber infrastructure for the provision of broadband transmission services. The new company will be controlled by a private investor (51%) which may not hold any means of control in another communications company, and the Israeli electric Company (49%).

Transmission and landline data services are provided by Bezeq, Hot, Partner (who acquired Med-1's operation in 2006) and us. These services are provided to business customers and to telecommunications operators.

Internet access is currently provided by three major Internet service providers, or ISPs: Netvision (our wholly owned subsidiary), Bezeq International, Smile Telecom (a subsidiary of Partner), and some other niche players. Hotnet, a subsidiary of Hot, began providing ISP services in February 2012. We estimate the market share of the three largest ISPs to be similar, with each holding around one third of the market, with Netvision

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(including its controlled subsidiary) holding the leading position. All three major providers are also suppliers of international voice services. Partner entered this market in December 2008 and following its acquisition of Smile Telecom in March 2011, announced it will transfer its ISP business to Smile Telecom. We have offered ISP services to selected business customers since 2009 and Hot was awarded an ISP license in December 2010.

Until 2011, the Israeli ISPs were connected to the World Wide Web through an underwater communications cable owned and operated by Mediterranean Nautilus Ltd., a subsidiary of Telecom Italia SpA. In January 2012, Bezeq International announced that its own underwater communications cable was operational and in February 2012, the Tamares Group's underwater communications cable, owned by the British businessman Poju Zabloudowicz commenced operations. We expect that these additional underwater cables will increase the effective bandwidth of international data connectivity and reduce costs for ISPs. However, proposed regulation published for public comments by the Ministry of Communication in November 2011, proposes certain limitations on the terms of agreements with Med Nautilus, which would, among others, limit the discounts and capacity Med Nautilus may provide and force ISP providers (other than Bezeq International) to purchase capacity on less favorable terms and prices.

International voice services

International voice services in Israel have been open for competition since December 1996. Until then, Bezeq International, was the only supplier of such services. There are currently six players in this market. The three major players are: Bezeq International, Netvision (our wholly owned subsidiary) and Smile Telecom. The fourth player is Xfone Communications, fifth operator, Telzar International Communications Services Ltd., commenced operating in February 2011 and a sixth operator, Hilat Ltd., commenced operations in January 2012. We estimate the market share of the three major players to be similar, with each having approximately 31-32% market share. Entry barriers to this market are low, technological alternatives such as Skype are commonly used and competition is intense.

Multichannel television

The multichannel pay-TV market is also highly penetrated with levels above those of most developed economies. Multichannel pay-TV services are provided by Hot and by YES, a subsidiary of Bezeq. Regulatory change allowing digital terrestrial television (DTT) broadcasting was commercially launched in 2010, and may affect the level of competition in this market and attract additional players, that may use the DTT as a basic service to be bundled with additional IPTV or Over the Top (OTT) channels. In February 2011, the Israeli government decided to enlarge the DTT service from the current 5 channels to 16 channels in two years.

See "Item 4. Information on the Company – B. Business Overview – Government Regulations – Competition" for recommendations to annul structural limitations in the communications market and create a wholesale market for wireline services.

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Competitive Strengths

We believe that the following competitive strengths will enable us to maintain and enhance our position as a leading communications group in Israel:

- Combination of leading operators. The combination of our market leading position in the cellular market, as reflected by our market share, , coupled with Netvision's leading position in the ISP market and significant market share in the ILD services, and the recent combination of these two leading companies, enables us to leverage synergies and create a rich portfolio of services which further strengthens our competitive abilities.

- Leading brands. Our established brands, Cellcom and Netvision, enjoy strong public recognition in Israel. We consider the enhancement of our image among consumers a top priority and continually invest substantial resources to maintain Cellcom and Netvision as leading brands in the Israeli communications market. Globes, a leading financial magazine in Israel, ranked Cellcom as the leading and strongest brand of Israel's telecommunications market in 2011 and Israel's 4th strongest brand in the Israeli market overall, after three prestigious global brands. We believe that the acquisition of Netvision will strengthen the Cellcom brand and the combination of the two leading brands will create an even stronger communications brand. Furthermore, Cellcom is not only considered a leading brand for consumers, it is also considered an attractive workplace. According to BDI, Cellcom is the 5th most desirable work place among graduating students in Israel. According to the same survey, Cellcom is number 6 most desirable workplaces in Israel. In addition to being a leading brand for both consumers and employees, Cellcom also leads the mobile communications market in terms of customer care. According to the two leading consumer organizations (Emun Hatzibur and the Israeli Consumers Council), Cellcom has the lowest rate of customer complaints while possessing the largest customer base in the market. According to an external survey conducted by Geocartography Group (a survey institute and one of the leading applied-research institutes in Israel (in November 2011, Netvision's brand is also one of the leading brands in the Israeli telecommunications market. According to that survey, Netvision is the most recognized ISP provider, with the highest score both in terms of retention and unaided awareness and also has the highest rate of promoters among its customers.

- Large market share across our core lines of business. We hold a large market share in each of our core lines of business – cellular, ISP and ILD services, providing us with economies of scale in a business characterized by significant fixed costs. In addition, partial customer overlap between our core businesses provides us with ample cross-selling opportunities.

- Transmission infrastructure. We have an advanced fiber-optic transmission infrastructure that consists of approximately 1,600 kilometers of inland fiber-optic cable, which, together with our complementary microwave-based infrastructure, connects the majority of our cell sites and provides for substantially all of our backhaul services. Our transmission infrastructure significantly reduces our operational reliance on Bezeq, the incumbent landline operator in Israel, and saves us substantial infrastructure-leasing cash costs. As our transmission network has

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transmission and data capacity in excess of our own backhaul needs and covers the majority of Israel's business parks, we offer transmission and data services to business customers and other telecommunications providers and landline telephony services to selected landline business customers. Following the acquisition of Netvision, this infrastructure will also be used to benefit Netvision's landline services for business customers, which are currently provided using external infrastructure. This advantage is expected to be less meaningful if and when the Israeli Electric Company commences to provide transmission to operators, and if and when landline operators who hold general licenses (such as Bezeq) will be required to permit usage of their infrastructure by other operators, as recommended by a public committee appointed by the Ministry of Communications.

- Strategic relationship with one of Israel's largest business groups. Our ultimate parent company, IDB, is one of the largest business groups in Israel. We enjoy access through our management services agreement to the senior management of the IDB group, who are some of the most experienced managers in Israel. These managers, including veterans of the Israeli telecommunications market, provide us with financial, managerial and strategic guidance.

- Strong management team. Our management team includes seasoned managers with significant experience and solid track records in previous managerial positions. Our Chairman, Mr. Ami Erel, is a veteran of the Israeli communications market and previously served as the Chief Executive Officer of Bezeq. Our Chief Executive Officer, Mr. Nir Sztern, has extensive experience in wireline and cellular services, having previously been Chief Executive Officer of Netvision and Deputy Chief Executive Officer of Pelephone. Mr. Heen, our Chief Financial Officer, previously held a variety of positions within our finance division, including head of our economic department, responsible for our budget, financial analysis, cost accounting and control over our performance. We believe that under the leadership of Messrs. Erel, Sztern and Heen, we are well positioned to execute our business strategy and maintain our leading position in the rapidly changing Israeli telecommunications market.

- Cash flow generation. Our cellular business is characterized by high cash flow generation though substantially lower following the regulatory changes regarding the compulsory reduction of interconnect tarrifs and Early Termination fees to a negligible amount. This allows us to invest in our business and deploy advanced network technology, enabling us to offer advanced services and applications, as well as distribute dividends to our shareholders. Further, Netvision also contributes to our financial results of operations and to our free cash flow. This contribution is significant in light of the adverse effects of several regulatory changes on our results of operations.

Business Strategy

Our goal is to strengthen our position as a leading Israeli telecommunications group. The principal elements of our business strategy are as follows:

- Formation of a leading Israeli telecommunications group - Following the acquisition of Netvision, we commenced the integration of Netvision's business with our existing business, in order to create a leading, strong and efficient Israeli telecommunications group. This includes the merger of our and Netvision's headquarters and our and Netvision's business customers operations to create a one stop shop for the group's

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portfolio of services, in both customer service and sales. The operation of our and Netvision's private customers will remain separate, maintaining a distinct focus in each market, in light of the increasing competition in the cellular market and the challenges in the landline market. We expect that the formation of a telecommunications group will enhance our ability to successfully compete with our main competitors, who are also part of or are in the process of forming major telecommunications groups, and will enable us to offer comprehensive packages of telecommunications services as are offered or expected to be offered by our competitors.

- Offering our customers comprehensive mobile and wireline solutions. Following the acquisition of Netvision, we are now able to offer our customers a wide range of mobile and wireline telecommunications services, while maximizing the synergies between the two entities, both in terms of revenue generation and cost efficiencies. This includes identifying the potential synergies between the two businesses, such as integrating the operations of the business customers of both businesses. In addition, we intend to leverage our leading position and large market share in those businesses for cross-sales and the offering of new services which are found to be synergetic to those businesses, in order to increase our overall revenues and market share.

- Maximize customer satisfaction, retention and growth. Our growth strategy is focused on retaining our subscribers, expanding the selection of services and products we offer to our subscribers, and tailoring offers to our customers' needs in order to enhance customer satisfaction and increase average revenues per user. We strive to be proactive at every service interaction with our customers, to offer service and service terms which are as clear, simple and methodical as possible, and to continually improve and enhance the flexibility of our customer service. In addition to providing quality customer service, we also strive to retain our subscribers and attract new subscribers by offering them comprehensive service packages and advanced handsets and services.

- Growing and developing of our Mobile Data and Value Added Services. We view Mobile Data as a significant growth engine for our business. Accordingly, during 2010 and 2011, we continued to build our Carrier Ethernet network in order to enable the provision of data services at high speeds and capacity. We intend to continue to invest in the improvement and upgrade of our high speed UMTS/HSPA+ network, to enhance its capacity and increase its speed, as well as enhance our readiness towards a 4G technology, in order to permit higher-quality and higher-speed multimedia content transmission. In 2012 we also plan to continue our efforts in expanding data services usage and revenues, focusing on increasing sales of data-enabled devices such as tablets and smartphones while enhancing the focus on data sales and marketing at our points of sales.

In Value Added Services, we intend to utilize our momentum to expand our content and data services, products and capabilities through our in-house expertise and strategic relationships with leading cellular content providers. We put special emphasis on original Israeli culture themes and on usage enhancing content and applications in the cellular and complementary media. In 2011 we launched a new "Cellcom Volume" music-streaming service, that contributed positively to our revenues, brand identity and popularity among users in general and youth in particular.

- Growing in wireline services. We intend to continue to expand our landline business with both private and business customers. For private customers, we provide ISP, VOB services (via Bezeq's and Hot's infrastructure) as well as ILD services. The possible

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development of wholesale wireline services as recommended in October 2011 by the public committee appointed by the Ministry of Communications, if and when made available, will enhance our ability to offer such services and compete with the incumbents, Bezeq and Hot as well as other competitors in these markets, specifically in relation to residential landline services which is currently non-material and generating negative net-income. For details of these recommendations see also “Item 4. Information on the Company – Government Regulations – Competition”. For business customers, following the merger with Netvision, we provide a wide range of telecommunications services, including cellular, ISP, ILD, landline telephony services, as well as hosting and data security services. These, combined with approximately 1,600 kilometer inland fiber-optic network, our microwave infrastructure, and Netvision’s high penetration in business parks and industrial centers, provide us with the ability to selectively offer cost-efficient landline telecommunications solutions to business customers and integrated offerings.

- Further develop and strengthen the Cellcom brand. External market surveys that we have commissioned indicate that brand recognition is an important factor in subscriber selection of, and loyalty to, a cellular operator and more so in the increasingly intensifying competitive market and given the additional competitors joining the market. We plan to continually enhance our brand through maintaining our high network quality, the provision of innovative products and services, quality customer service and investments in advertising and promotional campaigns. We believe these enhancements are key to maintaining our competitive advantage, differentiating our services from those of our competitors and establishing and maintaining a successful relationship with our subscribers.

- Offer new services that will complete our offering as a telecommunications group and provide us with growth engines that are synergetic to our core businesses. We are constantly looking for new, innovative ways to deliver new services to our customers. We continue to develop new complementary businesses which leverage our varied capacities and are synergetic to our core business. We have identified television services over the internet (known as Over the Top TV, or OTT TV) as a potential source of growth which is both synergetic and complementary to our core business. We are exploring the possibility of developing the OTT TV market as an attractive alternative to the traditional cable and satellite television services currently offered in Israel by Hot and Bezeq.

- Optimization of cost structure. We continue our efforts to control costs and improve our efficiency while improving the quality of our services. One area which we plan to focus on is to utilize the synergies created by the acquisition of Netvision, including the merger of our and Netvision’s headquarters and our and Netvision’s business customers operations and the transfer of Netvision’s employees to our headquarters’ facilities in Netanya, aimed at optimizing the associated costs and improving the service to our business customers by providing them a ‘one stop shop’ service. In addition, having already built our own fiber-optic and microwave infrastructure, we continue to reduce our operating costs, as our network maintenance costs and microwave spectrum fees are lower than the lease costs to rent backhaul capacity from Bezeq.

Cellular Services and Products

As of December 31, 2011, we provide cellular communications services to approximately 3.349 million subscribers, including basic cellular telephony services and value-added services as well as handset sales. We regularly evaluate, including through

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discussions with potential partners, ways to add additional communications and other services to our portfolio. Not all services are supported by all handsets or by all of our networks. In addition, we offer transmission and data services to business customers and telecommunications operators. Since July 2006, we have offered our landline telephony service to selected businesses.

We offer our cellular subscribers a variety of pricing plans, designed to adapt to their particular characteristics and changing needs. We adapt our pricing plans for the different types of usage – personal or business – and the number of users associated with the subscriber. For example, we offer different packages of air time services, packages with special tariffs for weekends, packages of surfing services at varying speeds, Israeli music services to youth and discounted rates on calls among members of immediate families. We offer two methods of payment: pre-paid and post-paid. Pre-paid services are offered to subscribers who pay for our services prior to obtaining them, usually by purchasing our "Talkman" pre-paid cards or "virtual" Talkman cards. Post-paid services are offered to subscribers who are willing to pay for our services through banking and credit arrangements, such as credit cards and direct debits. Following the regulatory reduction of Early Termination Fees to a negligible amount in the cellular market, as of January 2011, the majority of our new pricing plans do not include a commitment to purchase our services for a predefined period.

Basic cellular telephony services

- Our principal cellular service is basic cellular telephony. In addition we offer many other services with enhancements and additional features to our basic cellular telephony service. These services include voice mail, cellular fax, call waiting, call forwarding, caller identification, conference calling, "Talk 2" (two handsets sharing the same number, thus allowing our subscribers to own both a handset and a car phone), additional number service (enabling our subscribers to add a second phone number to their handset) and collect call service.

- We also offer both an outbound roaming service to our subscribers when traveling outside of Israel and an inbound roaming service to visitors to Israel who can "roam" into our network. Roaming allows cellular subscribers, while using their own cell phone number (and handset, in most cases) and being billed by their provider, to place and receive calls and text messages while in the coverage area of a network to which they do not subscribe. Where available, subscribers can also benefit from other cellular services such as advanced data and content services. As of December 31, 2011, we had commercial roaming relationships with 545 operators in 179 countries based on the standard agreements of the GSM organization (an umbrella organization in which all the cellular operators operating with GSM technology are members). This enables our subscribers to enjoy our services in almost the entire world. Most of our GSM subscribers who use these roaming services abroad can use their own handset and others can borrow or rent, depending upon the period of time, a suitable handset from us. In addition, as of December 31, 2011, we had 3G roaming arrangements with 260 of these operators, enabling our 3G roamers to participate in video calls and use high-speed data, video and audio content services in 106 countries.

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Value-added services

- In addition to basic cellular telephony services, we offer many value-added services. Value-added services are important to our business as they enable us to differentiate ourselves from our competitors, strengthen our brand and increase subscriber usage, ARPU and subscriber satisfaction. We offer those services that we believe are likely to be popular with subscribers and benefit our business. Some of the value-added services that we offer are available only to subscribers who have supporting handset models and some are offered only to business subscribers. The principal advanced value-added services that we currently offer are:

Cellcom Volume. This social music service offers a monthly subscription to a large offering of music items provided in streaming through mobile handsets and computers. The service provides a full music experience, featuring lyrics, playlists, albums, reviews, show schedules and recommendations incorporating also certain social network capabilities.

SMS and MMS services. These messaging services enable subscribers to send and receive text (SMS), photos, multimedia and animation (MMS) messages. Additional applications enable our subscribers to send SMS messages to a large number of handsets simultaneously.

Access to third party application providers. We provide our subscribers with access to certain services offered by third party application providers. These services include, among others: a service that allows subscribers to receive notification of roadway speed detectors in their vicinity; a service (using a cellular modem) that provides a comprehensive system for the management of vehicle fleets and a service that enables subscribers to remotely manage and operate time clocks and various controllers for industrial, agricultural and commercial purposes.

Video calls. This service enables our 3G users, using supporting 3G handsets, to communicate with each other through video applications.

Location-based services. We offer a number of location-based services. For example: “Cellcom Navigator” is a service provided through a third party that enables our subscribers to receive real-time travel directions, that take account of the traffic condition and visual data regarding their position using global positioning system, or GPS, technology; “Cellcom Radar” is a service that enables our subscribers to locate services such as restaurants, shops and entertainment centers in the proximity of their location and “Cellcom Taxi” enables our subscribers to call for a taxi located nearby.

Other information and content services. We also provide other information and content services, some provided directly by us and some by third party content providers. For example, we provide voice-based information services through interactive voice response platforms, or IVR, including interactive information services and radio and TV programs. We also provide text-based information services and interactive information services including news headlines, sports results, and traffic and weather reports. Some of these

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services are provided through our MMS or video-based technologies, and are offered to subscribers with supporting handsets.

Data services. We offer our subscribers a variety of channels to facilitate their access to data services, including handsets (in supporting models), cellular modems, laptops and tablets. We provide our customers with a variety of "internet surfing packages", including "unlimited surfing package" (with no volume limitation) and "surfing packages" for various speed rates and various capacities.

We have established relationships with content providers to provide us content for our value-added services, including Logia Development and Content Management Ltd., or Logia, to manage and develop cellular content in Israel exclusively for us. For further details about the content and other services provided by Netvision see below in this Item 4. B. under the caption "Netvision – Additional Activities".

Handsets

We sell a wide selection of handsets designed to meet individual preferences. Prices of handsets vary based on handset features and special promotions. In most cases, handsets are to be paid in 36 monthly installments. We offer a variety of handsets from world-leading brands such as Apple, LG, Motorola, Nokia, Samsung, Sony-Ericsson, HTC and RIM. The handset models we sell offer Hebrew language displays in addition to English, Arabic and Russian (in most of the models). We are also required to provide cellular phone services to subscribers who did not purchase their handsets from us, provided that the handset model has been approved for use by the Ministry of Communications. We offer our subscribers an extended handset warranty as well as repair and replacement services for most handsets, in approximately 80 locations, including through our wholly owned dealer. See also "Customer Care" below.

We also sell modems, tablets and laptops to promote our data services.

Landline services

In addition to our cellular services, we provide landline telephony, transmission and data services, using our approximately 1,600 kilometers of inland fiber-optic infrastructure and complementary microwave links. We have offered transmission and data services since 2001. We received a license to offer landline telephone service in April 2006 and, since July 2006, have been offering this service to selected businesses. Through our NGN system, we were the first landline operator in Israel to provide advanced, voice and data services, to selected business customers, as of February 2008.. In addition, Netvision also offers landline services to both private and business customers, focusing on the private sector. For further details, please see below in this Item 4. – B. under the caption "NETVISION".

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A wireline wholesale market, if and when made available, will facilitate our and Netvision's growth and allow us (as well as our competitors) to provide a wider selection of services at low cost; annulment of the structural limitations in the Bezeq group and change of the supervision on Bezeq tariffs from fixed to maximum tariffs, could adversely affect our ability to compete with Bezeq. See "Item 4. Information on the Company – Government Regulations – Competition" for additional details regarding these recommendations by a public committee nominated by the Ministry of Communications and the establishment of a new communications company that shall be granted the exclusive right to use the Israeli Electric Company's optic fibers infrastructure for the provision of broadband transmission services.

Network and Technology

General

Our network has developed over the years since we commenced our operations in 1994 and we now have dual cellular and wireline capabilities.

Our "third generation" UMTS/HSPA+, or high-speed downlink packet data access, technology, offers full interactive multimedia capabilities with current data rates of up to 15 Mbps on the downlink path and up to 4 Mbps on the uplink path. In 2012 we intend to further increase the downlink path speed up to 84 Mbps in selected urban areas. This network, considered to be a "3.9/4G" technology, is a network that uses the same core as our GSM/GPRS/EDGE network. Our UMTS/HSPA+ network covers substantially all of the populated territory in Israel. Moreover, our UMTS/HSPA+ network supports new types of services that require higher throughput and lower delay, such as video conferencing.

Our "second generation" GSM/GPRS/EDGE 1800MHz network allows for voice calls, data transmission and multimedia services, like video streaming and video live (using the EDGE technology), although at slower speeds than our UMTS/HSPA+ network. Our GSM/GPRS/EDGE technology is an advanced second-generation technology and considered to be a "2.75G" technology. It enables us to deliver multimedia and services at speed rates that are higher than the rates offered through regular "second generation" digital cellular technology. Packet data rates vary from 50 Kbps to 200 Kbps, depending mainly on handset capabilities. In addition, in the case of coverage gaps and for services supported by our GSM/GPRS/EDGE technology, the network provides an adequate fallback and capacity relief for our UMTS/HSPA+ network by means of smart features and network load sharing. As of January 2012, all of our traffic uses our GSM/GPRS/EDGE and UMTS/HSPA+ networks, with most of the Voice traffic using the GSM/GPRS/EDGE network and most of the data traffic using the UMTS/HSPA+ networks.

Until December 31, 2011 we also had a separate network using our initial TDMA 850MHz wireless technology, which was a "second generation" technology, at which time we discontinued its operation.

Our transmission network is comprised of approximately 1,600 kilometers of inland advanced fiber-optic cables that, together with our microwave infrastructure, enable us to provide our customers with telephony and high speed and high quality transmission and data services. Our transmission network is strategically deployed in order to cover the major portion of Israel's business parks and permits us to provide our own backhaul services while reducing our need to lease capacity from Bezeq, the incumbent landline operator in Israel.

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Our NGN system by Nokia Siemens, allows the provision of advanced voice and data services to our landline customers.

Infrastructure

We have built an extensive, durable and advanced cellular network system, enabling us to offer high-quality services to substantially the entire Israeli populated territory. Since maintaining a high-quality network is a basic element in our business strategy, we seek to satisfy quality standards that are important to our subscribers, such as high voice quality, high data rate packet sessions, low "blocked call" rate (calls that fail because access to the network is not possible due to insufficient network resources), low "dropped call" rate (calls that are involuntarily terminated) and deep indoor coverage. Therefore, we have made substantial capital expenditures and expect to continue to make capital expenditures on our network system. As of December 31, 2011, we had invested an aggregate of NIS 8.796 billion ($2.302 billion) on our network infrastructure since our inception in 1994 (not including investments made by Netvision).

We cover substantially all of the populated areas of Israel with both our UMTS/HSPA+ network and our GSM/GPRS/EDGE network. Our UMTS/HSPA+ network is mostly co-located with our GSM/GPRS/EDGE network. The suppliers of our UMTS/HSPA+ network are Ericsson Israel (for part of our 3G radio access network) and Nokia Siemens Israel (for our core network and part of our radio access network). The supplier of our GSM/GPRS/EDGE network is Nokia Siemens. Ericsson and Nokia Siemens, each with respect to the network supplied by it to us, provide us with maintenance services.

Since 2010 we are selectively enhancing and expanding both our UMTS/HSPA+ network and our GSM/GPRS/EDGE network, primarily in urban areas, by adding infrastructure to improve outdoor and indoor coverage including through UMTS/HSPA 850 MHz sites. We expect to substantially complete our UMTS/HSPA 850 MHz enhancement deployment by mid 2012.

Our SDH transmission network launched in 1999, which is based on Alcatel Lucent and Nortel technology and covers substantially all of the populated areas in Israel is maintained by Alcatel Lucent and Ciena Corporation (which purchased Nortel's relevant business). Our Carrier Ethernet network launched in 2010, which is based on Alcatel Lucent technology, and covering substantially all of the populated areas in Israel, is maintained by Alcatel Lucent.

Pursuant to the requirements of our license (as well as the licenses of the other telephony service providers in Israel), our network is interconnected, either directly or indirectly, to the networks of all other telephony service providers in Israel. Our network monitoring system provides around-the-clock surveillance of our entire network. The network operations center is equipped with sophisticated systems that constantly monitor the status of all switches and cell sites, identify failures and dispatch technicians to resolve problems. Operations support systems are utilized to monitor system quality and identify devices that fail to meet performance thresholds. These same platforms generate statistics on system performance such as dropped calls, blocked calls and handoff failures. Our network operations center is located in our Netanya headquarters. In addition, we have a partial duplicate backup center in Kiryat Gat, located approximately 80 kilometers south of Netanya. In 2012 we intend to complete implementation of a full scale disaster recovery plan, or DRP, for all of our engineering systems.

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Network design

We have designed our GSM/GPRS/EDGE and UMTS/HSPA+ networks in order to provide high quality and reliability well beyond the requirements set forth in our license while using a cost-effective design, utilizing shared components for our networks, where applicable.

During 2010 and 2011, we have completed a substantial part of our DRP project, aimed at increasing our network's survivability in case of damage to any of its elements, which we intend to complete in 2012. The project also provides our network with additional advantages including increased capacity and advanced qualities.

Our primary objective going forward is to improve and upgrade our high speed UMTS/HSPA+ network, mainly by enhancing its capacity and increasing its speed, in order to permit higher-quality and higher-speed multimedia content transmission. At the same time we intend to continue to perform extensive optimization work to provide our subscribers with maximum capability to support video and other broad-bandwidth content, complete our DRP program and enhance our readiness to 4G technology.

Network performance

We continually optimize our entire network in order to meet the key performance indicators for our services, including dropped calls, voice quality, accessibility, availability and packet success rate. We use advanced planning, monitoring and analyzing tools in order to achieve our performance goals efficiently and with minimum faults.

The two main indicators that we use to measure network performance for voice and packet data are the "blocked call" rate and the "dropped call" rate. Our levels of blocked and dropped calls are better than those required by our license.

Spectrum allocation

Spectrum availability in Israel is limited and is allocated by the Ministry of Communications through a licensing process. We have been allocated 2x10 MHz in the 850 MHz frequency band used by our TDMA network (until its shutdown in December 31, 2011) and currently by our UMTS/HSPA 850 MHz base stations, deployed for coverage improvement, and 2x17 MHz in the 1800 MHz frequency band used by our GSM/GPRS/EDGE network. In addition, the Ministry of Communications awarded us 2 x 10 MHz and 1 x 5 MHz in the 1900 - 2200 MHz frequency band for our UMTS third generation FDD and TDD spectrums, respectively. In December 2008, we returned the TDD spectrum to the Ministry of Communications, after not being able to use that spectrum since it was awarded to us in 2004, due to unavailability of supporting equipment. We believe that our available spectrum is sufficient for our current needs. However, in light of the growing demand for data consumption and 4G technology, we will be required to purchase additional spectrum in the future. We were not allowed to participate in the UMTS spectrum tender published in September 2010 by the Ministry of Communications and there is no assurance that additional spectrum will be made available to us in the future to satisfy our needs and plans or at all.

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Cell site construction and licensing

We construct cell sites based on our strategy to expand the geographical coverage and improve the quality of our network and as necessary to replace cell sites that need to be removed. Our acquisition teams survey the area in order to identify the optimal location for the construction of a cell site. In urban areas, this would normally be building rooftops. In rural areas, masts are usually constructed. Our transmission teams also identify the best means of connecting the base station to our network, based on our independent transmission network, either by physical optical fiber, microwave link or Bezeq landlines. Once a preferred site has been identified and the exact equipment configuration for that site decided, we begin the process of obtaining all necessary consents and permits. The construction of cell sites requires building permits from local or regional authorities, or an applicable exemption, as well as a number of additional permits from governmental and regulatory authorities, such as construction and operating permits from the Ministry of Environmental Protection in all cases, permits from the Civil Aviation Authority in most cases and permits from the Israeli Defense Forces in some cases. In special circumstances, additional licenses are required. See "Item 4. Information on the Company – B. Business Overview – Government Regulations—Permits for Cell Site Construction."

Suppliers

We entered into an agreement with LM Ericsson Israel Ltd., or Ericsson Israel, in September 2005 for the purchase of UMTS radio access network and ancillary products and services. We committed to purchase maintenance services for five years from the launch of the system (until 2011). We have an option to purchase additional maintenance services on an annual basis for 20 years from the launch of the system (until 2026). In December 2011, we entered into an addendum to the agreement for the purchase of upgraded UMTS /HSPA products and related services, under similar terms. Under the agreement, the parties generally have limited liability for direct damages of up to 40% of the value of the agreement.

We entered into an agreement with Nokia Israel Communications Ltd., in July 2001 for the purchase of our GSM/GPRS system (the agreement was assigned to Nokia-Siemens Networks Israel Ltd., or Nokia Siemens, in 2007). We were also granted an option to purchase GSM 800, EDGE, UMTS and ancillary systems. In 2002, we exercised our option to purchase an EDGE system, and in 2005, we purchased a UMTS core system, under similar terms. In May 2011, we entered into an addendum to the agreement for the purchase of UMTS/HSPA radio access network and related products and services in addition to the purchase of UMTS /GSM core system. Nokia Siemens is obligated to offer us maintenance services for 15 years from execution of the addendum (until 2026). Under the agreement, the parties generally have limited liability for direct damages of up to 10% of the value of the agreement.

We use Telcordia's intelligent platform, or "IN," to provide services to our GSM/GPRS/EDGE and UMTS networks, allowing us, at minimal cost, to internally develop sophisticated services with a short time-to-market that are customized to local market requirements. We have also deployed Comverse's Intelligent Peripheral, which enables us to develop services with rich voice interaction, such as Caller Name Announcement, Call Back and Fun Dial. Our IN platform supports all relevant IN protocols, which allows us to provide (subject to applicable roaming agreements) advanced roaming services, including Virtual

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Home Environment, abbreviated dialing, unified access to voice mail, VPN, local number format from subscribers' phone book and call screening.

In addition, we have agreements with several Israeli engineering companies for the construction of our cell sites. We also purchase certain network components from other suppliers.

Transmission Network

Our transmission network provides us with wireline connectivity for our cellular and landline network in substantially all of the populated territory of Israel. It is based on our fiber-optic network and complementary microwave infrastructure. Our transmission network includes links to our internal network and to our landline and transmission subscribers.

Our optical transmission network is deployed from Nahariya in the north to Beer Sheva in the south and Afula and Jerusalem in the east, consisting of approximately 1,600 kilometers. The fiber-optic network reaches most of the business parks in the country and is monitored by a fault-management system that performs real-time monitoring in order to enable us to provide our subscribers with high quality service. In order to efficiently complete our transmission network's coverage to substantially the entire country, we use a microwave network as a complementary solution in those areas that are not served by our fiber-optic network. As of December 31, 2011, we had deployed approximately 3,000 microwave links to both our cell sites and subscribers. In 2011 we upgraded our transmission network to support a downlink path speed up to 40 Mbps and intend to continue to upgrade it up to 84 Mbps in selected urban areas in 2012.

In February 1999, we entered into an agreement with Alcatel SEL AG (later assigned to Alcatel Lucent Israel Ltd., or Alcatel Lucent), for the purchase of SDH transmission network. Alcatel Lucent is obliged to offer us maintenance services for 15 year from the effective date (until March 2014). Under the agreement, Alcatel Lucent has generally limited liability for direct damages of up to the higher of the sum collected from its insurer less US $1,000,000 per year or US $1,000,000 per each calendar year.

In November 2009, we entered into an agreement with Alcatel Lucent for the purchase of our Carrier Ethernet network. We also agreed to purchase from Alcatel Lucent at least 51% of the equipment and services that we purchase for such network until the lapse of 7 years from final acceptance (until February 2017). Alcatel Lucent is obligated to offer us maintenance services for 12 years from conditional acceptance (until January 2022). Under the agreement, the parties generally have limited liability for direct damages of up to the value of the agreement.

To supplement our transmission network, we lease a limited amount of transmission capacity from Bezeq, the incumbent landline operator. Netvision owns a small transmission network and leases most of the transmission capacity it requires from us, Bezeq, Hot and Partner.

Information technology

We maintain a variety of information systems that enable us to deliver superior customer service while enhancing our internal processes.

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In July 2010, we entered into an agreement with Amdocs (Israel) Limited, or Amdocs Israel, for the provision of operation, maintenance, management and development services for our billing and customer care system, which were previously performed partly by Amdocs UK and Amdocs Israel and partly by our employees. Amdocs Israel is obligated to provide us with such services for a period of eight years (until August 2018), and after 30 months from entering into this agreement we have the option to terminate the agreement subject to the provision of a prior written notice and payment of certain amounts. Under the agreement, the parties generally have limited liability for direct damages of up to the value of the agreement for each year subject to certain additional exceptions to the limitation. Netvision uses a billing system supported internally and by Intech and a customer care system provided by PeopleSoft and supported by Matrix for Oracle.

We use Nortel's CTI system for the management of incoming calls to our telephonic call centers.

Our customer care system presents our customer care employees with a display of a subscriber's profile based on various usage patterns. This enables us to provide a service based upon information for that particular subscriber. We also use a knowledge management system relating to our various services and products by Blue Phoenix, branded "Cellcopedia".

We use ERP solutions provided by SAP, and Netvision uses ERP solutions provided by Priority. We use a data warehouse based on an Oracle data base system and various data mining tools, ETL by Informatica and reports generated by Cognos. The data warehouse contains data on our subscribers' usage and allows for various analytical segmentation of the data.

Sales and Marketing

Sales

As part of our strategy to fully penetrate every part of the Israeli market, we are committed to making the purchase of our services as easy and as accessible as possible. We offer pricing plans, value-added services, end user equipment, accessories and related services through a broad network of direct and indirect sales personnel. We pay our independent dealers commissions on sales, while our direct, employee sales personnel, receive base salaries plus performance-based incentives. We focus on subscriber needs and conduct extensive market surveys in order to identify subscribers' preferences and trends. Based on these findings, we design special pricing plans and promotional campaigns aimed at attracting new subscribers and enhancing our ability to provide new services to existing subscribers. We offer our subscribers rebates and other benefits for handset purchases. All of our, and our dealers', sales and other customer-facing stuff, go through extensive training prior to commencing their work. Our distribution and sales efforts for subscribers are conducted primarily through five channels:

Points of sale. We distribute our products and services through a broad network of physical points of sale providing us with nationwide coverage of our existing and potential subscriber base.

We operate directly, using our sales force and service personnel, in approximately 30 physical points of sale and service, mostly located in shopping centers and other frequently visited locations to provide our subscribers with easy and convenient

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access to our products and services. We record approximately 230,000 subscriber applications per month at our direct points of sale and service.

We also distribute our products and services indirectly through a chain of dozens of dealers (including our own wholly owned dealer – Dynamica) who operate in approximately 100 points of sale throughout Israel. Our dealers are compensated for each sale based on qualitative and quantitative measures. We closely monitor the quality of service provided to our subscribers by our dealers. In our efforts to penetrate certain sectors of our potential subscriber base, we select dealers with proven expertise in marketing to such sectors.

Telephonic sales. Telephonic sales efforts target existing and potential subscribers who are interested in buying or upgrading handsets and services. Our sales representatives (both in-house and outsourced) offer our customers a variety of products and services, both in proactive and reactive interactions.

Door-to-door sales. The door-to-door sales team target the door-to-door subscribers based on market surveys that we regularly conduct and database analysis. All information derived from our market surveys is uploaded into a database. Once a potential customer is identified, we contact the potential customer and schedule a meeting with a member of our door-to-door sales team.

Account managers. Our direct sales force for our business customers maintains regular, personal contact with our large accounts, focusing on sales, customer retention and tailor-made solutions for the specific needs of such customers (including project planning and management of external subcontractors), including advanced data services. Sales to larger business customers or governmental and local authorities sometimes involve participation in the customer's tender process.

Internet Shop – Launched in 2009, our website includes four "zones": Shop - a virtual shop allowing easy purchase of various products and services, including roaming services; Offers - special offers, discounts and loyalty rewards; Content - our content services, including music, games, video clips etc. and a Service zone. Our website also includes three additional designated websites: sites in Arabic and in Russian featuring the content and service zones and a site for our business customers.

Marketing

Our marketing strategy emphasizes our market leader position, dynamic nature and personal touch, the quality of our network and services and our innovation. Our marketing activities are based on the principle of focusing on subscribers' characteristics and needs and then adapting the service packages and prices that we offer to subscribers based on these characteristics and needs. From 2011, we put greater focus on customers loyalty and changed our new pricing plans so that the majority of which do not include a commitment to a predefined period. In addition, our customers can choose a "surfing" package which suits their needs from among our "surfing" packages and pay accordingly. We constantly invest efforts in providing our customers a comprehensive quality experience through the various means of communication that they use, including their mobile handset, tablet and computer.

From surveys that we conduct from time to time, we learn that subscribers base their choice of cellular provider primarily on the following parameters: general brand perception; perceived price of services and handsets; level of customer service; and selection of handsets

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and their compatibility with their needs. Our marketing activities take into consideration these parameters and we invest efforts to preserve our subscriber base, enhance usage and attract new subscribers. We utilize a system that allows the management of complex one-to-one marketing campaigns, such as tailoring our marketing activities to customers based on their unique profile of needs and usage patterns, thus improving customer loyalty and increasing ARPU.

Our marketing strategy is focused on our role as facilitators of interpersonal communication and our ability to foster relationships between people, as well as a general spirit of youthful exuberance and the strong local roots of our brand.

We leverage our extensive interactions with our customers, which we estimate to be approximately 630,000 unique customer applications per month, to provide the requested services and also to cross- and up-sell cellular and wireline products and services according to customer needs usage trends and profitability, mostly by using advanced CRM models, to increase customer satisfaction, loyalty and revenues.

We regularly advertise in all forms of media, in promotional campaigns and in the sponsorship of major entertainment events. In 2010 we also used "one to one" promotional campaigns such as advertisements in our subscribers' monthly bill. Our marketing and branding campaign has been very successful and highly acclaimed among the Israeli public, and our "Cellcom Media" initiative in particular has provided us with a high visibility association with mobile content services.

Cellcom was ranked by Globes, a leading financial magazine in Israel, as the leading and strongest brand of Israel's communication market in 2011 and Israel's 4th strongest brand among all the brands in the Israeli market, after 3 prestigious global brands. According to an annual survey conducted in 2011 by 'The-Marker', an Israeli business newspaper, we were the only cellular operator to improve its ranking compared with previous year's results and were placed in the leading position in the cellular sector. According to BDI, Cellcom is the 5th most desirable place to work for among graduating students in Israel and the number 6 most desirable workplaces in Israel. According to an external survey conducted in November 2011 by Geocartography Group (a survey institute and one of the leading applied-research institutes in Israel) Netvision's brand is also one of the leading brands in the Israeli telecommunications market. According to the same survey, Netvision is the most recognized ISP provider, with the highest score both in terms of retention and unaided awareness and also has the highest rate of promoters among its customers. We believe that our strong brand recognition gives us the high level of market exposure required to help us achieve our business objectives.

Customer Care

Our customer service unit is our main channel for preserving the long-term relationship with our subscribers. We focus on customer retention through the provision of quality service and customer care. In order to achieve this goal, we systematically monitor and analyze our subscribers' preferences, characteristics and trends by developing and analyzing sophisticated databases. We then adopt services that are aimed to respond to subscribers' needs and preferences. In addition, subscribers are encouraged to subscribe to additional value-added services, such as mobile data and content services as well other communications services such as ISP, landline and ILD services, in order to enhance customer satisfaction and increase ARPU. We continually strive to improve our service to our customers. Our customer care representatives receive extensive training before they begin providing service and thereafter regularly undergo training and review of their performance. We continuously invest in improving our training process. We provide our customer care representatives with a continually updated database, thus shortening the interaction time required to satisfy the customer's needs and preventing human errors and closely monitor the service provided by them, in order to assure its quality. We constantly review our performance by reviewing customers applications and conducting surveys among our subscribers in order to ensure their satisfaction with our services and to improve them as necessary. In addition, we constantly apply preventive and preemptive measures aimed at reducing churn.

According to the leading Israeli consumer organizations "Public Trust" and the Israeli Consumers Council reports for each of the years 2009, 2010 and 2011, we provide the best quality of customer care in the Israeli cellular market and received the lowest rate of customer complaints although we have the highest number of subscribers in the Israeli cellular market.

In order to better respond to subscribers' needs in the most efficient manner, our customer support and service network offers several channels for our subscribers:

Call centers. In order to provide quick and efficient responses to the different needs of our various subscribers, our call-center services are divided into several sub-centers: general services; technical services; billing; sales; international roaming; and data and internet. As of January 2012, we have a designated sub-call center for small businesses as well. The call center services are provided in four languages: Hebrew, Arabic, English and Russian. We regularly monitor the performance of our call centers. We currently operate call centers in eight locations throughout Israel, three of which are outsourced. In 2011 we witnessed a substantial increase in calls to our calls centers, following the regulatory changes implemented at the beginning of the year and responded, on average, to 1 million calls every month. During peak hours our call centers have the capability to respond to 1000 customer calls simultaneously.

Walk-in centers. As of December 31, 2011, we independently operated 30 service and sales centers with approximately 100 additional sale and service points operated by our dealers (including our wholly owned dealer - Dynamica), covering almost all the populated areas of Israel. These centers provide a walk-in contact channel and offer the entire spectrum of products and services that we provide to our subscribers and potential subscribers (the majority of which are provided in our dealers' sale and service points as well), including handsets and accessories sales, upgrades and other services, such as bill payment, pricing plan changes and subscriptions to new services. These stores are mostly located in central locations, such as popular shopping malls. Our walk-in centers also serve as a contact point for our subscribers who need repair services. Our subscribers deposit their handsets for repair in our walk-in centers and receive the repaired handset after two business days in the same center or at a location of their choice by a courier. Our subscribers may borrow a substitute handset, free of charge, in order to continue to enjoy our cellular phone services while their handset is being repaired. The repair services are conducted in a central lab. We also offer installation services of car phones and other hands free devices for cars.

Self-services. We provide our subscribers and potential subscribers with various self-service channels, such as interactive voice response, or IVR, web-based services and

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service using SMS. These channels provide general and specific information, including pricing plans, account balance, billing-related information and roaming tariffs. They also provide subscribers information regarding trouble shooting and handset-operation, and enable subscribers to activate and deactivate services and to download content. Our website also includes information on our various services, products and the monthly bill and further includes three additional designated service sites: in Arabic, in Russian and a site for our business customers.

Our business sales force and back office personnel also provide customer care to our business customers. We offer our business customers repair services by a dispatch service collecting and returning the repaired handset within two business days, during which time, the customer is provided with a substitute handset, free of charge.

All of our service channels are monitored and analyzed regularly in order to assure the quality of our services and to identify areas where we can improve.

We constantly invest time and efforts making our services compatible to persons with disabilities. We provide customers with disabilities convenient accessibility to our premises and adapted products and services, well beyond the requirements of the law, including sign language customer care at our walk-in services, free dispatch services, and the option to receive sales and support services in the customer’s home. We work closely with Accessibility Israel, a leading Israeli non-profit organization advancing accessibility for persons with disabilities in Israel and train our representatives to provide accessible service to all our customers.

Be’eri Printers provides our printing supplies and invoices as well as the distribution, packaging and delivery of invoices and other mail to the postal service distribution centers. We entered into an agreement with Be’eri Printers - Limited Partnership and with Be’eri Technologies (1977) Ltd., or together Be’eri, for printing services in August 2003. Under the terms of the agreement, we committed to purchase from Be’eri a minimum monthly quantity of production and distribution services which may be reduced if we modify our printed invoice delivery policy. The agreement is valid until December 2013.

Competition

There is intense competition in all aspects of the cellular communications market in Israel and we expect this to continue and further intensify in the future, due to the highly penetrated state of our market, the expected entry of additional competitors and the alleviation of transfer barriers between operators. We currently compete for market and revenue share with four other cellular communication operators: Partner, Pelephone, MIRS and Rami Levy (an MVNO which commenced operations in December 2011). For details of changes of ownership in the Israeli communication market since 2009, see “Item 4. Information on The Company - Business Overview - The Telecommunications Industry in Israel - Cellular Services”.

Our estimated market share based on number of subscribers was approximately 33.6% as of December 31, 2011. Estimated market shares at such time of Partner, Pelephone and MIRS were approximately 31.9%, 29.6% and 4.8%, respectively and Rami levy’s market share is estimated to be less than 1%.

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The competition in the cellular communications market increased following the launch of Pelephone's UMTS/HSPA network in 2009 and regulatory and other changes in our market. The competition has further intensified following the compulsory reduction of cellular Early Termination Fees to a negligible amount in February 2011 and expectations of entry of additional operators in 2011 and 2012, including the entry of Rami Levy. Competition is expected to intensify further as a result of the occurrence of any of the following events:

- the entry into the market of additional competitors and specifically the entry of additional MVNOs and UMTS operators, more so if hosting services to MVNOs and national roaming services for UMTS operators will be at unfavorable terms for us. Mirs is expected to commence its UMTS operations (using national roaming on Pelephone's network) in the first half of 2012 and Golan is expected to commence operating (using national roaming on our network) in the second half of 2012. An additional three MVNO operators are also expected to commence operations in the first half of 2012;

- the sale of bundles of communications services, including cellular services, as it is expected to entail further price erosion, more so if offered by either the Bezeq or Hot groups; the formation of three additional communications groups in the Israeli communications market in 2011, together with the regulatory changes relaxing the structural separation imposed on each of the Bezeq and Hot groups, will allow each of the groups to offer a bundle of services, in some cases quadruple and even quintuple service bundles to existing customers in each of their previously separated platforms, as well as to new customers. Bundles offerings are expected to blur boundaries among services and lead to price erosion, with each of the groups having an interest not to erode the prices of its core business, but rather of the core services of its competitors. Both Bezeq and Hot currently offer bundles of services, excluding cellular services. Bundle offerings by Hot and Bezeq, including cellular services, are expected to accelerate price erosion in the cellular market. See "Item 3. Key Information – D. Risk Factors – Risks related to our Business – We face intense competition in all aspects of our business" and "Item 4. Information on The Company - Business Overview - The Telecommunications Industry in Israel – Communications Groups – Structural Seperation" for additional details;

- increased usage of competing technologies, applications and services, allowing usage of our network, such as VoC or VoIP and applications such as Viber, WhatsApp and free SMS among iPhone holders, or other services, such WiFi, more so following the increased usage of smart phones; and

As of February 1, 2011, the compulsory reduction of Early Termination Fees to a negligible amount in the cellular market, which eliminated the transfer barrier between operators, led to the offering of packages at lower average revenue per minute and has resulted in accelerated price erosion and a materially increased churn rate and increased subscriber acquisition and retention costs due to materially increased rate of gross recruitment of subscribers. In August 2011, the Communications Law was amended to annul Early Termination Fees in all other communication markets and a bill, expected to be enacted during the first half of 2012, is proposing such annulment for certain new customers in the cellular market.

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We believe that full and comprehensive mobile and wireline solutions would benefit our competitive standing, mainly for our business customers. The principal competitive factors in the cellular market include general brand perception, perceived price, customer service and handset selection. In addition, mobile data and other value-added services constitute a potential growth engine for increasing revenues from subscribers and are also an important factor in selecting a cellular provider.

In the content provision market, we compete also with international media providers and handsets manufacturers, such as Apple, Google and Nokia, who have opened their own content enabling stores and are changing the traditional role of the cellular operator from the content provider into one of many content providers, competing to provide content to the operator's subscribers. The "Open Garden" international trend is facilitated by technological changes allowing high speed internet surfing and supporting handsets and is rapidly changing customers' consumption habits from surfing and downloading content mainly through the cellular operator's portal, to an off-portal surfing and content downloading as well as growing demand for internet surfing and content in general. Expansion of this trend, known as the "Open Garden", will enlarge the content market but will further increase competition in the content provision arena. Expansion of arrangements introduced by Apple, in which subscribers using an Apple handset can only purchase content through the Apple store, could adversely affect our content revenues.

In the wireline communications market – In October 2011, the public committee appointed by the Ministry of Communications in March 2010 to examine Bezeq's tariffs structure and tariffs for wireline wholesale services and to review the possible annulment of the structural limitations currently imposed on Bezeq and its subsidiaries, published its recommendations. The recommendations include: (1) The creation of an effective wholesale telecommunications access markets in Israel- Bezeq and Hot will allow other operators which do not own an infrastructure, to use their infrastructure in order to provide services to end users. The terms of such services will be agreed by the operators, or by the regulator, if no wholesale market has evolved within a certain period. (2) Annulment of structural separation in the communication market - Structural separation imposed on the holders of landline general licenses, would be annulled, other than as to multichannel television (which will be annulled only after internet based TV market is available), within 6 months from the earlier of the execution of a wholesale agreement or the provision of wholesale services, or upon the setting of wholesale tariffs by The Ministry of Communications, and replaced by accounting separation and restrictions on information transfer between the retail and wholesale divisions of the landline general license holders. If no wholesale market is established within 2 years, the regulator will resume structural separation between infrastructure and end-user services of landline general license holders. (3) Change of the supervision on Bezeq retail tariffs to setting maximum tariffs rather than the current setting of fixed tariffs. (4) Wholesale tariffs to be set by the regulators would be maximum tariffs, based on a cost plus basis in order to induce investments in the wholesale wireline market and shall be reviewed by the regulator every 3 years. Until such tariffs have been be set, the tariff shall be fixed, regardless of customer's traits and amount to 75% of Bezeq's average retail price for private customers, during July to September 2011. This tariff will be in place for 6 months, with a maximum extension of additional 6 months (5) Landline operators who hold general licenses (such as Bezeq and Hot) will deposit autonomous bank guarantees in substantial amounts to guarantee the existence of a wholesale market. (6) The provision of broadband access by Israel Electric Corporation, or IEC, should be promoted in order to increase competition and should be regulated in the same manner as Bezeq and Hot. The implementation of the

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recommendations, in whole or in part, is subject to the adoption thereof by the Minister of Communications and further legislative proceedings.

In February 2010, the Ministry of Communications provided a trial license to the IEC, allowing it to use its fiber optic infrastructure to provide transmission services to other operators. In March 2011, the Israeli government approved the establishment of a new communications company that will be granted the exclusive right to use the IEC's optic fibers infrastructure for the provision of broadband services to operators only but the Ministry of Communications may allow it to offer its services directly to certain large business customers. The new company will be controlled by a private investor (51%), which may not hold any means of control in another communications company, and the IEC (49%). This initiative would increase our and our competitors capabilities to compete in the wireline market with Bezeq and Hot, and would increase competition in the wireline market.

While an effective wholesale wireline market will enhance our ability (including through Netvision) to compete and extend our service offering, the recommendations regarding the structural separation and Bezeq's tariffs supervision may have a material adverse effect on Netvision's results of operation. For further details see below in this Item 4. B. under the "NETVISION".

In response to the enhanced competition in our market and in the Israeli telecommunications market in general, we have implemented various steps and strategies, including

- acquiring Netvision to create a competitive communication group; we believe that our acquisition of Netvision in 2011 strengthens our competitive position vis-à-vis other communications groups in the Israeli market, as it allows us to offer our customers a comprehensive mobile and wireline solutions.
- marketing and branding campaigns aimed at enhancing market leadership, perceived value, perception of the fairness and value of our pricing, brand recognition and loyalty among our existing and potential subscriber base;
- investing significant resources in improving customer service and retention, as well as supporting information technology systems;
- introducing innovative value-added services and identifying popular niches among various subscriber groups;
- taking efficiency measures in order to reduce costs and improve our agility;
- investing in improving our network technology to ensure our ability to offer quality services and advanced services, both cellular and wireline services;
- using innovative sales campaigns for attracting new subscribers by offering loyalty rebates;
- offering attractive pricing plans to subscribers, adapted to their needs and preferences and innovative pricing models, including cross sale and up sale of our and Netvision's services; and

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- identifying new opportunities to maximize our advantages as an operator, in order to expand our share in the "Open Garden" market place and the recent launch of certain financial services.

Our ability to compete successfully will depend, in part, on our ability to anticipate and respond to trends and events affecting the industry, including: the introduction of new services and technologies, changes in consumer preferences, demographic trends, economic conditions, pricing strategies of competitors and changes to the legal and regulatory environment. We believe that we are well positioned for the competition in our market.

Intellectual Property

We are a member of the GSM Association, together with other worldwide operators that use GSM technology. As a member of the association, we are entitled to use its intellectual property rights, including the GSM logo and trademark.

We have registered approximately 30 domain names and approximately 120 trademarks, the most important of which are the star design, “Cellcom”, “Talkman” and “Cellcom Volume”. Netvision has registered approximately 105 domain names and approximately 90 trademarks, the most important of which are "Netvision" and "013 Netvision". We are also the proprietor of a few registered patents and patent applications.

Government Regulations

The following is a description of various regulatory matters which are material to our operations, including certain future legislative initiatives which are in the process of being enacted. There is no certainty that the future legislation described here will be enacted or whether it will be subject to further change before its final enactment.

General

A significant part of our operations is regulated by the Israeli Communications Law, 1982, the regulations promulgated under the Communications Law and the provisions of our licenses, which were granted by the Israeli Ministry of Communications pursuant to the Communications Law. We are required by law to have a general license in order to provide cellular communications services in Israel. The Ministry of Communications has broad supervisory powers in connection with the operations of license holders and is authorized, among other things, to impose financial penalties for violations of the Communications Law, the regulations and our licenses. For a description of the principal licenses held by Netvision see below in this Item 4.B under the caption "NETVISION".

Our Principal License

The establishment and operation of a cellular communications network requires a license pursuant to the Communications Law for telecommunications operations and services and pursuant to the Israeli Wireless Telegraph Ordinance (New Version), 1972, for the allocation of spectrum and installation and operation of a cellular network.

We provide our cellular services under a non-exclusive general license granted to us by the Ministry of Communications in June 1994, which requires us to provide cellular services in the State of Israel to anyone wishing to subscribe. The license expires on January

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31, 2022, but may be extended by the Ministry of Communications for successive periods of six years, provided that we have complied with the license and applicable law, have continuously invested in the improvement of our service and network and have demonstrated the ability to continue to do so in the future. The main provisions of the license are as follows:

- The license may be modified, cancelled, conditioned or restricted by the Ministry of Communications in certain instances, including: if required to ensure the level of services we provide; if a breach of a material term of the license occurs; if DIC (or a transferee or transferees, if approved by the Ministry of Communications), in its capacity as our founding shareholder, holds, directly or indirectly, less than 26% of our means of control; if our founding shareholders who are Israeli citizens and residents hold, directly or indirectly, less than 20% of our means of control (DIC, as founding shareholder, has undertaken to comply with this condition); if at least 20% of our directors are not appointed by Israeli citizens and residents from among our founding shareholders or if less than a majority of our directors are Israeli citizens and residents; if any of our managers or directors is convicted of a crime of moral turpitude and continues to serve; if we commit an act or omission that adversely affects or limits competition in the cellular communications market; or if we and our 10% or greater shareholders fail to maintain combined shareholders' equity of at least $200 million. For the purpose of the license, "means of control" is defined as voting rights, the right to appoint a director or general manager, the right to participate in distributions, or the right to participate in distributions upon liquidation;

- It is prohibited to acquire (alone or together with relatives or with other parties who collaborate on a regular basis) or transfer our shares, directly or indirectly (including by way of creating a pledge which if foreclosed, will result in the transfer of shares), in one transaction or a series of transactions, if such acquisition or transfer will result in a holding or transfer of 10% or more of any of our means of control, or to transfer any of our means of control if as a result of such transfer, control over our company will be transferred from one party to another, without the prior approval of the Ministry of Communications. For the purpose of the license, "control" is defined as the direct or indirect ability to direct our operations whether this ability arises from our articles of association, from written or oral agreement or from holding any means of control or otherwise, other than from holding the position of director or officer;

- It is prohibited for any of our office holders or anyone holding more than 5% of our means of control, to hold, directly or indirectly, more than 5% of the means of control in Bezeq or another cellular operator in Israel, or, for any of the foregoing to serve as an office holder of one of our competitors, subject to certain exceptions requiring the prior approval of the Ministry of Communications;

- We, our office holders or interested parties may not be parties to any arrangement whatsoever with Bezeq or another cellular operator that is intended or is likely to restrict or harm competition in the field of cellular services, cellular handsets or other cellular services. For the purpose of the

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license, an “interested party” is defined as a 5% or greater holder of any means of control;

- We are subject to the guidelines of Israel’s General Security Services, which may include requirements that certain office holders and holders of certain other positions be Israeli citizens and residents with security clearance. For example, our Board of Directors is required to appoint a committee to deal with matters concerning state security. Only directors who have the requisite security clearance by Israel’s General Security Services may be members of this committee. In addition, the Minister of Communications is entitled under our license to appoint a state employee with security clearance to act as an observer in all meetings of our Board of Directors and its committees;

- Prior to operating a network, we are required to have agreements with a manufacturer of cellular network equipment for the duration of its intended operating period, which must include, among other things, a know-how agreement and an agreement guaranteeing the supply of spare parts for our network equipment for a period of at least seven years; –

- We are required to interconnect our network to other public telecommunications networks in Israel, on equal terms and without discrimination, in order to enable subscribers of all operators to communicate with one another; we are also required to provide national roaming services to new UMTS operators;

    - We may not give preference in providing infrastructure services to a license holder that is an affiliated company over other license holders, whether in payment for services, conditions or availability of services or in any other manner, other than in specific circumstances and subject to the approval of the Ministry of Communications;

- The license sets forth the general types of payments that we may collect from our subscribers, the general mechanisms for setting tariffs, providing cellular services related benefits, limitations on raising tariffs (for non-business subscribers under obligation to purchase our services for a predefined period, during such period), and on the duration of a non-business subscriber's obligation to purchase our services, the reports that we must submit to the Ministry of Communications and the obligation to provide notice to our customers and the Ministry of Communications prior to changing tariffs. The Ministry of Communications is authorized to intervene in setting tariffs in certain instances;

- The license requires us to maintain a minimum standard of customer service, including, among other things, establishing call centers and service centers, maintaining a certain service level of our network, collecting payments pursuant to a certain procedure, protecting the privacy of subscribers; using a specific format for our agreement with our customers; obtaining an explicit request from our subscribers to purchase services, whether by us or by third parties, as a precondition to providing and charging for such services, including specific requirements as to format and a default blockage of the customer's ability to purchase certain services; maintaining a specific form of

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evidence of customers' request to purchase our services as a precondition to charging our customers for those services, notifications we must provide them regarding the services ordered and the procedures for handling subscribers' objections as to billing and repayment of overcharged sums;

- The license or any part thereof may not be transferred, pledged or encumbered without the prior approval of the Ministry of Communications. The license also sets forth restrictions on the sale, lease or pledge of any assets used for implementing the license;

- We are required to obtain insurance coverage for our cellular activities. See "Item 8 – Financial Information - Legal Proceedings" for details of a purported class action filed against us in that regard in March 2010. In addition, the license imposes statutory liability for any loss or damage caused to a third party as a result of establishing, sustaining, maintaining or operating our cellular network. We have further undertaken to indemnify the State of Israel for any monetary obligation imposed on the State of Israel in the event of such loss or damage. For the purpose of guaranteeing our obligations under the license, we have deposited a bank guarantee in the amount of $10 million with the Ministry of Communications, which may be forfeited in the event that we violate the terms of our license.

In the event that we violate the terms of our license, we may be subject to substantial penalties, including monetary sanctions. In 2007, the Communications Law was amended to include an increase in the financial sanctions that may be imposed on us by the Ministry of Communications for a breach of our licenses. Following the increase, the maximum amount per violation that may be imposed is approximately NIS 1.6 million plus 0.25% of our annual revenue for the preceding year. An additional sanction amounting to 2% of the original sanction may be imposed for each day that the violation continues. In addition, the Ministry of Communications may determine certain service-related terms in our license as "service terms"; the maximum monetary sanctions per violation of a "service term" shall be double the amount of any other monetary sanction set in our license for such a violation per each period of 30 days or portion thereof during which the violation continues. In January 2012, a bill proposing to set gradual financial sanctions on communication operators, for breach of their licenses, the sum of which shall be calculated as a percentage of the operator's income and based on the gravity of the breach, has passed the preliminary stage of enactment in the Israeli Parliament. The adoption of the bill, if adopted, is expected to substantially increase the Ministry of Communications' usage of such sanctions. Substantial sanctions will harm our results of operations. In the event that we materially violate the terms of our licenses, the Ministry of Communications has the authority to revoke them.

Other Licenses

Special general license for the provision of landline communication services

In April 2006, Cellcom Fixed Line Communications L.P., or Cellcom Fixed Line, a limited partnership wholly-owned by us, was granted a non-exclusive special general license for the provision of landline telephone communication services. The license expires in 2026 but may be extended by the Ministry of Communications for successive periods of 10 years. We began providing landline telephone services in July 2006, concentrating on offering landline telephone services to selected businesses. The partnership deposited a bank

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guarantee in the amount of NIS 10 million with the Ministry of Communications upon receiving the license. The provisions of our general license described above, including as to its extension, generally apply to this license, subject to certain modifications. It should be noted that in addition to any 10% share transfer requiring the prior approval of the Ministry of Communications as noted in our general license, the special general license additionally requires prior approval for acquiring the ability to effect a significant influence over us. In this context, holding 25% of our means of control is presumed to confer significant influence.

Data and transmission license

In 2000, we were granted a non-exclusive special license for the provision of local data communication services and high-speed transmission services, which is effective until December 2012. Following the grant of a special general license for the provision of landline telephone communication services to Cellcom Fixed Line, which also includes the services previously provided through our data and transmission license, our data and transmission license was amended in June 2006 to permit only Cellcom Fixed Line to be our customer of these services (and these services are now being provided to our customers through Cellcom Fixed Line). The provisions of our general and general specific licenses described above, including as to their extension, generally apply to this license, subject to certain modifications.

Cellular services in Judea and Samaria

The Israeli Civil Administration in Judea and Samaria granted us a non-exclusive license for the provision of cellular services to the Israeli-populated areas in Judea and Samaria. This license is effective until December 31, 2013. The provisions of the general license described above, including as to its extension, generally apply to this license, subject to certain modifications.

Landline communication services in Judea and Samaria

The Israeli Civil Administration in Judea and Samaria granted us a non-exclusive license for the provision of landline communications services to the Israeli-populated areas in Judea and Samaria. This license is effective until December 31, 2013. The provisions of the general license described above, including as to its extension, generally apply to this license, subject to certain modifications.

Internet Service Provider license

In December 2001, we were granted a non-exclusive special internet services provider, or ISP license for the provision of internet access services. The license expires in 2013 but may be extended by the Ministry of Communications for successive periods of five years. The provisions regarding the transfer of our shares which are included in the special general license for the provision of landline communication services described above, generally apply to this license.

Tariff Supervision

Under the Israeli Communications Regulations (Telecommunications and Broadcasting) (Payment for Interconnecting), 2000, interconnect tariffs among landline operators, international call operators and cellular operators are subject to regulation and have been gradually decreased, leading to a material decrease in our revenues.

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In September 2010, the regulations were amended as follows:

- the maximum interconnect tariff payable by a landline operator or a cellular operator for the completion of a call on another cellular network was reduced from the previous tariff of NIS 0.251 per minute to NIS 0.0687 per minute from January 1, 2011; to 0.0634 per minute from January 1, 2012; to NIS 0.0591 per minute from January 1, 2013; and to NIS 0.0555 from January 1, 2014;

- the maximum interconnect tariff payable by a cellular operator for sending an SMS message to another cellular network was reduced from the previous tariff of NIS 0.0285 to NIS 0.0016 from January 1, 2011; to NIS 0.0015 from January 1, 2012; to NIS 0.0014 from January 1, 2013; and to NIS 0.0013 from January 1, 2014;

- the tariffs do not include VAT and will be updated annually from January 1, 2011, based on the change in the Israeli CPI published in November of the year preceding the update date from the average annual Israeli CPI for 2009. The tariffs will also be increased by the percentage of royalties payable to the Ministry of Communications by the operator.

As a result of these updates, including the increase of the royalties we pay to the Ministry of Communications, the current maximum interconnect tariffs are NIS 0.0728 per minute for the completion of a call on another cellular network and NIS 0.0017 for a completion of an SMS message to another cellular network.

This reduction had a material adverse effect on our results of operation in 2011 which is expected to continue. We have taken and intend to continue to take measures in order to reduce the adverse effects of such reduction, through revenue enhancement as well as cost reduction measures, but cannot offer any assurance that these measures will be successful. For details on the effects of the reduction see Item 5. Operating and Financial Review and Prospects. – A. Operating Results – Overview –General.

In addition, in 2011, the Ministry of Communications retained an international consulting company in order to provide the Ministry with recommendations regarding interconnect tariffs payable to land line operators, which is expected to publish its recommendations during the first half of 2012.

Under these regulations and our license, commencing January 1, 2009, our basic airtime charging units, including for interconnect purposes, were changed from twelve-second units to one-second units. Our general license also prevents us from offering our subscribers pricing plans using airtime charging units other than the basic airtime charging unit.

In October 2008, the Ministry of Communications amended our license in a manner that obligates us, commencing December 31, 2008, to set a fixed tariff for non-business subscribers under obligation to purchase our services for a predefined period, during that period, thus limiting our ability to raise tariffs to such subscribers.

In 2008, the Consumer Protection Law was amended in a manner that obligates us, commencing January 2009, to terminate certain services (excluding voice services) we provide to our subscribers during a predefined period, at the end of that period, unless the price for the services to be provided after the end of the predefined period has been set in advance or we have received the subscriber's affirmative consent to continue and provide these services.

In July 2009, the Ministry of Communications amended our license, effective November 1, 2009, in a manner that prohibits any linkage between a cellular services transaction and a handset purchase transaction, thus requiring us to offer any cellular services-related benefits offered to a customer purchasing a handset from us to any customer who purchased the handset elsewhere.

In June 2007, the European Union adopted a resolution to reduce and regulate roaming tariffs. In August 2008, the Israeli Government adopted a resolution to negotiate a reduction of inbound and outbound roaming tariffs with the European Union and/or members of the European Union or countries frequently visited by Israelis. In November 2008 and again in January 2012 the Ministry of Communications issued a supplemental request for information, following its request in 2007, requesting us to provide information in relation to our roaming services. The requests for information were made in order to evaluate the need for intervention in roaming tariffs. If the Ministry of Communications decides to intervene in the pricing of roaming services, this could reduce the revenues we derive from our roaming services.

In December 2010, the Communications Law was amended to reduce the Early Termination Fees in the cellular market. In accordance with the amendment, as of February 1, 2011, Early Termination Fees are calculated based on the subscriber's average monthly bill, resulting in a negligible fee. The reduced Early Termination Fees apply to customers with less than a certain amount of phone lines. The reduction applies to existing as well as new pricing plans. An additional amendment prohibits the collection of the handset's remaining installments in one payment pursuant to early termination. As of January 2011, we changed our new pricing plans so that the majority of which do not include a commitment to a predefined period nor an Early Termination Fee. In August 2011, the Communications Law was amended to annul Early Termination Fees in all other communications markets. In addition, a bill proposing to completely annul Early Termination Fees in relation to new cellular customers with less than a certain number of phone lines has passed preliminary enactment procedures in the Israeli parliament and is expected to be enacted during the first half of 2012. The reduction of Early Termination Fees has led to the offering of packages at lower average revenue per minute and resulted in accelerated price erosion, materially increased churn rate and increased subscriber acquisition and retention costs due to materially increased rate of gross recruitment of subscribers.

In December 2010, the Communication Law was amended to allow national roaming for new operators and Mirs. For additional details see "Additional UMTS operators" below. Following the amendment, if a new operator or Mirs and the hosting operator have not reached an agreement as to the terms of the service (including the consideration), for any reason, until the service is to commence (after certain criteria is met) the service will be provided for the then prevailing interconnect tariff (in case of a call and for data services - 65% of the interconnect tariff per 1 mega) and subsequently (but no later than February 1, 2012) shall be determined by the Ministry of Communications with the consent of the Minster of Finance and applied retroactively. Unfavorable terms and consideration for the service (such as equal or based on the interconnect tariff), may result in material adverse effect on our results of operations. In October 2011, we entered a national roaming agreement

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with Golan and in September 2011, Mirs entered a national roaming agreement with Pelephone.

Under the Communications Law, in the event that a MVNO and the cellular operator, will not have reached an agreement as to the provision of service by way of MVNO within six months from the date the MVNO has approached the cellular operator, and if the Ministry of Communications together with the Ministry of Finance determine that the failure to reach an agreement is due to unreasonable conditions imposed by the cellular operator, the Ministry of Communications may intervene in the terms of the agreement, including by setting the price of the service. Unfavorable terms and consideration for the service (such as equal or based on the interconnect tariff), may result in material adverse effect on our results of operations. For additional details see "Mobile Virtual Network Operators" below. In 2011 five MVNO's have entered into hosting agreements, one of which (Home Cellular) has entered into an agreement with us.

In December 2010, the Communication Law was amended to prevent any limitation on the usage of any internet service or application, including though differentiating pricing, (network neutrality). In addition, the Ministry of Communications published a hearing regarding VoC license, which among others, notes the Ministry of Communications' intention to require cellular operators to offer "data only" service, at a price not exceeding current data only subscription (such as for modem), including at lower speed rates. Such requirements may adversely affect our results of operations

Permits for Cell Site Construction

General

In order to provide and improve network coverage to our subscribers, we depend on cell sites located throughout Israel. The regulation of cell site construction and operation are primarily set forth in the Israeli National Zoning Plan 36 for Communications, which was published in May 2002. The construction of radio access devices, which are cell sites of smaller dimensions, is further regulated in the Communications Law.

The construction and operation of cell sites are subject to permits from various government entities and related bodies, including:

- building permits from the local planning and building committee or the local licensing authority (if no exemption is available);
- approvals for construction and operation from the Commissioner of Environmental Radiation of the Ministry of Environmental Protection;
- permits from the Civil Aviation Authority (in most cases);
- permits from the Israel Defense Forces (in certain cases); and
- other specific permits necessary where applicable, such as for cell sites on water towers or agricultural land.

In March 2010, a new Planning and Building bill, intended to replace the existing Planning and Building law passed the first stage of enactment at the Israeli parliament. If the bill would be enacted, it may have an effect, among others, on current permits for our cell sites, the procedures to receive building permits for our cell

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sites, the exemption for radio access devices set out in the Communications Law (which the bill proposed to annul), the scope of our indemnification obligations and the obligation to pay amelioration charge. In this preliminary stage, we cannot estimate what are the chances of its enactment and what would be its effects, if so enacted, on our network and network build-out.

See "Item 8 – Financial Information - Legal Proceedings" below for details regarding purported class actions filed against us in connection with cell sites construction and operation.

National Zoning Plan 36

National Zoning Plan 36 includes guidelines for constructing cell sites in order to provide cellular broadcasting and reception communications coverage throughout Israel, while preventing radiation hazards and minimizing damage to the environment and landscape. The purpose of these guidelines is to simplify and streamline the process of cell site construction by creating a uniform framework for handling building permits.

National Zoning Plan 36 sets forth the considerations that the planning and building authorities should take into account when issuing building permits for cell sites. These considerations include the satisfaction of safety standards meant to protect the public's health from non-ionizing radiation emitting from cell sites, minimizing damage to the landscape and examining the effects of cell sites on their physical surroundings. National Zoning Plan 36 also determines instances in which building and planning committees are obligated to inform the public of requests for building permits prior to their issuance, so that they may submit objections to the construction of a site in accordance with the provisions of the Planning and Building Law. Many local authorities have argued that a building permit issued in reliance on the Plan requires the payment of amelioration charge. The matter was not yet decided by a court of law. Should the matter be decided against us, the costs of constructing a site will substantially increase.

See "Site licensing" below for arguments against the application of National Zoning Plan 36 to certain cell sites.

However, National Zoning Plan 36 is in the process of being revised. Current proposed changes will impose additional restrictions and requirements on the construction and operation of cell sites. In June 2010, the proposed changes were approved by the National Council for Planning and Building and submitted for the approval of the Government of Israel. If the proposed changes are approved by the Israeli Government they will harm our ability to construct new cell sites, make the process of obtaining building permits for the construction and operation of cell sites more cumbersome and costly, could adversely affect our existing network and may delay the future deployment of our network.

Site licensing

We have experienced difficulties in obtaining some of the permits and consents required for the construction of cell sites, especially from local planning and building authorities. The construction of a cell site without a building permit (or applicable exemption) constitutes a violation of the Planning and Building Law. Violations of the Planning and Building Law are criminal in nature. The Planning and Building Law contains enforcement provisions to ensure the removal of unlawful sites. There have been instances in which we received demolition orders or in which we and certain of our directors, officers and employees faced criminal charges in connection with cell sites constructed and/or used without the relevant permits or not in accordance with the permits. In most of these cases, we were successful in preventing or delaying the demolition of these sites, through arrangements with the local municipalities or planning and building authorities for obtaining the permit, or in other cases, by relocating to alternate sites. As of December 31, 2011, we were subject to 18 criminal and administrative legal proceedings alleging that some of our cell sites were built and have been used without the relevant permits or not in accordance with the permits. As of the same date, a small portion of our cell sites operated without building permits or applicable exemptions. Although we are in the process of seeking to obtain building permits or modify our cell sites in order to satisfy applicable exemptions for a portion of these sites, we may not be able to obtain or modify them and in several instances we may be required to relocate these sites to alternative locations or to demolish them without any suitable alternative. In addition, we may be operating a significant number of our cell sites, in a manner which is not fully compatible with the building permits issued for them, although they are covered by permits from the Ministry of Environmental Protection in respect of their radiation level. In some cases we will be required to relocate these cell sites to alternative locations, to reduce capacity coverage or to demolish them without any suitable alternative.

Based on advice received from our legal advisors and consistent with most Court rulings on the matter and the Israeli Attorney General opinion on the matter (given in May 2008) that the exemption from obtaining a building permit applies to cellular radio access devices, we have not requested building permits under the Planning and Building Law for rooftop radio access devices.

Notwithstanding the Attorney General's opinion, in May 2008 the District Court of Tel-Aviv-Jaffa, in its capacity as court of appeals, ruled that our and other cellular operators' devices do not meet the exemption's requirements and therefore the exemption may not be relied upon by us and other cellular operators. We and other cellular operators appealed against this ruling to the Supreme Court and the State notified the Supreme Court it concurs with our and another cellular operator's appeals against the District Court ruling. The State requested that a third operator's appeal be returned to the District Court for further deliberation on specific questions regarding the interpretation of "rooftop" and the requirement to obtain an extraordinary usage permit in the circumstances of that case in the context of the exemption. Furthermore, in July 2008, a petition seeking to annul the Attorney General's opinion and apply the District Court ruling was filed with the Supreme Court by the Union of Local Authorities in Israel and certain local planning and building authorities which also requested to join our appeal and argue against the position of the State. In June 2009, another petition seeking similar remedies, was also filed with the Supreme Court. The Supreme Court decided to hear both petitions and our appeal together.

In July 2009, the inter-ministry committee established to examine the appropriateness of future application of the exemption according to the Attorney General opinion, published its recommendations for future application of the exemption. While the Ministry of Communications recommended that, given the difficulties in obtaining permits for the construction of cell sites, the exemption should be reviewed after the lapse of one to two years from the approval of the new National Zoning Plan 36, to verify that it provides an adequate solution that allows the cellular operators to provide required communication services, the Ministries of Interior Affairs and Environmental Protection recommended that the exemption be annulled within 6 months from the date of the recommendations, based,

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among others, on the following arguments: (1) current cellular infrastructure is sufficient, given it is currently used to provide advanced services such as internet, radio and television broadcasting, while such services may be provided by a landline network; and (2) with respect to radiation safety, cell sites constructed pursuant to a building permit are preferable to radio access devices, and utilizing a cellular network to provide advanced services which can be provided through a landline network, is unjustified in light of the preventive care principle set in the Israeli Non-Ionizing Radiation Law.

In September 2009, following publication of the recommendations of an inter-ministry committee established to examine the appropriateness of future application of the exemption, the Attorney General concluded that the application of the exemption does not balance properly the different interests involved and therefore cannot continue. In March 2010 the Israeli Ministry of Interior Affairs submitted draft regulations setting conditions for the application of the exemption for the approval of the Economy Committee of the Israeli Parliament. The regulations draft includes significant limitations on the ability to construct radio access devices based on such exemption, including a limitation of the number of such radio access devices to 5% of the total number of cell sites constructed or to be constructed with a building permit in a certain area during a certain period (which will render the construction of radio access devices based on the exemption practically impossible), and circumstances in which a request for a building permit for the radio access device was filed and no resolution has been granted within the timeframe set in the regulations.

In September 2010, the Israeli Supreme Court issued an interim order prohibiting further construction of radio access devices in cellular networks in reliance on the exemption. The interim order, that was issued pursuant to the Israeli Attorney General's request, will be in effect until the enactment of the proposed regulations or other decision by the court. A further decision of the Supreme Court in February 2011, states that the order will not apply to the replacement of existing radio access devices under certain conditions. In September 2011, the Supreme Court allowed Mirs and Golan to construct radio access devices in reliance on the exemption, under certain limitations, until July 31, 2012 and in December 2011 the Supreme Court extended this period with regard to Golan until November 6, 2012. Our application to relax the interim order against us was denied.

Additionally, in November 2008, the District Court of Central Region, in its capacity as court of appeals, ruled that the exemption does not apply to radio access devices, if the rooftop on which those devices are located is at the same level as a place of residence or other building that is regularly frequented by people. Other appeals relating to the exemption, including as to the requirement to obtain an extraordinary usage permit, are still under consideration in the District Court and other similar challenges, as well as other claims asserting that those cell sites and other facilities do not meet other legal requirements continue.

An annulment of, or inability to rely on, or substantial limitation of, the exemption could adversely affect our existing network and network build-out, particularly given the objection of some local planning and building authorities to grant due permits where required, could have a negative impact on our ability to obtain environmental permits for these sites, could negatively affect the extent, quality, capacity and coverage of our network, and our ability to continue to market our products and services effectively. This may have a material adverse effect on our results of operations and financial condition.

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Radio access devices do receive the required permits from the Ministry of Environmental Protection. Since October 2007, the Commissioner of Environmental Radiation at the Ministry of Environmental Protection took the position that he will not grant and/or renew operating permits to radio access devices, where the local planning and building committee's engineer objected to the Company's reliance upon this exemption for radio access devices. We believe that in taking this position, the Commissioner is acting beyond his powers.

For reasons not related to radiation hazards, we have not received environmental permits for a few of our cell sites, primarily due to building and planning issues, such as objections by local planning and building committee's engineers to our reliance on the exemption from obtaining building permits for radio access devices.

Several local planning and building authorities argue that Israeli cellular operators may not receive building permits in reliance on the current National Zoning Plan 36, or the Plan, for cell sites operating in frequencies not specifically detailed in the frequencies charts attached to the Plan. In a number of cases, these authorities have refused to issue a building permit for such new cell sites, arguing that the Plan does not apply to such cell sites and that building permits for such cell sites should be sought through other processes (which are longer and cumbersome), such as an application for an extraordinary usage or under existing local specific zoning plans. Since June 2002, following the approval of the Plan, building permits for the Company's cell sites (where required) have been issued in reliance on the Plan. The current proposed draft amendment to the Plan covers all new cell sites requiring a building permit, independently of the frequencies in which they operate. Most of our cell sites and many cell sites operated by other operators, operate in frequencies not specifically detailed in the Plan. The frequencies allocated in the 2011 UMTS tender are also not detailed in the Plan. We believe that the Plan applies to all cell sites, whether or not they operate in specific frequencies, consistent with the practice developed since 2002 and intend to defend our position vigorously. However, we are currently unable to assess the chances of success of the above argument.

If this approach continues, it would have a negative impact on our ability to deploy additional cell sites (until such time as the Plan is amended to include all cellular cell sites), which could negatively affect the extent, quality and capacity of our network coverage and our ability to continue to market our products and services effectively.

In addition to cell sites, we provide repeaters (also known as bi-directional amplifiers) to subscribers seeking a solution to weak signal reception within specific indoor locations. Based on advice received from our legal advisors, we have not requested building permits under the Planning and Building Law for outdoor rooftop repeaters, which are a small part of the repeaters that have been installed. It is unclear whether other types of repeaters require building permits. Some repeaters require specific permits and others require a general permit from the Ministry of Environmental Protection in respect of their radiation level, and we ensure that each repeater functions within the parameters of the applicable general permit. Should it be established that the installation of repeaters (including those already installed) requires a building permit, we will perform cost-benefit analyses to determine whether to apply for permits for existing repeaters or to remove them and whether to apply for permits for new repeaters.

In addition, we construct and operate microwave sites as part of our transmission network. The various types of microwave sites receive permits from the Ministry of

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Environmental Protection in respect of their radiation level. Based on advice received from our legal advisors, we believe that building permits are not required for the installation of these microwave facilities on rooftops. If the courts determine that building permits are necessary for the installation of these sites, it could have a negative impact on our ability to obtain environmental permits for these sites and to deploy additional microwave sites and could hinder the extent, quality and capacity of our transmission network coverage and our ability to continue to market our landline services effectively.

Operating a cell site or a facility without the requisite permits or not in accordance with permits granted could subject us and our officers and directors to criminal, administrative and civil liability. Should any of our officers or directors be found guilty of an offence, although this has not occurred to date, they may face monetary penalties and a term of imprisonment. In addition, our sites or other facilities may be the subject of demolition orders and claims of breach of contract and we may be required to relocate cell sites to less favorable locations or stop operation of cell sites. This could negatively affect the extent, quality and capacity of our network coverage and adversely affect our results of operations.

In July 2011, an inter ministry team of the Ministries of Communications, Finance, Interior, Environmental Protection and the Anti-Trust Commissionaire, published its recommendations regarding cell site sharing. The recommendations include compulsory cell sites sharing in the construction of new cell sites or modification to existing cell sites which require a building permit (the Ministry of Communications may exempt from the obligation to share cell sites where such obligation poses technological and engineering difficulties), while providing preference and leniencies to the new UMTS operators, as well as the reduction of existing non shared cell sites quantity. These recommendations or similar recommendations, if enacted, would further burden the construction of new cell sites and modifications to existing cell sites, and may adversely effect our existing cellular network, the network build-out and our results of operations.

Indemnification obligations

In January 2006, the Planning and Building Law was amended to provide that as a condition for issuing a building permit for a cell site, local building and planning committees shall require letters of indemnification from cellular operators indemnifying the committees for possible depreciation claims under Section 197 of the Planning and Building Law, in accordance with the directives of the National Council for Planning and Building. Section 197 establishes that a property owner whose property value has been depreciated as a result of the approval of a building plan that applies to his property or neighboring properties may be entitled to compensation from the local building and planning committee. In February 2007, the Israeli Minister of Interior Affairs extended the limitation period within which depreciation claims may be brought under the Planning and Building Law from three years from approval of the building plan to the later of one year from receiving a building permit under National Zoning Plan 36 for a cell site and six months from the construction of a cell site. The Minister retains the general authority to extend such period further. This extension of the limitation period increases our potential exposure to depreciation claims.

The National Council's guidelines issued in January 2006 provide for an undertaking for full indemnification of the planning and building committees by the cellular companies, in the form published by the council. The form allows the indemnifying party to control the defense of the claim. These guidelines will remain in effect until replaced by an amendment to National Zoning Plan 36.

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Since January 2006, we have provided approximately 340 indemnification letters in order to receive building permits. In addition, prior to January 2006, we provided three undertakings to provide an indemnification letter to local planning and building committees. Local planning and building committees have sought to join cellular operators, including us, as defendants in depreciation claims made against them even though indemnification letters were not provided. We were joined as defendants in a small number of cases, but are not, as of December 31, 2011, a party to any such depreciation claim. We expect that we will be required to continue to provide indemnification letters as the process of deploying our cell sites continues. As a result of the requirement to provide indemnification letters, we may decide to construct new cell sites in alternative, less suitable locations, to reduce capacity coverage or not to construct them at all, should we determine that the risks associated with providing such indemnification letters outweigh the benefits derived from constructing such cell sites, which could impair the quality of our service in the affected areas.

Construction and operating permits from the commissioner of environmental radiation

Under the Non-Ionizing Radiation Law (and previously under the Israeli Pharmacists Regulations (Radioactive Elements and their Products), 1980), it is prohibited to construct and operate cell sites without a permit from the Ministry of Environmental Protection. The Commissioner of Environmental Radiation, or Commissioner, is authorized to issue two types of permits: construction permits, for cell site construction; and operating permits, for cell site operation.

These permits contain various conditions that regulate the construction and/or operating of cell sites, as the case may be. Our cell sites routinely receive both construction and operating permits from the Commissioner within the applicable time frames. Some repeaters require specific permits and others require general permits from the Commissioner in respect of their radiation level, and we ensure that each repeater functions within the parameters of its applicable general permit.

The Pharmacists Regulations provide that each of the two kinds of permits is valid for one year from the date of its issuance, or for a shorter period of time as determined by the Commissioner. We submitted annual reports regarding radiation surveys conducted on our cell sites, which, according to the Commissioner, automatically renews the permits for additional one-year terms. Under the Pharmacists Regulations, the Commissioner may issue orders to take appropriate action should he believe a cell site or other facility poses a threat to the health or welfare of individuals, the public or the environment. Failure to comply with the Pharmacists Regulations, the terms of a permit or the instructions of the Commissioner can lead to sanctions, including the revocation or suspension of the permit.

Pursuant to the Non-Ionizing Radiation Law, the construction and operation of cell sites and other facilities requires the prior approval of the Ministry of Environmental Protection. The validity of a construction permit will be for a period not exceeding three months, unless otherwise extended by the Commissioner, and the validity of an operating permit will be for a period of five years and we are required to submit to the Commissioner annual reports regarding radiation surveys conducted on our cell sites and other facilities by third parties that were authorized to conduct such surveys by the Commissioner. Permits that were issued under the Pharmacists Regulations were deemed, for the remainder of their term, as permits issued under the Non-Ionizing Radiation Law. An applicant must first receive a construction permit from the Commissioner and only then may the applicant receive a building permit from the planning and building committee. In order to receive an operating

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permit from the Commissioner, certain conditions must be met, such as presenting a building permit or an exemption and means taken (including technological means) to limit exposure levels from each cell site or facility (relevant also for the receipt of a construction permit). In April 2010, the Commissioner amended all existing operating permits to include an obligation to provide the Commissioner with online, ongoing data regarding the radiation level on each of the cell sites and other facilities operated by each cellular operator, satisfied by a monitoring system supplied by the Commissioner and installed at the operator's premises. We provide the Commissioner with the requested data. See "Site licensing" above for additional details in regards to obtaining a building permit or relying on an exemption.

The Non-Ionizing Radiation Law also regulates permitted exposure levels, documentation and reporting requirements, and provisions for supervision of cell site and other facility operation. The Non-Ionizing Radiation Law grants the Commissioner authority to issue eviction orders if a cell site or other facility operates in conflict with its permit, and it imposes criminal sanctions on a company and its directors and officers for violations of the law. Failure to comply with the Non-Ionizing Radiation Law or the terms of a permit can lead to revocation or suspension of the permit, as well as to withholding the grant of permits to additional cell sites of that operator.

In December 2008, the Minister of Environmental Protection signed the Non-Ionizing Radiation Regulations, which did not include a section setting additional restrictions in relation to the operation of cell sites and other facilities, which was included in a previous draft of the regulations. This section is pending approval by the Internal Affairs Committee of the Israeli Parliament. Further, in February 2010, the Minister of Environmental Protection published a proposed amendment to the Non-Ionizing Radiation Law, aiming to cancel the requirement to obtain the Minister of Communications' approval to the Non-Ionizing Radiation Regulations, where such regulations may have a substantial and direct effect on the monetary burden imposed on the communication market, as is required under the current law.

In October 2010, a bill amending the Non-Ionizing Radiation Law so as to prohibit the grant of permits under such law for the construction and operation of cell sites situated within 75 meters from certain institutions, passed a preliminary phase of enactment in the Israeli Parliament. According to the bill, such permits granted prior to the enactment of the bill shall expire within 6 months from its effective date. If restrictions similar to those included in the previous draft of the Non-Ionizing Radiation Regulations (which included additional restrictions on the operation of cell sites and other facilities) or the proposed change to the Non Ionizing Radiation Law are subsequently adopted, they will, among other things, limit our ability to construct new sites (and if applied to existing cell sites, they will also limit our ability to renew operating permits for many of our existing sites), will adversely affect our existing networks and networks build out, specifically in urban areas, and could adversely affect our results of operations.

Handsets

The Israeli Consumer Protection Regulations (Information Regarding Non-Ionizing Radiation from Cellular Telephones), 2002, regulate the maximum permitted level of non-ionizing radiation from end-user cellular phones that emit non-ionizing radiation, according to the European standard, for testing GSM devices, and the American standard, for testing TDMA and CDMA devices. They also require cellular operators to attach an information leaflet to each cellular phone package that includes explanations regarding non-ionizing radiation, the maximum permitted level of non-ionizing radiation and the level of radiation of that specific model of equipment. The Radiation Regulations further require that such information also be displayed at points-of-sale, service centers and on the Internet sites of cellular operators.

Pursuant to procedures published by the Ministry of Communications at the end of 2005, end-user cellular equipment must comply with all relevant standards, including specific absorption rate, or SAR, level standards. We obtain type-approval from the Ministry of Communications for each handset model imported or sold by us. We include information published by the manufacturer regarding SAR levels with all of our handsets. SAR levels are a measurement of non-ionizing radiation that is emitted by a hand-held cellular telephone at its specific rate of absorption by living tissue. SAR tests are performed by handsets manufacturers on prototypes of each model handset, not for each and every handset. We do not perform independent SAR tests for equipment and rely for this purpose on information provided by the manufacturers. As the manufacturers' approvals refer to a prototype handset, we have no information as to the actual SAR level of each specific handset and throughout its lifecycle, including in the case of equipment repair.

According to these procedures, in the event of equipment repair, SAR levels must be tested again and if they are not tested, the repairing entity is required to inform the customer that there may be changes in the SAR levels by affixing a label to the equipment. The Ministry of Communications has appointed a consultant to create guidelines in that regard, but to date, the Ministry has not issued them. We have awaited the publication of these guidelines before implementing these requirements, but given the continued delay, are informing our customers that there may be changes in the SAR levels.

Obtaining a license for importing or trading in spare parts that are likely to affect the level of non-ionizing radiation requires receipt of compliance approvals from the manufacturer of the parts or from a laboratory authorized by the Ministry of Communications. To the best of our knowledge, to date no spare parts manufacturer has provided any cellular operator with such an approval and no laboratory has been authorized by the Ministry of Communications to issue such approvals.

We are required to provide warranty for handsets and other end user equipment purchased from us, for certain malfunctions during the first year, and are required to provide repair services for three years. We are also required to annul equipment sale in certain circumstances, at the request of the customer. See "Item 8 – Financial Information - Legal Proceedings" for details regarding purported class actions filed against us, in respect of handsets.

Royalties

Under the Communications Law, the Israeli Communications Regulations (Royalties), 2001, and the terms of our general license from the Ministry of Communications, in 2011 we were required to pay the State of Israel royalties equal to 1.75% of our revenues generated from telecommunications services, less payments transferred to other license holders for interconnect fees or roaming services, sale of handsets and losses from bad debt. The rate of these royalties has decreased in recent years, from 4.5% in 2002, to 4% in 2003, to 3.5% in 2004 and 2005, to 3% in 2006, to 2.5% in 2007, to 2% in 2008, to 1.5% in 2009 and 1% in 2010 and thereafter. A public committee appointed by the Ministry of Communications to review various issues in the Israeli communications market published its recommendations in March 2008, including a recommendation that our obligation to pay royalties be annulled no

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later than 2012 (subject to Israeli corporate income tax reduction between 2008 and 2012). However, in January 2011, these regulations were amended to increase the royalties payable regarding cellular operations only, for the year 2011 and 2012, commencing January 19, 2011, from 1% in 2010, to 1.75% in 2011 and 2.5% in 2012, unless the Ministry of Communications has notified that an additional UMTS operator has commenced providing service through national roaming services or that MVNO operators have gained 5% market share. This change will not apply to MVNOs and holders of a special general license for the provision of landline services. In March 2011, we, Pelephone and Partner have filed a petition with the Israeli Supreme Court against the Ministries of Finance and Communications in that regard. In July 2011 the State announced it accepts the Supreme Court's suggestion to set the royalties' rate to 1.75% in 2011 and 2012 (subject to the above conditions) and to 0% starting 2013. The state reserved its right to charge royalties or other payments by primary legislation. An amendment to the regulations requires the approval of the Israeli Parliament.

Frequency Fees

Frequency allocations for our cellular services are governed by the Wireless Telegraph Ordinance. We pay frequency fees to the State of Israel in accordance with the Israeli Wireless Telegraph Regulations (Licenses, Certificates and Fees), 1987. In December 2008, we returned the TDD spectrum allocated to us in 2004, to the Ministry of Communications, after not being able to use that spectrum since it was awarded to us, due to unavailability of supporting equipment, and in December 2010, we filed a lawsuit against the Ministry of Communications for the return of the frequencies fees we paid for the TDD spectrum, in the amount of approximately NIS 15 million.

Mobile Virtual Network Operator

A mobile virtual network operator, or MVNO, is a cellular operator that does not own its own spectrum and usually does not have its own radio network infrastructure. Instead, MVNOs have business arrangements with existing cellular operators to use their infrastructure and network for the MVNO's own customers. The operation of MVNOs in the Israeli cellular market could increase competition and may materially adversely affect our revenues, and more so, if such service is to be provided under unfavorable terms and consideration (such as equal to or based on the interconnect tariff).

The Communications Law was amended in July 2009 to include an MVNO license. In January 2010, the regulations necessary for the granting of an MVNO license were promulgated. The regulations regulate the operation of an MVNO pursuant to an agreement to be reached and entered between a cellular operator and an MVNO and sets, among others, the conditions for receiving an MVNO license, including a requirement to operate a mobile phone switch, a restriction on a cellular operator and landline operator to receive an MVNO license and limitations on parties related to an existing cellular operator and on other communication licensees, to receive an MVNO license. Although the regulations deal with an agreement based MVNO, the Communications Law, as amended, instructs further that in the event that a MVNO and the cellular operator will not have reached an agreement as to the provision of service by way of MVNO within six months from the date the MVNO has approached the cellular operator, and if the Ministry of Communications together with the Ministry of Commerce determine that the failure to reach an agreement is due to unreasonable conditions imposed by the cellular operator, the Ministry Of Communications

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will use its authority to provide instructions. Such instructions may include intervening in the terms of the agreement, including by setting the price of the service.

To date the Ministry of Communications granted nine MVNO licenses to Free Telecom, Ituran, Rami Levy, Bynet, Home Cellular, T2T and Alon Cellular. A ninth licensee has returned its license. Five MVNOs entered hosting agreements with cellular operators: Free Telecom with Pelephone, Rami Levy with Pelephone, Ituran with Pelephone and Partner, Home Cellular with us and Alon Cellular with Partner. Rami Levy commenced operations during December 2011 and the other four are expected to commence operations in the first half of 2012. For additional details see "Item 4. B. – Business Overview – The Telecommunications Industry in Israel – Cellular services".

Additional UMTS Operators

In September 2010, the Ministry of Communications published a UMTS spectrum tender for two additional UMTS operators (the general principles of which were published in October 2009). Participation in this tender was allowed only to new operators and Mirs. Mirs (in April 2011) and Golan (In December 2011) were awarded the new UMTS frequencies. Golan was awarded a general license for the provision of cellular services and Mirs' current license was amended. Mirs and Golan committed to pay license fees in the amount of approximately NIS 700 million and NIS 360 millions, respectively, after the lapse of 5 years from the grant date of the UMTS license which may be reduced up to a minimal license fee of NIS 10 million by one seventh of the sum, for each 1 percent of market share gained by each in the private sector during such 5 years period. Mirs and Golan were awarded certain additional benefits and leniencies, such as a prolonged timetable for network coverage completion and the right to use national roaming through cellular operators' networks. The expected entrance of additional UMTS operators is expected to further increase competition in the market and could materially adversely affect our results of operations.

In December 2010, the Communications Law was amended to require existing operators (other than Mirs) to provide new UMTS operators and Mirs national roaming services, for a period of 7 - 10 years (subject to certain conditions). If the new operator or Mirs and the hosting operator have not reached an agreement, as to the terms of this service (including the consideration), for any reason, by the time that the service is to commence (after certain criteria are met) the service will be provided for the then prevailing interconnect tariff and subsequently (but no later than February 1, 2012) shall be determined by the Ministry of Communications with the consent of the Minster of Finance and applied retroactively. Unfavorable terms and consideration for the service (such as equal to or based on the interconnect tariff) may result in material adverse effect on our results of operations.

In October 2011, we entered a national roaming agreement with Golan, under which we will provide Golan national roaming services and cell site sharing privileges.

See "Site Licensing" above for the recommendations of an inter-ministry team regarding compulsory cell site sharing, including providing preference and leniencies to the new UMTS operators.

Long Distance Services

In February 2011, the regulations preventing a cellular and landline operator from providing international services and preventing a cellular operator from having a significant

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influence over an international landline, or ILD, operator were amended to allow cellular operators to provide long distance services or have significant influence over an ILD operator upon the earlier of the date in which an MVNO operator begins providing services (and with regards to an ILD which requested an MVNO license before September 1, 2010 and was granted a license – when the Ministry of Communications intervened or decided not to intervene in the terms of it's hosting agreement with the cellular operator) or after December 31, 2012. In addition, the Ministry of Communications may allow a cellular operator to have significant influence over an ILD before those conditions are met, under structural separation of the long distance operation from the cellular operator's operation.

As a result of this change, in February 2011, the Ministry of Communications approved the acquisition of Smile Telecom by Partner, subject to the structural separation of the long distance operation until the aforementioned conditions are met, and the acquisition was completed in March 2011. Similary, in July 2011, the Ministry of Communications approved our acquisition of Netvision subject to the same conditions, and the acquisition was completed in August 2011.

In December 2011, a formal notification was published in the Israeli Official Gazette announcing that Rami Levy, an MVNO operator, commenced its operations in December 2011. Following such announcement, the structural separation required by the Ministry of Communications was lifted.

Emergency Situations

We may be subject to certain restrictions and instructions regarding our activities or provision of services during national emergencies or for reasons of national security or public welfare, including taking control of our cellular or land line networks. Further, the Prime Minister and the Ministry of Communications may determine that our services are deemed essential services, in which case we may be subject to further additional limitations on our business operations.

Reporting Requirements

We are subject to extensive reporting requirements. We are required to submit to the Ministry of Communications detailed annual reports with information concerning subscribers, revenues by service, the number of new subscribers and churn, annual financial statements and prior notice of tariff increases. In addition, under our license we may be required by the Ministry of Communications to file additional reports, such as reports on complaints, pricing, specific costs and revenues, network problems and the development of the network. We are required to provide the Commissioner of Environmental Radiation under the Non-Ionizing Radiation Law and regulations with periodic and online, ongoing data of all cell sites operated by us.

Securities Administrative Enforcement

An amendment to the Israeli Securities laws, which came into force in January 2011, established administrative enforcement measures for the handling of certain violations of certain securities and securities-related laws supervised by the Israeli Securities Authority, or ISA. This amendment allows the ISA to impose various civil enforcement measures, including financial sanctions, payment to the injured party, prohibition of the violator from serving as an executive officer for a certain period of time, annulment or suspension of licenses, approvals and permits granted under such laws and agreed settlement mechanism as

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alternative for a criminal or administrative proceeding. In case of a violation by a corporation, the amendment provides for additional responsibility of the chief executive officer in some cases, unless certain conditions have been met, including the existence and implementation of procedures for the prevention of the violation. The Company is in the process of examining its procedures for the prevention of such violations.

Contributing to the Community and Protecting the Environment

We and our employees have been contributing to the community since our inception and are proud to be among the leaders of community responsibility. Like other companies in the IDB group, we consider contribution to the community in Israel, and specifically to the communities residing next to the Israeli northern and southern borders, an important component of our business vision and believe we have a responsibility towards the Israeli community, as we acknowledge that business leadership goes hand in hand with social leadership.

In 2011 we continued to contribute to the community with a specific focus on our "Cellcom Volume" youth centers initiative. In addition to promoting Israeli music and artists and providing our customers with Israeli music through a variety of musical content, we have contributed to the creation of "Cellcom Volume" youth centers in various locations throughout Israel, in which we provide young people resources related to music, including music classes, facilities to bands and choirs for rehearsals and recording studios. During 2011 we opened an additional center in Israel, as we believe music is a language which connects and bonds different people together. As of December 31, 2011, we had eleven "Volume Centers" and five “mini Volume Centers” active throughout the country. Our employees volunteer regularly in these centers as well as with other community projects.

In addition to our contribution to the build-up and strengthening of the community, through activities such as our "Cellcom Volume" youth centers, we make financial donations to other worthy causes and entities. In August 2006, our Board of Directors determined our donation policy to be at an amount equal to up to one percent of our annual net income. In 2011 we donated a total sum of approximately NIS 6.2 million, including our contribution to the community.

We are aware of the importance of environmental protection. Accordingly, while providing quality products and services to our subscribers, we seek to operate responsibly to continuously reduce negative impacts on the environment and the landscape, aiming at a better environmental performance than required by local law. We dedicate personnel, funds and technologies to improve our performance, strive to achieve an efficient deployment of infrastructure subject to the applicable standards, and cooperate with the local authorities. We constantly monitor our environmental performance and aim to reduce our ecological footprint, through activities such as recycling, reduction of paper usage by managed printing, reduction of pollutants' emissions and energy usage as well as activities aimed at allowing our subscribers to better protect the environment, such as collecting used batteries, sending subscribers their monthly bill for our services and other correspondence from us via e-mail in lieu of regular mail, transfer to usage of environment friendly raw materials and separation between different types of waste in our repair services. In 2010, we entered into an agreement for the future purchase of electricity to be produced by a private natural gas based power station.

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NETVISION

General

On August 31, 2011, we completed the acquisition of 100% of the share capital of Netvision through a merger transaction. Netvision was founded as an Israeli company in 1994 and became a public company following its initial public offering on the TASE in 2005. In our description of Netvision's business, the term "Netvision" refers to Netvision and its subsidiaries.

Netvision is a leading company in the Israeli communications market and is engaged in two primary businesses through its wholly owned subsidiary 013 Netvision Ltd., or 013 Netvision: provision of internet connectivity and related services (ISP); and provision of telephony services consisting mainly of international calling services, operator services, teleconferencing services and landline telephony services. In addition, Netvision is engaged is additional activities such as internet content services and custom internet applications.

ISP Business

General - The provision of internet connectivity services is one of Netvision's primary businesses. Netvision is a leading provider of internet connectivity services. The Israeli internet market is characterized by a separation between the internet infrastructure providers and the internet connectivity service providers. Consequently, the internet customer is required to enter into a contractual arrangement with both of these providers. The infrastructure provider is responsible for the connection of the customer from his computer or other device to the infrastructure provider's operator. The internet service provider (such as Netvision) is responsible for providing access to the customer from the infrastructure provider's operator, through its own operator, to the local and global internet network. Currently, there are two main internet infrastructure providers having landline infrastructure for the private sector in Israel: Bezeq and Hot. Netvision's internet infrastructure is currently comprised of connectivity sites in two locations in Israel (Haifa and Petah-Tikvah), which provide Netvision's customers, through overseas connectivity points in New York City, London and Frankfurt, with connectivity to the global internet network. This internet infrastructure contains backup capability in order to ensure continuity of service.

Services and Products – Netvision's main service provided to its internet subscribers is internet connectivity service and related services and products, as well as bundles of its services, including bundling with other companies' products or services.

In addition, Netvision offers its internet subscribers value added services, such as data protection services to its private subscribers and connectivity integration solutions and global communications solutions to its business customers, including firewalls, anti-virus and anti-spam software, overseas internet connectivity services and server hosting services. In addition, Netvision provides through one of its controlled subsidiaries, ISP services which also offers the ability to filter the content viewed by the internet user; this service is targeted mainly to the orthodox religious sectors in Israel.

Netvision is constantly considering and evaluating the possibility of introducing additional products and services to its customers.

The Israeli ISP market is characterized by rapid technological changes, both in terms of the bandwidth offered to customers, as well as terms of expansion of the list of products and services offered. For developments in the Israeli internet infrastructure sector such as the entrance of new players into this sector, including our Company, see this Item 4.B above

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under "The Telecommunications Industry in Israel – Wireline Services - Broadband and Internet Services".

Suppliers – In the course of engaging in its ISP business, Netvision has entered into agreements with various suppliers, the principal of which are the following:

Netvision entered into a number of agreements with Mediterranean Nautilus Ltd. and Mediterranean Nautilus (Israel) Ltd., or collectively Med Nautilus, during the years 2003 through 2011. Med Nautilus is the owner of the principal communication infrastructure which connects the Israeli internet network to the "entry points" of the global internet network via an underwater communications cable (two additional cables were recently laid, one of them by one of Netvision's competitors – Bezeq International). Pursuant to its agreements with Med Nautilus, Netvision purchased rights of use, or IRU, of certain telecommunications capacities on Med Nautilus' communication cables, as well as maintenance and operation services relating to these cables. The agreements include options pursuant to which Netvision may expand the purchased capacity. The terms of these agreements may be subject to regulatory intervention. See additional details under "Item 3. Key Information - Risk Factors – Risk Factors Related to our wholly owned subsidiary Netvision - Netvision is exposed to risks relating to network infrastructure and is dependent on services it receives from its external suppliers". The term of the agreement with respect to part of the capacity purchased from MedNautilus is until May 2027. Netvision has the option to terminate agreements with respect to parts of the capacity in 2017 and 2022. See "Competition" below for possible regulatory intervention is these agreements.

Netvision entered into agreements with Bezeq and Hot, the primary internet infrastructure providers in the Israeli market. Netvision is dependent upon these suppliers since without their infrastructure Netvision would be unable to provide its ISP services to its customers. Due to the increase in customer demand for broadband width in recent years, Netvision is required from time to time to increase the capacity it purchases from Bezeq and Hot. During 2010, Netvision applied to the Ministry of Communications' intervention in the prices charged by Bezeq and Hot in consideration for connectivity services to their infrastructure. Following that petition, in 2010 Netvision and Bezeq entered into a new agreement that regulates the provision of the internet infrastructure services by Bezeq to Netvision, which was updated in 2011. Under this agreement with Bezeq, Netvision is required to purchase minimum bandwidth capacities in consideration to a price that reflects a considerable decrease in comparison to the previous price per giga-byte unit. The 2010 agreement with Bezeq, as updated in 2011, is valid until 2014.

In 2011 Netvision entered into an agreement with Cisco Systems, Inc., or Cisco, effective until 2013. Cisco provides Netvision maintenance and advanced services for its IP network equipment; in addition, Netvision sells various Cisco products to its customers.

Netvision uses several supporting systems for the provision of service to its customers, including communications infrastructure by Nortel (see additional details under "Telephony Business – Suppliers" below), customer relations management system by PeopleSoft supported by Matrix for Oracle, inventory and suppliers management system by Priority/Eshbel, billing system by CBP supported internally and by Intec, financial system by Coda and infrastructure integrations system by Microsoft BizTalk.

Sales and Marketing and Customer Care – Netvision conducts its sales and marketing activities in the ISP business through various channels, including media advertising in newspapers, internet and television, concentrated sales campaigns, telemarketing to potential

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customers, as well as targeting existing customers by offering them upgrades to existing subscription programs and value added products and services. In addition, Netvision regularly collaborates with other telecommunication providers (including Bezeq and Hot) in order to offer service packages to existing and potential customers.

Netvision's customer care center is located in Haifa, providing technical and support services, billing and general information, by specializing representatives as well as installation services provided by technicians teams at the landline customers' premises.

Competition - The Israeli ISP market is highly competitive and saturated and ischaracterized by relatively low entry barriers. Competition among the various players concentrates mainly on the ability to offer high-speeds of internet connection and on pricing. Although the provision of ISP services requires obtaining a license from the Ministry of Communication, the Ministry's policy is liberal in granting ISP licenses. As a result, as of the date of this report, there are a few dozen holders of ISP licenses in Israel, though most of them do not hold significant market shares. Entry into the ISP market requires, however, incurring substantial penetration costs associated with the formation of ISP infrastructure, support systems, customer care systems and marketing channels. Due to such penetration and the other ongoing costs of operating ISP service, profitability in the ISP market usually requires creation of a broad customer base.

The key success factors in the ISP market are brand recognition and reputation, advanced and updated technological capabilities, available bandwidth, high levels of customer care service, the ability to constantly develop innovative products and services and complementary products and services, competitive pricing, achieving and maintaining customer loyalty, and strategic cooperation with strong local and international corporations.

Netvision's main competitors in the ISP market are Partner (through its wholly-owned, recently-acquired subsidiary Smile Telecom), Bezeq (through its wholly owned-subsidiary Bezeq International) and Hot (through its wholly owned-subsidiary Hotnet).

In 2010, the Ministry of Communications amended Bezeq's and its subsidiaries licenses to allow them to offer bundles of services to private customers, under certain limitations, including that each of the services in the Bezeq bundle would be available for sale separately under the same terms as in the bundle, and the requirement that Bezeq allows its competitors to participate in a similar bundle - if includes ISP, VOB or ILD services - under the same terms and equally markets such bundles as its own bundle (the second requirement does not apply to the sale of the bundle by a subsidiary of Bezeq). In 2010 Bezeq began offering bundles of ISP services, internet infrastructure services and landline telephony services. This led to a decrease in the prices of the ISP services sold in the bundle. In February 2011, the Ministry of Communications published a hearing regarding the amendment of Bezeq's and its subsidiaries licenses to allow the offering of such bundles to business customers as well. At the end of 2010, Hotnet, a subsidiary of Hot, received an ISP license under structural limitation from the other Hot group entities (similar to the structural limitation in the Bezeq group) and Hot was also allowed to offer bundles of services including ISP services, under similar limitations as Bezeq, with respect to the ISP service component of the bundle. In February 2012 Hot began offering ISP services and has done so at tariffs significantly lower than market prices or at prices which would be lower than our costs and Bezeq also significantly lowered its internet infrastructure services tariffs to end-users. Netvision believes there is cause for regulatory intervention and has appealed to the regulators to intervene, but cannot predict the outcome of such appeals. This is expected to

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result in a further decrease in ISP service prices and lead to increased demand for greater bandwidth and would require Netvision to significantly increase the capacity it purchases, significantly increasing its expenses in purchasing capacity from Bezeq and Hot, while its revenues could decrease. This could have a material adverse effect on Netvision's results of operations. Also, in recent years, cellular operators started providing ISP services via wireline and wireless networks. The offering of bundles of services and entry into the ISP market of these players, who have a broad customer base and a wide offering of communication services, could further intensify the competition in this market and adversely affect Netvision's results of operations. In addition, the reduction of the early termination fees by the Ministry of Communication that was implemented in the ISP market during 2011 has increased and is expected to continue to increase the competition in the market. See also “Item 3. Key Information – D. Risk Factors - Risks Related to our wholly owned subsidiary Netvision - Changes in the regulatory environment could adversely affect Netvision's business”.

In late 2011 and early 2012, two additional underwater cables that could serve as an alternative to Med Nautilus were deployed. In addition, proposed regulation published for public comments by the Ministry of Communication on November 2011, proposes certain limitations on the terms of agreements with Med Nautilus, which will, among others, limit the discounts and capacity Med Nautilus may provide. While the deployment of additional underwater cables could improve the competition in the ISP market, as ISP providers will be able to find alternatives to Med Nautilus, which could lead to a decrease in the pricing of the global internet connectivity services provided to Israeli ISP providers, Bezeq International's deployment of one of them and adoption of the proposed regulatory changes might harm Netvision's results of operations and competitive position as it could force ISP providers other than Bezeq International to purchase capacity on less favorable terms and prices, and more so in comparison to Bezeq International. In addition, the Electric Company's initiative, intended to enable use its optic fiber infrastructure for the provision of broadband transmission services, would improve Netvision's competitiveness in the ISP market as this is likely to reduce its dependency on Bezeq and Hot as internet infrastructure providers. For additional details see this Item 4.B above under "- The Telecommunications Industry in Israel – Wireline Services - Broadband and Internet Services" and "– Government Regulations – Competition".

Regulation and Licenses – A major part of Netvision's ISP operations is subject to regulation by the Israeli Ministry of Communications pursuant to the Communications Law, including through its ISP license.

The provision of ISP and related services requires a license. Netvision was granted three ISP licenses, one to its wholly owned subsidiary 013 Netvision , one to its controlled subsidiary Internet Rimon, and third was granted to 013 Netvision by the Israeli Civil Administration in Judea and Samaria in respect of this territory. The licenses are valid through April 2012, May 2012 and August 2012 respectively. Netvision estimates that it will be able to renew these licenses without undue burden.

Under its ISP licenses, Netvision is required to maintain a minimum standard of customer service, is prohibited to condition the use of its services by the customer on the customer's having to be connected to a portal designated by it, and is generally prohibited from discriminating among subscribers in terms of service packages offered and pricing. Netvision is also required to inform its customers regarding the main features of the service provided, including commencement date of service, the consideration paid by the customer,

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quality standards, and maintenance details, and details about the possibility of email address portability.

Under its ISP licenses, Netvision may not transfer or encumber any of its licenses' related assets, without the prior written approval of the Ministry of Communication. The license may be terminated in case that Netvision fails to provide information or provides false information or in case it is engaged in anticompetitive practices in the communications market, subject to certain terms. The licensee is required to provide the Ministry of Communications with certain reports and is required to cooperate with the supervisory bodies of the Ministry of Communication.

In August 2011, the Communications Law was amended pursuant to which the Early Termination Fees in the ISP market were annulled, which led to an increase in competition, churn rates and rate of gross recruitment of subscribers and price erosion. Further intervention by the Ministry of Communication in the ISP market, including by means of granting additional ISP licenses and setting their terms and conditions, change or annulment of the structural separation currently in place for the Bezeq and Hot groups, permitting the bundling of certain services and intervening in the purchasing of global internet connectivity, could have a material adverse effect on Netvision's ISP business.

Telephony Business

General - The provision of telephony services is one of Netvision's primary businesses. Netvision's services in its telephony business consist mainly of the following:

- Provision of international calling services, or ILD services;
- Provision of landline telephony services, including teleconferencing services; and
- Sales of telephony equipment (including switchboards, telephones and communication switches), and operation and management of voice communication systems and data communications systems, including maintenance and support of telecommunication systems.

ILD services enable an end user (whether in Israeli or overseas) to conduct a telephone conversation with an end user located elsewhere in the world. These include calls (including cellular calls) from Israel to various destinations abroad as well as call (including cellular call) completion services to overseas operators transferring a call to Israel; transferring international calls between operators and signaling services to local and foreign cellular operators to allow roaming.

Netvision is a major player in the Israeli ILD market. As a result of a regulatory change that was adopted by the Israeli Ministry of Communication in February 2011, pursuant to which cellular operators were permitted, under certain conditions, to have significant influence over an ILD operator, we were permitted to acquire Netvision in 2011. This regulatory change also enabled the acquisition of Smile by Partner. For further details, see this Item 4.B above under "- Government Regulation – Long Distance Services". In recent years, the ILD market has witnessed a development of and an increase in the use of technologies that can serve as substitute to the traditional ILD services, including voice over IP technologies offered by companies such as Skype. This trend has resulted in a continual decline in the overall use of traditional ILD services. Further developments and penetration of

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such technologies into the Israeli ILD market could have a material adverse effect on the financial results of Netvision's ILD business.

Landline telephony service enables an end user to conduct a telephone conversation with another end user who uses either another landline or a cellular telephone or computer, either in Israel or overseas.

Services and Products – Netvision's principal service in the ILD market is the provision of outgoing and incoming telephone calls to and from substantially worldwide coverage. Netvision provides these services mostly to post-paid customers, but also to pre-paid customers mainly through the sale of calling cards. Most of the customers of the pre-paid services are foreign workers who work in Israel. In addition, Netvision provides "hubbing" services to non-Israeli international operators. Hubbing services are bridging services between two non-Israeli international operators. Such services are provided by Netvision where there is no direct connection between two non-Israeli international operators or where pricing differences in different locations make such bridging service desirable. The hubbing service market has been growing in the past few years because of the development of the international dialing market and because of the development of the corresponding arbitrage market on which various international operators trade international dialing capacities. In addition, Netvision provides "signaling" services to cellular operators who use roaming services. A cellular handset located out of its home network needs to "signal" its location to the hosting network in order to enable the cellular subscriber to get roaming services. Netvision provides these services to the cellular operators in Israel (including us), as well as to foreign cellular operators with respect to their customers when they visit Israel.

Netvision's principal service in the wireline market is the provision of basic landline telephony services (usually by VOB technology, but also by other traditional technologies, including time-division multiplexing, or TDM). Netvision offers these services to both business and private customers. In addition, Netvision offers switchboard equipment sales services, voice and data systems' sales and operation services, and teleconferencing services and communications solutions to business customers.

Suppliers – Netvision's principal suppliers in the telephony market are the following:

Bezeq, Hot and cellular operators: Under the Communication Law and licenses, all operators are required to interconnect their network to other public communications networks in Israel, on equal terms and without discrimination in respect of other operators. Netvision has entered into interconnect agreements with Bezeq, Hot and the cellular operators, for facilitating international traffic between Netvision's network and the other networks, as well as for billing and collection services for Netvision services, for certain customers. Substantially all of Netvision's traffic requires interconnections with these operators, as substantially all such traffic requires interconnection with them and is dependant on its availability and quality.

Most of the international dialing traffic between Israel and the rest of the world is conducted through the underwater communications cable of Med Nautilus. For further details on the agreements between Netvision and Med Nautilus, see above in the description of Netvision's ISP business under "Netvision - ISP Business - Suppliers".

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Netvision has also entered into agreements with more than 100 foreign carriers. These agreements regulate and facilitate the ILD services of Netvision, as well as its international voice hubbing services.

Netvision entered into an agreement with Nortel Networks Israel (Sales and Marketing) Ltd., or Nortel in this section, in June 2004, for the provision of Netvision's international communication switch, on which Netvision bases its ability to provide international calling service, as well as related equipment and services. From 2010, Geneband Inc. (which acquired Nortel's relevant business) provides Netvision with support and maintenance services for the equipment provided under this agreement.

Netvision has entered into an agreement with ECI Telecom Ltd. for the provision of transmission switches by ECI Telecom among the various location sites of Netvision in Israel and overseas, used for its ISP operations. Netvision is obligated to purchase maintenance services from ECI until 2012. Under the maintenance agreement, ECI's liability is generally limited to direct damages and the lesser of the total consideration paid or $200,000.

Sales and Marketing and Customer Care – The sale and marketing of Netvision's telephony products and services is conducted mainly through media advertising, primarily radio and television, but also through direct means such as telemarketing, mail and email campaigns. In addition, Netvision offers its telephony products and services on a non-exclusive basis through various retailers, through outsourced telemarketing centers and through distributors. Marketing to business customers is conducted also by approaching potential customers (including developers of large commercial real estate projects), participation in tenders (especially for maintenance and support services), through labor unions and targeted marketing campaigns and sponsorships.

Netvision's customer care centers provide its telephony services customers the same range of services provided to its ISP customers.

Competition –The Israeli ILD market is highly competitive, and the competition in the market is based mainly on the operator's ability to offer attractive pricing. The price of the international call is influenced also from the call completion tariff paid to the operator in the call's destination country, increased competition in the destination country leads to a decrease in tariffs for calls to those destinations and influence an increase of the quantity of minutes made to those destinations. The Israeli landline market is currently dominated by Bezeq (which is a monopoly in this market) and by Hot, currently the only two landline carriers with full scale landline infrastructure, but certain technological and possible regulatory changes could increase competition in this market. Recent regulatory changes in the telephony market such as the annulment of Early Termination Fees, which applies to existing as well as new pricing plans in November 2011 as well as the regulatory change that enabled cellular operators to have a significant influence over ILD operators have increased and are likely to intensify competition even further as transfer barriers between service providers have been significantly eased and the various communication groups in the market are competing for the opportunity to offer potential and existing customers a "one stop shop" of communication services.

The Israeli landline market has been dominated for many years by Bezeq, a monopoly which held as of December 31, 2011 a market share of 69% in the private landline sector and a market share of 79% in the business landline sector. In recent years, Hot, entered this market and was allowed to bundle its landline service together with its internet infrastructure

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service and its multi-television service. See Netvision – ISP business – Competition" above for details regarding service bundles. Bezeq and Hot are currently the only landline carriers having full scale landline infrastructure. Recent technological and regulatory developments have enabled landline carriers which do not have a landline infrastructure, including Netvision, to enter the landline market. Netvision commenced its landline telephony services in 2008 using Voice Over Broadband, or VOB, technology, and expanded this business during 2009 through 2011. Netvision is investing substantial efforts and resources in increasing its reach into the Israeli landline market, and predicts that in the long-run its landline business will contribute to its results of operations, to its brand recognition and to enhancing customers' loyalty. We believe that Netvision's penetration into the landline business could be an important element in our ability to offer comprehensive service packages to its subscribers.

The key success factors in the telephony market are competitive pricing, which are updated constantly, brand recognition and reputation, advanced and updated technological capabilities, reliable network and high levels of maintenance, high quality of human resources including customer care services, and the ability to develop comprehensive products and services packages, to build a substantial customer base, to enhance customers' loyalty and the ability to face competition. In addition, the ability to develop strong strategic relations with foreign international dialing carriers and continuous agreements with them are also key elements in the ILD market.

In recent years, the use of alternative telecommunication technologies such as voice-over-IP has resulted in downsizing of the telephony market, especially the ILD market. This trend is expected to continue in the future.

Netvision is a leading service provider in the Israeli ILD market. As of the date of this report, there are several ILD operators in the Israeli market. Netvision's main competitors in this market are Bezeq (through its wholly owned subsidiary Bezeq International), Partner (through its wholly owned subsidiary Smile Telecom) and additional competitors include Xfone, Telzar (commenced operation in 2011) and Hilat (commenced operations in 2012).

Netvision estimates that its current market share in the Israeli landline market is not material. Netvision's main competitors in the landline market are Bezeq and Hot, as well as Partner (through Smile Telecom) and Bezeq International. To our knowledge, Bezeq remains a monopoly in the landline market.

The development of a wholesale wireline services recommended in October 2011 by the public committee appointed by the Ministry of Communications, if and when made available, will enhance Netvision's ability to compete and allow us and Netvision (as well as our competitors) to provide a wider selection of services at low cost, specifically in relation to residential landline services which is currently non-material and generating negative net-income. The proposed changes to the structural separation limitations in the Bezeq group and the supervision on Bezeq tariffs, or anti-competitive behavior if not prevented by the regulators, however, could adversely affect Netvision's ability to compete with Bezeq and Hot in general, and in the landline market in particular and may have a material adverse effect on Netvision's results of operation. For details see also “Item 3. Key Information – D. Risk Factors - Risks Related to our wholly owned subsidiary Netvision - Changes in the regulatory environment could adversely affect Netvision's business” and "Item 4. Information on the Company – Government Regulations – Competition".

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Regulation and Licenses – Netvision's operations in the telephony business are subject to regulation, mostly pursuant to the provisions of the Communications Law and the regulations promulgated thereafter, the Communications Regulations (Telecommunication and Broadcasting) (Procedures and Conditions for the Receipt of General License for the Provision of the International Telecommunication Services) – 2004, or the ILD Regulations, with respect to its ILD business, and to the provisions of its ILD licenses, and the Communications Regulations (Telecommunication and Broadcasting) (Procedures and Conditions for the Receipt of General unique License) – 2004 with respect to its VOB services and the provisions its landline licenses and its 'network ending point' license.

Netvision's main ILD license is held by its wholly owned subsidiary 013 Netvision and expires on May 2025, and its main landline license is held by another wholly owned limited partnership Veidan Teleconferencing Solutions LP, or Veidan, and expires on March 2026. Each of the licenses may be extended by the Ministry of Communications for successive periods of ten years, provided that Netvision has complied with each such license and applicable law, respectively, has continually invested in the improvement of its services and network pursuant to such license and has demonstrated the ability to continue to do so in the future.

The main provisions of Netvision's principal ILD and landline licenses are the following:

- The license holder is required to interconnect its network to other public telecommunications networks in Israel, on equal terms and without discrimination, in order to enable subscribers of all operators to communicate with one another;

- The license holder may not take any action or be party to any arrangement which might adversely affect competition in the market;

- The license holder is required to, among other things, maintain a minimum standard of customer service, including, among other things, establishing call centers and service centers, maintaining a certain service level of its network, tariffs setting and updating and protecting the privacy of subscribers;

- The licenses or any part thereof may not be transferred, pledged or encumbered without the prior approval of the Ministry of Communications. The licenses also set forth restrictions on the sale, lease or pledge of any assets used for implementing the licenses;

- Pursuant to theses licenses and the Israeli Communications Regulations (Royalties), 2001, the license holders are required to pay the State of Israel royalties equal to 1% of their eligible revenues;

- The license holders are required to obtain insurance coverage for their activities pursuant to theses licenses. In addition, the licenses impose statutory liability for any loss or damage caused to a third party as a result of establishing, sustaining, maintaining or operating the license holder's network. The license holders have further undertaken to indemnify the State of Israel for any monetary obligation imposed on the State of Israel in the event of such loss or damage. For the purpose of guaranteeing our obligations under theses license, Netvision deposited bank guarantees for this liability under the ILD and landline licenses in the amounts of $9 million and $11 million, respectively, with the Ministry of Communications, which may be forfeited in the event that the license holder violates the terms of its license.

- The transfer or pledge of means of control in the license holder is prohibited without the prior written consent of the Ministry of Communications, if, as a result of such transfer, a person becomes a 5% holder or more in the license holder.

In addition, the ILD Regulations impose certain restrictions on cross-ownership in ILD operators, such as the prohibition on landline operators or holders of material international transmission infrastructure or on persons in which an ILD operator holds 5% or more from holding an ILD license. There are additional restrictions on cross-ownership in ILD operators under the ILD Regulations, which may be waived by the Ministry of Communication on grounds of public welfare or encouragement of competition in the communications market. For a regulatory change that was adopted by the Israeli Ministry of Communication in February 2011, pursuant to which cellular operators were permitted, under certain conditions, to have significant influence over an ILD operator, and pursuant to which we were permitted to acquire Netvision in 2011 (and also enabled the acquisition of Smile by Partner), see this Item 4.B above under "- Government Regulation – Long Distance Services".

In addition to its principal landline telephony license, Netvision (through its wholly owned limited partnership Veidan) received from the Israeli Civil Administration in Judea and Samaria a license for the provision of landline services to the Israeli-populated areas in Judea and Samaria. This license is effective until October 2017 and Netvision estimates that it will be able to renew these licenses without undue burden. The provisions of the principal landline license described above, generally apply to this license, as well, subject to certain modifications.

In addition to its principal ILD license, Netvision (through its wholly owned subsidiary 013 Netvision) received from the Israeli Civil Administration in Judea and Samaria a license for the provision of ILD services to the Israeli-populated areas in Judea and Samaria. This license is effective until August 2018 and Netvision estimates that it will be able to renew these licenses without undue burden. The provisions of the principal ILD license described above generally apply to this license, as well, subject to certain modifications.

In addition to its ISP, ILD and landline licenses, Netvision holds (through its wholly owned subsidiary 013 Netvision) a 'network ending point' license to mainly install and maintain telecommunication equipment at a customer's premises or the licensee's premises, which include telephones, switchboards, telephony cables and related equipment as well as enables Netvision to connect a customer premises ,through other license holders, to the public landline network. The license is valid until July 2012 and can be renewed subject to certain conditions, including the license holder's compliance with the terms of the license.

In addition, as a service provider, Netvision is subject, like us, to the general legislation governing relations between vendors and consumers, including the Consumer Protection Law, 1981.

In August 2011, the Communications Law was amended pursuant to which the Early Termination Fees in the ILD and in the landline telephony market were annulled, which led and is expected to continue to lead to an increase in competition, churn rates and rate of gross recruitment of subscribers and price erosion.

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In December 2011, the Ministry of Communications published a hearing regarding a proposed cancellation of the 'ADSL only' service and requiring Bezeq to set a unified tariff for ADSL services, whether the customer purchases another service form Bezeq or not, such tariff to include the relative cost of the access service. If such change was adopted, it would facilitate Netvision's competitive standing in the landline market as it would allow the reduction of the access service costs.

C. ORGANIZATIONAL STRUCTURE

The IDB Group

Our largest shareholder, DIC, is a majority-owned subsidiary of IDB Development Corporation Ltd., or IDB Development, which in turn is a wholly-owned subsidiary of IDB Holding Corporation Ltd., or IDB, one of Israel's largest business groups. IDB and DIC are public Israeli companies traded on the Tel Aviv Stock Exchange. IDB Development ceased being a public company in 2009 following the acquisitions of all its shares that were held by the public, but its debentures continue to be traded on the TASE. See the footnote to the table under "Item 7.A – Major Shareholders" for information on the holdings in IDB.

Netvision and 013 Netvision, our wholly owned subsidiary and wholly owned indirect company, respectively, incorporated in Israel, are our only significant subsidiaries.

D. PROPERTY, PLANT AND EQUIPMENT

Headquarters

In August 2003, we entered into a long-term agreement for the lease of our headquarters in Netanya, Israel. The leased property covers approximately 57,800 square meters, of which approximately 26,000 square meters consist of underground parking lots. The lease is in effect until December 31, 2019 and is renewable for two additional periods of five years each, upon our notice.

Central Laboratory

In October 2010, we entered into a long-term agreement for the enlargement of our current techno-logistic center, including our new central laboratory, in Netanya, Israel, and the lease thereof. The leased property covers approximately 11,000 square meters. The lease is for a term of ten years from August 2011 and is renewable for an additional period of 5 years, at our option. In case we do not exercise the option we shall be required to pay approximately NIS 11 million.

Netvision Properties

Netvision leases two main properties in Israel: one in Haifa and the other in Rosh-Ha'ayin. Netvision uses these properties for its offices, for its call centers, and for its network servers, as well as for equipment storage and until December 2011, has used them as headquarters as well. The Haifa lease covers approximately 8,900 square meters, is in effect until April 2017, and may be terminated by Netvision in April 2015 subject to prior notice. The Rosh-Ha'ayin lease covers approximately 8,400 square meters, is in effect until

December 2019, may be terminated by Netvision as of May 2013 by written notice and a certain compensation. Netvision intends to sublease part of the property in Rosh-Ha'ayin and is considering its steps regarding the property in Haifa.

Electricity

In December 2010, we entered into an agreement with Ashdod Energy Ltd., expected to construct a private power plant fueled by natural gas in Israel, by the end of 2013. Under the agreement we committed to purchase electricity for the earlier of a period of 15 years from commencement of operations of the power plant or until January 2028, subject to our right to terminate the agreement after 8 years from the commencement of operations of the power plant under certain conditions.

Service centers, points of sale and cell sites

As of December 31, 2011, we leased approximately 75 service centers, points of sale and other facilities (including those operated by our wholly owned dealer), which are used for marketing, sales and customer service. Lease agreements for our retail stores and service centers are generally for periods of two to three years, with extension options that vary by location.

In addition, we lease from various parties, including the Israeli Land Authority, or ILA, municipalities and private entities sites for the establishment, maintenance and operation of cell sites for our cellular network. The duration of these lease agreements varies and ranges, in most cases, from two to five years, with an option to extend the lease for successive similar periods. The lease agreements also differ from each other in aspects such as payment terms and exit windows that enable us to terminate the agreement prior to its scheduled expiration. In some of the agreements, the lessor is entitled to terminate the agreement at any time without cause, subject to prior notice. Based on our past experience, we encounter difficulties in extending the term of approximately 7% of the lease agreements for cell sites, which at times results in our having to pay substantially higher rent in order to remain in the same locations or to find alternative sites.

In addition, Netvision leases a number of points of presence in Israel that are used for equipment and servers storage and storage of operators and other communications equipment for the provision of landline telephony services, and leases storage space for its servers and equipment in New York City, London and Frankfurt.

Authorization agreement with land regulatory authorities

In October 2005, we entered into an authorization agreement with the ILA (which manages the lands of the Development Authority and the Jewish National Fund) that authorizes us to use lands managed by the ILA for the establishment and operation of cell sites. The authorization agreement is effective until December 31, 2009 and the parties have agreed to extend it until December 31, 2010. We are currently negotiating the renewal of the agreement with the ILA, in light of the ILA's demand for increased consideration and we estimate that the agreement will be renewed. Any delay in the renewal of the agreement may cause a delay in the construction of new cell sites on the lands managed by the ILA.

The authorization agreement provides that subject to the receipt of approval from the ILA, we will be entitled to establish and operate cell sites on the lands leased to third parties throughout the agreement's term. In connection with the authorization agreement we

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undertook to vacate at the end of the agreement's term all facilities installed in the authorized area unless the authorization period is extended.

Under the authorization agreement, the ILA is entitled to revoke authorizations granted to us in the event of changes in the designation of the land on which a cell site was erected, in the event that we violate a fundamental condition of the authorization agreement, in the event that the holders of rights in the properties on which we erected cell sites breach the agreements between them and the ILA and in the event that the land on which a cell site was erected is required for public use.

ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following operating and financial review and prospects should be read in conjunction with "Item 3. Key Information – A- Selected Financial Data" and our consolidated financial statements and accompanying notes appearing elsewhere in this annual report. Our financial statements have been prepared in accordance with International Financial Reporting Standards, or IFRS, which differ in certain respects from U.S. Generally Accepted Accounting Principles, or U.S. GAAP. Following our adoption of IFRS, as issued by the IASB, we are no longer required to reconcile our financial statements prepared in accordance with IFRS to U.S. GAAP.

In accordance with the instructions of the Israeli Accounting Standard No. 29, "Adoption of International Financial Reporting Standards (IFRS)", which was published in July 2006, we have adopted IFRS as issued by the IASB, with effect from January 1, 2008, based upon the guidance in IFRS 1, "First-time adoption of IFRSs", and have prepared our financial statements according to IFRS.

This discussion contains forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many important factors, including those set forth under "Item 3. Key Information – D. Risk Factors" and elsewhere in this annual report.

A. OPERATING RESULTS

Overview

General

We are the largest provider of cellular communications services in Israel with approximately 3.349 million cellular subscribers as of December 31, 2011, with an estimated market share of 33.6%.

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We earn revenues and generate our primary sources of cash by offering a broad range of communications services, including cellular, ISP, ILD and landline services. Our cellular services include basic and advanced cellular telephone services, text and multimedia messaging services and advanced cellular content and data services, which we provide through our network covering substantially all of the populated territory of Israel. We also provide international roaming services to our subscribers in 179 countries as of December 31, 2011 as well as to subscribers of foreign networks visiting Israel. We offer our subscribers a wide selection of handsets of various leading global manufacturers as well as extended warranty services. We have an advanced fiber-optic transmission infrastructure of approximately 1,600 kilometers. Together with our complementary microwave-based infrastructure, our fiber-optic infrastructure connects the majority of our cell sites with the remainder connected using supplemental transmission capacity leased from Bezeq, the incumbent landline operator. Having our own transmission network enables us to save substantial operating cash lease costs that would be associated with complete reliance on Bezeq's infrastructure, although these savings are partially offset by maintenance costs and microwave spectrum fees. It also allows us to sell transmission and data services to business customers and telecommunications operators. Following the receipt of our license to provide landline telephone services in Israel in 2006, we began to offer these services and as of February 2008, additional advanced landline services, through our NGN system, to selected landline business customers. Following the acquisition of Netvision in 2011, we are providing internet connectivity and related services (ISP) and landline telephony services consisting mainly of international calling services, operator services, teleconferencing services and landline telephony services.

Our management evaluates our performance through focusing on our key performance indicators, which include among others: number of cellular subscribers, cellular subscribers churn rate, average minutes of usage per cellular subscriber, or MOU, average revenue per cellular subscriber, or ARPU, EBITDA (as defined in "Results of Operations"), operating income and net income. These key performance indicators are primarily affected by the competitive and regulatory landscape in which we operate and our ability to adapt to the challenges posed.

Our competitive landscape is characterized primarily by a highly penetrated cellular market. Competition is intense and attracting new subscribers and retaining existing subscribers has become increasingly difficult and costly. The competition in our market has further increased following the launch of Pelephone's UMTS/HSPA network in 2009 and regulatory and other changes in the market and has increased further following the compulsory reduction of Early Termination Fees in February 1, 2011. We expect competition to intensify further with the expected entry of additional competitors, including additional UMTS operators and MVNOs, and technologies and regulatory changes that would facilitate the entry of such competitors such as the reduction of interconnect tariffs, the reduction of Early Termination Fees and national roaming. Following our acquisition of Netvision, we compete in additional markets, including ISP and ILD services. We expect competition to intensify further following the formation of communications groups in Israel, that are expected to offer bundles of services, which are expected to entail further price erosion, more so if the Bezeq and Hot groups' bundle will include cellular services. Also, the offering of services by the Bezeq and Hot groups at tariffs significantly lower than prevailing market tariffs or at prices which would be below our costs for such services, by cross subsidizing with other services in which they have the capacity to monopolize the market, is expected to increase competition in those markets and lead to further price erosion and possible loss of market share by us. See "Item 3. Key Information – D. Risk Factors - We face intense competition in all aspects of our business" and "Risks Related to our wholly owned subsidiary Netvision - Changes in the regulatory environment could adversely affect Netvision's business" and "Item 4. Information on the Company – B. Business Overview – Competition" and "Netvision – ISP Business - Competition".

We intend to drive revenue growth primarily by: forming a leading Israeli telecommunications group, offering our customers full and comprehensive mobile and wireline solutions, maintaining and enhancing our strong brand; retaining our existing subscribers; increasing our ARPU by offering new services that will complete our offering as a telecommunications group and provide growth engines that are synergetic to our core businesses, as well as growing and developing our mobile data and value added services and wireline services revenues; and attracting new subscribers. In particular, in addition to being an important factor in selecting a cellular provider, we believe that mobile data and other value-added services are a potential growth engine for increasing revenues.

The communications market and specifically the cellular industry are primarily regulated by the Ministry of Communications. See "Item 4. Information on the Company – B. Business Overview - Government Regulations." While our pricing is not generally regulated, certain of our rates and pricing mechanisms are subject to regulation. The annual reduction of interconnect tariffs by the Ministry of Communications between March 2005 and 2008, adversely affected our results and required us to find alternative sources of revenues to compensate for these reductions. The additional reduction of interconnect tariffs, beginning January 1, 2011, (for details see "Item 4. Information on the Company – B. Business Overview – Government Regulations – Tariff Supervision") had a material adverse effect on our results in 2011 and is expected to continue to adversely affect our results in the future. We have taken and intend to continue taking measures to reduce for the expected adverse effects of this tariff reduction, through revenue enhancement as well as cost reduction measures, but cannot assure that these will be successful.

Commencing January 1, 2009, our license prevents us from raising tariffs to non-business customers having an obligation to purchase our services for a predefined period during such period and as of February 2011, we were required to reduce Early Termination Fees to a negligible amount in the cellular market and as of November 2011, cannot charge any Early Termination Fees for other communications services, under an amendment to the Communication Law, which applies to existing as well as new pricing plans. The reduction of Early Termination Fees in the cellular market and the expected entry of additional competitors due to materially increased gross recruitment of subscribers have led to the offering of packages at lower average revenue per minute and resulted in accelerated price erosion, materially increased churn rate and increased acquisition and retention costs due to materially increased gross recruitment rate . Furthermore, these adverse changes were accompanied by materially increased sales of handsets, which caused a decrease in our free cash flow, due to an increase in the immediate payment to vendors for handset purchases, as opposed to spreading the consideration when these handsets are sold to our subscribers (usually in installments over a period of thirty six months). We expect further price erosion following the expected entry of additional competitors, services bundle offering, more so if the Bezeq and Hot groups' bundle will include cellular services and by the offering of services by the Bezeq and Hot groups at tariffs significantly lower than market tariffs, as they have begun offering in February 2012. See additional details under "Item 3. Key Information – D. Risk Factors - We face intense competition in all aspects of our business" and "Risks Related to our wholly owned subsidiary Netvision - Changes in the regulatory environment could adversely affect Netvision's business" and "Item 4. Information on the Company – B. Business Overview – Government Regulations – Tariff Supervision." We took steps to address the effects of these amendments through revenue enhancement as well as cost reduction measures, but cannot assure that these will be successful.

The construction and operation of our cell sites and other transmission facilities are highly regulated and require us to obtain various consents and permits. See "Item 4. Information on the Company – B. Business Overview - Government Regulations—Permits for Cell Site Construction." We have experienced difficulties in obtaining some of these consents and permits, particularly in obtaining building permits for cell sites from local planning and building authorities and as of September 2010, cannot rely on the exemption from obtaining a building permit due to an interim order issued by the Israeli Supreme Court to that effect, except for the replacement of existing radio access devices under certain conditions. Also, we may be operating a significant number of our cell sites in a manner not fully compatible with the building permits issued for them. However, even though 18 criminal and administrative proceedings (with three cell sites subject to a demolition order) are outstanding as of December 31, 2011, we do not expect that the demolition of these facilities would have a material impact on our results of operations and financial condition. Additional restrictions on the construction and operation of cell sites and other facilities may be enacted by amendment to the Non-Ionizing Radiation Law and Regulations. If such restrictions are subsequently adopted, they will, among other things, limit our ability to construct new sites and renew operating permits for many of our existing sites, especially in residential areas, will adversely affect our existing networks and networks build out, specifically in urban areas, and could adversely affect our results of operations. National Zoning Plan 36 is in the process of being revised. If proposed changes are approved, they will harm our ability to construct new cell sites, make the process of obtaining building permits for the construction and operation of cell sites more cumbersome and costly, could adversely affect our existing network, and may delay the future deployment of our network. Moreover, if we are unable to obtain or renew consents and permits or rely on exemptions from obtaining permits for our existing sites or other facilities, we will be required to demolish or relocate these cell sites and facilities. Our inability to relocate cell sites or other facilities in a timely manner and/or our inability to obtain the permits and consents for new cell sites, or rely on exemptions, could adversely affect our existing network resulting in the loss of subscribers, prevent us from meeting the networks coverage and quality requirements contained in our license and adversely impact our networks build-out, all of which may have a material adverse result on our results of operations and financial condition.

Our profitability is also affected by other factors, including changes in our cost of revenues and selling, general and administrative expenses, including depreciation and finance expenses.

Our results are also impacted by currency fluctuations. While substantially all of our revenues are denominated in NIS, for 2011, approximately 39% of cash outflow was denominated in, or linked to, other currencies, mainly U.S. dollars. These payments included capital expenditures, some cell site rental fees and payments for equipment including handset suppliers. Changes to the Israeli CPI, may also impact our results as our debentures (excluding Series E) and some of our expenses are linked to the Israeli CPI. Any devaluation of the NIS against the U.S. dollar or other foreign currencies will therefore increase the NIS cost of our expenses that are not denominated in NIS or are linked to those currencies and any increase in the Israeli CPI will increase the financial expenses associated with our

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debentures. We enter into derivative instruments to mitigate the effect of the various market risks associated with these expenses. See “Item 11 - Quantitative and Qualitative Disclosures About Market Risk.”

Further, from late 2005 we incurred significant debt by issuing debentures, the aggregate outstanding principal amount of which as of December 31, 2011 was NIS 6,035 million. See ““—Liquidity and Capital Resources—— A. Debt Service Public Debentures”.

In February 2006, our Board of Directors adopted a policy to distribute each year at least 75% of our annual net income. Our net income was determined under Israeli GAAP for periods until December 31, 2007 and for periods commencing on or after January 1, 2008, is determined under IFRS, following the adoption of IFRS in accordance with the Israeli Accounting Standard No. 29 “Adoption of International Financial Reporting Standards”. In March 2007, our Board resolved to distribute dividends within the boundaries of the February 2006 dividend policy and until resolved otherwise, on a quarterly basis. In March 2012, in connection with our plans to raise additional debt, we undertook limitations on our dividend distributions. See “Item 8. Financial Information – A. Statements and Other Financial Information - Dividend Policy” and “— B. Liquidity and Capital Resources—Dividend payments.” and "- Debt Service –Shelf Prospectus".

Recent Developments

Acquisition of Netvision Ltd.

On August 31, 2011, we completed the acquisition of 100% of the share capital of Netvision for a total consideration of approximately NIS 1.57 billion ($411 million) pursuant to a merger agreement dated June 15, 2011, by and among our Company, Netvision and a wholly owned subsidiary of our Company, which we formed solely for effecting the merger transaction. Following the consummation of the merger transaction, Netvision became a wholly owned subsidiary of our Company. We funded the acquisition of Netvision through a combination of available cash and issuance of additional debentures from our existing Series D and Series E debenture series on the TASE. The offerings described above were made in Israel to residents of Israel only. For further details, see "Item 5. B – Operating and Financial Review and Prospects – Liquidity and Capital Resources". For Additional details see "Item 4. Information on the Company - Significant Developments During 2011."

Since the acquisition of Netvision's share capital was completed on August 31, 2011, the consolidated results for the year ended December 31, 2011, included elsewhere in this annual report, include Netvision's results for the months of September through December 2011 only.

Revenues

We derive our revenues primarily from the sale of cellular network services (such as airtime), handsets and other services, including content and value added services, extended handset warranties and the provision of transmission and landline services. Revenues from airtime are derived from cellular subscribers originating calls on our network and from interconnect revenues from other operators for calls terminating on our network. Revenues also include roaming charges that we

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bill to our subscribers for the use of the networks of our roaming partners outside Israel, to which we refer as outbound roaming, and charges that we bill to our roaming partners whose subscribers use our network, to which we refer as inbound roaming.

Since the acquisition of Netvision, we also derive our revenues from the provision of internet connectivity and related services (ISP); and provision of telephony services consisting mainly of international calling services, operator services, teleconferencing services and landline telephony services. In addition, Netvision's revenues are also derived from additional business activities such as internet content services and custom internet applications.

Our revenues from cellular services are usually affected by seasonality. The third quarter of the year is usually the strongest quarter with the highest revenues, since it occurs in the summer season, characterized by longer daylight hours (facilitating higher airtime usage) and increased incoming and outgoing tourism (facilitating higher roaming revenues). The fourth quarter of the year is usually the weakest quarter with lower revenues, since the Jewish holiday season, characterized by reduced usage, usually occurs in this quarter, and since it occurs in the fall-winter seasons, characterized by shorter daylight hours (resulting in lower airtime usage).

Cost of revenues

The principal components of our cost of revenues are interconnect fees, the purchase of handsets, accessories, equipment and spare parts, content cost, cell site leasing costs, transmission services cost, the purchase of call minutes related mainly to international call services, outbound roaming services fees, royalty payments to the government of Israel, salaries and network development and maintenance. Our cost of revenues also includes depreciation of the cost of our network equipment and amortization of our spectrum licenses and capitalized handset subsidies. See "—Application of Critical Accounting Policies and Use of Estimates—Long-lived assets - depreciation."

Selling and marketing expenses

Selling and marketing expenses consist primarily of sales force salaries and commissions, advertising, public relations and promotional expenses. We compensate our sales force through salaries and incentives. Our selling and marketing expenses also include depreciation, mainly of leasehold improvements and equipment in our service centers and points of sales and amortization of capitalized sales commissions, as well as amortization of intangible assets related to the acquisition of Netvision.

General and administrative expenses

General and administrative expenses consist primarily of salaries and compensation, professional and consultancy fees, leases and maintenance of our offices, bad debt and doubtful accounts allowance, and other administrative expenses. Our general and administrative expenses also include depreciation and maintenance fees, mainly for our billing and information systems.

Other income and expenses

Other income and expenses consist primarily of capital gains or losses from sale and disposal of capital assets.

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Financing income and expenses

Financing income and expenses consist primarily of interest expense on long-term and short-term loans and interest on our debentures, the interest income component of handset long-term installment sales, the effects of fluctuations in currency exchange rates, Israeli CPI adjustments related to the Israeli CPI-linked debentures and other expenses, and income or losses relating to financial derivative instruments that do not qualify for hedge accounting according to IFRS. Financing income and expenses also include gains and losses from our current investment in tradable securities.

Income Tax

Generally, Israeli companies were subject to Corporate tax on their taxable income at the rate of 25% for the 2010 tax year which decreased to 24% for the 2011 tax year. Israeli companies are subject to capital gains tax at the Corporate tax rate. A deferred tax asset or liability is created for temporary differences between income recognized for tax purposes and for accounting purposes.

In December 2011, the Israeli Income Tax Ordinance was amended following the tax recommendations of the Israeli public committee for socio-economic reform. The amendment includes, among other things, cancelation of the previously scheduled reduction in the corporate tax rate, so that the corporate tax rate will increase to 25% commencing January 1, 2012 and will remain at such rate for future tax years (corporate tax rate for 2011 was 24% and was scheduled to gradually decrease to 18% by 2016). Following this amendment, we incurred a one-time deferred tax expense in the amount of approximately NIS 33 million, as a result of an increase in deferred tax liability.

Results of Operations - Comparison of 2009, 2010 and 2011

The following table sets forth key performance indicators for the periods indicated:

	Year Ended December 31,			Change*	
	2009	2010	2011	2010 vs. 2009	2011 vs. 2010
Subscribers at end of period(1) (in thousands)	3,292	3,394	3,349	3.1 %	(1.3 %)
Period churn rate(1)(2)	19.6 %	20.5 %	25.1 %	0.9pp	4.6pp
Average monthly usage per subscriber (MOU) (in minutes)(1)(3)	331	335	346	1.2 %	3.3 %
Average monthly revenue per subscriber (ARPU) (1)(4) (in NIS)	144	144	106	-	(26.3 %)
Operating income (in NIS millions)	1,768	1,938	1,422	9.6 %	(26.6 %)
Net income (in NIS millions)	1,182	1,291	825	9.2 %	(36.1 %)
EBITDA(5) (in NIS millions)	2,529	2,667	2,167	5.5 %	(18.7 %)
Operating income margin(6)	27.3 %	29.1 %	21.9 %	1.8pp	(7.2)pp
EBITDA margin(7)	39.0 %	40.0 %	33.3 %	1.0pp	(6.7)pp

*pp denotes percentage points and this measure of change is calculated by subtracting the 2009 measure from the 2010 measure and the 2010 measure from the 2011 measure, respectively.

(1) Cellular subscriber data refers to active subscribers. We use a six-month method of calculating our cellular subscriber base, which means that we deduct subscribers from our subscriber base after six months of no revenue

generation or activity on our network by or in relation to both the post-paid and pre-paid subscriber. The six-month method is, to the best of our knowledge, consistent with the methodology used by other cellular providers in Israel. During the fourth quarter of 2011, we have removed approximately 52,000 subscribers from our subscribers base, following the shutdown of our TDMA network as of December 31, 2011, since such subscribers have not requested a transfer to our other networks as of that date, and following a change to our previous policy which allowed subscribers to change from post to prepaid subscription as a result of the reduction of Early Termination Fees in the cellular market in early 2011, as we found this change to be futile since most of those customers ceased using our services. These changes affected other key performance indicators. We have not restated prior subscriber data to conform with these changes.

(2) Churn rate is defined as the total number of voluntary and involuntary permanent deactivations of cellular subscribers in a given period expressed as a percentage of the number of cellular subscribers at the beginning of such period. Involuntary permanent deactivations

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relate to cellular subscribers who have failed to pay their arrears for the period of six consecutive months. Voluntary permanent deactivations relate to cellular subscribers who terminated their use of our services.

(3) Average monthly minutes of use per cellular subscriber (MOU) is calculated by dividing the total billable minutes (of outgoing and incoming cellular calls from other networks, excluding roaming usage) during the month, by the average number of cellular subscribers during such month, and by dividing the sum of such results for all months in the reported period by the number of months in the period.

(4) Average monthly revenue per cellular subscriber (ARPU) is calculated by dividing revenues from cellular services for the period by the average number of cellular subscribers during the period and by dividing the result by the number of months in the period. Revenues from inbound roaming services are included even though the number of subscribers in the equation does not include the users of those roaming services. Inbound roaming services are included because ARPU is meant to capture all service revenues generated by a cellular network, including roaming services. Revenues from sales of extended warranties are included because they represent recurring revenues generated by subscribers, but revenues from sales of handsets, repair services, and other services are not. We, and industry analysts, treat ARPU as a key performance indicator of a cellular operator because it is the closest meaningful measure of the contribution to service revenues made by an average subscriber.

We have set out below the calculation of ARPU for each of the periods presented:

	Year Ended December 31,		
	2009	2010	2011
	(In NIS millions, except number of subscribers and months)		
Revenues	6,483	6,662	6,506
less revenues from equipment sales	751	802	1,747
less other revenues*	162	124	484
Revenues used in ARPU calculation (in NIS millions)	5,570	5,736	4,275
Average number of subscribers	3,215,492	3,322,891	3,361,803
Months during period	12	12	12
ARPU (in NIS, per month)	144	144	106

*Other revenues include revenues from other communication services such as ISP, transmission services and local and international landline services and repair services.

(5) EBITDA is a non-IFRS measure and is defined as income before financing income (expenses), net; other income (expenses), net; income tax; depreciation and amortization; share based payments. We present EBITDA as a supplemental performance measure because we believe that it facilitates operating performance comparisons from period to period and company to company by backing out potential differences caused by variations in capital structure (most particularly affecting our interest expense given our significant debt), tax positions (such as the impact on periods or companies of changes in effective tax rates or net operating losses) and the age of, and depreciation expenses associated with fixed assets. EBITDA should not be considered in isolation or as a substitute for operating income or other statement of operations or cash flow data prepared in accordance with IFRS as a measure of our profitability or liquidity. EBITDA does not take into account our debt service requirements and other commitments, including capital expenditures, and, accordingly, is not necessarily indicative of amounts that may be available for discretionary uses. In addition, EBITDA, as presented in this

annual report, may not be comparable to similarly titled measures reported by other companies due to differences in the way these measures are calculated.

The following is a reconciliation of EBITDA with net income and operating income:

	Year Ended December 31,		
	2009	2010	2011
	(In NIS millions)		
Net income	1,182	1,291	825
Financing expenses, net	219	230	293
Income taxes	367	417	304
Operating income	1,768	1,938	1,422
Other expenses (income), net	6	5	1
Depreciation and amortization	755	724	738
Share based payments	-	-	6
EBITDA	2,529	2,667	2,167

(6)Operating income margin is defined as operating income as a percentage of total revenues for each of the applicable periods.

(7)EBITDA margin is defined as EBITDA as a percentage of total revenues for each of the applicable periods.

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The following table sets forth our selected consolidated statements of operations as a percentage of total revenues from operations for the periods indicated:

	Year Ended December 31,					
	2009		2010		2011	
Revenues	100.0	%	100.0	%	100.0	%
Cost of revenues	51.4	%	49.9	%	52.4	%
Gross profit	48.6	%	50.1	%	47.6	%
Selling and marketing expenses	11.0	%	11.3	%	15.2	%
General and administrative expenses	10.2	%	9.6	%	10.5	%
Other (income) expenses, net	0.1	%	0.1	%	-	
Operating income	27.3	%	29.1	%	21.9	%
Financing expenses, net	3.4	%	3.5	%	4.5	%
Income before income tax	23.9	%	25.6	%	17.4	%
Income tax	5.7	%	6.2	%	4.7	%
Net income	18.2	%	19.4	%	12.7	%

Revenues

	Year Ended December 31,			Change			
				2010 vs.		2011 vs.	
	2009	2010	2011	2009		2010	
	(In NIS millions)						
Revenues	6,483	6,662	6,506	2.8	%	(2.3	%)

The decrease in revenues in 2011 is attributed to a 18.8% decrease in revenues from services as a result of the regulatory changes implemented in early 2011 and the increased competition, which resulted in significant airtime price erosion. The decrease in revenues from services was partially offset by a 117.8% increase in equipment revenues in 2011, as well as by Netvision's revenues (for the period from September through December 2011) in the amount of NIS 374 million (excluding inter-company revenues), which are consolidated for the first time.

The increase in revenues in 2010 was mainly due to a 26% increase in revenues from content and value added services (including SMS), an increase in revenues from landline services as well as an increase in roaming revenues. The increase in revenues has also resulted from a 6.8% increase in equipment revenues. These increases were partially offset by a decrease in revenues from domestic voice services, mainly due to the ongoing airtime price erosion, and by a one-time provision for a refund to all our subscribers in a total amount of approximately NIS 66 million ($19 million) related to a major network malfunction we experienced in December 2010.

The following table sets forth the breakdown of our revenues for the periods indicated based on the various sources thereof:

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	* 2009		* 2010		2011	
	Revenues (NIS in millions)	% of Total Revenues	Revenues (NIS in millions)	% of Total Revenues	Revenues (NIS in millions)	% of Total Revenues
Cellular voice services:						
Outgoing air time**	2,953	45.5 %	2,760	41.4 %	2,167	33.3 %
Incoming air time	1,178	18.2 %	1,272	19.1 %	398	6.1 %
Roaming	340	5.3 %	358	5.4 %	314	4.8 %
Total cellular voice services	4,471	69.0 %	4,391	65.9 %	2,879	44.2 %
Cellular content and value added services***	882	13.6 %	1,112	16.7 %	1,167	17.9 %
Internet services (ISP)	-	-	-	-	216	3.3 %
International long distance services	-	-	-	-	96	1.5 %
Other services****	379	5.8 %	357	5.4 %	401	6.2 %
Total services	5,732	88.4 %	5,860	88.0 %	4,759	73.1 %
Equipment	751	11.6 %	802	12.0 %	1,747	26.9 %
Total	6,483	100.0 %	6,662	100.0 %	6,506	100.0 %

*Reclassified (mainly reclassification of fixed monthly subscription fees from other services to outgoing air time)

**Including air time packages, interconnect fees and fixed monthly subscription fees.

*** Consists of content services, text messages and data services.

**** Consists of extended warranty fees, transmission services, landline services and others.

During 2011, revenues from services (comprising 73.1% of total revenues) decreased by approximately 19%, compared with 2010. This decrease in revenues from services resulted mainly from a significant decrease in interconnect fees paid to us by other local operators, due to the reduction in interconnect tariffs as of January 1, 2011 and the reduction in Early Termination Fees due to the regulatory changes, as well as from the ongoing airtime price erosion, due to the increased competition in the market. These decreases were partially offset by an increase of 4.9% in cellular content and value added services revenues in 2011, as well as by Netvision's revenues from services (for the period from September 1 through December 31, 2011) in the amount of NIS 339 million (excluding inter-company revenues), which are consolidated for the first time.

During 2010, revenues from services (comprising 88.0% of total revenues) increased by approximately 2%, compared with 2009. This increase in revenues from services resulted mainly from an increase in our subscriber base of approximately 3.1% (mainly among post-paid subscribers), an increase in revenues from cellular content and value added services, as well as an increase in revenues from landline services and roaming services. These increases were partially offset by the ongoing airtime price erosion and the one-time provision for a refund to all our subscribers related to a major network malfunction we experienced in December 2010.

During 2010 and 2011, revenues from cellular content and value added services increased by approximately 26% and 5%, respectively compared with the previous respective years, mainly as a result of the growth in content services and sales of data packages, which is significantly attributable to the growth of our 3G cellular subscriber base. As a percentage of service revenues (excluding Netvision's service revenues), revenues from cellular content and value added services increased from 15.4% in 2009 to 19% in 2010 and to 26.4% in 2011, and as percentage of total revenues (excluding Netvision's revenues), from 13.6% in 2009 to 16.7% in 2010 and 19% in 2011.

During 2011, revenues from other services increased by 12.3%, compared with 2010. This increase resulted mainly from the one-time provision recorded in the fourth quarter of 2010 for a refund in the total amount of NIS 66 million to all our subscribers related to a major network malfunction we experienced in December 2010, which was partially offset by a decrease in fixed monthly subscription fees. As a percentage of total revenues, revenues from other services increased to 6.2% in 2011 from 5.4% in 2010.

During 2010, revenues from other services decreased by 5.8%, compared with 2009. This decrease resulted mainly from a decrease in fixed monthly subscription fees and the one-

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time provision for a refund in the total amount of NIS 66 million to all our subscribers related to a major network malfunction we experienced in December 2010, which was partially offset by an increase in revenues from landline services and extended warranty. As a percentage of total revenues, revenues from other services decreased to 5.4% in 2010 from 5.8% in 2009.

During 2011, equipment revenues (comprising 26.9% of total revenues) increased by 117.8% compared with 2010. This increase in equipment revenues resulted from an increase in the number of cellular handsets sold during 2011 compared to 2010, as well as from a change in the mix of handsets sold, in favor of smartphones and advanced 3G handsets. The increase in the number of handsets sold resulted from the accelerated competition following the regulatory changes. The increase in equipment revenues also resulted from an increase in accessories sales in 2011 compared to 2010. Netvision's equipment revenues (for the period from September 1 through December 31, 2011) in the amount of NIS 35 million, which are consolidated for the first time, also contributed to the increase in equipment revenues.

During 2010, equipment revenues (comprising 12% of total revenues) increased by 6.8% compared with 2009. This increase primarily resulted from an increase in the average handset sale price, an increase in accessories sales, following the acquisition of Dynamica's operation, as well as an increase in the amount of modems and laptops sold during the year compared with 2009. These increases were partially offset by a decrease in the total amount of handsets sold during 2010 compared with 2009.

The following table sets forth the breakdown of our revenues for the periods indicated based on the types of subscribers:

	2009		2010		2011	
	Revenues (NIS in millions)	% of Total Revenues	Revenues (NIS in millions)	% of Total Revenues	Revenues (NIS in millions)	% of Total Revenues
Individual	4,775	73.7 %	4,917	73.8 %	4,727	72.7 %
Business	1,622	25.0 %	1,649	24.8 %	1,686	25.9 %
Other*	86	1.3 %	96	1.4 %	93	1.4 %
Total	6,483	100.0 %	6,662	100.0 %	6,506	100.0 %

* Consists of revenues from inbound roaming services and other services.

A breakdown of revenues according to types of subscribers (individual and business) during 2011 shows an approximately 3.9% decrease, compared with 2010, in revenues attributable to individual subscribers, which resulted mainly from a decrease in revenues attributed to the significant decrease in interconnect fees paid to us by other local operators, due to the reduction in interconnect tariffs as of January 1, 2011, as a result of the reduction of cellular Early Termination Fees, as well as from the ongoing price erosion, which was partially offset by increased usage and by Netvision's revenues, which are consolidated for the first time. Revenues attributable to business subscribers increased in 2011 by 2.2%, compared with 2010, mainly due to Netvision's revenues from business customers, which are consolidated for the first time. This increase in revenues attributable to business customers was partially offset by the decrease in interconnect fees and the ongoing price erosion. Other revenues decreased 3.1% in 2011 compared with 2010, mainly due to a decrease in revenues from inbound roaming services.

A breakdown of revenues according to types of subscribers (individual and business) during 2010 shows an approximately 3% increase, compared with 2009, in revenues

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attributable to individual subscribers, which resulted mainly from a higher subscriber base and increased usage. Revenues attributable to business subscribers increased in 2010 by 2%, compared with 2009, mainly as a result of an increase in landline services. Other revenues increased 7% in 2010 compared with 2009, mainly due to an increase in revenues from inbound roaming services, which resulted from an improvement in incoming tourism.

The following table sets forth the breakdown of our revenues for the periods indicated based on the types of subscription plans:

	2009		2010		2011	
	Revenues (NIS in millions)	% of Total Revenues	Revenues (NIS in millions)	% of Total Revenues	Revenues (NIS in millions)	% of Total Revenues
Pre-paid	657	10.1 %	675	10.1 %	488	7.5 %
Post-paid	5,741	88.6 %	5,891	88.5 %	5,925	91.1 %
Other*	86	1.3 %	96	1.4 %	93	1.4 %
Total	6,483	100.0 %	6,662	100.0 %	6,506	100.0 %

* Consists of revenues from inbound roaming services and other services.

A breakdown of revenues according to types of subscription plans (pre-paid and post-paid) shows that the decrease in revenues in 2011 compared with 2010 resulted mainly from pre-paid subscribers. This decrease was primarily the result of the significant decrease in interconnect fees paid to us by other local operators, due to the reduction in interconnect tariffs as of January 1, 2011. The increase in revenues attributed to post-paid subscribers was mainly due to an increase in revenues from equipment sales and due to Netvision's revenues from post-paid customers, which are consolidated for the first time. These increases were partially offset by the significant decrease in interconnect fees, the reduction of cellular Early Termination Fees, as well as by the ongoing airtime price erosion, due to the increased competition in the market.

A breakdown of revenues according to types of subscription plans (pre-paid and post-paid) shows that the increase in revenues in 2010 compared with 2009 resulted mainly from post-paid subscribers. This increase was primarily the result of an increase in usage of content and value-added services and in landline services, as well as from the expansion of our subscriber base. The revenues attributed to both pre-paid and post-paid subscribers also benefited from an increase in revenues from equipment sales.

Cost of revenues and gross profit

	Year Ended December 31,			Change	
	2009	2010	2011	2010 vs. 2009	2011 vs. 2010
		(In NIS millions)			
Cost of revenues-services	2,643	2,671	2,126	1.1 %	(20.4 %)
Cost of revenues-equipment	690	651	1,282	(5.7 %)	96.9 %
Total cost of revenues	3,333	3,322	3,408	(0.3 %)	2.6 %
Gross profit	3,150	3,340	3,098	6.0 %	(7.2 %)

The decrease in services cost of revenues in 2011 compared with 2010, resulted from a significant decrease in total interconnect fees paid to other local cellular operators following the reduction in interconnect tariffs as of January 1, 2011. The decrease in services cost of revenues also resulted from a decrease in depreciation and amortization expenses. These decreases were partially offset by Netvision's services cost of revenues (for the period from

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September 1 through December 31, 2011) in the amount of NIS 237 million (excluding inter-company expenses), which is consolidated for the first time.

The increase in services cost of revenues in 2010 compared with 2009, resulted mainly from an increase in interconnect fees due to an increase in the number of outgoing calls completed in other operators' networks and an increase in cost of content and value-added services due to increased usage. These increases were partially offset mainly by a decrease in roaming related expenses due to improved roaming agreements with foreign operators, in depreciation expenses and in royalties paid to the Ministry of Communications resulting from a decline in the royalties' rate. The increases were also offset in part by a decrease in the cost of handsets repair services due to a more efficient handsets repair process, and by the reversal of a one-time provision, which was recorded in 2009, in the amount of NIS 15 million related to a dispute with the Ministry of Communications regarding frequencies fees, following the Israeli Supreme Court's ruling in our favor in that matter.

The increase in equipment cost of revenues in 2011 compared with 2010, resulted primarily from a significant increase in cellular handsets cost resulted mainly from an increase in the number of handsets sold during 2011 compared with 2010, as well as from a change in the mix of handsets sold, in favor of smartphones and advanced 3G handsets. Netvision's equipment cost of revenues (for the period from September 1 through December 31, 2011) in the amount of NIS 27 million, which is consolidated for the first time, also contributed to the increase in equipment cost of revenues.

The decrease in equipment cost of revenues in 2010 compared with 2009, resulted primarily from a decrease in the average handset cost due to, among others, increased efficiency in handsets purchase, as well as a decrease in the total amount of handsets sold during 2010 compared with 2009.

The decrease in gross profit in 2011 compared with 2010, resulted mainly from the significant decrease in interconnect fees paid to us by other local operators, the reduction of cellular Early Termination Fess, and the ongoing price erosion, which was partially offset by increased handsets sales.

The increase in gross profit in 2010 compared with 2009, resulted mainly from increases in revenues from content and value added services and in revenues from landline services. The increase also benefited from an increase in the profitability of handsets sales. These increases were partially offset by the ongoing airtime price erosion.

Selling and marketing expenses and general and administrative expenses

	Year Ended December 31,			Change	
	2009	2010	2011	2010 vs. 2009	2011 vs. 2010
	(In NIS millions)				
Selling and marketing expenses	716	756	990	5.6 %	31.0 %
General and administrative expenses	660	641	685	(2.9 %)	6.9 %
Total	1,376	1,397	1,675	1.5 %	19.9 %

The increase in selling and marketing expenses in 2011 compared with 2010, reflects primarily the impact of the regulatory changes, resulting in an increase in the number of customers' queries to our sales and service centers, which led to an increase in our sales and customer service force leading to an increase in payroll expenses, as well as an increase in sales commissions. The increase in sales commissions also resulted from an increase in the

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number of sales transactions in 2011 compared with 2010. Netvision's selling and marketing expenses (for the period from September 1 through December 31, 2011) in the amount of NIS 79 million, which are consolidated for the first time, also contributed to the increase in selling and marketing expenses. These increases were partially offset by a decrease in amortization expenses related to capitalized sales commissions resulted from ceasing the capitalization of these commissions due to the absence of the required accounting conditions for such capitalization, following the regulatory change in relation to the reduction of Early Termination Fees.

The increase in selling and marketing expenses in 2010 compared with 2009, primarily resulted from an increase in our sales and customer service workforce, due to, among others, the acquisition of Dynamica's operation, one of our major dealers, which led to an increase in payroll expenses and rent expenses. These increases were partially offset by a decrease in sales commissions, due to the acquisition of Dynamica's operation, and in advertising expenses.

The increase in general and administrative expenses in 2011 compared with 2010, primarily resulted from Netvision's general and administrative expenses (for the period from September 1 through December 31, 2011) in the amount of NIS 34 million, which are consolidated for the first time, as well as from an increase in consulting expenses related to the merger of Netvision. These increases were partially offset by a decrease in bad debts and doubtful accounts expenses.

The decrease in general and administrative expenses in 2010 compared with 2009, primarily resulted from a decrease in depreciation and amortization expenses, mainly related to software and information systems, which was partially offset by an increase in allowance for doubtful accounts.

Other income (expenses), net

	Year Ended December 31,		
	2009	2010	2011
	(In NIS millions)		
Other expenses, net	6	5	1

Other expenses in 2009, 2010 and 2011 consisted mainly of capital losses which resulted from deletion of certain equipment items.

Financing expenses, net

	Year Ended December 31,		
	2009	2010	2011
	(In NIS millions)		
Financing expenses	(370)	(336)	(409)
Financing income	151	106	116
Financing expenses, net	(219)	(230)	(293)

Financing Expenses, net, for 2011 increased 27.4% compared with 2010. The increase resulted mainly from increased interest expenses and Israeli Consumer Price Index (CPI) linkage expenses, associated with the Company's debentures, in 2011, compared with 2010, due to the higher debt level following the issuance of additional debentures in 2011. The increase in financing expenses, net, also resulted from an increase in losses from expenses in 2011 from foreign currency exchange differences related to trade payables, which resulted

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from a depreciation of 7.7% of the NIS against the US dollar, compared to income from foreign currency exchange differences in 2010, which resulted from an appreciation of 6% of the NIS against the US dollar in that year. These increases were partially offset by an increase in interest income, associated with handsets sales, as well as an increase in deposit interest income in 2011 compared with 2010, due to higher deposits balance and increased interest rate.

Financing expenses, net, for 2010 increased 5% compared with 2009. The increase was primarily due to losses from our hedging portfolio, compared with gains from this hedging portfolio in 2009: (1) a loss from currency hedging transactions in 2010 due to a 6% appreciation of the NIS against the US dollar in 2010 compared with only 0.7% appreciation in 2009; (2) a loss from Israeli Consumer Price Index (CPI) hedging transactions in 2010 due to decreased inflation. The increase in financing expenses, net, was partially offset by a decrease in CPI linkage expenses associated with our CPI linked debentures due to the decreased inflation rate of 2.3% in 2010 compared with 3.8% in 2009, as well as by a net gain on our current investment in publicly traded debt securities in 2010. The increase was also offset in part by a one-time financing income in the amount of approximately NIS 12 million recorded in the fourth quarter of 2010, related to a dispute with the Ministry of Communications regarding frequencies fees, following the Israeli Supreme Court's ruling in our favor in that matter.

Interest and CPI linkage expenses associated with the principal amount of the debentures incurred during 2009, 2010 and 2011 were approximately NIS 370 million, NIS 310 million and NIS 377 million, respectively.

Income tax

Year Ended December 31,		Change
2009	2010	