INTERNET GOLD GOLDEN LINES LTD
Form 20-F
June 30, 2011

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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, 2010

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________

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: 0-30198

INTERNET GOLD – GOLDEN LINES LTD.
(Exact name of Registrant as specified in its charter
and translation of Registrant's name into English)

Israel
(Jurisdiction of incorporation or organization)

2 Dov Friedman Street, Ramat Gan 52503, Israel
(Address of principal executive offices)

Doron Turgeman, +972-3-9240000 (phone), +972-3-9399832 (fax)
2 Dov Friedman Street, Ramat Gan 52503, 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, NIS 0.01 Par Value	NASDAQ Global Select Market

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

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:

Ordinary Shares, par value NIS 0.01 per share ……………19,179,151 (as of December 31, 2010)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes o   No x

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 o   No x

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.

Yes x   No o

Indicate by check mark whether the registrant 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 o   No o

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 o	Accelerated filer x	Non-accelerated filer o

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

U.S. GAAP o	International Financial Reporting Standards as issued by the International Accounting Standards Board x	Other o

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

Item 17 o   Item 18 o

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 o   No x

INTRODUCTION

We are a leading communications group in Israel. Our shares are listed on the NASDAQ Global Select Market and on the Tel Aviv Stock Exchange, or TASE. Our subsidiaries are B Communications Ltd. (formerly known as 012 Smile.Communications Ltd.) and GoldMind Ltd. (formerly known as Smile.Media Ltd.). As used in this annual report, the terms "we," "us" and "our" mean Internet Gold - Golden Lines Ltd. and its subsidiaries, "B Communications" means B Communications Ltd., "GoldMind" means GoldMind Ltd., "Eurocom Communications" means Eurocom Communications Ltd., "Bezeq" means Bezeq The Israel Telecommunications Corp., Ltd.; "Pelephone" means Pelephone Communications Ltd., "Bezeq International" means Bezeq International Ltd. and "DBS" or "YES" (the trade name for DBS) means DBS Satellite Service (1998) Ltd.

On April 14, 2010, our principal subsidiary, B Communications, completed the acquisition of the controlling 30.44% interest in Bezeq (TASE:BZEQ), Israel's largest telecommunications provider, from Ap.Sb.Ar. Holdings Ltd. (a consortium of Apax Partners, Saban Capital Group and Arkin Communications), for an aggregate cash purchase price of approximately NIS 6.5 billion (approximately $1.83 billion). In accordance with the terms of the transaction, effective as of the closing of the acquisition, B Communications designated seven directors to replace the Apax-Saban-Arkin Group's representatives on Bezeq's Board of Directors, which numbers 13 directors. We began consolidating Bezeq's financial results into our financial statements effective as of the closing of the acquisition. On March 14, 2011, B Communications purchased an additional 14,590,000 ordinary shares of Bezeq at NIS 10.1716 per share, further increasing its ownership interest in Bezeq to 31.37% of its outstanding shares (30.14% on a fully diluted basis). As of June 30, 2011, B Communications ownership interest in Bezeq declined to 31.23% due to Bezeq employee option exercises.

Prior to January 2010, B Communications offered a wide range of broadband and traditional voice services in Israel, which we refer to in this annual report as the legacy communications business. As part of its acquisition of the controlling interest in Bezeq, on November 16, 2009, B Communications entered into an agreement to sell its legacy communications business (excluding certain retained indebtedness and liabilities) to a wholly-owned subsidiary of Ampal-American Israel Corporation (NASDAQ: AMPL), or Ampal, for NIS 1.2 billion (approximately $338 million). The sale of B Communications' legacy communications business to Ampal was completed on January 31, 2010, effective as of January 1, 2010.

B Communications changed its name from 012 Smile.Communications Ltd. to B Communications Ltd. on March 16, 2010 in connection with its acquisition of the controlling interest in Bezeq. B Communications' ordinary shares are listed on the NASDAQ Global Select Market (symbol: BCOM) and on the TASE. We currently own 78.11% of the ordinary shares of B Communications.

Effective as of January 1, 2009, we adopted International Financial Reporting Standards, IFRS, as issued by the International Accounting Standards Board, or the IASB, replacing the previous reporting standard which was generally accepted accounting principles in the United States, or U.S. GAAP. Accordingly, beginning January 1, 2009, we prepare our consolidated financial data according to IFRS as issued by the IASB. Our transition date to IFRS under First Time Adoption of International Financial Reporting Standards is January 1, 2008. Comparative data of our financial statements has been restated to retrospectively reflect the adoption of IFRS. Our consolidated financial statements appearing in this annual report are prepared in New Israeli Shekels, or NIS, and are translated into U.S. dollars at the representative rate of exchange at December 31, 2010 (NIS 3.549 = $1.00). The dollar amounts so presented should not be construed as representing amounts receivable, payable or incurred in dollars or convertible into dollars. All references in this annual report to "dollars" or "$" are to U.S. dollars and all references in this annual report to "NIS" are to New Israeli Shekels.

Statements made in this annual report concerning the contents of any contract, agreement or other document are summaries of such contracts, agreements or documents and are not complete descriptions of all of their terms. If we filed any of these documents as an exhibit to this annual report or to any registration statement or annual report that we previously filed, you may read the document itself for a complete description of its terms.

Except for the historical information contained in this annual report, the statements contained in this annual report are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995, as amended, with respect to our business, financial condition and results of operations. Such forward-looking statements reflect our current view with respect to future events and financial results. We urge you to consider that statements which use the terms "anticipate," "believe," "do not believe," "expect," "plan," "intend," "estimate," "anticipate" and similar expressions are intended to identify forward-looking statements. We remind readers that forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any future results, performance, levels of activity, or our achievements expressed or implied by such forward-looking statements. Such forward-looking statements are also included in Item 4 – "Information on the Company" and Item 5 – "Operating and Financial Review and Prospects." Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Except as required by applicable law, including the securities laws of the United States, we undertake no obligation to publicly release any update or revision to any forward-looking statements to reflect new information, future events or circumstances, or otherwise after the date hereof. We have attempted to identify significant uncertainties and other factors affecting forward-looking statements in the Risk Factors section that appears in Item 3.D. "Key Information - Risk Factors."

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PART I

ITEM 1.IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2.OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3.KEY INFORMATION

A. Selected Financial Data

For the years ended December 31, 2008, 2009, and 2010 we have prepared our consolidated financial statements in accordance with the International Financial Reporting Standards, or IFRS, as issued by the International Accounting Standards Board, or IASB.

For periods prior to December 31, 2007, our consolidated financial statements were prepared in accordance with accounting principles generally accepted in Israel, or Israeli GAAP with reconciliation to accounting principles generally accepted in the United States, or U.S. GAAP. Effective as of January 1, 2008, we prepared our consolidated financial statements in accordance with U.S. GAAP. We have therefore restated our consolidated financial information at and for the year ended December 31, 2008, in accordance with IFRS 1, on "First Time Adoption of IFRS," and financial information set forth in this annual report for the year ended December 31, 2008, may differ from information previously published.

IFRS

The tables below at and for the years ended December 31, 2008, 2009 and 2010 set forth selected consolidated financial data under IFRS, which is derived from our audited consolidated financial statements. The audited consolidated financial statements as of December 31, 2009 and 2010 and for the years ended December 31, 2008, 2009 and 2010 appear in this annual report.

Statement of Income Data:

	Year Ended December 31,			
	2008	2009	2010	2010
	(NIS in millions, except shares and per share data)			(US$ in thousands, except share and per share data)
Revenues	1,167	1,243	8,732	2,461
Depreciation and amortization	117	98	2,295	647
Salaries	184	171	1,500	423
General and operating expenses	741	811	3,711	1,045
Other operating expenses (income),net	(6)	2	(3)	(1)
	1,037	1,083	7,503	2,114

Operating income	130	160	1,229	347
Finance expense	139	134	716	202
Finance income	(27)	(132)	(327)	(92)
Finance expense, net	112	2	389	110
Income after financing expenses	18	158	840	237
Share of losses in equity-accounted investees	-	-	235	66
Income before income tax	18	158	605	171
Income tax	22	58	385	108
Income (loss) for the year	(4)	100	220	63
Income (loss) attributable to owners of the Company	(18)	62	(209)	(59)
Income (loss) attributable to non-controlling interest	14	38	429	122
Net income (loss) for the year	(4)	100	220	63
Basic earnings (loss) per share	(0.85)	3.39	(11.11)	(3.13)
Diluted earnings (loss) per share	(0.89)	3.39	(11.23)	(3.16)

Statements of Financial Position Data:

	As at December 31,			
	2008	2009	2010	2010
		(NIS in millions)		(US$ in thousands)
Cash and cash equivalents	86	1,350	404	114
Total assets	1,901	2,846	24,320	6,852
Total current liabilities	424	1,009	4,305	2,214
Total non-current liabilities	885	1,144	12,304	3,466

U.S. GAAP:

The table below for the years ended December 31, 2007 and 2006 sets forth selected consolidated financial information under U.S. GAAP, which has been derived from our previously published audited consolidated financial statements for the years ending on such dates.

Statement of Income Data:

	Year Ended December 31,	
	2006	2007
	(NIS in millions, except share and per share data)	
Operating expenses:		
Cost of revenues	252	802
Selling and marketing	76	176
General and administrative	34	70
Impairment and other expenses, net	13	15
Total operating expenses	375	1,063
Operating income	34	113
Financial expenses, net	21	58
Gain from issuance of shares in a subsidiary	–	120
Income before income taxes	13	176
Income tax expenses	1	50
Income after income tax	11	125
Minority share in income	*	(1)
Company’s share in net loss of investees from continued operations	*	–
Net income	11	124
Earnings per ordinary share - basic		
Net income per share	0.60	5.74
Weighted average number of shares used in the calculation	18,438	21,617
Earnings per ordinary share - diluted	0.60	5.44
Weighted average number of shares used in the calculation	18,438	24,795

* Represents an amount less than NIS 1 million

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Exchange Rate Information

The following table sets forth, for the periods and dates indicated, certain information regarding the Bank of Israel representative rate of exchange for dollars, expressed in NIS per one dollar. The representative rate is the average between the buying rate and the selling rate of exchange. We do not use such rates in the preparation of our consolidated financial statements included elsewhere herein. See Note 2 to the consolidated financial statements included elsewhere in this Form 20-F.

Period	Average	High	Low	At Period Ended
Year ended December 31, 2006	4.453	4.725	4.176	4.225
Year ended December 31, 2007	4.110	4.342	3.830	3.846
Year ended December 31, 2008	3.586	4.022	3.230	3.802
Year ended December 31, 2009	3.923	4.256	3.690	3.775
Year ended December 31, 2010	3.723	3.894	3.549	3.549

Period	High	Low
January 2011	3.710	3.528
February 2011	3.713	3.602
March 2011	3.635	3.481
April 2011	3.473	3.395
May 2011	3.538	3.377
June 2011 (through June 29)	3,485	3.363

On June 29, 2011, the representative rate of exchange was NIS 3.4260 = $1.00 as published by the Bank of Israel.

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D.RiskFactors

Risks Related to the Business of Bezeq

Investing in our ordinary shares involves a high degree of risk and uncertainty. You should carefully consider the risks and uncertainties described below before investing in our ordinary shares. If any of the following risks actually occurs, our business, prospects, financial condition and results of operations could be harmed. In that case, the value of our ordinary shares could decline, and you could lose all or part of your investment.

Bezeq's competition from other telecommunications providers, and potential changes in the competitive environment and communications technologies, could adversely affect its business and our results of operations.

Competition in the voice, cellular and Internet services markets in Israel is intensifying. The main characteristic of market competition in 2010 was the continued consolidation of communication groups and their offering comprehensive service packages and products. As reflected in the following table, four main groups, consisting of companies under common or joint control, operate in the communications market in Israel today: the Bezeq Group, the IDB group, Partner Communications Company Ltd., or Partner, and HOT Telecom, or HOT, a cable communications company and together with Mirs Ltd., the HOT-Mirs Group.

Type of Activity	Bezeq	IDB	Partner	Hot – Mirs
Cellular telephony	Pelephone	Cellcom	Partner	Mirs
Fixed-line telephony	Bezeq	Cellcom Netvision	Partner/012 Smile	HOT Telecom
Internet infrastructure	Bezeq/ Pelephone	Cellcom	Partner	HOT Telecom
Internet access (ISP)	Bezeq International	Cellcom Netvision	Partner/012 Smile	HOT-Net
International calls	Bezeq International	Netvision	012 Smile	-
Multi-channel television	(DBS)	-	-	HOT Broadcasts

While in the past the competition in the communications market was mainly among independent communications services providers in each segment separately, more recently and especially in the last year, the trend has reflected increased competition among communications groups. In some cases, the groups operate on the basis of marketing cooperation among the various communications providers in the group so as to provide full communications services, utilizing the marketing and operational advantage inherent in such a structure, while in other cases where there is no cooperation of this kind at present, there is likely to be cooperation in the future in view of the control links between the companies and the changing regulatory policy affecting the industry.

Another recent development is an increase in the consumption of "service packages" (packages containing various communications services such as telephony, Internet and broadcast services). This trend is strengthening with the transition to technologies based on IP protocol, which promotes technology convergence between the different communications systems and with the start of penetration of integrated products enabling various communications solutions on the same communications device (e.g. cellular and fixed-line telephony services in one handset). Communications groups market, or are likely to market in the future, joint service packages consisting of different communications services of the companies in each group. As a rule, the marketing of the joint service packages enables the communications group to offer its customers tariffs that are more attractive than purchasing each service separately (in some cases with "cross-subsidization" among the basket's components), and a comprehensive solution that does away with the need to subscribe to a number of different providers.

We believe that the Bezeq Group is subject to stricter limitations than those which apply to the other communications groups, including among other things structural separation limitations and a limitation on marketing "joint" service packages.

On March 2011, a committee appointed by the Israeli Ministers of Communications and Finance, the Hayek Committee, published its preliminary recommendations for public comments. The Hayek Committee's recommendations relate to an array of fields in the Israeli Communications market. The final recommendations of the Hayek Committee, if adopted, may have a significant influence on competition in the markets in which the Bezeq Group operates.

In September 2010, the Ministry of Communications published a tender for the grant of frequencies and a license for new cellular operators that will own infrastructure. Existing operators (other than Mirs), as well as their affiliates, were forbidden to bid in the tender. The tender includes various benefits for the winner, the purpose of which is to promote competition, remove barriers and to ease the entry of another operator.

In April 2011 Mirs Communication Ltd. (of the HOT-Mirs Group) and Marathon Telecommunications Ltd. (of the Xfone Group) won tenders for the grant of frequencies and a license for cellular operators that will own infrastructure. In May 2011, after Marathon Telecommunications. failed to timely submit the requisite guarantee, it's selection as a winner in the tender was revoked by the tender committee and the next runner-up, the Select Group, was declared the second winner in the tender. Under the terms of the tender, the new operators will be able to launch their operation after deploying a cellular network which initially will cover 10% of the population of Israel. After the deployment, the new operators will be able to use the networks of the existing operators for a period of seven years (with an extension option subject to approval for up to a further three years) based on a national roaming model. Pelephone anticipates that the entry of the new operators will intensify competition in the cellular market.

Another characteristic of market competition in 2010 was the continued actions to promote the entry of mobile virtual network operators, or MVNOs, into Israel’s cellular market. On January 20, 2010, the Minister of Communications signed regulations allowing the grant of MVNO licenses. MVNO licenses were recently granted to a number of companies and applications have been submitted to the Ministry of Communications by other companies for receipt of such licenses. Pelephone signed agreements with two MVNOs that will enable the MVNOs to use Pelephone’s infrastructure and network in order to service the MVNO’s customers and operation.

Competition in the communications market could also be affected by the reduction of cellular network interconnect tariffs. During the first quarter of 2011, the reduction in interconnect fees resulted in a reduction of approximately NIS 350 million ($99 million) in revenues which was offset in part by a reduction of approximately NIS 287 million ($81 million) of expenses. Bezeq is unable at this time to assess the long-term impact of the reduction in interconnect tariffs.

Bezeq operates in a highly regulated telecommunications market which limits its flexibility in managing its business and may materially and adversely affect our results of operations.

Bezeq operates in a highly regulated industry in Israel, which limits its flexibility in managing its business, mainly with respect to the land-line market. Bezeq is subject to government supervision and regulation relating to, among other things, licensing for activity, determining permitted areas of activity, determining tariffs, operation, competition, environment, payment of royalties, obligation to provide universal service, ability to hold its shares, relationships between Bezeq and its subsidiaries and prohibition to terminate or restrict its services (which may force Bezeq to provide services even when not economically feasible). This supervision and regulation at times lead to the intervention of the State of Israel. Bezeq’s business and operations could be adversely affected by decisions by regulators, in particular the Ministry of Communications as well as changes in laws, regulations or government policy affecting its business activities. Further risks and uncertainties result from the fact that changes in such laws, regulations or government policies may not be adopted or implemented in the manner that Bezeq expects and may be further amended, interpreted or enforced in an unexpected manner or in a manner adverse to Bezeq’s business and results of operations

Bezeq may face difficulties in obtaining some of the building and environmental permits required for the establishment and operation of its network sites, which could have an adverse effect on the coverage, quality and capacity of its network.

Bezeq, mainly with respect to its cellular operations through Pelephone, is subject to the Israeli Non-Ionizing Radiation Law, 5766-2006, which regulates the emission of electromagnetic radiation from broadcast facilities. Pelephone is currently working to obtain permits to set up and operate its various broadcasting installations; however, the policies maintained by the various relevant entities and amendments to applicable statutes and standards could adversely impact the infrastructure of such installations and the regularity of the services using the infrastructure. As a result, Bezeq’s revenues from these services could be adversely affected.

In addition, the establishment and operation of cellular antennas are subject to building permits from various planning and building committees, a process that involves a number of approvals from Israeli state entities and regulatory bodies. The foregoing may impair the quality and capacity of Bezeq's and Pelephone's existing networks and the deployment of new networks.

Actual and alleged health risks related to cellular network sites and mobile telecommunication devices could have a material adverse effect on our business, operations and financial condition.

Cellular network sites, handsets and accessories are known to be sources of non-ionizing radiation emissions. Pelephone takes steps to ensure that the levels of radiation emitted by these transmission facilities, equipment and devices do not exceed the levels of radiation permitted in the directives of the Israeli Ministry of Environment Protection (levels adopted in accordance with international standards). However, health risks may be found to exist and transmission sites or devices and equipment may emit more radiation than that allowed in radiation standards, causing a risk to health, which may have an adverse effect on our business and could result in a reduction in the use of cellular services, difficulty in renting sites, claims for physical and property damages in substantial amounts and attempts to exercise the deeds of indemnity that Pelephone deposited with the planning authorities pursuant to the Planning and Building Law. Pelephone’s third-party liability policy does not currently cover electromagnetic radiation.

Bezeq’s tariffs for its services are subject to government control, which harms its ability to compete and results in an erosion of its tariffs, which adversely affects its business.

Bezeq’s tariffs for its services are subject to government control. Some of these tariffs are stipulated in regulations and these regulations also stipulate a formula for updating tariffs. Bezeq is restricted in its ability to give discounts on its principal services and to offer differential tariffs. Further, alternative payment packages, which should provide an immediate alternative to the regulated tariffs, are currently subject to certain conditions which often render the alternative payment package option moot. The foregoing factors harm Bezeq’s ability to compete and results in an erosion of its tariffs, which adversely impacts its business.

On March 28, 2010, the Ministries of Communications and Finance announced the appointment of the Hayek Committee that will consider a new tariff arrangement for Bezeq, including determining new tariffs relating to the provision of services in the wholesale market for fixed-line communications (including resale and the provision of access to infrastructure) and call completion tariffs in the fixed-line networks. The Hayek committee presented its preliminary recommendations for public comments in March 2011.

Bezeq is subject to restrictions on intercompany relations with affiliated companies, which harms its ability to compete and adversely affects its business.

Bezeq’s general license for fixed-line communication services obligates it to ensure that its relationships with its principal subsidiaries do not result in favoring them over their competitors. Bezeq is also subject to various limitations as a result of its declaration as a monopoly in the fixed line services business, as well as limitations set forth in merger approvals granted by the Israeli Antitrust Commission. Separation is required between the managements of Bezeq and such other companies, as well as separation between the financial and marketing systems, assets and employees, which causes high administration overheads. Bezeq is also subject to limitations with respect to the offering of joint service packages with those companies, which adversely impacts its business, particularly in light of the recent entry into the market of communications companies competing directly with Bezeq in most of its areas of operation based on the provision of bundled services to the customer.

Bezeq’s systems and operations are vulnerable to damage or interruption, which could expose it to material risk of loss or litigation.

Bezeq provides services using various infrastructure systems that include, exchanges, transmission, data communication and access systems, cables and computerized systems. Some of Bezeq's systems have backup, but nevertheless, damage to some or all of these systems, whether due to a technical fault or natural disaster, could cause extreme difficulties in providing service, including if Bezeq is unable to repair the systems.

Bezeq is currently deploying its new generation network, which to a large extent will replace its traditional networks. The set-up of a new network based on advanced technology involves operational and business risks, such as damaging the continuity and quality of the services provided to Bezeq's customers, which could adversely impact its business.

Pelephone’s operations in the cellular market are exposed to losses in the event of malfunctions in the terminal equipment that it sells, including various property risks and liabilities. Pelephone’s cellular information systems are networked throughout the country through designated communications lines and via the Internet, and its cellular business is highly dependent upon these systems. Wide-scale malicious harm or malfunction might adversely affect Pelephone’s cellular business and financial results. Also, Pelephone’s cellular communications network is deployed around the country through network core sites and antenna sites and it cellular business is totally dependent upon these systems. Damage caused by natural or other disasters, war or damage to the switching farm and/or servers used by Pelephone for its core cellular activities could have an adverse effect on its business and results of operations. Pelephone’s cellular business uses two frequency ranges: 850 MHz and 2100 MHz. These frequencies are exposed to interruptions and could impair service quality of the networks that it operates.

Pelephone’s assigned frequency may not easily support the implementation of new technologies, which could have an adverse effect on Pelephone’s competitive position in the cellular market.

In certain situations the 850 MHz frequency available to Pelephone may not easily support the implementation of new technologies emerging in the cellular communication sector, which could make it difficult for Pelephone to implement them. This would have an adverse effect on Pelephone's competitive status, since the other licensees have other frequencies available to them, some of which may support those technologies, while obtaining new frequencies may be difficult. Furthermore, Pelephone’s frequencies are exposed to interference and could impair service quality of networks operated by Pelephone. The factors that could cause interference include among other things, the fact that the 850 MHz frequency is also used for terrestrial television broadcasts, and television stations broadcasting in the Middle East (mainly in Cyprus), which use could cause interference in Pelephone’s 850 MHz EVDO/XRTT1 and UMTS/HSPA networks.

Bezeq and its subsidiaries are parties to legal proceedings, which could result in them being ordered to pay significant sums.

Bezeq and its subsidiaries are parties to legal proceedings, including class actions, which could result in them being ordered to pay significant sums. Class action claims can reach large amounts, as virtually all residents of Israel are consumers of Bezeq’s services and a claim that relates to a minor loss for a single consumer can become a material claim for Bezeq if it is certified as a class action applicable to all consumers or a significant portion of them. In addition, since Bezeq provides communications infrastructure as well as billing services to other licensees, parties suing those licensees in other class actions may also try to involve Bezeq as a party to such proceedings.

The market in which Bezeq operates is characterized by material capital investments in infrastructure and subscriber equipment and changing technology, which imposes a heavy financial burden on Bezeq.

The market in which Bezeq operates is characterized by material capital investments in infrastructure and subscriber equipment and changing technology. The frequent technological changes in infrastructure and terminal equipment and the intense competition in various market segments impose a heavy financial burden on the companies operating in the market, requiring them to update their infrastructure technology from time to time or to introduce new devices into the market at heavy cost. The development of new technologies can render existing technologies obsolete, resulting in the need for large monetary investments in order to retain a competitive position. Bezeq’s future success will depend on its ability to develop and introduce, on a timely and cost-effective basis, new infrastructure and subscriber equipment that keep pace with technological developments. If Bezeq is unable to respond promptly and effectively to changing technology, it will be unable to compete effectively in the future and its business could be adversely affected.

Bezeq's results of operations are subject to market risks such as currency fluctuations, inflation in Israel and the financial condition of the market in Israel and worldwide.

Bezeq's results of operations are subject to market risks such as currency fluctuations, inflation in Israel and the financial condition of the market in Israel and worldwide. Bezeq measures exposure to changes in exchange rates and inflation by the surplus or deficit of assets against liabilities, based on the type of linkage. In addition, Bezeq's exposure to inflation changes in Israel is high. Bezeq's also has exposure to market risk for changes in interest rates relating primarily to its borrowings.

Bezeq collects payments from some of its customers in foreign currency, primarily U.S. dollars. In addition, Bezeq consumes services from suppliers outside Israel and pays for these services in foreign currency, primarily U.S. dollars. Changes in the exchange rates of the currencies in which Bezeq operates, primarily the NIS against the U.S. dollar, could have an adverse effect on Bezeq's cash flow and profitability.

Market and financial stability and the strength of the economy in Israel and worldwide have recently been subject to great volatility and led to a global economic slowdown. Although global economic conditions have begun to stabilize or improve, if the local market weakens, Bezeq's business results could be harmed and its revenues may decline.

Risks Related to Our Company

We and B Communications have a substantial amount of debt, which could restrict our financing and operating flexibility and have other adverse consequences.

To facilitate the funding of its acquisition of the controlling interest in Bezeq, B Communications entered into two financing agreements under which it received loans in a total principal amount of NIS 5.1 billion, of which NIS 4.1 billion (approximately $1.1 billion) was outstanding at December 31, 2010. The financing agreements include certain financial covenants, including, among other things, the requirement that Bezeq maintain certain minimum shareholders equity and minimum ratio of shareholders' equity. In addition, B Communications' wholly-owned subsidiary that directly holds the Bezeq interest must maintain a minimum ratio of debt to EBITDA and a debt service coverage ratio. The Bezeq shares that were acquired and all of such subsidiary's other rights and assets (except for 29,662,168 ordinary shares of Bezeq that were acquired in 2011 and such additional Bezeq shares that may be acquired in the future) have been pledged to the lenders as security under the loan agreements. In addition, B Communications has pledged to the lenders the entire equity it holds in the subsidiary established to acquire the Bezeq shares and the debt owed by such subsidiary. Our ability to repay our debt and B Communications' ability to repay its debt may be affected by Bezeq's distribution policy and the amount of dividends received from Bezeq. If we and B Communications are unable to meet our debt obligations or comply with our debt covenants, we could be forced to renegotiate or refinance our indebtedness, seek additional equity capital or sell assets. We may be unable to obtain financing or sell assets on satisfactory terms, or at all. For more information regarding our debt instruments and our consolidated indebtedness, see Item 5.B "Operating and Financial Review and Prospects - Liquidity and Capital Resources."

If we, B Communications or any other member of the Eurocom group subject to the control permit for the acquisition of the controlling interest in Bezeq fails to comply with such permit or other regulatory provisions relating to the control of Bezeq, the control permit could be revoked and our rights with respect to our Bezeq interest would be adversely impacted, which would have a material adverse effect on our business and financial position.

As part of the acquisition of the controlling interest in Bezeq, we, B Communications, its indirect fully owned subsidiary which holds the Bezeq interest, or SP2, its wholly-owned subsidiary that directly owns such subsidiary and other members of the Eurocom group were granted a permit to control Bezeq, pursuant to the Israeli Communications Law (Telecommunications and Broadcasting), 1982, or the Communications Law, the Communications Order (Determination of Essential Service Provided by "Bezeq" The Israel Telecommunication Corp. Limited), 5757-1997, or the Communications Order. The control permit includes several conditions, including, among others, the requirement that SP2 be controlled exclusively by the other parties to the control permit and that the parties to the control permit hold not less than 30% of any type of means of control of Bezeq and SP2. In February 2011, the Prime Minister and Minister of Communications gave approval for such holdings to reach 29% in the event of dilution resulting from the exercise of stock options by Bezeq employees, for a period of six months commencing from the date such holdings fall below 30%. In addition, the control permit requires that a certain percentage of SP2 be held at all times by an "Israeli Party," as defined in the Communications Order. The control permit also includes certain notice requirements regarding changes in the composition of the board of directors and certain holdings in us and B Communications. If we, B Communications or any other member of the Eurocom group subject to the control permit fails to comply with the terms of the control permit or with other regulatory provisions relating to the control of Bezeq, such permit could be revoked and our rights with respect to our Bezeq interest would be adversely impacted, which would have a material adverse effect on our business and financial position.

If we do not maintain control of Bezeq we may be deemed to be an "investment company" under the Investment Company Act of 1940, which could have a material adverse effect on our business.

Section 3(a)(1)(A) of the Investment Company Act of 1940, or the Investment Company Act, defines an investment company as any issuer that is, holds itself out as being, or proposes to be, primarily engaged in the business of investing, reinvesting or trading in securities and Section 3(a)(1)(C) of the Investment Company Act defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire "investment securities" (within the meaning of the Investment Company Act) having a value exceeding 40% of the value of the issuer's total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis. However, an issuer will be deemed not to be an investment company if no more than 45% of the value of such issuer's total assets (exclusive of government securities and cash items) consists of, and no more than 45% of such issuer's net income after taxes (for the last four fiscal quarters combined) is derived from, securities other than, among other things, securities issued by companies which are controlled primarily by such issuer. Primary control is presumed if the issuer owns over 25% of the controlled company's voting securities and the issuer has control greater than that of any other person. Accordingly, so long as we maintain control of Bezeq, we will not be deemed an investment company.

If we were to no longer maintain the control of Bezeq, we could, among other things, be required either (i) to change substantially the manner in which we conduct our operations to avoid being subject to the Investment Company Act or (ii) to register as an investment company. An investment company that is organized under the laws of a foreign country may not register as an investment company, or publicly offer its securities through interstate commerce in the United States, unless the company applies to the Securities and Exchange Commission for an order permitting the company to register under the Investment Company Act, and to make a public offering in the United States. The Securities and Exchange Commission may issue an order granting the application if it finds that, by reason of special circumstances or arrangements, it is both legally and practically feasible effectively to enforce the provisions of the Investment Company Act against the issuer, and further finds that granting the application is otherwise consistent with the public interest and the protection of investors.

If we were required to register as an investment company under the Investment Company Act, we would become subject to substantial regulation with respect to our capital structure (including our ability to use leverage), management, operations, transactions with certain affiliates, reporting, record keeping, voting, proxy and disclosure requirements, and meeting these requirements would be costly, if at all possible.

We may fail to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002, which could have an adverse effect on our financial results and the market price of our ordinary shares.

Section 404 of the Sarbanes-Oxley Act requires any company subject to the reporting requirements of the U.S. securities laws to do a comprehensive evaluation of its and its combined subsidiaries' internal control over financial reporting. To comply with this statute, we are required to document and test our internal control over financial reporting, and our independent registered public accounting firm must issue an attestation report on our internal control procedures, and our management is required to assess and issue a report concerning our internal control over financial reporting. The rules governing the standards that must be met for management to assess our internal control over financial reporting are relatively new and complex and require significant documentation, testing and possible remediation to meet the detailed standards under the rules.

Beginning in the 2010 second quarter, we began consolidating Bezeq's financials results into our financial statements following our acquisition of the controlling interest in Bezeq. Effective for the year ended December 31, 2011, our management report on internal control over financial reporting and our independent registered public accounting firm's attestation report must include an assessment with respect to Bezeq’s internal control over financial reporting. Prior to our acquisition of the controlling interest, Bezeq was not subject to Section 404 of the Sarbanes-Oxley Act. We may in the future identify a material weakness in Bezeq’s internal control over financial reporting. Failure to maintain effective internal control over financial reporting could result in investigation or sanctions by regulatory authorities and could have a material adverse effect on our operating results, investor confidence in our reported financial information and the market price of our ordinary shares.

Risks Related to Our Relationship with Eurocom Communications Ltd. and B Communications

Because Eurocom Communications controls substantially all the voting power of our ordinary shares, investors will not be able to affect the outcome of all shareholder votes.

Eurocom Communications beneficially owned 77.80% of our outstanding ordinary shares, as of June 30, 2011. Mr. Shaul Elovitch, the chairman of our board of directors and the chairman of the board of directors of Eurocom Communications, and the controlling shareholder of Eurocom Communications, will be able to exercise control over our operations and business strategy and control the outcome of all matters involving shareholder approval.

For as long as Eurocom Communications has a controlling interest in our company, it and Mr. Elovitch indirectly, will have the power to determine or significantly influence the outcome of matters submitted to a vote of our shareholders, including the power to elect all of the members of our board of directors (except outside directors, within the meaning of Israeli law), prevent an acquisition or any other change in control of our company and will have the ability to exercise a controlling influence over our business and affairs, including any determinations with respect to potential mergers or other business combinations involving us, our acquisition or disposition of assets, our incurrence of indebtedness, our issuance of any additional ordinary shares or other equity securities, our repurchase or redemption of ordinary shares and our payment of dividends. Because the interests of Eurocom Communications and Mr. Elovitch may differ from the interests of our other shareholders, actions taken by Eurocom Communications with respect to us may not be favorable to our other shareholders. See Item 10B. “Additional Information - Memorandum and Articles of Association” and Item 7B. “Major Shareholders and Related Party Transactions - Related Party Transactions.”

Conflicts of interest may arise between Eurocom Communications, B Communications, other companies within the Eurocom group and us that could be resolved in a manner unfavorable to us and result in reduced revenues and income.

Conflicts of interest may arise between B Communications, Eurocom Communications and us in a number of areas relating to our past and ongoing relationships. Areas in which conflicts of interest between B Communications, Eurocom Communications and us could arise include, but are not limited to, the following:

- Cross officerships, directorships and share ownership. The ownership interests of our directors in our ordinary shares could create, or appear to create, conflicts of interest when directors and executive officers are faced with decisions that could have different implications for the two companies. For example, these decisions could relate to the nature, quality and cost of services rendered to us by Eurocom Communications and B Communications, disagreements over the desirability of a potential acquisition opportunity or employee retention or recruiting. In addition, Eurocom Communications may take an opportunity for itself or preclude us from taking advantage of a corporate opportunity; and

- Intercompany transactions. From time to time, Eurocom Communications, B Communications or other companies within the Eurocom group may enter into transactions with us or our subsidiaries or other affiliates. Although the terms of any such transactions will be established based upon negotiations between employees of such companies and us and, when appropriate, subject to the approval of our independent directors or a committee of disinterested directors and in some instances a vote of shareholders, the terms of any such transactions may not be as favorable to us or our subsidiaries or affiliates as may otherwise be obtained in arm’s-length negotiations with unaffiliated third parties.

Risks Related to Our Ordinary Shares

Our share price has been volatile and may decline in the future.

The market price of our ordinary shares has been subject to significant price movements and could be subject to wide fluctuations in the future in response to factors such as the following, some of which are beyond our control:

- Quarterly variations in our operating results, which beginning in the 2010 second quarter include the operations of Bezeq;
- Global economic conditions;
- Price movements in the market price of B Communications' and Bezeq's ordinary shares;
- Operating results that vary from the expectations of securities analysts and investors;
- Changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;
- Regulatory changes that impact pricing of services and competition in Bezeq's markets;
- Changes in market valuations of other communications companies;
- Announcements of technological innovations or new services by Bezeq or its competitors;
- Announcements by Bezeq or its competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;
- Changes in the status of Bezeq's intellectual property rights;
- Announcements by third parties of significant claims or proceedings against us or Bezeq;
- Additions or departures of key personnel;
- Future sales of our ordinary shares; and
- Stock market price and volume fluctuations.

Domestic and international stock markets often experience extreme price and volume fluctuations. Market fluctuations, as well as general political and economic conditions, such as a recession or interest rate or currency rate fluctuations or political events or hostilities in or surrounding Israel, could adversely affect the market price of our ordinary shares.

We have never paid cash dividends to our shareholders and have not adopted a dividend distribution policy.

We have never declared or paid cash dividends on our ordinary shares and have not adopted a dividend distribution policy. B Communications' indirect wholly-owned subsidiary, B Communications (SP2) Ltd., or SP2, which directly holds Bezeq's shares and our principal source of revenues and income, is subject to limitations on the payment of dividends under the terms of the financing agreements entered into in connection with its acquisition of the controlling interest in Bezeq. You should not rely on an investment in our company if you require dividend income from your investments.

We may in the future be classified as a passive foreign investment company, which will subject our U.S. investors to adverse tax rules.

There is a risk that we may be treated in the future as a "passive foreign investment company." Our treatment as a passive foreign investment company could result in a reduction in the after-tax return to the U.S. holders of our ordinary shares and may cause a reduction in the value of such shares. A foreign corporation will be treated as a passive foreign investment company for U.S. federal income tax purposes if either (1) at least 75% of its gross income for any taxable year consists of certain types of "passive income," or (2) at least 50% of the average value of the corporation's gross assets produce, or are held for the production of, such types of "passive income." For purposes of these tests, "passive income" includes dividends, interest and gains from the sale or exchange of investment property; and cash is considered to be an asset that produces passive income. If we are classified in the future as a passive foreign investment company for U.S. federal income tax purposes, highly complex rules would apply to U.S. shareholders owning ordinary shares. Accordingly, you are urged to consult your tax advisors regarding the application of such rules. United States residents should carefully read "Item 10E. Additional Information - Taxation, United States Federal Income Tax Consequences" for a more complete discussion of the U.S. federal income tax risks related to owning and disposing of our ordinary shares.

Risks Related to the Operations of Bezeq and Our Company in Israel

Bezeq conducts its operations in Israel and its business focuses on the Israeli audience, therefore our results of operations may be adversely affected by political, economic and military instability in Israel.

We and Bezeq are incorporated and based in the State of Israel and Bezeq derives substantially all of its revenues from markets within the State of Israel. As a result, the political, economic and military conditions affecting Israel directly influence Bezeq and us. Any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in the economic or financial condition of Israel could have a material adverse effect on Bezeq's business, financial condition and results of operations.

Since the establishment of the State of Israel in 1948, Israel and its Arab neighbors have engaged in a number of armed conflicts. A state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Major hostilities between Israel and its neighbors may hinder Israel's international trade and lead to economic downturn. This, in turn, could have a material adverse effect on our operations and business. Ongoing violence between Israel and the Palestinians as well as tension between Israel and the neighboring countries may have a material adverse effect on our and Bezeq's business, financial condition and results of operations.

Recent popular uprisings in various countries in the Middle East are affecting the political stability of those countries. In addition, such instability may affect the global economy and marketplace as a result of changes in oil and gas prices. Any events that affect the State of Israel may impact us in unpredictable ways. If our operations are significantly impacted by such events, our results of operations may be adversely affected.

Many of Bezeq's and our executive officers and employees in Israel are obligated to perform annual reserve duty in the Israeli Defense Forces and may be called for active duty under emergency circumstances at any time. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Bezeq's operations could be disrupted by the absence for a significant period of one or more of its executive officers or key employees or a significant number of other employees due to military service. Any disruption in Bezeq's operations could adversely affect its business.

Bezeq may be restricted in the conduct of its operations during periods of national emergency, which could negatively affect its business operations.

During periods of national emergency, the Minister of Communications and other governmental authorities may issue various instructions regarding the use of Bezeq’s network, including the use of the network by the Israeli security forces. In addition, the Israeli Equipment Registration and IDF Mobilization Law, 1987 permits the registration, taking and use of engineering equipment and facilities by Israel’s Defense Forces. These actions could adversely affect Bezeq’s business operations.

Our operating results may be adversely affected by significant fluctuations of the NIS against foreign currencies and in the consumer price index in Israel.

We report our financial results in NIS. Bezeq receives payments in NIS for most of its sales. As a result, fluctuations in rates of exchange between NIS and the U.S. dollar may affect our operating results and financial condition. In addition, when the Israeli inflation rate exceeds the rate of the NIS depreciation against foreign currencies, some of our NIS expenses increase to the extent of the difference between the rates. A significant disparity of this kind may have a material adverse effect on our operating results.

From time to time, we engage in currency hedging transactions to reduce the impact on our cash flows and results of operations of currency fluctuations. We recognize freestanding derivative financial instruments as either assets or liabilities in our statements of financial position and we measure those instruments at fair value. However, accounting for changes in the fair value of a derivative instrument, such as a currency hedging instrument, depends on the intended use of the derivative instrument and the resulting designation. For derivative instruments that are not designated as cash flow hedges, changes in fair value are recognized in our income statement without any reference to the change in value of the related budgeted expenditures. These differences could result in fluctuations in our reported net income on a quarterly basis.

Further, as the principal amount of, and interest that we pay on, our Series B Debentures are linked to the Israeli consumer price index, any increase in the Israeli consumer price index will increase our financial expenses and could adversely affect our results.

As a foreign private issuer whose shares are listed on the NASDAQ Global Select Market, we may follow certain home country corporate governance practices instead of certain NASDAQ requirements.

As a foreign private issuer whose shares are listed on the NASDAQ Global Select Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Listing Rules. As a foreign private issuer listed on the NASDAQ Global Select Market, we may follow home country practice with regard to, among other things, the composition of the board of directors, compensation of officers, director nomination process and quorum at shareholders' meetings. In addition, we may follow home country practice instead of the NASDAQ requirement to obtain shareholder approval for certain dilutive events (such as for the establishment or amendment of certain equity-based compensation plans, an issuance that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company and certain acquisitions of the stock or assets of another company). A foreign private issuer that elects to follow a home country practice instead of NASDAQ requirements must submit to NASDAQ in advance a written statement from an independent counsel in such issuer's home country certifying that the issuer's practices are not prohibited by the home country's laws. In addition, a foreign private issuer must disclose in its annual reports filed with the Securities and Exchange Commission each such requirement that it does not follow and describe the home country practice followed by the issuer instead of any such requirement. Accordingly, our shareholders may not be afforded the same protection as provided under NASDAQ's corporate governance rules.

Our shareholders generally may have difficulties enforcing a U.S. judgment against us, our executive officers and directors and some of the experts named in this annual report, or asserting U.S. securities law claims in Israel.

We are incorporated in Israel and all of our executive officers and directors named in this annual report reside outside the United States. Service of process upon them may be difficult to effect within the United States. Furthermore, all of our assets and most of the assets of our executive officers and directors and some of the experts named in this annual report are located outside the United States. Therefore, a judgment obtained against us or any of them in the United States, including one based on the civil liability provisions of the U.S. federal securities laws, may not be collectible in the United States and may not be enforced by an Israeli court. It also may be difficult for you to assert U.S. securities law claims in original actions instituted in Israel.

Provisions of Israeli law, the licenses of Bezeq and our articles of association may delay, prevent or make difficult an acquisition of our company, which could prevent a change of control and, therefore, depress the price of our shares.

Following our acquisition of the controlling interest in Bezeq, we and our shareholders are required to comply with the Communications Law, the Communications Order and regulations promulgated by the Ministry of Communications.

Pursuant to the Communications Order, we were required to obtain the prior written consent of the Prime Minister of Israel and the Israeli Minister of Communications in order to acquire the controlling interest in Bezeq. Under the Communications Order, no person may acquire, directly or indirectly, the ability to exercise “significant influence” over Bezeq or 5% or more of any particular class of means of control in Bezeq, nor may any person, together with any other person, appoint the general manager of Bezeq or cause the election or appointment of any director of Bezeq, without the prior written consent of the Prime Minister of Israel and the Israeli Minister of Communications. Subject to certain exceptions, prior written approval of such Ministers is also required to increase the holdings or other rights in excess of those determined in the initial approval, including by means of an agreement (including a voting agreement). Furthermore, under the Communications Order, no person may transfer control, “significant influence” or means of control in Bezeq to another, if, as a result of the transfer, the holdings of the transferee would require approval pursuant to the Communications Law or Communications Order and the transferee is not in possession of the requisite approval. For the foregoing purposes, “significant influence” means the ability to significantly influence the activity of a corporation, whether alone or together with or through others, directly or indirectly, as a result of holding means of control in that corporation or in another corporation, including ability derived from the corporation’s articles of association, a written, oral or other kind of agreement, or from any other source, excluding solely as a result of the performance of an office holder’s duties in the corporation. In this context, holding 25% of our means of control is presumed to confer significant influence. ”Means of control” means the right to vote at a general meeting of the company, to appoint a director or general manager of the company, to participate in the profits of the company or a share of the remaining assets of the company after payment of its debts upon liquidation.

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. Furthermore, Israeli tax considerations may make potential transactions unappealing to us or to some of our shareholders, including Israeli shareholders and 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 of Israeli law may delay, prevent or make difficult an acquisition of our company, which could prevent a change of control and therefore depress the price of our shares. For additional discussion about some anti-takeover effects of Israeli law, see “Item 6C. Directors, Senior Management and Employees –Board Practices – Approval of Related Party Transactions under Israeli Law” and Item 10E. “Taxation -Israeli Tax Considerations.”

The rights and responsibilities of our shareholders are governed by Israeli law and differ in some respects from those under Delaware law.

Because we are an Israeli company, the rights and responsibilities of our shareholders are governed by our articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in a Delaware corporation. In particular, a shareholder of an Israeli company has a duty to act in good faith towards the company and other shareholders and to refrain from abusing his, her or its power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli law provides that these duties are applicable to shareholder votes on, among other things, amendments to a company's articles of association, increases in a company's authorized share capital, mergers and interested party transactions requiring shareholder approval. In addition, a shareholder who knows that it possesses the power to determine the outcome of a shareholders' vote or to appoint or prevent the appointment of a director or executive officer in the company has a duty of fairness towards the company. However, Israeli law does not define the substance of this duty of fairness. Because Israeli corporate law has undergone extensive revisions in recent years, there is little case law available to assist in understanding the implications of these provisions that govern shareholder behavior.

ITEM 4.INFORMATION ON THE COMPANY

A. History and Development of the Company

We were incorporated under the laws of the State of Israel in April 1992 under the name Euronet Golden Lines (1992) Ltd. In June 1999 we changed our name to Internet Gold - Golden Lines Ltd. We are a public limited liability company under the Israeli Companies Law 1999 and operate under this law and associated legislation. Our registered offices and principal place of business are located at 2 Dov Friedman Street, Ramat Gan 52503, Israel, and our telephone number is +972-72-924-0000. Our address on the Internet is www.igld.com. The information on our website is not incorporated by reference into this annual report on Form 20-F.

We are a leading communications group in Israel. Our principal subsidiary, B Communications, is the controlling shareholder of Bezeq (TASE:BZEQ), Israel's largest telecommunications provider. Since B Communications' initial public offering in October 2007, its ordinary shares have been listed on NASDAQ Global Market (symbol: BCOM) and the TASE, and since January 1, 2011, its ordinary shares have been listed on the NASDAQ Global Select Market. We currently own 78.11% of the ordinary shares of B Communications. B Communications maintains a website at b.communications.co.il. The information on B Communications' website is not incorporated by reference into this annual report on Form 20-F.

We began providing Internet access services in 1996, and began offering broadband services in 2001 and traditional voice services in 2004. As part of our internal restructuring in 2006, we transferred our broadband and traditional voice services businesses, which we refer to in this annual report as the legacy communications business, to B Communications (formerly named 012 Smile.Communications), and our media operations to GoldMind (formerly named 012 Smile.Media). Since purchasing the controlling interest in Bezeq, we have sold all of our media assets, other than one website, which is being held for sale.

Legacy Communications Business

Prior to January 2010, our principal subsidiary, B Communications (then named 012 Smile.Communications Ltd.), was a communication services provider in Israel that provided a wide range of broadband and traditional voice services.

On October 25, 2009, B Communications entered into a share purchase agreement to acquire the controlling interest in Bezeq, Israel's largest telecommunications provider, from Ap.Sb.Ar. Holdings Ltd.

As part of its acquisition of the controlling interest in Bezeq, on November 16, 2009, B Communications entered into an agreement to sell its legacy communications business (excluding certain retained indebtedness and liabilities) to a wholly-owned subsidiary of Ampal-American Israel Corporation (NASDAQ: AMPL), or Ampal, for NIS 1.2 billion (approximately $338 million). The sale of B Communications' legacy communications business to Ampal was completed on January 31, 2010, effective as of January 1, 2010. In connection with the sale of our legacy communications business, substantially all of the executive officers and employees of B Communications as of the closing of the transaction were hired by Ampal.

Acquisition of the Controlling Interest in Bezeq

On April 14, 2010, B Communications completed the acquisition of 30.44% of Bezeq's outstanding shares from Ap.Sb.Ar. Holdings Ltd. for an aggregate cash purchase price of approximately NIS 6.5 billion (approximately $1.83 billion) and became the controlling shareholder of Bezeq. The Bezeq interest was directly acquired by an indirect wholly-owned subsidiary of B Communications. The transaction was completed after all conditions in the agreement were met, including receipt of the approval of the Prime Minister of Israel and the Israeli Minister of Communications (including the grant of control permits) and the Israeli Antitrust Commissioner. In accordance with the terms of the transaction, effective as of the closing of the acquisition, we designated seven directors to replace the Apax-Saban-Arkin Group's representatives on Bezeq's 13 person Board of Directors. We began consolidating Bezeq's financial results into our financial statements effective as of the closing of the acquisition and began reporting the consolidated results in our 2010 second quarter earnings release. As of June 30, 2011, we hold a 31.23% ownership interest in Bezeq.

Bezeq is the principal provider of communications services in Israel. Bezeq and its subsidiaries implement and provide a broad range of telecommunications operations and services, including domestic fixed-line, cellular, Internet services, international communication services, multi-channel television, satellite broadcasts, customer call centers, maintenance and development of communications infrastructures, provision of communications services to other communications providers, television and radio broadcasts, and supply and maintenance of equipment on customer premises (such as network endpoint services). Bezeq, which was established as a government company in 1980, became a public company in 1990 and its shares are traded on the TASE.

Bezeq has the following four principal areas of operation:

- Bezeq – domestic fixed-line communications. This segment primarily includes Bezeq's operation as a domestic operator, including fixed-line telephony services, Internet services, transmission services and data communications.

- Pelephone – cellular telephone. Cellular mobile telephone services (cellular communications), marketing of end-user equipment, installation, operation and maintenance of cellular communications equipment and systems.

- Bezeq International– Internet, international communications and network endpoint, or NEP, services. Bezeq International is an Internet service provider, or ISP, and also provides international communications services and NEP services.

- D.B.S. Satellite Services (1998) Ltd. - Provides multi-channel broadcast and value added services via satellite.

In view of the decision in 2009 of the Israeli Supreme Court not to approve the merger of Bezeq and DBS, Bezeq ended its control over DBS and commencing August 21, 2009 it ceased consolidating the results of DBS into its financial statements and from August 21, 2009, Bezeq's investment in DBS shares is accounted for under the equity method.

On November 28, 2010, Eurocom D.B.S. Ltd., or Eurocom DBS, purchased all of the DBS shares and rights to purchase DBS shares held by shareholders in DBS other than Bezeq, following which Eurocom DBS and Bezeq remained as the only shareholders in DBS. According to Eurocom DBS, the purchased shares, which constitute approximately 17.62% of the outstanding share capital of DBS, will be held in trust pursuant to regulatory requirements, as well as the other DBS shares (32.6% of the outstanding shares)owned by Eurocom DBS. With the addition of the newly purchased shares the trustee holds 50.22% of the outstanding share capital of DBS.

The following chart sets forth Bezeq's shareholdings in its principal subsidiaries and affiliates:

The Public
49.78%
71.55%
100%
100%
31.23%
68.77%
D.B.S Satelite
Services (1998)
Ltd (2)
Wallat
Communications
Ltd (1)
Bezeq
International Ltd
Pelephone
Communications
Ltd
Bezeq The Israel Telecommunication Corp, Ltd
B Communications

(SP2) Ltd

(1) A public company traded on the Tel Aviv Stock Exchange.
(2) Bezeq holds options to purchase 8.6% of the shares of DBS.

In addition, Bezeq holds 100% of the shares of Bezeq On Line, which operates customer call centers which are not material to the operations of Bezeq, and 100% of the shares of Bezeq Zahav Holdings, whose sole activity is the ownership of Debentures Series 5 of Bezeq.

Below are details of the holdings in Bezeq at March 30, 2011 and June 30, 2011, and on a fully diluted basis at June 30, 2011, assuming exercise of all the options granted to employees and managers of the Bezeq Group at March 31, 2011.

	Percentage of holdings		
Shareholders	At March 31, 2011	At June 30, 2011	With full dilution at June 30, 20111
B Communications (through SP2)	31.36 %	31.23 %	30.13 %
The public	68.64 %	68.77 %	69.87 %

(1) The calculation of full dilution assumes that the granted options will be exercised for shares. In view of the mechanism of exercise of stock appreciation rights in the plan for managers and senior employees in the Group,

this assumption is theoretical only, since in practice, under the terms of the plan and according to the outline, offerees who exercise the options will not be allocated the full number of shares underlying the options, only the number of shares that reflect the amount of the financial benefit embodied in the options.

Permit to Control Bezeq Granted to Members of the Eurocom Group

As part of B Communications' acquisition of the controlling interest in Bezeq, we, B Communications, its indirect fully owned-subsidiary which holds the Bezeq interest, or SP2, B Communications' wholly-owned subsidiary that directly owns SP2 and other members of the Eurocom group applied for authorization to control Bezeq, pursuant to the Communications Law and Communications Order. On April 13, 2010, the control permit was granted subject to the condition that SP2 continues to be controlled exclusively by the other parties to the control permit, referred to as the Companies' Control Permit. Concurrently, a separate control permit was also granted to Messrs. Shaul Elovitch and Yossef Elovitch, our controlling shareholders, referred to as the Individuals' Control Permit.

According to the Companies' Control Permit, the parties must hold not less than 30% of any type of means of control of Bezeq and SP2. In February 2011, the Prime Minister and Minister of Communications gave approval for such percentage to reach 29% in the event of dilution resulting from the exercise of stock options by Bezeq employees, for a period of six months commencing from the date such holdings fall below 30%. B Communications' subsidiary which owns the Bezeq shares is deemed to hold the Bezeq shares directly notwithstanding that the Bezeq interest is recorded in the name of a trust company wholly-owned by Bank Hapoalim, which was granted a lien over the Bezeq shares that were purchased from Ap.Sb.Ar. Holdings Ltd and held by SP2 as a security for the repayment of the NIS 4.6 billion loan (which was reduced to NIS 3.6 billion (approximately $1.0 billion) at December 31, 2010) provided by Bank Hapoalim and other banking and financial institutions, referred to as the Lending Parties, for the funding of the acquisition of the Bezeq interest.

In accordance with the Companies' Control Permit, SP2, which holds the Bezeq shares is required to notify the Prime Minister of Israel and Israeli Minister of Communications of any changes in the composition of its board of directors every six months and if the change represents half or more of the members of the board of directors, within 30 days of the change. The parties to the Companies' Control Permit are also required to notify such Ministers of any "Exceptional Holdings" immediately upon becoming aware of such event. Such parties are also required to notify such Ministers in the event a shareholder becomes a "Principal Shareholder" and regarding any change in the holdings of a Principal Shareholder within 48 hours of becoming aware of such change. The terms "Exceptional Holdings" and "Principal Shareholder" are defined in the Communications Order and in our Articles of Association and are described below in Item 10B "Additional Information - Memorandum and Articles of Association - Rights Attached to Shares - Exceptional Holdings; Principal Shareholders."

The parties to the Companies' Control Permit may not transfer means of the control in Bezeq at a rate which requires the approval of the Prime Minister of Israel and Israeli Minister of Communications under the Communications Order, without such Ministers prior written approval. The foregoing includes a transfer of the Bezeq interest in one transaction or a series of transactions, by one party or together with the other parties to the Companies' Control Permit or the parties to the Individuals' Control Permit. However, the parties may transfer the means of control of Bezeq among themselves, subject to compliance with certain conditions set forth in the Companies' Control Permit

The Lending Parties undertook to comply with the provisions of the Communications Law, Communications Order and the lien permit granted to them relating to their rights under the credit agreement entered into among SP2 and the Lending Parties and the realization of the lien. The rights granted to the Lending Parties are deemed to be an encumbrance of collateral and the Lending Parties may not exercise rights pursuant to the means of control except as set forth in the lien permit. The lien permit was granted exclusively to the Lending Parties and any change in the composition of the Lending Parties or a modification of the credit agreement entered into among SP2 and the Lending Parties requires the prior written consent of the Prime Minister of Israel and Israeli Minister of Communications. The appointment of a receiver, on any grounds whatsoever, with respect to the holdings in SP2 or SP2's holdings in Bezeq, will constitute grounds for canceling the lien permit. The violation of the lien permit by the Lending Parties will constitute grounds for canceling such permit and for the appointment of a receiver and trustee, in accordance with the terms of such permit.

According to the Companies' Control Permit, SP2 must at all times be held by an "Israeli Party," as defined in the Communications Order, to the following extent:

- At least 19% of each of the means of control of SP2 must be held by an Israeli Party at all times; or

- At least 19% of the rights to vote at the general meeting of shareholders of SP2 and the rights to appoint directors of SP2 must be held by an Israeli Party at all times; and

The right to appoint at least one-fifth of the directors in Bezeq and Bezeq's subsidiaries and not less than one director in each such company will be held by an Israeli Party at all times, provided that the percentage of the Israeli Party's direct or indirect shareholdings in Bezeq is not less than 3% of any of the means of control of Bezeq. Indirect shareholdings will be calculated as the product of the Israeli Party's lowest rate of holdings in each of the means of control in SP2, multiplied by the percentage of the holdings of the parties to the control permit in each of the means of control in Bezeq.

The Prime Minister of Israel and Israeli Minister of Communications have determined that we and B Communications are deemed to be "Israeli Parties," so long as we and B Communications are controlled by a citizen and resident of Israel and that the ownership interest of Messrs. Shaul Elovitch and Yossef Elovitch in Internet Gold does not fall below 50.0% and our ownership in B Communications does not fall below 50%. In accordance with such approval, we and B Communications may only transfer our holdings in Bezeq to an Israeli Entity, subject to all approvals required by law.

The parties to the Companies' Control Permit may not be controlled by any country or government company or a company controlled by a government company. The Companies' Control Permit will terminate if the foregoing condition ceases to exist with respect to any such party without the approval of the Prime Minister of Israel and Israeli Minister of Communications. Such Ministers may authorize a government company to hold an interest in any such party, provided that the government company's aggregate direct or indirect holdings in Bezeq do not exceed 5% of any type of means of control of Bezeq and that it does not control such party.

In the event the Prime Minister of Israel and Israeli Minister of Communications find that the information they were provided is incorrect, that there has been a material change in the details provided by the parties to the Companies' Control Permit which justifies its cancellation, or such parties failed to submit a required report, and such Ministers determine that there is probable cause to believe that the provision of the services that Bezeq is required to provide pursuant to its general license (including basic telephone, infrastructure, transmission and data transmission services and ancillary services) or the grounds for determining that any such service has been harmed, such Ministers may take action to cancel the Companies' Control Permit. Upon its cancellation, all the shareholdings purchased under the Companies' Control Permit will be deemed "Exceptional Holdings," as described above.

The Companies' Control Permit also authorizes an interested party in B Communications and our company that is not a party to the Companies' Control Permit or the Individuals' Control Permit to hold means of control in Bezeq, provided that such interested party does not hold more than 15% of any type of means of control of B Communications and our company. The foregoing authorization is subject to the condition (among others) that the percentage of holdings of the parties to the Companies' Control Permit in B Communications, and of Eurocom Communications' holdings in our company exceed 50% of the means of control in each of such companies at all times. We and B Communications are required to notify the Prime Minister of Israel and Israeli Minister of Communications of the shareholdings of any such interested party.

The provisions of the Companies' Control Permit are subject to the terms of the Communications Order and Communications Law, as they may be amended from time to time.

B. Business Overview

Since April 14, 2010, we, through our B Communications subsidiary have been the controlling shareholder of Bezeq (TASE:BZEQ), Israel's largest telecommunications provider.

The Israeli Communications Industry

The communications industry around the world and in Israel has developed rapidly. The technology and corporate structure and regulations governing the communications industry in Israel has undergone and continue to be subject to constant changes. A number of communications groups operate in the Israeli communications market on the basis of cooperative marketing among a number of companies and/or among companies with common ownership for the supply of comprehensive communications service packages, thus utilizing the marketing and operational advantages inherent in such a structure.

Government Regulations

The Israeli communications industry is regulated and controlled by the Israeli Ministry of Communications and to a lesser degree by other governmental authorities. Bezeq is subject to government supervision and regulation relating to, among other things, licensing, determining permitted areas of activity, determining tariffs, operation, competition, environmental matters, payment of royalties, obligation to provide universal service, ability to hold its shares, relationships between Bezeq and its subsidiaries and prohibitions as to the termination or restriction of its services (which may force Bezeq to provide services at a loss. Bezeq was declared a monopoly in its main fields of activity, and is also subject to control and restrictions under the Antitrust Law, 5748-1988. This supervision and regulation at times lead to governmental intervention. Bezeq's business and operations could be adversely affected by decisions of regulators, in particular the Ministry of Communications as well as changes in laws, regulations or government policy affecting its business activities. Further risks and uncertainties result from the fact that changes in such laws, regulations or government policies may not be adopted or implemented in the manner that Bezeq expects and may be further amended, interpreted or enforced in an unexpected manner or in a manner adverse to Bezeq's business and results of operations.

Bezeq is under an obligation to provide services to the entire public in Israel, or universal service. Similar obligations are not imposed on holders of specific domestic operator licensees that are able to compete for Bezeq's lucrative customer base (primarily business customers) which represents a significant source of revenue for Bezeq.

Bezeq was declared a provider of essential telecommunications services under the Communications Order. By virtue of that declaration, Bezeq is required to provide certain types of services and may not interrupt its provision of such services or narrow them. Among these services are basic telephone services, infrastructure services, transmission services and data communication services including, interconnect, and other services listed in the schedule to the Communications Order. The main provisions of the Communications Order are:

- Limitations on the transfer and acquisition of means of control, which includes a ban on holding 5% or more of means of control of a certain kind without the prior written approval of the Prime Minister and the Minister of Communications, or the Ministers.

- Transfer or acquisition of control in Bezeq requires the approval of the Ministers by means of a Control Permit. The Control Permit establishes the minimum holding percentage in each of the means of control in Bezeq by the holder of the Control Permit where a transfer of shares or an issuance of shares by Bezeq, as a result of which the percentage of ownership of the Control Permit holder will fall below the minimum percentage, is prohibited without the prior approval of the Ministers, subject to permitted exceptions (including, an issuance to the public under a prospectus, or sale or private placement to institutional investors).

- Holdings not approved in compliance with the Communications Order will be considered "exceptional holdings" and any exercise of a right by virtue of exceptional holdings will not be valid. The Communications Order also contains provisions authorizing the Ministers and Bezeq to apply to the courts with an application for the enforced sale of exceptional holdings.

- A duty to report to the Ministers upon demand is imposed on Bezeq with respect to any information on matters relating to provision of an essential service.

- 75% of the members of the Board of Directors of Bezeq must be Israeli citizens and residents who have a security clearance as determined by the General Security Service.

- The Chairman of the Board of Directors of Bezeq, the external directors, the chief executive officer, the deputy chief executive officer and other office holders in Bezeq as listed in the Communications Order, must be Israeli citizens and residents and have a security clearance appropriate to their functions.

- Nationality requirements are established for the controlling shareholder in Bezeq: an individual must be an Israeli Entity (as defined in the Communications Order); a corporation must be incorporated in Israel, the center of its business must be in Israel, and an Israeli Entity must hold at least 19% of the means of control of such company.

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

- Provisions were established for the matter of protection of computerized systems and the purchase of hardware and software.

- Certain actions of Bezeq require the approval of the Minister of Communications, including voluntary liquidation, a settlement or arrangement between Bezeq and its creditors, a change or reorganization of the structure of Bezeq and a merger or split of Bezeq.

The regulations affecting the Bezeq Group are described in the sections of this annual report relating to each of the operating segments of Bezeq.

Changes in the Regulatory Environment

The Gronau Committee

On March 12, 2008, a report was published by a public committee appointed by the Minister of Communications in December 2006 to formulate detailed recommendations for a policy and principles of competition in the communication market in Israel. This committee, referred to as the Gronau Committee, was led by Professor Gronau. On August 13, 2008, the Minister of Communications announced his decision to adopt the conclusions of the Gronau Committee, subject to a number of changes, which constitute the policy of the Minister of Communications for the near future.

The following measures were proposed by the Ministry of Communications, aimed at enhancing competition in the sector, in part following a decision made by the government and the recommendations of the Gronau Committee:

- Changes in the fixed-line sector. The Minister of Communications decided that the Ministry of Communications will prepare the regulatory and pricing infrastructure for the establishment of a wholesale market for fixed-line communications (including resale and the provision of access to infrastructure), including arrangements for local loop unbundling, or LLU.

- Sale of service packages that cannot be unbundled by the subsidiaries. It was recommended that after implementation of the wholesale market arrangement, the subsidiaries of Bezeq would be granted a permit to provide service bundles that cannot be unbundled (i.e. bundles in which the separate services cannot necessarily be purchased on the same terms as those at which they are offered in the bundle).

- Flexibility in the approval of alternative payment packages for Bezeq. The tariffs for Bezeq's controlled services (telephony and others) which are fixed in regulations were updated in accordance with a linkage formula less an efficiency factor consisting of linkage to the Israeli Consumer Price Index, or the CPI, plus an efficiency factor), as provided in the regulations, so that on average, Bezeq's controlled tariffs will erode in real terms.

- Alternative payment packages. Under the Communications Law, if tariffs are fixed for the controlled services, the Minister of Communications may, with the consent of the Minister of Finance, approve the request made by the licensee for an alternative payment package for a service package. The approval mechanism was simplified in December 2010, so that the Bezeq Group may offer an alternative payment package after the period defined in the law unless the Minister of Communications or the Minister of Finance announces his objection. An alternative payment package will be approved only it is worthwhile for 30% or more of the subscribers who consume the services offered in the package.

- Promotion of grant of MVNO licenses to virtual cellular operators. In January 2009, the Israeli Government decided to promote the entry of MVNOs into Israel's cellular market and on January 20, 2010, the Minister of Communications signed regulations allowing the grant of MVNO licenses. MVNO licenses were recently granted to a number of companies and applications have been submitted to the Ministry of Communications by other companies for such licenses.

- Structural separation. It was decided to enforce structural separation within the HOT Group (nevertheless, the license of HOT Telecom was amended in June 2009 and exceptions were made with respect to the structural separation obligation between it and HOT Broadcasts) and to leave the structural separation in Bezeq Group as long as there are only two companies that own a nationally deployed fixed-line infrastructure.

- Entry of cellular operators into the international telephony market. It was decided to allow all cellular operators to enter the international telephony market.

- Reduction of the rate of royalties. The committee recommended a gradual reduction in the rate of royalties applicable to license-holders, until their eventual cancellation. Nevertheless the rate of royalties was raised in 2010 contrary to this recommendation.

The Hayek Committee

On March 28, 2010, the Ministers of Communications and Finance appointed the Hayek Committee to review and revise the structure of Bezeq's tariffs and to set wholesale service tariffs and call completion tariffs in the fixed-line networks. In the letter of appointment, the Committee was requested to make recommendations regarding setting the base level of telecommunications tariffs and how they would be calculated, a tariff control mechanism, tariff updates including an efficiency factor and mechanisms for the prevention of cross-subsidization among the various services, based on the cost of the services.

In addition, and with the approval of the Minister of Communications, the Chairman of the Hayek Committee would be able to discuss other topics not included in the letter of appointment. The Minister of Communications approved the Hayek Committee's discussion of structural separation in the communications market, and the question of tariff control – its format and its necessity, and the communications project of Israel Electric Corporation. On February 12, 2011, the Hayek Committee sent a request to Bezeq for data to enable it to examine the costs of components in domestic carrier networks.

On March 3, 2011, the Hayek Committee invited the public to submit by March 22, 2011 (which date was later extended to April 17, 2011), their positions on the Hayek Committee's recommendations on structural matters in the communications industry. The structural recommendations in the document constitute, according to the Hayek Committee's letter, conditions for implementation of the detailed arrangements that would then be formulated by the Hayek Committee. The main points are:

- Compulsory structural separation in fixed-line and other areas of the communications industry would be cancelled, except for the structural separation in multi-channel television, which would be cancelled after operation in the television market is enabled on the Internet infrastructure.

- Control of Bezeq's wholesale tariff would be determined by setting a maximum tariff. The Committee, which proposed that this arrangement be implemented immediately, is also considering ending control by means of setting tariffs by means of a transition to a methodology wherein a license holder may demand reasonable payments, which increases will be implemented gradually

- Holders of general domestic carrier licenses will provide service and allow use of all the infrastructures required to enable other license-holders to provide service for end-users (including, passive infrastructure, transmission lines in various technologies, and others).

- Broadband access service will be immediately provided in a manner that will enable a service provider that does not have its own infrastructure to manage the service. The infrastructure provider will be required to provide everything needed beyond the line itself, so as to permit the transparency needed for control and management of the service.

- Holders of general domestic carrier licenses will reach agreements with other license-holders for the use of the types of services referred to in the above bullet-point. The agreements will be forwarded to the regulating entity and will be made known to the public.

- In the absence of an agreement between the parties and to the extent required, the regulating entity will intervene to put in place the arrangements that the Hayek Committee intends to formulate

- Holders of general domestic carrier licenses will regularly inform other license-holders of the deployment of the existing infrastructures.

- The perceived need to advance the use of the infrastructure of the Israel Electric Corporation to provide wholesale services and that the terms of implementation should be applied equally to the entity that will be established as part of this initiative and to other general domestic carrier license-holders.

- The cancellation of structural separation is conditional upon and will be implemented immediately upon fulfillment of the following terms:

  - Implementation of the third, fifth and eighth bullet points above.

  - On the earlier of six months from the date on which agreements as referred to in fifth bullet point are signed, or from the date on which the holders of general domestic carrier licenses start to provide the wholesale services as provided in those agreements.

  - Deposit of autonomous bank guarantees in significant amounts(hundreds of millions of shekels) by general domestic carrier license-holders to assure the existence of a wholesale market.

Failure to comply with one or more of these principles will, among other things, result in stringent control, the imposition of personal liability on the managers of companies that hold general domestic carrier licenses, forfeiture of the guarantees, and an obligation for structural separation between the infrastructure of the license-holder and the services provided to the end-users.

Bezeq, which is studying these recommendations, believes that the recommendations that will eventually be adopted by the Hayek Committee could materially influence the Bezeq Group, even though they are difficult to assess before their adoption. The ultimate impact of the Hayek Committee's recommendations will also depend largely on the balancing of the various factors in the recommendations and in their detailed explanations. For example, the development of a wholesale market and imposition of the duty to break up the fixed-line network into sections, could have a significantly adverse effect on the Bezeq Group. Conversely, if recommendations are adopted concerning the cancellation of structural separation, such factors would have far-reaching and positive implications for the Group and its results. It is difficult to assess the implications of the proposed change in the tariff control mechanism before the final format is decided, although under certain conditions it could positively impact on Bezeq's operating results.

Bezeq and Bezeq International submitted their comments to the Hayek Committee, which stated that the various comments would be published on the Ministry of Communications website. The Hayek Committee intends to formulate detailed recommendations for these arrangements and to present them to the Ministers of Communications and Finance after considering the remarks of the public.

Proposal for a new communications authority

In July 2010, the Ministry of Communications distributed a memo, The Israel Communications Authority Law 5770-2010, concerning the establishment of a communications authority, which would become the main regulatory body for telecommunications and for broadcasting in Israel and would hold the powers now held by the Ministry of Communications, the Second Television and Radio Authority, the Second Authority Council and the Council for Cable and Satellite Broadcasts.

Structural separation

Bezeq's domestic carrier license states that it must maintain structural separation between itself and its Pelephone, Bezeq International, DBS and Bezeq On Line subsidiaries. This framework includes: (i) the complete separation of the managements of these subsidiaries, including business systems, the financial system and the marketing system;(ii) the complete separation of the assets; (iv) a ban on Bezeq hiring employees of a subsidiary and vice versa; (v) restrictions on the appointment of a Bezeq employee (other than the chairman of the board) as a director of a subsidiary; and (vi) a ban on the transfer of commercial information to a subsidiary (including in relation to Bezeq).

The structural separation limitations have placed the Bezeq Group in an inferior competitive position compared with the other communications groups which are not subject to such far-reaching limitations and give rise to high management overhead.

Other limitations on offering benefits to Bezeq Group companies and joint ventures

Other limitations on cooperative ventures between Bezeq and its subsidiaries arise from various provisions applicable to them, both under antitrust laws and conditions established by the Antitrust Commissioner in approvals of mergers between Bezeq and Group companies. Such limitations include a prohibition against discrimination in favor of companies within the Bezeq Group when providing certain services and by virtue of the provisions of Bezeq's license, the requirement to provide services equally to all and at a uniform tariff.

Service Packages

The Gronau Committee recommended that Bezeq and its subsidiaries be allowed to offer service packages consisting of telephony and Internet protocol television services once the wholesale market arrangements, as described above, have been implemented.

Until recently, the structural separation limitations prevented Bezeq from marketing joint baskets of services. The permit to market joint service packages was granted (by means of an amendment of Bezeq's domestic carrier license) pursuant to a policy paper published by the Minister of Communications in 2004, which stated that after Bezeq's market share in a particular segment (private or business) falls below 85%, it will be allowed to market joint baskets of services with the subsidiaries in the same segment. Bezeq's market share in the private sector (according to the method of calculation determined by the Ministry of Communications) fell below 85% in 2008, and fell below 85% in the business sector in September 2009. Following such declines, in May 2010 Bezeq was permitted to offer private subscribers joint baskets of services with its subsidiaries, subject to approvals by the Ministry of Communications and other conditions prescribed in Bezeq's domestic carrier license, including:

- The service packages must be able to be unbundled, meaning that a service included in a package will be offered separately and on the same terms.

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At the time a request for approval of a service packages is submitted, there must be a group of services in similar format being marketed to a private subscriber as a package by a license-holder who is not a subsidiary of Bezeq, or there is a group that includes license-holders who provide a private subscriber with all the services included in the joint service packages.

Joint service packages marketed by Bezeq’s subsidiaries and which include the services of Bezeq are also subject according to their licenses to similar limitations, including unbundling (except for a service package marketed by a subsidiary that contains only Bezeq's Internet infrastructure service).

These limitations, and in particular the unbundling obligation, which severely limits the Bezeq Group's ability to offer discounts on the components of a service package, place the Bezeq Group in a competitively inferior position compared to the competing communications groups, which are not subject to similar limitations in marketing joint service packages (other than a limitation on marketing a joint service packages by HOT-Net and other companies in HOT Group).

At present, Bezeq may market joint service packages to the private sector only. As Bezeq's market share in the business sector declined to below 85% in September 2009, Bezeq requested that the Ministry of Communications amend its domestic carrier license so as to enable it to also market joint service packages to business customers. On February 3, 2011, the Ministry of Communications sent a draft amendment to the communications licenses of the Bezeq Group companies that will enable them to market joint service packages to the business sector under the same limitations.

Limitation on the exit penalty a license-holder may collect from a subscriber

On February 13, 2011, the Ministry of Communications distributed a Law Memorandum – Communications (Amendment No. 47) (Limitation on payment and loss of benefit due to cancellation of an agreement) Bill, 2011, in which it is proposed to apply provisions to communications license-holders which are similar to those applied to the cellular companies with regard to limiting the exit commission that a license-holder can collect from a subscriber who cancels a subscription agreement to 8% of the average monthly bill of the subscriber up to the date of cancellation, multiplied by the number of months remaining to the end of the term of the commitment. License-holders are prohibited from demanding immediate payment of the balance of the subscriber's payments for terminal equipment in the event of cancellation of the agreement. According to the Memorandum, this prohibition will also apply to existing subscribers who request cancellation of their agreements with license-holders after the amendment comes into force.

Under the Memorandum, these provisions will also apply to domestic carriers (including Bezeq), international call operators (including Bezeq International) and to broadcasting licensees (including DBS). Bezeq, Bezeq International and DBS believe that if the proposed amendment is adopted, it could increase the churn rate of subscribers in their areas of operation.

The Consumer Protection Law

In March 2010, an amendment to the Consumer Protection Law came into force enabling a consumer to cancel a sale transaction made over the phone or the Internet even after the start of the provision of the service. The amendment broadens the rights of cancellation in the event of any deception. In December 2010, regulations came into effect which also allow the cancellation of a transaction and a refund in situations that are not remote sale transactions. In the past two years additional amendments were made to the Consumer Protection Law with respect to consumers disconnecting from ongoing services and the need for specific consent to continue transactions after the end of the defined period.

Competition in the Israeli Communications Market

The Israeli communications market is dominated by four main groups, the Bezeq group, the IDB group (which controls Cellcom and 013 NetVision), the Partner group, which recently purchased 012 Smile Communications Ltd., or 012 Smile, and the HOT group and several other players, each having interests in one or more of the main communications sub-sectors.

IDB Group - The IDB Group provides communications services through Cellcom Israel Ltd., or Cellcom, and Netvision Ltd., or Netvision, which are public companies under joint control. Cellcom provides cellular telephony services (including cellular Internet), fixed-line telephony mainly to business customers through its own infrastructure, transmission and data communication services for business customers through its own transmission network, and ISP services. Netvision provides ISP services, international call services and fixed-line telephony services using Voice over Broadband, or VoB, technology. In June 2011, Netvision and Cellcom announced that they had entered into a merger agreement. Under the merger agreement, of Netvision's shares would be acquired in exchange for cash based on a total valuation of Netvision's share capital estimated at NIS 1.54 billion ($434 million) plus interest. The closing of the merger is subject to finalization of a definitive agreement which is to be subject to among other things, the receipt of the requisite regulatory approvals.

Partner Group - The Partner Group provides communications services through Partner, a public company. Partner provides cellular telephony services (including cellular Internet), fixed-line telephony, transmission and data communications, ISP services, international call services and fixed-line telephony using VoB technology. In March 2011, Partner completed a transaction to purchase the shares of 012 Smile, an international telephony services provider and ISP, which purchased the legacy communications business of our company in January 2010. Partner and 012 Smile are subject to limitations of structural separation between 012 Smile's international telephony operations and Partner's cellular services.

HOT-Mirs Group - The HOT-Mirs Group provides communications services through HOT and through Mirs, which is controlled by Mr. Patrick Drahy, the controlling shareholder in HOT. The HOT-Mirs Group owns a cable infrastructure which is deployed nationwide, and it provides multi-channel television services though HOT, as well as fixed-line telephony services. The HOT-Mirs Group also has a nationwide Internet infrastructure and provides transmission and data communications services through HOT Telecom, a subsidiary of HOT. Mirs provides cellular communication services using iDEN technology, and in February 2011, it submitted a bid in a tender for Universal Mobile Telecommunications System, or UMTS, frequencies. In December 2010, HOT-Net, a subsidiary of HOT, was granted an ISP license, subject to structural separation limitations between HOT-Net and HOT and HOT Telecom, and limitations on marketing joint service packages that include HOT-Net's Internet access (among the limitations are an obligation to market service packages that correspond to competing ISPs, and an obligation to sell the ISP services separately and on the same terms as they are sold when part of the service package(unbundling). On May 4, 2011, HOT announced that its board of directors had received a proposal from companies controlled by its controlling shareholder to join them in negotiations for the acquisition of Mirs Communication Ltd. and it had authorized a committee to take the actions necessary to review the proposal and conduct negotiations.

The Ministry of Communications has encouraged competition in the communications market by imposing restrictions and limitations on Bezeq and its subsidiaries, including:

- an obligation to maintain complete structural separation among Bezeq and its subsidiaries pertaining to corporate structure and management systems, including finance, marketing, manpower, assets and data;
- supervision and regulation of part of Bezeq’s tariffs; and
- an obligation to provide “access” infrastructure services to other licensees on an equal, non-discriminatory basis and a prohibition on granting Bezeq’s subsidiaries advantageous terms when providing such services.

The Ministry of Communications has also supported competition by:

- separating infrastructure and service providers;
- granting new licenses and encouraging new and innovative technologies such as VoB; and
- mandating number portability.

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

On July 15, 2010, the Israeli government, during its discussion of the Arrangements Law, decided to instruct the Minister of National Infrastructures and the Minister of Finance to exercise their authority under the Electricity Law, 1996, and to permit IEC (which in 2010 started a technological trial to ascertain its ability to provide a high-speed communications infrastructure by optical fibers to the customer's home, or the FTTH method) to operate in communications on certain conditions. Such conditions include: the establishment of a communications company that will use a fixed-line communications infrastructure based on the electricity grid; IEC would not hold more than 49% of the means of control in the communications company and would not control it; the communications company would do business with communications license-holders and not directly with private consumers (which would exclude large business customers, for which it could provide transmission or other services, subject to the approval of the Ministry of Communications).

On March 7, 2011, the Israeli government resolved to grant IEC approval to establish the communications company together with another company, which would use and operate the fixed-line communications infrastructure of IEC’s electricity grid. In addition, in this resolution the Israeli government amended its resolution of July 15, 2010, to provide that the communications company would have an exclusive right of use for providing telecommunications services on the basis of IEC's optical fiber communications infrastructure, subject to certain volumes and terms. The same decision also provided that the financing of that company will be from sources made available by the controlling shareholder and will be selected in accordance with the Government's decision, including by that company raising capital. The resolution also provides that it does not restrain the Government’s right to change the decision or prevent the Ministers from exercising their authority under any law.

In Bezeq's estimation, such a communications company, if established, would compete with Bezeq in providing infrastructure and could have a material negative impact on its operations and results of operations, especially if that new company is permitted to provide services to operators and business customers without an obligation for universal deployment of an FTTH network or before completing deployment of a significant portion of the network. It is not certain that a competing communications company will be established, what limitations will be imposed on its activities and what concessions it might be granted.

HOT's Internet infrastructure is deployed nationwide and was recently upgraded to an Ultra Fast Internet, or UFI network in which a range of communications services and interactive applications can be provided. The network is currently the principal competitor with Bezeq in the private sector. The upgrade of the infrastructure and grant of an ISP license to HOT-Net in December 2010 are expected to increase the level of competition in Internet access and could also increase the number of HOT customers who subscribe to service packages.

In April 2011, Mirs and Marathon Telecommunications Ltd. (of the Xfone Group) each won a tender for the grant of frequencies and a license to operate as a cellular operator that own infrastructure. In May 2011, after Marathon Telecommunications failed to timely submit the requisite guarantee, its selection as a winner in the tender was revoked by the tender committee and the next runner-up, the Select Group, was declared the second winner in the tender. Under the terms of the tender, the new operators will be able to launch their operation after deploying a cellular network which initially will cover 10% of the population of Israel. After the deployment, the new operators will be able to use the networks of the existing operators for a period of seven years (with an extension option subject to approval for up to a further three years) based on a national roaming model. Under the terms of the tender, each one of the new operators will pay NIS 705 million in license fees) which will be reduced by one seventh (1/7) (approximately 14.3%) for each one percent (1%) of the market share they accumulate in the private sector in the five years following the grant of the license, so that a new operator achieving a market share of 7% in the private sector would not pay any license fees. To guarantee payment of the license fees, the new operators undertook to submit a bank guarantee in favor of the Ministry of Communications in the amount of approximately NIS 705 million. Pelephone anticipates that the entry of the new operators will intensify competition in the cellular market.

BUSINESS OF BEZEQ - THE ISRAEL TELECOMMUNICATIONS CORP. LTD.

Bezeq is the principal provider of communications services in Israel, providing a broad range of telecommunications operations and services, including domestic fixed-line, cellular and international communication services, multi-channel television, satellite broadcasts, Internet services, customer call centers, maintenance and development of communications infrastructures, provision of communications services to other communications providers, television and radio broadcasts, and supply and maintenance of equipment on customer premises, which is referred to as network end point, or NEP services. Bezeq was founded as a government company in 1980 and became a public company in 1990 with its shares traded on the TASE.

The following chart describes Bezeq's ownership interests in its principal subsidiaries and affiliates, as at March 31, 2011:

Bezeq The Israel Telecommunications Corp. Ltd.
Pelephone
Communications
Ltd.
Bezeq
International
Ltd.
100%
100%
Bezeq
Online Ltd.
100%
Bezeq Gold
(Holdings) Ltd.
100%
D.B.S Satellite
Services (1998)
Ltd.
Walla!
Communications
Ltd
71.55%
49.78%

The Group has four principal areas of operation, which are reported as business segments in Bezeq's consolidated financial statements.

- Bezeq domestic fixed-line communications - Primarily includes Bezeq's operation as a domestic operator, including telephony services, Internet services, transmission services and data communications.

- Pelephone Communications Ltd. - Provides cellular services (cellular communications), marketing of end-user equipment, installation, operation and maintenance of cellular communications equipment and systems.

- Bezeq International Ltd. - Provides international communications services, Internet access (ISP) services, and NEP services.

- D.B.S. Satellite Services (1998) Ltd. - Provides multi-channel broadcast and value added services via satellite.

Since August 2009, Bezeq no longer consolidates the operations of DBS into its consolidated financial statements, but reports its operations as a segment in its consolidated financial statements.

Bezeq holds 49.78% of the shares of DBS as well as options to purchase additional shares, with the balance held by Eurocom DBS, which is indirectly controlled by our controlling shareholder, Mr. Shaul Elovitch. Accordingly, cooperative ventures between DBS and the Bezeq Group companies (such as agreements for mutual marketing of products and services) must currently be approved as transactions in which the controlling shareholder in Bezeq has a personal interest, which process could impede the business flexibility of the Bezeq Group in such cooperative ventures.

In view of the position taken by the Antitrust Commissioner and the ruling of the Supreme Court in 2009, Bezeq is not permitted to increase its holdings in DBS or control it, which limits the Bezeq Group's ability to benefit fully from the advantages that could have been achieved from the inclusion of DBS in the Bezeq Group. If in the future these regulatory limitations and structural separation and the other limitations applicable to cooperative ventures between the companies in the Group are removed, then the options open to Bezeq to increase its holdings in DBS or to control it could create opportunities for the Group to benefit from synergies with DBS or facilitate the utilization of such synergies.

Bezeq also includes a category of “Other” in its consolidated financial statements, which mainly include customer call center services through its Bezeq Online Ltd. subsidiary, investments in a venture capital fund, an investment in Walla! Communications Ltd., or Walla!, a popular Israeli provider of Internet and portal services, whose shares are listed on the TASE, and other investments.

On September 2, 2010, Bezeq International completed the purchase of 2,274,299 shares of Walla! (approximately 5% of the issued and paid up share capital of Walla!) by means of a special tender offer at NIS 6 per share and total consideration of NIS 13,645,794. Subsequently, and after receipt of the approval of the Antitrust Commissioner, on September 21, 2010, a trustee that held 9,902,467 shares of Walla! on behalf of Bezeq International transferred such shares back to Bezeq International, and Bezeq then purchased from Bezeq International all the Walla! shares held by it (a total of 32,644,997 shares) at NIS 6 per share (a total of approximately NIS 195.87 million), so that after the purchase, Bezeq holds 71.55% of the shares of Walla!.

In September 2010, Walla completed the acquisition of 75% of the share capital of the Yad 2 website in consideration of NIS 117.5 million, subject to certain adjustments including the payment of additional amounts to certain of the shareholders of Yad 2, based on the amount of Yad 2's working capital.

The consolidated activities of Bezeq, Pelephone, Bezeq International and DBS are sometimes referred to as the Bezeq Group in this annual report. The operations of DBS are not included in Bezeq’s consolidated financial statements.

The Bezeq Group holds over 170 trademarks including its principal trademarks: Bezeq, B – Bezeq's logo and Pelephone.

For detailed information about Bezeq’s business, see Bezeq’s Periodic Report for 2010, prepared in accordance with Israeli Securities Regulation (Periodic and Immediate Reports), 5730-1970, which report is available on Bezeq’s website at http://ir.bezeq.co.il. The information on Bezeq’s website is not incorporated by reference into this annual report.

BEZEQ FIXED-LINE BUSINESS

General

Bezeq has a general license for the provision of domestic fixed-line communication services in Israel. As a domestic carrier, Bezeq provides fixed-line telephony services, Internet infrastructure and access services, transmission and data communication services.

Products and Services

Telephony

Bezeq's telephony services include basic telephony services on domestic telephone lines and associated services such as voice mail, caller ID, call waiting, call forwarding, speed dial, and conference calls. Bezeq also provides national services for businesses (1-800, 1-700) that offer full or partial payment for incoming calls by businesses. Bezeq currently operates about 12,500 public telephones around the country, which are operated by various types of pre-paid cards.

Bezeq operates a unified telephone directory for fixed-line and cellular telephony operators, as well as a unified website which is free of charge, in addition to its 144 (directory information) service. The unified directory service provides data with respect to all of the telephone subscribers in Israel. Fixed line and cellular telephony operators in Israel are required to provide unified directory services. At the end of 2009, the Ministry of Communications published a request for comments by the public with respect to the need for and format of opening number information services to competition, including by having these services provided by entities other than telephony operators or those acting on their behalf, or by canceling Bezeq's 144 code service. Bezeq opposed the proposed alternatives and to date, the position of the Ministry of Communications on the proposal has not been published.

In recent years, Bezeq's telephony services have been characterized by a decline in subscribers, use and revenues, mainly due to competition from the other fixed-line telephony service providers and the increased exclusive use of cellular services by many consumers. As of March 31, 2011, Bezeq had 2,342,000 active telephone lines compared with 2,445,000 lines at March 31, 2010.

As part of its marketing strategy, Bezeq is working on the development and penetration of new services in both the private and business sectors. Bezeq plans to continue to launch additional products on the basis of market trends and customer needs.

Internet Access Infrastructure Services

Bezeq provides broadband Internet access infrastructure services in xDSL technology. As of March 31, 2011, Bezeq had 1,079,66,000 Internet subscribers (compared with 1,0455,000 at March 31, 2010). At December 31, 2010, the percentage of Internet subscribers connected to the NGN was about 52% of total Internet subscribers and the percentage of subscribers using NGN services (those with packages of 10 mbps or higher) was 18% of all Internet subscribers. The average surfing speed of Bezeq's Internet subscribers at March 31, 2011 was 4.8 mbps, compared with 3.0 mbps at March 31, 2010.

The Internet market has been one of the fastest growing markets of recent years, and this service has become a focus of Bezeq and a central channel for its investments in technology, marketing, advertising and customer acquisition and upgrades.

Data Transmission and Communication Services

Data communications services are network services for point-to-point transfer of data, transfer of data between computers and various communications networks, services to connect communications networks to the Internet, and remote access services. The companies operating in this field are Cellcom, Partner (which acquired the Med-1 operation), HOT and Internet companies that also use leased infrastructures.

Data communication services are provided over established traditional infrastructures such as Sifranet and frame relay, on ATM infrastructure and on innovative and advanced infrastructures such as Internet Protocol, or IP, based virtual private networks, or IPVPN and Metro Ethernet. The IPVPN infrastructure enables managed communications solutions for businesses by connecting the various branches of the organization. Metro Ethernet infrastructure enables the supply of a communications infrastructure in Ethernet technology for services in the business and private sector. In recent years, customers have begun to switch from data communication solutions provided over older and traditional infrastructures, to IP and Ethernet-based infrastructures. This permits Bezeq to offer its customers greater capacity at lower prices, and the demand is increasing.

Bezeq offers transmission services, including high speed services, to other communications operators and to its business customers over a variety of protocols. Under the terms of its license, Bezeq is obliged to provide some of its communications services to the entire public in Israel. According to Ministry of Communications' interpretation of this and other provisions in the Domestic Carrier license, Bezeq is also obliged to provide infrastructure and transmission services to competing communications operators that provide services which compete with those of Bezeq. In October 2010, the Ministry of Communications notified Bezeq that it had violated the provisions of its license by refusing to provide transmission services to the domestic operator companies controlled by Cellcom and Partner and that if Bezeq did not give notice within 7 working days that it had ceased the violation, the Ministry would be compelled to institute a proceeding for the imposition of a financial sanction or consider some other action. Bezeq acted in accordance with the Ministry's decision but demanded the basis and reasons for it.

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

Other services

Services to communications operators-

Bezeq provides services to other communications operators, including the cellular and international operators, cable broadcasting license-holders, NEP operators, ISPs, domestic operators, and Palestinian communications providers. Bezeq's services include infrastructure, connection to Bezeq's network, transmission, billing and collection, rental of space and provision of services in its rented properties and rights of use for seabed cables.

Broadcasting services

Bezeq operates and maintains radio transmitters, including those operated by the Israel Broadcasting Authority, television transmitters of Channel 1, Educational Television and Channel 2, and the transmitters of regional radio stations. Bezeq also operates DTT transmitters. Bezeq is responsible only for operation and maintenance of the transmitters for distribution of radio and television programs, and not for the content of the broadcasts.

Contract work

Bezeq performs setup and operation work on networks and sub-networks for various customers such as the Ministry of Defense, HOT, radio and television broadcasting companies, cellular and international communication operators, local authorities, municipalities and government agencies. Bezeq and HOT have agreements for the provision of installation and maintenance services of cable networks, on Bezeq's infrastructure, from the starting point of those licensees' operating center, up to the point of delivery at the entrance to subscribers' homes. The connection and maintenance from these points to the subscribers' homes is not Bezeq's responsibility.

IP Centrex

The IP Centrex service is a virtual private exchange service.

Data Centers

Data Center service enables provision of a solution for customers from the aspects of backup and survivability.

144 Internet site (B144)

A search engine for finding business and private telephone numbers.

New services

Bezeq's launch of its new generation network, or NGN, in 2009 has enabled it to offer new services such as Bphone (a service enabling telephone calls to be made through the Internet as calls made from a fixed-line phone), on-hold music, storage services on the network and home exchange services.

The table below shows data for the distribution of Bezeq's revenues by principal product and service in its segment of operation, 2008-2010 (in NIS millions):

	2008		2009		2010	
Revenues from line telephony	3,572		3,333		3,160	
Percentage out of total Bezeq income	64.97	%	62.85	%	60.04	%

Revenues from Internet infrastructure services	790		863		977	
Percentage out of total Bezeq income	14.36	%	16.27	%	18.56	%
Revenues from transmission and communication services	811		851		882	
Percentage out of total Bezeq income	14.75	%	16.04	%	16.76	%
Revenues from other services	325		256		244	
Percentage out of total Bezeq income	5.92	%	4.84	%	4.64	%
Total income from domestic fixed-line communications services segment	5,498		5,303		5,263	

Customers

Bezeq’s sales are divided into two main sectors: the private sector which accounts for approximately 60% of revenues and the business sector which accounts for approximately 40% of revenues. Bezeq is not dependent on any single customer or small number of customers, the loss of which would materially affect its operation, and there is no customer which accounts for 10% or more of Bezeq's total revenue.

The following table provides Bezeq’s revenues for these two sectors during the three years ended December 31, 2010 (in NIS millions):

	2008	2009	2010
Revenues from private customers	3,303	3,165	3,128
Revenues from business customers	2,195	2,138	2,134
Total revenues	5,498	5,303	5,263

Competition

Domestic fixed- line telephony services

Since 2005, the Ministry of Communications has granted several general licenses for the provision of fixed-line domestic services without a geographical deployment or universal service obligations.

In the past few years, fixed-line telephony has been characterized by a decline in demand and in prices. The decline in demand is reflected in the gradual erosion of the number of calls originating in the fixed-line networks. In 2010, a decrease of 5% was recorded in the number of lines and of 8% in the volume of average call minutes (incoming and outgoing) on Bezeq's fixed telephone lines compared with 2009. These decreases followed the increased pace of removing fixed lines and the decrease in the volume of fixed-line calls recorded in recent years, which Bezeq believes is attributable to the increase in calls from cellular telephones and calls over the Internet, and to competition from other domestic carriers. No significant change has occurred in the average monthly revenues from a telephone line.

Bezeq believes that at the end of 2010, its market share in the fixed-line telephony market was approximately 65% in the private sector and 78% in the business sector, compared with 72% and 82% at the end of 2009 in those two sectors, respectively. There is a high degree of competition in the fixed-line communications segment in Israel.

Competition from other domestic carrier license-holders

Bezeq and HOT Telecom both own nationally-deployed fixed-line telephony infrastructure. HOT markets service packages combining Internet infrastructure, telephony and cable television aimed mainly at households. In addition, HOT markets telephony services to business customers. Bezeq faces competition from six license-holders for domestic fixed-line communications services, including VoB.

Competition in telephony from the cellular companies and VoIP-over-cellular, or VOC, services

The penetration rate of cellular telephony in Israel is among the highest in the world at 127%. In the opinion of Bezeq, this penetration rate combined with low airtime rates on an international scale, have made the cellular telephone a product that largely substitutes for the landline telephone. Bezeq believes that the increased substitution of cellular phones for fixed line telephones is one of the causes of the growing loss of installed telephone lines.

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

In December 2010, the Ministry of Communications published a hearing with respect to setting a policy for VoC services (a virtual cellular operator of telephony based on broadband) for the regulation of these services under a MVNO license and/or as part of a special VoB domestic carrier license. According to its work plan, by the end of 2011 the Ministry will announce its policy for the regulation of VoC operators and it recently granted licenses for trial use of VoC services. Bezeq believes that, if allowed, marketing VoC services under a VoB license will increase competition in telephony and will enable telephony services to be provided at fixed-line call prices on the cellular network.

Internet infrastructure market

Bezeq believes that at the end of 2010, its market share in the Internet infrastructure market was approximately 59%, similar to its market share at the end of 2009. There is significant competition in this field from the HOT Group and from the cellular operators. The Ministry of Communications' policy requires Bezeq and HOT to provide ISPs with "open access" to their infrastructure.

Hot's UFI (Ultar Fast Internet) network is currently the principal competitor with Bezeq in the private sector. In December 2010, HOT-Net was granted an ISP license, subject to structural separation limitations between HOT-Net, HOT and HOT Telecom, and limitations on marketing joint service packages that include HOT-Net's Internet access. Among the limitations are an obligation to market service packages that correspond to competing ISPs and an obligation to sell the ISP services separately and on the same terms as they are sold when part of the basket. The grant of the ISP license to HOT-Net is expected to increase the level of competition in Internet access.

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

Transmission and data communication services

The companies operating in this field are Cellcom, Partner (which acquired the Med-1 operations), HOT, and Internet companies that also use leased infrastructures. To the best of Bezeq's knowledge, Cellcom has deployed and set up a transmission network which it uses both for its own needs (instead of transmission provided for it in the past by Bezeq) and for competition with Bezeq in the transmission and data communications market. Cellcom offers its customers a complete package of solutions that includes domestic telephony, data communication and cellular communication, using its own infrastructure and its own sales array. Partner has also stepped up its activities in providing transmission and data communication services combined with telephony, for business customers.

Under the terms of its license, Bezeq is obliged to provide some of its communications services to the entire public in Israel. According to the Ministry of Communications interpretation of this and other provisions in the domestic carrier license regarding the provision of infrastructure services to license-holders, Bezeq is also obliged to provide infrastructure and transmission services to competing communications operators for providing services which compete with those of Bezeq. In October 2010, the Ministry of Communications notified Bezeq that it had violated the provisions of its license by refusing to provide transmission services to the domestic operator companies controlled by Cellcom and Partner, and that if Bezeq did not give notice within seven (7) working days that it had ceased the violation, the Ministry would be compelled to institute a proceeding for the imposition of a financial sanction or to consider some other action. Bezeq acted in accordance with the Ministry's decision but demanded the basis and reasons for it.

Marketing

Bezeq has marketing, sales and service groups for both the private and business sectors, which include customer managers for the business sector, combined sales and service centers located throughout Israel, technical support centers for private and business customers, and 15 points of sale and service (the Bezeq Store network) in Israel. Bezeq markets its fixed-line services mainly through mass media advertising and telesales centers, customer managers, and a system of independent dealers including ISPs, and outsourced points of sale.

Networks and Equipment

Bezeq’s property and equipment consist primarily of domestic telecommunications infrastructure, exchanges, various networks, real estate (land and buildings), computer systems, vehicles and office equipment. The telecommunications infrastructure has five principal components deployed throughout Israel:

- Exchanges - Used for switching calls and transferring them from their origin to their destination based on the signal received from the subscriber.

- Transmission network - A system through which there is connectivity between exchanges. This system actually functions as a national backbone that connects the local networks, each consisting of an exchange and an access network to it. The transmission network is based primarily on fiber-optic systems and to a lesser degree on wireless systems.

- Data communications networks - Networks for the provision of data communication services at various speeds and communication protocols.

- Access network - A system that connects subscriber NEPs to the exchange. The network is based on copper pairs, fiber-optic cables and to a lesser degree on wireless systems.

- Terminal equipment - Equipment installed at the subscriber site (such as telephones, private exchanges, fax machines, modems, routers, etc.) through which the subscriber receives the service.

Next Generation Network

The demand for communications services in Israel and worldwide is characterized by a demand for ever-increasing bandwidths and advanced IP platforms. In order to meet this demand, Bezeq at the end of 2008 started the gradual roll-out of an NGN based on a core IP network and deployment of an optical fiber network to street cabinets, known as fiber to the curb - FTTC.

Using VDSL2 technology, bandwidth of up to 100 mbs download speed can be provided by this network, as well as innovative value added services. Other advantages of the new technology are a simplification of the network structure and better management ability. The NGN roll-out is a gradual process, with the pace of deployment reviewed and reset annually. Bezeq launched the NGN in September 2009.

Bezeq has forecast that by the end of 2011, the NGN will be deployed in about 85% of Israeli households. Accordingly, Bezeq's investment in the network in 2011 is expected to be similar to 2010, while in 2012 Bezeq foresees a material decrease in investment in the network since it expects that most of the NGN will have been deployed by the end of 2011.

Computing

Bezeq's IT system supports four central areas: (i) marketing and customer management; (ii) information systems for engineering infrastructures of the telecommunications networks; (iii) information systems for management of Bezeq fixed-line resources; and (iv) company - wide systems. The systems support decision-making processes utilizing a data warehouse operated by Bezeq. Bezeq also operates a website which provides information about its services and enables the display of information about telephone bills, payment information and other services. Bezeq also maintains computerized office systems (e-mail, decision follow-up, etc.), and knowledge management systems.

Bezeq also develops and utilizes advanced computerization systems for its operations, including a customer relations management, or CRM, system, engineering network management systems and service order and supply systems.

Marketing and customer management

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

Information systems for the engineering infrastructures of the telecommunications networks

These systems support the planning, management, control and maintenance of engineering resources for the provision and assurance of the services.

Information systems for management of the Company's resources

These systems support the management, control and maintenance of the expense side of the Group's activities, including, financial information (including budget and control), purchasing and stock processes, property, real estate, human resources, salary control, fleet management, company projects, etc.

Company-wide systems

The group maintains large and complex computer information systems that support critical work processes and handle very large volumes of data. The array of information systems consist of a large number of systems, some of which are legacy systems which were developed many years ago and operate on mainframe computers, and more modern systems, whose applications were developed more recently and operate in open computerization environments.

Governmental Regulation

Bezeq was declared a provider of essential telecommunications services under the Communications Order. By virtue of that declaration, Bezeq is required to provide certain types of services and may not interrupt its provision of such services or narrow them. Among these services are basic telephone services, infrastructure services, transmission services and data communication services including, interconnect, and other services listed in the schedule to the

Communications Order.

In 2004, new Israeli regulations were published regarding the provision of domestic landline services, on a non-universal service basis. Under such regulations, an application may be filed by competitors of Bezeq for a special general domestic to provide landline services, which does not involve an obligation to provide services to the entire Israeli public, as is required under Bezeq's general license. 012 Smile Telecom (now owned by Partner), Cellcom and Partner, the principal competitors of Bezeq in this field, have all been granted such licenses. Unlike Bezeq, Partner, Cellcom and 012 Smile are entitled to offer service packages that combine cellular and landline services, which gives them a competitive advantage over Bezeq.

Control of Bezeq’s Tariffs

The tariffs for Bezeq’s controlled services (telephony and others) which are fixed in regulations promulgated under the communications Law, were updated in accordance with a linkage formula less an efficiency factor consisting of linkage to the CPI plus an efficiency factor, so that on average, Bezeq's controlled tariffs will erode in real terms. The Competition Policy Documents state that as long as the Bezeq Group's market share is higher than 60%, tariff control will continue in a format of fixing binding tariffs. The recommendations of the Hayek Commission for reviewing and revising the structure of Bezeq's tariffs, if adopted, could change the mechanism for fixing and updating the tariffs.

Under the Communications Law, if tariffs are fixed for controlled services, the Minister of Communications may, with the consent of the Minister of Finance, approve the request made by the licensee for an alternative payment package for a service package. The approval mechanism was simplified in December 2010 as part of the Arrangements Law, so that Bezeq can offer an alternative payment package after the period defined in the law unless the Minister of Communications or the Minister of Finance announces his objection. The Competition Policy Documents state that an alternative payment package will be approved only of it is worthwhile for 30% or more of the subscribers who consume the services offered in the package, and the smaller the market share of the Bezeq Group in fixed-line telephony, the higher the maximum discount rate permitted in an alternative payment package can be.

Under the Communications Law, a license-holder can demand reasonable payment for a telecommunications service for which payment is not fixed. Bezeq sets the tariffs for these types of services.

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

Bezeq's Domestic Carrier license

Bezeq operates, among other things, under the domestic carrier license. The main topics covered in the license are:

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

- Principles of structural separation - Bezeq employs various means or compliance with these principles among its employees, including training sessions and periodic refresher courses on the relevant procedures. In 2009, the Ministry of Communications notified Bezeq that it was considering imposing a monetary sanction on Bezeq in the amount of NIS 15 million in respect of alleged violation of the provisions of the license relating to structural separation, due to the ostensible transfer of commercial information about its customers to its subsidiaries. Soon after the date of the notice, Bezeq submitted its detailed response to the notice, stating that it had not violated the provisions of the license and the imposition of a monetary sanction was unjustified.

- Marketing joint service bundles - An amendment of the domestic carrier license enables Bezeq to request permission to market joint service bundles subject to limitations, see above.