

MATAV CABLE SYSTEMS MEDIA LTD
Form 20-F
June 30, 2004

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

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

For the fiscal year ended December 31, 2003
Commission file number: 0-28556

MATAV CABLE SYSTEMS MEDIA LTD.

(Exact name of Registrant as specified in its charter)

Israel

(Jurisdiction of incorporation or organization)

**42 Pinkas Street
North Industrial Park
P.O. Box 13600
Netanya 42134
Israel**

(Address of principal executive offices)

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Title of Each Class

American Depositary Shares
Ordinary Shares*

* Not for trading, but only in connection with the registration of American Depositary Shares representing such ordinary shares, pursuant to the requirements of the Securities and Exchange Commission.

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 of NIS 1.00 each

30,203,917

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 No

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Indicate by check mark which financial statement item the Registrant has elected to follow:

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INTRODUCTION

As used herein, references to we, our, us, Matav or the Company are references to Matav-Cable Systems Media Ltd., Matav Investments Ltd., Cable Systems Media Haifa-Hadera Ltd., Nonstop Internet (1999) Ltd., Matav Assets Ltd., Matav Infrastructure Ltd. and Matav Infrastructure 2001, L.P., all of which are wholly owned subsidiaries, and Nonstop Ventures, Ltd., except as the context otherwise requires.

In this document, references to \$, US\$, US dollars and dollars are to United States dollars and references to NIS and shekels are to Israeli Shekels. This annual report contains translations of NIS amounts into US dollars at specified rates solely for the convenience of the reader. No representation is made that the amounts referred to in this annual report as convenience translations could have been or could be converted from NIS into US dollars at these rates, at any particular rate or at all. The translations of NIS amounts into US dollars appearing throughout this annual report have been made at the representative exchange rate on December 31, 2003 of NIS 4.379= US\$1.00 as published by the Bank of Israel, unless otherwise specified. See Item 3A. Key Information Selected Financial Data Exchange Rate Data.

We maintain our financial books and records in shekels and present our financial statements in conformity with generally accepted accounting principles in Israel, or Israeli GAAP. As applicable to our financial statements, Israeli GAAP and U.S. GAAP vary in certain respects, as described in Note 26 to the financial statements. We present our historical statements in shekels that have been adjusted to reflect changes in purchasing power due to changes in the Israeli consumer price index. Unless otherwise specified in this annual report, all financial data relating to us are presented in shekels adjusted to December 31, 2003 purchasing power (adjusted NIS). See Item 5B. Liquidity and Capital Resources - Impact of Inflation and Exchange Rate Fluctuations and Note 23 to the financial statements.

FORWARD-LOOKING STATEMENTS

This annual report includes forward-looking statements within the meaning of Section 27A of the US Securities Act of 1933, as amended, Section 21E of the US Securities Exchange Act of 1934, as amended, and the safe harbor provisions of the US Private Securities Litigation Reform Act of 1995. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to risks, uncertainties and assumptions about us.

Words such as believe, anticipate, expect, intend, seek, will, plan, could, may, project, goal, target and similar identify forward-looking statements but are not the only way we identify these statements. All statements other than statements of historical fact included in this annual report, including the statements in the sections of this annual report entitled Item 3D. Key Information Risk Factors, Item 4. Information on the Company and Item 5. Operating and Financial Review and Prospects and located elsewhere in the annual report regarding our future performance, plans to increase revenues or margins or preserve or expand market share in existing or new markets, reduce expenses and any statements regarding other future events or our future prospects, are forward-looking statements.

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We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including all the risks discussed in Item 3D. Key Information Risk Factors, Item 4. Information on the Company and Item 5. Operating and Financial Review and Prospects. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this annual report might not occur.

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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

3A. SELECTED FINANCIAL DATA

The following table sets forth our selected consolidated financial data as at and for each of the years in the five-year period ended December 31, 2003. The selected consolidated financial data for the years ended December 31, 1999, 2000, 2001, 2002 and 2003 are based on consolidated financial statements that have been prepared in accordance with Israeli generally accepted accounting principles, or GAAP. As applied to our consolidated financial statements, Israeli GAAP and U.S. GAAP vary in certain respects, as described in Note 26 to the financial statements.

We were incorporated on June 28, 1987. The selected consolidated financial data set forth below should be read in conjunction with Item 5. Operating and Financial Review and Prospects, and the financial statements and notes thereto included elsewhere in this report on Form 20-F. The financial data for the year ended as at December 31, 2003 have been translated into US dollars using the representative rate of exchange of the US dollar to the New Israeli Shekel, as published by the Bank of Israel, at December 31, 2003 (NIS4.379 = US\$1.00). The translation is solely for convenience and should not be construed as a representation that Israeli currency amounts actually represent, or could be converted into US dollars.

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	1999	2000	2001	2002	2003	2003
(adjusted NIS)	NIS (in thousands) *	NIS (in thousands) *	NIS (in thousands) *	NIS (in thousands) *	NIS (in thousands)*	\$ (in thousands)*
Revenues	481,491	474,670	469,389	495,536	545,480	124,567
Operating income (loss)	115,029	(61,612)	(129,851)	(98,681)	(7,819)	(1,786)
Financial expenses, net	9,253	34,324	52,088	48,089	83,958	19,173
Other income (expenses) net	440,213	1,007	3,053	278,535	80,996	18,496
Income (loss) before taxes on income	545,988	(94,930)	(178,886)	131,765	(10,781)	(2,462)
Equity in earnings (losses) of affiliated companies, net	(151,252)	(128,554)	(78,822)	10,910	40,907	9,342
	334,060	(223,654)	(257,274)	33,824	(5,450)	(1,244)

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Net income (loss), under Israeli GAAP						
Net income (loss) per ordinary share, under Israeli GAAP	11.2	(7.7)	(8.9)	1.2	(0.2)	(0.04)
Net income (loss) per ADS, under Israeli GAAP	22.4	(15.4)	(17.8)	2.4	(0.4)	(0.08)
Weighted average number of shares outstanding in thousands, basic, under Israeli GAAP	29,899	28,914	28,834	28,860	29,347	29,347
ADS shares outstanding in thousands, basic - under Israeli GAAP	14,950	14,457	14,417	14,430	14,674	14,674
Net income (loss), under US GAAP	214,203	(219,400)	(215,639)	27,451***	(38,093)	(8,699)
Net income (loss) per ordinary share, under US GAAP	7.9	(7.7)	(7.4)	1.0***	(1.3)	(0.3)
Net income (loss) per ADS, under US GAAP	15.8	(15.4)	(14.8)	2.0***	(2.6)	(0.6)
Weighted average number of shares outstanding in thousands, basic, under US GAAP	17,243	28,604	29,286	28,860	29,347	29,347
ADS shares outstanding in thousands, basic, under US GAAP	13,622	14,302	14,643	14,430	14,674	14,674
Capital expenditures	134,330	394,206	272,817	116,841	55,655	12,710
<u>Balance Sheet Data:</u>						
Fixed assets, net	633,233	912,346	1,038,087	991,998	876,825	200,234
Total assets, net	1,142,814	1,163,059	1,183,732	1,132,626	1,142,552	260,916
Short-term credit (including current maturities of bank loans and debentures)	49,968	249,657	561,365	547,853	469,104	107,126
Long-term bank loans	1,714	233,300	186,154	142,085	127,403	29,094
Debentures	170,830	142,479	132,457	99,462	66,145	15,105
Shareholders equity under Israeli GAAP	536,061	367,694	112,273	147,072	180,748	41,276
Shareholders equity under US GAAP	408	299,831	102,552	281,409***	352,601	80,521
EBITDA**	203,275	44,504	256	56,735	146,992	33,567

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* The data set forth in the table above is expressed in NIS or US dollars, as applicable, except for data set forth in the table regarding numbers of shares and ADSs, as applicable.

** EBITDA is presented because it is a measure commonly used in the telecommunications industry and is presented solely in order to improve the understanding of the Company's operating results and to provide perspective regarding these results. EBITDA, however, should not be considered as an alternative to operating income or income for the period or as an alternative to cash flow from operating activities or as a measure of liquidity. EBITDA is not a measure of financial performance under generally accepted accounting principles and may not be comparable to other similarly titled measures for other companies.

EBITDA may not be indicative of the historic operating results of the Company nor is it meant to be predictive of potential future results. Reconciliation between the operating profit in the financial statements and EBITDA is presented in Item 5A. Operating and Financial Review and Prospects - Operating Results .

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*** Restated. See Note 26c to the financial statements.

Exchange Rate Data

The following table sets forth, for the years indicated, exchange rates between the shekel and the US dollar, expressed as shekels per US dollar and based upon the daily representative rate of exchange on the last day of each year as published by the Bank of Israel.

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004(2)</u>
Average(1)	4.14	4.077	4.214	4.736	4.512	4.593
High	4.29	4.198	4.416	4.994	4.924	4.634
Low	4.01	3.967	4.041	4.437	4.283	4.554
End of period	4.15	4.041	4.416	4.737	4.379	4.555

(1) Calculated based on the average of the exchange rates on the last day of each month during the relevant period.

(2) Through May 31, 2004.

	<u>December 2003</u>	<u>January 2004</u>	<u>February 2004</u>	<u>March 2004</u>	<u>April 2004</u>	<u>May 2004</u>
High	4.441	4.483	4.493	4.535	4.599	4.634
Low	4.352	4.371	4.437	4.483	4.515	4.555

At May 31, 2004, the representative rate of exchange was NIS 4.555 per US dollar, as published by the Bank of Israel.

Changes in the exchange rate between the shekel and the US dollar could affect our financial results.

Payment of Dividends to Shareholders

Our board of directors decided, on December 27, 1999, to distribute an interim cash dividend to our shareholders who held shares on January 11, 2000, in the nominal amount of NIS 7.576 (approximately US\$1.82) per ordinary share, for a total nominal amount of approximately NIS 222.0 million paid to the shareholders on January 26, 2000. Distribution of this dividend was approved as a final dividend for the year 1999 at our annual general meeting of shareholders held on December 31, 2000. No dividends were declared in 2000, 2001, 2002 or 2003.

3B. CAPITALIZATION AND INDEBTEDNESS.

Not applicable.

3C. REASONS FOR THE OFFER AND USE OF PROCEEDS.

Not applicable.

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3D. RISK FACTORS

Risks relating to our business and our industry

In order to operate our business, we must have and maintain valid licenses.

We conduct our operations pursuant to two general non-exclusive cable broadcast licenses, referred to as the Cable Broadcasting Licenses, granted by the Council of Cable and Satellite Broadcasting, or the Council, on April 30, 2002, and a special broadcasting HeadEnd license, referred to as the Broadcasting HeadEnd License, granted by the Israeli Minister of Communications on May 2, 2002. In addition, we received a non-exclusive telecommunications infrastructure license, referred to as the Telecommunications Infrastructure License, from the

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Minister of Communications in March 27, 2002. On November 2003, the Minister of Communications granted to HOT Telecom L.P., or HOT Telecom, a limited partnership owned approximately 26.5% by us, with the remainder owned by the other two Israeli cable television operators, Tevel Israel International Ltd. Group, or Tevel, and Golden Channels & Co. Group, or Golden Channels, an infrastructure license, referred to as the HOT Telecom Infrastructure License, covering the same services covered by the Telecommunications Infrastructure License and also including the requirement to start to provide domestic fixed communications services over cable networks including basic telephony services, to subscribers by November 25, 2004. The HOT Telecom Infrastructure License replaced and cancelled the Telecommunications Infrastructure License granted to us in 2002.

The Cable Broadcast Licenses are effective for a period of fifteen years, and the HOT Telecom Infrastructure License is effective for a period of twenty years, and each can be extended by additional ten-year periods if the Council, in respect of the Cable Broadcast Licenses, or the Minister of Communications, or the Minister, in respect of the HOT Telecom Infrastructure License, determine that we, or HOT Telecom, as applicable, have:

complied with the terms and conditions of the licenses and the applicable law and regulations;

complied with the instructions of the Council and the Minister;

continuously acted in a manner to improve our broadcasts, the technology of the broadcasts and the scope, availability and quality of our telecommunications services and our network technology;

the ability to continue to provide the broadcasts and to invest in improvements of the broadcasts in the future, and the ability to continue to provide the telecommunications services and make necessary investments in order to update our technology and the scope, availability and quality of our telecommunications services; and

continued to comply with the conditions upon which our licenses were granted.

Our Broadcasting HeadEnd License is valid for so long as our Cable Broadcast Licenses remain in force, but in any event no later than May 30, 2017, although we may apply for an extension of the Broadcasting HeadEnd License beyond this date.

In order to ensure compliance with our obligations pursuant to our Cable Broadcast Licenses, applicable law and regulatory bodies, we have provided a bank guarantee in the amount of NIS 9.2 million to the Council. In order to ensure compliance with the HOT Telecom Infrastructure License, we and the other two Israeli cable television operators provided bank guarantees in the aggregate amount of \$14 million to the Minister. The bank guarantee provided by us was in the total amount of \$3.72 million.

Each of the Minister and the Council has the authority to exercise the guarantees in the event that the licensee does not fulfill its obligations, and to cover any damage, loss or cost that the Council, the Minister or the government may incur as a result of any breach of obligations under the licenses, and to ensure any payments by the licensee, including royalty payments and payments of fines imposed by the Council or the Minister. The exercise of the guarantee does not derogate from the authority of the Council or the Minister to cancel the licenses, to amend the terms and conditions of the licenses or to impose other sanctions, including fines for certain stipulated breaches or actions.

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The Council or the Minister, as applicable, have the authority to amend the terms of our licenses or the HOT Telecom Infrastructure License, at any time, and, in relation to the Cable Broadcast Licenses, the Council must take into account any prejudice to the licensee that would result from such amendment. Further, the licenses may be cancelled for material breach of their provisions, or non-compliance with legal requirements, or the failure to remedy of an immaterial breach. The HOT Telecom Infrastructure License can further be cancelled by the Minister for non-supply of services, non-fulfillment of the conditions of receipt of the license, breach of the restrictions upon the means of control of HOT Telecom, breach of cross ownership restrictions or breach of obligations to provide information to the Minister. HOT Telecom is also required to meet certain requirements pursuant to the HOT Telecom Infrastructure License regarding the laying down of network infrastructure.

Although we believe that we are currently in compliance with all material requirements of our licenses, the interpretation and application of the standards used to measure these requirements are not certain, and disagreements may arise in the future between us and the Minister or the Council.

We are subject to special regulatory restrictions applicable to monopolies, which limit our ability to control the conduct of our business.

On November 8, 1999, the Controller of Restrictive Business Practices, or the Controller, declared that we, and all the other cable television operators in Israel, constitute a monopoly in the provision of multi-channel cable television services in our then respective franchise areas (which are the same areas in which we operate pursuant to our current licenses). On December 28, 1999, we filed an appeal of this

declaration in the Restrictive Business Practices Court, which has not yet been decided. Until the appeal is finally resolved (and thereafter, if the Controller's declaration is not dismissed), we are (and will continue to be) subject to the supervision of the Restrictive Business Practices Authority, in addition to the existing supervision of the Minister and the Council, including in the areas of pricing, quality of broadcasting services, agreements with our subscribers, agreements with content providers and the use of our cable television network. There can be no assurance that the declaration of the Controller will be dismissed.

We and the other cable television operators have agreed on the terms of a merger. The merger might not be consummated, and if it is, we might not be able to realize any anticipated benefits from the merger.

In February 2003, we and the other Israeli cable television operators agreed on a final version of an agreement outlining the structure and conditions of a merger among us. To date, the final merger agreement has not been signed, and we cannot predict when and if it will be signed.

Prior to the merger we will need to reach an understanding with the major Israeli banks, which are creditors of the parties to the merger. The merger must also receive approvals under applicable law, including the approvals of the Council, the Income Tax Commission, the Controller, and by an Israeli court, after receiving the approvals of certain creditors and the relevant corporate bodies of the relevant parties. To date, approvals have been granted, subject to terms and conditions, from the Council, the Controller and the Income Tax Commission. Subject to the final terms of the merger, further approval of the Income Tax Commission to the merger may be required. The Supervisor of Banks of the Bank of Israel, or the Supervisor of Banks, has not yet approved the merger, and has expressed reservations due to certain limitations under Israeli banking laws.

According to the position of the Supervisor of Banks, the merger of the cable operators and the formation of a merged cable entity would constitute a deviation from the directives of the Bank of Israel and of Proper Bank Management Directives of the Supervisor of Banks regarding, among other things, restriction on a Group of Borrowers as such term is defined in the Proper Bank Management Directives. The relevant directives deal with the issue of the giving of loans by banking corporations and allocation of the merged company's debts, among other things, to an indirect controlling shareholder of Matav.

Since April 2002, in accordance with the approval of the Controller to the proposed merger, we cooperate with the other two Israeli cable television operators in order to strengthen our competitive position in the telecommunications market and to achieve maximum operating efficiency in a broad range of activities, including, among others, our marketing and content related activities.

On November 19, 2003, we, together with the other Israeli cable television operators submitted a request to the Controller for an exemption from the requirement to receive an approval of a restrictive arrangement under Section 14 of the Restrictive Business Practices Law, to cover the period from November 16, 2003 and until the earlier of the date of consummation of the merger of the cable television operators or November 15, 2004, in order to facilitate the consummation of the merger. The application for the exemption related to the existing joint activities of the cable television operators, including among other things, multi-channel television broadcasts, domestic fixed telecommunications services, including access to High Speed Internet and telephony services, marketing, production and content purchasing. On December 17, 2003, the Controller granted us and the other cable television operators an exemption for a period of one year, until December 15, 2004. This exemption is conditional upon, among other things, all of the cable television operators refraining from taking any irreversible actions which would prevent them from being able to undertake separate and independent activities in the event that the merger will not be completed, or from undertaking any cooperation among themselves prior to December 15, 2004 which is not reversible.

In light of the above, there can be no assurance that the merger will take place, the date on which it will take place or the structure that will be implemented, and accordingly our management is examining the options available to us in order to continue the existing cooperation among the cable television operators, including the possibility of purchasing Tevel's cable television and access to High Speed Internet subscribers.

In this regard, we have entered into negotiations with Tevel and its shareholders regarding the purchase by us of all of Tevel's assets, including Tevel's holdings in Golden Channels. If we were to acquire Tevel's assets, we would have over 580,000 cable subscribers, representing approximately 60% of the Israeli cable television market, and we would hold 35% of Golden Channels. We have not signed a binding agreement with Tevel, and cannot be certain that this transaction will be completed, or if completed, on what timeframe or on what terms and conditions, including price. If this transaction were to take place, we would likely incur or assume substantial additional indebtedness. We believe that if we were to acquire all of Tevel's assets as aforesaid, the proposed merger of the three Israeli cable television operators would not be completed in its current proposed form.

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In order to strengthen the cooperation of the three Israeli cable television operators, we, Tevel and Golden Channels recently agreed to perform an operational merger. To this effect, a joint management was recently appointed to oversee the operational merger of the marketing, sales, engineering, customer service, operations and information systems activities of the three cable companies. We will be subject to decisions taken by the joint management of the merged operations, and accordingly, these decisions will affect our policy-making in the areas of the joint activities. There can be no assurance that the operational merger will result in a successful integration of the operations of us, Tevel and Golden Channels, or whether the operational merger will in fact enhance our profits and competitiveness.

There can be no assurance that the merger will be consummated. In the event that the merger is not consummated, it will be more difficult for us to realize our objectives and to compete effectively. In addition, should the merger not be consummated, our overall expenses may increase, since we may no longer benefit from reduced costs, which result from our joint activities with the other two Israeli cable television operators.

If the merger is consummated, there can be no assurance whether: (i) the conditions of the merger will enable the merged entity to successfully compete; (ii) there will be a successful integration between the merged entities; and (iii) the combined entity will be able to compete effectively against current or future competitors and will realize the anticipated benefits of the merger.

If the merger is consummated, we face the following risks:

As a result of the merger, we may be characterized as a passive foreign investment company, and as a result our U.S. shareholders may suffer adverse tax consequences. Generally, if for any taxable year 75% or more of our gross income is passive income, or at least 50% of our assets are held for the production of, or produce, passive income, we may be characterized as a passive foreign investment company for U.S. federal income tax purposes. This characterization could result in adverse U.S. tax consequences to our shareholders, including having gain realized on the sale of our shares be treated as ordinary income, as opposed to capital gain income, and having potentially punitive interest charges apply to such sales proceeds. U.S. shareholders should consult with their own U.S. tax advisors with respect to the U.S. tax consequences of investing in our ordinary shares.

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As a result of the merger, we may be deemed to be an investment company under the Investment Companies Act of 1940. A significant part of our assets may constitute investment securities as defined in the Investment Company Act. If we were deemed to be an investment company, then we would be required to be registered as such. In that case there would be a substantial risk that we would be in violation of the Investment Company Act because of the practical inability of a non-U.S. company to register under the Investment Company Act. If we were deemed to be an unregistered investment company under the Investment Company Act, our contracts may be voidable, we might not be allowed to offer securities in the United States, and we may also be subject to other materially adverse consequences.

The sums that will be deemed to have been borrowed by the merged entity may exceed the maximum borrowing limit of a single borrower under Israeli banking laws, which might materially restrict the ability of the merged entity to receive loans from Israeli banks. In addition, we, the merged entity and the other parties to the merger may be subject to additional limitations in connection with the receipt of loans from Israeli banks due to restrictions under Israeli Banking laws pertaining to the maximum borrowing by a group of borrowers.

The goodwill contributed to the merged entity by the merging entities could result in accounting expenses under Israeli GAAP in the years following the consummation of the merger that would reduce our shareholders' equity and would have an adverse effect on the public market for our shares and ADSs, and may negatively affect our ability to pay dividends to our shareholders. A material reduction in our shareholders' equity could cause our shares to be delisted from the Tel Aviv Stock Exchange and Nasdaq National Market.

For the merger, including certain ancillary actions performed in the framework of the merger, to qualify, pursuant to the approval of the Israeli Income Tax Commission, as a tax-free transaction under Sections 103, 104 and 105 of the Israeli Income Tax Ordinance, the merging entities and their respective shareholders (including us) are required to comply with certain restrictions, including restrictions on certain issuances of shares of the merged entity and restrictions on the number of shares that may be sold by the shareholders of the merged entity. In addition, the merged entity may not sell a majority of the assets (as defined in the Income Tax Ordinance) transferred to it by the merging entities during this restricted period, and no actions, transfers, provision of guarantees or any other activities may be performed between the merged entity and the other entities that participated in the merger, including their respective shareholders. In the event that any of these conditions or restrictions are not complied with, the tax exemption may be retroactively cancelled and the merger may be subject to tax, plus a consumer price index linkage adjustment and interest. These restrictions may deter an acquisition of the merged entity, and prevent us from selling or disposing of our shares in the merged entity. Additionally, subject to the final terms of the merger, further approval of the Income Tax Commission to the merger may be required and additional conditions or restrictions may be imposed on the merged entity, the merging entities and their respective shareholders.

The terms and conditions of the approvals that we have received to date to the merger affect the ability of the merged entity to manage its business, and restrict the ability of the merged entity to utilize any potential competitive advantage it may otherwise have.

In the event that the Controller considers there to be a material decline in the multi-channel television market as a result of the consummation of the merger, he has the power to oblige the merged entity to allow other broadcast license holders (including YES, the Israeli satellite multi-channel television operator) usage of the network infrastructure to access all potential subscribers, and not only to the subscribers of the merged entity.

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A condition of the approval of the Controller to the merger is an obligation upon the merged entity to begin to supply fixed line telephony services over cable infrastructure to the Israeli public not later than November 20, 2004. The merged infrastructure entity is obligated to invest in fixed line telephony cable infrastructure an aggregate of not less than NIS105 million until June 30, 2004, not less than NIS140 million until June 30, 2005, not less than NIS105 million until June 30, 2006 and any other amount as shall be required for the fulfillment of its business plan for the provision of telephony services which fully compete with those of Bezeq. We are responsible for 26.5% of these investments.

The approval of the Controller to the merger is conditional upon the provision of a bank guarantee in the amount of \$15 million to ensure compliance with the terms of the approval. In the event that the Controller decides, in his discretion, that there has been a material breach of the terms of the approval, he may fully or partially exercise the guarantee. We have provided our pro rata portion of this amount, by giving a guarantee in the amount of \$3.75 million.

Certain members of the Dankner family, which indirectly control Dankner Investments Ltd., one of our principal shareholders, also own indirectly 11.63% of Bank Hapoalim Ltd., the largest bank in Israel, and constitute part of the controlling group of Bank Hapoalim Ltd., which own approximately 45.18% of the Bank. We are consequently subject to restrictions under Israeli banking laws concerning credit, consents and limitations with respect to our relationship with Bank Hapoalim. The restrictions to which we are subject may therefore apply to the merged entity. Additionally, Bank Hapoalim is a creditor of the other parties to the proposed merger, and will therefore be a creditor of the merged entity. Please see Item 4C. Organizational Structure for a discussion of a recent transaction and pending further transaction between shareholders of Dankner Investments Ltd. and Delek Real Estate Ltd.

Our joint activities with the other two Israeli cable television operators is subject to regulation and antitrust review, which limits our ability to cooperate with them, causes us significant expenses and makes the future of these joint activities uncertain.

In 1989, together with the other two Israeli cable television operators, we established I.C.P. Israel Cable Television Programming Company Ltd., or ICP, for the purpose of jointly purchasing and producing content for our local cable channels. In January 2004, ICP changed its legal name to HOT Vision Ltd. Prior to the approval of the Controller to the proposed merger of the Israeli cable television operators, the validity of HOT Vision's activity was subject to the approval of the Restrictive Business Practices Authority. Under the approval of the Controller to the proposed merger of the Israeli cable television operators, it will not be necessary for the activity of HOT Vision to be subject to the approval of the Restrictive Business Practices Court. Should the merger not be consummated, the activity of HOT Vision will continue to be subject to the supervision of the Restrictive Business Practices Authority.

On November 19, 2003, we, together with the other two cable television operators, submitted a request to the Controller for an exemption from the requirement to receive the approval of the Restrictive Business Practices Court for a restrictive arrangement with respect to the period from November 16, 2003 and until the earlier of the date of consummation of the merger of the cable television operators, or November 15, 2004, in order to facilitate the consummation of the merger. The application for the exemption related to the existing joint activities of the cable television operators, including among other things, with respect to multi-channel television broadcasts, domestic fixed telecommunications services, including access to High Speed Internet and telephony services, marketing, production and content purchasing. On December 17, 2003, the Controller granted us the requested exemption for a period of one year. This exemption is conditional upon, among other things, all of the cable television operators refraining from taking any irreversible actions which would prevent them from being able to undertake separate and independent activities in the event that the merger will not be completed, or from undertaking any cooperation among themselves prior to December 15, 2004 which is not reversible. If the merger is not consummated, it will be necessary for us to receive an extension of this exemption. There can be no assurance that the Controller will agree to extend this exemption. If this exemption will not be extended, we may be required to cease our joint activities with the other two cable television operators.

The terms and conditions of the approvals of the Council and the Controller to the proposed merger also impose significant restrictions on the activity of the merged entity in relation to all areas of our business, including programming, marketing and broadcasting. We currently have the obligation to fulfill most of the conditions of the Controller's approval of the proposed merger.

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Each of the Israeli cable television operators, including us, is also under a continuing obligation, as set forth in the Telecommunications Law and in our Cable Broadcast Licenses, to fulfill programming obligations which remain outstanding pursuant to the previous franchises, including the obligation to invest in local productions. According to our Cable Broadcast Licenses, we may notify the Council of our intention to remove certain channels from our Basic Packages and to transmit those channels within the Premium Broadcastings that we offer our digital subscribers in our tiering system. In such event, the Council has the authority to recommend to the Ministry of Communications that our analog subscriber fees for the Basic Package be reduced. If the Ministry of Communications will order us to reduce our fees, this could have a material impact on our revenues, if the fees received from other sources do not compensate for the loss of such fees.

The telecommunications industry in Israel is highly regulated which limits our flexibility to manage our business.

Our business is subject to regulation under the Israeli Telecommunications Law as amended, or the Telecommunications Law, regarding, among other things:

- licenses;
- royalties and other payments to be paid by licensees to the government;
- content and scope of programming;
- the subscriber charges set by cable television operators for their cable television services;
- our cable infrastructure that will become a public telecommunications network; and
- the nature of telecommunications services.

Changes in laws, regulations or government policy affecting our business activities could adversely affect our business and operations. We cannot make any assurance that the Minister will not intervene in relation to the amounts we charge our subscribers.

As a result of the changing regulatory environment we have lost the competitive advantage we previously enjoyed as a holder of exclusive franchises, and we face competition from a variety of sources. This has lowered the entry barriers for potential new competitors and may affect our ability to provide services to our subscribers.

The Israeli telecommunications market is in a state of transition, moving to a more liberalized environment in which various markets are being gradually opened to competition. Amendments to the Telecommunications Law replaced the previous system of exclusive franchises by general non-exclusive licenses. The licenses we have received (and the terms of the approvals we have received from the regulatory authorities with regard to the proposed merger between the Israeli cable television operators), have significantly reduced the barriers to entry into our market and impose conditions upon us that allow our competitors to access our subscribers.

In January 1999, the Ministry of Communications granted a license for the provision of television broadcasts to subscribers in Israel via satellite to D.B.S. Satellite Services (1998) Ltd., commonly known as YES. YES began to operate and market its broadcasts in July 2000. Bezeq Israel Telecommunications Corporation Ltd., or Bezeq, is a principal shareholder of YES. Bezeq is a government company, which was declared as a monopoly by the Controller over the provision of basic telephony services, telecommunications infrastructure services, data transmission services and ancillary services and access to High Speed Internet. Bezeq has great financial resources, which it may place at the disposal of YES, thereby allowing YES to offer its services at low prices and use aggressive marketing strategies, including providing set-top boxes free of charge. For these reasons, we may not be able to successfully compete with YES. We also have an obligation to lease our inside wiring to YES, and YES is under a reciprocal obligation to us, pursuant to directives issued by the Minister of Communications. Such competition from YES has affected our income, reduced the number of our subscribers and caused us increased expenses, mainly in marketing and programming. In particular, the purchasing power of YES has raised the cost of content purchasing from the major production companies (namely Warner Brothers, Universal, Buena Vista, Paramount, MGM, Sony Columbia and Twentieth Century Fox).

The Telecommunications Law, our licenses and the terms of the approvals we have received to date from the regulatory authorities with regard to the proposed merger of the Israeli cable television operators, also may impose upon us an unbundling obligation, the purpose of which is to encourage competition in accordance with, and subject to the conditions of our licenses and applicable law. The obligation allows other broadcasting licensees access to our subscribers through our network infrastructure on terms that are not inferior to the terms that will be provided by HOT Telecom under the HOT Telecom Infrastructure Licensee, to our Cable Broadcast Licensees; and also allows other

telecommunications licensees (who may therefore be providers of, among other things, other value added services) to have access to our infrastructure. Furthermore, pursuant to the terms of the approvals we have received in relation to the proposed merger between the Israeli cable television operators, in the event that the Controller considers there to be a material decline in competition in the multi-channel television market we may be instructed to allow YES, or other broadcast licensees, usage of our network infrastructure to all potential subscribers, and not only to our subscribers, so long as our cable network infrastructure reaches their premises. If YES ceases to operate due to insolvency, this will be deemed to be a material decline in competition in the multi-channel television market and we may be instructed to allow YES or its successor usage of our network infrastructure as mentioned above.

Pursuant to our licenses and the Telecommunications Law, we are obliged to reserve and allow one sixth of our broadcasting network capacity for broadcasts of channels produced by special cable broadcast licensees to our subscribers. According to the Telecommunications Law, without derogating from the general unbundling obligation referred to above, and taking into account the obligation to reserve one sixth of our network capacity, the Minister has the authority to direct HOT Telecom to designate network capacity for the transmission of broadcast and other telecommunications services of a third party.

We cannot anticipate how and to what extent these obligations may affect our income and expenses, or our subscriber base in the future.

The provision of access to High Speed Internet over cable services in Israel is characterized by significant competition.

In April 2002, we commenced to provide access to High Speed Internet over cable services. In November 2003, HOT Telecom was granted a license to supply these services instead of us and the other cable companies. Our subscribers and those of the other cable companies have not yet been formally assigned to HOT Telecom. We are currently evaluating the implications of performing such assignment, and we have so notified the Minister of Communications. We have incurred considerable capital expenditure preparing for the provision of this service and anticipate that we and HOT Telecom shall continue to invest in the improvement and maintenance of this service in the future. However, we and HOT Telecom face significant competition in the access to High Speed Internet market from the government owned Bezeq and may face competition in the future from other well placed competitors. We can make no assurance that we will be able to compete effectively with such competitors, or that we will be successful in realizing a significant return on our investments in this service.

The provision of domestic fixed communications services in Israel is characterized by significant competition.

HOT Telecom must start providing basic telephony services over cable network to the Israeli public by no later than the end of November 2004. Pursuant to the approval of the Controller to the proposed merger of the cable operations, as amended, the merged infrastructure entity is obligated to invest in fixed line telephony cable infrastructure an aggregate of not less than NIS105 million until June 30, 2004, not less than NIS140 million until June 30, 2005, not less than NIS105 million until June 30, 2006 and any other amount as shall be required for the fulfillment of its business plan for the provision of telephony services which fully compete with those of Bezeq. We are responsible for 26.5% of these investments.

On September 17, 2002, the Minister of Communications adopted, with certain changes, the recommendations of a committee formed by the Ministry of Communications for the establishment of policies and rules for the opening of competition in the field of domestic fixed communications services, as the guiding principles in this field. In order to implement the committee's recommendations, the Israeli parliament approved an amendment to the Telecommunications Law at the end of May 2003. Under this amendment, as of September 1, 2004, the Minister may grant a special general license for domestic fixed telecommunications services without imposing on the holders of such licenses the obligation to provide their services to the entire public throughout the entire country or in any specifically defined area in Israel. The Ministry of Communications recently published the language of the special general license.

In March 2004, the Minister announced its new policy with respect to Bezeq's general license such that Bezeq would be allowed in the future, subject to certain conditions, to give discounts for size and allow the provision of a basket of services together with its subsidiaries. This would enable Bezeq to provide services jointly with its affiliates, which it was not allowed to do in the past, including among other things, telephony services (local and international), multi-channel television services, cellular services and access to High Speed Internet services. The Minister intends to hold a hearing on this policy. If the policy described above is implemented, HOT Telecom may not be able to compete effectively with Bezeq and others, and it may not recover its significant investments in telephony services. In addition, the offering by Bezeq of a basket of services, including multi-channel television services through YES, may have a material effect on our ability to supply telephony services to our subscribers and could cause us to lose multi-channel television subscribers. Accordingly, we may suffer losses as the result of our holdings in HOT Telecom, which would affect our results of operations.

We may face competition from other existing technologies in broadcasting and infrastructure that may be implemented in Israel, or new technologies that could reduce the appeal of our services.

While we believe that our existing technologies allow us to effectively compete with other existing technologies implemented in Israel, we may face competition from new technologies that may be implemented in Israel. We cannot anticipate whether, and to what extent if at all, future changes in technology will materially affect the continued use of fiber optic and coaxial cabling technologies that we employ. We may also face competition from technologies in development or that may be implemented in the future, such as LMDS and other wireless technologies in the fields of data over cable and telephony, video on demand or VOD, personal video recorder, or PVR, services that may be deployed over DSL, and satellite platforms. We cannot predict the effect of existing, emerging and future technological changes on the viability or competitiveness of our system. Accordingly, we cannot make any assurance that the technologies we currently employ, or shall employ in the future, will not become obsolete or subject to competition from new technologies in the future.

Our financial condition may be affected by the market price of one of the cellular telecommunications companies authorized to operate in Israel, in which we have invested.

We hold approximately 5.3% of the outstanding share capital of Partner Communications Company Ltd., or Partner, whose shares are traded on the Tel Aviv Stock Exchange under the symbol PTNR . American Depositary Shares, or ADSs, each representing one of Partner s ordinary shares are quoted on the Nasdaq National Market under the symbol PTNR , and are traded on the London Stock Exchange under the symbol PCCD . Partner holds a license to provide cellular telecommunications services in Israel, and is currently one of the two operators in Israel to use the global system for mobile telecommunications, or GSM, a comprehensive digital standard for the operation of all elements of a cellular telephone system on a fully commercial basis. Partner faces intense competition from other cellular telecommunications service operators in Israel and the Palestinian operator, Jawaal, and also faces competition from fixed line operators in Israel, currently Bezeq Israel Telecommunications Corporation Ltd. The market price of Partner s shares has been and may continue to be volatile in response to conditions in the global securities markets in general and the communications and technology sectors in particular. The foregoing and other factors could cause the market price of Partner s shares to fluctuate unpredictably, and could adversely affect the market price of Partner s shares.

Partner s results are reflected in our financial statements through December 31, 2003 on an equity accounting basis and consequently have a material effect on our financial results. All of our current holdings in Partner are pledged to banks under pledges unlimited in sum, to cover Partner s liabilities in respect of its loans from the banks.

We cannot assure you that Partner will be able to successfully compete against existing or new competitors in the field of cellular telecommunications, or that Partner s systems and business plan will be adequate, efficient and capable of performing in light of the large number of material factors that may affect its future operations and prospects.

For information regarding recent negotiations between ourselves and Partner for a transaction, please see Item 7B. Major Shareholders and Related Party Transactions - Related-Party Transactions .

We may lose our investment in an Israeli international telecommunications service provider.

We hold a 10% share ownership interest in Barak I.T.C. (1995) The International Telecommunications Services Corp. Ltd., or Barak, which holds a license to provide international telecommunications services and Internet services in Israel. Barak currently competes with two other licensed international telecommunications service providers, and several substantial Internet service providers. One of these competitors is Bezeq International Ltd., which is a subsidiary of the domestic telecommunications service provider, Bezeq Israel Telecommunications Corporation Ltd., which in the past had a sole monopoly. As a result of this connection, Bezeq International Ltd. has strong name recognition, long-standing customer relations, and significantly greater financial and marketing resources than the other competitors in the international telecommunications market, including Barak.

Users of international telecommunications services may subscribe for the services of any provider in Israel, and may change their choice of provider, at any time. In addition, a user may select the services of any of the providers on a call-by-call basis. As a result, regular subscribers of Barak may not necessarily use Barak services exclusively.

The Minister of Communications has recently granted an additional license for the establishment and operation of international telecommunications systems in Israel to one of the large local access to High Speed Internet providers. In addition, two other companies have applied to the Ministry for such a license. Any resulting competitors may be larger than Barak or have greater financial resources, better technology or services, and Barak may not be able to successfully compete with them. This may have the impact of reducing Barak s market share. Furthermore, the international telecommunications market is characterized by rapidly changing technology and customer requirements,

new industry standards and frequent new product and service introductions. If Barak is unable to anticipate and keep pace with these changes, it may lose market share. Barak's performance or market penetration might not be enhanced and we may lose our investment in Barak.

In addition, according to Barak's financial statements for the first quarter of 2004, as of March 31, 2004, Barak had a capital deficiency in the amount of NIS 563 million and a working capital deficit in the amount of NIS 200 million. If Barak is unable to reach agreement with its banks and other major creditors regarding the restructuring of its debt, or is unable to raise other financing, it might not be able to continue as a going concern, and as a result, we may be required to write-off a substantial portion of our investment in Barak. In addition, if Barak will raise equity financing in the future, and we will elect not to participate in such financing, our shareholding in Barak could be substantially diluted.

One party will directly and indirectly control a large block of our shares.

Delek Investments and Assets Ltd. directly holds 17.98% of our shares. Delek Real Estate Ltd. currently holds 25% of the shares of Dankner Investments Ltd., which holds 22.02% of our shares. In addition, Delek Real Estate Ltd. is expected to close a transaction in the upcoming weeks which will bring its shareholding in Dankner Investments Ltd. to 87.5%. Delek Investments and Assets Ltd. and Delek Real Estate Ltd. are both subsidiaries of Delek Group Ltd. which is controlled by Yitzchak (Tshuva) Sharon. Accordingly, Delek Group Ltd. and Yitzchak (Tshuva) Sharon will become the beneficial owner of 40% of our shares, and as the single largest beneficial shareholder, may have the ability to determine the election of a majority of our directors, and to direct our policies, including the payment of dividends, and may control the outcome of substantially all matters that may be brought before our shareholders. Please see the discussion of a recent transaction and a pending transaction between shareholders of Dankner Investments Ltd. and Delek Real Estate Ltd. in Item 4B. Organizational Structure .

We may not be able to obtain additional capital in order to implement our business plans on favorable terms.

Although our management currently believes that our existing capital resources, including our credit lines, are adequate to satisfy our financial needs in order to implement our business plans for the next 12 months, we may in fact require additional capital. Our financial needs in that period will be subject to, among other things: our ability to successfully provide our services; the need to upgrade our network to provide added value services; the need to acquire additional equipment; the need to implement the buildout of our infrastructure in peripheral areas; and the needs of companies in which we have significant investments, such as Partner, Barak and, if the proposed merger shall be consummated, the merged entity.

Any future equity or debt financing, if available, may be on terms that are not favorable to us, and in the event of equity financing, could result in dilution of our shareholders' interests. Although our principal shareholders have made loans and contributed equity to us in the past, they are not contractually obligated to do so in the future.

We commenced negotiations with the banks regarding an increase of our credit lines. These negotiations were ceased due to the proceedings in connection with the proposed merger of the Israeli cable television operators. Thereafter, these negotiations were recommenced, and then ceased again due to negotiations regarding proposed transactions with Tevel and Partner. Should we recommence such negotiations, there is no assurance that we will reach an agreement with the banks and receive such increased credit lines. In the event that we are granted increased credit lines to meet our financial needs, there can be no assurance that we would be able to obtain terms which are favorable to us, or which are not significantly expensive, in light of current market conditions. Our agreement with the bank supplying one of our credit lines contains a number of covenants relating to, among other things, our debt to equity ratio and the maintenance of a minimum number of subscribers. If we breach any of these covenants, we could be required to accelerate payment of all amounts owing to this bank. For further details regarding this credit arrangement, please see Item 5B. Operating and Financial Review and Prospects Liquidity and Capital Resources .

Our substantial leverage could adversely affect our financial health.

In recent years, we incurred intensive capital expenditures related to the continued construction of our cable television network and other technological projects, and operating losses, which have increased our indebtedness, resulting in our becoming highly leveraged.

Our ability to meet our debt obligations will depend on whether we can successfully implement our strategy, as well as on financial, competitive, regulatory and technical factors, including some factors that are beyond our control. If we are unable to generate sufficient cash flow from operations to meet principal and interest payments on our debt, we may have to refinance all or part of our indebtedness.

We cannot assure you that any such refinancing would be possible on terms that we could accept or that we could obtain additional financing. If refinancing were not possible or if additional financing were not available, we may have to sell our assets under circumstances that might not yield the highest prices, or default on our debt obligations.

Due to the fact that we have a significant amount of short-term loans bearing variable interest rates, we are vulnerable to interest rate increases.

Because we have a significant amount of short-term loans bearing variable interest rates, we are vulnerable to interest rate increases. In the event that the interest rates applicable to our short-term loans should increase significantly, this would increase our expenses. Any significant increase in our expenses will harm our results of operations.

Our industry is subject to rapid technological changes that will cause us to incur capital expenditures to remain competitive.

In order to provide advanced communication services, we have incurred significant capital expenditures expanding our cable network bandwidth from 550 MHz to 860 MHz. We have a technological advancement plan for deployment of additional two-way services, expansion of fiber optic cable networks and a digital broadcasting system or advanced data over cable/IP platform. We also aim to improve the network in terms of redundancy and manageability, by closing fiber rings, enhancing the powering and telemetry measures, and downsizing the fiber nodes. Such enhancements are necessary to allow us to provide telecommunication services at a Telco-Grade quality of service, which is the standard commonly used by telephone companies to grade availability and quality of services. We may not have sufficient capital resources to finance the expenditures required to remain competitive, which could adversely affect our results of operations.

Our business may be impacted by shekel exchange rate fluctuations and inflation.

Our financial statements are presented in shekels, adjusted to reflect changes in the Israeli consumer price index. Consequently, all shekel amounts set forth in our historical financial statements are adjusted each time that we publish new financial statements in order to reflect changes in the Israeli consumer price index as of the date of the latest balance sheet presented. Since we may be unable, or not permitted to raise our rates and fees pursuant to our licenses in a manner that would fully compensate for any increase in the Israeli consumer price index, inflation in Israel may have a material adverse impact upon us. Our financial expenses are also affected by inflation, such that high rates of inflation cause a decrease in the real value of our unlinked assets, which in turn, causes an increase in our financial expenses. Likewise, high rates of inflation cause a decrease in the real value of our unlinked liabilities, which in turn, causes a decrease in our financial expenses.

Substantially all of our revenues and a portion of our operating expenses are denominated in shekels, and on the other hand, substantially all of our programming expenses and certain other expenses are denominated or linked to foreign currency. Thus, any devaluation of the shekel against the US dollar (or other foreign currencies), will also increase the shekel cost of our non-shekel denominated or linked expenses. Such increase may have an adverse impact upon our operating results, which may be material. Our borrowings are mostly in Israeli shekels. We enter into option contracts to protect ourselves from the risk of the possible fluctuations in exchange rates. There can be no assurance that we adequately protect ourselves from exchange rate fluctuations.

Our results of operations may be adversely affected by the implementation of new accounting standards.

In October 2001, the Israel Accounting Standards Board published Accounting Standard No. 12 with respect to the discontinuance of the adjustment of financial statements. In December 2002, Accounting Standard No. 17 was published with respect to the deferral of the effective date of Accounting Standard No. 12 to January 1, 2004.

According to Accounting Standards No. 12 and No. 17, financial statements will cease to be adjusted for inflation in Israel beginning January 1, 2004. Until December 31, 2003, we continued to prepare adjusted financial statements in accordance with Opinion No. 36 of the Institute of Certified Public Accountants in Israel. The adjusted amounts included in our financial statements as of December 31, 2003, will serve as the starting point for nominal financial reporting beginning January 1, 2004.

The effect of the adoption of Accounting Standard No. 12, and its implication on our results of operations is dependent on the rate of inflation in Israel, and on the composition of our assets and our sources of financing. Accordingly, we cannot currently predict the affect that the new accounting standards may have on our results of operations.

The financial situation of the other Israeli cable television operators has an impact upon our business.

Due to the fact that we cooperate closely with the other two Israeli cable television operators, Tevel and Golden Channels, and have recently decided to merge our operations with those of Tevel and Golden Channels, the financial situation of these companies has an impact on our business.

Any future deterioration of Tevel or Golden Channels could have an impact upon our business and our day to day operations, including causing an increase in our respective pro rata portion of joint costs, including, among others, content costs which may have a material adverse affect upon our financial statements. Furthermore, it may affect the possibility of the consummation of the proposed merger between the Israeli cable television operators, and the conditions that the creditors of the companies that are parties to the merger may impose.

We have recently entered into negotiations with Tevel and its shareholders for the purchase by us of all of Tevel's assets. Please see the discussion of this proposed transaction in Item 4B. Business Overview Agreement for a Merger of the Cable Television Operators .

Our previous franchises required us to meet certain milestones with respect to cable access to potential customers in the areas covered by our licenses, which if not met, could expose us to litigation or administrative actions.

Our previous exclusive franchises contained specific construction milestones with respect to regions within a franchise area that must be passed by the cable television network by specified dates. We substantially completed the installation of the regional cable transmission network in all our operating areas, and believe that completing portions of the buildout requirements in peripheral regions in the operating areas would be substantially more expensive, on a per-subscriber basis than in the metropolitan areas. Therefore we did not fully complete build-out requirements in certain peripheral regions. Our current licenses require us to connect any applicant to purchase cable television broadcasts within a specified period of time. The Ministry of Communications or the exceptions committee thereof may allow an exception regarding the time schedule to connect applicants, or the obligation to connect every applicant.

We are subject to a lawsuit and have been subject to other lawsuits in the past, and may be exposed to additional lawsuits in the future, by residents of communities that are not, or were not, connected to our cable television network, seeking to force us to implement the build-out of our network in their communities, or compensation for being prevented from receiving cable television services. See Item 8A. Consolidated Statements and Other Financial Information - Legal and Arbitration Proceedings .

We may be required to pay royalties to, and could be subject to lawsuits by, owners of copyrights in connection with particular programs.

We re-transmit certain foreign channels from third parties. These foreign channels may purchase rights from third parties to broadcast particular programs. According to a recent final ruling of the Israeli Supreme Court in a further hearing, the re-transmission by us of programs broadcast by the foreign channels may constitute an infringement of the rights of the copyright owners of such programs if they did not consent to the broadcast of their programs into Israel. As the result of this ruling, we may be required to reach royalty arrangements with the owners of the copyrights of such programs prior to their re-transmission, in addition to the arrangements we reach with the foreign channels. This could increase our programming costs. In addition, we could be subject to lawsuits by the owners of copyrights in programs broadcast by the foreign channels. If we are found to have violated the copyrights of third parties, we could also be subject to regulatory sanctions. In the ruling, the Supreme Court called upon the legislators to amend the Copyrights Law to address this issue. We cannot predict if and when the legislators will address this issue, nor can we currently predict the magnitude of our exposure to increased royalty obligations and lawsuits relating to programs broadcast by the foreign channels we offer.

Pursuant to tax assessments made by the Israeli Income Tax Authority, we may be required to pay significant additional taxes in respect of past years.

We received tax assessments from the Israeli Income Tax Authority. For details, please see Item 8A. Financial Information Consolidated Statements and Other Financial Information Legal and Arbitration Proceedings . If, as a result of any of these tax assessments, we are required to pay significant additional amounts of taxes to the Israeli Income Tax Authority, our results of operations would be materially affected.

Risks relating to the market for our shares

Our ordinary shares and ADSs are listed for trading on different markets and this may result in price variations.

Our ordinary shares are listed for trading on the Tel Aviv Stock Exchange, or TASE, and our ADSs are listed for trading on the Nasdaq Stock Market, or Nasdaq. Each ADS represents two ordinary shares. Trading in our ordinary shares and ADSs on these markets is made in different currencies (NIS on TASE and US dollars on Nasdaq), and at different times (resulting from different time zones, different trading days and different public holidays in the United States and Israel). Actual trading volume on Nasdaq or the TASE could be insignificant and as such could be subject to volatility. The trading prices of our ordinary shares and ADSs on these two markets often differ, resulting from the factors described above, as well as differences in exchange rates. Any decrease in the trading price of our ordinary shares on the TASE could cause a

decrease in the trading price of our ADSs on Nasdaq, and any decrease in the trading price of our ADSs on Nasdaq could cause a decrease in the trading price of our ordinary shares on the TASE.

Risks relating to operations in Israel

We are subject to the political, economic and military conditions in Israel.

We are incorporated and based in, and currently derive all our revenues in Israel. As a result, the political, economic and military conditions in Israel directly influence us. Hostilities involving Israel, the interruption or curtailment of trade between Israel and its trading partners, political instability within Israel or its neighboring countries, a significant downturn in the economic or financial condition of Israel and changes in Israeli laws and regulations, including taxation, are likely to cause our revenues to fall and harm our business.

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A state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Since October 2000, there has been an increased level of hostilities and violence between Israel and the Palestinians, which has adversely affected the peace process and has negatively influenced our relationship with several Arab countries. The future effect of this deterioration and violence on the Israeli economy and our operations is unclear. From time to time Israeli companies or companies doing business with Israeli companies have been subject to an economic boycott initiated by several Arab countries. This boycott or similar restrictive laws or policies directed towards Israel or Israeli business could adversely affect us.

Due to a continuing budget deficit of the Israeli government and the slow down of the Israeli economy in recent years, the Israeli parliament approved, on May 29, 2003, an economic plan that entails, among other things, budget cuts in various sources of government spending, the increase of various tax liabilities and cuts in various social benefits. It is not known at this stage what impact the implementation of the approved economic plan would have on the Israeli economy. Since we are located in, and currently derive all of our revenues in Israel, economic events in Israel, or uncertainties associated with such events, could adversely affect our operations and financial results.

Our results of operations could be negatively affected by the obligations of our personnel to perform military service.

Some of our directors, officers and employees are currently obligated to perform annual reserve duty. Generally, male adult citizens and permanent residents of Israel under the age of between 45 and 54, unless exempt, may be required to perform up to approximately 36 days of military reserve duty annually. Certain reserve soldiers may be required to serve more. Additionally, all such reservists are subject to being called to active duty at any time under emergency circumstances. While we have operated effectively under these requirements since we began operations, we cannot assess the full impact of these requirements on our workforce and business if conditions should change, and we cannot predict the effect of any expansion or reduction of these obligations on us.

Provisions of our licenses and Israeli law could delay, prevent or make difficult a merger or acquisition or a change of control of us and therefore depress the market price of our shares.

Our Cable Broadcast Licenses and HeadEnd License, and the HOT Telecom Infrastructure License, include restrictions regarding changes of means of control of the licensees.

In addition, provisions of Israeli corporate law may have the effect of delaying, preventing or making more difficult a merger with, or acquisition of, us. The Israeli Companies Law generally requires that a merger be approved by a company's board of directors and by a majority of the shares present and voting on the proposed merger at a meeting called on at least 21 days' notice. For purposes of the shareholder vote, unless a court rules otherwise, the merger will not be deemed approved if a majority of the shares not held by the other party to the merger (or by any person who holds 25% or more of the shares or the right to appoint 25% or more of the directors of the other party or its general manager) have voted against the merger. Upon the request of any creditor of a party to the proposed merger, a court may delay or prevent the merger if it concludes that there is a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy the obligations of the surviving company. In addition, a merger may not be completed unless at least 70 days have passed since the filing of the merger proposal signed by both parties with the Israeli Registrar of Companies.

The Companies Law also provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser will become a 25% or greater shareholder of the company unless there is already a 25% or greater shareholder of the company. Similarly, an acquisition of shares must be made by means of a tender offer if as a result of the acquisition the purchaser would become a 45% or greater shareholder of the company, unless there is already a majority shareholder of the company. In any event, if as a result of an acquisition of shares the acquirer will hold more than 90% of a company's shares, the acquisition must be made by means of a tender offer for all of the shares of such class. If more than 95% of the outstanding shares are tendered in the tender offer, all the

shares that the acquirer offered to purchase will be transferred to it. However, the remaining minority shareholders may seek to alter the consideration by court order. Finally, Israeli tax law treats some acquisitions, such as stock-for-stock exchanges between an Israeli company and a foreign company less favorably than U.S. tax laws. For example, Israeli tax law may, under certain circumstances, subject a shareholder who exchanges his ordinary shares for shares in another corporation to taxation prior to the sale of the shares received in such stock-for-stock swap.

These provisions of our licenses and of the Israeli corporate and tax law (and the uncertainties surrounding such laws) may have the effect of delaying, preventing or making more difficult a merger or acquisition or change of control of us, and depress the market price of our ordinary shares which otherwise might rise as a result of such a change of control.

It may be difficult to (i) enforce a U.S. judgment against us, our officers and directors and our Israeli auditors, (ii) assert U.S. securities laws claims in Israel, and (iii) serve process on substantially all of our officers and directors and these accountants.

We are incorporated in Israel. Substantially all of our executive officers and directors and our Israeli auditors are nonresidents of the United States, and a substantial portion of our assets and the assets of these persons are located outside the United States. Therefore, service of process upon our directors and officers named herein may be difficult to effect within the United States because some of these people reside outside the United States. Any judgment obtained in the United States against us or these individuals or entities may not be enforceable within the United States.

There is doubt as to the enforceability of civil liabilities under the Securities Act and the Securities Exchange Act in original actions instituted in Israel. However, subject to specified time limitations, Israeli courts may enforce a U.S. final executory judgment in a civil matter, provided that:

adequate service of process has been effected and the defendant has had a reasonable opportunity to be heard;

the judgment and its enforcement are not contrary to the law, public policy, security or sovereignty of the State of Israel;

the judgment was obtained after due process before a court of competent jurisdiction according to the rules of private international law prevailing in Israel;

the judgment was not obtained by fraudulent means and does not conflict with any other valid judgment in the same matter between the same parties;

an action between the same parties in the same matter is not pending in any Israeli court at the time the lawsuit is instituted in the U.S. court; and

the U.S. court is not prohibited from enforcing the judgments of Israeli courts.

If a foreign judgment is enforced by an Israeli court, it generally will be payable in new Israeli shekels, which can then be converted into non-Israeli currency and transferred out of Israel. The usual practice in an action to recover an amount in non-Israeli currency is for the Israeli court to render judgment for the equivalent amount in new Israeli shekels at the rate of exchange on the date of payment, but the judgment debtor also may make payment in non-Israeli currency. Pending collection, the amount of the judgment of an Israeli court stated in new Israeli shekels ordinarily will be linked to the Israel Consumer Price Index plus interest at the annual rate (set by Israeli law) prevailing at that time. Judgment creditors bear the risk of unfavorable exchange rates.

ITEM 4. INFORMATION ON THE COMPANY

4A. HISTORY AND DEVELOPMENT OF THE COMPANY

We were incorporated as Matav-Cable Systems Media Ltd. under the laws of the State of Israel on June 28, 1987. Our principal executive offices are located at 42 Pinkas Street, North Industrial Area, Netanya 42134, Israel (telephone: +972-9-860-2160). Our website address is www.matav.co.il. Our agent for service of process in the United States is Puglisi & Associates, 850 Library Avenue, Suite 204, P.O. Box 885, Newark, Delaware 19715.

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We are one of three operators and providers of broadband cable television services in Israel. The other two cable television operators are Tevel Israel International Communications Ltd. Group, or Tevel, and Golden Channels & Co. Group, or Golden Channels. We market our cable television services and engage in content-related activities together with Tevel and Golden Channels under the brand name HOT .

In order to strengthen the cooperation of the three Israeli cable television operators, we, Tevel and Golden Channels recently agreed to perform an operational merger. To this effect, a joint management was recently appointed to oversee the operational merger of the marketing, sales, engineering, customer service, operations and information systems activities of the three cable companies. We will be subject to decisions taken by the joint management of the merged operations, and accordingly, these decisions will affect our policy-making in the areas of the joint activities. There can be no assurance that the operational merger will result in a successful integration of the operations of us, Tevel and Golden Channels, or whether the operational merger will in fact enhance our profits and competitiveness.

Prior to the grant of our licenses in 2002, we operated pursuant to five exclusive franchises granted to us by the Israeli Ministry of Communications to provide cable television services in franchise areas, which covered approximately 25% of Israel's households. As of December 31, 2003, we provided cable television services to approximately 26.4% of all cable television subscribers in Israel. We own substantially all of our cable television network infrastructure. Our exclusive franchises covered four operating areas, three of which included the major metropolitan areas of Bat-Yam Holon, Haifa, and Netanya Hadera, and one of which served the less densely populated area of the Galilee. Our exclusive franchises were subsequently cancelled and replaced by general non-exclusive long term broadcast licenses covering the same geographical areas. Our subscriber penetration is highest in the metropolitan operating areas.

We operate both directly and through subsidiaries in various fields of communications. We began serving cable television subscribers in 1990. We have adopted a growth strategy that combines core activities in the multi-channel television market, based on state-of-the-art technology, with the use of cable television infrastructure. The total number of our cable television subscribers was approximately 266,700 as of December 31, 2003, compared to approximately 275,000 as of December 31, 2002 and approximately 292,600 as of December 31, 2001. Cable television subscriber penetration has decreased by approximately 11% during the same period. In April 2002, we started to offer a commercial service of access to High Speed Internet over cable. We also provide various data transmission services and network services at different bit rates, services to the business sector, and other ancillary services.

Our aggregate revenue (including revenue from cable television and access to High Speed Internet subscribers) has increased from approximately NIS 469.4 million as of December 31, 2001 to approximately NIS 495.5 million as of December 31, 2002 and approximately NIS 545.5 million as of December 31, 2003. During the same period, our operating loss and net loss has decreased from approximately NIS 129.9 million and approximately NIS 257.3 million, respectively, for the year ended December 31, 2001, to an operating loss and net income of approximately NIS 98.7 million and approximately NIS 33.8 million, respectively, for the year ended December 31, 2002, and an operating loss and net loss of approximately NIS 7.8 million and approximately NIS 5.5 million, respectively, for the year ended December 31, 2003. EBITDA has increased from approximately NIS 0.3 million for the year ended December 31, 2001 to approximately NIS 56.7 million and approximately NIS 147.0 million for the years ended December 31, 2002 and 2003, respectively.

Through December 31, 2003, we have invested approximately NIS 2,028 million (approximately US\$ 463.2 million) in the build-out of our cable television network within our license areas and in other fixed assets.

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In July 2002, we and the other two Israeli cable television operators, Tevel and Golden Channels, submitted a request to receive a license to provide domestic fixed communications services. In October 2003, we and the other two Israeli cable television operators, acting through affiliates, entered into an agreement, as amended in November 2003, for the establishment of AMAT Telecom L.P., which would engage in the establishment and operation of a public telecommunications network by which it will supply domestic-fixed telecommunications services, including, fixed telephony services, access to High Speed Internet over cable, infrastructure services, messaging and data telecommunications services. On April 14, 2004, AMAT Telecom L.P. changed its name to HOT Telecom L.P. The partnership agreement includes, among other things, provisions relating to the management of HOT Telecom L.P., or HOT Telecom and its general partner, HOT Telecom Ltd., the distribution of its profits and income and limitations on the transfer of rights by the partners of HOT Telecom.

In November 2003, the Ministry of Communications granted HOT Telecom the HOT Telecom Infrastructure License covering the same services covered by the Telecommunications Infrastructure License granted to us in 2002 (to be supplied within the time frames set forth in the Telecommunications Infrastructure License), and including the requirement to start to provide other domestic fixed telecommunications services including basic telephony by not later than November 25, 2004. The HOT Telecom Infrastructure License replaced and cancelled our Telecommunications Infrastructure License.

We have recently entered into negotiations to acquire the cable and communications assets of Tevel. If this transaction is completed, we would have over 580,000 cable subscribers, representing approximately 60% of the Israeli cable market, and we would hold 35% of Golden Channels. We have not signed a binding agreement with Tevel, and cannot be certain that this transaction will be completed, or if completed,

on what timeframe or on what terms and conditions, including price. If this transaction were to take place, we would likely incur or assume substantial additional indebtedness.

We have expanded our telecommunications activities by investing in Barak I.T.C. (1995) The International Telecommunications Services Corp. Ltd., or Barak, an international telephony service provider in Israel, and in Partner Communications Company Ltd., or Partner, one of four licensed providers of mobile cellular telephone services in Israel, and one of the two providers using the global system for mobile telecommunications, a comprehensive digital standard for the operation of all elements of a cellular telephone system, known as GSM.

Until April 2002, we beneficially held, through Matav Investments Ltd., approximately 15.2% of Partner's issued and outstanding shares. Following the sale of shares in Partner in April 2002 and November 2003, we beneficially own approximately 5.3% of Partner's issued and outstanding shares.

Important events in the development of the cable television and telecommunications industry and our business

Overview

Television broadcasting in Israel began in 1967 through one off-air government controlled channel, known as Channel 1. In 1993, private operators commenced regular commercial broadcasts of a second off-air channel, known as Channel 2, and later, an additional channel, the Israeli Knesset Channel. In April 2000, the Ministry of Communications approved the establishment of a second commercial channel (Channel 10), which began broadcasting at the beginning of 2002.

In 1989, we, together with the other cable television operators, formed I.C.P. Israel Cable Programming Company Ltd., or ICP, for the purpose of jointly purchasing and producing our local cable channels, which then consisted of four channels: family, now known as HOT 3, movies, now known as HOT Movies, sport, and children's. The culture & science channel was later added. In January 2004, ICP changed its legal name to HOT Vision Ltd. Today, HOT Vision Ltd., or HOT Vision, creates, produces and acquires content for only two channels (HOT 3, and movies (HOT Movies)), and independent producers produce the other three channels in accordance with the Restrictive Business Practices Court's decision in 1996 regarding the approval of unified channels. For a discussion of this approval, please see Item 4B. Business Overview HOT Vision and Cooperation of Cable Television Operators in Production of Broadcasting.

In 1990, the Ministry of Communications began issuing exclusive franchises to operate cable television systems in various geographical areas in Israel. Each franchise paired a densely populated metropolitan area with a less densely populated rural area to ensure that smaller rural communities would also receive cable television services. The construction of the nationwide cable television network infrastructure began in late 1989 and, based on the number of homes covered by cable infrastructure, approximately 95% of our network had been completed by the end of 2003.

Pursuant to amendments to the Telecommunications Law in 2001 the exclusive franchises were replaced by a system of general non-exclusive long term broadcast licenses, broadcasting HeadEnd licenses, and general non-exclusive telecommunications infrastructure licenses, all of which we have been granted. In November 2003, our Telecommunications Infrastructure License was replaced by the HOT Telecom Infrastructure License. Please see the discussion regarding the HOT Telecom Infrastructure License in Item 4B. Business Overview Domestic Fixed Communications.

On September 17, 2002, the Minister adopted, with certain changes the recommendations of a committee formed by the Ministry of Communications for establishment of policies and rules for opening of competition in the telephony services market as the guiding principles in this field. The main purpose of the committee was to improve the benefits to the consumer in the field of telephony services, specifically by removing limitations to competition in this area. The committee found that, among other things, the merger of the cable television operators and the entrance of the merged entity into the telephony market will create opportunities for the opening of competition in the telephony market. In order to implement the committee's recommendations, the Israeli parliament approved an amendment to the Telecommunications Law at the end of May 2003. Under this amendment, as of September 1, 2004, the Minister may grant a special general license for domestic fixed telecommunications services without imposing on the holders of such licenses the obligation to provide their services to the entire public throughout the entire country or in any specifically defined area in Israel. The Ministry of Communications recently published the language of such special general license. For more information, please see Item 4A. History and Development of the Company Domestic Fixed Communications.

In March 2004, the Minister announced its new policy with respect to Bezeq's general license such that Bezeq would be allowed in the future, subject to certain conditions, to give discounts for size and allow the provision of a basket of services together with its subsidiaries. This would enable Bezeq to provide services jointly with its affiliates, which it was not allowed to do in the past, including among other things,

telephony services (local and international), multi-channel television services, cellular services and access to High Speed Internet services. The Minister intends to hold a hearing on this policy. If the policy described above is implemented, HOT Telecom may not be able to compete effectively with Bezeq and others, and it may not recover its significant investments in telephony services. In addition, the offering by Bezeq of a basket of services, including multi-channel television services through YES, may have a material effect on our ability to supply telephony services to our subscribers, and this could cause us to lose multi-channel television subscribers. Accordingly, we may suffer losses as the result of our holdings in HOT Telecom, which would affect our results of operations.

Direct Broadcasting by Satellite and Developments regarding YES

On January 5, 1998, the Israeli parliament approved an amendment to the Telecommunications Law, which allows the Ministry of Communications to grant licenses for distribution of direct broadcast by satellite (DBS) services to subscribers. The Ministry of Communications granted D.B.S. Satellite Services (1998) Ltd., or YES, a license for the provision of television broadcasts to subscribers via satellite, and YES commenced DBS broadcasting in July 2000. The development of competition to cable television services by the commencement of DBS broadcasting has adversely affected our business. Following a dispute arising out of the grant of the license to YES, and in consideration for the recognition by the government of our ownership of the cable television network infrastructure, in July 2001, the cable television operators entered into an agreement with the State of Israel pursuant to which the cable television operators, including us, undertook not to bring any claim in the future regarding the grant of a license to YES, and to make certain payments to the government over a 12 year period, commencing January 1, 2003.

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On September 13, 2000, we, together with the other Israeli cable television operators, entered into an agreement with YES, under which we and the other cable television operators granted YES a non-exclusive permit to use our Inside Wiring for the transfer of satellite broadcasts (multi-channel television and interactive channels only); and YES granted the cable television operators a non-exclusive permit to use its Inside Wiring for the transfer of cable television broadcasts (including any other service provided by the cable television operators). This agreement has since been terminated by YES, and in place of that agreement, in September 2001 the Minister of Communications issued administration directives, which were amended effective as of February 3, 2002, governing the reciprocal use of Inside Wiring between the cable television operators and YES. The directives establish instructions regarding the procedures of transition for cable television subscribers to become subscribers to YES and vice versa. These directives also provide that YES shall pay fees to the relevant cable television operators for the use of their Inside Wiring, and that the cable television operators shall pay fees to YES for the use of its Inside Wiring. The directives stipulate what such amounts should be. In addition, the Minister of Communications has the authority to issue directives regarding the common use of the Inside Wiring by both YES and by the cable television operators, with regard to the provision of different services by each party. The Ministry of Communications conducted a hearing regarding the common use of Inside Wiring. To date, the Ministry has not issued directives regarding this matter. In January 2004, we and the other cable operators reached an agreement with YES according to which YES will pay the aggregate amount of NIS 7.3 million (not including VAT) in consideration for the use of Inside Wiring for the period from January 2002 through December 2004. We are entitled to 26.6% of that amount. According to the Agreement, towards the end of 2004, we, the other cable operators and YES are to negotiate the terms for YES's use of our Inside Wiring thereafter.

In addition, the Telecommunications Law permits a person in residential premises to purchase from the service provider the Inside Wiring installed in the person's premises.

Digital Broadcasting

We commenced digital broadcasting in July 2001, pursuant to approvals from the Council for Cable and Satellite Broadcasting, or the Council, and the Ministry of Communications. These approvals allow us to broadcast in a digital format our analog basic package channels and Pay-Per-View services, as well as other channels that have been subsequently approved for digital broadcast. These approvals include authorization to provide electronic program guide services, commonly referred to as EPG services.

We informed the Ministry of Communications that we would provide digital set-top boxes to our subscribers' principal connection according to actual demand as follows: up to 100,000 set-top boxes will be provided in 2001; 70,000 in 2002, and 60,000 in 2003. The remainder is to be provided during the year 2004. As of April 30, 2004, we have provided approximately 214,000 set-top boxes to our subscribers. We have already purchased approximately 230,000 set-top boxes (including 6,000 one way only set-top boxes). In October 2002, we and our subsidiary Cable Systems Media Haifa - Hadera Ltd. entered into a term sheet with Advent Digital Broadcast Ltd., or Advent, pursuant to which we will purchase 40,000 digital set-top boxes, to be provided in four equal portions over the period commencing on December 1, 2002, and ending on August 1, 2003, for a total purchase price of \$5.2 million. As of May 31, 2004, 34,400 digital set-top boxes have been supplied by Advent Digital Broadcast Ltd. The Term Sheet shall bind the parties until such time that they shall enter into a definitive agreement.

We and Tevel, jointly and severally, recently signed a quotation with Advent to purchase an additional 50,000 set-top boxes.

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Recently, we also reached a subsequent oral understanding to purchase another 20,000 set-top boxes from Advent.

Tiering

On May 10, 2001, we received from the Council the approval to provide digital broadcasting services in a tiering system. The original approval included only a few channels. We apply for approvals for additional channels on a case by case basis. We began to provide services according to the tiering system in July 2001.

We offer our digital subscribers various channels and packages. Since December 2002, we and the other two Israeli cable television operators offer unified tiering packages. For a list of our channels and packages and the combinations of packages we offer as part of our tiering system, see Item 4B. Products and Services - Premium Broadcastings .

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Pay-Per-View, Near Video on Demand and Video On Demand

We began offering Pay-Per-View services in October 2000. We have not yet begun to offer Near Video On Demand services to our customers. Pay-Per-View and Near Video On Demand services are governed by our Cable Broadcast Licenses. We are in the process of preparing to provide Video on Demand services.

Internet Services

We received a license to provide ordinary dial-up Internet services in February 2000, and we commenced such services in April 2000. In parallel, we began to offer our subscribers access to High Speed Internet over cable on a trial basis, pursuant to a trial license.

On November 6, 2000, the Ministry of Communications granted Bezeq Israel Telecommunications Corporation Ltd., or Bezeq, a license to supply High Speed Internet services using ADSL technology. Since, at that time, we had not received a license to supply access to High Speed Internet over cable services, as a licensed Internet service provider, we decided to provide dial-up Internet services via Bezeq's ADSL. By April 2001, we had reached a share of approximately 20% of the ADSL Internet services market. In May 2001, we decided to cease these Internet activities and accordingly, we transferred 16,000 of our Internet dial up subscribers to Bezeq International in consideration for a payment of \$1.25 million.

We performed access to High Speed Internet over cable trials during 2000, 2001 and the first quarter of 2002. On March 27, 2002, we received our Telecommunications Infrastructure License, which allowed us to provide, among other things, access to High Speed Internet over cable services. After receipt of our Telecommunications Infrastructure License, the trials were discontinued and we began to offer (including to subscribers of the trial services) our commercial service of access to High Speed Internet over cable, which we launched on April 8, 2002. In November 2003, the Ministry of Communications granted HOT Telecom a license covering the same services covered by the Telecommunications Infrastructure License granted to us in 2002 within the time frames set forth in the Telecommunications Infrastructure License, and includes the requirement to start to provide other domestic fixed communications services over cable networks including basic telephony services to subscribers by not later than November 25, 2004. The HOT Telecom Infrastructure License replaced and cancelled our Telecommunications Infrastructure License. According to the HOT Telecom Infrastructure License access to High Speed Internet services shall be provided through HOT Telecom. Please see the discussion regarding the HOT Telecom Infrastructure License in Item 4B. Business Overview Domestic Fixed Communications Services . As of December 31, 2003, we provide access to High Speed Internet over cable services to 57,357 subscribers. As of the date of this annual report, we, Tevel and Golden Channels had not yet assigned our access to High Speed Internet over cable subscribers to HOT Telecom. We are currently evaluating the implications of performing such assignment, and we have so notified the Minister of Communications.

Ownership of Cable Infrastructure and Payments to the State of Israel

In light of the contention of the Ministry of Finance according to which, following the expiration of the cable television operators franchises, the cable television operators should pay the State of Israel appropriate consideration for the grant of a right to continue to provide multi-channel television services to subscribers, as well as other telecommunications services over the cable network, the cable television operators, including ourselves, came to an agreement with the State of Israel dated July 2001, in which we undertook, among other things, to make certain payments to the government over a 12 year period, and in consideration, each cable television operator received recognition by the government of its ownership of its respective cable television network infrastructure. Subsequent amendments to the Telecommunications Law adopted that agreement. The material terms of the agreement provide that:

Each cable television operator shall make payments to the government over a period of 12 years commencing on January 1, 2003, equal to its pro rata portion of a sum determined by multiplying certain accumulated income of all the cable television operators, including certain income derived from the use of cable infrastructure, by a percentage which is between 0% and 4%, increasing gradually according to the amount of such income. In the July 2001 agreement, it was agreed that our pro rata portion would be 24.1%, until agreed differently by all of the cable television operators.; and

Each cable television operator shall pay the State of Israel in the 12-year period up to 12% of its income from the sale of any activity related to the cable infrastructure or a right related to such activity, and the sale of certain assets as set forth in the agreement.

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The Israeli government (subject to payment of payments by the cable television operators) undertook not to assert any rights or claims regarding the ownership of the cable infrastructure.

As a result, each cable television operator is deemed to own all the rights to the cable network infrastructure in its license areas, and the right to operate it is subject to applicable law, following the expiration of the previous franchises.

In March 2003 the cable television operators approached the Israeli Ministry of Finance with a request to defer for one year the commencement of payments due under the July 2001 agreement. In April 2004, this request was rejected by the Accountant General of the State of Israel, and the Accountant General of the Ministry of Communications demanded that we pay all amounts outstanding in respect of 2003 and the first quarter of 2004 by May 31, 2004. As of the date of this annual report, we paid the amounts outstanding in respect of the first quarter of 2004, but we have not yet made any payments in respect of the amounts outstanding from 2003. We recently reached an agreement with the Accountant General of the State of Israel regarding the terms of payment of our obligations in respect of 2003. We agreed to pay the amount owed in seven equal quarterly installments, beginning on July 21, 2004, and ending on January 21, 2006. The amounts outstanding for 2003 will be linked to the Israeli Consumer Price Index, and will bear annual interest at the rate of 5.9%.

The July 2001 agreement, and its codification into law by way of amendments made to the Telecommunications Law, will continue to be in effect if the cable television operators consummate their proposed merger. Please see the discussion of the proposed merger below.

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Proposed Merger of the Israeli Cable Television Operators

In February 2003, we and the other Israeli cable television operators agreed on a final version of an agreement outlining the structure and conditions of a merger between us. The merger agreement, upon its signing, will add to and broaden the terms of the previous arrangement between the parties executed on December 31, 2001, which cancelled and replaced previous arrangements between the parties. The parties have agreed that if the final version of the merger agreement has not been signed by July 31, 2003, or a later date agreed upon by the parties, the provisions of the agreement will not apply, the parties shall not have any claim or suit towards another party with respect to the proposed merger agreement and/or the shareholders agreement, and shall be free to act independently or together with others, without any limitation. To date, the agreement has not been signed.

The purpose of the merger, among other things, is to enable us to provide additional telecommunications services, to increase our ability to compete successfully with Bezeq in the field of domestic fixed line services, including telephony, and, to cooperate in various areas, including purchase of content, marketing, sales and unified networks and effect substantial cost savings. The consummation of the merger is subject to reaching an understanding with the major Israeli banks and the other creditors of the merging entities, and receipt of approvals required under applicable law, including the approvals of the Income Tax Commission, the Council, the Controller of Restrictive Business Practices and the Israeli court. To date, we have received approvals, subject to certain terms and conditions, from the Council, the Controller of Restrictive Business Practices and the Income Tax Commission. Subject to the final terms of the merger, further approval of the Income Tax Commission to the merger may be required. See Item 4B. Business Overview - Arrangement for a Merger of the Cable Television Operators .

Since the date of the approval of the Controller to the merger on April 22, 2002, we, Tevel and Golden Channels collaborate in most of our areas of activities, including but not limited to marketing and content related activities, and since the end of 2003 we carry out these activities under the brand name HOT .

In order to strengthen the cooperation of the three Israeli cable television operators, we, Tevel and Golden Channels recently agreed to perform an operational merger. To this effect, a joint management was recently appointed to oversee the operational merger of the marketing, sales, engineering, customer service, operations and information systems activities of the three cable companies. We will be subject to decisions

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taken by the joint management of the merged operations, and accordingly, these decisions will affect our policy-making in the areas of the joint activities. There can be no assurance that the operational merger will result in a successful integration of the operations of us, Tevel and Golden Channels, or whether the operational merger will in fact enhance our profits and competitiveness.

In addition, in an effort to expand our business, we have recently entered into negotiations to acquire the cable and communications assets of Tevel. If this transaction is completed, we would have over 580,000 cable subscribers, representing approximately 60% of the Israeli cable television market and we would hold 35% of Golden Channels. We have not signed a binding agreement with Tevel, and cannot be certain that this transaction will be completed, or if completed, on what timeframe or on what terms and conditions, including price. If this transaction were to take place, we would likely incur or assume substantial additional indebtedness.

Domestic Fixed Communications Services

On September 17, 2002, the Minister of Communications adopted, with certain changes, the recommendations of a committee formed by the Ministry of Communications for the establishment of policies and rules for the opening of competition in the field of domestic fixed communications services, as the guiding policies in this field. The main purpose of the committee was to improve the benefits to the consumer in the field of domestic fixed communications services, specifically by removing limitations to competition in this area. In accordance with the recommendations of the committee, among other things, the merger of the cable television operators and the entrance of the merged entity to the domestic fixed communications services market, create opportunities for the opening of competition in the telephony services market. See below for information regarding the provision of telephony services by HOT Telecom. For information regarding the provision of telephony services by the merged entity, see Item 4B. Business Overview -Agreement for a Merger of the Cable Television Operators - Approval of the Controller of Restrictive Business Practices to the Merger - Interests in telephony services .

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In order to implement the committee's recommendations, the Israeli parliament approved an amendment to the Telecommunications Law at the end of May 2003. Under this amendment, as of September 1, 2004, the Minister may grant a special general license for domestic fixed communications services without imposing on the holders of such licenses the obligation to provide their services to the entire public throughout the entire country or in any specifically defined area in Israel. The Ministry of Communications recently published the language of the special general license.

In July 2002, we and the other two Israeli cable television operators, Tevel and Golden Channels, submitted a request to receive a license to provide domestic fixed communications, including telephony services. In October 2003, we and the other two Israeli cable television operators, acting through affiliates, entered into an agreement, which was amended in November 2003, for the establishment of AMAT Telecom L.P., which would engage in the establishment and operation of a public telecommunications network by which it will supply domestic-fixed telecommunications services, including, access to High Speed Internet over cable, infrastructure services, messaging, data telecommunications and fixed telephony services. On April 14, 2004, AMAT Telecom L.P. changed its name to HOT Telecom L.P. The partnership agreement includes, among other things, provisions relating to the management of HOT Telecom L.P., or HOT Telecom, the distribution of its profits and income and limitations on the transfer of rights by the partners of HOT Telecom.

We beneficially own 26.5% of the rights in HOT Telecom. We and the other two cable television committed to provide access to our cable networks to HOT Telecom on terms and conditions to be determined. Furthermore, we agreed that if, during the 36 months following the date of signature of the partnership agreement our cable broadcasting and communications operations would be merged, the holdings of the parties in HOT Telecom, including the operations of HOT Telecom would be transferred to the merged entity for no consideration. HOT Telecom is obligated to invest in fixed line telephony cable infrastructure an aggregate of not less than NIS105 million until June 30, 2004, not less than NIS140 million until June 30, 2005, not less than NIS105 million until June 30, 2006 and any other amount as shall be required for the fulfillment of its business plan for the provision of telephony services which fully compete with those of Bezeq. We undertook to invest up to NIS 93 million in HOT Telecom over a period of three years commencing on November 25, 2003, and in accordance with the aforesaid milestones.

In October 2003, the limited partners of HOT Telecom also entered into an agreement to establish AMAT Telecom Ltd. to serve as general partner of HOT Telecom (with a 1% interest). On April 14, 2004, AMAT Telecom Ltd.'s name was changed to HOT Telecom Ltd. We beneficially own 26.5% of HOT Telecom Ltd., and have the right to appoint two out of six directors to HOT Telecom Ltd.'s board of directors. This agreement includes provisions relating to the taking of decisions, distribution of profits and income, limitations on the transfer of rights in HOT Telecom Ltd. and the obligations of the three cable operators to afford access to their cable networks to HOT Telecom and HOT Telecom Ltd.

The abovementioned two agreements were made conditional upon the Israeli court overseeing Tevel's insolvency proceedings approving the entrance into such agreement by Tevel. On November 24, 2003 Tevel's trustee notified the court of, among other things, these agreements. To date, no decision, response or instruction has been received from the Court with respect to the approval of Tevel's entrance into

these agreements. As of January 8, 2004, all of the approvals that were required in order for the arrangement of creditors to become effective had been obtained, and accordingly the arrangement of creditors entered into effect. According to this arrangement, Tevel has reached agreement with its unsecured creditors and no longer has any obligation to these creditors with respect to debts incurred prior to April 22, 2002. According to the agreement reached with the secured creditors, Tevel's shares and remaining assets are subject to the right of Tevel's secured creditors which are banks to realize these shares and assets to cover Tevel's debts to these secured creditors.

In November 2003, the Ministry of Communications granted HOT Telecom a license covering the same services covered by the Telecommunications Infrastructure License granted to us in 2002 within the time frames set forth in the Telecommunications Infrastructure License, and includes the requirement to start to provide other domestic fixed communications services over cable networks including basic telephony services to subscribers by not later than November 25, 2004. The HOT Telecom Infrastructure License replaced and cancelled our Telecommunications Infrastructure License.

4B. BUSINESS OVERVIEW

We operate digital and analog cable television systems and provide a variety of channels and programs as one of three cable television operators in Israel. In addition we provide access to High Speed Internet over cable services and services to the business sector, data services and, commencing in November 2004, HOT Telecom intends to start to provide commercial telephony services. We believe that Israel is and will continue to be an attractive environment in which to provide cable television services for the following reasons:

Multi-Channel Cable Television Market. As of December 31, 2003, there were approximately 1.75 million homes covered by cable networks in Israel, with a penetration rate of approximately 57%. The high penetration rate for multi-channel cable television services in Israel is attributable to the high penetration of televisions, multiple televisions and home video cassette recorders in homes, the fact that we provide additional Hebrew language (including subtitled and dubbed) programs and other various programs and services.

Subscriber Base. Between 2001 and 2003, the population of Israel grew at an average rate of approximately 2% per year. In 2003, our number of cable television subscribers decreased. Of our cable television subscribers, our number of digital subscribers increased, and our number of subscribers for other services provided over cable increased. During the same period, our number of access to High Speed Internet subscribers increased.

Diverse Population. The cultural and linguistic diversity of Israel's population has created a large pool of potential cable television subscribers with different viewing needs. From 1991 through the end of 2003, approximately 918,000 new immigrants arrived in Israel, representing approximately 54% of the increase in Israel's population during that period. In addition, a substantial portion of Israel's population consists of first or second-generation immigrants, many of which we believe continue to speak the language of their country of origin and maintain strong cultural ties to that country.

Growth in the Number of Channels and Diversity of Content. We provide our subscribers with the most widely viewed cable television broadcasts in Israel. We continually aim to increase the number of channels we provide and improve the diversity of content, including channels in various languages for a large spectrum of viewers, in accordance with the perceived requirements of our subscriber base. The following are the new channels that we provide since January 1, 2000, most of which are subtitled or dubbed in Hebrew or Russian, which we believe promote viewer interest in cable television in Israel. The list is up to date as of May 31, 2004.

Added during 2000: the classical music channel (Mezzo); a new children's channel for preschoolers (Hop Channel); the American sport channel (ESPN); the TV movie channel (Hallmark), and the British entertainment channel (BBC Prime); the Cartoon Channel; the classic movie channel (TCM); the Russian classic movie channel (Nashe Kino); and the action channel (AXN).

Added during 2001: the children's channel (Fox Kids); the Indian entertainment channel (Zee TV); the Romanian entertainment channel (Pro TV); the youth channel (BIP); the 40 audio music channels; the European culture channel, (ARTE); the action channel (Reality); the Arabic family, sport, children movie and music channels (ART 1, 2, 3 4 and 5); the entertainment channel (E!); the History Channel; the movie channels (HOT Drama , HOT Action , and HOT Fun); the movie channel (MGM); the Adventure channel (Adventure 1); the lifestyle channel, (Good Life); two extra home cinema digital channels; the telenovella channel (Viva Platina); the sports channels (Sport 5+); and (NBA).

Added during 2002: the life style channel (Ego); the movie channel (HOT Prime), and four music channels (MTV Base , MTV 2 , MTV Hits , and VH1 Classic); the Russian movie channel (MF); the news channel (Fox News); the sports channel (Eurosportnews); the economics channel (CNBC); the sports channel (Fox Sport); and 4 regional radio channels.

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Added during 2003: the Russian channel (NTV Mir); the sports channel (the Teams channel); the Russian History channel (History Russian); the Judaism channel (Techelet); the Playboy channel (reinstated); the children s knowledge channel (Logi); and the Russian Telenovela channel (Romantica).

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Added through May 2004: the Academic channel; the General Russian channel (Moscow Open World); and the Extreme sports channel.

Digital Broadcasting Services. In July 2001, we began to provide digital broadcasting services, in addition to the analog broadcasting services which we provided all along. We offer our digital subscribers the digital Basic Package, and they may purchase all or part of any of the Premium Broadcastings. For additional information on the Basic Package and Premium Broadcastings, please see Item 4B. Products and Services .

Pay-Per-View, Near Video on Demand and Video on Demand. We began offering Pay-Per-View services in October 2000, which are commenced by digital and analog HeadEnd equipment and received at the subscribers premises by analog and digital set-top boxes. We have not yet begun to offer Near Video on Demand services to our subscribers. Pay-Per-View and Near Video On Demand services are governed by our Cable Broadcast Licenses. For information regarding our Cable Broadcast Licenses, see Item 4B. Business Overview - Our Licenses . We are currently in the process of preparing to provide Video On Demand, or VOD, services.

Interactive Services. Since September 2001, we provide the following interactive services to our digital subscribers: Games Channels, Horoscopes and Weather. Since February 2002, we provide an entertainment programming guide service. Since November 2002, we operate an interactive youth application (T.J.) that serves as a portal to our Youth Package , which includes a multi-optional interactive screen. Interactive applications have been integrated into the Ego channel, since July 2002, and the Good Life channel, since August 2002. Since August 2002 we provide an interactive invoice service. In December 2002, we began to implement an interactive voting application, which allows our subscribers to participate in television votes conducted on certain programs through the use of the subscriber set-top box. In January 2003, we began to implement an interactive commercial application. In February 2003, we began an interactive messaging service to subscribers, which allows us to send messages to subscribers regarding broadcasts and services in connection with broadcasts. We currently offer our digital subscribers Games Channels also on a pay-per-play basis (pay per game) or pay-per-use basis (pay per defined duration of time played), the use of which may be limited by the subscriber (for the purpose of parental control), on the basis of a predetermined maximum monthly fee. . We have recently commenced providing closed group chat services, known as HOT Talk, instant messaging services and multi-player game services. This service is currently provided free of charge. Subject to the receipt of the relevant regulatory approvals, we intend to provide additional interactive services in the future, including the integration of interactive applications into additional channels, additional games channels, an interactive lottery and soccer lottery. For a list of our interactive channels and services please see the table below under Item 4B. Business Overview Premium Broadcastings .

Access to High Speed Internet Over Cable Services. On April 8, 2002, as part of our competitive activity in the telecommunications market, we began to provide access to High Speed Internet over cable services through our infrastructure.

Services to the Business Sector. We and HOT Telecom have recently commenced the marketing of additional communication services designed for businesses, including Internet for businesses, Internet Protocol Visual Private Network, or IP VPN, and various data transmission services and network services at different bit rates. Please see the tables relating to our services to the business sector under Item 4B. Business Overview Services for the Business Sector .

Technologically Advanced Infrastructure. Due to the relatively recent buildout of the cable television industry in Israel, operators utilize advanced technologies, such as broadband, hybrid fiber optic/coaxial, or HFC, cable networks and digital video broadcasting, or DVB, platforms. The main benefits of using such technologies are the potential for greater capacity, increased functionality, improved broadcasting quality, and development of two-way communication based services. We installed and utilize a DVB platform, and previously upgraded our HFC network into a full two-way expanded bandwidth plant. We successfully employ access to High Speed Internet over our cable platform. We have upgraded our infrastructure to allow us to provide data over cable services. The technology upgrade is compliant with the technologies of the other parties to the proposed merger of the Israeli cable television operators. Based on our infrastructure, we plan to gradually implement more service layers, such as VOD services, enhanced television interactive applications and other services, which utilize the cable television platform upon other alternative platforms. Our VOD project is in the design stage. This project is conducted jointly together with the other two Israeli cable television operators, Tevel and Golden Channels.

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Integrated Fiber-Optic Network. The broadband networks of the three cable television operators in Israel are connected through nationwide fiber optic cable links. This interconnection is currently being used for sharing resources, for mutual back up measures and in order to create a uniform platform for new access to High Speed Internet services provided by us, Tevel and Golden Channels. That network also creates an opportunity, subject to regulatory approvals, to develop and provide subscribers throughout Israel with services such as telecommunications using the already installed cable television infrastructure networks.

Strategy

Our mission is to leverage our cable television infrastructure and market share to be a leader in the Israeli information, telecommunications and entertainment industry. In order to achieve our mission, we are implementing strategies designed to:

increase our range of value-added services offerings to our subscribers;

increase penetration in the services we provide today and expand into other telecommunications activities; and

enter into mergers, acquisitions and strategic alliances to add to our offering and expand our market share.

Competitive Strengths

We believe that the following competitive strengths differentiate us from our competitors and will assist us in achieving our mission and implementing our strategies:

state-of-the-art technology and an advanced network and infrastructure which we own entirely, including two-way broadband transmission, HFC cables, and a fully digitalized broadcasting system;

a diversified and rich selection of programming content;

high quality of broadcasting service and support for subscribers;

as of December 31, 2003, a large subscriber base which contains approximately 266,700 subscribers, constituting a penetration rate of approximately 56% in our license areas;

a highly experienced and dedicated management team and staff;

built in technological unique advantages, such as wide bandwidth, 2-way communication, one pipe for various, multiple services, segmented network (which allows reuse of bandwidth and implementation of narrowcast and Unicast services);

reasonable fees for our cable television broadcast offerings and access to High Speed Internet over cable services, and for other services; and

offering various value-added services to our subscribers, including services targeted to the business sector.

Availability and Sources of Programming

The increasing availability of cable television in Israel has provided an attractive alternative to the limited off-air television programming and the use of video cassette recorders and DVDs. We offer cable television analog and digital subscribers a single tier of basic service within the framework of the analog and digital Basic Packages. We offer our digital subscribers the possibility for additional channels and packages within the framework of our Premium Broadcastings and services. For information regarding the channels and packages included in the Basic Packages and the Premium Broadcastings, see Item 4B: Products and Services - Basic Packages and Item 4B: Products and Services - Premium Broadcastings. Two of the most popular channels available to cable television operators in Israel is provided by HOT Vision and by independent producers. The three cable television operators in Israel currently provide the same program scheduling on all of the channels in each of their license areas, enabling subscribers throughout Israel to watch the same program at the same time.

We aim to diversify and improve the content quality we provide to our subscribers. We do so by adding new broadcasting channels and enriching the existing ones. For example, we provide subscribers with broadcasts of the English football Premier League, the U.S. National Basketball Association League, the European Football Association Champion League, the French Open, various children's programs, channels dedicated to a variety of topics and interests, and films and popular series from leading major studios around the world. In addition, we offer our subscribers new interactive channels and applications. See the discussion in Item 4B: Business Overview Growth in the Number of Channels and Diversity of Content.

Products and Services

Overview of our Cable Television Services

We offer cable television analog and digital Basic Packages, and we offer our digital subscribers Premium Broadcastings and services.

Subscribers are offered access to a variety of Hebrew language programming (including original, subtitled and dubbed), a home shopping channel, off-air channels originating in Israel and other selected countries, and satellite television channels. We charge subscribers an initial installation fee of approximately NIS 99 including VAT, and an average monthly subscription fee for the analog and the digital Basic Packages of approximately NIS 175.5 including VAT. We also require a deposit of approximately NIS 99 including VAT, for the regular analog set-top box (for those subscribers without cable-ready televisions), or NIS 199 including VAT, for the addressable analog set-top box, and a deposit of approximately NIS 399 including VAT, for the digital set top box. We partially refund the deposit when the set-top box is returned. The refund amount (which is linked to the Israeli consumer price index) is reduced by 10% of the value of the set-top box for depreciation each year or each partial year commencing from the date of installation of the set-top box and until the earlier of the date we cease to provide services to such subscriber, or until removal of the set-top box. Alternatively, our subscribers may elect to lease the set-top box for a monthly fee that ranges between NIS 10 and NIS 15 including VAT, but not more than the value of the set-top box. We are allowed to sell the set-top box to a subscriber, at the subscriber's option, in consideration for an amount not exceeding the value of the set-top box. We also charge subscribers fees for reconnection, installation of additional outlets in subscribers' households, and provision of cable television services on the additional outlets. The fees set forth above include value added tax at a rate of 17%.

Programming

We currently transmit programming on varying numbers of channels in our operating areas, which consists of off-air channels, satellite channels, dedicated channels, and other channels. The tables set forth below present our analog and digital Basic Packages and those additional channels and packages that are included within the Premium Broadcastings which we provide to digital subscribers in the tiering system. For a discussion of the risks related to programming, see Item 3. Risk Factors, and for a discussion of certain of our costs associated with programming, see Item 5. Operating Financial Review and Prospects - Operating Expenses.

We and the other cable television operators have agreed, however, to pay royalties to certain organizations representing Israeli performing artists with respect to copyrighted materials broadcasted by the cable television operators. For the years ended December 31, 2001, 2002 and 2003, we recorded royalties expenses with respect to such organizations of approximately NIS 2.7 million, NIS 2.9 million and NIS 2.7 million, respectively.

Off-Air Channels. The off-air channels we transmit to our subscribers are the Israel Broadcast Authority channel (Channel 1, Channel 33 and Channel 2). Although subscribers can receive transmission of these off-air channels through a household antenna or a satellite dish, the antennae located on our HeadEnds enable subscribers to obtain superior picture and sound quality.

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Satellite Channels. We transmit to our subscribers broadcasts of foreign and Israeli television channels which we receive at our HeadEnds via satellite. We pay fees for the right to transmit certain of these broadcasts. We have not received permission to transmit the respective broadcasts from all foreign satellite television operators whose broadcasts we transmit. However, pursuant to our Licenses, and subject to the permission of the Council, our freedom to remove channels from the Basic Packages is limited. The telecommunications rules prohibit the broadcasting of channels or programs without the consent of the original broadcaster. Furthermore, there can be no assurance that the satellite television operators to whom we do not currently make payments will not request payments from us in the future. In addition, a lawsuit was filed against us in connection with these matters. See Item 8A. Consolidated Statements and Other Financial Information - Legal and Arbitration Proceedings.

Other Channels. We broadcast a wide variety of additional channels, including those channels listed in the Basic Packages tables below, and those pursuant to our tiering, Pay-Per-View and interactive services.

On May 30, 2001 we commenced broadcasting of the adult content in accordance with the approval of the Council granted at such time. Since October 2001, pursuant to amendments to the Telecommunications Law and Council decisions, we transmitted adult content channels by way of Pay-Per-View only. Pursuant to further amendments to the Telecommunications Law, broadcasts that include abominable material within the meaning in the Israeli Penal Law, 1977, and which include certain content as set forth in the Telecommunications Law, is prohibited as of August 2002. Following such further amendment, we ceased to transmit adult content channels also by way of Pay-Per-View. On June 12, 2003, the Council resolved to approve the broadcast of the Playboy channel, subject to existing and certain additional conditions and limitations, under which, among other things, the Playboy channel will be transmitted only at certain stipulated times and offered to digital

subscribers as a separate pay channel and not as part of the digital Basic Package. Cable Broadcast Licensees are required to, among other things, take reasonable measures to ensure that: the channel shall be purchased only by subscribers over the age of 18; the channel will be coded such that access will be available only by a personal code; and Cable Broadcast Licensees are required to transmit during the transmission of the channel certain broadcasts regarding the prohibition on exposure of children and youth to the channel. We have commenced broadcasts of the Playboy channel pursuant to and in accordance with the conditions and limitations set forth in the Council's latter decision. Subscribers can view the Playboy channel on a Pay-Per-Night basis, and the Erotica channel on a Pay Per View basis. A number of petitions filed before the Israeli High Court of Justice, in which we were listed as a respondent, against, inter alia, the Council's decision to approve the broadcast of the Playboy channel, were denied.

Locally Produced Programming. In 1989, together with the other Israeli cable television operators, we established a company named ICP Israel Cable Television Programming Company Ltd., which is now known as HOT Vision Ltd., for the purpose of jointly purchasing and producing content for our local channels. Today, HOT Vision creates, produces and acquires content for two channels (Channel 3 (HOT 3) and movies (HOT Movies)). We own approximately 25% of HOT Vision and make payments to it based on the number of our subscribers. For the years ended December 31, 2001, 2002 and 2003, we paid HOT Vision approximately NIS 70.0 million, NIS 62.0 million and NIS 54.0 million, respectively.

Under the Telecommunications Law and in accordance with the resolution of the Council of June 2002 as amended in September 2002 and in May 2003, each Cable Broadcast Licensee is required to allocate to local production or purchase of locally produced programs, a percentage of its annual income derived from subscriber fees for the year preceding the year of the investment, as follows: (i) commencing April 30, 2002 (the date of grant of the Cable Broadcast Licenses) and until the end of 2005, at least 8% of such income; and commencing 2006 and thereafter, as to be determined by the Council prior to the end of June 2005; and (ii) in the event a Cable Broadcast License is granted to the merged entity of the Israeli cable television operators, the Council shall determine, prior to the end of June 2005, the rate of the amounts that shall be allocated to local productions by the Cable Broadcast Licensees as of 2006 and thereafter. For this latter purpose, the Council shall consider, among other things, the financial condition of the licensees in connection with their broadcast activities and the contribution of the proposed merger of the cable television operators to the improvement of the financial condition of the licensees.

Under the Telecommunications Law, we are required to provide up to one-sixth of our network capacity for broadcasting to holders of special cable television licenses for specific channels. In addition, we have allocated programming time to broadcasting by local community organizations and the public educational channel, which we are obliged to broadcast according to the Telecommunications Law. With the exception of the broadcasts by local community organizations and the public educational channel, all such special cable television licensees are required to pay for the use of our network capacity. We are under an obligation to allow other broadcast license holders to have access to our network infrastructure, within three months from the date requested by the other licensee or producer. According to the approval of the Controller to the proposed merger, if we are unable to reach a commercial agreement with such broadcast licensee or producer within 60 days, the matter must be referred to arbitration and the arbitrator must act in accordance with the instructions of the Controller.

Local News Broadcasts. Our licenses also require that we provide periodic local news broadcasts in each license area. The content of our local news and local community programs varies in our operating areas. In accordance with the Council's decisions of December 2002 and February 2003, a Cable Broadcasting Licensee may produce local news broadcast for seven license areas through an external producer, subject to the Council's approval. According to decisions of the Council taken in April 2004, we are entitled to recognize, with respect to our obligations in the field of local productions, an amount not to exceed NIS 14 million in respect of broadcasts of magazines which are not daily events programs in an annual scope that will not be less than one local news broadcast and one magazine related to regional matters broadcast each day of the week, except one weekend day, and subject to the other conditions of the decision. We and the other two Israeli cable television operators entered into an agreement dated January 5, 2003, as amended on March 5, 2003, with Today's Cable News the Local News Company Ltd., commonly referred to as JCS, whereby JCS shall produce local news for the cable television operators for their respective areas in consideration for a payment of NIS 42.48 million per annum (linked to the Israeli consumer price index and subject to adjustments). The payment of the consideration was allocated among the three cable television operators, in proportion to the number of their respective subscribers.

Commercial Advertising and Dedicated Channels. According to the Telecommunications Law, the Council may grant special licenses to independent producers of specific dedicated cable television channels, and such channels may be entitled to offer commercial advertising. The Economic Committee of the Israeli Parliament, or Knesset, decided on January 27, 1998, that such dedicated channels will be: an Arabic channel, a Jewish traditional channel, two news channels, an Israeli music channel and one channel or more in foreign languages for new immigrants arriving to Israel. In 2001 and 2002, the Council selected winning bids for the tender for a News Channel, a general Russian Channel and an Israeli music channel, all of which are permitted to broadcast commercials. The general Russian Channel commenced broadcasts as of November 2002. The Israeli music channel commenced broadcasts as of June 2003. To date, the Arabic channel and the News Channel have not commenced broadcasts.

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Currently Channel 2, Channel 10, the general Russian Channel and the Israeli music channel are the only locally produced channels (which have commenced broadcasting) that have permits to air commercials. Some foreign satellite channels also air commercials. In addition to the prohibition on broadcasting commercials on our local channels, the Telecommunications Law, as amended, prohibits the broadcasting of commercials on channels that the Council has decided are targeted mainly to the Israeli public, without the prior approval of the Council. The Council has set certain criteria regarding these stipulations.

The approval of the Controller to the merger of the Israeli cable television operators provides, among other things, that if the merged broadcasting entity receives approval to air advertisements on its channels, then the Controller shall have the power to impose additional restrictions upon the entity. We have no assurance that the merged entity shall receive any such approval to air commercials.

Basic Packages

In accordance with Israeli law and our Broadcasting License, we must provide each of our subscribers (analog and digital) basic broadcasts that include:

Channels 1 and 33 of the Israeli Broadcasting Authority;

the commercial channels (Channels 2 and 10);

the Knesset channel;

the Israeli educational channel;

channels of special cable licensees according to the Council's instructions, on the digital service only - we currently broadcast Teva Hadvarim;

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dedicated channels pursuant to the Telecommunications Law (which currently only include the Shopping, Russian and Music Channels, but may in the future also include the News Channel that won a tender, and other channels that have yet to be tendered);

regional news and community broadcastings; and

the EPG service, on the digital service only.

Our Cable Broadcast Licenses stipulate that, in the event that we wish to reduce the scope of the basic broadcasts, we must request the Council's approval. In the event that the scope of the analog basic broadcasts has been reduced, the Council may instruct us (subject to the approval of the Minister) to reduce the price for such reduced package to an amount determined by the Council. In such case, we would be entitled to present our position to the Council prior to its rendering its decision.

Our Cable Broadcast Licenses stipulate that we may not charge our analog subscribers for the basic broadcasts more than approximately NIS 148 plus VAT in the Holon/Bat Yam and Haifa/Hadera regions, approximately NIS 140 plus VAT, in the Sea of Galilee/Netanya region, and approximately NIS 141 plus VAT, in the Golan/Safed and Kiryat Shemoneh region. Additionally, we may not charge our analog subscribers for a movie provided on Pay-Per-View basis more than approximately NIS 15 plus VAT, per broadcast. We may link our fees to the Israeli consumer price index from February 2002 (subject to regulations and the provisions of our licenses). Our Cable Broadcast Licenses do not stipulate fees for digital subscribers. Under regulations promulgated pursuant to the Telecommunications Law, we may determine our subscriber fees for digital subscribers (including the basic broadcasts package). The fees that we set for our digital subscribers must be reasonable, and the Minister may direct us to adjust such fees if he finds, among other things, that they are harmful to competition, discriminatory or misleading. The Council's approval to the proposed merger of the Israeli cable television operators (as amended) stipulates, as a condition to the merger, that we, or the merged entity, will be subject to a maximum subscriber fee for both the digital and analog basic broadcasts packages of NIS 156 including VAT. The subscriber fee will be linked to an index which includes the Israeli consumer price index of December 2001 (published January 15, 2002) and the US dollar exchange rate as published by the Bank of Israel, or any other index as shall be determined in regulations. The effectiveness of the Council's condition regarding the linkage to the combined index is subject to the amendment of the applicable regulations promulgated under the Telecommunications Law. To date, the Ministry has not adopted such an amendment.

The Council has determined that all channels in the Basic Package on our digital platform must be included in the Basic Package on our analog platform, unless otherwise authorized by the Council.

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Digital Basic Package

The following table lists information regarding the Basic Package that we offer to our digital subscribers as of April 30, 2004.

Channel	Description	Language ⁽¹⁾
HOT 3	Entertainment	Hebrew
HOT Movies	Cinema Movies	Hebrew
Sport	Local and intentional games & Competition	Hebrew
Children	Cartoons, movies & other children entertainment	Hebrew
MTV	Europe video music	English
Channel 8	Culture, Science & Education	Hebrew and Russian
Local Channel	Local news & others-general	Hebrew
Channel 10	Third national channel	Hebrew
Israel 1	First national channel	Hebrew
Israel 33	General Channel of the Israel Broadcasting Authority	Arabic, Hebrew and English
CNN	World news	English

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Channel	Description	Language (1)
Sky news	World news	English
BBC World	Collection of BBC best programs	English
Channel One- Russia	Russian channel	Russian
RTR Planeta	Russian channel	Russian
NASHA KINO	Russian Channel	Russian
RTV Int	Russian Channel	Russian
NTV MIR	Russian Channel	Russian
National Geographic	Localized channel of NGC	Hebrew
Star World	Entertainment	English
Shopping	Israeli shopping channel	Hebrew
Israel 2	Second national channel	Hebrew
Education	Israeli educational channel	Hebrew
Knesset	Israeli parliament channel	Hebrew
SAT 3	German channel	German
RTL	German channel	German
TV5	French channel	French
France 2	French channel	French
Arte	Culture	French
Euro sport	European sport broadcasting	English
VH-1	Video Music	English
TVE	Spanish channel	Spanish
RETE 4	Italian channel	Italian
TRT 1	Turkey 1	Turkish
TRT 2	Turkey 2	Turkish
INTERSTAR	Turkish channel	Turkish
DUNA TV	Hungarian channel	Hungarian
Emergency (2)	Emergency communications	Hebrew
SAT 1	German channel	German
LBC	Arabic channel	Arabic
Viva	Teledrama Channel	Hebrew
Fashion TV	Fashion TV	French
MEZZO	Classic Music Channel	French
Hop	Children Channel	Hebrew
Hallmark	Series and Movies	Hebrew/Russian
BBC Prime	English channel	English/ Hebrew
AXN	Action	Hebrew
TCM	Movies	English/ Hebrew
ESPN	Sport	English

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CARTOON	Cartoons, movies & other Children entertainment	English
TV 7 -TUNIS	Tunisian channel	Arabic
Jordan	Jordanian channel	Arabic
Morocco	Moroccan national channel	Arabic
Egypt	Egyptian national channel	Arabic
METV	Free Lebanon television	Arabic/English
MBC	Arabic channel	Arabic
Almustakbal	Entertainment	Arabic
Saudia	National	Arabic
Syria	National	Arabic
Aljazeera	News	Arabic
Dubai	National	Arabic
EPG	User Guide	Hebrew/English /Russian

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Channel	Description	Language (1)
User Guidance Channel	User Guidance Channel	Hebrew /Russian
13 Radio Channels	Music, News General	Hebrew /Russian

(1) Originated, subtitled or dubbed, as indicated.

(2) Operates only during emergencies.

Analog Basic Package

The following table lists information regarding the Basic Package that we offer to our analog subscribers as of April 30, 2004.

Channel	Description	Language (1)	Bat-				Arab section	Galilee
			Yam/ Holon	Haifa	Netanya/ Hadera	Golan		
HOT 3	Entertainment	Hebrew	ü	ü	ü	ü	ü	ü
HOT Movies	Cinema Movies	Hebrew	ü	ü	ü	ü	ü	ü
Sport	Local and intentional games & Competition	Hebrew	ü	ü	ü	ü	ü	ü
Children	Cartoons, movies & other Children entertainment	Hebrew	ü	ü	ü	ü	ü	ü
MTV	Europe video music	English	ü	ü	ü	ü	ü	ü
Channel 8	Culture, Science & Education	Hebrew/ Russian	ü	ü	ü	ü	ü	ü
Local channel	Local news & others	Hebrew	ü	ü	ü	ü	ü	ü
TVE	Spanish channel	Spanish	ü	ü	ü	ü	----	ü
Channel 10	Third national channel	Hebrew	ü	ü	ü	ü	ü	ü
Israel 1	First national channel	Hebrew	ü	ü	ü	ü	ü	ü
CNN	World news	English	ü	ü	ü	ü	ü	ü
Sky news	World news	English	ü	ü	ü	ü	ü	ü
ORT Russia	Russian channel	Russian	ü	ü	ü	ü	ü	ü
RTR Planeta	Russian channel	Russian	ü	ü	ü	ü	-----	ü
National Geographic	Localized channel of NGC	Hebrew	ü	ü	ü	ü	ü	ü
Star World	Entertainment	English	ü	ü	ü	ü	-----	ü
RETE 4	Italian channel	Italian	ü	ü	ü	ü	ü	ü
Shopping	Israeli shopping channel	Hebrew	ü	ü	ü	ü	ü	ü
Israel 2	Second national channel	Hebrew	ü	ü	ü	ü	ü	ü
Education	Israeli educational channel	Hebrew	ü	ü	ü	ü	ü	ü
SAT 3	German channel	German	----	ü	---	ü	ü	ü

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RTL	German channel	German	ü	ü	ü	-----	-----	ü
Jordan	Jordanian channel	Arabic	ü	ü	ü	ü	-----	ü
TV Guide	TV broadcasting programs	Hebrew	ü	ü	ü			ü
Morocco	Moroccan national channel	Arabic	ü	ü	ü	ü	----	ü
Egypt	Egyptian national channel	Arabic	ü	ü	ü	ü	ü	ü

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Channel	Description	Language (1)	Bat-Yam/ Holon	Haifa	Netanya/ Hadera	Golan	Arab section	Galilee
METV	Free Lebanon television	Arabic/ English	ü	ü	ü	ü	ü	ü
MBC	Arabic channel	Arabic	ü	ü	ü	ü	ü	ü
Israel 33	General channel of the Israeli Broadcasting Authority	Hebrew	ü	ü	ü	ü	ü	ü
TV5	French channel	French	ü	ü	ü	-----	-----	ü
France 2	French channel	French	ü	ü	ü	ü	-----	ü
Euro sport	European sport broadcasting	English	ü	ü	ü	-----	ü	ü
VH-1	Video Music	English	ü	ü	ü	ü	ü	ü
TRT1	Turkey 1	Turkish	ü	-----	ü	-----	-----	-----
TRT2	Turkey 2	Turkish	ü	-----	-----	-----	-----	-----
DUNA TV	Hungarian channel	Hungarian	ü	ü	ü	ü	----	ü
INTERSTAR	Turkish channel	Turkish	ü	ü	ü	ü	ü	ü
Emergency (2)	Emergency communications	Hebrew						ü
TV 7 -TUNIS	Tunisian channel	Arabic	-----		ü	ü	----	ü
SAT 1	German channel	German	ü	ü	ü	ü	ü	ü
LBC	Arabic channel	Arabic		ü		ü	ü	
Viva	Teledrama Channel	English / Hebrew	ü	ü	ü	ü	ü	ü
Fashion TV	Fashion TV	French	ü	ü	ü	ü	-----	ü
MEZZO	Classic Music Channel	French	ü	ü	ü	ü	ü	ü
Hop	Children Channel	Hebrew	ü	ü	ü	ü	ü	ü
RTV Int.	Russian Channel	Russian	ü	ü	ü	ü	-----	ü
Hallmark	Series and Movies	English/ Hebrew	ü	ü	ü	ü	ü	ü
BBC Prime	English channel	English/ Hebrew	ü	ü	ü	ü	ü	ü
AXN	Action	English/ Hebrew	ü	ü	ü	ü	ü	ü
TCM	Movies	English/ Hebrew	ü	ü	ü	ü	ü	ü
ESPN	Action	English	ü	ü	ü	ü	ü	ü
CARTOON	Cartoons, movies & other Children entertainment	English	ü	ü	ü	ü	ü	ü
NASHA KINO	Russian Channel	Russian	ü	ü	ü	ü	ü	ü
Almustakbal	Entertainment	Arabic	-----	-----	-----	-----	ü	-----
Saudia	National	Arabic	-----	-----	-----	-----	ü	-----
ART 1	Family	Arabic					ü	
ART 2	Sport	Arabic					ü	
ART 3	Children	Arabic					ü	
ART 4	Movies	Arabic					ü	

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ART 5	Music	Arabic					ü	
Syria	National	Arabic	-----	-----	-----	-----	ü	-----
Aljazeera	News	Arabic					ü	
Dubai	National	Arabic	-----	-----	-----	-----	ü	-----

- (1) Originated, subtitled or dubbed as indicated.
(2) Operates only during emergencies.

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Tiering

On April 5, 2001, the Council published its decision concerning its policy in relation to broadcasting in the tiering system. The tiering system enables us to supply to our digital subscribers the digital Basic Package at a fixed price and additional single channels and packages of channels for additional payment. The policy behind the Council's decision is that the tiering system should enable subscribers to receive and pay for only the channels or packages chosen by them in addition to the Basic Package. The Council will not oblige us to offer our broadcastings in the tiering system in the analog transmission platform. We received approval from the Council to provide digital broadcast services in a tiering system on May 10, 2001. We are allowed to operate the tiering system only in our digital transmission platform. Marketing of our tiering broadcasting packages began in July 2001.

The Council's decision that permits tiering in our digital transmission platform is subject to our fulfilling a commitment that we made to the Ministry of Communications on January 7, 2001, to supply and connect digital set-top boxes to our subscribers over the years 2001 to 2004. For additional information, see Item 4A. Information on the Company - History and Development of the Company - Important Events in the development of Cable Television and telecommunication industry, and our business - Digital Broadcasting .

Since December 2002, we and the other two Israeli cable television operators offer unified tiering packages, in the framework of which we changed the structure of the tiering packages we offer to our digital subscribers and the channels included in such packages. For a list of our channels and packages and the combinations of packages we offer as part of our tiering system, see Item 4B. Products and Services - Premium Broadcastings .

Premium Broadcastings

Pursuant to the Council's approval dated May 10, 2001, we may supply in our digital broadcastings those Premium Broadcastings that the Council has approved. As of May 31, 2004, approximately 60% of our subscribers are subscribers to the digital broadcasting system and of those, 88% are provided with packages or channels through the tiering system.

Premium Broadcastings may be provided only to a digital subscriber that has purchased the digital Basic Package. The purchase of any of the Premium Broadcastings may not be conditioned upon the purchase of other Premium Broadcastings. Rather, digital subscribers may purchase all or any part of the Premium Broadcastings in any combination of channels and packages, as they wish.

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The following channels and packages have been approved by the Council to be included within the Premium Broadcastings in the tiering system as of April 30, 2004.

Name of Package	Channels Included
Movies	HOT Drama HOT Action HOT Fun HOT Prime
Entertainment	Bip E! History Channel Adventure 1 Life Style

	Viva Platina Leisure Guide
Men & Sports	Channel 5+ NBA Ego Reality TV Adventure 1 Teams channel Eurosportnews Fox Sport CNBC
MTV	MTV HITS MTV2 MTV BASE VH1 CLASSIC
Russian	Mega Film History (Russian) Reality TV Romantica
Games	Gogo Klick Gogo Gold
Music Choice	40 Audio Channels
Various channels a la carte	Zee TV ART 1-5 Pro TV Techelet Playboy
Children s	MGM Academic Channel Moscow open world Cinema Fun Fox Kids Gogo or Klick Logi Portal Super Kid
Youth	BIP MTV HITS MTV2 MTV BASE VH1 CLASSIC TJ Portal Game channel (Gogo or Klick) Extreme sports channel
Interactive services	Weather Horoscope Gordy s Friends HOP Educational HOT Entertainment Who Wants to be a Millionaire

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Gogo Club
Gogo
Klick
Double Click (subscriber against
subscriber)

We offer combinations of packages as part of our tiering system as follows:

- Duet:** Any combination of two of the following channels and packages: Movies ; Children ; Youth and Entertainment .
- Duet Plus:** Any combination of two of the following channels and packages: Movies ; Children ; Youth ; Entertainment ; and Men & Sports .
- Trio:** Any combination of three of the following packages and channels: Movies ; Children ; Youth ; and Entertainment .
- Trio Plus:** Any combination of three of the following packages and channels: Movies ; Children ; Youth ; Entertainment ; and Men & Sports .
- 4U:** Any combination of four of the following packages and channels: Movies ; Children ; Youth ; Entertainment ; and Men & Sports .

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Take 5: Any combination of the following packages and channels: Movies ; Children ; Youth ; Entertainment ; and Men & Sports
Shopping Channel

In late 1995, we began transmitting a home-shopping channel, which offers products directly to cable television subscribers, known as the Shopping Channel. The Shopping Channel is broadcast pursuant to a special broadcast license and is provided to our subscribers as part of the digital and analog Basic Packages. We are entitled to a fee from the producer of the Shopping Channel for the use of one of our channels. For the years ended December 31, 2001, 2002 and 2003, we received approximately NIS 2.0 million, NIS 1.2 million and NIS 0.9 million, respectively, from the Shopping Channel in fees.

In addition, on January 2, 2003, the Council determined its policy regarding shopping channel broadcasts by a cable broadcast licensee following the receipt of a separate approval from the Council for the broadcasts of shopping channels. To date, we have not requested permission to broadcast additional shopping channels.

Pay-Per-View, Near Video On Demand and Video On Demand

Pay-Per-View and Near Video On Demand services are covered by our Cable Broadcast Licenses. We are subject to maximum price restrictions for analog Pay-Per-View services, of approximately NIS 15 plus VAT, per broadcast. We are also subject to restrictions regarding payment for specific broadcasts, the time duration of a single broadcast and certain restrictions regarding the cancellation of a Pay-Per-View order by a subscriber. We are authorized to offer live broadcasting by Pay-Per-View. We began providing Pay-Per-View services to our subscribers in October 2000. We currently broadcast 4 Pay-Per-View channels on the analog platform and 10 on the digital platform. Pursuant to our request, on June 24, 2004, the Council resolved to allow us to cease to provide Pay-Per-View services on our analog platform, subject to our commitment, with respect to subscribers that received such service commencing from January 1, 2003, to provide to such subscribers who approach us, the option to use such service upon their request, on terms determined in the Council's decision.

We have not yet begun to offer Near Video On Demand services to our subscribers. We are currently in the process of preparing to provide Video On Demand services. Our VOD project is in the design stage. This project is conducted jointly together with the other two Israeli cable television operators.

Interactive Services

As of April 2004, we supply our digital subscribers with interactive services, including among others, games channels, Horoscopes and Weather, an entertainment programming guide service, an interactive youth application (T.J.) that serves as a portal to our Youth Package , interactive applications integrated into the Ego channel and the Good Life channel, an interactive invoice service, interactive voting applications, interactive commercial applications and an interactive messaging service to subscribers (which allows us to send messages to subscribers regarding broadcasts and services in connection with broadcasts). We intend, subject to the receipt of the relevant regulatory approvals, to provide additional interactive services in the future, including the integration of interactive applications into additional channels, additional games channels, an interactive lottery and soccer lottery. We currently offer our digital subscribers the games channels also on a pay-per-play

basis (pay per game) or pay per-use basis (pay per defined duration of time played), the use of which may be limited by the subscriber (for the purpose of parental control), on the basis of a predetermined maximum monthly fee. We also provide a portal free of charge which enables our digital subscribers access to all of our interactive services. For a fee, we also enable subscribers to play games against each other from their own home, and an interactive channel which enables our subscribers to learn Spanish. We also offer a music portal which enables access to all of our music channels, and HOT DJ, which is an interactive music channel in the Russian language.

In July 2002, the Ministry of Communications granted us special licenses to provide messaging services, which were subsequently extended to July 2008. Under these special licenses, as subsequently amended in October 2002, March 2004 and May 2004, we may provide the following services:

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SMS services (between our subscribers and subscribers of mobile cellular telephone service providers);

T-Mail services (from television to television, between our subscribers and between our subscribers and subscribers of Internet service providers);

chat services (between our subscribers of this service, and between our subscribers and subscribers of chat services of other cable operators);

instant messaging (between our subscribers of this service, and between our subscribers and subscribers of instant messaging services of other cable operators); and

interactive games (between our subscribers of this service or between our subscribers of other cable operators), including multi-player messaging between these subscribers, and personal data information services (allows a subscriber to connect to databases through the cable network, which includes information on the subscriber, and for the purpose of receiving and inputting personal information and data, and connection of the licensee's network to databases).

On December 28, 2003, we notified the Ministry of Communications that we will no longer provide T-Mail and SMS messaging services, and we formally ceased to provide these messaging services in January of 2004. In connection with our cessation to provide messaging services, the memorandum of understanding with Comverse Network Systems Ltd., or Comverse, from July 2001, regarding the supply by Comverse of products for interactive television unified messaging using Comverse's TVGATE system was terminated by the parties, and we ceased to acquire such products from Comverse.

Internet Services

On April 8, 2002, we launched a service of access to High Speed Internet over cable. Initially we offered promotional packages to the subscribers to the trial services and other initial subscribers to the service. We currently offer access to High Speed Internet over cable services in all of our license areas, and at December 31 2003, we had 57,357 access to High Speed Internet over cable subscribers. As of May 31, 2004, we had approximately 70,000 access to High Speed Internet subscribers. The table below sets forth the products we offer to our private subscribers of access to High Speed Internet over cable services.

<i>Upload Speed</i>	<i>Download Speed</i>
64Kbps	0.256Mbps
96Kbps	0.75Mbps
128Kbps	1.5Mbps
150 Kbps	3.0Mbps

In addition, we offer our Internet subscribers the option to upgrade the Upload Speed of our access to High Speed Internet over cable products, by 64Kbps (Extra) and 128Kbps (Extra Plus).

Our access to High Speed Internet over cable service allows the user to directly access the Internet over cable broadband infrastructure, through the use of a cable modem and personal computer, and there is no need for dial-up activity. We recently began to provide access to High Speed Internet services to certain establishments, businesses and communal settlements in Israel. As of May 31, 2004, we have purchased approximately 94,000 cable modems and intend to purchase more in the future in accordance with the market penetration of the service. In the future, we and the other cable operators intend to assign our access to High Speed Internet subscribers to HOT Telecom. We are currently evaluating the implications of performing such assignment, and we have so notified the Minister of Communications.

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Services for the Business Sector

We have recently commenced the marketing of additional communication services designed for businesses, including High Speed Internet for businesses, Internet Protocol Visual Private Network, or IP VPN, and data transmission services and network services at different bit rates.

We market packages with the following various broadband widths:

Broad Band Cable Internet for Businesses

<i>Name of Package</i>	<i>Upload Speed</i>	<i>Download speed</i>
HOT Business 750K	150 Kbps	750 Kbps
HOT Business 1.5M	150 Kbps	1.5 Mbps
HOT Business 3M	150 Kbps	3 Mbps

In addition, we offer our subscribers the option to upgrade the upload speed of these products by 64Kbps and 128 Kbps.

Access to High Speed Cable Internet for Businesses

<i>Name of Package</i>	<i>Upload Speed</i>	<i>Download speed</i>
HOT Business 2M/512K	512 Kbps	2 Mbps
HOT Business 3M/512K	512 Kbps	3 Mbps
HOT Business 3M/1M	1 Mbps	3 Mbps
HOT Business 4M/1M	1 Mbps	4 Mbps

Set-top boxes

While our broadband network is configured to support a wide variety of services, such as Pay-Per-View, Premium Broadcastings and Interactive Services, it is necessary to provide addressable set-top boxes to subscribers in order to implement such services. We bear the cost of the addressable set-top boxes supplied to subscribers having set-top boxes in their homes. Those subscribers that are provided with addressable set-top boxes that choose the deposit option are required to bear, in whole or in part, the cost of the set-top boxes by way of a deposit. We are not permitted to charge a fee for the deposit of the set-top box equal to more than the value of the set-top box. We are permitted to reduce the amount we refund to a subscriber upon return of a set-top box by up to 10% of the value of the set-top box for depreciation for each year or each partial year, commencing from the earlier of the date of installation of the set-top box and until the date we cease to provide services to such subscriber, or until the removal of the set-top box. In accordance with the terms of our Cable Broadcast Licenses, as amended by the Council on March 6, 2003, our subscribers may alternatively elect to lease the set-top box for a monthly fee. We are not permitted to charge an aggregate fee for the lease of the set-top box equal to more than the value of the set-top box to us. On June 16, 2003, the Economic Committee of the Israeli parliament approved an amendment to regulations promulgated under the Telecommunications Law, which regulates the ability of the Cable Broadcast Licensees to lease the set-top box to the subscriber, at the subscriber's option, in accordance with the terms of the Cable Broadcast License, and in addition, pursuant to this amendment Cable Broadcast Licensees are allowed to sell the set-top box to subscribers, at the subscriber's option, in consideration for an amount not exceeding the value of the set-top box.

Sales, Marketing and Customer Service

Sales and Marketing. Our marketing strategy is to increase the subscriber penetration within our license areas and maintain subscriber satisfaction in order to preserve low subscriber churn rate and to increase the average revenue per user, or ARPU. We market and sell our services through the combined efforts of integrated sales, marketing, technical and customer service groups. We train our personnel to provide information concerning technological advances and to address the specific requirements of existing and potential subscribers. We monitor the performance of these personnel through a variety of supervising methods. In addition, HOT Vision participates in rating surveys conducted by independent organizations, and we also use training programs and surveys prepared by independent professional marketing consultants to help increase the effectiveness and efficiency of its sales and marketing groups.

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During the initial phase of the buildout of our network, we sought to create awareness of our cable television services and stimulate subscriber demand. In an effort to increase subscriber penetration, we initially relied on door-to-door visits by sales personnel who introduced our products and services by offering on-location demonstrations. We also utilized billboards, direct mail and mass marketing programs, including radio advertising, print media and shopping mall demonstrations to further marketing efforts. As the buildout of our cable television network continued and subscriber penetration rates increased in the license areas, we placed greater emphasis on telemarketing and direct mail efforts to target those groups that had not subscribed for our services, tailoring the campaign to the specific requirements of such potential subscribers. This targeted marketing had the effect of reducing the marketing costs incurred in attracting new subscribers. We have further refined our focus to preserve our existing subscriber base and, in this context, we have established marketing locations in centrally located consumer malls within our license areas.

As part of our effort to attract and maintain subscribers, we market our services by advertising particular programs that are broadcast on various channels on our cable network which we believe would be of interest to potential subscribers on television and through print media, direct mail, telemarketing and cross-promotions on dedicated channels. In addition, as part of our effort to maintain subscribers, we promote channels and programs that we broadcast. We also invest in promotions specifically aimed at the Russian sector in Israel due to the potential of this market. Since the end of April 2002, in accordance with the approval of the Controller of Restrictive Business Practices to the proposed merger of the Israeli cable television operators, we cooperate with the other two Israeli cable television operators, among other things, in our marketing activities and content related activities. In addition, since December 2002, we and the other two Israeli cable television operators offer unified tiering packages (in the framework of which we changed the structure of the tiering packages we previously offered to our digital subscribers and the channels included in such packages).

Since September 2003, our joint activities with Tevel and Golden Channels have been conducted under the brand name HOT .

When we started to provide our subscribers with digital broadcasting services we began signing new subscribers and those subscribers electing to purchase such digital services, on a new subscriber agreement. This agreement was approved by the Council in January 2001, together with the Council's approval of our digital broadcasting services. This agreement was submitted to the Standard Contract Court in Israel for its approval, which has not yet been received.

Additionally, when we started to provide our subscribers with access to High Speed Internet over cable services we began signing such subscribers on an access to High Speed Internet over cable agreement. This agreement was submitted to the General Manager of the Ministry of Communications for its approval. This agreement was submitted to the Standard Contract Court for its approval as required by our Telecommunications Infrastructure License in effect at such time. The consideration of our application was later joined with similar applications submitted by the other cable television operators. To date, comments or amendments to this agreement by the General Manager have not been received. We are currently working towards receiving the Court's approval.

We also contact subscribers who request to be disconnected and attempt to rectify any perceived or actual problem promptly. Under the Telecommunications Law and the subscriber agreement, we are required to disconnect an analog subscriber within 14 days of receipt of a written disconnection request, or such later date as the subscriber may request. According to our Cable Broadcast Licenses, we are required to disconnect a digital services subscriber within 2 business days of receipt of a written disconnection request or such later date as the subscriber may request, and we must not charge the subscriber any fees from the date of the disconnection. According to the HOT Telecom Infrastructure License, HOT Telecom is required to disconnect services provided under our Cable Broadcast Licenses and the HOT Telecom Infrastructure License (including access to High Speed Internet over cable services) within 2 business days of receipt of a written disconnection requestor such later date as the subscriber may request. During those periods, the marketing and sales groups contact the subscriber in an effort to retain the subscriber.

Although we seek to limit disconnections initiated by subscribers, a certain amount of such disconnections is inevitable, either because a subscriber has moved outside of our license areas or has decided that it no longer wishes to receive cable broadcasts or access to High Speed Internet services. We make marketing efforts towards such homes that have disconnected cable services in order to get cable television subscriptions reinstalled by new subscribers who have moved into such locations or by subscribers who made a decision to no longer receive cable television services.

We believe that satisfaction with cable television services is essential to reaching and maintaining high levels of penetration. An integral part of our efforts has been to create for ourselves a positive image among our potential and existing subscriber base. To foster such image, we have been involved, and intend to continue to be involved, with various communities within our license areas by participating in public campaigns with local authorities.

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Customer Service. We believe that highly efficient, responsive and prompt customer service is a significant factor in our marketing efforts to build and retain subscriber satisfaction. Since 1999, we operated a service number for the convenience of our subscribers. We currently operate a toll free number for our cable television subscribers. As of December 31, 2003, we had a staff of 209 customer service personnel on a full-time or full-time equivalent basis. Our subscriber service personnel provide information regarding, among other things, subscriber bills, special offers, channels, packages and available services. Our customer service personnel also provide technical support via telephone so that, to the extent possible, subscribers will not have to wait for on-site service. However, if a problem cannot be resolved over the telephone, a service technician is dispatched to the location, usually at no cost to the subscriber. The customer support staff routinely provides feedback to the marketing and research and development groups. Since February 2002, our customer service personnel also engage in sales activities.

Franchises and Licenses. Between 1990 and April 2002, we conducted our operations pursuant to five exclusive franchises to operate cable television in central and northern Israel, including three of Israel's largest cities, and numerous smaller communities and rural areas. Pursuant to the terms of each franchise deed, we were granted the right to operate cable television systems in specified geographic regions, each of which included a densely populated metropolitan area and a less densely populated rural area. In 2002, these franchises were replaced by non-exclusive Cable Broadcast Licenses, a Telecommunications Infrastructure License and a Broadcasting HeadEnd License, to operate in the same geographical areas as the franchises. These licenses were granted on April 30, 2002, March 27, 2002 and May 2, 2002, respectively. In November 2003, the Ministry of Communications granted to HOT Telecom L.P., or HOT Telecom, a limited partnership owned by the three Israeli cable operators (of which we beneficially own approximately 26.5%), a license covering the same services covered by the Telecommunications Infrastructure License granted to us in 2002 within the time frame set forth in the Telecommunications Infrastructure License, and also includes the requirement to start to provide other domestic fixed communications services over cable networks including basic telephony services to subscribers by no later than November 25, 2004. The HOT Telecom Infrastructure License replaced and cancelled the Telecommunications Infrastructure License granted to us in 2002. As of December 31, 2003, the area covered by our non-exclusive licenses was approximately 510,300 homes.

To maximize technological and administrative efficiencies, during 2003 we reorganized our operational areas, and we currently operate the cable television services through two operational areas representing the geographical areas covered by our previous franchises and new licenses: Netanya and Haifa. Our principal national common HeadEnd is located in Haifa, and we have secondary common HeadEnds in Netanya, Bat-Yam, Ramot Naftali (serving the Kiryat Shemona, Safed and the Sea of Galilee license areas), and Pardess Hanna.

A description of the geographical areas where we currently conduct our operations covered by our licenses are set forth below.

Bat-Yam/Holon: The Bat-Yam/Holon operating area includes the cities of Bat-Yam and Holon (which border Tel Aviv to the south) and neighboring areas. We completed installation of most of the cable transmission network in this operating area by the end of 1991. As of December 31, 2003, the area included approximately 116,000 households, and our network in the Bat-Yam/Holon area passed 116,000 homes and had approximately 72,200 cable television subscribers.

Haifa: The Haifa operating area includes the city of Haifa and the surrounding communities. We substantially completed the installation of a regional cable transmission network in this operating area in 1995. As of December 31, 2003, the area included approximately 135,000 households, and our network in the Haifa area passed 132,600 homes and had approximately 76,700 cable television subscribers.

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Netanya/Hadera: The Netanya/Hadera operating area includes the coastal cities of Netanya, approximately 30 kilometers north of Tel Aviv, and Hadera, located between Haifa and Tel Aviv, and adjacent communities to these cities. We substantially completed the installation of a regional cable transmission network in this operating area in 1995. As of December 31, 2003, the area included approximately 202,500 households, and our network in the Netanya/Hadera area passed 179,000 homes and had approximately 89,900 cable television subscribers.

Galilee: The Galilee operating area includes the city of Tiberias, along the Sea of Galilee, Safed and Kiryat Shemona, in Israel's north, as well as the surrounding small towns and agricultural communities, and the Golan Heights. As of December 31, 2003, the area included approximately 56,900 households, and our network in the Galilee operating area passed 52,800 homes and had approximately 27,900 cable television subscribers. We have not completed the buildout of the cable network in this operating area.

The table below contains information on subscriber penetration on a geographical basis in the areas in which we currently operate, as of December 31, 2003.

Area	Date Commenced Cable	Approx No. of Households	Plant Length (km)	Homes Covered	Cable Television Subscribers	Penetration Rate of Homes	Penetration Rate of Households	Internet Subscribers
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	Television Operations					Passed(1)	(2)	
Bat-Yam								
Holon	March 1990	116,004	593	116,004	72,227	62.3%	62.3%	13,229
Haifa	September 1991	135,005	1,131	132,593	76,675	57.8%	56.8%	16,716
Netanya								
Hadera	January 1993	202,464	3,233	178,976	89,869	50.2%	44.4%	21,789
Galilee	December 1990	56,856	1,182	52,846	27,919	52.8%	49.1%	5,623
Total		510,329	6,139	480,419	266,690	55.5%	52.3%	57,357

- (1) Cable television penetration of homes covered is calculated by dividing the total number of cable television subscribers at applicable date by the total number of homes covered.
- (2) Cable television penetration of households is calculated by dividing the total number of cable television subscribers at the applicable date by the total number of households.

Technological Preparations for Competition in the Telecommunications Market

As part of our technological preparations toward becoming a multi-service operator for multi-channel television broadcasting and interactive television, access to High Speed Internet over cable, telephony and data over cable services, we have completed the installation of an addressable analog broadcast system, a digital broadcast system and a data-over-cable platform.

The digital system enables us to provide our subscribers with dozens of broadcasting channels, channel packages according to choice, Internet services, interactive services, and added value services, including Pay-Per-View and Near Video On Demand services (the latter of which we have not commenced).

As part of our preparation for competition in the telecommunications market, we have defined, performed and completed a network upgrade project, for segmentation and bandwidth expansion.

In order to enable fast two-way communication via cable modems, a split of the HFC network into smaller sub-networks, known as Segmentation, is necessary. The Segmentation project involves significant installation of new fibers and optical equipment. We completed the Segmentation process by the end of 2000 to the extent actually required to reflect our subscriber demand.

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Our original network bandwidth was 50-550MHz, and fully occupied 45-48 analog television channels. Full utilization of our network capacity is not possible due to regulatory restrictions. We have upgraded our network in order to expand the network capacity to 860MHz. The upgrade project included bandwidth expansion of both the downstream and the upstream paths. The network's old equipment has been replaced, in all of our operational areas, by a new uniform type of equipment. The bandwidth expansion increased the network capacity by approximately 25 analog channels, which is equivalent to more than 350 digital channels, and enabled bandwidth allocation for new added value services.

The network Segmentation and bandwidth expansion projects are part of our technological enhancement plan, which enables us to offer subscribers a new variety of interactive services, access to High Speed Internet over cable using, alternatively, the television screen or a personal computer, Pay-Per-View services, and may enable us in the future to offer telephony over cable and other bandwidth consumer services.

We have completed a substantial portion of the construction of our cable television broadcast and transmission system, including technologically advanced HeadEnds and a broadband, hybrid optical fiber/coaxial cable television network. Our cable network consists almost entirely of underground plant. Our cable transmission network is capable of supporting both broadcast transmission and two-way data transmissions for various telecommunications applications.

A cable television system begins with a HeadEnd, which transmits signals obtained from the following three main sources: satellite broadcasts received by dish antennae; local broadcasts received off-air or via optical transmission; and programs played back from video cassette recorders and/or video servers. A fiber optic cable network transmits signals carrying all the system's channels from the HeadEnd to secondary HeadEnds and distribution hubs, which cover the different areas of the licenses and service zones. From the secondary HeadEnds/hubs, the services are distributed to subscriber homes via coaxial network. The drop cable terminates at a wall outlet installed in the subscriber household; a cable from the wall outlet passes through a channel converter or a set-top box to the subscriber's television set. A

wireless remote unit enables the viewer to select a channel from among the broadcasted channels. Subscribers who own cable-ready television sets and prefer the analog services only, may connect their sets directly to the wall outlet and select the viewing channel via the television set's control panel/remote control.

In November 1989, pursuant to a special permit issued by the Ministry of Communications prior to our receiving a franchise, we became the first cable television operator in Israel to supply cable television services when we commenced operation of our HeadEnd in Bat-Yam. This HeadEnd currently includes a playback system and 11 parabolic antennas for reception of satellite broadcasts and serves the Netanya operating area.

The subscribers in the Galilee license area are served by a HeadEnd located at Ramot Naftali (completed in December 1990), which includes, among other things, a back-up play-back system and satellite dish antennas, cable-television programming is transmitted by microwave from the HeadEnd to 2 unattended sites, located in the Galilee license area, which in turn is transmitted by underground cable to subscribers. Those microwave links have been progressively replaced by modern fiber optics links.

In September 1991, we completed construction of a HeadEnd located in Haifa, which we now operate as our master HeadEnd. This HeadEnd includes, among other things, a playback system, satellite dish antennas and a production studio that generates original programming. Subscribers in the Haifa operating area are served by this HeadEnd via underground fiber optic and coaxial cables. A fiber-optic network carries television channels from the Haifa HeadEnd to the Netanya operating area. The Haifa and Netanya operating areas form a contiguous geographic area.

We acquired the HeadEnd equipment primarily from suppliers in the United States. Construction of the HeadEnds was for the most part carried out by sub-contractors supervised by a technical team we provided. The HeadEnds are located on land that we either purchased or lease under a long-term lease.

The cable installation includes several stages, such as: preparation of an engineering plan and receipt of permits from local authorities, excavation, laying the cable and network installation (including connecting cables that have been laid and installation of network components); and repaving the area where the work was conducted.

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The network installation for a given geographic area is deemed to have been completed when the infrastructure necessary to connect a building to the network has been installed adjacent to each of the buildings in the area. After completion of the network installation, network equipment is installed in the buildings in the relevant area and subscribers are connected to the system. As of December 31, 2003, we completed the installation of approximately 3,815 miles of underground cable.

We supervise the various stages of network installation, which are performed by design, infrastructure and network contractors. We are not dependent on the services of any one of those contractors. In addition, we purchase equipment, including cable, from a number of foreign suppliers and are not dependent on any particular supplier. In building the network, we have left additional conduit space for future uses.

HOT Telecom recently conducted national trials for the provision of telephony services via IP technologies over cable networks. As of April 30, 2004, there were 550 trial subscribers.

Cellular Telecommunication Services

As part of our strategy to develop and become involved in new telecommunication projects and become a leading telecommunication company in Israel, we became a shareholder in Partner Communications Company Ltd., or Partner, one of four providers of mobile cellular telephone services in Israel, and one of the two operators which use the GSM technology on a fully commercial basis in Israel.

In April 1998, Partner received its license to establish and operate a mobile telephone network in Israel. In October 1999, Partner completed an offering of its shares to the public, raising a gross sum of \$525 million. Partner's shares are traded on the Tel Aviv Stock Exchange, and its American Depositary Shares, or ADSs, each representing one of Partner's ordinary shares, are quoted on the Nasdaq National Market and are traded on the London Stock Exchange. As a result of Partner's initial public offering we recorded capital gains in the amount of approximately NIS 447 million. In addition, Partner repaid its shareholder loans which it owed to us. In April 2002, we sold approximately 50% of our holdings in Partner to a subsidiary of Hutchison Whampoa Ltd., in consideration for approximately NIS 305 million. In November 2003, we sold shares of Partner representing approximately 2.1% of Partner's issued and outstanding share capital in market transactions. Currently, through Matav Investments Ltd., we beneficially own approximately 5.3% of Partner's issued and outstanding share capital.

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The other major beneficial shareholders in Partner are Hutchison Whampoa Ltd., Elron Electronic Industries Ltd. (through Elbit Ltd.) and Eurocom Communications Ltd. We have the beneficial right, through Matav Investments Ltd., to appoint up to two directors to the board of directors of Partner (which is comprised of 17 directors) as long as we hold at least 4.99% of Partner's issued share capital, pursuant to a shareholders' agreement.

All of our current holdings in Partner are pledged to the banks participating in Partner's senior credit facility, which was NIS 1,807 million as of December 31, 2003, by means of pledges unlimited in sum, to secure Partner's undertakings under the credit facility.

On January 1, 1999, Partner commenced operations and the supply of services to the public on a fully commercial basis. Partner's GSM infrastructure covers approximately 97% of the Israeli population, and according to Partner's financial annual report on Form 20-F for the year ended December 31, 2003, filed with the U.S. Securities and Exchange Commission, or SEC, on April 30, 2004, the number of its subscribers as of December 31, 2003, is 2,103,000, equal to approximately 31% of the total subscribers of cellular telecommunications in Israel.

Partner reported total nominal revenue of NIS 4,467.7 million (US\$ 1,020.3 million) in 2003 as compared to total nominal revenue of NIS 3,249.3 million in 2001 and NIS 4,054.6 million in 2002, respectively, and net nominal income before taxes of NIS 529.6 million (US\$ 120.9 million) in 2003 as compared to net nominal income of approximately NIS 84.2 million in 2002, and losses of approximately NIS 306.8 million in 2001, respectively.

On March 14, 2004, we, Danker Investments Ltd. and Delek Investments Properties Ltd., two of our principal shareholders, entered into a memorandum of understanding with Partner pursuant to which Partner will invest up to \$137 million in our company, for up to 40% of our issued and outstanding share capital. This memorandum of understanding has since expired and has no legal effect. However, the parties announced that they intend to continue discussions in an effort to reach an agreement. For more details regarding this transactions, please see Item 7B. Related Party Transactions - Memorandum of Understanding with Partner .

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International Telecommunication Services

On November 7, 1996, Barak I.T.C. (1995) - The International Telecommunications Services Corp. Ltd., or Barak, in which we indirectly hold a 10% share ownership interest, was granted a license to provide international telecommunications services in Israel. Barak and one other international telecommunications license holder, 012 Golden Lines International Telecommunications Services Ltd., or Golden Lines, began offering international telecommunication services in July 1997. The other major beneficial shareholders in Barak are Clalcom Ltd., and indirectly, Sprint International, Inc., Deutsche Telekom AG and France Cables et Radio SA. We have the right to appoint 1 director to the board of directors of Barak (which is comprised of 10 directors), pursuant to a shareholders' agreement.

During 2003, Barak increased the total volume of voice traffic by approximately 10%. Since 1998, Barak has provided Internet services to its customers, and, according to Barak's management, as at December 2003, Barak holds a market share of approximately 9% of the access to High Speed Internet market. As of December 31, 2003, our investments in Barak totaled approximately NIS 16.2 million, after a write-off of approximately NIS 8.8 million of our investment in Barak (among other things, based on a company valuation of Barak). In November 1997, Barak issued senior subordinated discount notes, the proceeds of which amounted to \$100 million. In addition, Barak entered into loan agreements with two Israeli banks under which it was entitled to borrow up to \$170 million. The availability period of the bank loans ended during November 2002. Barak reported revenue of NIS 711 million in 2003 as compared to NIS 694.7 million and NIS 673.9 million in 2002 and 2001, respectively, and net income of NIS 55.9 million in 2003 as compared to net income of NIS 62.6 million in 2002 and a loss of NIS 70.6 million in 2001.

In addition, according to Barak's financial statements for the first quarter of 2004, as of March 31, 2004, Barak had a capital deficiency in the amount of NIS 563 million and a working capital deficit in the amount of NIS 200 million. If Barak is unable to reach agreement with its banks and other major creditors regarding the restructuring of its debt, or is unable to raise other financing, it might not be able to continue as a going concern, and as a result, we may be required to write-off a substantial portion of our investment in Barak. In addition, if Barak will raise equity financing in the future, and we will elect not to participate in such financing, our shareholding in Barak could be substantially diluted.

Since we have a 10% interest in Barak and our holdings in Barak are reflected in our financial statements on a cost basis, Barak's financial results do not affect our financial statements.

In December 2001, the Minister of Communications published its policy to work towards opening the international telecommunications market in Israel to competition. In April 2004 the Minister published regulations in order to achieve this. The regulations provide that companies that meet the requirements to serve as a international telecommunications operator may receive licenses, other than domestic operators, cellular operators or material operators in the field of international transmission services. The regulations establish a number of

pre-conditions to qualify to receive a license, and set forth the procedure for application for a license. The Ministry of Communications has recently granted an additional license for the establishment and operation of international telecommunications systems in Israel to one of the large access to High Speed Internet providers. In addition, two other companies have applied to the Ministry for such a license.

Investments in Technological Companies

In May 2000, we and some of our shareholders decided to invest in start-up companies which engage in fields of Internet, cable television, data telecommunications, applications, content, infrastructure and Internet Protocol telephony. To this end, Nonstop Ventures Ltd. was formed by several of our shareholders, in which we hold, as of November 2002, 50% of the issued share capital, following the exercise of an option granted to us under a memorandum of understanding dated December 31, 2000, as amended. Pursuant to the exercise of the said option, 50% of certain amounts we invested and loans we made on behalf of Nonstop Ventures Ltd. are deemed to be provided by us to Nonstop Ventures Ltd., in consideration for the issuance to us of a non-convertible promissory note by Nonstop Ventures Ltd., and the transfer and assignment to Nonstop Ventures Ltd. of our rights and obligations towards third parties in connection with such investments and loans. The shareholders of Nonstop Ventures Ltd. have agreed to finance its operations in proportion to their respective holdings up to a total sum of \$15 million.

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As of December 31, 2003, we and the other shareholders have invested through Nonstop Ventures Ltd. in seven start-up companies an aggregate amount of approximately \$5.8 million. Of the aggregate investment, we invested approximately \$2.9 million. Due to, among other things, market factors, the financial situation of these companies and our accounting policies, these investment amounts were reduced in our financial records, and were recorded in our financial statements for the year ended December 31, 2001 at a value of approximately \$1.4 million and were further reduced and recorded in our financial statements for the year ended December 31, 2002 at a value of approximately \$0.6 million. These investments are recorded in our financial statements for the year ended December 31, 2003 at a value of approximately \$0.3 million (which reflects a write-off performed by Nonstop in March 2003 of \$0.3 million in respect of its investment in one of the start-up companies).

Government Regulation

General

The operation of cable television systems and other telecommunication services relating to our business is regulated in Israel by the Telecommunications Law, the Ministry of Communications, and the Council for Cable and Satellite Broadcasting.

The Council is established pursuant to the Telecommunications Law and is comprised of 13 members (including 6 representatives of the government and 7 representatives of the public) appointed by the Israeli Government upon the recommendation of the Ministry of Communications. The Council is authorized, among other things, to:

- grant cable broadcast licenses;
- establish policies and adopt rules concerning the type, subject and content of cable television programming;
- supervise the provision of broadcasting services by cable television and satellite operators; and
- advise the Ministry of Communications.

The Telecommunications Law and Our Licenses

Until we received our licenses, we operated under five exclusive franchises in central and northern Israel. In July 2001, the Israeli parliament approved amendments to the Telecommunications Law, under which terms were set for the granting of licenses for the provision of telecommunication services via cable television networks, in place of the exclusive franchises. The amendments also set new regulatory standards with respect to television broadcasting services provided to subscribers in a highly competitive environment.

We now operate under non-exclusive long-term licenses pursuant to the provisions of the amended law. On March 27, 2002, we were granted a Telecommunications Infrastructure License by the Minister of Communications for the provision of infrastructure services for the distribution of cable broadcasts and access to High Speed Internet providers. On April 30, 2002, we were granted 2 Cable Broadcast Licenses by the Council. On May 2, 2002, we were granted a special license to hold a Broadcasting HeadEnd by the Minister of Communications. In November 2002, our Telecommunications Infrastructure License was amended by the Minister of Communications, pursuant to which we were allowed to provide additional infrastructure services of data communications, digital transmission and optic transmission services. In November

2003, the Ministry of Communications granted to HOT Telecom, a limited partnership owned by the three Israeli cable operators (of which we beneficially own approximately 26.5%), a license covering the same services covered by our Telecommunications Infrastructure License ((to be supplied within the time frames set forth in the Telecommunications Infrastructure License), and also including the requirement to start to provide other telephony services over cable networks including basic telephony services to subscribers by no later than November 25, 2004. The HOT Telecom Infrastructure License replaced and cancelled the Telecommunications Infrastructure License granted to us in 2002. These licenses cover the same geographical areas as our previous five exclusive franchises.

The terms and conditions of the various regulatory approvals we have received to the proposed merger between the Israeli cable television operators also affect the regulation of our current business in certain respects. See Item 4B. Business Overview - Arrangement for a Merger of the Cable Television Operators .

Pursuant to the terms of the Telecommunications Law, as amended, and the terms of our licenses, we are now subject, among other things, to the terms, conditions and restrictions set forth below.

Our Licenses

Corporate Separation of Cable Broadcast and Telecommunications Infrastructure Licensees and Ownership of Network

We must operate through separate entities, namely the broadcast entities, on the one hand, and an infrastructure entity, on the other hand, which must each hold a Cable Broadcast License or Telecommunications Infrastructure License, as appropriate. Pursuant to the Telecommunications Law, the licensee under the Telecommunications Infrastructure License, or the Telecommunications Infrastructure Licensee, must own the cable network infrastructure as a condition to the receipt of the license. However, according to an agreement with the Ministry of Communications incorporated in our Telecommunications Infrastructure License, and subsequently, in the HOT Telecom Infrastructure License, our Cable Broadcast Licensees are allowed to continue to own the cable network infrastructure and to provide infrastructure services for an additional interim period of the earlier of two years following the date of the grant of the HOT Telecom Infrastructure License, which was November 25, 2003, or the date of the consummation of the merger of the Israeli cable television operators.

During such interim period, the necessary arrangements must be made regarding the transfer of the ownership of the cable network infrastructure to the Telecommunications Infrastructure Licensee. Accordingly, and as a condition for the receipt of our original Telecommunications Infrastructure License, our Cable Broadcast Licensees and the Telecommunications Infrastructure Licensee entered into an agreement dated March 5, 2002, whereby our Cable Broadcast Licensees granted an exclusive lease to the Telecommunications Infrastructure Licensee to operate the cable network infrastructure. In October 2002, our Cable Broadcast Licensees and the Telecommunications Infrastructure Licensee entered into an agreement, whereby the Telecommunications Infrastructure Licensee shall provide the Cable Broadcast Licensees infrastructure services for the broadcast of cable broadcasts in the areas covered by their respective license, including installment, maintenance and disconnection of terminal equipment. Since November 2003, HOT Telecom is our Telecommunications Infrastructure Licensee and the prior agreements are no longer in effect. Agreements in this regard will be signed between HOT Telecom and us in the future.

The Cable Broadcast Licenses, the original Telecommunications Infrastructure License and the HOT Telecom Infrastructure License all contain restrictions limiting the number and identity of directors that are permitted to serve in both the infrastructure entity (and its general partner), and the Cable Broadcast companies.

In the event that either another entity is granted a general license to broadcast through the cable network, or in the event that HOT Telecom reaches a number of subscribers to access to High Speed Internet over cable services equal to 350,000, or if the number of the telephony lines operated by HOT Telecom pursuant to the HOT Telecom Infrastructure License reaches 250,000, the separation rules set forth below shall apply. Subject to the aforesaid, the Council with respect to us, and the Minister with respect to HOT Telecom, also have the authority to impose conditions in addition to those set forth below, regarding the relationship between the Cable Broadcast Licensees or the Telecommunications Infrastructure Licensee and their connected companies, including the identity of the officers of each company, the transfer of information, the separation of entities between broadcast and infrastructure, the accounting systems, and technological, geographical or commercial restrictions regarding the laying down of infrastructure or regarding the provision of services or broadcasts.

Separation rules:

- i. A separation must be effected between the management of the Cable Broadcast Licensees, on the one hand, and the management of the Telecommunications Infrastructure Licensee and its general partner (but not including the board of directors), on the other hand, including in relation to the business, financial and marketing systems;

- ii. subject to the interim period mentioned above, a division of the assets of both Cable Broadcast Licensees and the Telecommunications Infrastructure Licensee must be effected;
- iii. the Telecommunications Infrastructure Licensee and its general partner shall not be permitted to employ the employees of the Cable Broadcast Licensees and vice versa; and
- iv. no employee of both the Telecommunications Infrastructure Licensee and its general partner can also be a director of either Cable Broadcast Licensee, if pursuant to such employee's duties he has access to commercial information regarding any other general broadcast licensee that competes with our Cable Broadcast Licensees.

In the event that a company connected to the Telecommunications Infrastructure Licensee is an Internet service provider, then there will be an immediate obligation of structural separation between the Telecommunications Infrastructure Licensee and the Internet service provider, in accordance with the above restrictions. If the Minister finds that special circumstances exist, after he is convinced that competition in the field of telecommunications broadcasting will not be harmed, he is entitled, upon a written request by a license holder, to amend the license to include exceptions to the separation obligation subject to conditions that the Minister may set.

Term of our Licenses

Our Cable Broadcast Licenses are each valid for initial periods of 15 years. The HOT Telecom Infrastructure License is valid for a period of 20 years. The Cable Broadcast Licenses and the HOT Telecom Infrastructure License may be extended for additional 10-year periods, by the Council and the Minister respectively, upon the request of the licensees. Our Broadcasting HeadEnd License is valid for as long as our Cable Broadcast Licenses are valid, but not later than May 30, 2017. It may be extended upon request to the Ministry of Communications.

In order to have our licenses extended, we are obliged to, among other things, prove, during the terms of the licenses, that we have met with their terms and conditions. To this end, we are required to deliver detailed reports to the Council as to our compliance with our Cable Broadcast Licenses and applicable law, and evidence of acts that we have taken to improve the quality and technology of the broadcasts. We are similarly required to deliver detailed reports to the Minister in respect of telecommunications services that we provide.

Guarantees

In order to ensure compliance with our obligations pursuant to the licenses, applicable law and regulatory bodies, and to ensure payment of fines that may be imposed by the Council and the Ministry of Communications, the following guarantees have been provided:

bank guarantees by the three cable operators in the aggregate amount of \$14 million to the Ministry of Communications pursuant to the HOT Telecom Infrastructure License, of which we provided a bank guarantee in the amount of \$3.72 million; and

a guarantee of NIS 9.2 million to the Council pursuant to the Cable Broadcast Licenses given by us.

Each of the Minister and the Council has the authority to exercise the applicable guarantees in the event that we or HOT Telecom, as the case may be, do not fulfill our or its obligations, and to cover any damage, loss or cost that the Council, the Minister, or the government may incur as a result of any breach of our obligations under the licenses, and to ensure all payments by the licensee, including royalty payments and payments of fines imposed by the Council or the Minister. The exercise of the guarantee does not derogate from the authority of the Council or the Minister to cancel the licenses, to amend the terms and conditions of the licenses or to impose other sanctions including fines for certain stipulated breaches or actions.

Subscriber Services

Infrastructure services must be provided to all applicants in our service areas, upon non-discriminatory terms. A licensee is obliged to connect anyone wishing to be a subscriber of cable broadcast services or infrastructure services according to the terms of the relevant license, within stipulated time periods.

Our standard cable broadcasting subscriber agreements are subject to the approvals of the Council and the Court for Standard Contracts. We may be directed to amend the terms of our standard cable broadcasting subscriber contracts. The standard subscriber agreement with respect to the services granted pursuant to the HOT Telecom Infrastructure License must be submitted to the General Manager of the

Ministry of Communications for approval if so requested.

HOT Telecom is obliged to offer its services to all applicants, regardless of whether or not they may be a subscriber of another licensee (including a broadcast licensee). HOT Telecom is prohibited from discriminating, and will refrain from giving a preference to a licensee that is related to it, in the provision of services, including with respect to payment for services, conditions of the services, availability of the services, providing information regarding the services, or in any other manner. HOT Telecom is prohibited from making the provision of the infrastructure services dependant upon the purchase of its own or another party's services, or dependant upon refraining from receiving services from another party, unless authorized by the Minister.

We are prohibited from making the supply of broadcasts dependant upon unreasonable, discriminatory or unfair terms, such as: minimum periods; the receipt of other services; or the obligation to obtain equipment from another party or us. We are prohibited from discriminating between subscribers. We are also subject to rules concerning the time limits allowed for connection and disconnection of subscribers, after such subscriber has given us notice.

We or HOT Telecom, as the case may be, must continue to operate a customer service call center and office, for technical and general customer support, and appoint a complaints officer. Minimum standards are set in our licenses as to the operation of such services and the management of customer complaints.

Under our Cable Broadcast License and under the HOT Telecom Infrastructure License, we or HOT Telecom, as the case may be, do not have the right to disconnect or discontinue the broadcast and infrastructure services except: upon the subscribers request, for a material breach of the subscriber agreement, for the purpose of maintenance, or due to risk, or as further set forth in our Cable Broadcast Licenses and the HOT Telecom Infrastructure License.

Restrictions upon Transfer of Assets

According to the Telecommunications Law, the licenses themselves and the rights granted thereunder may not be charged, transferred, or made subject to a lien, with the exception of transfers within the framework of structural reorganizations. Both our Cable Broadcast Licenses and the HOT Telecom Infrastructure License also stipulate that the assets of the licensees pertaining to the licenses (including terminal equipment of the Cable Broadcast Licensees) may not be transferred, assigned, charged or otherwise pledged in any way, other than in accordance with the provisions of the Telecommunications Law (in respect of the Cable Broadcast Licenses), and only upon the advanced written consent of the Minister (in respect of the HOT Telecom Infrastructure License). However, according to the Telecommunications Law, it is possible to create a charge upon the assets of a cable broadcast licensee in favor of a bank legally operating in Israel.

In addition, under the HOT Telecom Infrastructure License, HOT Telecom is allowed to create a charge in favor of a bank legally operating in Israel in order to receive financial credit, provided that prior notice is given to the Minister of Communications, and so long as the charge agreement includes a provision according to which the exercise of rights pursuant to the charge shall not be harmful to the provision of services by HOT Telecom.

Restrictions upon Ownership and a Change of Means of Control.

According to the Telecommunications Law, a cable television operator must be a citizen and a resident of Israel, or an entity incorporated in Israel, and at least 26% of any means of control of such entity must be held by Israeli citizens and residents.

According to our Cable Broadcast Licenses, the Council's authorization is necessary for any of the following changes of means of control in a Cable Broadcast Licensee, and any such change effected without the Council's authorization shall be void:

- (i) a change of identity of the controlling entity of the Cable Broadcast Licensees;
- (ii) an increase in shareholding by over 10% in the Cable Broadcast Licensees; or
- (iii) a change in the holdings in the Cable Broadcast Licensees following which any party becomes an interested party (a holding of 5% or greater), or has a material influence (a holding of 25% or more); or if such party has ceased to be an interested party or holder of material influence.

A change in the holdings in Cable Broadcast Licensees of up to 15% of the means of control (but which does not result in a change of control in the Cable Broadcast Licensee) which result from transactions performed on a stock exchange require

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notification to the Council, rather than authorization, as well as to the Senior Vice President of Engineering and Licensing of the Ministry of Communications.

In addition, any agreement pledging the controlling shareholding must be made conditional upon the Council's approval if the exercise of such pledge would cause a change in the means of control of the Cable Broadcast Licensees.

The restrictions outlined above must also be included in the articles of association of the Cable Broadcast Licensees. These provisions appear in our amended articles of association.

According to the HOT Telecom Infrastructure License, the authorization of the Minister is necessary for any of the following changes of means of control in HOT Telecom:

- (i) if any party becomes an interested party (a holding of 5% or greater of any means of control);
- (ii) if any party gains a material influence (inter alia, a holding of 25% or more of any means of control);
- (iii) if any party becomes a controlling shareholder (inter alia, a holding of 50% or more of any means of control); or
- (iv) transfer of means of control which would result in any party becoming an interested party, holder of material influence, or controlling shareholder.

Furthermore, in the event that a charge is placed over the means of control of HOT Telecom or over the means of control of an interested party of HOT Telecom, which, if exercised will make the grantee a holder of means of control in HOT Telecom which vest the grantee with material influence over HOT Telecom, or as a result of which the grantee shall become a controlling shareholder of HOT Telecom, then such charge must include a provision stating that the exercise of the charge is conditional upon receipt of advanced written consent from the Minister of Communications. Due to restrictions regarding cross ownership interests, certain entities or individuals are prohibited from becoming an interested party in HOT Telecom. According to our HeadEnd License, the prior written approval of the General Manager of the Ministry of Communications is necessary for the transfer of the license, directly or indirectly, to another party. For this purpose, transfer includes a change in the holdings of the means of control of the licensee, even if this does not include a change of identity of the controlling entity of the licensee.

Specific Terms and Conditions of our Cable Broadcast Licenses

In addition to those mentioned above, our Cable Broadcast Licenses also include, among others, the following specific terms and conditions.

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Subscription fees

The subscription fees that we charge for cable television services are regulated under the terms of our Cable Broadcast Licenses and by regulations promulgated under the Telecommunications Law. Pursuant to such regulations, the fees are linked to the Israeli consumer price index. If the consumer price index increases between 4% and 10% after the date of a previous increase of the fees and rates we charge, then we can increase fees and rates once every 3 months. However, if the consumer price index increases in excess of 10% after the previous increase of our fees and rate charges, then we may increase fees and rates regardless of whether three months have passed since the previous increase of such fees and rates. We are authorized to charge subscribers a monthly subscription fee, fees for the Premium Broadcastings, fees for Pay-Per-View services, an installation fee, lease payments or a deposit for the set-top boxes, an additional outlet fee and fees for certain ancillary services.

We have the right to offer discounts and make special offers for limited periods, subject to giving prior notice to the Chairman of the Council and a Senior Manager of the Ministry of Communications. They have the combined authority to disallow and to direct us to take actions with regard to any offers that we wish to make, upon specific considerations set forth in our Cable Broadcast Licenses. In the event that such offers last for longer than the limited period allowed, the Chairman of the Council and a Senior Manager of the Ministry of Communications have the authority to deem the sale prices to be a request to amend our price list accordingly.

Broadcasts and Programming

Pursuant to the terms of our Cable Broadcast Licenses, the Cable Broadcast Licensees shall air only the broadcasts that have been authorized by the Council, according to the terms of such approval. Such broadcasts shall be both digital and analog, or any other system authorized in advance by the Council. We may request permission to reduce the scope of the analog broadcasts, and in such event, we may be

instructed to charge lower subscription fees. We are prohibited from ceasing the supply of approved programs or packages without the Council's prior approval. The Council has the authority to change the terms of its approval of broadcasts, and has the authority to cancel the approval for the broadcast of any channel following breach of the terms of the approval, or in the case of a material change in the content of the channel.

We are required to provide a stipulated amount of independent and local original programming, including information and broadcasts/programs exclusively regarding events in local areas, as well as a variety of films, and entertainment, music, arts, education, science, culture and sport programming material, all in accordance with quantity and content criteria established by the Telecommunications Law, Council Regulations and our Cable Broadcast Licenses. We are also required to provide real-time, unedited transmission of radio and television programming broadcasts to the public in Israel, receivable from the open airwaves, including those of foreign television stations and educational television broadcasts. We must provide an electronic programming guide. On July 31, 2003, the Council amended the telecommunications rules and our Cable Broadcast Licenses, according to which, obligations of the Cable Broadcast Licensees in respect of the content and scope of broadcasts that the licensees are required to provide were reduced.

On December 31, 2003, the Council resolved that prior to determining the final version of new broadcast rules, it will conduct a procedure according to which individuals and companies which have interests in the subject matter will be able to present their positions to the Council regarding the proposed version of the new rules. On April 25, 2004, the cable companies presented their position regarding the proposed new rules. To date, such rules have not yet been adopted.

Our Cable Broadcast Licenses prohibit us from conditioning (directly or indirectly) the provision of any broadcasts to a subscriber upon the purchase of other broadcasts, including by means of pricing that is unreasonable in the opinion of the Council and which was not approved in advance by the Council. However, this does not affect our ability to condition the receipt of additional digital broadcasts upon the purchase of the digital basic broadcasts package. The Council may, for special reasons, direct us to alter the composition of the tiering packages, or to separate a channel from the basic packages. We are obliged to allow subscribers the right to purchase individual channels separately, although if the Council is convinced that we are offering our subscribers a broad choice at reasonable prices, it has the authority to exempt us from this latter requirement.

We are prohibited from advertising new broadcasts, channels, or packages before we have served the Council with a request to broadcast such broadcasts, channels or packages. The Council has the authority to prohibit such advertisements until such request is granted. Furthermore, any offering of free broadcasts to subscribers must include an express clarification, to be approved by the Council in advance, as to our plans to charge subscribers for such broadcasts in the future.

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We are entitled to broadcast notices regarding sponsorships during certain sports broadcasts, subject to certain conditions, in accordance with and as set forth in the Council's decision of September 3, 2002.

Under the Telecommunications Law and in accordance with the resolution of the Council of June 2002 as amended in September 2002 and in May 2003, each Cable Broadcast Licensee is required to allocate to local production or purchase of locally produced programs in initially broadcasting in Israel, a percentage of its annual income derived from subscriber fees for the year preceding the year of the investment, as follows: (i) commencing April 30, 2002 (the date of grant of the Cable Broadcast License) and until the end of 2005, at least 8% of such income; and commencing 2006 and thereafter, as to be determined by the Council prior to the end of June 2005; and (ii) in the event a Cable Broadcast License is granted to the merged entity of the Israeli cable television operators, the Council shall determine, prior to the end of June 2005, the rate of the amounts that shall be allocated to local productions by the Cable Broadcast Licensees as of 2006 and thereafter. For this latter purpose, the Council shall consider, among other things, the financial condition of the licensees in connection with their broadcast activities and the contribution of the proposed merger of the cable television operators to the improvement of the financial condition of the licensees. According to the valuation of our management, the investment amount made by us for local production in initial broadcasting in 2001, 2002 and 2003 is higher than 8% of our annual revenues from the subscription fees for the same years.

Obligation to Broadcast Specific Channels of Special Broadcast License Holders

Our Cable Broadcast Licenses stipulate that we must allow any holder of a special broadcast license to broadcast a specific channel to have access to our subscribers. Restrictions apply to the terms of any agreement with the holder of the special broadcast license, to the effect that such terms cannot be inferior to the terms on which we broadcast our own channels. The obligation to allow such access does not apply to analogical broadcasts, with the exception of dedicated channels or channels that were broadcast on the analogical system before the granting of the general non-exclusive license (such as the Shopping Channel). We are required to commence the broadcasts of such special broadcast license holder at any time, or upon such date that the Council shall direct, even if no agreement has been reached with such special broadcast license holder, and even if we have been unable to reach agreement as to the price, provided that such special broadcast license holder will provide guarantees.

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In any advertisement of the broadcast schedule of the independent channels, a special broadcast license holder may not be discriminated against by the Cable Broadcast Licensee. The fee that we are permitted to charge for such broadcasts may include costs in addition to reasonable profit for such inclusion of information in such advertisement. We must include broadcasts of a special broadcast license holder on the electronic programming guide, and we must air trailers for such broadcasts. We shall also be responsible for taking any specific actions necessary to enable broadcasts of the special broadcast license holder, including the provision of technical services upon terms equal to those provided to independent channels. The price for such services must be included in the general fee for the broadcast. We are obliged to connect subscriber(s) to channels of a special broadcast license holder within 3 working days of notification by the special broadcast license holder and the special broadcast license holder is entitled to elect whether to offer its broadcasts to subscribers as part of a package of channels of such special broadcast license holder or of other special broadcast license holders, in addition to the offer of its broadcasts to subscribers as a single channel. We are prohibited from preventing such choice from being effected.

Outstanding Obligations from the Previous Franchises

Our Cable Broadcast Licenses, as amended by the Council's decisions dated April 10, 2003, list all of the following unfulfilled obligations on behalf of all of the previous franchise holders in Israel which are still outstanding under the terms of the previous exclusive franchises. Based upon the number of subscribers, our pro rata portion of the cost of such common obligations would be approximately 25%. During a period of 8 years commencing two years from the date of our Cable Broadcast Licenses, we and the other cable television operators are obliged to fulfill these obligations. According to the Council's decision, the total outstanding obligations include:

- i. 398 total hours of original locally produced broadcasts;

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- ii. \$6,466,178 worth of total investments in original locally produced broadcasts;

- iii. 3,890 total hours in total of original programming on Channels 3, 6 and 8;

- iv. 342 total movies on Channel 4;

- v. 5,483 total regional news broadcasts of at least 15 minutes each; and

- vi. 1,350 total hours of translated programs with subtitles and 118 total new broadcasts with translation into sign language for the hearing impaired.

On May 6, 2003 a letter was sent to the Council on behalf of the Israeli cable television operators expressing their objections to the Council's decisions described above regarding the outstanding obligations as determined by the Council. On June 1, 2004, we and the other two cable operators presented our suggested settlement regarding the outstanding obligations to the Council. We are currently waiting for the response of the Council to our suggested settlement.

The status of our Cable Broadcast Licenses in the event that the merger between the Israeli cable television operators is consummated

The terms of the approval of the Council to the merger (dated March 7, 2002, as amended on February 13, 2003) shall be incorporated into any new broadcast license that will be granted to the merged entity and that will replace our current Cable Broadcast License. Pursuant to the Council's amended approval, an application for a general broadcast license was filed with the Council on behalf of the merged entity on March 5, 2003.

Specific terms and conditions of the HOT Telecom Infrastructure License

In addition to the above, the HOT Telecom Infrastructure License also includes, among other things, the following terms and conditions.

Services

HOT Telecom has the right to grant general cable broadcast license holders services, and to provide services of access to High Speed Internet over cable, messaging services, data communications services, and other ancillary telephony services.

The provision of our service to a broadcast licensee shall be effected in such a manner that the broadcast licensee shall be able to provide its services to the subscribers in accordance with the terms and conditions of its license. HOT Telecom is prohibited from discriminating, and will refrain from giving a preference to a licensee that is related to it, in the provision of services, including with respect to

payment for services, conditions of the services, availability of the services, providing information regarding the services, or in any other manner.

Fees

The fees we are permitted to charge our subscribers include, among other things: payment of installation fee for connection; payment for terminal equipment and installation thereof; payment for installation of extensions; relocation fees; payment for the sale, loan or lease of terminal equipment; regular periodic payments; varying payments for use of the service according to time or traffic volume; and payment for conversion of services and any other payment approved by the Minister or the General Manager of the Ministry of Communications. In addition, with respect to cable modems, we may not charge subscribers for a deposit in excess of the cost of the cable modem, for cable modem leased to the subscriber, and we may reduce the amount by 10% of the value of the cable modems each year or partial year, as mentioned above.

We have the right to determine service packages of telecommunications services that we provide, at an overall price per package of services, or at a price for each service. We are obliged to offer, without discrimination, every service and every service package on equal terms and at a uniform fee, according to the type of subscribers all over the service area. We must make information with respect to fees fully available to every applicant, including on the Internet.

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We are obliged to notify the Ministry in advance of any intended changes in fees. The Minister has the right to alter the fee if he finds that it contravenes the provisions of the license or might compromise competition or the rights of subscribers.

When collecting payment from a subscriber for another service provider, no addition may be charged to the other entity's fee.

Frequencies

Certain frequency bands are forbidden, including between 806MHz and 862 MHz. We are prohibited from causing interference to other systems and shall cooperate in preventing interference.

Termination

Upon termination of the HOT Telecom Infrastructure License, in the event that HOT Telecom is unable to reach an agreement with a potential purchaser of its infrastructure within 6 months, then an arbitrator shall be appointed who shall impose a valuation calculated according to the value of the infrastructure, on a going concern basis and according to its economic value.

Our Broadcasting HeadEnd License

This license allows us to among other things; construct, maintain and operate broadcasting HeadEnds, for the purpose of maintaining the cable services provided by the Cable Broadcast Licensees; to connect our telecommunication system to the public telecommunications network operated by HOT Telecom or another entity licensed for transmission; to connect our telecommunications system to the system of another special licensee for operating a HeadEnd, to enable broadcasting reception via our telecommunications system and to construct and operate monitoring mechanisms needed to ensure the orderly operation of our telecommunications system. In October 2002, two of our Cable Broadcast Licensees entered into an agreement, pursuant to which one Licensee will provide the other HeadEnd services for the purpose of transmission of cable broadcasts. The General Manager of the Ministry of Communications has the authority to conduct inspections to ensure that the terms of our Broadcast HeadEnd License have been complied with.

Royalties and Payments to the State of Israel

Under our Cable Broadcast Licenses, we are required to pay the Ministry of Communications an annual license fee and variable royalties. The variable royalties are payable annually in an amount equal to a certain percentage of our annual gross revenues (not including VAT) from the provision of certain broadcast services, which include, among other things, certain installation and subscribers fees. For purposes of payment of these royalties, revenues derived from subscriber fees for tiering and pay-per-view broadcasts are to be calculated net of payments that the licensee is contractually obligated to pay to the holder of the rights to such broadcasts. Under amendments to regulations promulgated under the Telecommunications Law proposed by the Minister of Communications and approved by the Economic Committee of the Israeli parliament on June 16, 2003, royalties payable by Cable Broadcast Licensees have been reduced, effective retroactively, from 5% of annual gross revenues (not including VAT), to 4% of such revenues in 2002 and 2003, and 3.5% of such revenues in 2004. Payments are made on a quarterly basis.

In addition, regulations promulgated under the Telecommunications Law provide for royalties payable by general telecommunications licensees (which includes HOT Telecom) for the right to provide local fixed line communication services (including access to High Speed Internet and others), as follows: until December 31, 2003, 4% of certain income, and from January 1, 2004, 3.5% of certain income. Certain income for these purposes includes all income of the general telecommunications licensee that is derived from the provision of telecommunications services pursuant to its license, excluding:

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- i. income collected by the licensee on behalf of another licensee (general or special) and transferred to the other licensee; or payments made to a different general license holder for the completion of calls, or the transfer of such calls in the telecommunications network of such other license holder, including payments made for interconnection;
 - ii. income of the licensee from the provision of transmission services to other license holders;
 - iii. income of the licensee from segments of transmission services by way of satellite;
 - iv. income of the licensee from selling terminal equipment; and
 - v. bad debts that are related to income from the provision of services in relation to which the licensee pays royalties.

Our Broadcasting HeadEnd License provides that we must pay fees in consideration for the license as determined by the Ministry of Communications pursuant to the Telecommunications Law and the Telegraph Ordinance [New Version], 1972.

On December 2003, the Minister of Communications announced his intention to amend the regulations in several aspects, and among them, in a way that will exclude from the royalties payment obligation, income from certain data communication and transmission services that are supplied by special licensees, which are not obliged to pay royalties.

HOT Telecom asked for certain amendments to the Minister of Communications proposal. The proposed amendment to the regulation haven t been executed yet.

HOT Vision and Cooperation of Cable Television Operators in Production of Broadcasting

In 1989, we, together with the other Israeli cable television operators, formed I.C.P. Israel Cable Programming Company Ltd., or ICP, for the purpose of jointly purchasing and producing our local cable channels, which then consisted of four channels: family, movies, sport and children. The culture and science channel was later added. In January 2004, ICP changed its legal name to HOT Vision Ltd. We currently hold approximately 25% of the outstanding share capital of HOT Vision. In January 1995, the cable television operators and ICP (as it was known at such time) reached an agreement for the approval of unified channels with the Controller of Restrictive Business Practices, or the Controller, regarding its operations, according to which, among other things, it would produce, create or acquire at least 15% of its programming from local agents and suppliers. This agreement was extended from time to time by the Restrictive Business Practices Court.

According to Council decisions in March 2000, March 2002, May 2002 and December 2002, the Council further extended the approval of joint broadcast channels until June 30, 2003, subject to the obligation to allow YES to broadcast those channels for consideration, excluding originally produced content, until the earlier of either: December 31, 2003 (regarding the family channel (HOT 3), the movie channel (HOT Movies), and the sports channel), and March 1, 2003 (regarding the children s channel); or the date upon which YES has at least 500,000 subscribers. After the expiry of this obligation upon the cable television operators, YES may request an extension. To date, YES has not requested an extension. These obligations to YES have since expired. YES broadcasts the family channel (HOT 3) produced by HOT Vision, except for original productions, pursuant to an agreement effective until December 31, 2006. YES ceased to broadcast the movie channel (HOT Movies) produced by HOT Vision on June 30, 2002. Furthermore, pursuant to the Council s decision in March 2000, we are prohibited from broadcasting content that we purchased on an exclusive basis (with the exception of originally produced content).

Under the approval of the Controller to the proposed merger of the Israeli cable television operators, and the exemption provided by the Controller from the requirement to receive approval of a restrictive arrangement in connection with the joint activities of the cable television operators, it is no longer necessary for these joint activities of the cable companies to be subject to the approval of the Restrictive Business Practices Court. However, the terms and conditions of the approvals of the Council to the proposed merger impose on the merged entity similar provisions to those that currently apply to the cable companies regarding the broadcasting obligations towards YES. For additional information regarding the conditions of the approvals for the proposed merger and an exemption we received from the Restrictive Business Practices Authority, see Item 4B. Business Overview - Agreement for a Merger of the Cable Television Operators .

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For information regarding certain guarantees we have provided to two banks in order to secure certain liabilities of HOT Vision, see Item 5B. Operating and Financial Review and Prospects - Liquidity and Capital Resources .

For information regarding two law suits filed in the District Court of Los Angeles, California, United States, by Warner Bros. International Television Distribution, a provider of movie and series content broadcasted on Channel 3 (HOT 3) and movie channels (HOT Movies) of the Israeli cable television operators, including ours, against the two other Israeli cable television operators, Tevel and Golden Channels, alleging that they are in breach of their respective license agreements with Warner Bros., see Item 8A. Consolidated Statements and Other Financial Information - Legal and Arbitration Proceedings . As the result of these lawsuits, we now provide content purchased from alternative studios and content providers in place of the programs we previously purchased from Warner Bros.

On June 30, 2003, HOT Vision and the cable companies signed an agreement for the indemnification of HOT Vision relating to all of the amounts that it shall bear in connection with the debt to major studios and expenses associated with the management of the above legal procedures. According to the indemnification agreement, the cable companies are committed, one towards the other, to jointly finance through HOT Vision the debt to the major studios and expenses associated with the management of these legal procedures which were implemented until the date of the financial statements against certain of the cable companies as well as any other procedure between Tevel and/or Golden Channels and the major studios in connection with agreements which were signed and/or terminated with the major studios - regarding content which was provided to channels 3 and 4. As for the pay channels (HOT Drama, HOT Action, HOT Fun and HOT Prime), it was agreed that the amounts will be paid directly to Tevel. According to the indemnification agreement, the debt to the major studios contains amounts that Tevel and/or Golden Channels have to pay, as the case may be, to the major studios in connection with the legal proceedings associated with these agreements, including the amounts of new guarantees provided to the major studios, if so provided, and which the major studios will forfeit and legal fees that Tevel and/or Golden Channels will have to pay to the major studios, all by virtue of a judgment or a decree rendered in the context of the proceedings. The indemnification does not include amounts that are payable by the cable companies to Tevel and/or Golden Channels through Hot Vision and Avdar for purchase of content to channels 3 and 4 and to the pay channels (HOT Drama, HOT Action, HOT Fun and HOT Prime).

The indemnification agreement further stipulates that the commitments of the cable companies shall be revoked in the following cases: (1) if the cable companies release HOT Vision in writing from its obligations under this agreement (2) if Tevel, Golden Channels and we were to merge into another cable company and the merged entity assumes, in writing and without any condition, the commitments of all of the cable companies towards Hot Vision under this agreement even if HOT Vision is not released from all of its said obligations given that the merged cable company holds all of the issued share capital of HOT Vision and that its commitments cover all of HOT Vision's obligations under the indemnification agreement.

Cooperation Among the Cable Companies and Conducting Negotiations for the Acquisition of the Cable Operations and Assets of Tevel

Agreement for a Merger of the Cable Television Operators

In February 2003, we and the other Israeli cable television operators and us agreed on a final version of an agreement which sets forth the structure and conditions of a merger among us. The parties have agreed that this merger agreement, upon its signing, will add to and broaden the terms of the previous arrangement between these parties executed on December 31, 2001, which cancelled and replaced previous arrangements between the parties dated December 29, 1999 and April 30, 2001. In the event any terms of these agreements shall conflict, the terms of the latter agreement of February 2003 shall prevail. Under the terms of this merger agreement, on the date of the consummation of the merger, all of our cable broadcast operations will be transferred to our subsidiary, Cable Systems Media Haifa-Hadera Ltd., immediately following which all of the cable broadcast operations of the cable television operators shall be merged into and together with Gvanim Cable TV Ltd., such that Gvanim Cable TV Ltd. shall become the merged broadcasting entity. Likewise, all of the infrastructure operations of the subsidiaries of the cable television operators shall be merged into and together with a wholly owned subsidiary of Gvanim Cable TV Ltd., such that this subsidiary shall become the merged infrastructure entity. The parties have agreed that if the final version of the merger agreement has not been signed by July 31, 2003, or a later date agreed upon by the parties, the provisions of the agreement will not apply, the parties shall not have any claim or suit towards another party with respect to the proposed merger agreement and/or the shareholders agreement, and shall be free to act independently or together with others, without any limitation.

Prior to the merger we will need to reach an understanding with the major Israeli banks, which are creditors of the parties to the merger. The merger must also receive approvals under applicable law, including the approvals of the Council, the Income Tax Commission, and the Controller of Restrictive Business Practices and by the Israeli court, after receiving the approvals of certain creditors and the relevant corporate bodies of the relevant parties. To date, approvals have been granted, subject to terms and conditions, from the Council, the Controller,

and the Income Tax Commission. Subject to the final terms of the merger, further approval of the Income Tax Commission to the merger may be required. One of the issues outstanding to date in connection with the consummation of the merger is the position of the Supervisor of Banks of the Bank of Israel in connection with, among other things, certain limitations under Israeli banking laws.

According to the position of the Supervisor of Banks of the Bank of Israel, the merger of the cable operators and the formation of a merged cable entity would constitute a deviation from the directives of the Bank of Israel and of Proper Bank Management Directives of the Supervisor of Banks regarding, among other things, restriction on a Group of Borrowers as such term is defined in the Proper Bank Management Directives. This position of the Supervisor of Banks has an impact as to the issue of giving loans by banking corporations and as to the issue of allocation of the merged company's debts, among other things, to an indirect controlling shareholder of Matav.

Based on the aforesaid, and due to the difficulties arising from the position of the Supervisor of the Banks and the provisions of Proper Bank Management Directives there is no certainty whether the merger will be actually completed and if it will be completed when it will actually occur and what will be its structure.

Since April 2002, in accordance with the approval of the Controller of Restrictive Business Practices to the proposed merger, we cooperate with the other two Israeli cable television operators in order to strengthen our competitive position in the telecommunications market and to achieve maximum operating efficiency in a broad range of activities, including, among others, our marketing and content related activities.

On November 19, 2003, we, together with the other Israeli cable television operators submitted a request to the Controller of Restrictive Business Practices for an exemption from the requirement to receive an approval of a restrictive arrangement under Section 14 of the Restrictive Business Practices Law, to cover the period from November 16, 2003 and until the earlier of the date of consummation of the merger of the cable television operators or November 15, 2004, in order to facilitate the consummation of the merger. The application for the exemption related to the existing joint activities of the cable television operators, including among other things, multi-channel television broadcasts, domestic fixed communications services including Internet access and telephony services, marketing, production and content purchasing. On December 17, 2003, the Controller granted us and the other cable television operators an exemption for a period of one year. This exemption is conditional upon, among other things, all of the cable television operators refraining from taking any irreversible actions which would prevent them from being able to undertake separate and independent activities in the event that the merger will not be completed, or from undertaking any cooperation among themselves prior to December 15, 2004 which is not reversible.

According to the Controller's conditions to the approval of the merger, as extended, it was determined that, among other things, the merged infrastructure company must commercially supply telephony services over cable infrastructure to the public in Israel by no later than November 20, 2004. Furthermore, it was determined that the merged infrastructure company will provide telephony services that compete with those of Bezeq in scope and time as set forth in the Controller's conditions to his approval of the merger. The investment in telephony must meet certain required minimums as further detailed below.

In light of the above, there can be no assurance that the merger will take place, the date on which it will take place or the structure that will be implemented, and accordingly our management is examining the options available to us in order to continue and maintain the existing cooperation among the cable television operators, including the possibility of purchasing Tevel's cable television and access to High Speed Internet subscribers.

In that regard, we have entered into negotiations with Tevel and its shareholders regarding the purchase by us of all Tevel's assets including Tevel's holdings in Golden Channels. If we were to acquire Tevel's assets, we would have over 580,000 cable subscribers, representing approximately 60% of the Israeli cable television market, and we would hold 35% of Golden Channels. We have not signed a binding agreement with Tevel, and cannot be certain that this transaction will be completed, or if completed, on what timeframe or on what terms and conditions, including price. If this transaction were to take place, we would likely incur or assume substantial additional indebtedness.

We believe that if we were to acquire all of Tevel's assets as aforesaid, the proposed merger of the three Israeli cable television operators would not be completed in its current proposed form. However, we believe that following an acquisition by us of Tevel's assets, we would expand our cooperation with Golden Channels and facilitate the consummation of a merger among the cable television operators.

In order to strengthen the cooperation of the three Israeli cable television operators, we, Tevel and Golden Channels recently agreed to perform an operational merger. To this effect, a joint management was recently appointed to oversee the merger of the marketing, sales, engineering, customer service, operations and information systems activities of the three companies. We will be subject to decisions taken by the joint management of the merged operations, and accordingly, these decisions will affect our policy-making in the areas of the joint activities. There can be no assurance that the operational merger will result in a successful integration of the operations of us, Tevel and Golden Channels,

or whether the operational merger will in fact enhance our profits and competitiveness.

Tevel filed a motion for stay of proceedings on April 22, 2002. The stay of proceedings was granted by the Court on April 22, 2002. In September 2003, the meeting of creditors of the shareholders of Tevel approved the creditors arrangement proposed by Tevel's trustee. Following the approval of the creditors arrangement by the meetings of creditors, the Court approved the arrangement. In September and December 2003 the Court extended the stay of proceedings order until January 11, 2004 in order to allow the continuation of the process of receiving the approvals required in order for the arrangement of creditors to become effective. As of January 8, 2004, all of the approvals that were required in order for the arrangement of creditors to become effective had been obtained, and accordingly the arrangement of creditors entered into effect. According to this arrangement, Tevel has reached agreement with its unsecured creditors and, subject to the fulfillment of the arrangement, no longer has any obligation to these creditors with respect to debts incurred prior to April 22, 2002. According to the agreement reached with the secured creditors, Tevel's shares and remaining assets are subject to the right of Tevel's secured creditors which are banks to realize these shares and assets to cover Tevel's debts to these secured creditors.

The Approval of The Council for Cable and Satellite Broadcasting

The approval of the Council to the merger of March 7, 2002, as amended on February 13, 2003, is subject to a number of conditions, including:

an obligation upon the cable television operators to allow direct broadcasting by YES, to broadcast the HOT 3, HOT Movies, sports and childrens channels, for consideration. This obligation expires upon the earlier of either: December 31, 2003 (regarding HOT 3, HOT Movies and sports channels), and March 1, 2003 (regarding the children's channel); or the date on which YES has at least 500,000 subscribers, after which YES may request an extension. To date, YES has not required an extension. These obligation to YES have since expired. YES broadcasts the HOT 3 channel produced by HOT Vision, except for original productions, pursuant to an agreement effective until December 31, 2006. YES ceased to broadcast HOT Movies produced by HOT Vision on June 30 2002;

an obligation of unbundling, requiring the merged entity to grant special broadcast license holders which broadcast on a digital platform a non-exclusive permit, for consideration, to use its network in order to transfer their broadcasts (which will be up to a maximum of the higher of either: (i) one sixth of our broadcasting network capacity; or (ii) 75 Mhz from the date of the approval of the merger, including the capacity required for dedicated channels and special cable broadcasting licensees (one sixth of the broadcasting network capacity); and 150Mhz after 2005);

a maximum subscriber fee for the basic packages (digital or analog) of NIS 156 including VAT, linked to the combined index, that includes the Israeli consumer price index of December 2001 (published January 15, 2002) and the US dollar exchange rate as published by the Bank of Israel, or any other index as shall be determined in regulations. The effectiveness of the Council's approval regarding the said linkage to the combined index is subject to the amendment of the applicable regulations promulgated under the Telecommunications Law. To date, the Ministry has not adopted such an amendment;

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an obligation to sell 20% of the entity that shall control broadcasting content (as opposed to infrastructure) to third parties, within four years from the date of the decision (in relation to which a public offering will be considered such a sale) unless certain conditions stipulated in the decision shall occur;

a limitation upon the number of channels which the cable television operators shall be allowed to produce (not including up to 16 optional channels on a pay-per-view and near video on demand basis); and

the provision by all of the cable television operators of a guarantee of NIS 45 million to cover the obligations of the merged entity under the Council's approval, and all the Cable Broadcast Licensees (taking into account any amount already provided by way of guarantee pursuant to all the Cable Broadcast Licenses). Our pro rata portion of the NIS 45 million amounts to approximately NIS 11 million.

In addition, in accordance with the approval of the Council, in the event that the Council is convinced that there is a material decline in competition in the multi-channel television market, the Council is entitled to instruct the cable television operators to allow each special and general cable broadcast license holder that broadcasts in a digital format use of our infrastructure in order to access all potential subscribers, even if they are not our subscribers, so long as our cable network infrastructure reaches their premises. According to the Council's decision, a material decline will be deemed to occur, among other things, in the event that YES shall cease its operation or the merged entity shall provide services to more than 80% of multi-channel television subscribers in Israel.

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Pursuant to the Council's amended approval, an application for a general broadcast license was filed with the Council on behalf of the merged entity on March 5, 2003.

In accordance with the Council's approvals to the merger, upon the merger, the terms of the Council's approvals to the merger will be an integral part of the terms of the Cable Broadcast License of the cable television operator or any merged entity in place of the cable television operators.

The eventual application of the above terms and other provisions are subject to interpretation and clarification.

The Approval of the Controller of Restrictive Business Practices to the Merger

The approval of the Controller to the merger, granted in April 2002, is also subject to a number of terms and conditions, set forth below. On April 14, 2003, the Controller extended the validity of his approval to the merger until the earlier of June 6, 2003 or the consummation of the merger. In June, November and December 2003, the Controller further extended the validity of his approval to the merger until the earlier of December 15, 2004 or the consummation of the merger. The eventual application of these terms and conditions and the way in which they will be implemented together with the terms of the Council's approval may be subject to interpretation and further clarification.

Separation of activities: the merged entity shall conduct its activities through a broadcasting entity and a cable infrastructure entity, whose activities must be completely separated.

Unbundling: the merged infrastructure entity must allow other cable broadcast license holders to use its cable infrastructure on terms that are not inferior to those offered to the merged broadcasting entity, up to the same maximum commitment as provided by the terms of the approval of the Council, with the additional stipulation of not less than 75 Mhz from the date of the consummation of the merger, and not less than 100Mhz after January 2005 for third parties who are not dedicated channels. This obligation shall not apply to any broadcaster of multi-channel national television broadcasts, on a national infrastructure network in its control, unless there is a material decline in the multi-channel television market. In the event that the Controller considers there to be a material regression in the multi channel television market for subscribers, he shall have the authority to instruct the merged infrastructure entity (and if necessary, the merged broadcast entity) to provide any cable broadcast license holder the telecommunications infrastructure services needed to supply the package of channels of such licensee to any person whose premises is reached by the cable network even if such person is not a subscriber of the merged broadcast entity; however, such instruction shall not oblige the merged infrastructure entity to lay down additional telecommunications infrastructure for such a cable broadcast license holder, to a person who is not a subscriber of the merged broadcast entity. Without derogating from the above, in the event that YES ceases to operate, it will be deemed to be such a material decline in competition. Regarding these conditions, YES or its successor shall be deemed to be such a cable broadcast license holder if it ceases its operation due to insolvency.

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Restrictions upon the corporate structure: within 48 months of the Controller's approval, at least 20% of the controlling entities of the merged broadcasting entity must be owned by an entity that does not hold, directly or indirectly, any means of control in any other cable or infrastructure entity. This restriction may be amended or waived at the discretion of the Controller, or will be deemed inapplicable, if either at the end of 48 months there are at least two other holders of a general cable broadcasting license in Israel that are not linked to either the merged broadcasting entity or the merged infrastructure entity; or, if the Minister of Communications has set rates for usage of the merged entity's infrastructure by third parties within 30 months of the date of the approval (and the Controller finds that such rates encourage competition significantly). According to clarifications provided by the Controller in relation to this obligation, in the event that 20% of the means of control of the merged infrastructure entity is purchased by a third party and 20% of the means of control of the merged broadcast entity is purchased by a different third party, neither of whom have a connection to the existing cable television operators, it will not be necessary to meet this requirement.

Restrictions upon the ownership and purchase of broadcasting material:

(i) The merged broadcasting entity and the merged infrastructure entity shall be prohibited from holding means of control of a producer of a channel, except Channel 3 (HOT 3) and the movies channel (HOT Movies) in the basic packages, and shall be prohibited from owning or having any interest in any other producer of a channel, unless it has received authorization to the contrary from the Controller by way of amendment of the terms of the Controller's approval to the merger. Subsequent to the approval and pursuant to the said restriction, we sold and transferred an option that we held to purchase certain interests in the Hop channel, we and the other cable operators sold and transferred options we held to purchase certain interests in the sports channels (Channel 5 and the Sport 5+ channel), and we and the other cable operators relinquished our interests in the children's channel and the culture and science channel.

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(ii) The merged broadcasting entity and the merged infrastructure entity are permitted to use the content of another producer, but shall be prohibited from owning the content of another producer, and further, these entities shall be prohibited from determining to whom content shall be sold or transferred to third parties for use (with the exception of agreements with the major production companies, namely Warner Bros., Universal, Buena Vista (Walt Disney), Paramount, MGM, Columbia, and Twentieth Century Fox, which were signed prior to the date of the Controller's merger approval and received prior regulatory approvals).

(iii) The merged broadcasting entity shall only be allowed to purchase content for Channel 3 and movie channels and for Pay-Per-View and Near Video On Demand, and such purchase shall be in accordance with restrictions concerning, among other things, the purchase of exclusive content. In addition, the merged broadcasting entity shall have a must sell requirement to YES or any other general license holder regarding certain material content broadcast on Channel 3 and the movies channel stipulated in the Controller's approval. Further, all content purchased, by any party to the merger or any person related to such parties, from the major production companies within 24 months following the Controller's approval to the merger (April 2002), shall be subject to the must sell requirement to YES or any other general license holder, provided that any person who receives content pursuant to this must sell requirement shall also be subject to the must sell requirement with respect to contents purchased or that may be purchased from the major production companies during such period.

Obligation to supply multi-channel television broadcasts to the entire population of Israel: subject to price restrictions, and existence of appropriate infrastructure.

Infrastructure:

The merged infrastructure entity shall be prohibited from preventing the development of competing infrastructures, and shall be prohibited from using its control over the merged infrastructure to prevent or hinder competition. Unless prior written consent has been received from the Controller, both the merged broadcasting entity and the merged infrastructure entity shall be prohibited from holding any interest, directly or indirectly, in any person or entity that holds an interest greater than 10% in any other company that owns infrastructure for cable television or any other infrastructure for telecommunications services.

The merged infrastructure entity shall be prohibited from preventing any registered building contractor from laying down infrastructure, regardless of the presence of infrastructure belonging to the merged entity already in such area. Without derogating from the above, the infrastructure entity shall be prohibited from preventing a building contractor from laying down infrastructure in places where it has laid its own infrastructure, subject to the receipt of an indemnity for any damages to its infrastructure caused thereby.

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The merged infrastructure entity and the merged broadcasting entity shall be separated entirely from Internet service providers. In addition, companies such as Barak I.T.C. (1995) The International Telecommunications Services Corp. Ltd., and other Internet service providers connected to the cable television operators or their shareholders, are also prohibited from transferring Internet service provider activities to the merged entities.

The merged infrastructure entity and the merged broadcasting entity shall be prohibited from preventing any end user which has Inside Wiring on his property from: (i) connecting with any other provider of multi-channel television; (ii) the common use of Inside Wiring by such user to connect to another provider in addition to the merged entities; and (iii) gaining access to Internet infrastructure, or access by such end user to Internet services, which are marketed either by the merged infrastructure entity or by the merged broadcasting entity, even in the event that such end user purchases multi-channel television from a competitor. The merged entities shall still be subject to the administrative directives published by the Minister of Communications governing the reciprocal obligation to lease Inside Wiring between the cable television operators and YES.

Restrictions upon connected persons or entities:

The terms of the Controller's approval shall equally apply to any person or entity connected to the cable television operators, the infrastructure entity, or the broadcast entity whose action is needed in order to fully and exactly comply with all or part of such terms. Any restriction or condition applying under the terms of the Controller's approval upon a party to the merger, on the infrastructure entity, or on the broadcast entity, shall also equally apply to any person or entity connected to them, and non-compliance with such restriction or condition by a connected person or entity, or together with such connected person or entity, shall be deemed to be non-compliance with the terms of the Controller's approval on the part of the party to the merger to which such person is connected, and by non-compliance by the broadcast entity and the infrastructure entity to which such person or entity is connected.

Restrictions shall also apply upon the activities of the officers or owners of the groups of the controlling shareholders of the merged entities, including, among others, as follows:

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prohibition upon such officers having activities in businesses that compete, directly or indirectly, with the business of the merged broadcasting entity and/or the merged infrastructure entity, without the written approval of the Controller;

prohibition upon such owners from sharing information related to the business of the merged broadcasting entity and/or the merged infrastructure entity;

an enforced total separation between specific named Israeli corporate entities such as cellular telecommunications companies and newspapers, on the one hand, and the merged broadcasting entity and the merged infrastructure entity, on the other hand; and

if the merged broadcasting entity shall be allowed to air commercials in multi channel television channels, then the Controller shall have the authority to impose further restrictions stemming from concerns arising from the cross interests of the controlling shareholders of the parties to the merger in other entities that sell commercial time to the public.

Interests in telephony services: The merger is conditional upon the merged entity supplying telephony services on cable infrastructure no later than November 20, 2004, and supplying all of its offered services to any applicant within at least fifteen defined areas, in each city within such areas that has a population of more than 10,000 people, by no later than November 20, 2005. The merged infrastructure entity is bound by minimal infrastructure investment commitments of not less than NIS 350 million, to be completed in stages as follows: not less than NIS 105 million until June 30, 2004, not less than NIS 140 million until June 30, 2005, not less than NIS 105 million until June 30, 2006 and any other amount as shall be required for the fulfillment of its business plan for the provision of telephony services which fully compete with the telephony services of Bezeq.

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In accordance with the terms of the approval of the Controller to the merger, in July 2002, the Israeli cable television operators filed an application for the merged infrastructure entity for an infrastructure license, which includes the provision of fixed line telephony services. This license was granted in November 2003 to HOT Telecom. HOT Telecom has undertaken actions to meet the conditions and timetable set in the HOT Telecom Infrastructure License and the approval of the Controller to the merger with respect to the provision of telephony services.

Bank Guarantee: The approval of the Controller to the merger is also conditional upon the provision of a bank guarantee in the amount of US\$15 million to ensure compliance with the terms of the approval of the Controller. In the event that the Controller decides, in his discretion, that there has been a material breach of the terms of the approval, he may fully exercise the guarantee. We have provided our pro rata portion of this guarantee in the amount of \$3.75 million.

In the event of a non-material breach, the Controller may exercise \$500,000 of the bank guarantee in relation to each breach, and an additional \$500,000 per month, until such breach is remedied. Such amounts are non-refundable and the guarantee must be maintained at US\$15 million at all times, including in the event of breach. The provision and usage of the guarantee does not derogate from the Controller's ability to take any other remedy according to the provisions of the Restrictive Business Practices Law against the merged entities in the event of breach.

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4C. ORGANIZATIONAL STRUCTURE

We have eight significant subsidiaries, all of which are Israeli entities, which we control directly or indirectly, as described below.

Matav Investments Ltd. is a company wholly owned by us and it owns 100% of the share capital of Matav Assets Ltd. Through Matav Investments Ltd. we are the beneficial owners of 10% of the share capital of Barak I.T.C. (1995) The International Telecommunications Services Corp. Ltd., an international telephony service provider in Israel, and through Matav Investments Ltd., we are the beneficial owners of approximately 5.3% of the share capital of Partner Communications Company Ltd., the third of four licensed providers of mobile cellular telephone services in Israel, and one of the two operators which use GSM.

Cable Systems Media Haifa-Hadera Ltd. is a company wholly owned by us, and holds the Cable Broadcast License for the Haifa-Hadera area.

Matav Infrastructure 2001 L.P., is a limited partnership, of which we own approximately 72% of the rights, with the remainder being held by our wholly owned subsidiary Cable Systems Media Haifa-Hadera Ltd.

Matav Assets Ltd. is a company wholly owned by us, through Matav Investments Ltd., and engages in real estate activities.

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Matav Infrastructure Ltd. is a company wholly owned by us, and is the general partner of Matav Infrastructure 2001 L.P.

Nonstop Ventures Ltd. is a company of which we hold 50% of the issued share capital, with the remainder being held by several of our shareholders.

HOT Telecom L.P. is a limited partnership owned by the three Israeli cable television operators, of which we beneficially own approximately 26.5% through Matav Investments Ltd. HOT Telecom L.P. holds the HOT Telecom Infrastructure License.

HOT Telecom Ltd. is a company owned by the three Israeli cable television operators, of which we beneficially own approximately 26.5% through Matav Investment Ltd. HOT Telecom Ltd. is the general partner of HOT Telecom L.P.

We were formerly part of the Dankner Group. As of June 20, 2003, Dankner Investments Ltd., or Dankner Investments, held approximately 47.74% of our outstanding ordinary shares and 49.70% of the voting rights. In November and December of 2003, and in January of 2004, Dankner Investments sold approximately 7.7% of our outstanding shares in private transactions. In February 2004, Dankner Investments sold approximately 18% of our outstanding shares to Delek Investments and Assets Ltd., or Delek, and granted to Delek an option exercisable for two years to purchase an additional 2% of our outstanding shares. As of April 30, 2004, Dankner Investments still held approximately 22% of our outstanding shares, and nominates a majority of our directors pursuant to the terms of a shareholders agreement. On May 31, 2004, Dankner Investments Ltd. issued an immediate report to the Israel Securities Authority and the Tel Aviv Stock Exchange stating that the members of the Dankner and Gineo families that hold shares in Dankner Investments Ltd. signed an agreement with Delek Real Estate Ltd. for the purchase of such shares, constituting 87.5% of the issued share capital of Dankner Investments Ltd. The transaction is subject to a number of approvals, including the approval of the Controller of Restrictive Business Practices and the Cable and Satellite Broadcasting Council. The agreement also provides that in the event the conditions to the aforesaid sale are not met by a specified date, subject to certain other conditions, Delek Real Estate Ltd. may purchase shares of Dankner Investments Ltd. from the other parties to the agreement representing 20-25% of the issued share capital of Dankner Investments Ltd. . On June 16, 2004, Delek Group Ltd. issued an immediate report to the Israel Securities Authority stating that Delek Real Estate Ltd. purchased 25% of the issued share capital of Dankner Investments Ltd. on June 15, 2004. This immediate report also stated that, with respect to the purchase of the remaining shares to arrive at the total 87.5% referred to above, so far the approval Cable and Satellite Broadcasting Council and the Ministry of Communications have been obtained.

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For additional information regarding the shareholders agreement, see Item 7. Major Shareholders and Related Party Transactions . The shares of Dankner Investments are publicly traded on the Tel Aviv Stock Exchange. On February 5, 2004, the Council approved the change of means of control resulting from the sale of Matav shares to Delek by Dankner Investments.

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4D. PROPERTY, PLANTS AND EQUIPMENT

We own our telecommunications network infrastructure and related equipment. Our network infrastructure covers covers 480,419 homes and is approximately 3,815 miles of underground cable.

Our principal executive offices are in Netanya, Israel in a building purchased by us in 1992 for approximately NIS 3.0 million, which currently has 1,528 square meters of built space.

Our HeadEnd, studio and regional administrative offices in Haifa are situated in a 1,700 square meter building on 6,690 square meters of land leased from the Israel Lands Authority pursuant to a lease which will expire in 2040. In July 1991, we paid approximately NIS 1.5 million, constituting the entire amount due under such lease in advance as well as approximately NIS 3.8 million to the City of Haifa for the buildings on the plot. We have an option to renew the lease for 49 additional years.

Our HeadEnd in Bat-Yam is situated on a 200 square meter property, which we lease under a lease agreement providing for a monthly rent of NIS 10,000. The lease is scheduled to expire in August 31, 2004. We have an option to extend the lease for an additional period of one year.

Our HeadEnd and microwave broadcast tower in Ramot-Naftali is situated on 520 square meters of land, owned by the Israel Lands Authority, which is subleased to us by the Mevot Hermon Local Council under a lease agreement expiring in October 2006, of which 160 square meters is the HeadEnd and 77 square meters is a basement. Pursuant to the terms of the lease agreement, we are obligated to pay the Mevot Hermon Local Council an annual fee of NIS 1 and to provide cable television services to the residents of Moshav Kadash Naftali free of charge.

Upon termination of the lease agreement, our interest in the property will pass to the Mevot Hermon Local Council, although we will be entitled to remove all of our transmission equipment.

We also hold real property in Bat-Yam of 2,500 square meters, under a lease from the Israel Lands Authority which is scheduled to expire in 2038. In 1989, we paid approximately NIS 1.8 million for this lease, constituting the entire amount due under the lease, in advance, and approximately an additional NIS 1.28 million in order to extend the deadline under the lease for completion of a building on the property to January 1, 1997. In March 2004, the Israel Lands Authority notified us that its management agreed to extend our lease agreement for this property, subject to the payment of property value differentials amounting to approximately NIS 1.3 million, plus VAT. This amount was based on the valuation of a land appraiser. In April 2004, we paid approximately NIS 988,000. We have submitted an appeal on the valuation of the land appraiser, and we provided a bank guarantee in the amount of approximately NIS 320,000. An agreement for the extension has not yet been signed.

In Pardess Hanna, we lease a 1,009 square meter plot of land from the Israel Lands Authority. Two structures which contain a HeadEnd for the Hadera license area are located on this property.

In 1999, we purchased 1,927 square meters in a building near our headquarters in Netanya, for approximately NIS 8.4 million. We use this property, among other things, for our Netanya Hadera cable operations and for our access to High Speed Internet over cable activities.

In addition to the foregoing, we lease several other small properties totaling approximately 3,200 square meters throughout our operating areas, which we use for office space, storage, and microwave reception towers. Altogether with the leased properties described above, the aggregate monthly rental payments made by the Company are approximately \$20,000.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following operating and financial review and prospects are based upon and should be read in conjunction with our financial statements and selected financial data, which appear elsewhere in this annual report. You should also read the risk factors appearing elsewhere in this annual report for a discussion of a number of factors that affect and could affect our financial condition and results of operations.

The financial statements have been prepared in conformity with accounting principles generally accepted in Israel, which differ in certain respects from those followed in the United States. U.S. generally accepted accounting principles (as restated, see Note 26 to the financial statements). The financial information in this section is presented in adjusted NIS, unless stated otherwise.

We reported certain amounts in adjusted NIS which have been translated for convenience into US dollars using the representative exchange rate of the US dollar as published by the Bank of Israel on December 31, 2003 (\$1.00 = NIS 4.379). Except where otherwise stated, amounts appearing in dollars have been translated from NIS at this exchange rate.

Critical Accounting Policies

In order to improve understanding of the discussions below, it is important to obtain some degree of familiarity with our principal or significant accounting policies. These policies are described in Note 2 to the Consolidated Financial Statements listed in Item 18. We review our financial reporting, disclosure practices and accounting policies annually to ensure that the financial statements developed, in part, on the basis of these accounting policies provide complete, accurate and transparent information concerning the financial condition of our company. As part of this process, we reviewed the selection and application of our critical accounting policies and financial disclosures as of December 31, 2003.

In preparing our financial statements in accordance with generally accepted accounting policies, our management must often make estimates and assumptions which may affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures as of the date of the financial statements and during the reporting period. These estimates and judgments are reviewed by management on an ongoing basis, and by our Audit Committee at the end of each quarter prior to the public release of our financial results. Some of those judgments can be subjective and complex, and consequently actual results may differ from those estimates. For any given individual estimate or assumption made by our management, there may be alternative estimates or assumptions which are also reasonable. We consider our most significant accounting policies to be those relating to depreciation of fixed assets, allowance for doubtful accounts and contingent liabilities, which are discussed below:

Depreciation of fixed assets:

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Our fixed assets are depreciated by the straight-line method on the basis of their estimated useful life. A significant portion of our operating expenses results from depreciation of fixed assets. The vast majority of our fixed assets are composed of cable network, equipment in the broadcasting centers, studios and converters. If rapid technological changes are to occur in our industry, the estimated useful life of some of our fixed assets could be shortened and consequently lead to an increase in annual depreciation costs and operating expenses.

Allowance for doubtful accounts:

The allowance is principally determined for specific debts that are doubtful of collection, based on the age of the customer's debt. Our revenues are derived from a large number of subscribers in the license areas. We perform ongoing credit evaluations of our subscribers for the purpose of determining the appropriate allowance for doubtful accounts, by taking into account variables such as past experience, age of the receivable balance, and current economic conditions that may affect a subscriber's ability to pay. The use of different estimates or assumptions could produce different allowance balances. We fully provide for the balance of disconnected subscribers. If the financial condition in Israel was to deteriorate, resulting in an impairment of our subscriber's ability to make monthly payments, additional allowance for doubtful accounts may be required. If we were to face stronger competition, we might experience a higher rate of disconnections and hence additional allowance for doubtful accounts may be required.

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Contingent liabilities:

We are party to certain legal actions as described in Item 8A. Consolidated Statements and Other Financial Information - Legal and Arbitration Proceedings and described in Note 15 in the financial statements.

With regard to claims and petitions for certification of some of these actions as class actions, we believe, based on the opinion of our legal counsel, that since the claims and petitions for certification of them as class actions, and our response to the claims and petitions raise complex legal and factual questions which have not yet been resolved in Israeli case law and for which there are no precedents based on similar facts, we can not currently evaluate the likelihood of success of such claims, and therefore, no provision has been included in our financial statements in respect of such claims. With regard to other claims in which the proceedings are in early stages, the prospects of the claims cannot be estimated and no provision has been included in our financial statements in respect of such other claims. As to the remaining claims, we believe, based on the opinion of our legal counsel, that we have good defensive arguments against these claims, and therefore, no provision has been included in our financial statements in respect of such claims.

As additional information becomes available, we will assess our potential liability related to our pending litigation and revise our estimates if needed. Such revisions of our estimates of our potential liability under legal claims could materially impact our results of operation and financial position.

New Accounting Standards in the United States

In January 2003, the FASB issued Interpretation No. 46R, Consolidation of Variable Interest Entities (FIN No. 46R). The objective of FIN No. 46R is to improve financial reporting by companies involved with variable interest entities. A variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN No. 46R requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN No. 46R also requires disclosures about variable interest entities that the company is not required to consolidate but in which it has a significant variable interest. The consolidation requirements of FIN No. 46R apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period ending after December 15, 2003.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (SFAS No. 150). SFAS No. 150 establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. In accordance with the standard, financial instruments that embody obligations for the issuer are required to be classified as liabilities. SFAS No. 150 shall be effective for financial instruments entered into or modified after May 31, 2003 and otherwise shall be effective beginning in our first quarter of fiscal year 2004. The adoption of SFAS No. 150 is not expected to have a significant impact on the Company's results of operations or financial position.

In November 2002, Emerging Issues Task Force (EITF) reached a consensus on Issue No. 00-21, Revenue Arrangements with Multiple Deliverables. EITF Issue No. 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple

products, services and/or rights to use assets. The provisions of EITF Issue No. 00-21 applied to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. Additionally, companies will be permitted to apply the consensus guidance in this issue to all existing arrangements as the cumulative effect of a change in accounting principle in accordance with APB Opinion No. 20, Accounting Changes. The adoption of EITF Issue No. 00-21 had no material impact upon the Company's financial position, cash flows or results of operations.

New Accounting Standards in Israel

In October 2001, the Israel Accounting Standards Board published Accounting Standard No. 12 with respect to the discontinuance of the adjustment of financial statements. In December 2002, Accounting Standard No. 17 was published with respect to the deferral of the effective date of Accounting Standard No. 12 to January 1, 2004.

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According to Accounting Standards No. 12 and No. 17, which deal with the discontinuance of the adjustment of financial statements, financial statements will cease to be adjusted for inflation in Israel beginning January 1, 2004. Until December 31, 2003, the Company continued to prepare adjusted financial statements in accordance with Opinion No. 36 of the Institute of Certified Public Accountants in Israel. The adjusted amounts included in the financial statements as of December 31, 2003, will serve as the starting point for nominal financial reporting beginning January 1, 2004.

The effect of the adoption of Accounting Standard No. 12 is dependent on the inflation rate in Israel, on the composition of the Company's assets and its sources of financing at that time.

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5A. OPERATING RESULTS

We were formed in June 1987. We began building out our cable television network and offering cable television services on a trial basis in November 1989. In March 1990, we began providing full cable television services. Between 1990 and 2002, we operated pursuant to five exclusive franchises granted to us by the Ministry of Communications covering the following areas: Bat-Yam and Kiryat Shemona, Holon, Safed and the Golan Heights, Haifa, Hadera, and Netanya and the Sea of Galilee. During 2002, these franchises were replaced by two general non-exclusive Cable Broadcast Licenses, a Telecommunications Infrastructure License and a Broadcasting HeadEnd License. The Telecommunications Infrastructure License was subsequently replaced and cancelled by the HOT Telecom Infrastructure License. Under the terms of our previous franchises and current licenses, we pay the Ministry of Communications variable and fixed franchise/license royalties. For the years ended December 31, 2001, 2002 and 2003, we recorded aggregate expenses for royalties to governmental authorities of NIS 21.9 million, NIS 20.6 million and NIS 17.8 million, respectively.

As of December 31, 2003, we provided cable television services to 266,690 subscribers, representing approximately 26% of all cable television subscribers in Israel, and have achieved an average subscriber penetration rate of approximately 55.5% for all of our license areas. For the years ended December 31, 2001, 2002 and 2003, we generated revenue of NIS 469.4 million, NIS 495.5 million and NIS 545.5 million, respectively. Our operating loss for the years ending December 31, 2001, 2002 and 2003, was NIS 129.9 million, NIS 98.7 million and NIS 7.8 million, respectively.

Our net loss for the year ended December 31, 2001 was NIS 257.3 million. Our net income for the year ended December 31, 2002 was NIS 33.8 million. Our net loss for the year ended December 2003 was NIS 5.5 million. During the years 2001, 2002 and 2003 we achieved EBITDA (Earnings Before Interest Taxation Depreciation and Amortization) of NIS 0.3 million, NIS 56.7 million and NIS 147.0 million, respectively. The EBITDA excludes other income or expenses and equity in earnings (losses) of affiliates.

Through December 31, 2003, we invested approximately NIS 2,028.4 million (\$463.2 million) in building out our cable television network and in other fixed assets within our license areas. As of December 31, 2003, our cable television network extended 3,815 miles and covered approximately 480,000 homes, or approximately 94% of the households in the areas in which we operate.

With our transition to digital cable television services, we increased our revenues, but also increased our expenses by investments in digital set top boxes, program content purchasing and providing other services to our subscribers. Each digital set-up box costs us between approximately \$130 to \$200. Due to marketing considerations, we do not charge the customer the full cost of the digital set-up box, and we subsidize this cost. As of May 31, 2004, we have already purchased approximately 228,000 digital set top boxes, including 6,000 one-way only set-top boxes. As of May 31, 2004, approximately 60% of our subscribers were equipped with digital set-top boxes.

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In 2000 and part of 2001, we provided dial-up Internet services and Internet content under the brand name Nonstop . We ceased these activities during 2001. In April 2002, we commenced providing access to High Speed Internet over cable services. As of December 31, 2003, we had 57,357 access to High Speed Internet subscribers.

Revenues

We derive a substantial amount of our revenue from a monthly subscriber fee of NIS 170.9 176.5 (including VAT) for providing the analog and the digital Basic Packages of cable television services. We also charge our subscribers a one-time deposit of NIS 99 (including VAT), for the regular analog set-top box (for those subscribers without cable-ready televisions), or NIS 199 (including VAT), for the addressable analog set-top box. With respect to digital set-top boxes, we collect a one-time deposit of NIS 399 (including VAT). We partially refund these deposits when the set-top boxes are returned. The refund amount, linked to the Israeli consumer price index, is reduced to reflect depreciation of 10% of the value of the set-top box to us for each year or each partial year (until September 2003 the refund amount was reduced to reflect a depreciation of 10% of the deposits for each year or each partial year), commencing from the date of installation of the set-top box and until the earlier of the date we cease to provide services to such subscriber, or until the removal of a set-top box. Such depreciation is included in our revenue, exclusive of VAT. Instead of paying the deposits referred to above, our subscribers may elect to lease the set-top box for a monthly fee that ranges between NIS 10 and NIS 15 including VAT, but in any event, not more than the value of the set-top box. Additional revenues are derived from our tiering services, Pay-Per-View services, interactive services, access to High Speed Internet over cable services and other services.

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Our revenue per subscriber, penetration rate and churn rate may vary in the future from historical levels depending upon numerous factors, which are mostly beyond our control. These factors include amongst others, the nature of our future cable television and telecommunications services, the development of competition for revenue per subscriber and the success of our marketing strategies as well as market acceptance of our services by subscribers.

Cost of Revenues and Other Operating Expenses

Our principal operating expenditures are:

- programming costs;
- depreciation and amortization of fixed assets;
- pay-roll and related expenses;
- license (previously franchise) royalties and payments to the government of Israel; and
- maintenance.

Churn

Churn refers to subscriber disconnection from network services, either involuntary, due to non-payment of bills or suspected fraudulent use, or voluntary, due to subscribers terminating their use of our services.

We recognize that managing subscriber churn is an important factor in maximizing revenue and cash flow. In order to control churn caused by subscribers voluntarily terminating our services, we attempt to ensure that our services are of high quality and are competitive. We use our advanced information technology systems as a tool to understand, monitor and control voluntary churn. We have a retention team within our customer services group that makes follow-up phone calls to subscribers who call us with complaints or problems in order to resolve any problems and to retain the subscribers. We also host exclusive subscriber events, such as shows and parties for subscribers, in order to encourage subscriber loyalty. For the year ended December 31, 2003, our churn rate for our operating areas averaged approximately 23%.

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Results of Operations

The following table sets forth certain items from our results of operations for the periods indicated:

In adjusted NIS (in millions)

Years ended December 31,

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	<u>2001</u>	<u>2002</u>	<u>2003</u>
Revenues	469.4	495.5	545.5
Operating expenses	484.2	507.4	466.7
Gross profit (loss)	(14.8)	(11.9)	78.8
Selling and marketing expenses	58.0	40.7	44.0
General and administrative expenses	57.1	46.1	42.6
Operating loss	(129.9)	(98.7)	(7.8)
Financial expenses, net	52.1	48.1	84.0
Loss after financial expenses	(182.0)	(146.8)	(91.8)
Other income, net	3.1	278.6	81.0
Income (loss) before taxes on income	(178.9)	131.8	(10.8)
Taxes on income	(0.4)	108.9	35.6
Income (loss) from operations of the Company and its subsidiaries	(178.5)	22.9	(46.4)
Equity in earnings (losses) of affiliated companies, net	(78.8)	10.9	40.9
Net income (loss)	<u>(257.3)</u>	<u>33.8</u>	<u>(5.5)</u>
EBITDA	<u>0.3</u>	<u>56.7</u>	<u>147.0</u>

Comparison of Years Ended December 31, 2001, 2002 and 2003

Operating results according to business segments

The following table sets forth our consolidated statement of operation according to our various business segments:

In adjusted NIS (in millions)	2001		2002		2003	
	<u>Cable TV</u>	<u>Internet</u>	<u>Cable TV</u>	<u>Internet</u>	<u>Cable TV</u>	<u>Internet</u>
Revenues	463.8	5.6	486.4	9.1	511.1	34.4
Operating expenses	461.6	22.6	494.7	12.7	449.3	17.4
Gross profit (loss)	2.2	(17.0)	(8.3)	(3.6)	61.8	17.0
Selling and marketing expenses	55.1	2.9	37.5	3.2	38.3	5.7
General and administrative expenses	52.0	5.1	45.1	1.0	41.7	0.9
Operating (loss) profit	(104.9)	(25.0)	(90.9)	(7.8)	(18.2)	10.4
Financial expenses, net	49.2	2.9	48.1	---	84.0	---
Income (loss) after financial expenses	(154.1)	(27.9)	(139.0)	(7.8)	(102.2)	10.4
Other income, net	1.5	1.6	278.6	---	81.0	---

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Income (loss) before taxes on income	(152.6)	(26.3)	139.6	(7.8)	(21.2)	10.4
Taxes on income	(0.4)	---	108.9	---	35.6	---
Income (loss) from operations of the Company and its subsidiaries	(152.2)	(26.3)	30.7	(7.8)	(56.8)	10.4
Equity in earnings (losses) of affiliated companies, net	(78.8)	---	10.9	---	40.9	---
Net income (loss)	(231.0)	(26.3)	41.6	(7.8)	(15.9)	10.4
EBITDA	19.4	(19.1)	58.5	(1.8)	129.8	17.2

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Revenues

	Years ended December 31,			% Change 2001 vs. 2002	% Change 2002 vs. 2003
	2001	2002	2003		
	in adjusted NIS in millions				
Cable TV	463.8	486.4	511.1	4.9	5.1
Internet	5.6	9.1	34.4	62.5	278.0
Total revenues	469.4	495.5	545.5	5.6	10.1

Of our total revenues, approximately 93.7% can be attributed to cable TV activities in 2003, in comparison to 98.2% in 2002 and 98.8% in 2001. Our revenue from cable TV activities increased by NIS 24.7 million in 2003 and NIS 22.6 million in 2002. Our revenue from cable TV activities is derived from monthly subscription fees, Pay-Per-View services, interactive services, depreciation of subscribers deposits for set-top boxes, installation fees, payments from the Shopping Channel and other minor sources.

Here is the distribution of our subscribers for the periods covered:

	2001	2002	2003	% Change 2001 vs. 2002	% Change 2002 vs. 2003
Average of total number of subscribers for cable TV services	297,112	281,241	270,592	(5.3)	(3.8)
Average of total digital subscribers	56,373	137,811	151,266	144.5	9.8
Average of total access to High Speed Internet services subscribers	NA	10,395	39,440	NA	279.4

The increase in revenue from cable TV services despite a decline in subscriber number, is mainly due to an increase in the rate of digital subscribers out of total subscribers from 49.0% in 2002 up to 55.6% in 2003, and also due to an increase in subscription fees. The increased total revenues in 2002, despite a decrease in total subscribers, are attributed to higher sales of tiering and high-speed Internet services.

Our revenues from High Speed Internet services are derived mainly from monthly subscription fees, and increased by NIS 25.3 million in 2003, compared by an increase of NIS 3.5 million in 2002. The sharp increase in revenue from High Speed Internet services is due to an increase in subscriber number. We anticipate that in spite of our continuing marketing efforts to increase our subscribers base for High Speed Internet services, subscription fees might be eroded as a result of the intensive competition in this field.

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Operating expenses

	Years ended December 31,			% Change 2001 vs. 2002	% Change 2002 vs. 2003
	2001	2002	2003		
	in adjusted NIS in millions				
Cable TV	461.6	494.7	449.3	7.2	(9.2)
Access to High Speed Internet	22.6	12.7	17.4	(43.8)	37.0
Total operating expenses	484.2	507.4	466.7	4.8	(8.0)

Of our total operating expenses, approximately 96.3% can be attributed to cable TV only activities in 2003, in comparison to 97.5% in 2002 and 95.3% in 2001. As a percentage of revenue from cable TV only activities, operating expenses from cable TV only activities increased from 99.5% in 2001 to 101.7% in 2002, and decreased to 87.9% in 2003.

The decrease in operating expenses (excluding depreciation and amortization) in 2003 is derived mainly from a decrease in programming costs. The increase in operating expenses in 2002 is mainly derived from an increase in programming costs and depreciation costs due to our investments in infrastructure and digital set-top boxes.

Cable TV operating expenses are comprised of:

	Years ended December 31,			% Change 2001 vs. 2002	% Change 2002 vs. 2003
	2001	2002	2003		
	in adjusted NIS in millions				
Cable TV programming expenses	224.0	242.8	194.4	8.4	(19.9)
Depreciation and amortization of fixed assets	136.4	156.0	153.7	14.4	(1.5)
Other operating expenses from Cable TV activities	101.2	95.9	101.2	(5.2)	5.5
Total	461.6	494.7	449.3	7.2	(9.2)

As a percentage of total revenue from cable TV activities our cable television programming expenses decreased from 49.9% of our total revenue in 2002, to 38.0% in 2003. The decrease in programming expenses in 2003 reflects lower costs for most of the channels in spite an increase in tiering services, which generates additional expenses as a result of additional purchase of content.

Our cable television programming expenses increased from 48.3% of our total revenue from cable TV activities in 2001, to 49.9% in 2002. The increase in programming expenses in 2002 reflects an increase in tiering services, which generates additional expenses as a result of additional purchase of content.

Since all of our programming expenses are either paid in US dollars or linked to US dollars, any substantial devaluation of the shekel against the US dollar will increase the shekel cost of our US dollar denominated expenses. There is no assurance that programming expenses will continue to decrease.

The decrease in depreciation and amortization of fixed assets in 2003 reflects a lower level of investment in infrastructure and digital set-top boxes and the fact that parts of our fixed assets are terminating their accounting life. The increase in depreciation and amortization of fixed assets in 2002 reflects the continuation of investment in infrastructure and digital set-top boxes.

The increase in other operating expenses in 2003 is primarily due to an increase in maintenance costs mainly those which related to digital set-top-boxes. The decrease in other operating expenses in 2002 is primarily due to a decrease in employee salaries.

Selling and marketing expenses

	Years ended December 31,			% Change 2001 vs. 2002	% Change 2002 vs. 2003
	2001	2002	2003		
	in adjusted NIS in millions				
Cable TV	55.1	37.5	38.3	(31.9)	2.0
Access to High Speed Internet	2.9	3.2	5.7	10.3	78.1
Total selling and marketing expenses	58.0	40.7	44.0	(29.8)	8.1

Of the total selling and marketing expenses, approximately 87% can be attributed to cable TV only activities in 2003, in comparison to 92.1% in 2002, and 95% in 2001.

As a percentage of total revenue from cable TV only activities, our selling and marketing expenses for cable TV activities decreased from 11.9% in 2001 to 7.7% in 2002, and 7.5% in 2003. The decrease in selling and marketing expenses in 2002 compared to 2001 is mainly due to lower marketing expenses due to a joint advertising campaign of the three Israeli cable television operators. The increase in selling and marketing expenses in 2003 compared to 2002 is mainly due to our increased advertising expenditures in the fourth quarter of 2003 in connection with the launch of the HOT brand name.

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General and administrative expenses

	Years ended December 31,			% Change 2001 vs. 2002	% Change 2002 vs. 2003
	2001	2002	2003		
	in adjusted NIS in millions				
Cable TV	52.0	45.1	41.7	(13.3)	(7.5)
Access to High Speed Internet	5.1	1.0	0.9	(80.0)	(10.0)
Total general and administrative expenses	57.1	46.1	42.6	(19.3)	(7.6)

Of the total general and administrative expenses, approximately 97.9% can be attributed to cable TV only activities in 2003, in comparison to 97.8% in 2002, and 91.1% in 2001.

As a percentage of total revenue from cable TV activities, our general and administrative expenses from cable activities decreased from 11.2% in 2001 to 9.3% in 2002, and 8.2% in 2003. Please see Note 19b, of the financial statements for more details regarding our general and administrative expenses. Our payroll and related expenses decreased significantly in 2003 compared to 2002 due to a one-time reduction which is likely not to apply, in whole or in part, in 2004. In 2004, we expect our general and administrative expenses to increase to approximately the amount we recorded in 2002.

Operating income (loss) and total EBITDA

	Years ended December 31,			% Change 2001 vs. 2002	% Change 2002 vs. 2003
	2001	2002	2003		
	in adjusted NIS in millions				
Cable TV	(104.9)	(90.9)	(18.2)	(13.3)	(79.9)
Access to High Speed Internet	(25.0)	(7.8)	10.4	(68.8)	*
Total operating profit (loss)	(129.9)	(98.7)	(7.8)	(24.1)	(92)
EBITDA from Cable TV	19.4	58.5	129.8	201.5	121.9

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Total EBITDA 0.3 56.7 147.0 * 159.3

*Percentages not provided where negative number became a positive number, or where resulting calculation is in thousands of percentage points due to inability to provide a meaningful mathematical number.

EBITDA from cable TV only activities represented 25.4% of our total revenue in 2003 as compared to 12.0% of our total revenue in 2002, and 4.2% of our total revenue in 2001.

Total EBITDA is comprised of the following:

In adjusted NIS in millions

	Years ended December 31,		
	2001	2002	2003
Total operating profit (loss)	(129.9)	(98.7)	(7.8)
Depreciation and amortization, including income from amortization of set-top boxes deposits	130.2	155.4	154.8
Total EBITDA	0.3	56.7	147.0
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Net financial expenses

	Years ended December 31,			% Change 2001 vs. 2002	% Change 2002 vs. 2003
	2001	2002	2003		
	In adjusted NIS in millions				
Total net financial expenses	52.1	48.1	84.0	(7.7)	74.6

Net financial expenses include interest on our borrowings in Israel and linkage payments related to the fluctuations in the Israeli inflation rate (with respect to our borrowings in shekels) and the US dollar exchange rate (with respect to our borrowings in US dollars). Accordingly, our net financial expenses are affected by the level of our borrowings, from time to time, by changes in the interest rates announced by the Governor of the Bank of Israel and as determined by our creditors, and by changes in the Israeli inflation rate and the exchange rate of the US dollar against the shekel. The increase in our net financial expenses in 2003 compared to 2002, despite a reduction in our bank credit, is principally attributable to fluctuations in the rate of inflation from +6.5% in 2002 to 1.9% in 2003. The reduction in the rate of inflation in 2003 caused an increase in the real interest on unlinked NIS credit which is a principal component of our credit portfolio. In addition, our net financial expenses increased in 2003 as the result of losses derived from exchange rate hedging transactions we performed.

Other income. This item includes non-recurring sources of income (expenses) or other income (expenses) not derived from our ordinary operations. Other income is primarily derived from the sale of 13,778,668 shares in Partner in April 2002, approximately 50% of our holdings at such time, and 3,826,169 shares in Partner in November 2003. See Item 4B. Information on the Company Business Overview Cellular Telecommunication Services and Note 19d in our financial statements.

Taxes on income. Costs related to taxes on income decreased by NIS 73.3 million, or 67.3% from NIS 108.9 million in 2002 to NIS 35.6 million in 2003. Costs related to taxes on income increased by NIS 109.3 million, from NIS -0.4 million in 2001 to NIS 108.9 million in 2002. These increases are primarily due to a capital gain derived from our sale of shares in Partner described above. For more information regarding our taxes on income, please see Note 17 in our financial statements. See the discussion regarding our sales of shares in Partner in Item 5B. Operating and Financial Review and Prospects - Liquidity and Capital Resources .

Equity in earnings of affiliated companies, net. Our share in the earnings of affiliated companies increased by NIS 30.0 million, from NIS 10.9 million in 2002 to NIS 40.9 million in 2003. Our share in the earnings of affiliated companies increased by NIS 89.7 million, from losses of NIS 78.8 million in 2001 to earnings of NIS 10.9 million in 2002, mainly due to Partner's gains in 2002, as opposed to its losses in 2001.

During 2003, our management revised its plans as to the nature of the investment in the shares of Partner from an investment whose realization in the foreseeable future is unlikely to an investment whose realization in may be in the foreseeable future. The revision of the plans of our management, as aforesaid, included the sale of holdings in Partner's unrestricted shares during November 2003.

In view of the change in our management's plans as to the nature of the investment in the shares of Partner, as aforesaid, and in accordance with the provisions of Opinion 68 of the Institute of Certified Public Accountants in Israel, in the year ended December 31, 2003, we recorded a deferred tax liability of approximately adjusted NIS 22 million for the difference between the cost of the investment in shares for tax purposes and their book value as presented in the financial statements as of December 31, 2003. This expense was presented at the profit and loss

accounts as an offset from our share in earnings of affiliates. Please see Note 5b of the financial statements for a further discussion regarding our investment in Partner.

5B. LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations through cash we generated from our operations, equity contributions and loans from our principal shareholders, loans and credit lines from banks and others, sale of financial assets (including 4.45% of our shares that were held by Cable Systems Media Haifa-Hadera Ltd., a wholly owned subsidiary of ours, for aggregate consideration of approximately NIS 40.1 million), and from the public offerings, in Israel of our ordinary shares on the Tel Aviv Stock Exchange in October 1993 and of debentures and warrants in August 1997, and in the United States of our American Depository Shares in June 1996. For details regarding the terms of the debentures, including outstanding amounts, please see Note 14 of our financial statements.

In April 2002, we sold 13,778,668 shares of Partner Communications Company Ltd., or Partner, to a subsidiary of Hutchison Whampoa Ltd., representing approximately 50% of our holdings in Partner. The gross consideration we received was approximately \$62.4 million. In November 2003 we sold 3,826,169 shares of Partner. The gross consideration we received was approximately \$25.5 million. The gain received for the sales of our shares in Partner is subject to income tax. We have paid approximately NIS 70 million as an advance payment on account of this income tax. See Note 17 of our financial statements. We currently own indirectly, approximately 5.3% of the outstanding share capital of Partner. All of our shares in Partner are pledged to banks under pledges unlimited in sum to cover Partner's liabilities in respect of its loans from the banks.

We received net capital contributions from our principal shareholders in the amount of approximately NIS 36.3 million prior to December 31, 1995. In addition, such shareholders have, from time to time, made loans available to us, although as of December 31, 1997 we had no outstanding balances due to such shareholders. We do not anticipate that equity contributions and loans from our principal shareholders will be a source of capital in the foreseeable future.

During the past several years, we made use of external funds to finance our operating activities, capital expenditures associated with building-out our network and investments in associated companies. We have relied on internal cash flows, equity investments and loans from our principal shareholders, together with loans from banks and the proceeds from the issuance of our ordinary shares, American Depository Shares, debentures and warrants, and credit arrangements with suppliers to provide us with the necessary funding for building-out of our cable television network operating and investing activities. Our net capital expenditures, as determined on a cash basis, were NIS 253.3 million for the year ended December 31, 2001, NIS 77.3 million for the year ended December 31, 2002, and NIS 56.6 million for the year ended December 31, 2003. This decrease in our capital expenditures is due to large projects relating to infrastructure (such as upgrading the network and the digital infrastructure), which required intensive capital expenditures that were completed in 2001. Our investments in affiliated and other companies (on cash basis, net) were approximately NIS 3.5 million for the year ended December 2001. We did not invest in affiliated or other companies in 2002 or 2003. See Note 5 in our financial statements.

In 2002, we sold in private transactions in Israel an aggregate amount of 26,651 of our ordinary shares held by our subsidiary Cable Systems Media Haifa-Hadera Ltd., in consideration for an aggregate gross amount of approximately NIS 1.0 million. In 2003, we sold the remaining 1,343,497 of our ordinary shares held by Cable Systems Media Haifa-Hadera Ltd. in private transactions in Israel, in consideration for an aggregate amount of approximately NIS 39.1 million.

As of December 31, 2003, our investments in Barak I.T.C. (1995) The International Telecommunications Services Corp. Ltd., or Barak, totaled NIS 16.2 million. In 2002, we wrote-off approximately NIS 8.8 million of our investment in Barak, based on, among other things, a company valuation of Barak. We may be required to make additional capital contributions in proportion to our relative holdings in Barak in the foreseeable future because Barak may not have readily available financing resources, including from its shareholders. We provided a guarantee on behalf of Barak to a bank in the amount of \$200,000. In addition, according to Barak's financial statements for the first quarter of 2004, as of March 31, 2004, Barak had a capital deficiency in the amount of NIS 563 million and a working capital deficit in the amount of NIS 200 million. If Barak is unable to reach agreement with its banks and other major creditors regarding the restructuring of its debt, or is unable to raise other financing, it might not be able to continue as a going concern, and as a result, we may be required to write-off a substantial portion of our investment in Barak. In addition, if Barak will raise equity financing in the future, and we will elect not to participate in such financing, our shareholding in Barak could be substantially diluted.

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We hold approximately 26.6% of the outstanding shares of HOT Vision Ltd. The results of HOT Vision were recorded based on the equity method until December 31, 2003. On December 31, 2003, the accounts of HOT Vision were consolidated for the first time by the proportionate consolidation method on the basis of our proportionate share in the issued share capital of HOT Vision. We provided an unlimited guarantee to Bank Leumi L Israel B.M., or Bank Leumi, for purposes of securing up to 24.6% of the credit the Bank Leumi will provide to HOT Vision. The board of directors of HOT Vision determined that the line of credit of HOT Vision from Bank Leumi would be limited to approximately US\$35 million, unless otherwise determined. As of December 31, 2003, we guaranteed to Bank Leumi US\$4.6 million on this line of credit.

In addition, we provided a guarantee in an amount of up to US\$16 million to Bank Hapoalim B.M., or Bank Hapoalim, to secure approximately 25% of the credit provided by Bank Hapoalim to HOT Vision, and upon the fulfillment of certain conditions, up to 44% of the total credit. As of December 31, 2003, we guaranteed to Bank Hapoalim between US\$4.3 million to US\$7.0 million. In January 2003, Bank Hapoalim requested to exercise the guarantee, however, to date, no additional request was made. See Note 15c to the financial statements.

Since March 26, 2002, Bank Leumi, Bank Igud, Bank Mizrahi, Israel Mercantile Discount Bank and Investec Trust Company have floating charges over all of our current and future assets, and specific fixed charges for an unlimited sum over our unpaid share capital and goodwill. According to the charge documents, any exercise of the charges shall be subject to the restrictions contained in our licenses, including the right of the licensee to use its assets to continue to supply services to its subscribers for so long as such license is valid. Furthermore, any terminal equipment situated in the subscribers' premises is exempted from the application of the charge. The provisions of the Telecommunications Law prohibit the grant of a charge over our licenses.

As of December 31, 2003, our borrowings consist of short and long-term loans from Israeli banks and other sources and debentures issued to the public, part of which are linked to the Israeli consumer price index or the US dollar. Below is a tabular summary of our outstanding indebtedness:

In adjusted NIS in millions	Total	Up to one year	Two to three years	Four to five years
Short-term bank credit (1)	389.7	389.7	0	0
Debentures (Series A) (2)	99.8	33.7	66.1	0
Long-term bank loans and other (3)	173.1	45.7	55.0	72.4
Total	662.6	469.1	121.1	72.4

(1) In NIS (not linked to the Israeli consumer price index), and as of December 31, 2003, bears average annual interest of approximately 7%.

(2) Linked to the Israeli consumer price index, and bears annual interest of 3.7%. See Note 14 of our financial statements for the terms of these debentures.

(3) In NIS (linked to the Israeli consumer price index and to the US dollar), and bears annual interest at rates ranging from 5.5% to 6.2%, or in US dollars and bearing average annual interest of LIBOR + 1.7%.

We commenced negotiations regarding an increase of our present credit lines with our banks, in order to have, together with our internal cash flow, sufficient funds to finance the investment in the continued build-out, development acquisition of additional digital set-top boxes and upgrade of our cable television network. In the framework of our negotiation with the banks regarding the extension of our credit lines, we agreed to enhance the security granted to the banks as collateral for our credit lines by granting a floating charge in their favor, subject to the terms of our licenses. These negotiations were ceased due to the proceedings in connection with the proposed merger of the Israeli cable television operators, however may be recommenced depending on the progress of the merger or should the merger proceedings cease to continue. Thereafter, these negotiations were recommenced. Subsequently, as the result of the proposed Partner and Tevel transactions, we ceased the negotiations with the banks regarding our credit lines. For more details regarding the proposed Partner transaction, please see Item 7B. Major Shareholders and Related Party Transactions - Related Party Transactions. For more details regarding the proposed Tevel transaction, please see Item 4B. Business Overview - Agreement for a Merger of the Cable Television Operators. Should we recommence such negotiations, there is no assurance that that we shall reach an agreement with the banks and receive such increased credit lines.

In the event that we shall increase our present credit lines, we expect that the amount and cost of the additional bank credit as well as the security we will be obligated to make available to the banks will be influenced by many factors, including: the absence of private and public markets in debt and equity, our financial results, the effect of competition and regulatory uncertainty. Therefore, we cannot assure you that the additional financing, if any, will be on the same terms as our current financing from the banks, or on terms which are favorable to us or which

are not significantly expensive.

Under our credit agreements with the banks that finance our operations, we are subject to conditions and limitations on our business activities, including limitations on our ability to obtain additional credit, sell or purchase assets and distribute dividends. One of our credit agreements with a bank in Israel includes certain covenants according to which, until the date of consummation of the merger of the three Israeli cable television operators, we are required to maintain certain financial ratios, such as, with respect to our level of equity, total financial credit, operational costs and financing expenses. We are also required to maintain a certain number of subscribers. If we fail to fulfill any of our covenants we could be deemed to be in breach of our loan agreements with the bank. In such event, the bank will be entitled to demand immediate payment of all amounts owing to it under the line of credit, loans, banking services and any other obligation we have to such bank. The balance of credit taken from this bank as of December 31, 2003 was approximately NIS 39 million. We are not currently in breach of any of our covenants to this bank.

Cash Flow (Cable TV and Internet activities together)

Below is a condensed presentation of certain aspects of our cash flow during 2002 and 2003. For our full cash flow statements please see the financial statements attached at Item 18. Financial Statements .

	Years ended December 31,	
	2002	2003
	in adjusted NIS in millions	
	<hr/>	<hr/>
Net cash provided by (used in) operating activities	(89.4)	96.0
Net cash provided by investing activities	228.4	60.4
Net cash used in finance activities	(131.9)	(126.1)
Increase in cash and cash equivalents	7.1	30.3
Cash and cash equivalents at beginning of year	0.5	7.6
Cash and cash equivalents at end of year	7.6	37.9

The increase in net cash from our operating activities in 2003 compared to 2002 derives from an increase in our revenues and a decrease in our operating expenses (primarily costs of programming), and this is despite an increase in our net financing costs.

Cash derived from investment activities in 2003 in the amount of approximately NIS 60.4 million is primarily derived from the proceeds of the sale of a portion of our shares in Partner in the amount of NIS 114.4 million, which was set off by investments in fixed assets in the amount of NIS 56.6 million, compared to cash from investment activities in 2002, primarily derived from the proceeds of the sale of a portion of our shares in Partner in the amount of approximately NIS 305.1 million, which were set off against investments in fixed assets in the amount of approximately NIS 77.3 million.

Net cash used in finance activities in 2003 is comprised of NIS 131.5 million net used for repayment of bank loans and NIS 33.7 million used for payments on our debentures, and NIS 39.1 million provided by sales of our shares held by a subsidiary. Net cash provided by or used in finance activities in 2002 is comprised of NIS 99.2 million net used for repayment of bank loans and NIS 33.6 million used for payments on our debentures, and NIS 1.0 million provided by sales of our shares held by a subsidiary.

We paid a dividend on January 26, 2000 of approximately NIS 222.0 million. We did not pay a dividend in 2001, 2002 or 2003. We have not adopted any dividend distribution policy, and we cannot assure you that we would pay additional dividends in the future.

Our management believes that our cash and cash equivalents reserve, as well as cash flow from our operations and available credit lines, will be sufficient to meet our anticipated cash needs for a period of at least twelve months commencing on December 31, 2003.

Impact of Inflation and Exchange Rate Fluctuations

Our financial statements are presented in shekels, adjusted to reflect changes in the Israeli consumer price index. Consequently, all shekel amounts set forth in our historical financial statements are adjusted each time that we publish new financial statements in order to reflect changes in the Israeli consumer price index as of the date of the latest balance sheet presented. See Note 2 to the financial statements. Since we may not be permitted to raise our fees pursuant to our Licenses in a manner that would fully compensate for any increase in the Israeli consumer

price index, inflation in Israel may have a material adverse impact upon us.

Substantially all of our revenues and a majority of our operating expenses are denominated in shekels. However, through December 31, 2003, a substantial amount of our operating expenses were linked to non-shekel currencies. These expenses related mainly to programming where the price paid by us is based on the US dollar. Some of our capital expenditures are incurred in, or linked to, non-shekel currencies, mainly US dollars. Thus, any devaluation of the shekel against the US dollar, will also increase the shekel cost of our non-shekel denominated or linked expenses. Such increase may have an adverse impact upon our operating results, which may be material. Our borrowings are mostly in Israeli shekels with the remainder in US dollars.

Differences Between Israeli GAAP and U.S. GAAP

Israeli GAAP varies in certain respects from U.S. GAAP. The application of U.S. GAAP to our financial statements would have affected the determination of net loss, determination of capital deficiency, comprehensive income, investment in affiliates and marketable securities available for sale, debentures and deferred taxes as of December 31, 2003 to the extent summarized in Note 26 to the financial statements.

5C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES

Not applicable.

5D. TREND INFORMATION

1. During 2003, our number of cable television subscribers declined, due in part to increased competition from YES, the Israeli satellite television broadcaster. However, during the same period, our number of access to High Speed Internet subscribers increased. This trend has continued in 2004 so far.

2. During 2003, our total revenues and monthly average revenues per subscriber increased. This trend has continued in 2004. We do not know if this trend will continue at the same rate, if at all.

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3. In recent years our results, such as gross profits, profit from operations and EBITDA, have improved. We do not know if our results will continue to improve at the same rate, if at all.

4. In 2000 and 2001 we made significant capital expenditures to upgrade our network. In 2002 and 2003, we significantly reduced our capital expenditures. We expect that our capital expenditures will increase in 2004 as the result of our provision of telephony and other new services. Such increased capital expenditures will affect our operating results, cash flow and liquidity.

For more information about other factors that may affect our results of operations, see Item 3D. Key Information Risk Factors.

5E. OFF-BALANCE SHEET ARRANGEMENTS

We hold approximately 26.6% of the outstanding shares of HOT Vision Ltd. The results of HOT Vision were recorded based on the equity method until December 31, 2003. We provided an unlimited guarantee to Bank Leumi L. Israel B.M., or Bank Leumi, for purposes of securing up to 24.6% of the credit the Bank Leumi will provide to HOT Vision. The board of directors of HOT Vision determined that the line of credit of HOT Vision from Bank Leumi would be limited to approximately US\$35 million, unless otherwise determined. As of December 31, 2003, we guaranteed to Bank Leumi US\$4.6 million on this line of credit.

In addition, we provided a guarantee in an amount of up to US\$16 million to Bank Hapoalim B.M., or Bank Hapoalim, to secure approximately 25% of the credit provided by Bank Hapoalim to HOT Vision, and upon the fulfillment of certain conditions, up to 44% of the total credit. As of December 31, 2003, we guaranteed to Bank Hapoalim between US\$4.3 million to US\$7.0 million. In January 2003, Bank Hapoalim requested to exercise the guarantee, however, to date, no additional request was made. All of our shares in Partner are pledged to banks under pledges unlimited in sum to cover Partner's liabilities in respect of its loans from the banks.

We also provided a guarantee on behalf of Barak to a bank in the amount of \$200,000.

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5F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The following table sets forth, as of December 31, 2003, our known contractual obligations by type of obligation and for the periods indicated:

In thousands of NIS adjusted as of December 31, 2003	Payment due by period				
	Total	Less than 1 year	1-3 years	3-5 years	more than 5 years
Long-term debt obligations (banks and others)	173,076	45,673	55,015	72,388	--
Operating lease obligations	8,753	3,910	4,843	--	--
Debentures	99,846	33,701	66,145	--	--
Total	281,675	83,284	126,003	72,388	--

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES**6A. DIRECTORS AND SENIOR MANAGEMENT****Directors**

Set forth below is certain information about our officers and directors as of June 15, 2004.

Directors

Name	Age	Position
Shmuel Dankner	73	Chairman of the Board of Directors
Shimon Cheifetz (1)	61	Director
Dr. David Dankner	76	Director
Dor Dankner (1)	43	Director
Leah Dankner	78	Director
Alon Dankner	53	Director
Dr. Zvi Dinstein (2)	77	Director
Hananya Gibstein	70	Director
Yair Keusch (2) (3)	64	Director
Yeshayahu Drori (2) (3)	66	Director
Zvi Mor	55	Director
Joseph Bartfeld	52	Director
Meir Srebernik	45	Director
Yehuda Gill	76	Director
Yehoshua Gibstein (1)	44	Alternate Director

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Officers

Name	Age	Position
Amit Levin	41	Chief Executive Officer
Ori Gur Arie	47	Counsel and Company Secretary
Shalom Bronstein	55	Chief Financial Officer
Genia Raichel-Gil	51	Vice President, Customer Service

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Meidad Katz	41	Vice President, Engineering
Shlomi Ashkenazi	38	Vice President, Sales, Marketing and Operational Areas
Ron Sharon	48	Vice President, Information Systems

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- (1) Member of the Finance Committee.
 - (2) Member of the Audit Committee.
 - (3) Independent Director.

Shmuel Dankner has been the chairman of our board of directors since 1988. Mr. Dankner is the chairman of the board of directors of Dankner Investments Ltd., and serves as a director of various companies, including Dor Chemicals Ltd., Israel Salt Company Ltd., Israel Salt Company (Eilat) 1976 Ltd., Dankner Holdings Ltd., Dankner Assets Haifa (1996) Ltd., Dankner Communications Ltd., Dankner Transportation Ltd., Carmel Resins Ltd., Carmel Chemicals Ltd., H.K. Trade Ltd., Conlog Control Ltd., Alex Control Systems Ltd., Israel Salt Industries Ltd., Kirkwood Enterprises Inc., Alcar-Electric Productions Ltd., G.D. Chemicals Ltd., Cable Systems Media Haifa-Hadera Ltd., Matav Investments Ltd., Partner Communications Company Ltd., Matav Infrastructure Ltd., Dor Chembat Ltd., Elran (D.D.) Investments Ltd., Elran (D.D.) Holdings Ltd. and Shamdar Holdings Ltd. Mr. Dankner is the brother of Leah Dankner and David Dankner, the father of Dor Dankner, and the uncle of Alon Dankner and Orli Mor, wife of Zvi Mor. In April 2004, Mr. Dankner and Dor-Alon Gas Technologies Ltd. (formerly known as Dor Gas Ltd.), together with others, were indicted by the representative of the Attorney General on behalf of the Israeli Restrictive Business Practices Authority in connection with an alleged unlawful restrictive arrangement for the supply of gas to industries and household consumers during the years 1994 through 1997. Mr. Dankner is not charged with having been a party to the restrictive arrangement, but he was among the parties named in the indictment due to the fact that he served as a director of Dor-Alon Gas Technologies Ltd. during the period in question, and the indictment alleges that he knew or should have known of the restrictive arrangement during the period in question, or at least for part of it. The indictment alleges that certain of the defendants unlawfully divided the gas supply market among themselves and others. Mr. Dankner has not yet submitted his answer to the indictment. If convicted, Mr. Dankner could face criminal penalties including imprisonment and fines. As a result, Mr. Dankner might be precluded by a court from serving as a director of any public company, including ours. Mr. Dankner is no longer a director of Dor-Alon Gas Technologies Ltd. The action described above concerns matters that are not related to Matav.

Alon Dankner has been a director of Matav since July 26, 1999. Mr. Alon Dankner serves as a director in various companies, including: Cable Systems Media Haifa - Hadera Ltd., Matav Investments Ltd., Nave Shoshana Ltd., Israeli Salt Company (Eilat) Ltd., Intact Holdings Ltd., Danran Holdings Ltd., Elran (D.D.) Holdings Ltd., Elran (D.D.) Investments Ltd. and G.D.A.D. Atlit Development Ltd. Mr. Alon Dankner is the nephew of Shmuel Dankner, Leah Dankner and David Dankner, and cousin of Dor Dankner and Orli Mor (wife of Zvi Mor).

Dr. David Dankner has been a director of Matav since July 26, 1999. Dr. David Dankner has been serving as the Chief Executive Officer of Carmel Chemicals Ltd. since 1966. Dr. David Dankner also serves as a director of various companies, including: Dankner Constructions and Development Ltd., Dor Chemicals Ltd., Carmel Resins Ltd., Carmel Chemicals Ltd., Israel Salt Industries Ltd., Israel Salt Company (Eilat) 1976 Ltd., Israel Salt Company Ltd., Alcar-Electric Productions Ltd., G.D. Chemicals Ltd., H.K. Trade Ltd., Conlog Control Ltd., Alex Control Systems Ltd., Salit Salts Ltd., Limor Development Ltd., Unigad Ltd., Dankner Assets Haifa (1996) Ltd., Dor Chembat Ltd., Salt Productions Ltd., Chutzot Hayotzer Ltd., Kastrat Ltd., D.G.D Haifa Ltd., Matav Investments Ltd., and Cable Systems Media Haifa-Hadera Ltd. Dr. David Dankner is the brother of Shmuel Dankner and Leah Dankner, and the uncle of Alon Dankner, Dor Dankner and Orli Mor (wife of Zvi Mor).

Dor Dankner has been a director of Matav since July 26, 1999. Mr. Dor Dankner also serves as a director in various companies, including: Cable Systems Media Haifa - Hadera Ltd., Matav Assets Ltd., Matav Investments Ltd., Dankner Investments Ltd., Israel Salt Industries Ltd., Partner Communications Company Ltd., Dankner (D.D.) Infrastructures Ltd., Elran (D.D.) Management & Holdings Ltd., Elran (D.D.) Investments Ltd. (as chairman of the board of directors), Elran (D.D.) Holdings Ltd., Elran (D.D.) Technologies Ltd., Elran Gmul Power Stations Ltd., Shachaf Dan Investments Ltd., Dankner Communications Ltd., Carmel Assets Ltd., D.Retail (Dankner Corporation) Ltd. and Avirad Holdings (1998) Ltd. In addition, Mr. Dor Dankner serves as Chief Executive Officer of D.S.D. Investments Ltd. Mr. Dor Dankner is the son of Shmuel Dankner, and the nephew of Leah Dankner and David Dankner, and the cousin of Alon Dankner and Orli Mor (wife of Zvi Mor).

Dr. Zvi Dinstein has been a director of Matav since August 14, 1987. Since 1985 Dr. Dinstein has been the Chairman of the board of directors of the Belfer Center for Energy Research, which grants research funding and operates in cooperation with the Israeli Ministry of National Infrastructure and the Ministry of Environment. Dr. Dinstein is also the chairman of the board of directors of Dorot Properties and Holdings Ltd., and director of various companies, including Cable Systems Media Haifa - Hadera Ltd., Matav Investments Ltd. and F.I.B.I. Holding Company Ltd. Dr. Dinstein is also a member of the Board of Governors of the Tel Aviv University, the Weizmann Institute of Science and The Hebrew University of Jerusalem.

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Leah Dankner has been a director of Matav since September 17, 1997. Ms. Leah Dankner also serves as a director of Cable Systems Media Haifa- Hadera Ltd., Matav Investments Ltd., Dankner Investments Ltd., Dor Chemicals Ltd., Carmel Chemicals and the Israel Salt Industries Ltd., Kikar Leah Hanynon Ltd. and G.D. Chemicals Ltd., Ms. Leah Dankner is the sister of Shmuel Dankner and David Dankner and the aunt of Alon Dankner, Dor Dankner and Orli Mor, wife of Zvi Mor.

Hanania Gibstein has been a director of Matav since August 14, 1987. Mr. Gibstein also serves as a director of Cable Systems Media Haifa - Hadera Ltd. and Matav Investments Ltd. Mr. Gibstein was a member of the Municipal Council of the city of Rishon Le-Zion, and was the mayor of that city from 1969 to 1983. Mr. Gibstein is the chairman of the Society of Friends of The Beer Yaacob Mental Health Center. Since 1991 Mr. Gibstein has been the vice-chairman of the Association for Welfare of the Soldiers of Israel, and has managed private businesses, primarily in real estate.

Shimon Cheifetz has been a director of Matav since January 20, 1989. Mr. Cheifetz is also a director of various companies in Israel: Matav Investments Ltd., Cable Systems Media Haifa-Hadera Ltd., Matav Assets Ltd. and Barak I.T.C.- The International Telecommunications Services Ltd. Mr. Cheifetz served as the general manager of Maariv-Modiin Publishing House Ltd. until April 1992. Since April 1992 Mr. Cheifetz has been the chairman of the board of directors and a director in various other companies including, Mifratz Flour Mills Ltd., Man Haifa Bay Flour Mills (1999) Ltd., Grand Moulins D Israel Ltd., Ugda Investment Ltd., Synet Industries Ltd., El-Mul Technologies Ltd., and Yeda Research and Development Co. Ltd.

Zvi Mor has been a director of Matav since September 17, 1997. Mr. Mor serves as the Chairman of Dor Gaz Ltd. and Dor Chemicals Ltd. Mr. Zvi Mor also serves as a director in various companies, including: Dankner Investments Ltd., the Israel Salt Industries Ltd., Carmel Chemicals Ltd., Dankner Assets Haifa (1996) Ltd., Cable Systems Media Haifa - Hadera Ltd. and Matav Investments Ltd. Mr. Zvi Mor is married to Orly Mor (Gineo), niece of Shmuel Dankner, Leah Dankner and David Dankner, and cousin of Alon Dankner and Dor Dankner. On April 13, 2004, the representative of the Attorney General on behalf of the Restrictive Business Practices Authority indicted Dor Gas and several of its former senior officers, including Mr. Mor, as well as other liquid petroleum gas supplying entities, on three counts of charges related to violations of the Restrictive Business Practices Law, 5748-1988. The indictment was submitted as a result of an investigation which was conducted by the Restrictive Business Practices Authority between 1998 and 2001. If convicted, Mr. Mor could face criminal penalties including imprisonment and fines. As a result, Mr. Mor might be precluded by a court from serving as a director of any public company, including ours. Mr. Mor is no longer a director of Dor-Alon Gas Technologies Ltd. The action described above concerns matters that are not related to Matav.

Meir Srebernik has been a director of Matav since March 2002. Mr. Srebernik is the Chief Executive Officer of Dankner Investments Ltd., since February 2002. Mr. Srebernik serves as a director of various other companies, including Dankner Assets Ltd., Dankner Assets Haifa (1996) Ltd., Dankner Constructions and Development Ltd., Dankner Investments in Real Estate (USA) Ltd., Neot Dankner Maintenance & Services (1982) Ltd., Drorim Mall Ltd., Rehovot Shopping and Transport Center Management Company Ltd., Dankner Transportation Ltd., Dankner Communications Ltd., Dankner Holdings Ltd., Shalom Industrial Park Ltd., Matav Investments Ltd., Cable Systems Media Haifa-Hadera Ltd., Matav Assets Ltd., Matav Infrastructure Ltd., HOT Telecom Ltd. and Nonstop Ventures Ltd. Between 1995 and 2000, he was the president and Chief Executive Officer of Netia Holding SA, a leading Polish alternative fixed line telecommunications company. He has also served as the head of the cable television division of the Israeli Ministry of Communications, as Vice President of Telecommunications of Dankner Investments Ltd. and as a director of Pelephone Communications Ltd., one of the four mobile phone service providers in Israel.

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Yehuda Gill has been a director of Matav since November 2001. Mr. Yehuda Gill also serves as a director of Union Bank of Israel Ltd. Since 2001, Mr. Gill serves as the managing director and executive vice chairman of Israel Oil Prospectors Corporation Ltd.

Yehoshua Gibstein has been an alternate director of Matav for Mr. Hanania Gibstein since May 24, 1998. Mr. Yehoshua Gibstein was a director of Matav between 1992 and May 1998. Mr. Gibstein is also a director in Pikom Ltd., Exent Technologies Ltd., Cabletek Ltd. and Noa (G.P.A) Investment Company Ltd., which specializes in investment and project development. Mr. Gibstein is the son of Hanania Gibstein.

Joseph Bartfeld has been a director since June 8, 2004. Mr. Bartfeld is currently the CEO of Delek Group Ltd., and the CEO of Delek Investments and Assets Ltd. Prior to holding his current positions in the Delek Group he was CFO of Delek Group. Mr. Bartfeld serves as the chairman of the board of directors of Delek Real Estate Ltd., Gadot Biochemical Industries Ltd., Delek Balron International Ltd., and is a member of the board of directors of several other entities within the Delek Group. Mr. Bartfeld has a B.A. degree in economics from Tel Aviv University.

Yair Keusch has been an external director of Matav since June 3, 2004. Mr. Keusch has served as an economic and financial advisor to various companies since 2001. From 1972 to 2000, Mr. Keusch served as the Vice President of Finance of Delek The Israel Fuel Corporation Ltd., an energy company publicly traded on the Tel-Aviv Stock Exchange. Mr. Keusch also served as a director in many companies. In the past, Mr. Keusch lectured in the Department of Economics of Tel-Aviv University and at other institutions of higher education in Israel. Mr. Keusch previously served as the Manager of the Economics Department of the Institute for Productivity of Labor and Manufacture. Mr. Keusch has a

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B.A. in economics and an MBA from the Hebrew University in Jerusalem.

Yeshayahu Drori has been an external director of Matav since June 3, 2004. Mr. Drori held various positions with the Dan bus cooperative from 1978 to 2000, including heading the inspection, planning/development and finance divisions, and served as the Chairman of the cooperative's Secretariat from 1997 to 2000. From 1992 to 2000, Mr. Drori served as the Chairman of AVIS Dan Rent a Car. Mr. Drori has served as a member of the Tel Aviv municipal council since 1999. Mr. Drori serves as a member of various municipal councils and committees, environmental bodies and is a member of the board of directors of Netivey Ayalon Ltd.

Amit Levin has been our Chief Executive Officer since October 7, 1999. Mr. Levin also serves as Vice President of Marketing and Programming of the merged operations of the three cable companies. Before that and since September 1998, he served as our interim Chief Executive Officer. Between October 1994 and September 1998, he was Matav's Vice President of Israeli Operations. Mr. Levin is a director of Nonstop Internet (1999) Ltd., Matav Assets Ltd. and Matav Infrastructure Ltd. Between 1991 and 1994, Mr. Levin was Matav's area manager for Netanya.

Ori Gur Arieh has been Matav's Counsel and Company Secretary since November 2000. Mr. Gur Arieh also serves as General Counsel to HOT Telecom and General Counsel to the merged operations of the three cable companies, referred to as HOT. Prior to his employment with Matav, Mr. Gur Arieh was a partner in the private law practice of Avital, Dromi & Co.

Shalom Bronstein has been our Chief Financial Officer since 1989. Prior to 1989, Mr. Bronstein was vice president of finance of SI Holdings Ltd., an industrial, construction and real estate company.

Genia Raichel-Gil has been Matav's Vice President of customer service since February 2000. Before that and since November 1994, she served as an operating area manager of our Netanya and Haifa franchise areas.

Meidad Katz has been Matav's Vice President of engineering since 1996. Before that he served as a hardware engineer at ECI Telecom Ltd. in their SDH (Synchronous Digital Hierarchy) Telecom department.

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Shlomi Ashkenazi has been Matav's Vice President of sales, marketing and operational areas since August 2002 and also serves as Vice President of Sales of the merged operations of the three cable companies, referred to as HOT. Between February 2002 and August 2002 he served as Matav's Vice President of marketing and sales. Before that and since 1998, he served as Matav's Vice President and Chief Operating Officer. Between 1995 and 1998 he served as an operating area manager for our Bat-Yam, Holon and the Galilee franchise areas.

Ron Sharon has been Matav's Vice President of information systems since November 2000. Before that and since May 1998, he worked at Hamashbir Fashion House Ltd. as their information system officer.

Under the shareholders agreement dated October 18, 1993, as amended in July 2002, to which Dankner Investments Ltd., Mr. Hanania Gibstein, Mr. Eli Cheifetz, Mr. Shimon Cheitetz and Dr. Zvi Dinstein, and the companies controlled by such parties that hold our ordinary shares are currently parties, certain of our shareholders have agreed to vote their respective shares in a manner that would enable each of such shareholders to appoint a number of directors to our board of directors in proportion to each of such shareholder's holdings in our company as compared with the original holdings of all parties to this agreement. For additional information regarding the shareholders agreement, see Item 7A. Major Shareholders and Related Party Transactions - Major Shareholders .

Except as disclosed above, none of the above directors or members of senior management has any family relationship with any other director or senior manager of Matav.

6B. COMPENSATION

The aggregate net compensation paid, and benefits in kind granted to or accrued on behalf of all of our directors, officers and members of our extended management, as a group, for their services in all capacities during the year ended December 31, 2003 (23 persons of which 3 are directors) was approximately NIS 8.5 million. This amount excludes amounts we expended for automobiles we made available to our officers and members of extended management and expenses (including business travel, professional and business association dues and expenses) with which we reimbursed our officers and members of extended management.

In addition, options were granted to our senior management under our 1997 Senior Employee Share Option Plan, or the 1997 Plan, and as of January 2003, options to purchase up to 71,100 of our ordinary shares, at an exercise price of \$8 per share were outstanding. The 1997 Plan

terminated and all of the outstanding options granted under the 1997 Plan expired. We also granted options under our 2001 Senior Employee Option Plan, or the 2001 Plan. 37,235 options to purchase ordinary shares granted under the 2001 Plan were exercised, and 34,233 options granted under the 2001 Plan remain outstanding.

In addition, as of December 31, 2003, options were granted to approximately fifty members of our senior management under our 2003 Employee and Officers Option Plan, or the 2003 Plan, to purchase up to 770,000 of our ordinary shares. The options under the 2003 Plan vest in three equal portions. The first portion vested on January 31, 2004 and has an exercise price of 85% of the average 30 day trading price on the Tel Aviv Stock Exchange, or TASE prior to November 17, 2003. The second portion vests on January 31, 2005 and has an exercise price of 90% of the average 30 day trading price on TASE prior to the vesting date. The third portion vests on January 31, 2006 and has an exercise price of 90% of the average 30 day trading price on TASE prior to the vesting date. In addition, all of the employees that were entitled to receive options under the 2003 Plan that received options under the 2001 Plan were required to waive their vested options under the 2001 Plan as a condition to receiving options under the 2003 Plan. The options that were granted under the 2001 Plan that were not vested at such time were cancelled with the agreement of the grantees. For more information, see Item 6E. Directors, Senior Management and Employees Share Ownership .

During 2003, we compensated Michael Goldschmidt and David Harnik, our previous two external directors whose terms ceased during 2004, and Yehuda Gill for their services as members of our board of directors and its committees.

Pursuant to bonus incentive agreements with directors, on January 20, 2003, we paid the amount of approximately NIS 0.2 million to the heirs of our former director, Mr. Uri Levit, and on April 13, 2004, we paid Mr. Moshe Gavish the amount of approximately NIS 1 million. For more details regarding these bonus arrangements, please see Item 7B. Major Shareholders and Related Party Transactions Related Party Transactions .

6C. BOARD PRACTICES

Israeli Companies Law

We are subject to the provisions of the Israeli Companies Law, 5759-1999, which became effective on February 1, 2000 and regulations adopted thereunder, or the Companies Law, which supersede most of the provisions of the Israeli Companies Ordinance (New Version), 5743-1983.

Terms of Directors

Generally, each director is elected at the annual general meeting of shareholders and holds office until the election of his/her successor at the next annual general meeting, except for external directors, who hold office for three-year terms and may be re-elected by the shareholders for an additional three-year term. Currently, our articles of association provide that our board of directors consists of at least 4 directors but not more than 15. Our articles of association provide that a majority of our board of directors, entitled to participate, may appoint additional directors, up to the maximum number permitted. Our articles of association also provide that our board of directors may delegate all of its powers to committees of the board of directors, as it deems appropriate, subject to the provisions of the Companies Law. No director has a service contract with our company or its subsidiary providing for benefits upon termination of employment. Our officers serve at the discretion of our board of directors or until their successors are appointed.

Alternate Directors

Our articles of association provide that a director may at any time, appoint any individual as an alternate director. In addition, no person who already serves as a director or alternate director of Matav may serve as the alternate director of another director of Matav. An alternate director may not serve as such unless such person is qualified to serve as a director. Under the Companies Law, an alternate director shall have all of the rights and obligations of the director appointing him or her. The alternate director may not act at any meeting at which the director appointing him or her is present. Unless the time period or scope of any such appointment is limited by the appointing director, such appointment is effective for all purposes and for an indefinite time, but will expire upon the expiration of the appointing director's term. Mr. Yehoshua Gibstein is alternate director for Mr. Hanania Gibstein, in his absence.

Independent Directors and External Directors

Pursuant to the current listing requirements of the Nasdaq National Market, as a foreign private issuer which was already publicly traded in December 1999, we are required to have at least two independent directors on our board of directors and to establish an audit

committee, a majority of whose members must be independent.

The Companies Law requires that we have two external directors. The election of an external director under the Companies Law must be approved by a general meeting of shareholders provided that either: (a) the majority of shares voted at the meeting, including at least one third of the shares of non-controlling shareholders voted at the meeting, vote in favor of such election; or (b) the total number of shares voted against such election does not exceed one percent of the aggregate voting rights in the company.

On June 3, 2004, Mr. Yair Keusch and Mr. Yeshayahu Drori were appointed as external directors to replace Mr. David Harnik and Mr. Michael Goldschmidt whose terms expired on June 4, 2004. Our current external directors satisfy the provisions of the Companies Law pursuant to which they were appointed, and also satisfy the requirements of the Nasdaq National Market regarding independent directors.

Audit Committee

As a foreign private issuer, we received an automatic exemption from the listing requirements of Nasdaq relating to audit committees that were adopted in 2000. Accordingly, we are required to have at least two, rather than three, independent directors on our audit committee. The responsibilities of the audit committee under the Nasdaq requirements include, among other things, evaluating the independence of our directors. In addition, we are not required to adopt a formal audit committee charter.

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The Companies Law requires public companies, including us, to appoint an audit committee. The responsibilities of the audit committee include reviewing our financial statements, identifying irregularities in the management of the company's business (including in consultation with the internal auditor and the company's independent accountants) and to suggest an appropriate course of action to amend such irregularities, and approving certain related party transactions as required by law. An audit committee must consist of at least 3 members, and include all of the company's external directors. However, the chairman of the board, any director employed by the company or providing services to the company on an ongoing basis, any controlling shareholder or any relative of a controlling shareholder, may not be a member of the audit committee. The current members of our audit committee are: Dr. Zvi Dinstein, Mr. Yair Keusch and Mr. Yeshayahu Drori.

Internal Auditor

The Companies Law requires the board of directors of a public company to appoint an internal auditor proposed by the audit committee. A person who does not satisfy certain independence requirements may not be appointed as an internal auditor. The role of the internal auditor is to examine, among other things, the compliance of the company's conduct with applicable law and orderly business procedures. Shai Nagor of the accounting firm Elan Katatz Nagor was appointed as our internal auditor in November 17, 2003.

Fiduciary Duties of an Office Holder

The Companies Law imposes fiduciary duties on an office holder of a company, which consist of a duty of loyalty and a duty of care. An office holder is defined in the Companies Law as a director, general manager, chief executive officer, executive vice president, vice president, other manager directly subordinate to the any other person assuming the responsibilities of any of the foregoing positions regardless of that person's title and other managers directly subordinate to the general manager. The duty of loyalty requires the office holder to avoid any conflict of interest between the office holder's duties for the company and other duty or personal affairs, and proscribes any competition with the company or the exploitation of any business opportunity of the company in order to receive personal advantages for himself or herself, or for others. This duty also requires him or her to reveal to the company any information or documents relating to the company's affairs that the office holder has received due to his or her position as an office holder. The duty of care requires an office holder to act with the level of care which a reasonable office holder in the same position would employ under the same circumstances. This includes the duty to utilize reasonable means to obtain information regarding the advisability of a given action submitted for his or her approval or performed by virtue of his or her position, and all other relevant information pertaining to such action.

Approval of Related Party Transactions

Generally, under the Companies Law the compensation of office holders who are directors requires the approval of the audit committee, the board of directors and the general meeting of the shareholders of the company (in that order). The Companies Law also requires that arrangements as to the compensation of office holders who hold a controlling interest in the company must be approved by the audit committee, the board of directors and a meeting of the shareholders (in that order) provided that either: (a) the majority of shares voted at the meeting, including at least one third of the shares of shareholders not having a personal interest in the matter voted at the meeting, vote in favor of such arrangement; or (b) the total number of shares voted against such arrangement does not exceed one percent of the aggregate voting rights in the company.

The Companies Law requires that an office holder promptly disclose any direct or indirect personal interest that he or his affiliates may have, and all related material information known to him, in connection with any existing or proposed transaction by the company. The office holder must make his disclosure orally or in writing no later than the first meeting of the company's board of directors meeting which discusses the particular transaction. The company may approve the transaction in accordance with the provisions of its articles of association and the Companies Law. Under the Companies Law, if the office holder has a personal interest, the company may approve the transaction provided that the transaction is not adverse to the company's interest. In addition, if the transaction is an extraordinary transaction, then in addition to any approval required by the articles of association, it also must be approved by the company's audit committee, its board of directors (in that order) and, in certain circumstances, the shareholders of the company at a general meeting. Generally, a director who has a personal interest in a matter that is considered at a meeting of the board of directors or the audit committee may not attend that meeting or vote on the matter, unless a majority of the board of directors or the audit committee also has a personal interest in the matter.

For information concerning the direct and indirect personal interests of certain of our office holders and principal shareholders in certain transactions, see Item 7. Major Shareholders and Related Party Transactions.

Under the Companies Law, the disclosure requirements which apply to an office holder also apply to a controlling shareholder of a public company. Moreover, under the Companies Law, extraordinary transactions between a public company and a controlling shareholder of the company or with a third party in which a controlling shareholder has a personal interest, in addition to any approvals stipulated by the articles of association, require the approval of the audit committee, the board of directors and of the shareholders with the same majority requirement as required for the approval of compensation arrangements of office holders who hold a controlling interest in the company.

Duty of a Shareholder

Under the Companies Law, a shareholder has a duty to act in good faith towards the company and other shareholders, and refrain from improperly exploiting his power in the company, including when voting in the general meeting of shareholders on (a) any amendment to the articles of association, (b) an increase of the company's authorized share capital, (c) a merger or (d) approval of transactions with interested parties which require shareholder approval. In addition, any controlling shareholder, any shareholder who knows that it possesses the power to determine the outcome of a shareholder vote and any shareholder that, pursuant to the provisions of the articles of association, has the power to appoint or prevent the appointment of an office holder in the company or any other power towards the company, is under a duty to act in fairness towards the company. The Companies Law does not detail the substance of this duty.

Exculpation of Office Holders

Under the Companies Law, an Israeli company may not exempt an office holder from liability with respect to a breach of his duty of loyalty, but may exempt in advance an office holder from his liability to the company, in whole or in part, with respect to a breach of his duty of care, provided that the articles of association of the company permit it to do so. Our articles of association allow us to exempt our office holders to the fullest extent permitted by law.

Indemnification of Office Holders

Our articles of association permit us to undertake in advance to indemnify our officers and directors, provided that the undertaking is restricted to the events of a kind which the board of directors may anticipate at the time it makes such undertaking and limited to an amount which the board of directors determines is reasonable under the circumstances. In addition, we can indemnify an officer or director for specific occurrences retroactively.

Our articles of association further provide that the total amount as to which we may indemnify our officers and directors under these provisions shall not exceed 25% of our equity according to the last financial statements that were published.

Our articles of association also provide that we may indemnify an officer or director for liability or expense imposed on him as a result of an action performed by him in his capacity as our officer or director as follows:

- (1) Any financial liability imposed on the officer or director in favor of a third party in accordance with a judgment, including a judgment given in a settlement or a judgment of an arbitrator, approved by the court.
- (2) Reasonable litigation expenses, including legal fees, incurred by the officer or director or which he was ordered to pay by the court:

- (a) within the framework of proceedings filed against him by Matav or on Matav's behalf or by a third party,
- (b) in a criminal proceeding in which he was acquitted,
- (c) in a criminal proceeding in which he was convicted of a felony which does not require a finding of criminal intent.

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Insurance of Office Holders

Our articles of association provide that, subject to the provisions of the Companies Law, we may enter into a contract for the insurance of the liability of any of our office holders with respect to an act performed by such individual in his or her capacity as an office holder, for:

- (1) a breach of an office holder's duty of care to us or to another person;
- (2) a breach of an office holder's duty of loyalty to us, provided that the office holder acted in good faith and had reasonable cause to assume that his or her act would not prejudice our interests; or
- (3) a financial liability imposed upon an office holder in favor of another person.

We have obtained a directors and officers insurance policy, currently valid until August 31, 2004.

Limitations on Exculpation, Indemnification and Insurance

Under the Companies Law, in no event may we enter into a contract for the insurance of our office holders, indemnify an office holder or exempt an officer from responsibility toward the company, for:

- (1) breach of the duty of loyalty toward Matav, unless, with respect to insurance coverage, the officer or director acted in good faith and had reasonable grounds to assume that the action would not harm us;
- (2) breach of the duty of care if it was committed intentionally or recklessly;
- (3) an act or omission committed with the intent to yield a personal profit; or
- (4) any fine or penalty imposed on the office holder.

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6D. EMPLOYEES

As of December 31, 2003, we had 841 employees on a full-time or full-time equivalent basis. Of these employees, 111 were in engineering and technical support, 307 were in customer service and support, 255 were in marketing, 71 were in Internet activities, and the remainder in administration and management.

As at December 31, 2003, all of our employees are located in Israel.

Substantially all of our employees have entered into employment contracts with us, terminable at will by either party.

Our employees are not covered by any specific collective bargaining agreement. However, we are subject to various Israeli labor laws and practices, as well as orders extending certain provisions of collective bargaining agreements between the Histadrut, currently the largest labor organization in Israel, and the Coordination Bureau of Economic Organizations, the federation of employers' organizations. Such laws, agreements and orders cover a wide range of areas and impose minimum employment standards including, working hours, minimum wages, vacation and severance pay, and special issues, such as equal opportunity in employment, and employment of women, youth, disabled persons and army veterans.

We generally contribute funds on behalf of our employees to a fund known as Managers' Insurance. This fund provides a combination of savings plan, insurance and severance pay benefits to the employees, giving the employees a lump sum payment upon retirement or a pension upon retirement and securing some of the severance pay, if legally entitled, upon termination of employment. Most of our employees are entitled

to participate in the plan upon the start of employment or after an initial period. Each employee contributes an amount equal to 5% of his salary and we contribute between 13.3% and 15% of such employee's salary.

We also offer some of our employees the opportunity to participate in a Continuing Education Fund, which functions also as a savings plan. Each of the participating employees contributes an amount equal to 2.5% of his salary and we contribute 7.5% of such employee's salary.

According to the National Insurance Law, Israeli employers and employees are required to pay predetermined sums to the National Insurance Institute. These contributions entitle the employees to health insurance and benefits in periods of unemployment, work injury, maternity leave, disability, reserve military service and bankruptcy or winding-up of the employer. We have never experienced a strike or work stoppage.

Except for one action pending against us, by a former service provider, claiming an employer-employee relationship existed at the time he provided his services, no material labor-related claims are pending. For more information on this claim, also see Item 8A. Financial Information Consolidated Statements and Other Financial Information Legal and Arbitration Proceedings.

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6E. SHARE OWNERSHIP

As of April 30, 2004, our directors owned an aggregate of 3,592,209 or approximately 11.9% of our outstanding ordinary shares. Except for Shimon Cheifetz, Dr. Zvi Dinstein and Hanania Gibstein, no individual director or senior manager listed in Item 6B - Directors and Senior Management, owns directly (or through fully owned companies) 1% or more of our outstanding ordinary shares.

As of April 30, 2004, our senior managers, held, in the aggregate options to purchase up to 770,000 of our ordinary shares under the 2003 Plan. The options granted under the 2003 Plan vest in three equal installments. The first portion vested on January 31, 2004, and has an exercise price of 85% of the average 30 day trading price on the Tel Aviv Stock Exchange, or TASE prior to November 17, 2003. The second portion vests on January 31, 2005 and has an exercise price of 90% of the average 30 day trading price on TASE prior to the vesting date. The third portion vests on January 31, 2006 and has an exercise price of 90% of the average 30 day trading price on TASE prior to the vesting date.

As of April 30, 2004, Mr. Hanania Gibstein owned 262,939 ordinary shares, or approximately 0.87% of our outstanding ordinary shares directly, and an additional 1,207,426 ordinary shares, or approximately 3.99% of our outstanding ordinary shares indirectly, through his holdings in Gibstein Holdings Ltd., Gibstein Financial Holdings (1998) Ltd. and Gibstein Investments (1997) Ltd.

As of April 30, 2004, Messrs. Shimon Cheifetz and Eli Cheifetz owned 616,896 ordinary shares or 2.04% of our outstanding ordinary shares directly, and 710,392 ordinary shares or 2.35% of our outstanding ordinary shares, indirectly through their holdings in Cheifetz Holdings Ltd.

As of April 30, 2004, Dr. Zvi Dinstein owned 596,170 ordinary shares or 1.97% of our outstanding ordinary shares, indirectly through his holdings in Dorot Communications Ltd.

Members of the Dankner and Gineo families are parties to a shareholders agreement in Dankner Investments Ltd., concerning the voting of a part of their respective shares in coordination with the other parties to the agreement. For additional information, see Item 7A. Major Shareholders Shareholders Agreements. Each member of the Dankner and Gineo families who is a party to this agreement could be deemed to be the beneficial owner of all the shares of our ordinary shares owned by Dankner Investments Ltd., but they disclaim beneficial ownership of such shares.

2001 Senior Employee Share Option Plan

On January 30, 2001, our board of directors adopted the 2001 Employee Share Option Plan, or the 2001 Plan, to promote the interests of our company and its shareholders by providing our senior management and other key employees with appropriate incentives and rewards to encourage them to enter into and continue in the employ of Matav and to acquire a proprietary interest in our long-term success.

The 2001 Plan authorized the issuance of options to purchase up to 864,000 of our ordinary shares, or 432,000 ADSs. Each option represents the right to receive, upon exercise, our ordinary shares or ADSs in the value of the appreciation, if any, of the price of our ordinary shares on the Tel Aviv Stock Exchange, on the day of exercise, over the exercise price for each ordinary share subject to the option.

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As of April 30, 2004, options to purchase 37,235 ordinary shares granted under the 2001 Plan were exercised by our senior employees, and options to purchase 34,233 ordinary shares were outstanding.

The ordinary shares issuable upon exercise of the options covered by the 2001 Plan, are registered for sale on both Nasdaq and the Tel Aviv Stock Exchange.

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2003 Employee and Officers Option Plan

In November and December 2003, our board of directors adopted a new Employee and Officers Option Plan, or the 2003 Plan, which provides for the grant of up to 770,500 options to purchase our ordinary shares to approximately 50 of our employees and officers. The 2003 Plan was approved by our shareholders in December 2003. The options under the 2003 Plan vest in three equal portions. The first portion vested on January 31, 2004 and has an exercise price of 85% of the average 30 day trading price on the Tel Aviv Stock Exchange, or TASE prior to November 17, 2003. The second portion vests on January 31, 2005 and has an exercise price of 90% of the average 30 day trading price on TASE prior to the vesting date. The third portion vests on January 31, 2006 and has an exercise price of 90% of the average 30 day trading price on TASE prior to the vesting date. In addition, all of the employees that were entitled to receive options under the 2003 Plan that received options under the 2001 Plan were required to waive their vested options under the 2001 Plan as a condition to receiving options under the 2003 Plan. The options that were granted under the 2001 Plan that were not yet vested were cancelled with the agreement of the grantees. On December 29, 2003, pursuant to the 2003 Plan, our board of directors approved the issuance of 770,000 options to employees and officers, and, subject to the waiver of each of the grantees, approved the cancellation of 208,766 options granted under the 2001 Plan. All of such waivers were received. 500 options are still reserved and available for grant under the 2003 Plan.

For an English summary of the principal terms of the 2003 Plan, please see Exhibit 4(c)(ii).

Warrants and Debentures

In August 1997, the Company issued NIS 200 million par value registered debentures, of Series A, for redemption in seven equal installments on every August 20, commencing August 2000. As of December 31, 2003, the net outstanding balance of debentures appearing in our financial statements is approximately NIS 100 million.

On August 28, 1997, in connection with the issuance of debentures to the public, we issued warrants, of series one, to the purchasers of our debentures, to purchase an aggregate of 2,850,000 of our ordinary shares. By August 20, 2001 (the expiry date of the warrants), warrants to purchase 2,786,764 ordinary shares had been exercised, for consideration of approximately NIS 134.8 million (out of which we, through a fully owned subsidiary, exercised warrants to purchase 1,370,148 ordinary shares for a total payment of approximately NIS 65.8 million), and warrants to purchase 63,236 ordinary shares had expired.

Item 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

7A. MAJOR SHAREHOLDERS

The following table sets forth certain information with respect to the beneficial ownership of our ordinary shares as of April 30, 2004 with respect to each person or entity that we believe to be the beneficial owner of 5% or more of our outstanding ordinary shares. Except where otherwise indicated, we believe, based on information furnished to us by the principal shareholders, that the beneficial owners of the ordinary shares listed below have sole investment and voting power with respect to such ordinary shares.

Name	Number of Ordinary Shares Beneficial Owned	Percentage of Outstanding Ordinary Shares Beneficially Owned	Percentage of Voting Securities
Dankner Investments Ltd. (1)	6,654,933	22.02%	22.02%
Delek Investments and Assets Ltd.(2)	5,433,685	17.98%	17.98%
Bank Leumi L Israel B.M. (3)	2,454,354	8.12%	8.12%
Bank Hapoalim B.M. (4)	1,853,978	6.14%	6.14%
Ma ariv Modein Publishing House Ltd. (5)	1,529,890	5.06%	5.06%

(1) Dankner Investments Ltd. owns 22.02% of our ordinary shares directly. Dankner Investments Ltd. is a publicly held company, whose securities are traded on the Tel Aviv Stock Exchange, controlled by members of the Dankner and Gineo families (who collectively hold

approximately 87.5% of Dankner Investments Ltd. issued share capital). Members of the Dankner and Gineo families are parties to the shareholders agreement in Dankner Investments Ltd., concerning the voting of part of their respective shares in coordination with the other parties to the agreement. Each member of the Dankner and Gineo families who is a party to the Dankner shareholders agreement could be deemed to be beneficial owners of all of our ordinary shares owned by Dankner Investments Ltd., but except to the extent of their pecuniary interest in such shares, they disclaim beneficial ownership of such shares. Shmuel Dankner, the chairman of our board of directors, owns 3.46% of the share capital of Dankner Investments Ltd. and together with Roz Dankner, owns an additional 0.79% of such share capital and together with Dor Dankner, owns an additional 0.04% of such share capital. David Dankner, one of our directors, owns 3.09% of the share capital of Dankner Investments Ltd. and together with Erlen Roda Dankner, owns an additional 1.4% of such share capital. Alon Dankner, one of our directors, owns 1.07% of the share capital of Dankner Investments Ltd. Leah Dankner, one of our directors, owns 18.24% of the share capital of Dankner Investments Ltd. Zvi Mor, one of our directors, is married to Orly Mor, who owns 5.35% of the share capital of Dankner Investments Ltd. Dor Dankner, one of our directors, owns approximately 1.94% of the share capital of Dankner Investments Ltd. and together with Shmuel Dankner, owns an additional 0.04% of such share capital. In addition, Shmuel Dankner, Abraham Dankner, David Dankner, Leah Dankner, Rachel Elran and Orly Mor (wife of Zvi Mor), collectively own, together, 29.71% of the share capital of Dankner Investments Ltd. Each of Shmuel Dankner, Abraham Dankner, Rachel Elran, Leah Dankner, Dor Dankner and Zvi Mor are directors on the board of directors of Dankner Investments Ltd.

On May 31, 2004, Dankner Investments Ltd. issued an immediate report to the Israel Securities Authority and the Tel Aviv Stock Exchange stating that the members of the Dankner and Gineo families that hold shares in Dankner Investments Ltd. signed an agreement with Delek Real Estate Ltd. for the purchase of such shares, constituting 87.5% of the issued share capital of Dankner Investments Ltd. The transaction is subject to a number of approvals, including the approval of the Controller of Restrictive Business Practices and the Cable and Satellite Broadcasting Council. The agreement also provides that in the event the conditions to the aforesaid sale are not met by a specified date, subject to certain other conditions, Delek Real Estate Ltd. may purchase shares of Dankner Investments Ltd. from the other parties to the agreement representing 20-25% of the issued share capital of Dankner Investments Ltd. On June 16, 2004, Delek Group Ltd. issued an immediate report to the Israel Securities Authority stating that Delek Real Estate Ltd. purchased 25% of the issued share capital of Dankner Investments Ltd. on June 15, 2004. This immediate report also stated that, with respect to the purchase of the remaining shares to arrive at the total 87.5% referred to above, so far the approvals of the Council and the Ministry of Communications have been obtained.

(2) In February 2004, Delek Investments and Assets Ltd. acquired approximately 18% of our outstanding shares from Dankner Investments Ltd., and was granted an option exercisable for two years to purchase from Dankner Investments Ltd. an additional 2% of our outstanding shares. Delek Investments and Assets Ltd. is a private company wholly owned by Delek Group Ltd., a public company whose securities are traded on the Tel Aviv Stock Exchange. As of April 30, 2004, Sharon Tshuva Ltd., a private company wholly owned by Mr. Yitzchak (Tshuva) Sharon, owns approximately 36.1% of the shares of Delek Group Ltd. April M.I. Ltd., a private company wholly owned by Tashluz Assets Ltd., owns approximately 45.4% of the shares of Delek Group. Tashluz Assets Ltd., is a private company owned approximately 21.4% by Tashan Investments Ltd. (a private company wholly owned by Tashluz Assets Ltd.), approximately 17.2% by Ori Dori Ltd., approximately 25.8% by Sharon Tshuva Investments Ltd., and approximately 33.4% by Tashluz Investments (1993) Ltd. Tashluz Investments (1993) Ltd. is a private company owned by Tashluz Investments and Assets Ltd. Tashluz Investments and Assets Ltd. is a private company owned approximately 26.3% by Carmi Dor Ltd. and approximately 15.4% by Ori Dori Ltd. Carmi Dor Ltd. and Ori Dori Ltd. are private companies wholly owned by Yitzchak (Tshuva) Sharon. On June 15, 2004, Delek Real Estate Ltd. acquired 25% of the issued and outstanding shares of Dankner Investments Ltd. Please see details above.

(3) Bank Leumi L Israel Ltd., or BLL, is one of the two largest commercial banks in Israel. The shares beneficially owned by BLL are held by various of its affiliated mutual funds and provident funds.

(4) Bank Hapoalim B.M., or Bank Hapoalim, is one of the two largest commercial banks in Israel. The shares beneficially owned by Bank Hapoalim are held by various of its affiliated mutual funds and provident funds.

(5) Ma'ariv Modi'in Publishing House Ltd. is a company fully owned by Ma'ariv Holdings Ltd. Dankner Investments Ltd. own approximately 3.24% of Ma'ariv Holdings Ltd. Approximately 61.73% of the issued share capital of Ma'ariv Holdings Ltd. is directly and indirectly owned by The Israel Land Development Company Ltd., or ILDC, a public company whose securities are traded on the Tel Aviv Stock Exchange. ILDC is directly and indirectly controlled by Mr. Jacob Nimrodi (68.08% in voting power and 36.16% in share capital). Mr. Ofer Nimrodi, Jacob Nimrodi's son, holds 6.65% of the voting power and 13.29% of the share capital of ILDC. Accordingly, Messrs. Jacob and Ofer Nimrodi could be deemed to be beneficial owners of our ordinary shares owned by Ma'ariv Modi'in Publishing House Ltd., but they each disclaim beneficial ownership of such shares. 27.19% of the issued share capital of Ma'ariv Holdings Ltd. is held by Mr. Vladimir Gusinsky. Our Cable Broadcast

Licenses include a comment stating that the Council has considered including a provision in these licenses, whereby Ma ariv Holdings Ltd. or its current controlling shareholder will cease to be the beneficial owner of 5% or more of our outstanding ordinary shares, due to certain convictions of Mr. Jacob Nimrodi for criminal offenses according to the Telecommunications Law, which are currently under appeal; however, due to the fact that the merger of the Israeli television operators has been approved by the Council and the Controller of Restrictive Business Practices, and to the Council's best knowledge, these operators intend to effect the merger, and since such a merger would nullify the necessity for such a provision, the Council decided to grant these licenses without, at such stage, including such a provision; in the event that the merger will not be consummated by February 28, 2003, or in the event that following the merger Ma ariv Holdings Ltd. will be an interested party of the merged entity, the Council will reconsider the integration of such a provision into our licenses. The Council approached us in this regard, following which there have been exchanges of correspondence between the Council and us. We have expressed our objection to including such a provision in our licenses, due to, among other things, the fact that we do not have the right or any other legal means to force a shareholder to sell its shares in Matav. Since Ma ariv holds only 5.06% of our outstanding shares, we believe that this issue is not material to us.

Mr. Hanania Gibstein ceased to be a 5% shareholder of Matav during 2003.

Our major shareholders do not have different voting rights.

Shareholders Agreements

On October 18, 1993, Dankner Investments Ltd., Mr. Hanania Gibstein, Hapoalim Electronic Communications Ltd., Ma ariv Electronic Communications, Shamrock Holdings of California Inc., Mr. Eli Cheifetz, Mr. Shimon Cheifetz and Dr. Zvi Dinstein entered into a shareholders agreement. In this agreement certain of our shareholders have agreed to vote their respective shares in a manner that would enable each of such shareholders to appoint a number of directors to our board of directors in proportion to each of such shareholder's holdings in our company as compared with the original holdings of all parties to this agreement. This agreement further grants each shareholder a right of first refusal to acquire the shares of a shareholder who offers his shares to a third party or a shareholder who offers more than 15% of his cumulative shareholdings (as of the date of our initial public offering) in a transaction through the Tel Aviv Stock Exchange. This agreement remains in force as to a party so long as such party holds at least 25% of the number of shares in our company held by such shareholder immediately prior to our initial public offering. This agreement binds these shareholders as well as their assignees and transferees.

In July 1998, Dankner Investments Ltd. reached an agreement with Mr. Hanania Gibstein, Mr. Shimon Cheifetz and Mr. Eli Cheifetz according to which Mr. Gibstein and Messrs. Cheifetz agreed not to sell their shares in our company without the consent of Dankner Investments Ltd. and Dankner Investments Ltd. agreed not to sell its shares in our company without allowing Mr. Gibstein and Messrs. Cheifetz to take part in the sale and Mr. Gibstein and Messrs. Cheifetz agreed to join the sale of all or most of Dankner Investment's shares of our company. This agreement is subject to the Matav shareholders agreement described above.

In July 2002, the parties to the original shareholders agreement agreed to amend such agreement. Under the amendment, Ma ariv Electronic Communications ceased to be a party to the shareholders agreement and has no right or obligation in connection with such agreement or the amendment. In addition, pursuant to the amendment, if Messrs. Cheifetz shall not have a right to nominate a director to our board of directors, on account of the number of original shares held by them, then the parties shall act to nominate a director to our board of directors designated by Messrs. Cheifetz, provided that the number of original shares held by Messrs. Cheifetz shall be at least 60% of the number of original shares required in order to have a right to nominate one director to our board of directors. Dankner Investments Ltd. shall not be obligated to act according to the above, if as a result the number of directors nominated by Dankner Investments Ltd. shall not constitute the majority of our directors (the director designated by Messrs. Cheifetz shall not be considered a director nominated by Dankner Investments Ltd.).

In February 2004, Danker Investments Ltd. completed a transaction with Delek Investments and Assets Ltd., pursuant to which Delek Investments and Assets Ltd. purchased from Dankner Investments Ltd. 17.99% of our outstanding ordinary shares. At the time of the transaction's completion, Dankner Investments Ltd. waived certain of its rights under the original shareholders agreement. In February 2004, Dankner Investments Ltd. sent Mr. Hanania Gibstein, Mr. Shimon Cheifetz and Mr. Eli Cheifetz a twelve months prior notice of termination of the agreement that was entered into between them in July 1998. Accordingly, this agreement will cease to be in effect on February 15, 2005.

Significant Changes in the Ownership of Major Shareholders

Set forth below is a list of significant changes in the ownership of major shareholders for the years ended 2001, 2002 and 2003, as applicable.

Transactions by Dankner Investments Ltd.

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1. On January 1, 2001, Dankner Investments Ltd. acquired 8,276 ordinary shares on the Tel Aviv Stock Exchange at a price per share of NIS 66.99 and at an aggregate price of NIS 554,409.
2. On January 7, 2001, Dankner Investments Ltd. acquired 5,805 ordinary shares on the Tel Aviv Stock Exchange at a price per share of NIS 65.79 and at an aggregate price of NIS 381,911.
3. On January 8, 2001, Dankner Investments Ltd. acquired 23,200 ordinary shares on the Tel Aviv Stock Exchange at a price per share of NIS 65.86 and at an aggregate price of NIS 1,527,952.
4. On January 9, 2001, Dankner Investments Ltd. acquired 13,059 ordinary shares on the Tel Aviv Stock Exchange at a price per share of NIS 65.58 and at an aggregate price of NIS 856,409.
5. On January 11, 2001, Dankner Investments Ltd. acquired 3,886 ordinary shares on the Tel Aviv Stock Exchange at a price per share of NIS 64