Cellcom Israel Ltd.
Form 20-F
March 02, 2010

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20–F

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

OR

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

For the fiscal year ended December 31, 2009

OR

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

For the transition period from _________________ to _________________

OR

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

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

Commission file number 001-33271

CELLCOM ISRAEL LTD.

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

ISRAEL

(Jurisdiction of incorporation or organization)

10 Hagavish Street, Netanya 42140, Israel

(Address of principal executive offices)

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

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

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

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

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

None

(Title of Class)

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

None

(Title of Class)

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

As of December 31, 2009, the Registrant had outstanding 98,895,729 Ordinary Shares, par value NIS 0.01 per share.

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

If this report is an annual or transition report, indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

[ ] Yes [X] No

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

Indicate by check mark whether the Registrant (1) has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files)

[ ] Yes [ ] No

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

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

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

U.S. GAAP [ ]

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

Other [ ]

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

Item 17 [ ]

Item 18 [ ]

If this is an annual report, indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

[ ] Yes [X] No

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INTRODUCTION

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

Presentation of Financial and Share Information

We prepare our consolidated financial statements in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board ("IASB"). Until and including our financial statements for the year ended December 31, 2007, we prepared our consolidated financial statements in accordance with Israeli GAAP. Following the Company's adoption of IFRS, as issued by the IASB, the Company is no longer required to reconcile its financial statements prepared in accordance with IFRS to U.S. GAAP.
Unless we indicate otherwise, U.S. dollar translations of the NIS amounts presented in this annual report are translated for the convenience of the reader using the rate of NIS 3.775 to $1.00, the representative rate of exchange as of December 31, 2009 as published by the Bank of Israel.

Trademarks

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

Industry and Market Data

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

Special Note Regarding Forward-Looking Statements

We have made statements under the captions “Item 3.D - Risk Factors,” “Item 4 – Information on the Company,” “Item 5 - Operating and Financial Review and Prospects,” and in other sections of this annual report that are forward-looking statements. In some cases, you can identify these statements by forward-looking words such as “may,” “might,” “will,” “should,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “predict,” “potential” or “continue,” the negative of these tern comparable terminology. These forward-looking statements, which are subject to risks, uncertainties and assumptions about us, may include projections of our future financial performance, our anticipated growth strategies and anticipated trends in our business. These statements are only predictions based on our current expectations and projections about future events. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the results, level of activity, performance or achievements expressed or implied by the forward-looking statements, including those factors discussed under the caption entitled “Item 3.D - Risk Factors.” You should specifically consider the numerous risks outlined under “Item 3.D - Risk Factors.”

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

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA

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

The selected data presented below under the captions “Income Statement Data,” and “Balance Sheet Data” for, and as of the end of, each of the years in the five-year period ended December 31, 2009, are derived from the consolidated financial statements of Cellcom Israel Ltd. and subsidiaries, which financial statements have been audited by Somekh Chaikin, an independent registered public accounting firm and a member firm of KPMG International. The consolidated financial statements as of December 31, 2009, 2008 and 2007, and for each of the years in the three-year period ended December 31, 2009, and the report thereon, are included elsewhere in this annual report. The selected data should be read in conjunction with the consolidated financial statements, the related notes, and the independent registered public accounting firm’s report and the convenience translation of the consolidated financial statements as of and for the year ended December 31, 2009 into US dollars solely for the convenience of the reader.

The figures for the years 2005 and 2006 have been restated to give retroactive effect to the initial implementation of the new Israeli Accounting Standard No. 27, "Property, plant and equipment", which came into effect on January 1, 2007. See note 2.U.2. to our consolidated financial statements for the year ended December 31, 2007 (included in our annual report on Form 20-F for the year ended December 31, 2007).

The figures for the years 2007 and 2008 have been adjusted to give the retrospective application effect of the change in our accounting policy with respect to subscriber acquisition and retention costs, applied in June 2009, retrospectively from January 1, 2007. See "Item 5. Operating and Financial Review and Prospects – A. Operating Results – Overview – Change in Accounting Policy Regarding Subscriber Acquisition and Retention Costs". Also see note 2.H to our consolidated financial statements for the year ended December 31, 2009 included elsewhere in this annual report.

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

The selected information also includes certain items for the years 2005 and 2006 in accordance with U.S. GAAP. Israeli GAAP differs in certain significant respects from U.S. GAAP. For a summary of certain significant differences, see note 28 to our consolidated financial statements for the year ended December 31, 2007 (included in our annual report on Form 20-F for the year ended December 31, 2007).

For your convenience, the following tables also contain U.S. dollar translations of the NIS amounts presented at December 31, 2009, translated using the rate of NIS 3.775 to $1.00, the representative rate of exchange on December 31, 2009 as published by the Bank of Israel.

	Year Ended December 31,	
	2005	2006
	(In NIS millions, except per share data)	
Income Statement Data:		
In accordance with Israeli GAAP		
Revenues	5,114	5,622
Cost of revenues	* 3,081	* 3,273
Selling and marketing expenses	623	656
General and administrative expenses	656	659
Other (income) expenses, net	* 13	* 6
Operating income	741	1,028
Financing income (expense), net	24	(155)
Income tax	* 234	* 314
Net income	531	559
Basic earnings per share	* 5.44	* 5.73
Diluted earnings per share	* 5.44	* 5.73
Weighted average ordinary shares used in calculation of basic earnings per share	97,500,000	97,500,000
Weighted average ordinary shares used in calculation of diluted earnings per share	97,500,000	97,500,000
U.S. GAAP Data(1):		
Net income	491	494
Basic earnings per share	5.04	5.07
Diluted earnings per share	5.04	5.07
Other Data:		

EBITDA(2)	1,643	1,864
Capital expenditures	747	521
Dividends declared per share	34.87	4.41
Net cash provided (used) by operating activities	1,272	1,477
Net cash provided (used) in investing activities	(619)	(633)
Net cash provided (used) by financing activities	1,114	(2,560)
Subscribers (in thousands) (3)	2,603	2,884
Period churn rate(4)	15.0%	16.8%
ARPU (in NIS)(5)	151	149

* Restated due to initial implementation of a new Israeli Accounting Standard No. 27 commencing January 1, 2007.

	Year Ended December 31, 2007*	2008*	2009	2009 (In US$ millions)
	(In NIS millions, except per share data)			
Income Statement Data:				
In accordance with IFRS				
Revenues	6,050	6,417	6,483	1,717
Cost of revenues	3,315	3,396	3,333	883
Selling and marketing expenses	685	701	716	189
General and administrative expenses	653	659	660	175
Other (income) expenses, net	3	(29)	6	2
Operating income	1,394	1,690	1,768	468
Financing income (expense), net	(147)	(310)	(219)	(58)
Income tax	328	391	367	97
Net income	919	989	1,182	313
Basic earnings per share	9.42	10.12	12.01	3.18
Diluted earnings per share	9.34	9.96	11.90	3.15
Weighted average ordinary shares used in calculation of basic earnings per share	97,500,000	97,721,339	98,432,757	
Weighted average ordinary shares used in calculation of diluted earnings per share	98,441,260	99,279,924	99,306,714	
Other Data:				
EBITDA(2)	2,187	2,482	2,529	670
Capital expenditures	651	633	663	176
Dividends declared per share	13.90	11.23	11.91	3.15
Net cash provided (used) by operating activities	1,820	1,763	2,088	553
Net cash provided (used) in investing activities	(560)	(546)	(782)	(207)
Net cash provided (used) by financing activities	(405)	(1,853)	(678)	(180)
Subscribers (in thousands) (3)	3,073	3,187	3,292	
Period churn rate(4)	16.3%	18.9%	19.6%	
ARPU (in NIS)(5)	150	149	144	38

* Retrospective application due to accounting policy change in 2009 regarding Subscriber Acquisition and Retention Costs.

	As at December 31, 2005	2006
	(In NIS millions)	
Balance Sheet Data:		
In accordance with Israeli GAAP		
Cash	1,772	56
Working capital	1,909	237
Total assets	* 7,361	* 5,323
Shareholders' equity	* 3,897	* 597
U.S. GAAP Data(2):		
Total assets	11,100	8,998
Shareholders' equity	4,490	4,134

* Restated due to initial implementation of a new Israeli Accounting Standard No. 27 commencing January 1, 2007.

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	As at December 31,			
	2007*	2008*	2009	2009
	(In NIS millions)			(In US$ millions)
Balance Sheet Data:				
In accordance with IFRS				
Cash	911	275	903	239
Working capital	716	461	1,254	332
Total assets	6,294	5,488	6,379	1,690
Shareholders' equity	881	390	374	99

* Retrospective application due to accounting policy change in 2009 regarding Subscriber Acquisition and Retention Costs.

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(1) Following the Company's adoption of IFRS, as issued by the IASB, the Company is no longer required to reconcile its financial statements prepared in accordance with IFRS to U.S. GAAP. Therefore, certain items in accordance with U.S. GAAP are presented only for the years 2005 and 2006. Under U.S. GAAP, DIC's acquisition of our shares in 2005 is treated as a purchase that requires a revaluation of our assets and liabilities, leading to increased amortization expense of intangible assets, offset by decreased depreciation expense of tangible assets under U.S. GAAP. In addition, we were required to push down certain DIC debt and the interest expense relating to such debt incurred to finance the acquisition until it was repaid in early 2006, leading to increased financial expense under U.S. GAAP.

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

The following is a reconciliation of net income to EBITDA:

	Year Ended December 31,	
	2005	2006
	(In NIS millions)	
In accordance with Israeli GAAP		
Net income	531	559
Financing expense (income), net	(24)	155
Other expenses (income), net	13	6
Income taxes	234	314
Depreciation and amortization	889	830

EBITDA			1,643	1,864

	Year Ended December 31			
	2007*	2008*	2009	2009
	(In NIS millions)			(In US$ millions)
In accordance with IFRS				
Net income	919	989	1,182	313
Financing expense (income), net	147	310	219	58
Other expenses (income), net	3	(29)	6	2
Income taxes	328	391	367	97
Depreciation and amortization	790	821	755	200
EBITDA	2,187	2,482	2,529	670

* Retrospective application due to accounting policy change regarding Subscriber Acquisition and Retention Costs.

(3) Subscriber data refer to active subscribers. Until June 30, 2006, we had a three-month method of calculating our subscriber base, which means that we deducted subscribers from our subscriber base after three months of no revenue generation or activity on our network by or in relation to both our post-paid and pre-paid subscribers. Commencing July 1, 2006, we adopted a six-month method of calculating our subscriber base, since many subscribers that were inactive for three months become active again before the end of six months. We have not restated our prior subscriber data presented in this table to reflect this change. The six-month method is, to the best of our knowledge, consistent with the methodology used by other cellular providers in Israel. This change in methodology resulted in an increase of our number of reported subscribers by approximately 80,000 compared to the prior methodology and affected our other key performance indicators accordingly.

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

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

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

	Year Ended December 31,					
	2005	2006	2007	2008	2009	2009
	(In NIS millions, except number of subscribers and months)					(In US$ millions)
Revenues	5,114	5,622	6,050	6,417	6,483	1,717
less revenues from equipment sales	565	636	635	745	751	199
less other revenues*	38	61	93	135	162	43
Revenues used in ARPU calculation (in NIS millions)	4,511	4,925	5,322	5,537	5,570	1,475
Average number of subscribers	2,489,453	2,757,133	2,955,855	3,105,022	3,215,492	3,215,492
Months during period	12	12	12	12	12	12
ARPU (in NIS, per month)**	151	149	150	149	144	38

* Other revenues include revenues from repair services, transmission services and landline services.

** ARPU for 2006 was restated to reflect the full impact of the change in the methodology of calculating our subscriber base implemented in July 2006, to allow comparison with 2007. If our methodology of calculating our subscriber base had not changed in July 2006, ARPU for the year ended December 31, 2006 and for the year ended December 31, 2007 would have been NIS 153, for the year ended December 31, 2008 would have been NIS 152 and for the year ended December 31, 2009 would have been NIS 148.

Exchange Rate Information

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

Month	High (NIS)	Low (NIS)
September 2009	3.807	3.729
October 2009	3.780	3.690
November 2009	3.826	3.741
December 2009	3.815	3.772
January 2010	3.765	3.667
February 2010	3.796	3.704

On February 26, 2010 the daily representative rate of exchange between the NIS and U.S. dollar as published by the Bank of Israel was NIS 3.796 to $1.00.

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

Year	Average (NIS)
2005	4.503
2006	4.442
2007	4.085
2008	3.568
2009	3.927

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

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

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

Risks Related to our Business

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

A substantial part of our operations is subject to the Israeli Communications Law, 1982, the Israeli Wireless Telegraph Ordinance (New Version), 1972, the regulations promulgated thereunder and the license for the provision of cellular services that we received from the Ministry of Communications in accordance with the Communications Law. The interpretation and implementation of the Communications Law, Wireless Telegraph Ordinance and regulations and the provisions of our general license, as well as our other licenses, are not certain and disagreements have arisen and may arise in the future between the Ministry of Communications and us. The Communications Law and regulations thereunder grant the Ministry of Communications extensive regulatory and supervisory authority with regard to our activities, as well as the authority to impose substantial sanctions in the event of a breach of our licenses or the applicable laws and regulations. In the event that we materially violate the terms of our licenses, the Ministry of Communications has the authority to revoke them.

Our general license is valid until February 2022. It may be extended for additional six-year periods upon our request to the Ministry of Communications and confirmation from the Ministry of Communications that we have complied with the provisions of our license and the applicable law, have continuously invested in the improvement of our service and network and have demonstrated the ability to do so in the future. Our other licenses are also limited in time. However, our licenses may not be extended when necessary, or, if extended, the extensions may be granted on terms that are not favorable to us. In addition, the Ministry of Communications has modified and may modify our licenses without our consent and in a manner that could limit our freedom to conduct our business.

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

- further reduce interconnect tariffs, as the gradual reduction of interconnect tariffs from March 2005 to March 2008, which was imposed by the Ministry of Communications, led to a decrease in our revenues and any additional reduction, if decided upon, is expected to have an additional adverse effect on our results of operations, the extent of which will depend on the level of reduction and our ability to compensate for lost revenues. The Ministry of Communications is examining interconnect fees and is expected to conduct a hearing on the matter in the near future. Further, following the recent Ministry of Communications decision to change the pricing mechanism of cellular originated international calls, effective July 30, 2010, whereby the cellular operator will be entitled only to interconnect fees, any reduction of interconnect tariffs would effect our revenues from cellular originated international calls as well. See "Item 4. Information on the Company – B. Business Overview – Government Regulations – Tariff Supervision" for additional details.

- reduce other tariffs, including roaming tariffs, or otherwise intervene in the pricing policies for our products and services, including by requiring us to offer a "limited credit" service to our post-paid customers. See "Item 4. Information on the Company – B. Business Overview – Government Regulations – Tariff Supervision" for additional details;

- increase the number of competitors in the cellular market, including by awarding cellular licenses to additional UMTS operators and Mirs with certain benefits and leniencies not available to existing cellular operators, providing mobile virtual network operators, or MVNO, licenses, WiMAX licenses and/or licenses for the use of our network by competing technologies, such as Voice Over Broadband over cellular, or VOBoC; limit our ability to compete, including by limiting our ability to develop our network, by preferring new and/or small competitors in the allocation of new frequencies, including those designated to the 4th generation of cellular services. See "Item 4. Information on the Company – B. Business Overview" under "Competition" and under "Government Regulations – Mobile Virtual Network Operator" for additional details ;

- impose new safety or health-related requirements;

- impose additional restrictions or requirements with respect to the construction and operation of cell sites;

- impose restrictions on the provision of content and data services, including by preventing differentiation among the services provided, based on usage;
- impose restrictions on the provision of services or products we currently provide or regulate or otherwise intervene with the terms under which we provide them to our subscribers;
- impose restrictions on the provision of cellular internet services, including by preventing cellular operators from providing ISP services and mobile internet access as a bundle;
- limit or otherwise intervene with the services or products that we may sell;
- set higher service standards; or
- impose additional restrictions or requirements on the usage, operation or maintenance of databases or a stricter policy with respect to privacy protection.

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

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

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

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

We have experienced difficulties in obtaining some of these consents and permits, particularly in obtaining building permits for cell sites from local planning and building authorities. As of December 31, 2009, we operated a small portion of our cell sites without building permits or applicable exemptions. Although we are in the process of seeking to obtain building permits or to modify our cell sites in order to satisfy applicable exemptions, we may not be able to obtain all the necessary permits or make the necessary modifications.

Approximately 29% of our cell sites operate without building permits in reliance on an exemption from the requirement to obtain a building permit, mainly for radio access devices. Our reliance on the exemption for radio access devices had been challenged by local planning and building authorities in the courts. and in May 2008 the District Court of Tel-Aviv-Jaffa, in its capacity as court of appeals, ruled that our and other cellular operators' devices do not meet the exemption's requirements and therefore the exemption may not be relied upon by us and by other cellular operators. We and other cellular operators appealed against this ruling to the Supreme Court. Additionally, in November 2008, the District Court of Central Region, in its capacity as court of appeals, ruled that the exemption does not apply to radio access devices, if the rooftop on which those devices are located is at the same level as a residence or other building that is regularly frequented by people. The exemption is also the subject of two petitions filed with the Supreme Court.

In September 2009, the Attorney General concluded that the current application of the exemption does not balance properly the different interests involved and therefore cannot continue unchanged. The Attorney General further concluded that, in accordance with its authority under applicable law, the Israeli Ministry of Interior Affairs (in consultation with the Ministry of Communications) should prepare regulations setting conditions for the application of the exemption, such as limiting the exemption to extraordinary circumstances, and bring such regulations for approval by the Economy Committee of the Israeli Parliament by the end of October 2009. Conditions substantially limiting our ability to use the exemption could adversely affect our existing network and network build-out. In January 2010, the Attorney General advised the Supreme Court that the regulations are expected to be brought before the Economy Committee of the Israeli Parliament by the end of February 2010 and that in case the government fails to do so by such date, the Attorney General will not object to the grant of an interim order preventing the construction of cellular radio access devices without a building permit. To the best of our knowledge, to date, no such regulations were brought before the Economy Committee of the Israeli Parliament.

Other appeals relating to the exemption, including as to the requirement to obtain an extraordinary usage permit, are still under consideration in the District Court and other similar challenges, as well as other claims asserting that those cell sites and other facilities do not meet other legal requirements continue. Further, in July 2008 and again in July 2009, an amendment to the Communications Law proposing to annul the exemption passed the preliminary phase of enactment in the Israeli parliament. An annulment or substantial limitation of the exemption could adversely affect our existing network and network build-out, particularly given the objection of some local planning and building authorities to grant due permits where required. See "Item 4. Information on the Company – B. Business Overview - Government Regulations— Permits for Cell Site Construction" for additional details regarding the exemption.

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

Operation of a cell site or other facility without a building permit or not in accordance with the permit or other legal requirements may result in the issuance of a demolition order for the cell site or other facility or the bringing of criminal charges against us and our officers and directors. Certain of our cell sites have been subject to demolition orders. In addition, criminal charges have been brought against us and our officers and directors in connection with cell sites that were alleged to have been constructed or used without the required permits or not in accordance with the permits granted. As of December 31, 2009, 22 criminal and administrative proceedings are outstanding; a demolition order has been granted with respect to two cell sites while the remaining 20 proceedings are pending further litigation.

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

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

An amendment is being prepared to the Non-Ionizing Radiation Regulations published in December 2008, which may include additional restrictions in relation to the operation of cell sites and other facilities (including maximum levels of exposure to non ionizing radiation). If restrictions similar to those included in a previous draft are subsequently adopted, they will, among other things, limit our ability to construct new cell sites(and if applied to existing cell sites, it will also limit our ability to renew operating permits for a number of our existing cell sites), especially in residential areas. See “Item 4. Information on the Company – B. Business Overview - Government Regulations— Permits for Cell Site Construction" for additional details regarding a petition on the matter as well as a proposed amendment to the Non-Ionizing Radiation Law, aiming to cancel the requirement to obtain the Minister of Communications' approval to the Non-Ionizing Radiation Regulations, where such regulations may have a substantial and direct effect on the monetary burden imposed on the communication market.

The Israeli National Zoning Plan 36, or the Plan, which regulates cell site construction and operation is in the process of being changed. Current proposed changes impose additional restrictions and requirements on the construction and operation of cell sites and will, if approved by the Israeli National Council for Planning and Building and thereafter by the Government of Israel, harm our ability to construct new cell sites, make the process of obtaining building permits for the construction and operation of cell sites more cumbersome and costly, could adversely affect our existing network and may delay the future deployment of our network. The National Council is expected to deliberate on the subject in the first half of 2010.

Several local planning and building authorities are claiming that Israeli cellular operators may not receive building permits, in reliance on the current National Zoning Plan 36, for cell sites operating in frequencies not specifically detailed in the frequencies charts attached to the Plan. In a number of cases, these authorities have refused to provide a building permit for such new cell sites, arguing that the Plan does not apply to such cell sites and that building permits for such cell sites should be sought through other processes (which are longer and cumbersome), such as an application for extraordinary usage or under existing local specific zoning plans. Since June 2002, following the approval of the Plan, building permits for our cell sites (where required) have been issued in reliance on the Plan. The current proposed draft amendment to the Plan covers all new cell sites requiring a building permit, independently of the frequencies in which they operate. Most of our cell sites and many cell sites operated by other operators operate in frequencies not specifically detailed in the Plan.

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

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

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

In January 2006, the law was amended to require an applicant, as a precondition to obtaining a cell site construction permit from a planning and building committee, to provide a letter to the committee indemnifying it for possible depreciation claims. As of December 31, 2009, we have provided approximately 289 indemnification letters to local planning and building committees. Calls upon our indemnification letters may have a material adverse effect on our financial condition and results of operations. We may also decide to demolish or relocate existing cell sites to less favorable alternatives and to construct new cell sites in alternative, less suitable locations or not at all, due to the obligation to provide indemnification. As a result, our existing service may be impaired or the expansion of our network coverage could be limited.

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

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

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

Handsets, accessories and various types of cell sites are known to be sources of non-ionizing radiation emissions and are the subject of a public debate in Israel. While, to the best of our knowledge, the handsets that we market comply with the applicable legislation that relate to acceptable “specific absorption rate,” or SAR, levels, we rely on the SAR levels published by the manufacturers of these handsets and do not perform independent inspections of the SAR levels of these handsets. As the manufacturers’ approvals refer to a prototype handset, we have no information as to the actual level of SAR of the handsets throughout the lifecycle of the handsets, including in the case of handset repair. See also “Item 4. Information on the Company – B. Business Overview - Government Regulations - Handsets”. Recommendations by the Israeli Ministry of Health published in July 2008, to take precautionary measures when using cellular handsets, have increased the concerns of the Israeli public. The Ministry of Health indicated that although the findings of the international study on whether cellular phone usage increases the risk of developing certain tumors were not yet finalized, partial results of several of the studies were published, and while these studies did not demonstrate a connection between cellular phone exposure and tumor growth, a relationship between prolonged cellular phone usage and tumor development was observed in some of these studies. This publication and other media reports have resulted in the introduction of several bills, aimed at increasing awareness of the possible risks of cellular phones usage and reducing usage thereof, mainly by young people. These bills await deliberation by the Israeli Parliament.

Concerns regarding cell sites have already caused us difficulties in obtaining permits for cell site construction and obtaining or renewing leases for cell sites and even resulted in unlawful sabotage of a small number of cell sites. In July 2009, the Ministries of Interior Affairs and Environmental Protection adopted a position (as part of the recommendations made by an inter-ministry committee established to examine the appropriateness of future application of the exemption from obtaining building permits for radio access devices) that, with respect to radiation safety, cell sites constructed pursuant to a building permit are preferable to radio access devices and that the utilizing a cellular network to provide advanced services which can be provided through a landline network, is unjustified in light of the preventive care principle set forth in the Israeli Non-Ionizing Radiation Law.

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

We face intense competition in all aspects of our business.

The Israeli cellular telephone market is highly competitive. We compete for subscribers with three other cellular operators. While we enjoy the largest market share, estimated to be 34.6% as of December 31, 2009, two of our competitors, Partner and Pelephone, enjoy estimated market shares of 32% and 28.9% respectively, with MIRS Motorola Communications Ltd., or MIRS, estimated to have a market share of 4.5%. The current competitive pressure in the Israeli market results primarily from the highly penetrated state of the market. See also “Item 4. Information on the Company - B. Business Overview - The Telecommunications Industry in Israel”. This means that market growth is limited and cellular operators compete intensely to retain their own subscribers and attract those of their competitors. The competition in our market has further increased following the launch of Pelephone's UMTS/HSPA network in 2009. Further, competition changes as cellular operators enter into additional communication markets, such as broadband and landline telephony . Any of the following developments in our market or the implementation by the Ministry of Communications of the recommendations of a public committee appointed by it to review issues in the telecommunications market adopted by the Ministry of Communications (certain such recommendations were also adopted in the Israeli Government resolutions) in August 2008 (see "Item 4. Information on the Company – B. Business Overview – Competition.”), are expected to increase competition further and may result in an increased churn rate, increased subscriber acquisition and retention costs and ultimately reduced profitability for us:

- Pelephone’s offering of certain services jointly with its parent company, Bezeq, the incumbent landline operator; although Bezeq and Pelephone may not currently offer integrated or combined packages of cellular and landline telephone and other telecommunication services, the Ministry of Communications has stated that once Bezeq’s share of the Israeli landline telephone market falls below 85%, it would be permitted to offer certain services jointly with its subsidiaries, provided that a similar bundle is made available by a competitor of Bezeq (such as a landline and cellular bundle) and subject to each of the services in Bezeq's bundle being available for sale separately. In February 2010 the Ministry of Communications determined that Bezeq's market share as of December 2009 is 75.7% in the private sector and 83.9% in the business sector.

- the entry into the Israeli cellular market by additional operators or MVNOs, could increase competition and thus may have material adverse affect on our revenues. Regulations necessary for the issuance of an MVNO license, came into effect in January 2010, and entities wishing to obtain an MVNO license may now file an application for an MVNO license with the Ministry of Communications. Further, in October 2009, general principles for an additional UMTS spectrum tender, expected to be published during the first half of 2010, were published by the Ministry of Communications and the

Israeli Treasury Ministry joint tender committee. These principles include a regulatory change intended to alleviate entry barriers and shorten the time frame for countrywide cellular service provision by a new entrant or by an existing operator wishing to upgrade its network, by allowing national roaming or regulating compulsory site sharing; the Ministry of Communications is expected to conduct a hearing on those regulatory changes during 2010;. See "Item 4. Information on the Company – B. Business Overview" under "Competition" and under "Government Regulations – Mobile Virtual Network Operator" for additional details;

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

- new initiatives and combinations of services following the recent acquisitions in the Israeli communication market, as it will allow some of the players to offer quadruple and even quintuple service bundles to existing customers in each of their previously separated platforms as well to new customers, such as the Mirs – Hot combination, when the acquisition of Mirs is completed. For details see "Item 4. Information on The Company -Business Overview - The Telecommunications Industry in Israel - Cellular Services".

- the launch of a UMTS network by Mirs as it would strengthen Mirs's ability to compete in the provision of inbound and outbound roaming services as well as improve its competitive position in the market; under the general principles for an additional UMTS spectrum tender, Mirs will be the only existing cellular operator allowed to participate in the tender;

- a proposed amendment to the Israeli Restrictive Trade Practices Law, 1988, including: (1) giving the Director General of the Israeli Antitrust Authority the power to determine that certain entities in a specific market act as oligopoly, based on the existence of conditions for effective competition (or lack thereof) in the relevant market rather than on the actual lack (or low level) of competition; (2) giving the Director General of the Antitrust Authority the power to distinguish between an oligopoly and a monopoly allowing the Director General to give instructions to all or some of the participants of an oligopolic market, in order, among others, to maintain or increase the competition level among the participants, including the authority to issue orders to remove or to ease entry or transfer barriers, to cease a participant's activity, or otherwise regulate the activities of such oligopoly. If the Director General decides that the Israeli cellular market is oligopolistic, the Director General may take measures which could limit our freedom to manage our business, increase the competitive pressures that we face and adversely affect our results of operations;

- the entry into the cellular market of mobile WiMAX technology (by a new entrant) or landline WiMAX technology (as it will enlarge coverage by cordless landline networks); the Ministry of Communications published a WiMAX policy on March 1, 2009 and is expected to publish a landline WiMAX frequencies tender in 2010;and
- the entry into the communications market of operators of competing technologies, which may be granted a license to use the cellular networks, such as VOBoC; To date, the Ministry of Communications has granted three trial licenses for VOBoC and demanded cellular operators to provide the VOBoC customers with service equal to the operator's own data customers, following which it is expected to conduct a hearing regarding VOBoC policy and licenses.

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

In order to attract and retain the maximum number of subscribers in our highly competitive market, we design specific calling plans to suit the preferences of various subscriber groups. We require sophisticated information systems to record accurately subscriber usage pursuant to the particular terms of each subscriber's plan as well as accurate database management and operation of a very large number of calling plans. From time to time, we have detected some discrepancies between certain calling plans and the information processed by our internal information systems, such as applying an incorrect rebate or applying an incorrect tariff to a service resulting in a higher charge. We have invested substantial resources to refine and improve our information and control systems and ensure that our new calling plans are appropriately processed by our information systems; we have also taken steps to remedy the identified discrepancies and have established reserves where the discrepancies are quantifiable. Despite our substantial investments, we may experience discrepancies in the future due to the multiplicity of our plans and the scope of the processing tasks. Further, while we invest substantial efforts in monitoring our employees and third-party distributors and dealers that market our services, it is possible that some of our employees, distributors or dealers may offer terms and make (or fail to make) representations to existing and prospective subscribers that do not fully conform to applicable law, our license or the terms of our calling plans. As a result of these discrepancies, we may be subject to subscribers' claims, including class action claims, and substantial sanctions for breach of our license or the applicable laws and regulations that may materially adversely affect our results of operations.

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

We provide services to millions of subscribers on a daily basis. As a result of the scope and magnitude of our operations we are subject to the risk of a large number of lawsuits, including class action suits by consumers and consumer organizations, with respect to billing and other practices. These actions may be costly to defend and could result in significant judgments against us. The Israeli Class Actions Law, 2006 and the 2005 amendment to the Israeli Consumer Protection Law, 1981 include provisions that expand the causes of action for which a class of litigants may bring suit, including with regard to any damages allegedly incurred prior to the effective date of these laws, reducing the minimal requirements for certification of a class action lawsuit and reducing the qualifications required to be a lead plaintiff in a class action lawsuit. Following these changes, an increased number of requests to certify lawsuits as class actions were approved by Israeli courts. These laws have increased and may continue to increase the number of requests for certification of class actions against us, our legal exposure and our legal costs in defending against such suits, which as a result may materially and adversely affect our financial results. Other legislative amendments, such as the amendment to the Communications Law, regulating "spam" and other amendments to the Consumer Protection Law, also encourage the filing of lawsuits, including purported class actions, against us. Currently, we are engaged in a number of purported class action suits as a defendant, some of which are for substantial amounts. In 2009, two requests to certify lawsuits as class actions against us were approved and shall be tried as class actions. We have settled one and appealed the other. Should our appeal be rejected and the class action succeed or other requests to certify lawsuits against us as class actions are approved and succeed, this may have a material adverse affect on our financial results. For a summary of certain material legal proceedings against us, see “Item 8 – Financial Information - A. Consolidated Statements and Other Financial Information –Legal Proceedings”.

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

We may face claims of having been in violation of the law and our license requiring the implementation of number portability and the terms of our license governing the method of charging for SMS messages.

As a result of an amendment to the Communications Law in March 2005, cellular and landline telephone operators were required to implement number portability by September 1, 2006. Number portability permits subscribers to change to another network operator without having to change their telephone numbers. Despite efforts to introduce the requisite technology and coordinate the transition to number portability by September 1, 2006, no cellular or landline operator had implemented number portability by that date and. Number portability was implemented on December 2, 2007. See "Item 4. Information on the Company – B. Business Overview – Competition” for additional details.

In 2005, our license was amended to regulate charging for SMS messages sent outside our network, which, under one interpretation of the amendment, may lead to claims of our not being in compliance with our license. To date, we have fulfilled the license requirements, even under this potential interpretation, with respect to substantially all SMS messages sent to subscribers outside our network. However, due to technological difficulties which we and our competitors face and have not yet been resolved, we may face claims, if such interpretation of the amendment prevails, of having been late in implementing this amendment with respect to all such SMS messages. We had notified the Ministry of Communications of our technological inability to fully implement the amendment, if it is so interpreted. The Ministry of Communications had proposed an amendment to our license to resolve this problem, which we believe is unsatisfactory because it does not change the charging criteria but mainly proposes certain customer notification requirements. Until such time as the cellular operators develop the necessary interfaces or our license is amended, we may be exposed, if such an interpretation prevails, to substantial sanctions and legal claims.

We may be required to make substantial investments or cease offering certain products or services or change their terms to meet growing demand for data consumption

Experience in other developed countries has indicated that the growing demand for Internet, content and data through advanced third generation cellular phones, modems and other devices using cellular data (such as net books) results in a rapid growth of data traffic on cellular networks. Experts estimate that data traffic will grow even faster in the future and some operators have already taken steps aimed at reducing data usage by their subscribers, including by transferring traffic to non-cost alternative networks. Our strategy to grow and develop our Internet, content and data services has proven to be successful and contributed positively to our results of operations. Any unexpected growth in data consumption by our subscribers and/or regulatory changes (including with respect to the 'fair usage' principle in respect of Internet usage loads management to allow proper usage for all users, the construction and operation of our network or the allocation of additional spectrum) may require us to cease offering certain products and/or services we currently offer and/or change their terms and conditions and/or make substantial unplanned investments, which may have an adverse affect on our results of operations.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The cellular market is known for rapid and significant technological changes. Our current technologies, including our 3.5G technologies, may be overtaken rapidly, requiring us to invest in alternative technologies to remain competitive. Further, technologies such as wireless broadband access services such as WiMAX, Wi-Fi, VOB and other technologies that have the capacity to handle cellular calls or data transfer (such as VoBoC), may enter our market and compete with traditional cellular providers, thus further intensifying the competition we face and requiring us to reduce prices, thus adversely affecting our results of operations. The Ministry of Communications has granted trial licenses to certain entities to use cellular networks for the provision of VOBoC and is expected to publish a WiMAX frequencies tender in 2010, in which it is expected to allocate mobile WiMAX frequencies to a new operator, since the present cellular operators, including us, are not eligible to participate in that tender under the Ministry of Communications' policy.

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

We rely on agreements to provide roaming capability to our subscribers in many areas outside Israel. As of December 31, 2009, we had roaming arrangements with 552 cellular providers in 177 countries around the world. However, we cannot control the quality of the service that they provide and it may be inferior to the quality of service that we provide. Equally, our subscribers may not be able to use some of the advanced features that they enjoy when making calls on our network. Some of our competitors may be able to obtain lower roaming rates than we do because they may have larger call volumes. Competition is expected to intensify further, if Mirs begins providing roaming services as well. If our competitors' providers can deliver a higher quality or a more cost effective roaming service, then subscribers may migrate to those competitors and our results of operation could be adversely affected. Further, we may not be able to compel providers to participate in our technology migration and enhancement strategies. As a result, our ability to implement technological innovations could be adversely affected if these overseas providers are unable or unwilling to cooperate with the further development of our network or if they cease to provide services comparable to those we offer on our network.

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

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

As of December 31, 2009, our total indebtedness was approximately NIS 4,535 million ($1,201 million). The indentures governing our debentures currently permit us to incur additional indebtedness. Our substantial debt could adversely affect our financial condition by, among other things:

- increasing our vulnerability to adverse economic, industry or business conditions, including increases in the Israeli Consumer Prices Index, or CPI;
- limiting our flexibility in planning for, or reacting to, changes in our industry and the economy in general;

- requiring us to dedicate a substantial portion of our cash flow from operations to service our debt, thus reducing the funds available for operations and future business development; and

- limiting our ability to obtain additional financing to operate, develop and expand our business.

In February 2010, the Committee for Establishing Parameters for Institutional Bodies' Investments in Nongovernmental Bonds, nominated by the commissioner of Capital Markets, Insurance and Savings in the Ministry of Finance, published its recommendations for regulatory intervention of the commissioner as well as recommendations for Israeli institutional investors to follow, before investing in non-governmental debentures. If the committee's report recommendations are adopted, they may adversely affect our possibilities of raising debt from Israeli institutional investors as well as the terms and price of such debt raising. See “Item 5. Operating and Financial Review and Prospects. – B. Liquidity and Capital Resources” for additional details.

Our business results may be affected by continued recession

Most of our revenues are not guaranteed or prepaid and are usage dependant. In 2009 we experienced a substantial decline in our roaming services revenues due to a reduction in incoming and outgoing tourism due to the current global economic recession and also an increase in allowance for doubtful accounts which have been influenced by the global economic slowdown. For further details see "Item 5. Operating and Financial Review and Prospects – A. Operating Results – Results of Operations Comparison of 2007, 2008 and 2009 - Selling and marketing expenses and general and administrative expenses") If this recession continues or reoccurs, usage of our services decreases and we cannot otherwise compensate for lost revenues, it may have a material adverse effect on our results of operations, financial condition or prospects. If the number of customers that are unable to pay their bills increases or one or more of our larger business customers fails to pay the amount owed to us, it may materially increase our bad debts and have a material adverse effect on our results of operations and financial condition. Furthermore, the recession may adversely affect third parties we rely upon in the provision of our services, including interconnecting telecommunication providers, roaming partners and services and equipment providers. If those providers fail to provide reliable and consistent services and/or equipment to us on the requisite standards of quality and on a timely basis, our ability to provide services to our subscribers may be reduced in scope and/or in quality, until and inasmuch as an alternative provider can be found, and consequently our license may be at risk of revocation for failure to satisfy the required service standards. An alternative provider and/or solution, may involve additional expenses and/or investments on our part and/or may involve terms that are less favorable to us, including reduced revenues. In addition, if any damage is caused to us and/or we are found liable for damages caused to third parties by such service or equipment providers and such providers are unable to indemnify us for such damages, we may have to bear the cost of such damages, which may be substantial, and such outcome may adversely affect our financial condition.

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

A portion of our cash payments are incurred in, or linked to, foreign currencies, mainly US Dollars. In particular, in 2007, 2008 and 2009, payments in U.S. dollars or linked to the U.S. dollar represented approximately 33%, 33% and 36%, respectively, of total cash outflow (including payments of principal and interest on our debentures). These payments included capital expenditures, some of our operating lease payments, payments to equipment suppliers including handset suppliers and, in 2007 and in 2008, payments of principal and interest on our credit facility (voluntarily prepaid in full in March 2008). As almost all of our cash receipts are in NIS, any devaluation of the NIS against those foreign currencies in which we make payments, particularly the U.S. dollar, will increase the NIS cost of our foreign currency denominated or linked expenses and capital expenditures.

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

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

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

In February 2006, we adopted a dividend policy targeting a payout ratio of at least 75% of our net income in each calendar year, subject to any applicable law, our license and contractual obligations and provided that such distribution would not be detrimental to our cash needs or to any plans approved by our Board of Directors. In 2007, 2008 and 2009, our Board of Directors has declared dividends constituting as much as 95% or more of our net income and may declare dividends in similar rates in the future. See "Item 8. Financial Information - A. Consolidated Statements and Other Financial Information - Dividend Policy". Our license requires that we and our 10% or more shareholders maintain at least $200 million of combined shareholders' equity. Dividend payments are not guaranteed and our Board of Directors may decide, in its absolute discretion, at any time and for any reason, not to pay dividends or to pay dividends at a ratio to net income that is less than that paid in the past.

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

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

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

We depend upon a small number of suppliers to provide us with key equipment and services. For example, Nokia Siemens Israel provides our network system based on

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

We are a member of the IDB group of companies, one of Israel's largest business groups. This may limit our ability to expand our business, to acquire other businesses or to borrow money from Israeli banks.

We are an indirect subsidiary of IDB, one of Israel's largest business groups. Other indirect subsidiaries of IDB also operate in the Israeli communication market providing high speed Internet, international telephone services and wireline and landline communication services. As a result, conflicts of interest may arise between us and other IDB group companies. Due to the limited size of the Israeli market and due to the high level of regulation of the Israeli market, in particular in the communications market, our being a member of the IDB group of companies may limit our ability to expand our business in the future, to form joint ventures and strategic alliances and conduct other strategic transactions with other participants in the Israeli communications market.

In addition, pursuant to the "Guidelines for Sound Bank Administration" issued by the Israeli Supervisor of Banks, the amount that an Israeli bank may lend to one group of borrowers and to each of the six largest borrowers of such banking corporation is limited. Since we are a member of IDB's group of borrowers, these guidelines may limit the ability of Israeli banks to lend money to us.

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

As of December 31, 2009, DIC held, directly and indirectly, approximately 48.57% of our outstanding share capital. Pursuant to shareholders agreements among DIC and certain of our minority shareholders, who in the aggregate own approximately 3.45% of our ordinary shares, DIC has been granted the voting rights in respect of those shares. In addition to DIC's shareholdings and such additional voting rights, it has the right to appoint the 20% of our directors that we are required by our license and articles of association to have appointed by Israeli citizens and residents among our founding shareholders. Accordingly, subject to legal limitations, DIC has control over all matters requiring shareholder approval, including the election and removal of our directors and the approval of significant corporate transactions. This concentration of ownership could delay or prevent proxy contests, mergers, tender offers, open-market purchase programs or other purchases of our ordinary shares that might otherwise give our shareholders the opportunity to realize a premium over the then-prevailing market price for our ordinary shares.

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

Risks Relating to Operating in Israel

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

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

More generally, any armed conflicts, terrorist activities or political instability in the region would likely negatively affect business conditions and could harm our results of operations, including following termination of such conflicts, due to a decrease in the number of tourists visiting Israel.

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

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

The Communications Law grants the Prime Minister of Israel the authority, for reasons of state security or public welfare, to order a telecommunications license holder to provide services to security forces, to perform telecommunication activities or to establish a telecommunications facility as may be required for the security forces to carry out their duties. Further, the Israeli Equipment Registration and IDF Mobilization Law, 1987, also permits the registration of engineering equipment and facilities and the taking thereof for the use of the Israel Defense Forces. This law further sets the payment for use and compensation for damages caused to the operator as a result of such taking. Our general license also permits the Israeli Government, during national emergencies or for reasons of national security, to take all necessary actions in order to ensure state security, including taking control of our network, and requires us to cooperate with such actions. If national emergency situations arise in the future and if we are to be subject during such time to any of the foregoing actions, this could adversely affect our ability to operate our business and provide services during such national emergencies and adversely affect our business operations.

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

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

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

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

Risks Relating to Our Ordinary Shares

A substantial number of our ordinary shares could be sold into the public market, which could depress our share price.Our largest shareholder, DIC, holds approximately 48.57% of our outstanding ordinary shares, as of December 31, 2009. The market price of our ordinary shares could decline as a result of future sales into the market by DIC or other existing shareholders or the perception that these sales could occur. DIC sold 11,425,000 ordinary shares, or approximately 11.62% of our outstanding shares in a number of transactions outside the United States in 2007 and 2008. Sales may be made pursuant to a registration statement, filed with the U.S. Securities and Exchange Commission, or the SEC pursuant to the terms of a registration rights agreement or otherwise, or in reliance on an exemption from the registration requirements of the Securities Act, including the exemptions provided by Rule 144 or Regulation S. Any decline in our share price could also make it difficult for us to raise additional capital by selling shares.

In addition, as of December 31, 2009 we have 704,674 shares reserved for issuance upon the exercise of options; the options are subject to vesting schedules but vesting will be accelerated upon certain events including any sale by DIC that leads to DIC ceasing to control (as such term is defined in the Israeli Securities Law, 1968, namely the ability to direct our activities) us. See "Item 6. Directors, Senior Management and Employment – E. Share Ownership – 2006 Share Incentive Plan".

ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

Our History

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

We hold one of the four general licenses to provide cellular telephone services in Israel. Our cellular license was granted by the Ministry of Communications in 1994 and is valid until 2022.

Our principal founding shareholders were DIC, a subsidiary of IDB, which prior to September 2005 indirectly held approximately 25% of our share capital, and BellSouth Corporation and the Safra brothers of Brazil, which together indirectly held approximately 69.5% of our share capital and voting rights in respect of an additional 5.5% of our share capital. DIC acquired the stakes of BellSouth and the Safra brothers in September 2005 and, following the sale of minority stakes to four groups of investors in 2006, the sale of shares as part of our initial public offering in February 2007, subsequent sales of minority stakes in 2007 and 2008 and purchases of minority stakes from two of the original 1997 shareholders (the voting rights of which were held by DIC prior to the purchase) in 2009, DIC currently directly and indirectly holds approximately 48.57% of our share capital and the voting rights in respect of an additional approximately 3.45% of our share capital.

Following the acquisition by DIC in 2005, DIC put in place a new management team, including Ami Erel, the Chairman of our Board of Directors, who had previously been President and CEO of Bezeq, Amos Shapira, our Chief Executive Officer, who had been CEO of Kimberly-Clark's Israeli subsidiary and El Al Airlines, Tal Raz, our Chief Financial Officer until September 2009, who continues to serve as a director, and formerly had been one of the founders and a director of Partner, one of our principal competitors and Adi Cohen, our VP Marketing, who had been marketing manager of Shufersal, Israel's largest retail chain, and previously, Partner's marketing manager. While maintaining its focus on increasing efficiency, our management team has successfully implemented a series of initiatives to drive our growth, including the continued enhancement of our distinctive brand, a greater focus on customer service and new sales campaigns. These initiatives resulted in continuous growth in all operational and financial parameters and strengthening our position as the largest cellular operator in Israel.

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

As of the date of this Annual Report on Form 20-F, there has been no indication of any public takeover offer by any third party, respecting our ordinary shares, or by us, respecting another company's shares.

Principal Capital Expenditures

Our accrual capital expenditure in 2007, 2008 and 2009 amounted to NIS 651 million, NIS 633 million and NIS 663 million, respectively. Accrual capital expenditure is defined as investment in fixed assets and other assets, such as spectrum licenses, UMTS networks' enhancement and expansion and development of new products and services during a given period. The amounts of Capital expenditure have been adjusted to include capitalized subscriber acquisition and retention costs. For the periods under review, a key focus of our capital investment has been the enhancement and expansion of our networks and transmission infrastructure.

B. BUSINESS OVERVIEW

General

We are the leading provider of cellular communications services in Israel in terms of number of subscribers, revenues from services, EBITDA and EBITDA margin for the year ended December 31, 2009. Upon launch of our services in 1994, we offered significantly lower prices for cellular communications services than the incumbent provider and transformed the nature of cellular telephone usage in Israel, turning it into a mass market consumption item. We surpassed the incumbent cellular operator and became the market leader in terms of number of subscribers in 1998 and, despite the entry of two additional competitors, we have continued since then to have the highest number of subscribers. As of December 31, 2009, we provided services to approximately 3.292 million subscribers in Israel with an estimated market share of 34.6%. Our closest competitors have estimated market shares of 32% and 28.9%, respectively. In the year ended December 31, 2009, we generated revenues of NIS 6,483 million ($1,717 million), EBITDA of NIS 2,529 million ($670 million), and operating income of NIS 1,768 million ($468 million). See note 2 to the table in "Item 3. Key Information – A. Selected Financial Data" for a definition of EBITDA.

We offer a broad range of cellular services through our cellular networks covering substantially all of the populated territory of Israel. These services include basic and advanced cellular telephone services, text and multimedia messaging services and advanced cellular content and data services. We also offer international roaming services in 177 countries as of December 31, 2009. We offer our subscribers a wide selection of handsets from various leading global manufacturers, as well as extended warranty and repair and replacement services to most handsets we offer. We also offer landline transmission and data services to business customers and telecommunications operators and, since July 2006, we offer landline telephony services to selected businesses, using our advanced inland fiber-optic infrastructure.

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

	Year Ended December 31,				
	2005	2006	2007	2008	2009
Subscribers (end of period) (in thousands)(1)	2,603	2,884	3,073	3,187	3,292
Revenues (in NIS millions)	5,114	5,622	6,050	6,417	6,483

(1) Subscriber data refer to active subscribers. Until June 30, 2006, we had a three-month method of calculating our subscriber base, which means that we deduct subscribers from our subscriber base after three months of no revenue generation or activity on our network by or in relation to both the post-paid and pre-paid subscribers. Commencing July 1, 2006, we adopted a six-month method of calculating our subscriber base since many subscribers that were inactive for three months become active again before the end of six months. We have not restated our prior subscriber data presented in this table to reflect this change. The six-month method is, to the best of our knowledge, consistent with the methodology used by other cellular providers in Israel. This change in methodology resulted in an increase of our number of reported subscribers by approximately 80,000 compared to the prior methodology and affected our other key performance indicators accordingly.

The Telecommunications Industry in Israel

The following table sets forth selected macro statistics about Israel at and for the year ended December 31, 2009:

Population (millions, at end of year)	7.5
GDP ($ billions) (1)	192
GDP per capita ($ 000) (1)	26
Exports of goods & services ($ billions) (1)	67
CPI change	3. 9%
Long-term local currency sovereign credit rating by S&P	A(Stable)
Unemployment rate (yearly average)	7.7%

(1) for the 12 months ended September 30 2009, translated to USD based on the average representative rate of exchange for the 12 months ended September 30,2009.

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

The size of Israeli telecommunications services revenues in 2008 was approximately NIS 29 billion. Telecommunications services consist of several segments, which are highly competitive. Of the total telecommunications services revenues in 2008, approximately 55% was comprised of cellular services, approximately 24% was local landline voice and Internet access services, approximately 6% was international voice services, approximately 13% was multichannel television services, and approximately 2% was Network Termination Point. Cellular spending was approximately 2.1% of GDP, higher than in developed European economies and the United States.

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

In 2009, the Israeli telecommunications market underwent several ownership changes. See "Cellular Services" below for additional details.

Cellular Services

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

The Israeli cellular market is highly penetrated. The market reached an estimated penetration rate (the ratio of cellular subscribers to the Israeli population) at December 31, 2009, of approximately 127%, representing approximately 9.5 million cellular subscribers.

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

	December 31,				
	2005	2006	2007	2008	2009
Total subscribers (millions)	7.8	8.4	9.0	9.2	9.5
Cellular penetration (%)	112	118	124	124	127

Source: Reported by Cellcom, Partner and Pelephone (Pelephone's most updated report dates 3rd quarter 2009). Cellcom estimates for MIRS as MIRS does not disclose operating information.

There are currently four cellular operators in Israel: Cellcom, Partner, Pelephone, and MIRS. We estimate that the distribution of cellular subscribers among these operators as of December 31, 2009 was: Cellcom 34.6%, Partner 32%, Pelephone 28.9% and MIRS 4.5%. Subscriber data is based on public information as of December 30, 2009, excluding Pelephone's data which is as of September 30 2009 and except for MIRS, which is based on our estimate. However, there is no uniform method of counting subscribers.

We are controlled by DIC, a subsidiary of IDB, and started operations at the end of 1994. Until recently, Partner was majority-owned by Hutchinson Whampoa Ltd. and started operations in 1998. In October 2009, Scailex Corporation Ltd., or Scailex, an Israeli company listed on the TASE and indirectly controlled by Israeli businessman Mr. Ilan Ben-Dov, purchased the controlling stake in Partner. Scailex is also the official importer of Samsung cellular phones to Israel. Pelephone is a wholly-owned subsidiary of Bezeq and started operations in 1986. The major controlling shareholder of Bezeq following its privatization in 2005 is F.Sab.Ar Holdings Ltd. which is controlled by Saban Capital Group (controlled by the media entrepreneur Haim Saban), Apax Partners (the international private equity firm) and Arkin Communications (controlled by the Israeli businessman Mori Arkin). In October 2009, Bezeq announced that F.Sab.Ar Holdings Ltd. entered into an agreement for the sale of its holdings in Bezeq to 012 Smile Communication Ltd., or Smile. Smile is an Israeli company traded on the NASDAQ and the TASE and controlled by Internet Gold Golden Lines Ltd., or Internet Gold. Both Smile and Internet Gold form part of the Eurocom Communication Group, or Eurocom, which includes Eurocom Cellular Communication Ltd. - the official representative of Nokia cellular phones in Israel. The transaction is scheduled to be completed in April 2010. In January 2010, Ampal-American Israel Corporation, an Israeli company traded on the NASDAQ completed the purchase of Smile's on-going business,

through its indirect wholly owned subsidiary – 012 Smile Telecom Ltd, or Smile Telecom. MIRS, wholly owned by Motorola, had its license upgraded from push-to-talk to a cellular license in February 2001. To the best of our knowledge, in December 2009, Motorola has entered into an agreement for the sale of its holding in MIRS to the French businessman Mr. Patrick Derhy. Mr. Derhy has recently also purchased the controlling stake in HOT Telecom, or HOT, which provides multichannel pay-TV services and Internet, data and landline telephony services.

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

1986	Bezeq and Motorola create a joint venture called "Pelephone", which becomes Israel's first cellular operator. Pelephone launches N-AMPS services
1994	Cellcom awarded a license and launches TDMA services
1997	Cellcom introduces first pre-paid plan to the market
1998	Partner awarded a license and launches GSM services
1998	Pelephone launches CDMA services
2001	Ministry of Communications allocates additional 2G and 3G cellular frequencies for existing cellular operators and for the licensing of a new operator
2001	MIRS becomes Israel's fourth cellular operator with iDEN services
2002	Cellcom launches GSM/GPRS services
2003	Cellcom launches EDGE services
2004	Partner launches UMTS services Pelephone launches EVDO services
2006	Cellcom launches full scale UMTS/HSDPA services
2007	Partner launches HSDPA services
2008	Cellcom launches HSUPA services
2009	Pelephone launches UMTS/HSPA services

Key characteristics of the Israeli cellular services market

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

High cellular telephone penetration. The estimated penetration rate in Israel as of December 31, 2009 was 127%. Penetration rate is calculated by dividing the total number of subscribers by the Israeli population. The Israeli population does not include foreign workers and Palestinian subscribers who are included in the number of subscribers. The number of subscribers also includes subscribers with more than one subscription to a cellular network may also include subscribers to more than one network including those in the process of switching networks. As a result, the effective penetration rate after adjustment for these factors is likely to be lower than 127%.

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

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

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

Low average voice revenue per minute. Cellular operators in Israel have lower average voice revenues per minute than in most developed calling party pay economies. This is a consequence, among other things, of the importance given to low prices in the first five years of our operation, in the awarding criteria during the original licensing process for a second cellular operator, strong competition and a heavy regulated environment.

Different cellular technologies. We use TDMA, GSM/GPRS/EDGE and UMTS/HSPA networks. Partner uses GSM/GPRS and UMTS/HSDPA networks. Pelephone uses CDMA, CDMA1x, EVDO and UMTS/HSPA network. MIRS uses an iDEN network.

High potential for value-added services. The contribution of non-voice revenues to total revenues in the Israeli cellular market is below the level of developed markets such as the European Union. This characteristic is attributable in part to the low voice tariffs in Israel compared to the tariffs in other markets, which has the effect of keeping text messaging usage low and in part, due to late launch of advanced added value services in Israel. We believe that there is potential for narrowing this gap by increasing marketing efforts of new content services and the growth in our existing 3G subscriber base.

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

Low annual churn rates. The average annual churn rate in Israel in 2009 is estimated to be approximately 17-19%, which is lower than the churn rates in other developed economies. This churn rate reflects a slight increase in churn rate attributed to the implementation of number portability in December 2007 and the increased competition.

Landline Services

Voice Services

Bezeq operates approximately 2.5 million lines and provides local services. The second largest competitor in landline telephony services is HOT, a provider of cable TV services, which started landline operations in late 2003. HOT's network has been upgraded to offer Internet, data and voice services.

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

Three players entered this market in 2006, including us. Partner entered this market in 2007 (and further intensified its efforts at the end of 2008) and Bezeq International (VOB only) entered this market in 2009, bringing to a total of seven players.

Broadband and Internet services

Israeli broadband services are characterized by high growth and high penetration levels. The Ministry of Communications estimates that at the end of 2008, there were

approximately 1.7 million subscribers, and the household penetration rate was approximately 82%. The dominant landline broadband access technologies are ADSL and cable. ADSL services were launched by Bezeq in 2000 and currently represent a 58% share of broadband connections. Cable modems, which account for the rest of the market, have been available since 2002. We offer similar services using cellular modem and router as well as data communication services over broadband.

Transmission and landline data services are provided by Bezeq, HOT, Partner (who acquired Med-1's operation in 2006) and us. These services are provided to business customers and to telecommunications operators. Bezeq and Hot are in the process of upgrading their network into high speed NGN. In February 2010, the Ministry of Communications provided a trial license to the Israeli Electric Company, allowing it to use its fiber optic infrastructure to provide transmission services to other operators. Landline services are also provided by Internet Gold and 013 NetVision Ltd., or Netvision, (an indirect subsidiary of IDB).

Internet access is currently provided by three major Internet service providers, or ISPs: Netvision, Bezeq International, Smile Telecom, and some other niche players. All those major providers are also suppliers of international voice services. Partner entered this market in December 2008.

International voice services

International voice services in Israel have been open for competition since December 1996. Until then, Bezeq International, was the only supplier of such services. There are currently four players in this market. The three major players are: Bezeq International, Netvision and Smile Telecom. The fourth player is Xfone Communications. Today there is no single dominant player in this market, and competition is very intense.

Multichannel television

The multichannel pay-TV market is also highly penetrated with levels above those of most developed economies. Multichannel pay-TV services are provided by HOT and by YES, a subsidiary of Bezeq. Regulatory change allowing digital terrestrial television (DTT) broadcasting, with trial broadcasting implemented in August 2009 and expected to be commercially launched in 2010, may affect the level of competition in this market and attract additional players.

Competitive Strengths

We believe that the following competitive strengths will enable us to maintain and enhance our position as the leading provider of cellular communications services in Israel:

- Combination of leading market position and strong operational momentum. In 2009, we maintained our market-leading position, as reflected in our subscriber base, revenues from services, EBITDA and EBITDA margin growth, leveraging a series of brand, customer service and content initiatives, as well as -cost efficiencies initiatives regarding essential operational processes within our company.

- Strong and distinctive own brand. Our established brand enjoys strong recognition in Israel. We consider the enhancement of our image among consumers a top priority and continue to invest substantial resources to maintain Cellcom as a local cellular company with a warm personal touch. Our focus on music and music-related content services, which was broadened in 2009, to encompass versatile mobile media formats, such as music, games, video and data services under one marketing umbrella - "Cellcom Media", is our leading marketing theme, corresponding to our growing focus on content and data service growth .

- Transmission infrastructure and landline services. We have an advanced fiber-optic transmission infrastructure that consists of approximately 1,500 kilometers of inland fiber-optic cable, which, together with our complementary microwave-based infrastructure, connects the majority of our cell sites and provides for substantially all of our backhaul services. Our transmission infrastructure significantly reduces our operational reliance on Bezeq, the incumbent landline operator in Israel, while also saving us substantial infrastructure-leasing cash costs. As our transmission network has transmission and data capacity in excess of our own backhaul needs, and covers the majority of Israel’s business parks, we offer transmission and data services to business customers and telecommunications providers. In addition, since July 2006, following the receipt of a landline transmission, data and telephony services license, we offer landline telephony services and as of February 2008, additional advanced landline services through our NGN system, to selected landline business customers.

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

- Strong management team. Since DIC acquired control of us in September 2005, we have put in place a team of seasoned managers with significant experience and solid track records in previous managerial positions. Our Chairman, Mr. Ami Erel, is a veteran of the Israeli communications market and previously served as the chief executive officer of Bezeq. Our chief executive officer, Mr. Amos Shapira, has been chief executive officer of Kimberly-Clark’s Israeli subsidiary and of El Al Airlines, where he was credited with its successful restructuring and improvements in customer service. Our newly appointed chief financial officer, Mr. Heen, has held a variety of positions within our finance division, most recently as head of our economic department, responsible for our budget, financial analysis, cost accounting and control over our performance. Our VP Marketing, Mr. Adi Cohen had been marketing manager of Shufersal, Israel's largest retail chain, and previously, Partner's marketing manager. Under the leadership of Messrs. Erel, Shapira, Heen and Cohen, we have demonstrated significant improvements in our operating results and believe that we are well positioned to continue this trend and to execute our business strategy.

- Strong cash flow generation. We have a proven track record of strong financial performance and profitability with cash operating margins. As a result, we have been able to invest in our business and deploy advanced network technology so that we can offer advanced services and applications, as well as distribute dividends to our shareholders.

Business Strategy

Our goal is to strengthen our position as the leading cellular provider in Israel. The principal elements of our business strategy are:

- Focus on core business and synergetic complementary business. We remain focused on our primary source of business, mobile communications and value added services over our advanced cellular network, while continuing to develop new complementary business, which we identify to be both cost synergetic to our core business and provide direct contribution to our business, such as the landline services to the business community, provided over our fiber-optic cables and microwave links. We believe that our steadfast focus on our core competencies is one of the main factors for our market leading position and intend to identify and track opportunities as they arise, with a goal of continuing to generate long term growth.

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

- Grow and develop our Internet, content and data services. The usage of cellular content and data services in Israel is currently relatively low compared to western European countries, attributed to Israel launching 3G services two years after its European peers. We launched our UMTS network in 2006, over a year after our competitors. Since then we experienced a significant growth in content and value added services. . As of December 31, 2009 approximately 997,000 of our subscribers are 3G subscribers, mostly post paid. We believe that the "Open Garden" approach to content, offers significant growth potential for content and data revenues and are constantly looking out for new opportunities to maximize our advantages as an operator, and to maintain and further develop our share in the “Open Garden” content and data evolving market (for additional details regarding the “Open Garden” see “Item 4. Information on the Company – B. Business Overview" under "Competition”) .We intend to continue to invest in the improvement and upgrade of our high speed UMTS/HSPA network, mainly to enhance its capacity and increase its speed, in order to permit higher-quality and higher-speed multimedia content transmission.

We also plan to utilize our momentum in the arena of Israeli content to expand our content and data services, products and capabilities through in-house expertise and strategic relationships with leading cellular content providers, with special emphasis on original Israeli culture and usage enhancing content and applications in the cellular and complementary media. In 2009 we have launched our “Cellcom Media” initiative, following our “Cellcom Volume” music-related initiative, featuring, among other things, our cellular music store, original content including drama series and on-net-reality programs, video games, social networks applications, location based and other applications. The launch of "Cellcom Media" follows the success of our “Cellcom Volume” music-related initiative that contributed positively to our revenues, brand identity and popularity amongst users in general and youth in particular. We also continued marketing our data-enhancing products, including a cellular modem and a cellular router.

- Further develop and strengthen the Cellcom brand. External market surveys that we have commissioned indicate that brand recognition is an important factor in subscriber selection of, and loyalty to, a cellular operator. Due to our extensive efforts in the past few years, we believe that we have established the Cellcom brand as one of the most recognized and respected consumer brands in Israel. We plan to continually enhance our brand through maintaining our high network quality, the provision of innovative products and services, quality customer service and investments in advertising and promotional campaigns. We believe these enhancements are key to maintaining our competitive advantage, differentiating our services from those of our competitors and establishing and maintaining a successful relationship with our subscribers.

- Optimize our cost structure. We intend to continue our efforts to control costs so that we can improve profitability while also improving the quality of our services. In addition, having already built our own fiber-optic and microwave infrastructure, reduces our operating costs, as our network maintenance costs and microwave spectrum fees are lower than the lease costs to rent backhaul capacity from Bezeq. In 2009 we continued our focus on cost efficiencies and identifying further opportunities to manage our costs without reducing the quality of our service, such as introducing our new internet site, which provides a cost efficient alternative channel to the traditional customer care and sales channels, further reducing our reliance on Bezeq and continuing the change of handsets repair process.

- Capitalize on our existing infrastructure to selectively provide landline telephony services. Our approximately 1,500 kilometer inland fiber-optic network and our microwave infrastructure provide us with the ability to offer cost-efficient landline telecommunications solutions. We hold a license to operate a landline service in Israel and, since July 2006, we offer our landline telephony service to selected businesses. As of February 2008, we offer additional value added landline services to selected businesses, through our NGN system, such as toll free number dialing, call forward and fax to mail, IP CENTREX services, ADSL and Transmission internet connectivity services, which will enable us to penetrate the residential sector as well, should we choose to do so.

Services and Products

As of December 31, 2009, we provide cellular communications services to approximately 3.292 million subscribers, including basic cellular telephony services and value-added services as well as handset sales. We regularly evaluate, including through discussions with potential partners, ways to add additional communications and other services to our portfolio. Not all services are supported by all handsets or by all of our networks. In addition, we offer transmission and data services to business customers and telecommunications operators. Since July 2006, we have offered our landline telephony service to selected businesses.

We offer our cellular subscribers a variety of calling plans, designed to adapt to their particular characteristics and changing needs. We adapt our calling plans for the different types of usage – personal or business – and the number of users associated with the subscriber. For example, we offer discounted rates on the weekend for soldiers, Israeli music services to youth and discounted rates on calls among members of immediate families. We offer two methods of payment: pre-paid and post-paid. Pre-paid services are offered to subscribers who pay for our services prior to obtaining them, usually by purchasing our "Talkman" pre-paid cards or "virtual" Talkman cards. Post-paid services are offered to subscribers who are willing to pay for our services through banking and credit arrangements, such as credit cards and direct debits. Some of our post-paid subscribers are not under a commitment to purchase our services for a predefined period and some do not pay a monthly fee.

Basic cellular telephony services

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

- We also offer both an outbound roaming service to our subscribers when traveling outside of Israel and an inbound roaming to visitors to Israel who can "roam" into our network. Roaming allows cellular subscribers, while using their own cell phone number (and handset, in most cases) and being billed by their provider, to place and receive calls and text messages while in the coverage area of a network to which they do not subscribe. Where available, subscribers can also benefit from other cellular services such as advanced data and content services. As of December 31, 2009, we had commercial roaming relationships with 552 operators in 177 countries based on the standard agreements of the GSM organization (an umbrella organization in which all the cellular operators operating with GSM technology are members). This enables our subscribers to enjoy our services in almost the entire world. Most of our GSM subscribers who use these roaming services abroad can use their own handset and others can borrow or rent, depending upon the period of time, a suitable handset from us. In addition, as of December 31, 2009, we had 3G roaming arrangements with 171 of these operators, enabling our 3G roamers to participate in video calls and use high-speed data, video and audio content services in 79 countries.

Value-added services

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

Cellcom Media. This mobile content initiative, which expands our “Cellcom Volume” music-related marketing initiative onto additional content formats, is focused on providing a rich downloadable content consisting of music, games, on-net-reality programs, drama series, video games and other content services through our popular cellular music portal and Internet site, and also on promoting Israeli content and the use of the handset as a mobile media center.

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

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

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

Zone services. This service provides discounts on airtime for calls initiated from a specific location, such as a university campus. Our network identifies the location from which the call is initiated in order to apply the discounted rate on the call.

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

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

Data services - We offer our subscribers a variety of channels to facilitate their access to data services, including handsets (in supporting models), cellular modems and cellular routers. Usage of our cellular modem services increased substantially in 2009, following our marketing initiatives including an "unlimited surfing package". The cellular router enables the use of landline communication devices such as phones, faxes and computers, over the cellular network, in addition to our cellular communications services, thus providing a complete communication solution for private and small businesses customers.

We have established relationships with content providers to provide us content for our value-added services, including Logia Development and Content Management Ltd., or Logia, to manage and develop cellular content in Israel exclusively for us. Our agreement with Logia has a one-year term renewable annually and grants us an option to acquire 51% of Logia’s equity or 51% of Logia’s cellular content activity for us, at any time during the term of the agreement. Exercise of the equity option will be at a value to be set by an independent appraiser whereas exercise of the content option would be at no cost to us.

Handsets

We sell a wide selection of handsets designed to meet individual preferences. Prices of handsets vary based on handset features, calling plans and special promotions. In most cases, handsets are to be paid in 36 monthly installments. We offer a variety of handsets from world-leading brands such as Apple, LG, Motorola, Nokia, Samsung, Sony-Ericsson and RIM. The handset models we sell offer Hebrew language displays in addition to English, Arabic and Russian (in most of the models). We are also required to provide cellular phone services to subscribers who did not purchase their handsets from us, provided that the handset model has been approved for use by the Ministry of Communications. We offer our subscribers an extended handset warranty as well as repair and replacement services for most handsets, in approximately 31 walk-in centers. See also "Customer Care" below.

In 2009 we entered an agreement with Apple Sales International, for the purchase and distribution of iPhone handsets in Israel. Under the terms of the agreement, we committed to purchase a minimum quantity of handsets over a period of three years, which is expected to represent a significant portion of our expected handset purchase amount over that period. The total amount of the purchases will depend on the handsets purchase price at the time of purchase.

Landline services

In addition to our cellular services, we provide landline telephony, transmission and data services, using our approximately 1,500 kilometers of inland fiber-optic infrastructure and complementary microwave links. We have offered transmission and data services since 2001. We received a license to offer landline telephone service in April 2006 and, since July 2006, have been offering this service to selected businesses. Through our newly acquired NGN system, we were the first landline operator in Israel to provide advanced, voice and data services, to selected business customers, as of February 2008. Revenues from these services increased significantly in 2009 and we consider landline telephone services to be a substantial growth opportunity. In August 2008 the Ministry of Communications adopted the recommendation of a public committee regarding unbundling of Bezeq's network, which may facilitate our growth in this market but also the entry of additional competitors. In February 2010, a public committee was appointed to deliberate on Bezeq's tariffs for use of its network and interconnect tariffs to land line operators, among other issues related to the recommendation,. See “Item 4. Information on the Company – B. Business Overview – Competition.”

Network and Technology

General

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

Our “third generation” UMTS/HSPA, or high-speed downlink packet data access, technology, offers full interactive multimedia capabilities with current data rates of up to 7.2Mbps on the downlink path and up to 1.4 Mbps on the uplink path. We were the first operator in Israel to offer data transfer in the uplink path at such high speed. During 2010 we intend to further increase the downlink path speed up to 21 Mbps in selected urban areas. This network, considered to be a “3/3.5G” technology, is a network that uses the same core as our GSM/GPRS/EDGE network. Our UMTS/HSPA network covers substantially all of the populated territory in Israel. Moreover, our UMTS/HSPA network supports new types of services that require higher throughput and lower delay, such as video conferencing.

Our “second generation” GSM/GPRS/EDGE 1800MHz network allows for voice calls, data transmission and multimedia services, like video streaming and video live (using the EDGE technology), although at slower speeds than our UMTS/HSPA network. Our GSM/GPRS/EDGE technology is an advanced second-generation technology and considered to be a “2.75G” technology. It enables us to deliver multimedia and services at speed rates that are higher than the rates offered through regular “second generation” digital cellular technology. Packet data rates vary from 50 Kbps to 200 Kbps, depending mainly on handset capabilities. In addition, in the case of coverage gaps and for services supported by our GSM/GPRS/EDGE technology, the network provides an adequate fallback and capacity relief for our UMTS/HSPA network by means of smart features and network load sharing. Approximately 99% of our traffic uses our GSM/GPRS/EDGE and UMTS/HSPA networks, with substantially all of that traffic using the GSM/GPRS/EDGE network.

We also have a separate network using our initial TDMA 850MHz wireless technology, which is widely used as a “second generation” technology in North and South America. Approximately 1% of our traffic uses this network. This technology supports voice calls and low rate data services known as CSD (circuit switch data) and CDPD (cellular digital packet data). Our TDMA network, which is based on Nortel technology, is maintained and operated by our engineers and technicians. Operating costs for this network are low and we expect that it will not require additional capital expenditures.

Our transmission network is comprised of approximately 1,500 kilometers of inland advanced fiber-optic cables that, together with our microwave infrastructure, enable us to provide our customers with telephony and high speed and high quality transmission and data services. Our transmission network is strategically deployed in order to cover the major portion of Israel's business parks and permits us to provide our own backhaul services while reducing our need to lease capacity from Bezeq, the incumbent landline operator in Israel. Our NGN system by Nokia Siemens, allows the provision of advanced voice and data services to our landline customers.

Infrastructure

We have built an extensive, durable and advanced cellular network system, enabling us to offer high-quality services to substantially the entire Israeli populated territory. Since maintaining a high-quality network is a basic element in our business strategy, we seek to satisfy quality standards that are important to our subscribers, such as high voice quality, high data rate packet sessions, low "blocked call" rate (calls that fail because access to the network is not possible due to insufficient network resources), low "dropped call" rate (calls that are involuntarily terminated) and deep indoor coverage. As a result, we have made substantial capital expenditures and expect to continue to make capital expenditures on our network system. As of December 31, 2009, we had invested an aggregate of NIS 8.153 billion ($2.160 billion) on our network infrastructure since our inception in 1994.

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

We are currently selectively enhancing and expanding both our UMTS/HSPA network and our GSM/GPRS/EDGE network, primarily in urban areas, by adding infrastructure to improve outdoor and indoor coverage.

Our TDMA network, which is based on Nortel technology, is maintained and operated by our engineers and technicians.

Pursuant to the requirements of our license (as well as the licenses of the other telephony service providers in Israel), our network is interconnected, either directly or indirectly, to the networks of all other telephony service providers in Israel. Our network monitoring system provides around-the-clock surveillance of our entire network. The network operations center is equipped with sophisticated systems that constantly monitor the status of all switches and cell sites, identify failures and dispatch technicians to resolve problems. Operations support systems are utilized to monitor system quality and identify devices that fail to meet performance thresholds. These same platforms generate statistics on system performance such as dropped calls, blocked calls and handoff failures. Our network operations center is located in our Netanya headquarters. In addition, we have a partial duplicate backup center in Kiryat Gat, located approximately 80 kilometers south of Netanya. During 2010 and 2011 we intend to complete implementation of a full scale disaster recovery plan for all of our engineering systems.

Network design

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

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

Network performance

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

The two main indicators that we use to measure network performance for voice and packet data are the “blocked call” rate and the “dropped call” rate. Our levels of blocked and dropped calls are better than those required by our license and since we commenced operations we have steadily improved our rate of both blocked calls and dropped calls.

Spectrum allocation

Spectrum availability in Israel is limited and is allocated by the Ministry of Communications through a licensing process. We have been allocated 2x10 MHz in the 850 MHz frequency band used by our TDMA network and since 2008, 2x5 MHz of which are used by our UMTS/HSPA 850 MHz base stations, deployed for coverage improvement , and 2x17 MHz in the 1800 MHz frequency band used by our GSM/GPRS/EDGE network. In addition, the Ministry of Communications awarded us 2 x 10 MHz and 1 x 5 MHz in the 1900 - 2200 MHz frequency band for our UMTS third generation FDD and TDD spectrums, respectively. In December 2008, we returned the TDD spectrum to the Ministry of Communications, after not being able to use that spectrum since it was awarded to us in 2004, due to unavailability of supporting equipment. We believe that our available spectrum is sufficient for our current needs. However, in light of the growing demand for data consumption, we will likely be required to purchase additional spectrum in the future.

Cell site construction and licensing

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

Suppliers

We entered into an agreement with LM Ericsson Israel Ltd., or Ericsson Israel, in September 2005 for the purchase of UMTS radio access network and ancillary products and services. We committed to purchase maintenance services for five years from the launch of the system (until 2011). We have an option to purchase additional maintenance services on an annual basis for 20 years from the launch of the system (until 2026). We also agreed to purchase from Ericsson at least 60% of the 3G cell sites that we purchase by September 2010. Under the agreement, the parties generally have limited liability for direct damages of up to 40% of the value of the agreement.

We entered into an agreement with Nokia Israel Communications Ltd., or Nokia Israel, in July 2001 for the purchase of our GSM/GPRS system. We were also granted an option to purchase GSM 800, EDGE, UMTS and ancillary systems. In 2002, we exercised our option to purchase an EDGE system, and in 2005, we purchased a UMTS core system, under similar terms. Nokia Israel is obligated to offer us maintenance services for 15 years from final acceptance (until 2017). Under the agreement, the parties generally have limited liability for direct damages of up to 10% of the value of the agreement.

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

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

Transmission Network

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

Our optical transmission network is deployed from Nahariya in the north to Beer Sheva in the south and Afula and Jerusalem in the east, consisting of approximately 1,500 kilometers. The fiber-optic network reaches most of the business parks in the country and is monitored by a fault-management system that performs real-time monitoring in order to enable us to provide our subscribers with high quality service. In order to efficiently complete our transmission network's coverage to substantially the entire country, we use a microwave network as a complementary solution in those areas that are not served by our fiber-optic network. As of December 31, 2009, we had deployed approximately 2,700 microwave links to both our cell sites and subscribers.

To supplement our transmission network, we lease a limited amount of transmission capacity from Bezeq, the incumbent landline operator.

Information technology

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

We use Amdocs' customer care and billing system. We entered into our agreement with Amdocs (UK) Limited, or Amdocs UK, in February 1999 for the supply of a central computer system for customer care, billing and collection capable of generating customer profiles based on various usage patterns. This system is based on Amdocs UK's generic pricing system and is customized to our specific requirements. We own the intellectual property rights for the customized developments. We currently purchase maintenance services for the generic system from Amdocs UK and ongoing support services from its affiliate, Amdocs (Israel) Limited. Amdocs (UK) is obligated to offer us maintenance services until May 2011. Under the agreement, the parties' current liability for direct damages is generally limited to $500,000.

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

Our customer care system presents our customer care employees with a display of a subscriber's profile based on various usage patterns. This enables us to provide a service based upon information for that particular subscriber.

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

Sales and Marketing

Sales

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

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

We operate directly, using our sales force and service personnel, in approximately 30 physical points of sale and service, mostly located in shopping centers and other frequently visited locations to provide our subscribers with easy and convenient access to our products and services. We record approximately 250,000 subscriber applications per month in our direct points of sale and service.

We also distribute our products and services indirectly through a chain of dozens of dealers who operate in approximately 120points of sale throughout Israel. Our dealers are compensated for each sale based on qualitative and quantitative measures. We closely monitor the quality of service provided to our subscribers by our dealers. In our efforts to penetrate certain sectors of our potential subscriber base, we select dealers with proven expertise in marketing to such sectors.

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

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

Account managers. Our direct sales force for our business customers maintains regular, personal contact with our large accounts, focusing on sales, customer retention and tailor-made solutions for the specific needs of such customers, including advanced data services.

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

Marketing

Our marketing activities are based on the principle of focusing on subscribers' characteristics and needs and then adapting the service packages and prices that we offer to subscribers based on these characteristics and needs.

From surveys that we conduct from time to time, we learn that subscribers base their choice of cellular provider primarily on the following parameters: general brand perception; perceived price of services and handsets; level of customer service; and selection of handsets and their compatibility with their needs. Our marketing activities take into consideration these parameters and we invest efforts to preserve our subscriber base, enhance usage and attract new subscribers. We utilize a system that allows the management of complex one-to-one marketing campaigns, such as tailoring our marketing activities to customers based on their unique profile of needs and usage patterns, thus improving customer loyalty and increasing ARPU.

Our marketing strategy is focused on our role as facilitators of interpersonal communication and our ability to foster relationships between people, as well as a general spirit of youthful exuberance and the strong local roots of our brand. We launched a highly successful branding campaign at the end of 2004 and continue to follow this marketing strategy. Our marketing strategy also emphasizes our leadership, dynamic nature and personal touch, the quality of our network and services and our innovation.

In recruiting new subscribers, we are focused on current and potential high value customers, such as students, and subscribers who influence family and business purchasing decisions, such as senior executives. We leverage our extensive interactions with our customers, which we estimate to be approximately 650,000 unique customer applications per month, to provide the requested services and also to cross- and up-sell products and services according to customer needs and usage trends, mostly by using advanced CRM models, to increase customer satisfaction, loyalty and revenues. In addition, we offer loyalty rewards, such as video subscriptions and tickets to concerts, performances and movies, from time to time.

We regularly advertise in all forms of media, in promotional campaigns and in the sponsorship of major entertainment events. Our marketing and branding campaign has been very successful and highly acclaimed among the Israeli public, and our “Cellcom Media” initiative in particular has provided us with a high visibility association with mobile content services.

We believe that our strong brand recognition gives us the high level of market exposure required to help us achieve our business objectives.

Customer Care

Our customer service unit is our main channel for preserving the long-term relationship with our subscribers. We focus on customer retention through the provision of quality service and customer care. In order to achieve this goal, we systematically monitor and analyze our subscribers’ preferences, characteristics and trends by developing and analyzing sophisticated databases. We then adopt services that are aimed to respond to subscribers’ needs and preferences. In addition, subscribers are encouraged to subscribe to additional value-added services, such as cellular Internet and content services, in order to enhance customer satisfaction and increase ARPU. We continually strive to improve our service to our customers. Our customer care representatives receive extensive training before they begin providing service and thereafter regularly undergo training and review of their performance. We continuously invest in improving our training process. We provide our customer care representatives with a continually updated database, thus shortening the interaction time required to satisfy the customer’s needs and preventing human errors and closely monitor the service provided by them, in order to assure its quality. We constantly review our performance by reviewing customers applications and conducting surveys among our subscribers in order to ensure their satisfaction with our services and to improve them as necessary. In addition, we constantly apply preventive and preemptive measures aimed at reducing churn, which has somewhat increased, in line with other countries experience, following number portability application in December 2007 and increased competition in the cellular market. In 2009, the Israeli "Public Trust" organization report stated that we provide the best quality of customer care in the Israeli cellular market and that we received the lowest number of customer complaints although we have the highest number of subscribers in the Israeli cellular market. The 2009 Israeli Consumers Council, the largest consumers organization in Israel, report, published in January 2010, stated that although the number of cellular customer complaints increased substantially, our number of customer complaints was the lowest.

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

Call centers. In order to provide quick and efficient responses to the different needs of our various subscribers, our call-center services are divided into several sub-centers: general services; finance; network; international roaming; and data transfer. The call center services are provided in four languages: Hebrew, Arabic, English and Russian. We regularly monitor the performance of our call centers. We currently operate call centers in twelve locations throughout Israel, two of which are outsourced. On average, we respond to 1 million calls every month. During peak hours our call centers have the capability to respond to 800 customer calls simultaneously.

Walk-in centers. As of December 31, 2009, we independently operated approximately 30 service and sales centers with approximately 110 additional sale and service points operated by our dealers, covering almost all the populated areas of Israel. These centers provide a walk-in contact channel and offer the entire spectrum of products and services that we provide to our subscribers and potential subscribers (the majority of which are provided in our dealers' sale and service points as well), including handsets and accessories sales, upgrades and other services, such as finance, calling-plan changes and subscriptions to new services. These stores are mostly located in central locations, such as popular shopping malls. Our walk-in centers also provide our subscribers with repair services, performed by highly skilled technicians. In 2008 we introduced several efficiency measures to our repair services process (and continued rolling out these measures during 2009), aimed at improving its quality and reducing its costs, primarily given the higher costs of repairing 3G handsets which are more complex and expensive. The measures included repair by advanced regional labs instead of the on-site labs and allowed concentration of the technical services in specialist teams and management of the related inventory in fewer locations. Consequently, as of December 31, 2009, approximately 70% of our centers were converted to offer a 48 hours repair service, while our other centers offer onsite express repair services where the subscriber deposits a handset with our repair lab and receives the repaired handset, on average, within one hour. We intend to continue extending these measures to other centers. Our subscribers may borrow a substitute handset, free of charge, in order to continue to enjoy our cellular phone services as their handset is being repaired.

Self-services. We provide our subscribers and potential subscribers with various self-service channels, such as interactive voice response, or IVR, web-based services and service using SMS. These channels provide general and specific information, including calling plans, account balance, billing-related information and roaming tariffs. They also provide subscribers information regarding trouble shooting and handset-operation, and enable subscribers to activate and deactivate services and to download content. In 2009 we launched our new and improved website, which also includes information on our various services, products, the monthly statement etc. Our new website further includes three additional designated service sites: in Arabic, in Russian and a site for our business customers.

Our business sales force and back office personnel also provide customer care to our business customers. We offer our business customers repair services by a dispatch service collecting and returning the repaired handset within 48 hours, during which time, the customer is provided with a substitute handset, free of charge.

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

Be'eri Printers provides our printing supplies and invoices as well as the distribution, packaging and delivery of invoices and other mail to the postal service distribution centers. We entered into an agreement with Be'eri Printers - Limited Partnership and with Be'eri Technologies (1977) Ltd., or together Be'eri, for printing services in August 2003. Under the terms of the agreement, we committed to purchase from Be'eri a minimum monthly quantity of production and distribution services which may be reduced if we modify our printed invoice delivery policy. The agreement is valid until December 2010.

Competition

There is substantial competition in all aspects of the cellular communications market in Israel and we expect this to continue in the future due to the highly penetrated state of our market and the expected entry of additional competitors. We compete for market and revenue share with three other cellular communication operators: Partner ; Pelephone, which is a wholly-owned subsidiary of the incumbent landline provider, Bezeq; and MIRS.. For recent acquisitions in the Israeli communication market See "Item 4. Information on The Company - Business Overview - The Telecommunications Industry in Israel - Cellular Services".

Our estimated market share based on number of subscribers was approximately 34.6% as of December 31, 2009. To our knowledge, the market shares at such time of Partner, Pelephone (assuming no material changes in the fourth quarter, since Pelephone did not yet publish its year-end figures) and MIRS were estimated to be approximately 32%, 28.9% and 4.5%, respectively. Since MIRS does not publish data on its number of subscribers, estimates of its market share are based on surveys.

The competition in our market has further increased following the launch of Pelephone's UMTS/HSPA network in 2009. Competition may intensify further following the recent acquisitions in the Israeli communications market which may lead to new initiatives and combinations of services. New communication groups, such as the Mirs – Hot group, if and when Mirs' acquisition is completed, will allow some of the players to offer quadruple and even quintuple service bundles to existing customers in each of their previously separated platforms as well as new customers, and as for the Mirs – Hot combination, more so once (and if) Mirs upgrades its network to UMTS. The Mirs upgrade and/ or the entry of additional cellular operators and - subject to the design and grant of an appropriate form of license by the regulator, and agreement with cellular providers – MVNOs, into the market, will further intensify competition in the market. We may also face competition in the future from other providers of voice and data communications, including service providers that may offer WiMAX, WiFi and/or VOBoC.

We believe that the principal competitive factors include general brand perception, perceived price, customer service and handset selection. In addition, content, data and other value-added services constitute a potential growth engine for increasing revenues from subscribers and are also an important factor in selecting a cellular provider.

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

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

- marketing and branding campaigns aimed at enhancing market leadership, perceived value, brand recognition and loyalty among our existing and potential subscriber base;
- investing significant resources in improving customer service and retention, as well as supporting information technology systems;
- introducing innovative value-added services and identifying popular niches among various subscriber groups;
- investing in improving our network technology to ensure our ability to offer quality services and advanced services, both cellular and landline services;
- using innovative sales campaigns for attracting new subscribers by offering subsidies on handsets to new subscribers ; and
- offering attractive calling plans to subscribers, adapted to their needs and preferences;
- identifying new opportunities to maximize our advantages as an operator, in order to expand our share in the "Open Garden" market place.

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

In August 2008, the Ministry of Communications adopted the majority of the recommendations published in March 2008 by a public committee appointed by the Ministry of Communications to review various issues in the Israeli communications market. The recommendations adopted include recommendations: to accelerate the procedures necessary to allow the entry of MVNOs and additional infrastructure based operators to the cellular market; to publish a WiMAX frequencies tender for cellular use; to examine interconnect fees and further revise them accordingly, during 2009; to negotiate a reduction of inbound and outbound roaming tariffs with the European Union and/or members of the European Union and/or countries frequently visited by Israelis; to regulate charges for cellular-originated international calls; and unbundling of Bezeq's network to be followed by alleviating some of the restrictions with respect to offering integrated packages of services currently imposed on Bezeq and its subsidiaries. Also, in August 2008, the Israeli Government adopted resolutions in line with the recommendations concerning MVNO, roaming tariffs and interconnect fees, as well as a resolution directing the Ministry of Communication to examine ways to encourage the entry into the cellular market of additional operators, including by providing certain relieves and incentives. In October 2009, the Ministry of Communications published the general principles for an additional UMTS spectrum tender, expected to be published in 2010, as decided upon by the tender committee, comprising of Ministry of Communications and Ministry of Finance representatives. According to the principles published, which the Ministry of Communications noted may still change, the tender will include additional UMTS spectrum for two additional UMTS operators; participation will be allowed for new operators and MIRS; and the winners shall be awarded certain benefits and leniencies (not available to other existing operators, such as us) such as discounts in spectrum fees and a five year exemption from royalties payment, rebates on spectrum allocation fees and license fees; additional means to facilitate their entry are under consideration, such as regulatory change allowing national roaming and/or regulating compulsory cell site sharing. The Ministry of Communications is expected to conduct a hearing on these regulatory changes in the near future. The implementation of the recommendations adopted is expected to further increase competition in the market and could adversely influence our results of operations. Following the change to cellular originated international calls charging mechanism and the entry of MVNO operators, including International Landline Operators, or ILDs, to the cellular market, the Ministry of Communications is expected to change current regulation to allow cellular operators to hold ILDs. Such change will allow us to pursue a business combination with Netvision, an IDB affiliate, if we so agree with Netvision and subject to, among others, the requisite regulatory and corporate approvals. For developments regarding MVNO see "Government Regulation – Mobile Virtual Network Operator"; For developments regarding interconnect fees and regulating charges for cellular originated international calls see "Government Regulation – Tariff Supervision".

Intellectual Property

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

We have registered approximately 20 domain names and approximately 120 trademarks and several trade names, the most important of which are the star design, “Cellcom”, “Talkman” and “Cellcom Volume”. We are also the proprietor of a few registered patents and patent applications.

Government Regulations

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

General

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

Our Principal License

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

We provide our cellular services under a non-exclusive general license granted to us by the Ministry of Communications in June 1994, which requires us to provide cellular services in the State of Israel to anyone wishing to subscribe. The license expires on January 31, 2022, but may be extended by the Ministry of Communications for successive periods of six years, provided that we have complied with the license and applicable law, have continuously invested in the improvement of our service and network and have demonstrated the ability to continue to do so in the future. The main provisions of the license are as follows:

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

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

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

- We, our office holders or interested parties may not be parties to any arrangement whatsoever with Bezeq or another cellular operator that is intended or is likely to restrict or harm competition in the field of cellular services, cellular handsets or other cellular services. For the purpose of the license, an "interested party" is defined as a 5% or greater holder of any means of control;

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

- During the entire period of operation under the license, we are required to have agreements with a manufacturer of cellular network equipment which must include, among other things, a know-how agreement and an agreement guaranteeing the supply of spare parts for our network equipment for a period of at least seven years;

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

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

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

- The license requires us to maintain a minimum standard of customer service, including, among other things, establishing call centers and service centers, maintaining a certain service level of our network, collecting payments pursuant to a certain procedure, protecting the privacy of subscribers and obtaining an explicit request from our subscribers to provide services, whether by us or by third parties, as a precondition to providing and charging for such services;

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

- We are required to obtain insurance coverage for our cellular activities. In addition, the license imposes statutory liability for any loss or damage caused to a third party as a result of establishing, sustaining, maintaining or operating our cellular network. We have further undertaken to indemnify the State of Israel for any monetary obligation imposed on the State of Israel in the event of such loss or damage. For the purpose of guaranteeing our obligations under the license, we have deposited a bank guarantee in the amount of $10 million with the Ministry of Communications, which may be forfeited in the event that we violate the terms of our license.

In 2005, our license was amended to regulate charging for SMS messages sent outside our network, which, under a certain interpretation of the amendment, may lead to claims of our not being in compliance with our license. To date, we have fulfilled the license requirements with respect to substantially all SMS messages sent outside out network. However, due to technological difficulties which have not yet been resolved, we may face claims, if such interpretation of the amendment prevails, of having been late in implementing this amendment with respect to all such SMS messages. We had notified the Ministry of Communications of our technological inability to fully implement the amendment, in light of this interpretation. The Ministry of Communications had proposed an amendment to our license to resolve this problem, which we believe is unsatisfactory.

In the event that we violate the terms of our license, we may be subject to substantial penalties, including monetary sanctions. In 2007, the Communications Law was amended to include an increase in the financial sanctions that may be imposed on us by the Ministry of Communications for a breach of our licenses. Following the increase, the maximum amount per violation that may be imposed is NIS 1.4 million plus 0.25% of our annual revenue for the preceding year. An additional sanction amounting to 2% of the original sanction may be imposed for each day that the violation continues. In addition, the Ministry of Communications may determine certain service-related terms in our license as “service terms”; the maximum monetary sanctions per violation of a “service term” shall be double the amount of any other monetary sanction set in our license for such a violation per each period of 30 days or portion thereof during which the violation continues.

Other Licenses

Special general license for the provision of landline communication services

In April 2006, Cellcom Fixed Line Communications L.P., or Cellcom Fixed Line, a limited partnership wholly-owned by us, was granted a non-exclusive special general license for the provision of landline telephone communication services. The license expires in 2026 but may be extended by the Ministry of Communications for successive periods of 10 years. We began providing landline telephone services in July 2006, concentrating on offering landline telephone services to selected businesses. The partnership deposited a bank guarantee in the amount of NIS 10 million with the Ministry of Communications upon receiving the license. The provisions of our general license described above, including as to its extension, generally apply to this license, subject to certain modifications. It should be noted that in addition to any 10% share transfer requiring the prior approval of the Ministry of Communications as noted in our general license, the special general license additionally requires prior approval for acquiring the ability to effect a significant influence over us. In this context, holding 25% of our means of control is presumed to confer significant influence.

In December 2007 this license was amended to include the provision of voice services over the internet broadband infrastructure of other operators (VOB), as well. This amendment will enable us to penetrate the residential sector as well, should we choose to do so.

Data and transmission license

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

Cellular services in Judea and Samaria

The Israeli Civil Administration in Judea and Samaria granted us a non-exclusive license for the provision of cellular services to the Israeli-populated areas in Judea and Samaria. This license is effective until December 31, 2011. The provisions of the general license described above, including as to its extension, generally apply to this license, subject to certain modifications.

Internet Service Provider license

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

Tariff Supervision

Under the Israeli Communications Regulations (Telecommunications and Broadcasting) (Payment for Interconnecting), 2000, interconnect tariffs among landline operators, international call operators and cellular operators are subject to regulation and have been gradually decreased. The current maximum tariffs are in effect as of March 1, 2008, except for the maximum interconnect tariff payable by a cellular operator for sending an SMS message to another cellular network, which is in effect as of March 2006.

Following the Israeli Government resolutions adopted in August 2008 to examine and revise interconnect fees, the Ministry of Communications is examining interconnect fees to cellular operators and is expected to conduct a hearing on the matter in the near future, after it receives the recommendations of an international consulting company appointed for that purpose by the Ministry of Communications. A public committee is expected to review interconnect tariffs to land line operators, among other issues relating to the land line market, during 2010.

The gradual reduction of interconnect tariffs from March 2005 to March 2008 by the Ministry of Communications, led to a decrease in our revenues. Any additional reduction, if decided upon, is expected to have an additional adverse effect on our results of operations, the materiality of which will depend on the level of reduction and our ability to compensate for lost revenues. Further, following the recent Ministry of Communications decision to change the pricing mechanism of cellular-originated international calls, effective June 30, 2010, to be priced by the ILD operator, whereby the cellular operator will be entitled only to interconnect fees, any reduction of interconnect tariffs could have an adverse effect on our revenues from cellular originated-international calls as well.

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

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

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

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

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

In January 2010, the Ministry of Communications issued a request for information, in order to evaluate the implications of requiring cellular, landline and ILD operators, to offer "limited credit" services to their post-paid customers. In February 2010, a proposed amendment to the Communications Law, requiring cellular operators to provide such "limited credit" services, passed the preliminary phase of enactment in the Israeli parliament. If this requirement is implemented, we will be required to limit post-paid customers usage of our services to their choice of "credit limit" which may adversely affect our revenues and will require us, among others, to make substantial investments in the adaptations of our IT systems, including our billing system.

Permits for Cell Site Construction

General

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

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

- building permits from the local planning and building committee or the local licensing authority (if no exemption is available);

- approvals for construction and operation from the Commissioner of Environmental Radiation of the Ministry of Environmental Protection;

- permits from the Civil Aviation Authority (in most cases);

- permits from the Israel Defense Forces (in certain cases); and
- other specific permits necessary where applicable, such as for cell sites on water towers or agricultural land.

In February 2010, the Israeli Ministry of Interior published a memorandum of a new Planning and Building bill, intended to replace the existing Planning and Building law. If the bill would be enacted, it may have an effect, among others, on current permits for our cell sites, the procedures to receive building permits for our cell sites and the scope of our indemnification obligations. In this preliminary stage, we cannot estimate what are the chances of its enactment and what would be its effects, if so enacted, on our network and network build-out.

National Zoning Plan 36

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

National Zoning Plan 36 sets forth the considerations that the planning and building authorities should take into account when issuing building permits for cell sites. These considerations include the satisfaction of safety standards meant to protect the public's health from non-ionizing radiation emitting from cell sites, minimizing damage to the landscape and examining the effects of cell sites on their physical surroundings. National Zoning Plan 36 also determines instances in which building and planning committees are obligated to inform the public of requests for building permits prior to their issuance, so that they may submit objections to the construction of a site in accordance with the provisions of the Planning and Building Law.

See "Item 4. Information on the Company – B. Business Overview - Government Regulations - Site licensing" below for arguments against the application of National Zoning Plan 36 to certain cell sites.

However, National Zoning Plan 36 is in the process of being revised. Current proposed changes will impose additional restrictions and/or requirements on the construction and operation of cell sites and will, if approved by the National Council for Planning and Building and thereafter by the Government of Israel, harm our ability to construct new cell sites, make the process of obtaining building permits for the construction and operation of cell sites more cumbersome and costly, could adversely affect our existing network and may delay the future deployment of our network. The National Council is expected to deliberate on the subject in the first half of 2010.

Site licensing

We have experienced difficulties in obtaining some of the permits and consents required for the construction of cell sites, especially from local planning and building authorities. The construction of a cell site without a building permit (or applicable exemption) constitutes a violation of the Planning and Building Law. Violations of the Planning and Building Law are criminal in nature. The Planning and Building Law contains enforcement provisions to ensure the removal of unlawful sites. There have been instances in which we received demolition orders or in which we and certain of our directors, officers and employees faced criminal charges in connection with cell sites constructed and/or used without the relevant permits or not in accordance with the permits. In most of these cases, we were successful in preventing or delaying the demolition of these sites, through arrangements with the local municipalities or planning and building authorities for obtaining the permit, or in other cases, by relocating to alternate sites. As of December 31, 2009, we were subject to 22 criminal and administrative legal proceedings alleging that some of our cell sites were built and/or have been used without the relevant permits or not in accordance with the permits. As of the same date, a small portion of our cell sites operated without building permits or applicable exemptions. Although we are in the process of seeking to obtain building permits or modify our cell sites in order to satisfy applicable exemptions for a portion of these sites, we may not be able to obtain or modify them and in several instances we may be required to relocate these sites to alternative locations or to demolish them without any suitable alternative. In addition, we may be operating a significant number of our cell sites, in a manner which is not fully compatible with the building permits issued for them, although they are covered by permits from the Ministry of Environmental Protection in respect of their radiation level. In some cases we will be required to relocate these cell sites to alternative locations, to reduce capacity coverage or to demolish them without any suitable alternative.

Based on advice received from our legal advisors and consistent with most Court rulings on the matter and the Israeli Attorney General opinion on the matter (given in May 2008) that the exemption does apply to cellular radio access devices, we have not requested building permits under the Planning and Building Law for rooftop radio access devices. The Israeli Attorney General further recommended that an inter-ministry committee be established to examine the appropriateness of future application of the exemption to cellular devices given the changed circumstances since the enactment of the exemption and opined that failure to conclude the examination within a reasonable period may affect the legal assessment of the exemption as being reasonable.

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

In July 2009, the inter-ministry committee established to examine the appropriateness of future application of the exemption according to the Attorney General opinion, published its recommendations for future application of the exemption. While the Ministry of Communications recommended that, given the difficulties in obtaining permits for the construction of cell sites, the exemption should be reviewed after the lapse of one to two years from the approval of the new National Zoning Plan 36, to verify that it provides an adequate solution that allows the cellular operators to provide required communication services, the Ministries of Interior Affairs and Environmental Protection recommended that the exemption be annulled within 6 months from the date of the recommendations, based, among others, on the following arguments: (1) current cellular infrastructure is sufficient, given it is currently used to provide advanced services such as internet, radio and television broadcasting, while such services may be provided by a landline network; and (2) with respect to radiation safety, cell sites constructed pursuant to a building permit are preferable to radio access devices, and utilizing a cellular network to provide advanced services which can be provided through a landline network, is unjustified in light of the preventive care principle set in the Israeli Non-Ionizing Radiation Law.

In September 2009, following publication of the inter-ministry committee's recommendations, the Attorney General concluded that the current application of the exemption does not balance properly the different interests involved and therefore cannot continue. The Attorney General further concluded that, in accordance with its authority under applicable law, the Ministry of Interior (in consultation with the Ministry of Communications) should prepare regulations setting conditions for the application of the exemption, such as limiting the exemption to instances in which the local building and planning authority did not respond within a reasonable fixed time frame and to extraordinary circumstances, and bring such regulations for approval by the Economy Committee of the Israeli Parliament by the end of October 2009. Conditions substantially limiting our ability to use the exemption could adversely affect our existing network and network build-out. In January 2010, the Attorney General advised the Supreme Court that the regulations are expected to be brought before the Economy Committee of the Israeli Parliament by the end of February 2010 and that in case the government fails to do so by the such date it will not object to the grant of an interim order preventing the construction of cellular radio access devices without a building permit. Following the Attorney General's statement, the Supreme Court did not grant such interim orders and will review the matter again in March 2010. To the best of our knowledge, to date, no such regulations were brought before the Economy Committee of the Israeli Parliament.

Additionally, in November 2008, the District Court of Central Region, in its capacity as court of appeals, ruled that the exemption does not apply to radio access devices, if the rooftop on which those devices are located is at the same level as a place of residence or other building that is regularly frequented by people. Other appeals relating to the exemption, including as to the requirement to obtain an extraordinary usage permit, are still under consideration in the District Court and other similar challenges, as well as other claims asserting that those cell sites and other facilities do not meet other legal requirements continue. Further, in July 2008 and again in July 2009, an amendment to the Communications Law proposing to annul the exemption passed the preliminary phase of enactment at the Israeli parliament.

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

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

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

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

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

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

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

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

Indemnification obligations

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

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

Since January 2006, we have provided approximately 289 indemnification letters in order to receive building permits. In addition, prior to January 2006, we provided three undertakings to provide an indemnification letter to local planning and building committees. Local planning and building committees have sought to join cellular operators, including us, as defendants in depreciation claims made against them even though indemnification letters were not provided. We were joined as defendants in a small number of cases, but are not, as of December 31, 2009, a party to any such depreciation claim. We expect that we will be required to continue to provide indemnification letters as the process of deploying our cell sites continues. As a result of the requirement to provide indemnification letters, we may decide to construct new cell sites in alternative, less suitable locations, to reduce capacity coverage or not to construct them at all, should we determine that the risks associated with providing such indemnification letters outweigh the benefits derived from constructing such cell sites, which could impair the quality of our service in the affected areas.

Construction and operating permits from the commissioner of environmental radiation

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

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

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

Pursuant to the Non-Ionizing Radiation Law, which has become effective, for the most part, on January 1, 2007, the construction and operation of cell sites and other facilities requires the prior approval of the Ministry of Environmental Protection. The validity of a construction permit will be for a period not exceeding three months, unless otherwise extended by the Commissioner, and the validity of an operating permit will be for a period of five years and we are required to submit to the Commissioner annual reports regarding radiation surveys conducted on our cell sites. Permits that were issued under the Pharmacists Regulations were deemed, for the remainder of their term, as permits issued under the Non-Ionizing Radiation Law. An applicant must first receive a construction permit from the Commissioner and only then may the applicant receive a building permit from the planning and building committee. In order to receive an operating permit from the Commissioner, certain conditions must be met, such as presenting a building permit or an exemption. See “Site licensing“ above for additional details in regards to obtaining a building permit and/or relying on an exemption.

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

In July 2008, a petition was filed with the Supreme Court by certain environmental organizations against the Minister of Environmental Protection, the Minister of Communications and the cellular companies, including us, seeking remedies relating to the delayed enactment of the Non-Ionizing Radiation regulations, the last draft of which included additional restrictions in relation to the operation of cell sites and other facilities. In December 2008, the Minister of Environmental Protection signed the Non-Ionizing Radiation Regulations, which did not include the section setting the aforesaid restrictions (including maximum exposure levels to non ionizing radiation). Following an update delivered by the Minister of Environmental Protection and the Minister of Communications to the Supreme Court that such section of the Regulations, is in the process of being enacted and requested permission to further update the Supreme Court in April 2010, the Supreme Court postponed the hearing of this petition for the meantime. Further, in February 2010, the Minister of Environmental Protection published a proposed amendment to the Non-Ionizing Radiation Law, aiming to cancel the requirement to obtain the Minister of Communications' approval to the Non-Ionizing Radiation Regulations, where such regulations may have a substantial and direct effect on the monetary burden imposed on the communication market, as is required under the current law. If restrictions similar to those included in the draft are subsequently adopted, they will, among other things, limit our ability to construct new sites (and if applied to existing cell sites, it will also limit our ability to renew operating permits for a number of our existing sites), especially in residential areas.

Handsets

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

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

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

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

Royalties

Under the Communications Law, the Israeli Communications Regulations (Royalties), 2001, and the terms of our general license from the Ministry of Communications, in 2009 we were required to pay the State of Israel royalties equal to 1.5% of our revenues generated from telecommunications services, less payments transferred to other license holders for interconnect fees or roaming services, sale of handsets and losses from bad debt. The rate of these royalties has decreased in recent years, from 4.5% in 2002, to 4% in 2003, to 3.5% in 2004 and 2005, to 3% in 2006, to 2.5% in 2007, to 2% in 2008, to 1.5% in 2009 and 1% in 2010 and thereafter. A public committee appointed by the Ministry of Communications to review various issues in the Israeli communications market published its recommendations in March 2008, including a recommendation that our obligation to pay royalties be annulled no later than 2012 (subject to Israeli corporate income tax reduction between 2008 and 2012).

Frequency Fees

Frequency allocations for our cellular services are governed by the Wireless Telegraph Ordinance. We pay frequency fees to the State of Israel in accordance with the Israeli Wireless Telegraph Regulations (Licenses, Certificates and Fees), 1987. We are currently in dispute with the Ministry of Communications over a sum of approximately NIS 73 million (including interest and CPI linkage differences) as of December 31, 2009, in GSM and UMTS frequency fees. For further information, see "Item 8 – Financial Information - Legal Proceedings." Furthermore, in December 2008, we returned the TDD spectrum allocated to us in 2001, to the Ministry of Communications, after not being able to use that spectrum since it was awarded to us, due to unavailability of supporting equipment.

Mobile Virtual Network Operator

A mobile virtual network operator, or MVNO, is a cellular operator that does not own its own spectrum and usually does not have its own radio network infrastructure. Instead, MVNOs have business arrangements with existing cellular operators to use their infrastructure and network for the MVNO's own customers. The introduction of the operation of MVNOs in the Israeli cellular market could increase competition and may result in a reduction in our market share, which may adversely affect our revenues.

In August 2007 and again in August 2008, the Israeli Government instructed the Ministry of Communications to take all measures necessary to allow any MVNO wishing to provide cellular services to the public using the network of a cellular operator to do so. We understand that a small number of companies, including Smile Telecom and the Israeli Post Service Company, informed the Ministry of Communications of their intention to request an MVNO license. The Communications Law was amended in July 2009 to include an MVNO license and a hearing regarding the application of an MVNO based on agreement with a cellular operator, was published on January and November 2009. Following the enactment of the regulations necessary for the provision of an MVNO license in January 2010, entities wishing to obtain an MVNO license may file an application with the Ministry of Communications. A form of the MVNO license has not been published yet and is expected to be published shortly. The regulations published, regulate the operation of an MVNO pursuant to an agreement to be reached and entered between a cellular operator and an MVNO and sets, among others, the conditions for receiving an MVNO license, including a requirement to operate a mobile phone switch, a restriction on a cellular operator and landline operator to receive an MVNO license and limitations on parties related to an existing cellular operator and on other communication licensees, to receive an MVNO license. Although the regulations – following the hearing on the matter – deal with an agreement based MVNO, the Communications Law, as amended, instructs further that in the event that a MVNO and the cellular operator will not have reached an agreement as to the provision of service by way of MVNO within six months from the date the MVNO has approached the cellular operator, and if the Ministry of Communications together with the Ministry of Commerce determine that the failure to reach an agreement is due to unreasonable conditions imposed by the cellular operator, the Ministry Of Communications will use its authority to provide instructions. Such instructions may include intervening in the terms of the agreement, including by setting the price of the service.

Emergency Situations

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

Reporting Requirements

We are subject to extensive reporting requirements. We are required to submit to the Ministry of Communications detailed annual reports with information concerning subscribers, revenues by service, the number of new subscribers and churn, annual financial statements and prior notice of tariff increases. In addition, under our license we may be required by the Ministry of Communications to file additional reports, such as reports on complaints, pricing, specific costs and revenues, network problems and the development of the network.

Contributing to the Community and Protecting the Environment

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

In 2009 we continued to contribute to the community with a specific focus on our "Cellcom Volume" initiative. In addition to promoting Israeli music and artists and providing our customers with Israeli music through a variety of musical content, we have contributed to the creation of "Cellcom Volume" youth centers in various locations throughout Israel, in which we provide young people resources related to music, including music classes, facilities to bands and choirs for rehearsals and recording studios. During 2009 we opened an additional center in Israel, as we believe music is a language which connects and bonds different people together. As of December 31, 2009, we had ten "Volume Centers" and five “mini Volume Centers” active throughout the country. Another "Volume Center" is currently under construction. Our employees volunteer regularly in these centers as well as with other community projects.

In addition to our contribution to the build-up and strengthening of the community, through activities such as our "Cellcom Volume" youth centers, we make financial donations to other worthy causes and entities. In August 2006, our Board of Directors determined our donation policy to be at an amount equal to up to one percent of our annual net income. In 2009 we donated a total sum of approximately NIS 6.4 million, including our contribution to the community.

We are aware of the importance of environmental protection. Accordingly, while providing quality products and services to our subscribers, we seek to operate responsibly to continuously reduce negative impacts on the environment and the landscape, aiming at a better environmental performance than required by local law. We dedicate personnel, funds and technologies to improve our performance, strive to achieve an efficient deployment of infrastructure subject to the applicable standards, and cooperate with the local authorities. We constantly monitor our environmental performance and aim to reduce our ecological footprint, through activities such as recycling, reduction of paper usage by managed printing, reduction of pollutants' emissions and energy usage as well as activities aimed at allowing our subscribers to better protect the environment, such as collecting used batteries and sending subscribers their monthly bill for our services and other correspondence from us via e-mail in lieu of regular mail. In 2009 we prepared and published in Israel a public report on our corporate social responsibility, as of December 31, 2008, and it is also available on our website at www. cellcom.co.il.

C. ORGANIZATIONAL STRUCTURE

The IDB Group

Our largest shareholder, DIC, is a majority-owned subsidiary of IDB Development Corporation Ltd., or IDB Development, which in turn is a wholly-owned subsidiary of IDB Holding Corporation Ltd., or IDB, one of Israel’s largest business groups. IDB and DIC are public Israeli companies traded on the Tel Aviv Stock Exchange. IDB Development ceased being a public company in 2009 following the acquisitions of all its shares that were held by the public, but its debentures continue to be traded on the TASE. See the footnote to the table under “Item 7.A – Major Shareholders” for information on the holdings in IDB. We do not have any significant subsidiaries.

D. PROPERTY, PLANT AND EQUIPMENT

Headquarters

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

Service centers, points of sale and cell sites

As of December 31, 2009, we leased approximately 30 service centers, points of sale and other facilities, which are used for marketing, sales and customer service. Lease agreements for our retail stores and service centers are generally for periods of two to three years, with extension options that vary by location.

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

Authorization agreement with land regulatory authorities

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

The authorization agreement provides that subject to the receipt of approval from the ILA, we will be entitled to establish and operate cell sites on the lands leased to third parties throughout the agreement’s term. In connection with the authorization agreement we undertook to vacate at the end of the agreement’s term all facilities installed in the authorized area unless the authorization period is extended.

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

ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

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

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

A. OPERATING RESULTS

Overview

General

We are the leading provider of cellular communications services in Israel in terms of number of subscribers, revenues, revenues from services, EBITDA and EBITDA margins as of December 31, 2009, providing services to approximately 3.292 million subscribers in Israel with an estimated market share of 34.6%.

We earn revenues and generate our primary sources of cash by offering a broad range of cellular services through our network covering substantially all of the populated territory of Israel. These services include basic and advanced cellular telephone services, text and multimedia messaging services and advanced cellular content and data services. We also provide international roaming services to our subscribers in 177 countries as of December 31, 2009 as well as to subscribers of foreign networks visiting Israel. We offer our subscribers a wide selection of handsets of various leading global manufacturers as well as extended warranty services. We have an advanced fiber-optic transmission infrastructure of approximately 1,500 kilometers. Together with our complementary microwave-based infrastructure, our fiber-optic infrastructure connects the majority of our cell sites with the remainder connected using supplemental transmission capacity leased from Bezeq, the incumbent landline operator. Having our own transmission network enables us to save substantial operating cash lease costs that would be associated with complete reliance on Bezeq's infrastructure, although these savings are partially offset by maintenance costs and microwave spectrum fees. It also allows us to sell transmission and data services to business customers and telecommunications operators. Following the receipt of our license to provide landline telephone services in Israel in 2006, we began to offer these services and as of February 2008, additional advanced landline services, through our NGN system, to selected landline business customers. Although we do not expect revenues from landline telephony services to amount to a material portion of our revenues in 2010, we consider landline telephone services to be a future growth opportunity and we believe that revenues from these services will continue to grow in 2010.

Our management evaluates our performance through focusing on our key performance indicators, which include among others: number of subscribers, churn rate, average minutes of usage per subscriber, or MOU, average revenue per subscriber, or ARPU, EBITDA (as defined in "Results of Operations"), operating income and net income. These key performance indicators are primarily affected by the competitive and regulatory landscape in which we operate and our ability to adapt to the challenges posed. We have modified our process for calculating our number of subscribers at various times in the past. This modification impacts the comparability of our subscriber count and other key performance indicators.

Our competitive landscape is characterized by a highly penetrated cellular market. Competition is intense and attracting new subscribers and retaining existing subscribers has become increasingly difficult and costly. The competition in our market has further increased as a result of the implementation of number portability in December 2007, as it has removed a deterrent to switching providers. We intend to drive revenue growth primarily by: focusing on core business and synergetic complementary business; maintaining and enhancing our strong brand; retaining our existing subscribers; increasing our ARPU by offering new and advanced services as well as increasing our Internet, content, data services and land line services revenues; and attracting new subscribers. In particular, in addition to being an important factor in selecting a cellular provider, we believe that content, data and other value-added services are a potential growth engine for increasing revenues. Since the full launch of our 3.5G HSPA based services, in 2006, revenues from our content and data services have grown significantly. The cellular industry is primarily regulated by the Ministry of Communications. See "Item 4. Information on the Company – B. Business Overview - Government Regulations." While our pricing is not generally regulated, certain of our rates and pricing mechanisms are subject to regulation. In particular, the annual reduction of interconnect tariffs by the Ministry of Communications commencing in March 2005 and ending in 2008, adversely affected our results and required us to find alternative sources of revenues to compensate for these reductions. Following a Government resolution adopted in August 2008, to review the interconnect fees and adjust them accordingly, the Ministry of Communications is currently reviewing interconnect fees. Commencing January 1, 2009, the basic airtime charging unit, as well as the interconnect tariff unit, was decreased from a 12-second basic charging unit to a one-second basic charging unit. Additionally, in September 2007 our general license was further amended in a manner that prevents us from offering our subscribers calling plans using airtime charging units other than the basic airtime charging unit. Commencing January 1, 2009, our license prevents us from raising tariffs to non-business customers having an obligation to purchase our services for a predefined period during such period. We took steps to address the effects of these amendments including initiating new and innovative marketing plans. In February 2010, a proposed amendment to the Communications Law, requiring cellular operators to provide "limited credit" services to their post-paid subscribers, passed the preliminary phase of enactment in the Israeli parliament.

The construction and operation of our cell sites and other transmission facilities are highly regulated and require us to obtain various consents and permits. See “Item 4. Information on the Company – B. Business Overview - Government Regulations—Permits for Cell Site Construction.” We have experienced difficulties in obtaining some of these consents and permits, particularly in obtaining building permits for cell sites from local planning and building authorities. See “Item 3. Key Information – D. Risk Factors. We may not be able to obtain permits to construct and operate cell sites.” However, even though 22 criminal and administrative proceedings (with two cell site subject to a demolition order) are outstanding as of December 31, 2009, we do not expect that the demolition of these facilities would have a material impact on our results of operations and financial condition. In December 2008, the Minister of Environmental Protection signed the Non-Ionizing Radiation Regulations, which do not include a section setting restrictions (including maximum levels of exposure to non ionizing radiation) in relation to the operation of cell sites and other facilities, that had appeared in the earlier draft legislation. This Section is in the process of being enacted and the Supreme Court postponed the hearing of a petition filed in connection with such regulations until further update by the Minister of Environmental Protection and the Minister of Communications. If such restrictions are subsequently adopted, they will, among other things, limit our ability to construct new sites and renew operating permits for a number of our existing sites, especially in residential areas. National Zoning Plan 36 is in the process of being revised. If proposed changes are approved, they will harm our ability to construct new cell sites, make the process of obtaining building permits for the construction and operation of cell sites more cumbersome and costly, could adversely affect our existing network and may delay the future deployment of our network. Moreover, if we are unable to obtain or renew consents and permits or rely on exemptions from obtaining permits for our existing sites or other facilities, we will be required to demolish or relocate these cell sites and facilities. Our inability to relocate cell sites or other facilities in a timely manner and/or our inability to obtain the permits and consents for new cell sites, or rely on exemptions, could adversely affect our existing network resulting in the loss of subscribers, prevent us from meeting the network coverage and quality requirements contained in our license and adversely impact our network build-out, all of which may have a material adverse result on our results of operations and financial condition.

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

Following the acquisition by DIC of a majority interest in us in September 2005, DIC brought in a new management team, including Ami Erel, the Chairman of our Board of Directors, who has been President and CEO of Bezeq, Amos Shapira, our Chief Executive Officer who has been chief executive officer of Kimberly-Clark’s Israeli subsidiary and of El Al Airlines, Tal Raz, our Chief Financial Officer (until September 2009, at which time he was replaced as Chief Financial Officer in September 2009 by Yaacov Heen, one of our top financial executives, and continues to serve as our director), formerly one of the founders and a director of Partner, one of our principal competitors, and Adi Cohen, our VP Marketing, who had been marketing manager of Shufersal, Israel's largest retail chain, and previously, Partner's marketing manager. Our management team has implemented a series of initiatives to drive growth, including the continued enhancement of our distinctive brand, greater focus on customer service and new sales campaigns, including the launch of new content and data services, alongside a continued managerial focus on ongoing efficiency increase. This streamlining has improved our operating cost structure and reduced our general and administrative expenses. Following implementation of these initiatives, our revenues and operating income increased in 2007 by approximately 8% and 36%, respectively (compared with 2006), in 2008 by approximately 6% and 21%, respectively (compared with 2007) and in 2009 by approximately 1% and 5%, respectively (compared with 2008). Notwithstanding these savings and management's continued focus on cost cutting initiatives, we expect that the higher cost of 3G enabled handsets to support our advanced content and data services may increase the costs related to subscriber acquisition and retention and handset repairs.

Our results are also impacted by currency fluctuations. While substantially all of our revenues are denominated in NIS, for 2009, approximately 36% of cash outflow was denominated in, or linked to, other currencies, mainly U.S. dollars. These payments included capital expenditures, some cell site rental fees, payments to equipment including handset suppliers. Changes to the Israeli CPI, may also impact our results as our debentures (excluding Series E) and some of our expenses are linked to the Israeli CPI. Any devaluation of the NIS against the U.S. dollar or other foreign currencies will therefore increase the NIS cost of our expenses that are not denominated in NIS or are linked to those currencies and any increase in the Israeli CPI will increase the financial expenses associated with our debentures. We enter into derivative instruments to mitigate the effect of the various market risks associated with these expenses. See "Item 11 - Quantitative and Qualitative Disclosures About Market Risk."

Further, we incurred significant debt in late 2005 and in the first half of 2006, which increased our financial expenses compared with historical results. We issued approximately NIS 2.0 billion ($530 million) principal amount of two series of debentures which bear interest at the rates of 5.0% and 5.3% and are linked to the Israeli CPI. In addition, in October 2007 and February 2008, we issued two new series of debentures to the public in Israel, for an aggregate principal amount of approximately NIS 1,647 million ($436 million) which bear interest at annual rates of 4.60% and 5.19%, respectively and are linked to the Israeli CPI. Further, in April 2009 we issued to the public in Israel, additional debentures of our existing series of debentures bearing annual interest rate of 5.19% as well as debentures of a new series, Series E, which bears interest at an annual rate of 6.25%, without any linkage, for an aggregate principal amount of approximately NIS 975 million ($ 258 million) See "Item 5. Operating and Financial Review and Prospects – A. Debt Service".

In February 2006, our Board of Directors adopted a policy to distribute each year at least 75% of our annual net income. Our net income was determined under Israeli GAAP for periods until December 31, 2007 and for periods commencing on or after January 1, 2008, is determined under IFRS, following the adoption of IFRS in accordance with the Israeli Accounting Standard No. 29 "Adoption of International Financial Reporting Standards". In March 2007, our Board resolved to distribute dividends within the boundaries of the February 2006 dividend policy and until resolved otherwise, on a quarterly basis. During 2006, we distributed cash dividends in the aggregate amount of NIS 3.83 billion mainly from retained earnings accumulated over the previous years, in 2007 and 2008 we distributed cash dividends in the aggregate amount of NIS 655 and 1,530 million, respectively. Prior to 2006, we had not distributed dividends since our inception.

In 2009, we distributed cash dividends in the aggregate amount of approximately NIS 1.19 billion, including the dividend declared for the fourth quarter of 2008. Our board of directors has also declared a cash dividend for the fourth quarter of 2009 of NIS 2.60 per share, or approximately NIS 257 million in the aggregate, which will be paid on March 31, 2010.

Any dividends may be declared solely by our Board of Directors, which will take into account the factors set out in "Item 8. Financial Information – A. Statements and Other Financial Information - Dividend Policy". The dividend per share that we will pay for the fourth quarter of 2009 does not reflect the level of dividends that will be paid for future quarterly periods, which can change at any time in accordance with the policy set out above. See "Item 8. Financial Information – A. Statements and Other Financial Information - Dividend Policy" and "—Liquidity and Capital Resources—Dividend payments." Also, in the future our Board of Directors may determine that our cash needs for debt service, capital expenditures or operations may increase and that it would not be prudent to distribute dividends.

On February 9, 2007, we closed the initial public offering of our ordinary shares and their listing on the NYSE. The offering was made solely by certain of our existing shareholders, and we did not receive any proceeds. The selling shareholders agreed to bear the out-of-pocket expenses of the offering. This offering fulfilled the agreement of our majority shareholder, DIC, with some of our other shareholders to endeavor to cause us to undertake an initial public offering by 2009 and it enables us to take advantage of the equity and debt capital raising opportunities available to a public company in the capital markets, to have the ability to use equity based compensation schemes as a tool to incentivize management to generate positive operating results and to provide access to certain of our shareholders to sell their shares. In July 2007, our shares were dual listed on the TASE. As a public dual-listed company, our legal and financial compliance costs are higher than as a private company and some activities are more time-consuming and costly.

Change in accounting policy regarding Subscriber Acquisition and Retention Costs

In the second quarter of 2009, we decided to change our accounting policy regarding subscriber acquisition and retention costs and to recognize certain subsidies provided to handsets, which are sold with a service agreement containing guaranteed minimum future revenue, as additional costs that are eligible for capitalization. Under our previous accounting policy, capitalized subscriber acquisition and retention costs included only deferred costs in respect of sales commissions related to the acquisition and retention of subscribers, provided the costs could be measured reliably and were directly attributable to obtaining a specific subscriber, and we recognized subsidies on handset sales as an expense in the period incurred. The change in policy has been retrospectively applied to all reported periods starting from January 1, 2007 , when the relevant criteria for capitalizing these costs were first met, and therefore, the comparable data for previous years has been amended to reflect this change in accounting policy. The retrospective application of that accounting policy change increased our retained earnings, as of January 1, 2009 by approximately NIS 48 million and had the following effect on our results of operations for all of the periods reported herein.

	Year Ended December 31,	
	2007	2008
	(In NIS millions)	
Decrease in purchase of handsets	(77)	(76)
Increase in amortization expense	15	70
Increase in operating income	62	6
Increase in income tax	18	2
Increase in net income	44	4
Increase in basic and diluted earnings per share (in NIS)	0.45	0.04
Increase in EBITDA	77	76

2006 Share Incentive Plan

In September 2006, our Board of Directors approved an option plan for our employees, officers and directors. The plan had an initial pool of 2,500,000 shares in respect of which options and restricted stock units, or RSUs, may be granted. In October and November 2006, we granted options to purchase an aggregate of 2,414,143 ordinary shares at an exercise price of $12.60 per share. Among those grants were options to purchase up to 450,000 ordinary shares to each of Ami Erel, our Chairman of the Board, and Amos Shapira, our Chief Executive Officer. The remainder of the options grants was made to our senior employees. In March 2007, August 2008 and August 2009, we granted additional options to purchase an aggregate of 30,786, 27,500 and 74,164 ordinary shares, respectively, at an exercise price of $12.60, $25 and $24.65 per share, respectively, to certain of our senior employees, under the terms of the plan. Distribution of cash dividends before the exercise of these options will reduce the exercise price of each option by an amount equal to the gross amount of the dividend per share distributed. During 2008 and 2009, 844,591 and 546,417 shares, respectively, were issued due to the exercise of options, which constitute substantially all vested options and approximately three quarters of the amount of options granted, by Messrs. Ami Erel and Amos Shapira and other grantees; 300,817 and 90,177 options, respectively, were canceled (due to our net exercise mechanism); and 4,125 and 7,759 options, respectively, previously granted to senior employees were revoked and returned to the option pool. As of December 31, 2009, the number of outstanding options to purchase ordinary shares amounted to704,674. However, the terms of the 2006 Share Incentive Plan provide for a net exercise mechanism, the result of which is to require us to issue a smaller number of ordinary shares than represented by the outstanding options. Unless the Board of Directors otherwise approves, the number of ordinary shares issuable by us upon the exercise of an option will represent a market value that is equal to the difference between the market price of the ordinary shares and the option exercise price of the exercised options, at the date of exercise. In 2008, we amended the option plan and the terms of our outstanding options as follows: (1) the definition of corporate transactions triggering accelerated vesting of the options, was changed to DIC ceasing to “control” us (as the term “control” is defined in the Israeli Securities Law, namely the ability to direct a company's activities) (previously - upon a decrease in DIC's share ownership to less than 50.01% of our outstanding share capital); (2) we are required to provide the grantees with a ten day period to exercise the options upon the occurrence of a corporate transaction. An additional change was approved only in regards to options already granted prior to the adoption of the amendment: when a grantee is dismissed without cause, an additional period of up to six (6) months from the date of dismissal will be allowed for vesting of the third or fourth portions of the options to occur.

In general, the options and RSUs vest in four equal installments on each of the first, second, third and fourth anniversaries of the date of grant. Under IFRS, we are required to expense the grant date fair value of the options over their vesting period. In accordance with these standards, we estimated the total compensation cost related to the options granted in 2006 to be approximately NIS 53 million as of the date of grant, to be recognized over the vesting period commencing on February 9, 2007, the date of completion of our initial public offering. In 2007 we expensed approximately NIS 29 million of the total compensation cost. During 2008 we reevaluated the total compensation cost related to the options granted and increased it by approximately NIS 4 million. Due to sales in 2008 of our ordinary shares held by DIC, that led to a reduction in DIC's ownership to below 50.01%, the vesting of the options granted in 2006 and 2007 was considered accelerated for accounting purposes and the balance of the total compensation cost, related to those grants, in the amount of approximately NIS 28 million, was expensed during 2008.

Revenues

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

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

Cost of revenues

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

Selling and marketing expenses

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

General and administrative expenses

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

Other income and expenses

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

Financial income and expenses

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

Income Tax

Generally, Israeli companies were subject to Corporate tax on their taxable income at the rate of 26% for the 2009 tax year which will decrease to 25% for the 2010 tax year. The Israeli Economic Efficiency Improvement Law (legislative amendments for the implementation of the economic program for the years 2009 and 2010), enacted in July 2009, provides, among others, for an additional gradual reduction of the corporate tax rate. According to this Law the Corporate tax rate will decrease to 24% for the 2011 tax year, to 23% for the 2012 tax year, to 22% for the 2013 tax year, to 21% for the 2014 tax year, to 20% for the 2015 tax year and to 18% for the 2016 tax year and thereafter. Israeli companies are generally subject to capital gains tax at a rate of 25% for capital gains (other than gains deriving from the sale of listed securities) derived from assets purchased after January 1, 2003. A deferred tax asset or liability is created for temporary differences between income recognized for tax purposes and for accounting purposes.

Results of Operations - Comparison of 2007, 2008 and 2009

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

	Year Ended December 31,			Change**	
	2007*	2008*	2009	2008 vs. 2007	2009 vs. 2008
Subscribers at end of period(1) (in thousands)	3,073	3,187	3,292	3.7%	3.3%
Period churn rate(1)(2)	16.3%	18.9%	19.6%	2.6pp	0.7pp
Average monthly usage per subscriber (MOU) (in minutes)(1)(3)	322	329	331	2.2%	0.6%
Average monthly revenue per subscriber (ARPU) (1)(4) (in NIS)	150	149	144	(0.7%)	(3.4%)
Operating income (in NIS millions)	1,394	1,690	1,768	21.2%	4.6%
Net income (in NIS millions)	919	989	1,182	7.6%	19.5%
EBITDA(5) (in NIS millions)	2,187	2,482	2,529	13.5%	1.9%
Operating income margin(6)	23.0%	26.3%	27.3%	3.3 pp	1.0 pp
EBITDA margin(7)	36.1%	38.7%	39.0%	2.6 pp	0.3 pp

* Retrospective application due to accounting policy change regarding Subscriber Acquisition and Retention Costs.

**

pp denotes percentage points and this measure of change is calculated by subtracting the 2007 measure from the 2008 measure and the 2008 measure from the 2009 measure, respectively.

(1) Subscriber data refer to active subscribers. Commencing in 2006, we use a six-month method of calculating our subscriber base, which means that we deduct subscribers from our subscriber base after six months of no revenue generation or activity on our network by or in relation to both the post-paid and pre-paid subscriber. The six-month method is, to the best of our knowledge, consistent with the methodology used by other cellular providers in Israel.

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

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

(3) Average monthly minutes of use per subscriber (MOU) is calculated by dividing the total billable minutes (of outgoing and incoming calls from other networks, excluding roaming usage) during the month, by the average number of subscribers during such month, and by dividing the sum of such results for all months in the reported period by the number of months in the period. Following the regulatory requirement to change the basic airtime charging unit from twelve-seconds to one-second units commencing January 1, 2009, MOU for 2007 and 2008 has been adjusted to the same per-one second unit basis to enable a comparison. MOU for 2007 and 2008 based on the former charging units were 348 and 350 minutes, respectively.

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

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

	Year Ended December 31,		
	2007	2008	2009
	(In NIS millions, except number of subscribers and months)		
Revenues	6,050	6,417	6,483
less revenues from equipment sales	635	745	751
less other revenues*	93	135	162
Revenues used in ARPU calculation (in NIS millions)	5,322	5,537	5,570
Average number of subscribers	2,955,855	3,105,022	3,215,492
Months during period	12	12	12
ARPU (in NIS, per month)	150	149	144

* Other revenues include revenues from repair services, transmission services and land-line services.

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

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

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

	Year Ended December 31,		
	2007*	2008*	2009
	(In NIS millions)		
Net income	919	989	1,182
Financing expenses, net	147	310	219
Income taxes			