PARTNER COMMUNICATIONS CO LTD
Form 20-F/A
March 26, 2012

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
AMENDMENT TO APPLICATION OR REPORT
FILED PURSUANT TO SECTION 12, 13 or 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

As filed with the Securities and Exchange Commission on March 26, 2012

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

FORM 20-F/A
Amendment No. 1

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

OR

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2011

OR

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

OR

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

Date of event requiring this shell company report ___________

Commission file number 1-14968

PARTNER COMMUNICATIONS COMPANY LTD.

(Exact Name of Registrant as Specified in its Charter)

ISRAEL
(Jurisdiction of Incorporation or Organization)

8 AMAL STREET
AFEQ INDUSTRIAL PARK
ROSH-HA'AYIN 48103
ISRAEL
(Address of Principal Executive Offices)

Roly Klinger

ExecutiveOffices@orange.co.il

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

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

| Title of each class | Name of each exchange on which registered |
|---|---|
| American Depositary Shares, each representing one ordinary share, nominal value NIS 0.01 per share | The NASDAQ Global Market |
| Ordinary Shares, nominal value NIS 0.01 per share* | The NASDAQ Global Market |

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

Securities Registered Pursuant to Section 12(g) of the Act:

NONE

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

NONE

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

ORDINARY SHARES OF NIS 0.01 EACH 155,645,708

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

YES x NO o

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 1934.

YES o NO x

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

YES x NO o

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

YES x NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer x Accelerated Filer o Non-Accelerated Filer o

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

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

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

ITEM 17 o ITEM 18 o

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

YES o NO x

AMENDMENT NO. 1 TO FORM 20-F

EXPLANATORY NOTE

The registrant hereby amends its annual report on Form 20-F for the fiscal year ended December 31, 2011, which was filed with the Securities and Exchange Commission on March 22, 2012 (the “Form 20-F”), solely for the purpose of amending (i) Item 5B to eliminate a typographical error and (ii) Item 6A to clarify the dates on which the appointments of two members of senior management became effective. Other than such amendment, this amendment does not amend, update or restate any information set forth in the Form 20-F.

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## INTRODUCTION

As used herein, references to "we," "our," "us," "Partner" or the "Company" are references to Partner Communications Compa Ltd. and its wholly-owned subsidiaries, Partner Future Communications 2000 Ltd., Partner Land-Line Communications Solutions LLP and Partner Business Communications Solutions LLP (of which Partner Future Communications 2000 Ltd. serves as the general partner and the Company serves as the limited partner), and as of March 3, 2011 (the date of acquisition), 012 Smile Telecom Ltd., except as the context otherwise requires. In addition, references to our "financial statements" are to our consolidated financial statements, unless the context requires otherwise.

The Company provides telecommunications services in the following two segments: (1) cellular communications services ("Cellular Services") and (2) fixed-line communication services ("Fixed--Line Services"), which include: (a) transmission services; (b) Primary Rate Interface ("PRI") lines for business sector customers; (c) Voice over Broadband ("VoB") telephony services; (d) outgoing and incoming international telephony, hubbing, roaming and signaling and calling card services ("ILD Services"); and (e) Internet service provider ("ISP") services, including value added services, specialized data services and server hosting, and WiFi network of hotspots across Israel. In addition, the Fixed-Line Services segment includes sales of related equipment such as routers and phones. Unless the context indicates otherwise, expressions such as "our business", "Partner's business" and "the Company's business" or "industry" refer to both Cellular and Fixed-Line Services.

In this document, references to "$," "US$," "US dollars", "USD" and "dollars" are to United States dollars, and references to "NIS" and "shekels" are to New Israeli Shekels. We maintain our financial books and records in shekels. This annual report contains translations of NIS amounts into US dollars at specified rates solely for the convenience of the reader. No representation is made that the amounts referred to in this annual report as convenience translations could have been or could be converted from NIS into US dollars at these rates, at any particular rate or at all. The translations of NIS amounts into US dollars appearing throughout this annual report have been made at the exchange rate on December 31, 2011, of NIS 3.821 = US$1.00 as published by the Bank of Israel, unless otherwise specified. See "Item 3A. Key Information – Selected Financial Data – Exchange Rate Data".

## INTERNATIONAL FINANCIAL REPORTING STANDARDS

Our financial statements included in this annual report are prepared in accordance with International Financial Reporting Standards ("IFRS") published by the International Accounting Standards Board ("IASB"). See "Item 18. Financial Statements" and "Item 5A. Operating and Financial Review and Prospects – Operating Results".

## FORWARD-LOOKING STATEMENTS

This annual report includes forward-looking statements within the meaning of Section 27A of the US Securities Act of 1933, as amended, Section 21E of the US Securities Exchange Act of 1934, as amended, and the safe harbor provisions of the US Private Securities Litigation Reform Act of 1995. Words such as "believe," "anticipate," "expect," "intend," "seek," "will," "plan," "could," "may," "project," "goal," "target" and similar expressions often identify forward-look statements but are not the only way we identify these statements. All statements other than statements of historical fact included in this annual report, including the statements in the sections of this annual report entitled "Item 3D. Key Information – Risk Factors," "Item 4. Information on the Company" and "Item 5. Operating and Financial Review and Prospects" and elsewhere in this annual report regarding our future performance, revenues or margins, or to preserve or expand market share in existing or new markets, reduce expenses and any statements regarding other future events or our future prospects, are forward-looking statements.

We have based these forward-looking statements on our current knowledge and our present beliefs and expectations regarding possible future events. These forward-looking statements are subject to risks, uncertainties and assumptions about Partner, consumer habits and preferences in cellular and fixed-line telephone usage, trends in the Israeli telecommunications industry in general, the impact of current global economic conditions and possible regulatory and legal developments. For a description of some of the risks we face, see “Item 3D. Key Information – Risk Factors,” “Item 4. Information on the Company,” “Item 5. Operating and Financial Review and Prospects,” “Item 8A. Consolidated Financial Statements and Other Financial Information – Legal and Administrative Proceedings” and “Item 11. Quantitative and Qualitative Disclosures about Market Risk”. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this annual report might not occur, and actual results may differ materially from the results anticipated. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

3A. Selected Financial Data

For the years ended December 31, 2008, 2009, 2010 and 2011, we have prepared our consolidated financial statements in accordance with the International Financial Reporting Standards ("IFRS") published by the International Accounting Standards Board ("IASB").

On January 1, 2008, the transition date to IFRS, the Company adopted an exemption provided in IFRS1 which allows the Company to measure its property and equipment as of the transition date to IFRS at fair value, and to use this value as its deemed cost as of that date. The deemed cost was based upon an appraisal, performed by management with the assistance of independent appraisers. The appraisal was based on considering the different elements and components of the property and equipment, and assigning them the appropriate estimation of useful life and fair value. The fair value on January 1, 2008 of property and equipment was NIS 1,690 million.

The tables below at and for the years ended December 31, 2008, 2009, 2010 and 2011, set forth selected consolidated financial data under IFRS. The selected financial information is derived from our consolidated financial statements, which have been audited by Kesselman & Kesselman, independent certified public accountants in Israel and a member of PricewaterhouseCoopers International Limited. The audited consolidated financial statements at and for the years ended December 31, 2009, 2010 and 2011, appear at the end of this report.

The tables below at and for the years ended December 31, 2007 and 2008, set forth selected consolidated financial information under U.S. GAAP, which has been derived from our originally published audited consolidated financial statements at and for the years ending on such dates.

| IFRS | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2008 | 2009 | 2010 | 2011 | 2011 |
| | New Israeli Shekels in millions (except per share data) | | | | US$ in millions (1) |
| Consolidated Statement of Income Data | | | | | |
| Revenues | 6,302 | 6,079 | 6,674 | 6,998 | 1,831 |
| Cost of revenues | 3,868 | 3,770 | 4,093 | 4,978 | 1,303 |
| Gross profit | 2,434 | 2,309 | 2,581 | 2,020 | 528 |
| Selling and marketing Expenses | 388 | 387 | 479 | 711 | 186 |
| General and administrative Expenses | 284 | 290 | 306 | 291 | 76 |
| Impairment of goodwill | | | | 87 | 23 |
| Other income - Net | 64 | 69 | 64 | 105 | 28 |
| Operating profit | 1,826 | 1,701 | 1,860 | 1,036 | 271 |
| Finance income | 30 | 28 | 28 | 39 | 10 |
| Finance expenses | 214 | 204 | 209 | 333 | 87 |
| Finance costs, net | 184 | 176 | 181 | 294 | 77 |
| Profit before income tax | 1,642 | 1,525 | 1,679 | 742 | 194 |
| Income tax expenses | 444 | 384 | 436 | 299 | 78 |
| Profit for the year | 1,198 | 1,141 | 1,243 | 443 | 116 |
| Earnings per ordinary share and per ADS | | | | | |
| Basic: | 7.71 | 7.42 | 8.03 | 2.85 | 0.75 |
| Diluted | 7.65 | 7.37 | 7.95 | 2.84 | 0.74 |
| Weighted average number of shares outstanding (in thousands) | | | | | |
| Basic: | 155,350 | 153,809 | 154,866 | 155,542 | 155,542 |
| Diluted: | 156,520 | 154,817 | 156,296 | 155,779 | 155,779 |

| IFRS | Year ended December 31, 2008 | 2009 | 2010 | 2011 | 2011 |
|---|---|---|---|---|---|
| | New Israeli Shekels in millions (except per share data) | | | | US$ in millions (1) |
| Other Financial Data | | | | | |
| Capital expenditures (2) | 589 | 522 | 435 | 468 | 122 |
| EBITDA (3) | 2,298 | 2,304 | 2,570 | 2,178 | 570 |
| Dividend per share (4) | 5.45 | 6.86 | 7.85 | 2.25 | 0.59 |
| Capital reduction (4) | - | – | 9.04 | - | - |
| Statement of Cash Flow Data | | | | | |
| Net cash provided by operating activities | 1,915 | 1,753 | 1,958 | 1,570 | 410 |
| Net cash used in investing activities | (514) | (732) | (486) | (1,085) | (284) |
| Net cash used in financing activities | (1,365) | (876) | (1,480) | (274) | (71) |
| Balance Sheet Data (at year end) | | | | | |
| Current assets | 1,472 | 1,807 | 1,830 | 2,308 | 604 |
| Non current assets | 3,693 | 3,816 | 3,797 | 4,779 | 1,252 |
| Advance payment in respect of the acquisition of 012 smile | - | - | 30 | - | - |
| Property and equipment | 1,935 | 2,064 | 2,058 | 2,051 | 537 |
| License and other intangible assets | 1,260 | 1,260 | 1,077 | 1,290 | 338 |
| Goodwill | - | - | - | 407 | 107 |
| Deferred income tax asset | 81 | 14 | – | 30 | 8 |
| Derivative financial instruments | - | 4 | 6 | 24 | 6 |
| Total assets | 5,165 | 5,623 | 5,627 | 7,087 | 1,856 |
| Current liabilities (5) | 1,734 | 1,915 | 1,826 | 1,889 | 495 |
| Long-term liabilities (5) | 1,699 | 1,746 | 3,175 | 4,773 | 1,249 |
| Total liabilities | 3,433 | 3,661 | 5,001 | 6,662 | 1,744 |

| | | | | | |
|---|---|---|---|---|---|
| Shareholders’ equity | 1,732 | 1,962 | 626 | 425 | 112 |
| Total liabilities and shareholders’ equity | 5,165 | 5,623 | 5,627 | 7,087 | 1,856 |

| US. GAAP | Year ended December 31, 2007 | 2008 |
|---|---|---|
| Statement of Operations Data | | |
| Revenues, net | | |
| | | |
| Services | 5,329 | 5,546 |
| | | |
| Equipment | 785 | 756 |
| | | |
| | 6,114 | 6,302 |
| | | |
| Cost of revenues | | |
| | | |
| Services | 3,090 | 3,209 |
| | | |
| Equipment | 1,002 | 843 |
| | | |
| | 4,092 | 4,052 |
| | | |
| Gross profit | 2,022 | 2,250 |
| | | |
| Selling and marketing Expenses | 392 | 389 |
| General and administrative Expenses | 231 | 256 |
| | | |
| Operating profit | 1,399 | 1,605 |
| | | |
| Financial expenses, net | 121 | 158 |
| | | |
| Income before tax | 1,278 | 1,447 |
| | | |
| Tax expenses | 338 | 396 |
| | | |
| Net income for the year | 940 | 1,051 |

| US. GAAP | Year ended December 31, 2007 | 2008 |
|---|---|---|
| Earnings per ordinary share and per ADS | | |
| Basic: | | |
| Before cumulative effect | 6.01 | 6.77 |
| Cumulative effect | – | – |
| | 6.01 | 6.77 |
| | | |
| Diluted: | | |
| Before cumulative effect | 5.96 | 6.73 |
| Cumulative effect | – | – |
| | 5.96 | 6.73 |
| | | |
| Weighted average number of shares outstanding (in thousands) | | |
| | | |
| Basic: | 156,415 | 155,350 |
| Diluted: | 157,787 | 156,520 |
| | | |
| Other Financial Data | | |
| | | |
| Capital expenditures (2) | 499 | 590 |
| | | |
| EBITDA (3) | 2,009 | 2,257 |
| Dividend per share (4) | 4.77 | 5.45 |
| | | |
| Statement of Cash Flow Data | | |
| | | |
| Net cash provided by operating activities | 1,446 | 1,839 |
| | | |
| Net cash used in investing activities | (529) | (531) |
| | | |
| Net cash provided by used in financing activities | (846) | (1,273) |
| | | |
| Balance Sheet Data (at year end) | | |
| | | |
| Current assets | 1,520 | 1,542 |
| | | |
| Investments and long-term receivables | 535 | 499 |
| | | |
| Fixed assets, net | 1,728 | 1,756 |
| | | |
| License and deferred charges, net | 1,154 | 1,061 |
| | | |
| Deferred income taxes | 94 | 110 |
| | | |
| Total assets | 5,031 | 4,968 |

| | | |
|---|---|---|
| Current liabilities (5) | 1,157 | 1,734 |
| Long-term liabilities (5) | 2,219 | 1,794 |
| Total liabilities | 3,376 | 3,529 |
| Shareholders’ equity | 1,655 | 1,439 |
| Total liabilities and shareholders’ equity | 5,031 | 4,968 |

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(1) The translations of NIS amounts into US dollars appearing throughout this annual report have been made at the exchange rate on December 31, 2011, of NIS 3.821 = US$1.00 as published by the Bank of Israel, unless otherwise specified. See “Item 3A. Key Information – Selected Financial Data – Exchange Rate Data”.

(2) Capital Expenditure represents additions to property and equipment and computer software.

(3) EBITDA as reviewed by the Chief Operator Decision Maker ("CODM"), represents earnings before interest (finance costs, net), taxes, depreciation, amortization and impairment charges, as a measure of operating profit. EBITDA is not a financial measure under IFRS and may not be comparable to other similarly titled measures for other companies. EBITDA may not be indicative of the Company's historic operating results nor is it meant to be predictive of potential future results.

(4) The dividend per share was calculated in respect of the period for which it was announced. For the year 2011, the Company declared a dividend which in the aggregate amounted to approximately NIS 350 million (US$ 92 million), or NIS 2.25 per share. The aggregate total dividend for 2010 was NIS 1,217 million or NIS 7.85 per share. Further, NIS 1,400 million or NIS 9.04 per share was distributed to shareholders in March 2010 following the reduction of the shareholders’ equity as approved by the Courts (see “Item 5A. Operating Results - Capital Reduction”).

(5) See notes 16 and 17 to our consolidated financial statements for information regarding long-term liabilities and current maturities of long-term bank loans and notes payable.

The tables below at and for the years ended December 31, 2008, 2009, 2010 and 2011, set forth a reconciliation between operating cash flow and EBITDA under IFRS.

| IFRS | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2008 | 2009 | 2010 | 2011 | 2011 |
| | New Israeli Shekels in millions | | | | US $ in millions (1) |
| Reconciliation Between Operating Cash flow and EBITDA | | | | | |
| Net cash provided by operating activities | 1,915 | 1,753 | 1,958 | 1,570 | 410 |
| Liability for employee rights upon retirement | (5) | (1) | (8) | 26 | 7 |
| Accrued interest, exchange and linkage differences on long-term liabilities | (182) | (167) | (160) | (289) | (75) |
| Increase (Decrease) in accounts receivable: | | | | | |
| Trade | (47) | 229 | 214 | 190 | 50 |
| Other (*) | (4) | 16 | 34 | 2 | 1 |
| Decrease (Increase) in accounts payable and accruals: | | | | | |
| Trade | (10) | (43) | 40 | 37 | 10 |
| Parent group-trade | (1) | 17 | (38) | (70) | (18) |
| Other (*) | 48 | (43) | (15) | 54 | 14 |
| Increase (decrease) in inventories | (8) | 33 | (57) | 58 | 15 |
| Decrease (Increase) in asset retirement obligation | (1) | 1 | (1) | (1) | (1) |
| Income tax paid | 420 | 339 | 426 | 311 | 81 |

| | | | | | |
|---|---|---|---|---|---|
| Financial expenses (**) | 173 | 170 | 177 | 290 | 76 |
| | | | | | |
| EBITDA | 2,298 | 2,304 | 2,570 | 2,178 | 570 |

The tables below at and for the years ended December 31, 2007 and 2008 set forth a reconciliation between operating cash flow and EBITDA under U.S. GAAP.

| US. GAAP | Year ended December 31, 2007 | 2008 |
|---|---|---|
| | New Israeli Shekels in millions | |
| Reconciliation Between Operating Cash flow and EBITDA | | |
| Net cash provided by operating activities | 1,446 | 1,839 |
| Liability for employee rights upon retirement | (18) | (16) |
| Accrued interest, exchange and linkage differences on long-term liabilities | (60) | (94) |
| Amount carried to deferred charges | – | – |
| Gain (loss) from assets in respect of severance pay funds | 6 | (16) |
| Increase (Decrease) in accounts receivable: | | |
| Trade | 329 | (47) |
| Other (*) | 2 | (13) |
| Decrease (Increase) in accounts payable and accruals: | | |
| Trade | (101) | (9) |
| Related parties | 12 | (1) |
| Other (*) | 276 | 476 |
| Decrease (Increase) in inventories | 9 | (8) |
| Decrease (Increase) in asset retirement obligation | (1) | (1) |
| Financial expenses (**) | 109 | 147 |
| EBITDA | 2,009 | 2,257 |

(1) The translations of NIS amounts into US dollars appearing throughout this annual report have been made at the exchange rate on December 31, 2011, of NIS 3.821 = US$1.00 as published by the Bank of Israel, unless otherwise specified. See "Item 3A. Key Information – Selected Financial Data – Exchange Rate Data".

(*) Excluding provision for tax expenses.

(**) Financial expenses excluding any charge for the amortization of pre-launch financial costs.

| | At December 31, 2009 | 2010 | 2011 |
|---|---|---|---|
| Industry Data | | | |
| Estimated population of Israel (in millions) (1) | 7.5 | 7.7 | 7.8 |
| Estimated Israeli cellular telephone subscribers (in millions) (2) | 9.0 | 9.9 | 10.0 |
| Estimated Israeli cellular telephone penetration (3) | 126% | 129% | 128% |

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| | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2010 | 2011 |
| Partner Data | | | | | |
| Cellular subscribers (000's) (at period end) (4) | 2,860 | 2,898 | 3,042 | 3,160 | 3,176 |
| Pre-paid cellular subscribers (000's) (at period end) (4) | 792 | 745 | 811 | 870 | 894 |
| Post-paid cellular subscribers (000's) (at period end) (4) | 2,068 | 2,153 | 2,231 | 2,290 | 2,282 |
| Share of total Israeli cellular subscribers (at period end) (5) | 32 % | 32 % | 32 % | 32 % | 32 % |
| Average monthly usage per cellular subscriber ("MOU") (mins.) (6) | 336 | 365 | 364 | 366 | 397 |
| Average monthly revenue per cellular subscriber including in roaming ("ARPU") (NIS) (7) | 161 | 161 | 151 | 148 | 111 |
| Churn rate for cellular subscribers (8) | 15 % | 18 % | 18 % | 21 % | 29 % |
| Number of fixed-lines (000's) (at period end) | | | | 69 | 292 |
| ISP subscribers (000's) (at period end) | | | | 60 | 632 |
| Estimated cellular coverage of Israeli population (at period end) (9) | 97 % | 98 % | 98 % | 99 % | 99 % |
| Number of employees (full time equivalent) (at period end) (10) | 4,130 | 4,671 | 5,670 | 6,068 | 7,891 |

(1) The population estimates are as published by the Central Bureau of Statistics in Israel as of December 31, 2011.

(2) We have estimated the total number of Israeli cellular telephone subscribers from information contained in published reports issued by, and public statements made by Pelephone Communications Ltd. ("Pelephone") and Cellcom Israel Ltd. ("Cellcom"), or by their shareholders, and from Partner subscriber data. The number of subscribers of Mirs Communications Ltd. ("MIRS") is based on the figures reported by HOT Telecommunication Systems Ltd. ("HOT") based on the figures reported by Hot on July 25, 2011, in the valuation of MIRS performed by TASC, an Israeli consulting firm. The number of subscribers of Pelephone includes subscribers of Rami Levy, an MVNO which began operating on the Pelephone network in December 2011.

(3) Total number of estimated Israeli cellular telephone subscribers expressed as a percentage of the estimated population of Israel. The total number of estimated cellular telephone subscribers includes dormant subscribers as well as other subscribers who are not included in the Israeli population figures, such as Palestinians, visitors, and foreign workers.

(4) In accordance with general practice in the cellular telephone industry, we use the term "subscriber", unless the context otherwise requires, to indicate a telephone or a data or video device, rather than either a bill-paying network customer, who may have a number of telephones connected to the network, or a cellular telephone user who may share a single telephone with a number of other users. "Subscriber" includes our pre-paid customers. As of

2008, a pre-paid subscriber is recognized as such only following the actual use of his pre-paid SIM card. Based on this policy in January 2008, we reduced the number of reported pre-paid subscribers by approximately 61,000. Applying this policy retroactively, the increase in subscribers in 2008 was 3.5%. In addition, as of January 2011, a pre-paid subscriber is recognized as such only once they have generated revenues in the amount of at least one shekel.

References to the number of subscribers are stated net of subscribers who leave or are disconnected from the network, or who have not generated revenue for the Company for a period of over six consecutive months ending at a reporting date.

(5) Total number of Partner subscribers expressed as a percentage of the estimated total number of Israeli subscribers.

(6) We have calculated our average monthly usage per cellular subscriber by (i) dividing, for each month in such period, the total number of minutes of usage, excluding in roaming usage, during such month by the average of the number of our subscribers, and (ii) dividing the sum of such results by the number of months in the relevant period.

(7) We have calculated Partner average monthly revenue per cellular subscriber by (i) dividing, for each month in the relevant year, the Partner revenue during the month, excluding revenue from equipment sales but including revenues from handset warranties and including revenue from foreign network operators for calls made by their roaming customers while in Israel using our network, by the average number of Partner cellular subscribers during that month, and (ii) dividing the sum of all such results by the number of months in the relevant period.

(8) We define the "churn rate" as the total number of cellular subscribers who disconnect from our network, either involuntarily or voluntarily, in a given period expressed as a percentage of the average of the number of our subscribers at the beginning and end of such period. Our churn rate includes subscribers who have not generated revenue for us for a period of the last six consecutive months ending at a reporting date. This includes cellular subscribers who have generated minute revenues only from incoming calls directed to their voice mail. Involuntary churn includes disconnections due to non-payment of bills or suspected fraudulent use, and voluntary churn includes disconnections due to subscribers terminating their use of our services.

(9) We measure cellular coverage using computerized models of our network, radio propagation characteristics and topographic information to predict signal levels at two meters above ground level in areas where we operate a network site. According to these coverage results, we estimate the population serviced by our network and divide this by the estimated total population of Israel. Population estimates are published by the Central Bureau of Statistics in Israel.

(10) A full-time employee is contracted to work a standard 186 hours per month. Part-time employees are converted to full-time equivalents by dividing their contracted hours per month by the full-time standard. The result is added to the number of full-time employees to determine the number of employees on a full-time equivalent basis.

Exchange Rate Data

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

| | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2010 | 2011 |
| Average (1) | 4.108 | 3.588 | 3.927 | 3.732 | 3.579 |
| High | 4.342 | 4.022 | 4.256 | 3.894 | 3.821 |
| Low | 3.830 | 3.230 | 3.690 | 3.549 | 3.363 |
| End of period | 3.846 | 3.802 | 3.775 | 3.549 | 3.821 |

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

| | September 2011 | October 2011 | November 2011 | December 2011 | January 2012 | February 2012 | March 2012 (through March 19) |
|---|---|---|---|---|---|---|---|
| High | 3.725 | 3.763 | 3.800 | 3.821 | 3.854 | 3.803 | 3.814 |
| Low | 3.574 | 3.602 | 3.650 | 3.727 | 3.733 | 3.700 | 3.769 |

On December 31, 2011, the exchange rate was NIS 3.821 per US$1.00 as published by the Bank of Israel. Changes in the exchange rate between the shekel and the US dollar could materially affect our financial results.

3B. Capitalization and Indebtedness

Not applicable.

3C. Reasons for the Offer and Use of Proceeds

Not applicable.

3D. Risk Factors

You should carefully consider the risks described below and the other information in this Annual Report. Depending on the extent to which any of the following risks materializes, our business, financial condition, cash flow or results of operations could suffer, and the market price of our shares may be negatively affected. The risks below are not the only ones we face, and other risks currently not affecting our business or industry, or which are currently deemed insignificant, may arise.

3D.1 RISKS RELATING TO THE REGULATION OF OUR INDUSTRY

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

We are exposed to government regulatory intervention regarding a broad range of issues in the telecommunications industry, such as interconnect tariffs, roaming charges and other billing and customer service matters; the terms and conditions of our subscriber agreements; the construction and maintenance of antennas and other network infrastructure; providing infrastructure access to existing or new telecommunications services providers; frequency allocation; limitations or other constraints on the services and products that we may sell; anti-trust regulation; and obligations under our operating licenses. We are also affected by changes in enforcement measures in connection with violations of securities laws. As further described below, these regulations impose substantial limitations on our flexibility in managing our business; may limit our ability to compete by, among other measures, limiting our ability to develop our network; may give preference to new and/or small competitors in the allocation of new frequencies, including those designated for the next generation of cellular services; and may increase our costs, decrease our revenues and reduce our ability to expand our business.

In the last few years, the Ministry of Communications has also taken active steps to increase competition in the cellular telecommunications market, and in the past two years it has escalated its interventions in this regard:

- During 2010, the Ministry of Communications adopted regulations for providing licenses to Mobile Virtual Network Operators ("MVNOs"), and granted MVNO licenses to a number of companies, the first of which began to operate in December 2011. See “Item 3D.1 Risks Relating to the Regulation of our Industry -- We have been required to offer access to our cellular network infrastructure to other operators, which has enabled new competitors, such as MVNOs and new cellular operators, to enter the market, and may reduce our ability to provide quality services to our subscribers and negatively affect our operating results.”

- the Ministry of Communications has reduced entry barriers to enable new operators as well as existing telecommunications services providers to enter the cellular market through site sharing and national roaming. In September 2010, the Ministry of Communications published a tender for the allocation of UMTS frequency to additional infrastructure-based cellular operators in Israel. In April 2011, the tender was concluded and the UMTS frequencies were ultimately awarded to MIRS and Golan Telecom Ltd. ("Golan Telecom"). See “Item 4B Regulation - 4.8 Integrated Tender Committee For UMTS Frequency Allocation For An Additional Cellular Operator and National Roaming";

- the Ministry of Communications also increased competition by continuing to promote reforms that facilitate the migration of subscribers among cellular companies by, among other measures, limiting the amount which telecommunication operators may charge subscribers who terminate their agreement before the end of their commitment period, prohibiting linkage between the sale of handsets and the provision of various benefits regarding cellular services, and prohibiting cellular companies from selling locked handsets for use only with the company's SIM card and requiring them to agree to unlock all handsets they have sold in the past, free of charge; and

- the Ministry of Communications published in 2009 an instruction to cellular operators and Internet Service Providers ("ISP") to maintain Internet "network neutrality" by avoiding any limitation on the transmission through their networks of applications or on Internet protocol usage, as well as any other action which might proactively hinder a type of service or the quality of service other than due to a technical need related to network quality. As part of an amendment to the Communications Law (Telecommunications and Broadcasting), 1982 (the "Telecommunications Law"), new provisions became effective as of January 2011, according to which a mobile operator is prohibited from limiting or blocking, including by requiring payment for, the ability of a subscriber to use any service and any application supplied over the Internet, except for limitations or blocking that are required as a result of proper and fair management of traffic transferred over its network. This new amendment may significantly limit our ability to manage traffic on our network, which could cause the performance of internet connectivity services to be degraded. As a result, we may be required to acquire more bandwidth and network capacity to serve our customers, which we may not be able to obtain, or whose cost would increase our expenses and reduce profits.

The Ministry of Communications has also recently taken steps to increase competition in the fixed-line market:

- A public committee (the "Hayek Committee"), appointed to examine the fixed line telecommunications sector, published recommendations in October 2011 that include (1) abolishing the structural separation imposed upon Bezeq, Israel's largest telecommunications provider, in the provision of certain services; (2) replacing the existing supervision over Bezeq's retail tariffs, which sets tariffs, with supervision which sets maximum tariffs; and (3) requiring the holders of general fixed line telecommunications licenses to provide services and allow the use of their infrastructure by other license holders in accordance with wholesale service tariffs to be set by the regulator. If the Minister of Communications adopts the first two recommendations, which are expected to strengthen Bezeq's market position, before adopting the third recommendation to create a wholesale market, it may affect our ability to compete with the existing fixed-line operators since Partner, without its own fixed-line infrastructure in the private market and only a partial fixed-line infrastructure in the business market, would not be able to offer fixed-line services and service packages that could compete with those of Bezeq. See "Item 4B Regulation- 4.7 Public Committee to Examine the Fixed-Line Telecommunications Sector."

- The Ministry of Communications is also considering providing new company protections for Tamares Telecom Ltd. ("Tamares"), a new company which has recently laid an underwater cable, to facilitate the company's entry into the international transmission market. More specifically, the Ministry of Communications may fix, for a specified period of time, the minimum tariffs which Tamares's main competitor, Mediterranean Nautilus Israel Ltd. ("Med Nautilus") may charge its customers, which includes Partner, as well as maximum capacity which it may offer its customers, thus creating a place in the market for Tamares at rates which will protect its new business. However, because Bezeq International Ltd. ("Bezeq International") has recently completed the installation of its own underwater cable, it will not be required to purchase capacity from Med Nautilus or Tamares and may supply itself with its own international transmission services at a lower cost. As a result, our ability to compete on price with Bezeq for services in the fixed line telecommunications market may be reduced. See "Item 4B. Regulation- 4.6 Hearings and Examinations".

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- The Ministries of Finance, National Infrastructures and Communications and the Israeli Electric Corporation, the Israeli national electric company (the “Electric Company”), published in October 2011 a tender to identify an investor for the Electric Company's telecommunications project. Together with the investor, the Electric Company would establish a new hard-line telecommunications infrastructure capable of offering Internet broadband access (two such infrastructures already exist in Israel, owned by Bezeq and HOT respectively). The new company would be controlled by the investor and held jointly with the Electric Company and would ultimately be awarded a telecommunications license by the Ministry of Communications. If the new company is allowed to sell services to end users (retail) and not just to other providers of telecommunications services (wholesale), it would enter into direct competition with other companies offering Internet broadband access infrastructure services, such as Partner, which may have an adverse affect on our business, operating results and financial condition.

For further discussion of important risks related to competition, see also “Item 3D.2 Risks Relating to Our Business Operations - Competition resulting from consolidation in the telecommunications industry, the expanded offerings of full service telecommunications groups, and new entrants into the mobile telecommunications market, despite its current saturation, as well as other actual and potential changes in the competitive environment and communications technologies, may cause an increase in subscriber acquisition and retention costs and a decrease in tariffs, and may reduce our subscriber base and increase our churn rate, each of which could adversely affect our business and results of operations.”

During 2011, the Israeli parliament debated numerous proposals affecting consumer protection and telecommunications regulations. Whether and in what form such proposals may eventually be adopted, and any negative effects they may have on our business, operating results or financial condition, cannot be predicted at this time. See “Item 4B. Regulation – 4 Regulatory Developments".

In July 2010, the Israeli Parliament approved an amendment to the Restrictive Trade Practices Law, according to which the Israeli Commissioner of Restrictive Trade Practices is authorized to regulate practices in oligopolistic markets, to determine that certain entities in a certain market act as an oligopoly and to give instructions to the participants of an oligopoly markets. This legislation may result in increased anti-trust regulation of the mobile telephone industry in Israel, which could have a material adverse effect on our revenues and financial results. A parliamentary committee is currently preparing for final readings an amendment to the Restrictive Trade Practices Law, which, if adopted, would empower the Commissioner of Restrictive Trade Practices to impose administrative fines of up to 8% of the annual turnover (but capped at NIS 24,000,000) for infractions of Restrictive Trade Practices Law. The stated aim of the amendment is to give the Commissioner an effective, fast and efficient enforcement tool. If adopted, the amendment may result in increased enforcement, since imposing administrative fines is subject to a significantly faster and less onerous procedure than criminal proceedings.

For the reasons given above and further below, regulation of our industry has had in the past, and may in the future have, a material adverse effect on our business and results of operations. In addition, new laws, regulations or government policies, or changes in current regulations, may be adopted or implemented in a manner which damages our business and operating results. Announcements by the government of changes or other developments in applicable regulations may have a negative impact on the market value of our shares. For information regarding the principal regulations and regulatory developments affecting our business, see “Item 4B. Business Overview – Regulation”. Furthermore, defending ourselves against regulatory violations alleged by state authorities or consumers has required, and may in the future require, substantial financial and management resources. We may not always be successful in our defense, and should we be found in violation of these regulations, we and our management may be subject to civil or criminal penalties, including the loss of our operating license. For information regarding on-going litigation or proceedings, see “Item 8A. Consolidated Financial Statements and Other Financial Information – Legal and Administrative Proceedings”.

Recent and potential future regulation and negotiation of roaming tariffs, both within Israel and elsewhere, may increase our roaming expenses, decrease our roaming revenues and prevent us from raising our tariffs. If our competitors, including new entrants into the telecommunications market, can deliver a more cost effective roaming service or more sophisticated roaming services, then our subscribers may migrate to those competitors and our results of operations could be adversely affected.

Regulation and negotiation of roaming charges. The Ministry of Communications has declared its intention to evaluate roaming charges, and in 2008 the government instructed the Ministry of Communications, together with other ministries, to negotiate a reduction of inbound and outbound roaming tariffs with the European Union ("EU") and/or members of the EU or countries frequently visited by Israelis, and to consider other tools for reducing roaming charges. As a result, in the last few years and at a much more detailed level in January 2012, the Ministry of Communications has requested Partner and its competitors to provide information regarding our roaming services. Because roaming charges represent a significant source of our revenue and profits, if roaming tariffs are reduced as a result of the review by the Ministry of Communications or as a result of the proposed negotiations or otherwise, if additional EU member operators raise their tariffs, or if we are not able to raise our tariffs or otherwise compensate for possibly higher roaming expenses, our profitability and results of operations could be materially adversely affected.

Competition in roaming. Some of our competitors may be able to obtain lower roaming rates than we because they have larger call volumes or through their affiliations with other international cellular operators. Some competing service providers use alternative technologies for roaming that bypass the existing method of providing roaming services. In addition, the entry into the market of MVNOs and two new infrastructure based cellular operators is expected to increase competition in the roaming market since some of the new entrants are expected to offer roaming solutions that will allow them to set lower roaming charges. In addition, the requirement to sell unlocked handsets facilitates the ability of subscribers to use local SIM cards in their handsets when traveling abroad, which may compete with our roaming services.

Reliance on other service providers for roaming. We rely on agreements to provide roaming capability to our subscribers in many areas outside Israel. However, we cannot control the quality of the service that other telecommunication companies provide, and it may be inferior to our quality of service. Our subscribers also may not be able to use some of the advanced features that they enjoy when making calls on our network. As a result, we may lose some of our customers' roaming traffic to other roaming solutions, which would negatively impact our results of operations from this important source of earnings.

We have had difficulties obtaining some of the building and environmental permits required for the erection and operation of our network sites, and some building permits have not been applied for or may not be fully complied with. These difficulties could have an adverse effect on the coverage, quality and capacity of our network. Operating network sites without building or other required permits, or in a manner that deviates from the applicable permit, may result in criminal or civil liability to us or to our officers and directors.

Our ability to maintain and improve the extent, quality and capacity of our network coverage depends in part on our ability to obtain appropriate sites and approvals to install our network infrastructure, including network sites. The erection and operation of most of these network sites require building permits from local or regional planning and building authorities, as well as a number of additional permits from other governmental and regulatory authorities. In addition, as part of our UMTS network build-out, we are erecting additional network sites and making modifications to our existing network sites for which we may be required to obtain new consents and approvals.

For the reasons described in further detail below, we have had difficulties obtaining some of the building permits required for the erection and operation of our network sites. As of December 31, 2011, less than 10% of our network sites were operating without local building permits or exemptions which, in our opinion, are applicable and in addition, some of our network sites are not built in full compliance with the applicable building permits.

Network site operation without required permits or that deviates from the permit has in some cases resulted in the filing of criminal charges and civil proceedings against us and our officers and directors, and monetary penalties against the Company, as well as demolition orders. See “Item 8A. Consolidated Financial Statements and Other Financial Information – Legal and Administrative Proceedings”. In the future, we may face additional demolition orders, monetary penalties and criminal charges. The prosecutor’s office has set up a national unit to enforce planning and building laws. The unit has stiffened the punishments regarding violations of planning and building laws, particularly against commercial companies and its directors. If we continue to experience difficulties in obtaining approvals for the erection and operation of network sites and other network infrastructure, this could have an adverse effect on the extent, coverage and capacity of our network, thus impacting the quality of our voice and data services, and on our ability to continue to market our products and services effectively. In addition, as we seek to improve the range and quality of our services, we need to further expand our network, and difficulties in obtaining required permits may delay, increase the costs or prevent us from achieving these goals in full. Our inability to resolve these issues in a timely manner could also prevent us from achieving or maintaining the network coverage and quality requirements contained in our license.

Possible amendment to the Non-ionizing Radiation Law. In October 2010, a bill was submitted to amend the Non-Ionizing Radiation Law. In accordance with the bill, permits from the Ministry of Environmental Protection will not be given to cell sites that are within 75 meters of senior citizens institutions, including senior citizen housing, education institutions, shelters and hospitals. In accordance with the bill, any permit that will be given to a cell site that does not fulfill the said provision shall expire within 6 months from the date of the amendment. The bill passed a preliminary reading in the Parliament and received the approval of the Ministerial legislative committee. If the bill is approved, it will cause significant damage to the telecommunications coverage in urban areas since we will be required to remove hundreds of telecommunication sites to less suitable locations which, as a result, will adversely affect the Company’s revenues. In addition, we may need to change the location of our network sites to less suitable locations or to dismantle existing network sites, which may have an adverse effect on the quality and capacity of our network coverage.

Uncertainties under National Building Plan 36. Since June 2002, following the approval of the National Building Plan 36 (the “Plan”), which regulates network site construction and operation, building permits for our network sites (where required) have been issued in reliance on the Plan. Several local planning and building authorities have questioned the ability of Israeli cellular operators to receive building permits, in reliance on the Plan, for network sites operating in frequencies not specifically detailed in the frequency charts attached to the Plan. In a number of cases, these authorities have refused to grant building permits for 3G network sites, claiming that 3G frequencies are not included in the Plan. There has been no judicial ruling at this stage. However, a class action was filed against us as well as other cellular operators with a request for the revocation of the building permits given to the 3G network sites.

The Plan is in the process of being changed. See “Item 4B Regulation-7.3-National Building Plan No. 36”.

Uncertainties regarding the validity of exemptions for wireless access devices. We have set up several hundred small communications devices, called wireless access devices, pursuant to a provision in the Telecommunications Law, which exempts such devices from the need to obtain a building permit. A claim was raised that the exemption does not apply to cellular communications devices and the matter reached first instance courts a number of times, resulting in conflicting decisions. This claim is included in an application to certify a class action filed against the three principal Israeli cellular telephone operators. In May 2008 a district court ruling adopted the position that the exemption does not apply to wireless access devices. We, as well as our competitors, filed a request to appeal this ruling to the Supreme Court. In May 2008, the Attorney General filed an opinion regarding this matter stating that the exemption does apply to wireless radio access devices under certain conditions;  two petitions were filed with the High Court of Justice in opposition to the Attorney General’s opinion. The matter is still pending before the Supreme Court and the High Court of Justice. “Item 4B Regulation- 7 Network Site Permits”.

If a definitive court judgment holds that the exemption does not apply to cellular devices at all, we may be required to remove the existing devices and would not be able to install new devices on the basis of the exemption. As a result, our network capacity and coverage would be negatively impacted, which could have an adverse effect on our revenue and results of operations.

Uncertainties regarding requirements for repeaters and other small devices. We, like the other cellular telephone operators in Israel, provide repeaters, also known as bi-directional amplifiers, to subscribers seeking an interim solution to weak signal reception within specific indoor locations. In light of the lack of a clear policy of the local planning and building authorities, and in light of the practice of the other cellular telephone operators, we have not requested permits under the Planning and Building Law for the repeaters. However, we have received an approval to connect the repeaters to our communications network from the Ministry of Communications and have received from the Ministry of Environmental Protection permit types for all our repeaters. If the local planning and building authorities determine that permits under the Planning and Building Law are also necessary for the installation of these devices, or any other receptors that we believe do not require a building permit, it could have a negative impact on our ability to obtain permits for our repeaters.

In addition, we construct and operate microwave links as part of our transmission network. The various types of microwave links receive permits from the Ministry of Environmental Protection in respect of their radiation level. Based on an exemption in the Telecommunications Law, we believe that building permits are not required for the installation of most of these microwave links on rooftops, but to the best of our knowledge, there is not yet a determinative ruling on this issue by the Israeli courts. If the courts determine that building permits are necessary for the installation of these sites, it could have a negative impact on our ability to obtain environmental permits for these sites and to deploy additional microwave links, and could hinder the coverage, quality and capacity of our transmission network and our ability to continue to market our transmission services effectively.

The Ministry of Environmental Protection’s Request for the Installment of Monitoring Devices. In May 2010, the Ministry of Environmental Protection notified the Company of a new condition for all of the Company’s network site operation permits, according to which the Company must install in its systems software (provided by the Ministry of Environmental Protection) that continuously monitors and reports the level of power created in real time from the operation of its network sites. The Ministry of Environmental Protection refused to provide the Company with any technical data regarding the monitoring software and therefore the Company cannot anticipate the manner of operation of the software nor its reliability. The Company complied with the Ministry of Environmental Protection’s condition and as of August 19, 2010, provides reports to the Ministry every fifteen minutes regarding the power of all of its transmitters. Since the installment of the software, the Company has received several alerts reporting exceeded transmission power at some of the Company’s cell sites. All purported alerts were examined by the Company’s engineers and were found to be baseless. Recently, the Ministry of Environmental Protection has sent to all the cellular companies notice of an administrative and criminal enforcement procedure that will be implemented by the Ministry as part of the monitoring devices. Partner, as well as the other cellular companies, has advised the Ministry that based on their experience so far from the alerts that have been received and examined by their engineers, it seems that the devices are not credible and therefore administrative and criminal proceeding should not be based on their findings. The Ministry of Environmental Protection has not yet responded.

The Company is of the opinion that all of the antennas that it operates comply with the conditions of the safety permits that the Company was granted by the Ministry of Environmental Protection. However, implementation of the monitoring software increases the exposure of the Company and its senior officers to civil and criminal proceedings in the event that any antennas are found to not meet the conditions of the permits granted to the Company and the maximum permitted power. In addition, if our antennas are found to not meet the conditions of the permits granted to the Company and the maximum permitted power, the Ministry of Environmental Protection may revoke existing permits, which would require us to dismantle existing network sites. As a result, our network capacity and coverage would be negatively impacted, which could have an adverse effect on our revenue and results of operations.

We may be required to terminate the use of certain spectrum or to share with another operator some of the spectrum we are currently using on an exclusive basis. We may not be allocated sufficient spectrum band or any spectrum at all needed in order to provide 4th generation (4G) services. These requirements may adversely affect our network quality and capacity as well as our results of operations.

There are demands from different third parties to rearrange the current spectrum allocation in Israel and the Palestinian Administered Areas, particularly the 900 Mhz frequencies, and also to allocate additional frequencies for the use of other mobile operators in the Palestinian Administered Areas.  We have received notification from the Civil Administration in Judea and Samaria of its intention to change the allocation of some of the spectrum previously allocated to us for our use in the West Bank, and that following the change, we may be allocated other spectrum in the West Bank and additional spectrum for our use in Israel. If we were to be prevented from using a portion of our existing spectrum, or if alternative equivalent spectrum are not allocated to us, or if we were to be required to share some of our spectrum, this could affect our ability to establish a UMTS 900 network and have a material adverse effect on our operations, profitability and on our capital expenses.  Until we receive further details regarding this allocation of spectrum, we are unable to evaluate the impact that the intended change in spectrum allocation, if it occurs, will have on our business or our results of operations. If such a frequency rearrangement takes place, the spectrum that has been allocated to us for use on an exclusive basis may also be allocated to another operator in the Palestinian Administered Areas, or we may be required to terminate the use of part of our existing spectrum, which might be replaced by an allocation of a new band of spectrum that may be of inferior quality.

There are also demands to allocate additional frequencies for mobile operators for the next mobile generation (4G), Long Term Evolution ("LTE"). In addition to the possibility that spectrum for 4G may not be allocated at all by the Ministry of Communications to any operator, if allocations do take place and spectrum is allocated to our competitors and not to us, or if the spectrum allocated to us is insufficient to provide quality 4G services, this may put us at a disadvantage compared to our competitors and, it may harm our ability to migrate to the next generation technologies and may have a material adverse effect on our operations and profitability. See "Item 4B – Regulation – 4.3 LTE Spectrum Allocation ".

We can only operate our business for as long as we have licenses from the Ministry of Communications. Pending legislation may increase the extent of monitoring and enforcement measures of the Ministry of Communications.

We conduct our operations pursuant to licenses granted to us by the Ministry of Communications, which may be extended for additional periods upon our request to the Ministry of Communications and confirmation from the Ministry that we have met certain performance requirements. We cannot be certain that our licenses will not be revoked, will be extended when necessary, or, if extended, on what terms an extension may be granted.

Furthermore, although we believe that we are currently in compliance with all material requirements of our licenses, the interpretation and application of the technical standards used to measure these requirements, including the requirements regarding population coverage and minimum quality standards and other license provisions, disagreements have arisen and may arise in the future between the Ministry of Communications and us. We have provided significant bank guarantees to the Ministry of Communications to guarantee our performance under our licenses. If we are found to be in material breach of our licenses, the guarantees may be forfeited and our licenses may be revoked. In addition, the Ministry of Communications is authorized to levy significant fines on us for breaches of our licenses, which could have a material adverse effect on our financial condition or results of operations. In addition, the Ministry of Communications has recently submitted a bill to set a mechanism that would allow them to impose financial sanctions on a licensee based on two parameters: the annual income of the violator and the degree of severity of the violation. The bill has recently passed a first reading in the Parliament. If the bill passes, it could materially increase the extent of monitoring and enforcement measures of the Ministry of Communications towards the licensees.

We have been required to offer access to our cellular network infrastructure to other operators, which has enabled new competitors, such as MVNOs and new cellular operators, to enter the market, and may reduce our ability to provide quality services to our subscribers and may negatively affect our operating results.

Under both the Telecommunications Law and our operating license, the Ministry of Communications has the power to require us, and the other cellular operators in Israel, to offer access to our cellular network infrastructure to other operators such as MVNOs (mobile virtual network operators) and may impose the terms and tariffs for such access. MVNOs are mobile telecommunications operators that do not own their own spectrum and usually do not have their own physical network infrastructure. Instead, MVNOs have business arrangements with existing cellular operators to use their infrastructure and network for the MVNOs' own customers. The Ministry of Communications granted MVNO licenses to a number of companies and is expected to grant additional MVNO licenses. Partner, as well as two of our competitors, has signed agreements with MVNOs to offer cellular network infrastructure access. See "Item 4B.11 Competition – Recent regulatory developments causing new entrants into Cellular Services".

In September 2010, the Ministry of Communications published a tender for the allocation of UMTS frequencies to additional infrastructure-based cellular operators in Israel. In April 2011, the tender was concluded and the UMTS frequencies were ultimately awarded to MIRS and Golan Telecom. See "Item 4B Regulation - 4.8 Integrated Tender Committee For UMTS Frequency Allocation For An Additional Cellular Operator and National Roaming".

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These new regulatory developments have significantly lowered the entry barriers for potential new competitors and are already enabling new competitors to enter the mobile telephone market in Israel. Our capacity is limited, and since we are required to allocate capacity to other operators, the services we provide to our subscribers may be harmed or we may be required to invest additional capital in order to enable additional use of our network. In addition, new operators, such as MVNOs, that offer mobile telecommunication services to our current customers at prices that are lower than our prices, may reduce our market share and/or cause price erosion and adversely affect our financial results and condition. The impact of these developments may have a material effect on our competitive position and thus our business and operating results.

Our mobile telephone license imposes certain obligations on our shareholders and restrictions on who can own our shares. Ensuring compliance with these obligations and restrictions may be outside our control, but if the obligations or restrictions are not respected by our shareholders, we could lose our license.

As with other companies engaged in the telecommunications business in Israel, our license requires that a minimum economic and voting interest in, and other defined means of control of, our company be held by Israeli citizens and residents or entities under their control. If this requirement is not complied with, we could be found to be in breach of our license, even though ensuring compliance with this restriction may be beyond our control. See "Item 4B Regulation - 5.10 Our Mobile Telephone License- License Conditions".

Our general mobile telephone license requires that our founding shareholders or their approved substitutes hold at least 26% of the means of control in the company and 5% of which shall be held by Israeli citizens and residents who were approved as such by the Minister of Communications. The license also requires that these Israeli shareholders appoint at least 10% of our Board of Directors. In 2006, our founding Israeli shareholders sold substantially all of their shares in the Company to Israeli institutional investors, who are approved substitutes. Since then, there were additional share sales to Israeli institutional investors that were approved as substitutes by the Minister of Communications. Some of these shares sales were to Suny Electronics Ltd. (“Suny”).

In addition, according to our license, no transfer or acquisition of 10% or more of any of such means of control, or the acquisition of control of our company, may be made without the consent of the Minister of Communications. Our license also restricts cross-ownership and cross-control among competing mobile telephone operators, including the ownership of 5% or more of the means of control of both our company and a competing operator, without the consent of the Minister of Communications, which may limit certain persons from acquiring our shares. Shareholdings in breach of these restrictions relating to transfers or acquisitions of means of control or control of Partner could result in the following consequences: the shares will be converted into “dormant” shares as defined in the Israeli Companies Law, with no rights other than the right to receive dividends or other distributions to shareholders, and to participate in rights offerings until such time as the consent of the Minister of Communications has been obtained and our license may be revoked.

In connection with some building permits, we may also be required to indemnify planning committees in respect of claims against them relating to the depreciation of property values that result from the granting of permits for network sites.

Under the Planning and Building Law, 1965, local planning committees may be held liable for the depreciation of the value of nearby properties as a result of approving a building plan. Under the Non-Ionizing Radiation Law, 2006, the National Council for Planning and Building requires indemnification undertakings from cellular companies as a precondition for obtaining a building permit for new or existing network sites. The National Council has decided that until the Plan is amended to reflect a different indemnification amount, cellular companies will be required to undertake to indemnify the committees in full against all losses resulting from claims against a committee for reductions in property values as a result of granting a permit to the network site. On June 1, 2010, the National

Council for Planning and Building approved the National Building Plan No. 36/A/1 version that incorporates all of the amendments to the Plan ("the Amended Plan"). The Amended Plan sets forth the indemnification amounts as a percentage of the value of the depreciated property claims in accordance with the manner in which the licenses were granted. See "Item 4B Regulation 7.3 National Building Plan No. 36". The Amended Plan is subject to governmental approval, in accordance with the Planning and Building Law. It is unknown when the government intends to approve the Amended Plan.

As of December 31, 2011, we have provided local authorities with 421 indemnification undertakings. These indemnifications expose us to risks which are difficult to quantify or mitigate and which may have a material adverse effect on our financial conditions and results of operations, if we are required to make substantial payments in connection therewith.

In addition, the requirement to provide indemnification in connection with new building permits may impede our ability to obtain building permits for existing network sites or to expand our network with the erection of new network sites. The indemnification requirement may also cause us to change the location of our network sites to less suitable locations or to dismantle existing network sites, which may have an adverse effect on the quality and capacity of our network coverage.

In 2007, the Israeli Ministry 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 for a network site under the Plan and six months from the construction of a network site. The Ministry retains the general authority to extend such period further. This extension of the limitation period increases our potential exposure to depreciation claims.

3D.2 RISKS RELATING TO OUR BUSINESS OPERATIONS

Competition resulting from consolidation in the telecommunications industry, the expanded offerings of full service telecommunications groups, and new entrants into the mobile telecommunications market, despite its current saturation, as well as other actual and potential changes in the competitive environment and communications technologies, may cause an increase in subscriber acquisition and retention costs and a decrease in tariffs, and may reduce our subscriber base and increase our churn rate, each of which could adversely affect our business and results of operations.

Telecommunications industry consolidation. Over the past few years, many changes have occurred in the Israeli telecommunications market. In the past, the Company competed primarily with the three other cellular operators: Cellcom, Pelephone and MIRS, and focused mainly on issues regarding brand identification, customer service, quality of telecommunication services and variety of handsets and prices. However, cellular operators have recently increased the breadth of services they offer through acquiring other operators or service providers or becoming part of large telecommunication groups, such that the scope of competition between the principal companies has expanded to include a wider range of telecommunications services and products, including fixed-line services, International Long Distance ("ILD") services, ISP services, Voice Over Broadband ("VoB") services, Primary Rate Interface ("PRI") services and transmission services. As part of Partner’s strategic transformation into a comprehensive communications group, on March 3, 2011, the Company acquired all of the outstanding shares of 012 Smile Telecom Ltd, an Israeli operator of ILD services, ISP services and Fixed-line services using VoB technology (see “Item 4A. History and Development of the Company”).

Four main groups have formed in the Israeli telecommunications market: the Bezeq Group, the HOT Group, the Cellcom Group and the Partner Group.

Bezeq Group – The Israel Telecommunications Corp., Ltd (“Bezeq”), Israel's largest telecommunications provider and the primary fixed-line operator, owns Pelephone, Bezeq International Ltd. and DBS Satellite Service (1998) Ltd. ("YES") (together with Eurocom Communications Ltd.) (the "Bezeq Group"). The Bezeq Group provides fixed-line telephony services, cellular telephony services, primary rate interface (“PRI”), broadband internet access infrastructure services, ISP services, transmission and data communications services, ILD services and multi channel television services. The Ministry of Communications has allowed the Bezeq Group to market bundled telecommunications services to the private sector, subject to conditions and limitations. The Bezeq Group may thus offer its customers a full range of integrated telecommunications services in one package but may not discount the price of bundled services from their unbundled prices.

In October 2011, the Hayek Committee published its recommendations with respect to the fixed-line telecommunications sector. See “Item 4B Regulation- 4.7 Public Committee to examine the fixed-line telecommunications sector". The Hayek Committee recommended, among other things, abolishing the structural separation imposed upon Bezeq in the provision of certain services, and replacing the existing supervision over Bezeq's tariffs, which sets tariffs, with supervision which sets maximum tariffs. If the Minister of Communications adopts these recommendations before adopting another of the Hayek Committee’s recommendations, to create a wholesale market, it could affect our ability to compete with the existing fixed-line operators since Partner, without its own fixed-line infrastructure in the private market and only a partial fixed-line infrastructure in the business market, would not be able to offer fixed-line services individually or in packages that could compete with those of Bezeq.

HOT Group – The HOT Group consists of HOT Telecommunications Systems Ltd., HOT Telecom Limited Partnership and HOT-NET Internet Services Ltd. ("HOT-NET"), and in November 2011, it acquired all of the outstanding shares of MIRS (collectively, the "HOT Group"). The HOT Group provides multi channel television services, fixed-line telephony services, PRI, broadband internet access infrastructure services, transmission and data communications services as well as ISP services. In 2010, the Ministry of Communications granted HOT-NET a license to provide ISP services and gave permission to the HOT Group to market bundled services, subject to certain structural limitations between the companies in the HOT Group. On February 15, 2012, the HOT Group announced that it will begin providing ISP services to the private market and subsequently announced an offering for a limited time of bundled services including multi channel television, fixed-line telephony, and broadband internet access, together with ISP services at a price well below their historical level in the Israeli market. MIRS's cellular license was amended to include UMTS frequencies allocated subsequent to winning a Ministry of Communications' tender offer for frequencies in the 2100 Mhz spectrum. See "Item 4B. Business Overview-4B.11-Competition- Recent regulatory developments causing new entrants into Cellular Services".

Cellcom Group - In August 2011, Cellcom acquired Netvision Ltd., ("Netvision"). The Cellcom Group provides cellular telephony services, fixed-line telephony services, PRI, transmission and data communications services, ISP services and ILD services.

Recent and potential future consolidations could substantially affect our position in the Israeli telecommunications market, in particular, by attracting a broad range of telecommunications subscribers to one or two full-service telecommunications groups, as well as by permitting such a group or groups to apply substantial pressure on market prices. In particular, because the Bezeq Group and the HOT Group operate their own broadband internet access and transmission infrastructures, they do not depend on any third party for broadband internet access, and thus are able to offer bundled fixed-line, ILD services (only the Bezeq Group), ISP services, broadband internet access, infrastructure services, multichannel television services and even cellular services, some of which Partner and other telecommunications services providers, who do not have broadband internet access infrastructure , are unable to provide, thus substantially limiting their ability to compete.

Uncertain future of the ISP market. While there are only two broadband internet access infrastructure providers (Bezeq and HOT), the Ministry of Communications has granted dozens of licenses for Internet Service Providers ("ISPs"). Those groups that can offer ISP service on their own broadband internet access infrastructure and transmission infrastructure have a distinct competitive advantage over ISPs of other groups and over stand-alone ISPs, since it allows such groups to offer consumers the required services in one "stop shop". HOTs recent price offering for ISP Services has created significant downward price pressure in the ISP market, and may reach a point where offering stand-alone ISP Services, without the required broadband internet access infrastructure service, may not be commercially viable. In 2011, the Company conducted impairment testing of specific assets of the fixed-line segment, including the amount recorded as goodwill in connection with the acquisition of 012 Smile by Partner, and material asset value impairments have been recognized. See "Item 5A.1.3 Acquisition of 012 Smile". Further adverse developments in the ISP market may have a material negative effect on Partner's consolidated revenues, and could lead to further asset impairment.

Market Saturation. Because the Israeli cellular market has reached a level of full saturation, the acquisition of new subscribers by any service provider generally requires an increase in market share and results in a loss of market share for its competitors.

New entrants into the mobile telecommunications market. Following the Ministry of Communications' tender for the allocation of UMTS frequencies to two additional operators, the frequencies were ultimately awarded to MIRS and Golan Telecom; therefore, two new entrants have joined the mobile telecommunications market. As a result, and in light of the current saturation of the cellular communications market, the market share of existing mobile operators may diminish and pricing for services may be subject to additional pressure. See “Item 4B Regulation - 4.8 Integrated Tender Committee For UMTS Frequency Allocation For An Additional Cellular Operator and National Roaming".

The Ministry of Communications recently granted MVNO licenses, which is expected to further increase competition in the market. One MVNO began operating in December 2011, and the other operators are expected to launch their operations during 2012. See “Item 3D.1 Risks Related to the Regulation of Our Industry - We have been required to offer access to our cellular network infrastructure to other operators, which has enabled new competitors, such as MVNOs and new cellular operators, to enter the market, and may reduce our ability to provide quality services to our subscribers and may negatively affect our operating results”.

Limitation of exit fees. As part of amendments to the Telecommunications Law, during 2011, changes were made which reduce the exit fees that telecommunication operators are allowed to charge subscribers who wish to terminate their subscriber agreement during the commitment period. These regulatory changes increased the competition which was one of the main factors for the increase in churn rates during 2011. See “Item 4B Regulation- 4.2 Regulatory Consumer Amendments".

Prohibition of linkage between the sale of handsets and the provision of various benefits regarding cellular services. The Ministry of Communications amended the conditions of the licenses of all the cellular telecommunication companies in Israel, whereby as of November 1, 2009, cellular telecommunications operators are prohibited from linking the sale of handsets to the provision of various benefits regarding cellular services, including air time service. This amendment to the license also allows subscribers that purchased their handsets from one cellular telecommunications operator, or from another handset supplier, to benefit from the various benefits regarding cellular services that the cellular telecommunications operator offers to subscribers who purchase their handsets from that operator. This provision contributed to the increase in churn of post-paid cellular subscribers and its affect may increase.

Prohibition of the sale of locked handsets. As part of an amendment to the Telecommunications Law, effective January 2011, cellular companies are prohibited from selling locked handsets for use only with the company’s SIM card and must agree to unlock all handsets they have sold in the past, free of charge. It was further resolved that this provision will not apply to a subscriber or group of subscribers that requested from the cellular operator in a specific and detailed request that this provision not apply to them.

Sale of handsets. Pursuant to an amendment to the Telecommunications Law adopted in January 2011, the import of cellular handsets to Israel was significantly facilitated by exempting certain mobile radio telephone handsets from receiving a type approval if they meet conditions set by the Minister of Communications. In addition, the amendment exempted handset imports which meet the Minister of Communications conditions from receiving a commerce license. The purpose of the amendment was to increase competition and reduce cellular handset prices in Israel. In June 2011, the procedures with respect to the import of cellular handsets were again facilitated to further increase competition. As a result of this subsequent amendment, our revenues and profit from equipment sales may be adversely affected.

Competition in Roaming Services. We are also subject to competition from other businesses offering roaming services which use alternative technologies. See "Item 3D.1 Risks Relating to the Regulation of Our Industry - Recent and potential future regulation and negotiation of roaming tariffs, both within Israel and elsewhere, may increase our roaming expenses, decrease our roaming revenues and prevent us from raising our tariffs. If our competitors, including new entrants into the telecommunications market, can deliver a more cost effective roaming service or more sophisticated roaming services, then our subscribers may migrate to those competitors and our results of operations could be adversely affected."

4G licenses. 4G is an evolved mobile technology that allows a wide bandwidth for data services. To date, although LTE is the most dominant 4G technology, WiMAX is still considered a 4G technology as well. In February 2009, the Ministry of Communications published a policy regarding the allocation of frequencies and establishing a broadband wireless access network in the 2.5 GHz frequency band, excluding existing cellular operators (excluding MIRS) from participating and focusing mainly on WiMAX. If 4G licenses are granted to new operators or to any of our competitors and not to us, or if the spectrum allocated to us is insufficient to provide quality 4G services, we may suffer a competitive disadvantage which could adversely affect our business, since it would impair our ability to migrate to LTE and compete in the mobile broadband market. See "Item 3D.1 Risks Relating to the Regulation of Our Industry - We may be required to terminate the use of certain spectrum or to share with another operator some of the spectrum we are currently using on an exclusive basis. We may not be allocated sufficient spectrum band or any spectrum at all needed in order to provide 4th generation (4G) services. These requirements may adversely affect our network quality and capacity as well as our results of operations".

Moreover, this 3-year old policy of the Ministry of Communications has not been updated to reflect the global market trend in which LTE has become more dominant compared to WiMAX and has become de-facto the industry's sole 4G technology. This fact, together with the Ministry of Communications' failure to allocate enough 4G LTE spectrum, challenges our planned roadmap to begin testing and deploying LTE.

VoC Technology. The Ministry of Communications has granted a special license to a few of the new operators to conduct a marketing experiment that will examine the provision of domestic telephony services using VoC (VoIP over Cellular) technology. VoC services may provide an alternative to traditional mobile telephony services or virtual mobile networks, offering an easier and more cost efficient service. In addition, a licensed VoC service improves user experience, since it has a standard phone number and can be ported in and out with number portability. In addition, the VoC network is inter-connected to existing telephony providers. If the VoC marketing experiment is successful and the Ministry of Communications grants licenses to offer VoC service, demand for our mobile telephone services may be reduced, which would negatively impact revenues and profits from that segment.

Unanticipated growth in subscriber demand for cellular data may require us to modify certain products or services and could require us to make unplanned investments.

As part of our strategy of evolving into a diversified multi-service communications and media service provider, we have developed services providing, and successfully encouraged subscriber demand for, Internet access and content and data consumption using 3G cellular phones, smartphones, data cards and ISP Services. However, in the event subscriber demand for data increases more rapidly than expected, we may need to develop strategies to avoid data traffic overloading the capacity of the network. Such strategies may include modifying certain products or services or undertaking significant unanticipated investments. In addition, regulatory developments seeking to ensure "fair usage" of the Internet for all persons may impose changes on the terms and conditions of certain of our current or future services. In the event of substantial, rapid growth in data consumption by our subscribers and the public generally, we may be obliged to adjust our product offering or undertake significant investments, both of which could have a material adverse effect on our financial condition or results of operations.

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

In order to attract and retain the maximum number of subscribers in our highly competitive market, we design specific tariff 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 tariff plans. From time to time, we have detected some discrepancies between certain tariff 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 tariff plans are appropriately processed by our information systems. We have also taken steps to remedy the identified discrepancies. Despite our 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 tariff 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 that may materially adversely affect our results of operations.

Actual and alleged health risks related to network sites and the use of mobile telecommunications devices, including handsets, could have a material adverse effect on our business, operations and financial condition.

A number of studies have been conducted to examine the health effects of wireless phone use and network sites, and some of these studies have been construed as indicating that radiation from wireless phone use causes adverse health effects. Media reports have suggested that radio frequency emissions from network sites, wireless handsets and other mobile telecommunication devices may raise various health concerns. While, to the best of our knowledge, the handsets that we market comply with the applicable laws that relate to acceptable Specific Absorption Rate ("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, and not for each and every handset, we have no information as to the actual level of SAR of the handsets along the lifecycle of the handsets, including in the case of repaired handsets. See also "Item 4B-Regulation-Other Licenses-7.5 Other Approvals". Furthermore, our network sites comply with the International Council on Non-Ionizing Radiation Protection standard, a part of the World Health Organization, which has been adopted by the Israeli Ministry of Environmental Protection.

In May 2011, the International Agency for Research on Cancer ("IARC"), which is part of the World Health Organization ("WHO"), published a press release according to which it classified radiofrequency electromagnetic fields as possibly carcinogenic to humans based on an increased risk for adverse health effects associated with wireless phone use. We have complied and are committed to continue to comply with the rules of the authorized governmental institutions with respect to the precautionary rules regarding the use of cellular telephones. We refer our customers to the precautionary rules that have been recommended by the Ministry of Health, as may be amended from time to time.

In June 2011, WHO published a fact sheet (no. 193) in which it was noted that "A large number of studies have been performed over the last two decades to assess whether mobile phones pose a potential health risk. To date, no adverse health effects have been established as being caused by mobile phone use". It was also noted by WHO that "While an increased risk of brain tumors is not established, the increasing use of mobile phones and the lack of data for mobile phone use over time periods longer than 15 years warrant further research of mobile phone use and brain cancer risk in particular, with the recent popularity of mobile phone use among younger people, and therefore a potentially longer lifetime of exposure". WHO notified that in response to public and governmental concern it will conduct a formal risk assessment of all studied health outcomes from radiofrequency fields exposure by 2012.

Several lawsuits have been filed against operators and other participants in the wireless industry alleging adverse health effects and other claims relating to radio frequency transmissions to and from sites, handsets and other mobile telecommunications devices, including lawsuits against us. A class action was filed against us and three other operators alleging, among other things, that health effects were caused due to a lack of enough cell sites resulting in elevated levels of radiation, mainly from handsets. Another class action filed against us and two other cellular operators claimed, among other things, the opposite, that adverse environmental effects were caused by an excessive amount of cell sites that we erected. In both class actions the plaintiffs stressed that health damages are not a part of these claims. A class action was also filed against us and three other operators alleging, among other things, that the supply of accessories that are intended for carrying cellular handsets on the body are sold in a manner that contradicts the instructions and warnings of the cellular handset manufacturers and the recommendations of the Ministry of Health, and without disclosing the risks entailed in the use of these accessories when they are sold or marketed. In addition, a tort claim was filed against the Company alleging that the use of handsets, under certain circumstances, results in elevated radiation which caused health damage. If this claim is successful, we may be subject to additional future litigation relating to these health concerns.

In February 2009, a municipal court ruled against one of our competitors, stating that there is no need for the standard burden of proof to prove damages from a cellular network site, and that under certain circumstances it would be sufficient to prove the possibility of damage in order to transfer the burden of proof to the cellular companies. To the best of our knowledge, the defendant appealed the ruling and the ruling was dismissed as part of a settlement between the parties. Although we were not a party to this proceeding, such rulings could have an adverse affect on our ability to contend with claims of health damages as a result of the erection of network sites.

The Ministry of Health published in July 2008 recommendations regarding precautionary measures when using cellular handsets. The Ministry of Health indicated that although the findings of an 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 a relationship between prolonged cellular phone usage and tumor development was observed in some of these studies. These studies, as well as the precautionary recommendations published by the Ministry of Health, have increased concerns of the Israeli public with regards to the connection between cellular phone exposure and illnesses.

The perception of increased health risks related to network sites may cause us increased difficulty in obtaining leases for new network site locations or renewing leases for existing locations or otherwise in installing mobile telecommunication devices. If it is ever determined that health risks existed or that there was a deviation from radiation standards which would result in a health risk from sites, other telecommunication devices or handsets, this would have a material adverse effect on our business, operations and financial condition, including through exposure to potential liability, a reduction in subscribers and reduced usage per subscriber. Furthermore, we do not expect to be able to obtain insurance with respect to such liability.

In the event critical elements of our mobile network are damaged or rendered non-operational, we may not be able to replace them or return them to service quickly and, as a result, we may not be able, for an indeterminate period of time, to provide services to a substantial portion of our subscribers, furnish some services properly or at all, charge for services provided, or ensure data security.

Some elements of our mobile network perform critical functions for broad sectors of our network operation, such as switching, billing and data platforms. If such a critical element were damaged or ceased proper operation due to fire, water, earthquake or some other natural, technical or man-made cause including cyber incidents generated either externally through accidental malfunctioning or deliberate intrusion, or internally as a result of technical breakdown, damages may result to us or to our customers. For example, an entire sector of our network coverage may be rendered non-functioning, which means that we would not be able to provide telecommunications services to a substantial portion of our subscribers; or we may be unable to provide certain services, or to provide them without disruptions or charge for services rendered, or we may experience loss of data of the Company or of our customers stored with us. Although we have integrated systems to protect against events such as cyber incidents and prepared disaster recovery plans, it is not possible to determine in advance whether our defense systems and recovery plans will continue to be entirely effective, or how quickly we will be able to restore service. In the event we are unable to provide telecommunications services to a substantial portion of our subscribers, whether temporarily or for an extended period of time, our business and short- and long-term results of operations will be materially negatively affected and we may be exposed to legal claims and liability.

The telecommunications industry is subject to rapid and significant changes in technology and industry structure which could reduce demand for our services.

We may face competition from existing or future technologies, including fixed-line and cordless technologies, satellite-based personal communications services, private and shared radio networks, broadband wireless access services, Voice over IP (“VoIP”) services, wireless fidelity (“Wi-Fi”) technologies, WiMAX, VoC, and other communications technologies that have the technical capability to handle mobile and fixed-line telephone calls, and to interconnect with local and international telephone networks and the Internet. For example, the rapid development in recent years of technologies that allow international calls to be placed over the Internet without the need to use the services of an ILD has caused a decrease in the amount of international call minutes placed through the ILD services and also serve as an alternative for fixed-line communications. In particular, the risk posed by VoIP is that cellular and message services will be provided only by data packages.

The effect of emerging and future technological changes, including the convergence of technologies, on the viability or competitiveness of our network cannot be accurately predicted. The technologies we employ or intend to employ may become obsolete or subject to competition from new technologies in the future and competition from new technologies in the future may have a material adverse impact on our business and results of operations.

Moreover, global equipment vendors and Internet providers have expressed their interest in penetrating the cellular telephone industry and strengthening their position along the value chain. They have expressed their intention, and some have already begun, to provide direct access to the end-user to a wide variety of applications and services (e.g

Apple, with iTunes, Google with the Android market) Such a change might adversely change our competitive position and increase the dominance of those new providers at the expense of cellular service providers. Changes in the industry value chain structure might result in an increase in our expenses as well as a decrease in our revenue generated from those services.

We face operational and legal risks associated with the integration of 012 Smile Telecom Ltd.

On October 13, 2010, we entered into a share purchase agreement to acquire all of the outstanding shares of 012 Smile Telecom Ltd. (“012 Smile”), an Israeli operator of international telecommunication services and local telecommunication fixed services and a provider of internet services. The acquisition was completed on March 3, 2011. As of December 14, 2011, following the termination of the period during which structural separation between the Company and 012 Smile was required, the Company and 012 Smile were allowed to merge their operations.

If we are unable to successfully integrate 012 Smile into our communications group as we planned, we may not achieve the operational synergies we anticipated in connection with the acquisition within the planned time frame or at all. We also may not be able to realize the personnel and cultural integration we expected to achieve, which may lead to the loss of key personnel necessary to operate the acquired business. If we are not successful in integrating 012 Smile's operations and organization into Partner, growth in our revenues and earnings may be negatively affected, and we may incur unanticipated costs or operating inefficiencies.

As part of the integration process, the Company has assessed the exposure of 012 Smile to various legal risks, including in connection with employment and labor law. 012 Smile and, as its parent company, Partner are subject to the risk of legal claims arising from such risks, as well as to other potential risks which have not yet been identified by 012 Smile or the Company. If such risks lead to litigation and adverse judgments, such risks could have a material negative impact on the Company's consolidated results of operations and financial condition.

See also "Uncertain future of the ISP market" under Item 3D.2 "Risks relating to Our Business Operations – Telecommunications industry consolidation".

Our level of indebtedness could adversely affect our business and our liquidity.

At December 31, 2011, our total long-term indebtedness was NIS 5,174 million net of deferred charges including capital lease obligations and current maturities (NIS 4,642 million net of cash on hand), compared to NIS 3,716 million at December 31, 2010 (NIS 3,395 net of cash on hand). See "Item 5B.3 Total Net Financial Debt".

Our substantial indebtedness could adversely affect our financial health by, among other things:

- increasing our vulnerability to adverse economic, industry or business conditions or increases in the CPI, particularly because a substantial portion of our borrowings is linked to the CPI;

- limiting our flexibility in planning for, or reacting to, changes in our industry and business as well as the economy generally;

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

- limiting our ability to obtain the additional financing we may need to operate, develop and expand our business.

If our future cash flows are not sufficient to allow us to pay principal and interest on our debt, we might not be able to satisfy our financial and other covenants and may be required to refinance all or part of our existing debt, use existing cash balances or issue additional equity or other securities. We cannot be sure that we will be able to do so on commercially reasonable terms, if at all.

We are exposed to, and currently engaged in, a variety of legal proceedings, including several potential class action lawsuits related primarily to our network infrastructure and consumer claims.

In addition to a number of legal and administrative proceedings arising in the ordinary course of our business, we have been named as defendants in a number of civil and criminal proceedings related to our network infrastructure, which may result in civil liabilities or criminal penalties against us or our officers and directors, and consumer claims regarding, for example, our tariff plans and billing methods, which may result in significant monetary damages and civil penalties. The costs that may result from these lawsuits are only accrued when it is more likely than not that a liability, resulting from past events, will be incurred and the amount of that liability can be quantified or estimated within a reasonable range. The amount of the provisions recorded is based on a case-by-case assessment of the risk level, and events arising during the course of legal proceedings may require a reassessment of this risk. The Company's assessment of risk is based both on the advice of legal counsel and on the Company's estimate of the probable settlement amounts that are expected to be incurred, if such a settlement will be agreed by both parties. See "Item 8. Financial Information – Legal and Administrative Proceedings".

Plaintiffs in some of these proceedings are seeking certification as class actions. A motion also was filed in November 2011 by a shareholder to approve a derivative claim against several current and past directors of Partner, including the Chairman of the Board of Directors, for breach of their duty of care by resolving to raise capital through notes and by approving dividend distributions which, according to the claimant, were intended to assist Partner's parent company to repay financing it undertook to acquire the controlling stake in the Company.

We are also subject to the risk of intellectual property rights claims against us, including in relation to innovations we develop ourselves and the right to use content, including music content, which we have purchased from third parties who present themselves as the owners of the intellectual property rights included in the content, or as the representatives of the owners of the intellectual property, when in fact they may not be. 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 are dependent upon our ability to interconnect with other telecommunications carriers. We also depend on Bezeq and other suppliers for transmission services and some of our Fixed-Line Services are dependent on our having access to Bezeq and Hot's fixed-line network. The failure of these carriers to provide these services on a consistent basis could have a material adverse effect on us.

Our ability to provide commercially viable cellular telephone services depends upon our ability to interconnect with the telecommunications networks of existing and future fixed-line, cellular telephone and international operators in Israel in order to complete calls between our customers and parties on the fixed-line or other cellular telephone networks. All fixed-line, cellular telephone and international operators in Israel are legally required to provide interconnection to, and not to discriminate against, any other licensed telecommunications operator in Israel. We have signed interconnect agreements with cellular telephone network operators in Israel, and with Israeli international operators, and in 2008, we signed an agreement with Bezeq for the provision of fixed-line transmission services which replaces an earlier transmission agreement. We have interconnect relations with Bezeq and HOT although we are currently operating without any formal agreements with Bezeq, and our day-to-day arrangements with Bezeq substantially conform to a draft interconnect agreement negotiated with Bezeq. In connection with the ISP services and VoB fixed telephony services to the residential market, we also depend on Bezeq's and HOT's internet broadband access infrastructure in order to be able to provide those services.

We are also dependent on the submarine infrastructure made available by Mediterranean Nautilus Israel Ltd ("Med Nautilus"), which provides mutual international transmission based on fiber optics between Israel and other countries. See "Item 10C. Material Contracts".

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. Disruptions, stoppages, strikes and slowdowns experienced by them may significantly affect our ability to provide telecommunication services. The failure by our suppliers to provide reliable interconnections and transmission services to us on a consistent basis could have a material adverse effect on our business, financial condition or results of operations.

We depend on a limited number of suppliers for our handsets and network equipment. Our results of operations could be adversely affected if our suppliers fail to provide us with adequate supplies of handsets and network equipment or maintenance support on a timely basis.

We purchased our network equipment, such as switching equipment, base station controllers and base transceiver stations and network software, from Ericsson and Nokia. As of January 2008, we purchase all our UMTS network equipment from Ericsson, and are therefore materially dependent on Ericsson as our sole vendor for our UMTS network. We purchase the majority of our handsets from a limited number of suppliers. We cannot be certain that we will be able to obtain handsets or equipment from one or more alternative suppliers on a timely basis in the event that any of our suppliers is unable to satisfy our handsets or equipment requirements, or that the equipment provided by such alternative supplier or suppliers will be compatible with our existing equipment. Our handset suppliers may experience inventory shortages from time to time.

Our results of operations could be adversely affected if Ericsson or one of our other key suppliers fails to provide us with adequate supplies of equipment, as well as ongoing maintenance and upgrade support, in a timely manner. In addition, our results of operations could be adversely affected if the price of network equipment rises significantly. In our experience, suppliers from time to time extend delivery times, limit supplies and increase the prices of supplies due to their supply limitations and other factors. If the availability of handsets furnished by our handset suppliers is insufficient to meet our customers' demands, we may lose opportunities to benefit from demand for this product, and our unserved customers may migrate to our competitors. In addition, the constant development of new handsets can render existing handsets obsolete resulting in high levels of slow moving inventory.

Our marketing strategy relies on using the international Orange brand. If our brand license agreement terminates or is revoked, we will lose one of our main competitive strengths.

Our marketing strategy relies on the use of the international Orange brand, which we license from Orange Brand Services Limited, a member of the France Telecom Group ("Orange"). The license granted to us under the agreement that was entered into on July 1, 1998, shall be in effect for as long as we are able and legally eligible under the laws of Israel to offer telecommunications services to the public in Israel and for as long as we comply with the terms of the agreement. Under the brand license agreement, Orange may terminate our license if they determine that we have materially breached the agreement and such breach has not been remedied within a certain time period. If we lose the use of the Orange brand, we would lose one of our main competitive strengths and have to create and position a new brand, which could require substantial time and financial resources. As a result, our business and results of operation may be negatively affected.

The political and military conditions in Israel may adversely affect our financial condition and results of operations.

The political and military conditions in Israel directly influence us. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors. Hostilities involving Israel, the interruption or curtailment of trade between Israel and its trading partners and political instability within Israel or its neighboring countries are likely to cause our revenues to fall and harm our business. During the last decade, there has been a high level of violence between Israel and the Palestinians, including missile strikes by Hamas against Israel, which led to an armed conflict between Israel and the Hamas in December 2008 and January 2009. Ongoing violence between Israel and its Arab neighbors and Palestinians may have a material adverse effect on the Israeli economy, in general, and on our business, financial condition or results of operations. In particular, in recent conflicts, missile attacks have occurred on civilian areas, which could cause substantial damage to our infrastructure network, reducing our ability to continue serving our customers as well as our overall network capacity. In addition, in the event recent political unrest and instability in the Middle East, including changes in some of the governments in the region, causes investor concerns resulting in a reduction in the value of the shekel, our expenses in non-shekel currencies may increase, with a material adverse affect on our financial results.

Some of our directors, officers and employees are currently obligated to perform annual reserve duty. Additionally, all reservists are subject to being called to active duty at any time under emergency circumstances. In addition, some of our employees may be forced to stay at home during emergency circumstances in their area. We cannot assess the full impact of these requirements on our workforce and business if conditions should change.

During an emergency, including a major communications crisis in Israel's national communications network, a natural disaster, or a special security situation in Israel, control of our network may be assumed by a lawfully authorized person in order to protect the security of the State of Israel or to ensure the provision of necessary services to the public. During such circumstances, the government also has the right to withdraw temporarily some of the spectrum granted to us. Under the Equipment Registration and Mobilization to the Israel Defense Forces Law, 1987, the Israel Defense Force may mobilize our engineering equipment for their use, compensating us for the use and damage. This may materially harm our ability to provide services to our subscribers in such emergency circumstances, and would thus have a negative impact on our revenue and results of operations.

Moreover, the Prime Minister of Israel may, under powers which the Telecommunications Law grants him for reasons of state security or public welfare, order us to provide services to the security forces, to perform telecommunications activities and to set up telecommunications facilities required by the security forces to carry out their duties. While the Telecommunications Law provides that we will be compensated for rendering such services to security forces, the government is seeking a change in the Telecommunications Law which would require us to bear some of the cost involved with complying with the instructions of security forces. Such costs may be significant and have a negative impact on our revenue and results of operations.

Operating a telecommunications network involves the inherent risk of fraudulent activities and potential abuse of our services, which may cause loss of revenues and non-recoverable expenses.

There is an inherent risk of potential abuse by individuals, groups, businesses or other organizations that use our telecommunications services and avoid paying for them. The effects of such fraudulent activities may be, among others, a loss of revenue and out-of-pocket expenses which we will have to pay to third parties in connection with those services, such as interconnect fees, payments to international operators or to operators overseas and payments to content providers. Such payments may be non-recoverable. Although we are taking measures in order to prevent fraudulent activities, we have suffered from these activities in the past, and we may suffer from them in the future. The financial impact of fraudulent activities that have occurred in the past has not been material. However, we cannot assure you that should fraudulent activities occur in the future, they will not materially affect our financial condition and results of operations.

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

Substantially all of our revenues and a majority of our operating expenses are denominated in shekels. However, in recent years, approximately one quarter of our operating expenses (excluding depreciation and amortization), including a substantial majority of our equipment purchases, were linked to non-shekel currencies, mainly the US dollar. These expenses related principally to the acquisition of handsets, where the price paid by us is based mainly on US dollars. In addition, a substantial majority of our capital expenditures are incurred in, or linked to, non-shekel currencies, mainly US dollars. A decline in the value of the shekel against the dollar (or other foreign currencies) could have a further adverse impact on our results, which may be material. Material changes in exchange rates may cause the amounts that we must invest to increase materially in shekel terms.

We have hedged a portion of our foreign currency commitments. As of December 31, 2011, the notional amount of our foreign currency forward derivatives: Receive USD and Pay NIS was US$ 100 million and Receive USD and Pay EUR was EUR 20 million. Our derivative transactions are mainly designed to hedge short-term cash flows related to anticipated payments in respect of purchases of handsets and capital expenditures in foreign currency as well as payments to foreign international operators.

Our bank credit facility borrowings, bank borrowings and repayments of principal and interest on our Series A Notes due 2012, Series B Notes due 2016, Series C Notes due 2018, Series D Notes due 2021 and Series E Notes due 2017 are currently in shekels, of which Series A, B and C, and bank borrowings, at a total principal of NIS 2,564 million (including current maturities, less offering expenses) are linked to the consumer price index (“CPI”). We may not be permitted to raise our tariffs pursuant to our license in a manner that would fully compensate for any increase in the CPI. Therefore, an increase in the rate of inflation may also have a material adverse impact upon us by increasing our financial expenses without an offsetting increase in revenue.

See “Item 11. Quantitative and Qualitative Disclosures About Market Risk” for more information regarding the Company’s exposure to exchange rate fluctuations and inflation.

We may fail to maintain effective internal controls in accordance with Section 404 of the Sarbanes-Oxley Act of 2002, which may have a material adverse effect on our operating results and our share price.

Our efforts to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 relating to the evaluation of our internal control over financial reporting have resulted in increased general expenses and required substantial management time and attention. We expect these efforts to require a continued commitment of resources. If we fail to maintain the adequacy of our internal controls, we may not be able to conclude on an ongoing basis that we have effective internal control over financial reporting. Although our management has concluded that our internal control over financial reporting was effective as of December 31, 2011, we may identify material weaknesses or other disclosable conditions in our future control over financial reporting. Failure to maintain effective internal control over financial reporting could result in investigation or sanctions by regulatory authorities and significant effort and expense, and could have a material adverse effect on our operating results and on the market price of our ordinary shares

We may not be able to fulfill our dividend policy in the future. If we implement our current dividend policy, we might reduce our future cash reserves, which may require us to borrow additional money.

We first distributed dividends in 2005, and we have distributed dividends in each subsequent year. On March 16, 2010, the Company's Board of Directors approved a dividend policy, targeting a minimum of 80% payout ratio of annual net income for the year 2010. This dividend policy was reaffirmed by the Board of Directors with respect to 2011 and on March 21, 2012, with respect to 2012.

Under Israeli law, the payment of dividends is generally made from accumulated retained earnings or, retained earnings accrued over a period of the last two years (after deducting prior dividends to the extent not already deducted from retained earnings), and in either case, provided there is no reasonable concern that the dividend will prevent the company from satisfying current or foreseeable obligations as they come due. A dividend distribution that does not meet the above- mentioned conditions would be allowed only after receiving court approval and after providing debtors with the opportunity to present to the court any opposition to the dividend distribution.

There is no assurance that we will be able to continue paying dividends or increase our payment of dividends in the future, nor is there any assurance that our Board of Directors will not change our dividend policy in the future.

Our current dividend policy, if continued to be implemented, will significantly reduce our future cash reserves and may adversely affect our ability to fund unexpected capital expenditures. As a result, we may be required to borrow additional money, 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.

Our business results may be affected by a recurrence of a recession.

In 2009 we experienced a substantial decline in our roaming service revenues due in part to a reduction in incoming and outgoing tourism as a result of the global economic recession and also due to the decrease of outgoing minutes of our business subscribers. If a recession or economic downturn reoccurs, usage of our services may decrease and we may not otherwise be able to compensate for lost revenues, it may have a material adverse effect on our results of operations and financial condition. Subscribers may also be more inclined to switch to using low-cost service providers which may increase the rate of churn. Furthermore, the economic downturn 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 in accordance with 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. 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. Particularly in light of current global economic conditions, there can be no assurance that we will be able to obtain additional bank loans, issue new corporate notes or securitize accounts receivable on acceptable terms or at all, which could have a material adverse effect on our cash flow and financial condition.

3D.3 RISKS RELATED TO OUR PRINCIPAL SHAREHOLDER

45.94% of our shares and voting rights are indirectly controlled by a single shareholder.

As of February 29, 2012, our controlling shareholder, Mr. Ilan Ben-Dov, held indirectly 45.94% of our issued and outstanding shares and total voting rights as a result of his indirect control of Scailex Corporation Ltd. ("Scailex") and

Suny Electronics Ltd.("Suny").

As our largest shareholder, Scailex, who is also one of our main handset suppliers, has the ability to influence our business through its ability to virtually control all actions that require majority approval by the shareholders and through its representatives on our Board of Directors. Scailex is not obligated, however, to provide us with financial support or to exercise its rights as a shareholder in our best interests or in the best interests of our minority shareholders and noteholders, and it may engage in activities that conflict with such interests. If the interests of Scailex conflict with the interests of our other shareholders and noteholders, those shareholders and noteholders could be disadvantaged by the actions that this shareholder chooses to pursue. In addition, Scailex may cause our business to pursue strategic objectives that may conflict with the interests of our other shareholders and noteholders.

On February 1, 2012, Scailex filed an immediate report stating that its Board of Directors resolved to appoint Deutsche Bank and Lazard Freres to advise Scailex to propose potential purchasers and to formulate a deal structure in any transaction regarding Scailex itself and/or Scailex's holding in Partner and the joining of a significant partner to Partner, including the possibility of transforming Partner or Scailex into a private company. Deutsche Bank has confirmed that it will be able to supply Scailex a credit line of up to $1 billion with respect to a possible transaction, subject to certain conditions. As of the date of this annual report, we do not have, or have access to, any non-public information regarding the advice which may be provided or the transactions, conditions or timetables which may be considered by Scailex and its advisors.

ITEM 4. INFORMATION ON THE COMPANY

4A. History and Development of the Company

We were incorporated in Israel under the laws of the State of Israel on September 29, 1997, as Partner Communications Company Ltd. Our products and services are marketed under the Orange brand. Our principal executive offices are located at 8 Amal Street, Afeq Industrial Park, Rosh Ha'ayin 48103, Israel (telephone: 972-54-7814-888). Our website address is www.orange.co.il. Information contained on our website does not constitute a part of this annual report. Our agent for service in the United States is CT Corporation, 111 Eighth Avenue, New York, New York 10011.

Since our incorporation, we have achieved a number of important milestones:

- In April 1998, we received our license to establish and operate a cellular telephone network in Israel.
- In January 1999, we launched full commercial operations with approximately 88% population coverage and established a nationwide distribution.
- In October 1999, we completed our initial public offering of ordinary shares in the form of American Depositary Shares, and received net proceeds of approximately NIS 2,092 million, with the listing of our American Depositary Shares on NASDAQ and the London Stock Exchange. We used part of these net proceeds to repay approximately NIS 1,494 million in indebtedness to our principal shareholders, and the remainder to finance the continued development of our business.
- In August 2000, we completed an offering, registered under the US Securities Act of 1933, as amended, of $175 million (approximately $170.5 million after deducting commissions and offering expenses) in 13% unsecured senior subordinated notes due 2010. These notes were redeemed in August 2005.
- On March 31, 2001, we had over 1,000,000 cellular subscribers.
- In July 2001, we registered our ordinary shares for trading on the Tel Aviv Stock Exchange.
- In December 2001, the Ministry of Communications awarded us two bands of spectrum: one band of GSM 1800 spectrum and one band of 2100 UMTS third generation spectrum.
- In June 2002, our license was extended until February 2022.
- In August 2003, we had over 2,000,000 cellular subscribers.
- In December 2004, we commercially launched our 3G network.

- In March 2005, we completed a debt offering, raising NIS 2.0 billion in a public offering in Israel of notes due 2012.
- In April 2005, we repurchased approximately 33.3 million shares from our Israeli founding shareholders, representing approximately 18.1% of our outstanding shares immediately before the repurchase.

- In the third quarter of 2005, our Board of Directors and shareholders approved the distribution of our first cash dividend, in the amount of NIS 0.57 per share, totaling approximately NIS 86.4 million.

- In March 2006, we launched services based on the High Speed Downlink Packet Access ("HSDPA") technology. HSDPA is a technological enhancement to our 3G services that offers subscribers the ability to access our 3G services at higher speeds. The HSDPA technology has already been deployed to support up to 21 Mbps on the downlink and 5.76 Mbps on the uplink.

- In July 2006, we purchased Med-1 I.C.–1 (1999) Ltd.'s fiber-optic transmission business for approximately NIS 71 million, in order to enable us to reduce our transmission costs as well as to provide our business customers with bundled services of transmission of data and voice and fixed-line services.

- In January 2007, we were granted a domestic fixed license by the Ministry of Communications, and in February 2007 we were granted a network termination point license.

- In August 2008 the ISP license granted to us in 2003 by the Ministry of Communications was renewed for an additional period of five years.

- In December 2008 and January 2009, we launched three additional non-cellular business lines: VoB telephony services, ISP services and Web VOD (video on demand).

- In October 2009, Scailex became our principal shareholder through acquiring the entire interest in the Company of our previous controlling shareholder. Scailex is indirectly controlled by Mr. Ilan Ben-Dov. See "Item 3D.3 45.94% of our shares and voting rights are indirectly controlled by a single shareholder".

- In February 2010, the District Court approved the application submitted by the Company for a special dividend distribution in the total amount of NIS 1.4 billion (exceeding the surpluses for distribution) to the Company's shareholders ("the capital reduction"). Following the District Court's approval, a total amount of NIS 1.4 billion or approximately NIS 9.04 per share was paid on March 18, 2010, to shareholders and ADS holders of record on March 7, 2010, which resulted in a reduction of the shareholders' equity by an equal amount.

- In October 2010, we entered into a share purchase agreement to acquire all of the outstanding shares of 012 Smile Telecom Ltd. from Merhav-Ampal Energy Ltd. 012 Smile, a private Israeli company, is a leading provider of communication services in Israel, which provides a wide range of broadband and traditional voice services. 012 Smile's broadband services include broadband Internet access (ISP) with a suite of value-added services, specialized data services and server hosting, as well as new innovative services such as local telephony via voice over broadband (VOB) and a WiFi network of hotspots across Israel. Traditional voice services include outgoing and incoming international telephony, hubbing, roaming and signaling and calling card services. 012 Smile services residential and business customers, as well as Israeli cellular operators and international communication services providers through its integrated multipurpose network. 012 Smile's network allows it to provide services to almost all of the homes and businesses in Israel. The acquisition will allow us to become a leading comprehensive communications group, expanding our services and products.

- After receipt of approval from the Anti Trust Commissioner and the Ministry of Communications, the transaction was completed on March 3, 2011. However we were required by the Ministry of Communications to maintain 012 Smile's operations structurally separated until December 14, 2011.

- On December 25, 2011, the Company announced a change in the organizational structure, in which the parallel infrastructure and headquarters activities of Partner and 012 Smile will be merged and integrated. As part of the integration strategy, along with maintaining separate segments (cellular and fixed-line), the headquarter services of 012 Smile and the Company, including human resources, finance, legal, procurement and logistics, will be integrated and will be provided jointly under an integrated management.

For information on our capital expenditures for the last three financial years, and for the principal capital expenditures currently in progress, see “Item 5B. Liquidity and Capital Resources – Capital Expenditures”.

4B. Business Overview

Partner Communications Company Ltd. is a leading Israeli telecommunications company, providing a range of cellular and fixed-line telecommunication services. We offer our subscribers competitive tariffs, technologies and services that we believe are advanced, including our 3G services and cellular data services through external or internal (in laptops) cellular modems, tablets and smartphones.

As part of our strategy to evolve into a diversified multi-service communications group, we supply our services through two business segments:-

- the cellular business segment, our main business, which represents the substantial portion of our total revenues. The cellular business segment includes all services provided over our cellular networks including airtime, interconnect, roaming and content services. In addition, the cellular business segment's activities include sales of relevant equipment including cellular handsets, tablets, datacards, modems including built-in modems in laptops and related equipment and accessories.

On December 31, 2011, we had approximately 3,176 million cellular subscribers, representing an estimated 32% of total Israeli cellular telephone subscribers at that date. At December 31, 2011, approximately 72% of our customer base (approximately 2,282,000 subscribers) was represented by subscribers who subscribe to post-paid tariff plans and 28% (approximately 894,000 subscribers) by subscribers who subscribe to pre-paid tariff plans. (For a definition of "subscriber", see "Item 3A. Selected Financial Data -- Partner Data".); and

- the fixed line business segment, which includes a number of services provided over fixed line networks including (1) transmission services; (2) Primary Rate Interface ("PRI") lines for business sector customers; (3) Voice over Broadband ("VoB") telephony services; (4) outgoing and Incoming international telephony, hubbing, roaming and signaling and calling card services (ILD); and (5) Internet service provider ("ISP") services, including value added services, specialized data services and server hosting, and WiFi network of hotspots across Israel. In addition, this segment includes sales of related equipment such as routers and phones.

As of December 31, 2011, our fixed-line telephony subscriber base for both residential as well as business subscribers reached approximately 292,000 lines and our ISP subscriber base reached approximately 632,000 customers.

Subscribers to more than one service including cellular, fixed- line and ISP services are counted separately for each service for the purposes of subscriber count.

We market our services under the Orange brand which is licensed to us and has been used successfully in other markets around the world to promote telecommunications services. Throughout the years Orange has been the leading telecommunications brand in Israel. We also market some of our Fixed-Line Services under the 012 Smile brand.

Our GSM/UMTS network covered 99% of the Israeli population at year-end 2011. We currently operate our GSM network in the 900 MHz and 1800 MHz bands and the UMTS network in the 2100 MHz band and experimentally in the 900 MHz band. Our GSM services include standard and enhanced GSM services, as well as value-added services and products such as roaming, voice mail, voice messaging, color picture messaging, ringtone and game downloads, information services, and General Packet Radio Services ("GPRS"), which enables the packet transfer of data.

Our 3G network offers a wide range of services, such as video calls, a portal of content services including a rich selection of video-based services, and the transmission of data.

In 2011, we were named as the number one communications brand in Israel by Superbrands Organization Israel for the third consecutive year. In 2011, we won the “best workplace” award in the telecommunication industry for the sixth time, an award granted to us by Business Data Information.

4B.1 Special characteristics of the Cellular Telecommunications Industry in Israel

We believe that the following special characteristics differentiate the Israeli market from other developed cellular telecommunications markets:

- High Cellular Phone Usage. Israeli usage of cellular phones is relatively high compared to Western Europe in terms of average monthly usage per subscriber.

- Calling Party Pays. In Israel, only the party originating a telephone call pays for the airtime. Cellular telephone network operators do not charge subscribers to receive calls on their handsets, except while roaming. This encourages higher rates of cellular telephone usage.

- High Ratio of Post-Paid Subscribers. In Israel it is estimated that approximately 80% of the cellular companies' subscribers subscribe to post-paid plans, which is relatively high compared to the European average.

- Cellular Telephone Market Saturation. Since 1994, the market has sustained a rapid annual rate of growth from a 2.6% penetration rate at year-end 1994 to an estimated penetration rate in Israel at December 31, 2011, of 128%, representing approximately 10.0 million subscribers out of an estimated population of approximately 8 million. The total number of estimated cellular telephone subscribers includes dormant subscribers and subscribers to multiple networks as well as other subscribers who are not included in the Israeli population figures, such as Palestinians, visitors, and foreign workers.

- Increased Competition due to Regulatory Changes. The recent regulatory changes in the telecommunications industry with respect to new entrants that include MVNOs and new cellular operators, low exit fees, number portability, prohibition of linkage between the sale of handsets and the provision of various benefits regarding cellular services and prohibition of the sale of locked handsets, have created a high level of competition in the industry.

.• Favorable Geography. Israel covers an area of approximately 8,000 square miles (20,700 square kilometers) and its population tends to be centered in a small number of densely populated areas. In addition, the terrain of Israel is relatively flat. These factors facilitate the roll out, maintenance and subsequent upgrades of a cellular network in a cost effective manner.

- Strong Potential For Value-Added Services. Published market data shows that the relatively young Israeli population has a propensity to accept and use high technology products. The level of penetration of smartphones in the Israeli market is also estimated to be one of the highest in the world. We believe that these characteristics of the Israeli population has facilitated and will continue to facilitate, the acceptance of new value-added services, including services for new data devices such as tablets and laptops.

4B.2 Special characteristics of the Fixed-Line Telecommunications Industry in Israel

The fixed-line telecommunications market in Israel is highly competitive in the markets for fixed-line telephony, ILD services and ISP services. The internet market is split between internet infrastructure providers and internet service providers (ISP). While there are only two internet infrastructure providers (Bezeq and the HOT Group), many telecommunication companies hold ISP licenses.

Fixed-line Services

The two main competitors in the fixed-line telephony market are Bezeq and HOT. 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.

Hot entered this market in 2004, Cellcom entered this market in 2006, 012 Smile entered this market in 2007, we and Netvision entered in 2008, and Bezeq International (VOB only) entered the market in 2009, bringing the number of total players to seven. Following our acquisition of 012 Smile in March 2011, we announced that we will transfer our fixed-line telephony business to 012 Smile.

Broadband and Internet services

The Israeli broadband market is characterized by a regulatory structural separation between the providers of the internet access infrastructure services and the internet access services. Based on the reports of Bezeq and Hot, at the end of September 2011, there were approximately 1.864 million subscribers, and the household penetration rate was approximately 85%. The only providers of infrastructure in the market are Bezeq through ADSL technology and Hot through cable. ADSL services were launched by Bezeq in 2000 and currently represent an approximate 60% share of broadband connections. Cable modems, which account for the rest of the market, have been available since 2002.

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

Transmission and fixed-line data services are provided by Bezeq, Hot, Cellcom and us. These services are provided to business customers and to telecommunications operators.

Internet access is currently provided by three major Internet service providers, or ISPs -- Netvision, Bezeq International and us -- as well as some other niche players. Hotnet, a subsidiary of Hot, began providing ISP services in February 2012. The Company estimates that it accounted for approximately 35% of the ISP market in 2011, with the rest of the market split approximately equally by the other two major providers. All three major providers are also suppliers of international long distance services (see below).

Until 2011, the Israeli ISPs were connected to the World Wide Web through an underwater communications cable owned and operated by Mediterranean Nautilus Ltd., a subsidiary of Telecom Italia SpA. In January 2012, Bezeq International announced that its own underwater communications cable was operational and in February 2012, the Tamares Group’s underwater communications cable commenced operations. We expect that these additional underwater cables will increase the effective bandwidth of international data connectivity and reduce costs for ISPs. However, proposed regulation published for public comments by the Ministry of Communication in November 2011, proposes certain limitations on the terms of agreements with Med Nautilus, which would, among others, limit the discounts and capacity Med Nautilus may provide and force ISP providers (other than Bezeq International) to purchase capacity on less favorable terms and prices. See "Item 3D.1- We operate in a highly regulated telecommunications market which limits our flexibility in managing our business and may materially and adversely affect our business and results of operations" for further details. See also “Uncertain future of the ISP market.” under “Item 3D.2 Telecommunications Industry Consolidation”.

International long distance services

International long distance (ILD) services in Israel have been open for competition since December 1996. Until then, Bezeq International, was the only supplier of such services. There are currently six players in this market. The three major players are: Bezeq International, Netvision and us. The other players are Xfone Communications, Telzar International Communications Services Ltd., which commenced operating in February 2011 and a sixth operator, Hilat Ltd., that commenced operations in January 2012. We estimate the market share of the three major players to be similar.

4B.3 Our Strategy

We intend to continue to enhance revenues and profitability, and to create value for our shareholders, customers and employees. In order to accomplish this, we intend to:

- Pursue our Evolution into a Diversified Multi-service Communications Group. We are continuing to broaden and diversify our portfolio of products and services to evolve into a diversified multi-service communications and media service provider. In addition to our major business providing cellular telecommunications services, our services offering range now includes fixed-line telephony, ISP services, transmission services and, ILD services and other accompanying telecom and media services. The acquisition of 012 Smile in 2011 enables us to expand our service offerings (see "Item 4A. History and Development of the Company"). We also intend to further enrich our media and content offerings in order to attract new customers and increase the level of loyalty and satisfaction of our existing customer base. Our licenses to operate in various telecommunications areas enable us to provide a wide range of services that will potentially be used to create a bundle of telecom and other adjacent services which we believe will favorably affect our ability to limit churn rates, increase customer loyalty, maximize the synergy between our lines of business and generate additional streams of revenues.

- Maintain Strong Branding. We believe that a focused marketing strategy based upon strong branding for our products and services has substantially reinforced our subscriber loyalty. We intend to continue to promote a strong brand. We also intend to support our branded image by continuing to focus on service, innovation and advanced technology.

- Customer Centric Strategy. We place a priority on striving for excellence in the customer experience and differentiating ourselves from our competitors by our high level of customer service. Through our offering of telecommunications services, our tariff packages and our customer service, we provide added value to our customers. Internally, we seek to improve and align all company business model elements to deliver consistent satisfaction at each step of the customer's experience.

- Improve Efficiency. We place a premium on improving operational efficiency, adjusting costs and workforce to a level appropriate for evolving market conditions. During the fourth quarter of 2011, the structural separation between the Company and 012 Smile was terminated and we started the process of merging the fixed-line businesses of Partner and of 012 Smile. We are currently in the process of integrating some of the headquarter activities, including human resources, finance, legal, procurement and logistics, under one management structure. This process is designed to maximize operating synergies and to enhance the organizational and managerial focus required for dealing with the market challenges in both the short and the long term.

- Growth in Mobile Broadband. We are pursuing growth in mobile broadband to capitalize on the rapid increase in demand for ubiquitous mobile data services and devices. In this context, we are responding to the rapid growth of mobile data traffic, and adopting targeted segmentation and pricing strategies as well as taking advantage of different broadband connection modes, to deliver a valuable quality of broadband service to users.

- Maintain High Quality Network. We have had and shall continue to have, a commitment to ensuring network quality of both our cellular and transmission networks and the integration of technological progress to support mobile broadband growth. We continuously invest in our transmission network and are preparing our network for upgrading to 4G, while ensuring smooth migration from existing networks to next generation networks.

4B.4 Competitive Strengths

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

- Wide variety of communication products. We believe that our offering of VoB, ISP services and ILD services, strengthens our position in the communications market. Offering a wide variety of combined mobile and fixed-line products and services will enable us to better compete with the bundled services of other players, increase customer loyalty, and serve as an additional source of revenue.

- Focus on Customer Experience. We believe we provide a quality customer experience through quick, simple and reliable handling of customer needs and interactions, which we have achieved through investments in technology, launching new and clear plans, launching a new portfolio of smartphones and tablets, and training of customer service skills.

- High Quality Networks. We believe that we set high standards for network quality. Our use of sophisticated network planning and optimization tools and techniques, and our investment in dense base cellular station coverage, together with our transmission network, have produced a high quality network.

- Strong Brand Identity. Since the launch of our full commercial operations in the cellular segment in 1999, we have made a substantial investment in promoting our brand identity in Israel to represent quality, innovation and customer service. Our marketing activities have resulted in wide-scale recognition of our brand for cellular services in Israel.

- Strong and Motivated Management Team. We have been able to attract a number of Israeli senior managers from the telecommunications, high-tech and consumer products industries. Our management team is experienced and highly respected and, we believe, well-positioned to manage and lead the Company.

4B.5 Marketing and Brand

We believe that a focused marketing strategy is critical to support our goal of sustaining our position as a leading provider of quality and innovative communications solutions in Israel. Our marketing strategy is based upon the strong international Orange brand and emphasizes high value for money, network quality, feature rich services, simplicity, innovation and customer service. In addition, since we entered the VoB/ISP businesses in 2009, and subsequently acquired 012 Smile in 2011, the Company is marketing its services under two brands, Orange and 012 Smile. The Orange brand has continuously maintained its advertising and media language and invests in strengthening the brand values.

In order to promote our advanced new handsets, tariffs and services, we employ a large number of promotional activities and use a broad range of advertising media. During 2011 we continued to pursue extensive advertising presence in the media in order to maintain high exposure for our brand and advanced technologies. Our main advertising activities focus on promoting the subscribership and usage of 3G and HSPA services, and of advanced mobile applications and content such as mobile broadband using data-cards and smartphones, as well as increasing loyalty among our customers. Our marketing strategy focuses on promoting our services to various segments of the Israeli population, and we have extended this strategy to our 3G services. We advertise our services in several languages. In addition to traditional media, we promote our brand and services by sponsoring and initiating cultural and community programs. We use the distinctive Orange brand logo in our promotional activities and advertising. See “Item 4B.13 Intellectual Property”.

4B.6 Services and Products

Our principal business, which provides approximately 81% of our revenues, is currently the provision of Cellular Services in Israel. Approximately 19% of our revenues (excluding inter-segment revenues) are generated through our Fixed-Line Services.

Our goal is to provide the best mobile broadband and fixed line network, offering a wide range of content to the cellular and fixed line products and provide an excellent customer experience.

Cellular Services. Our major service is cellular telephony service – provided on both our GSM/GPRS network and our UMTS/HSPA network. Our basic offer includes domestic mobile calls, international dialing, roaming, voice mail, short message services, intelligent network services, content based on our cellular portal, data and fax transmission, mobile broadband and other services. We are continually developing tailored value-added services to meet the special needs of our subscribers and to enhance our long-term relationship with our subscribers.

Our 3G network offers a wide range of services, such as a mobile portal of content services and applications including a rich selection of television, music and games under the Orange brand, and the transmission of data at speeds of up to 21 Mbps[1]. We have concluded content agreements with a variety of content providers and suppliers in the Israeli television and entertainment industry.

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1 The cellular data transmission speed is not constant and is dependent on various factors including coverage, network availability, the chosen connectivity technology, the handset, and cellular , internet and other telecommunication networks.

Our main focus throughout 2011 was to continue to expand our 3G and HSPA business in Israel and to enhance our relationship with our customers through active retention activities. To meet these goals, we have expanded our 3G handset portfolio to cater to several specific market segments, we have enhanced our content portal offering and we have launched several innovative retention activities including virtual application malls.

During 2011, the Company experienced an increase (as part of a global trend) in the purchase of cellular data packages that allows surfing and data consumption on the cellular network through lap-top computers, smartphones and tablets. The Company expects this trend to continue and to increase during the upcoming year.

Fixed-line Services. We offer fixed-line services that include ISP services as well as home Wi-Fi networks, ILD services, transmission services and VoB telephony services.

- ISP services. As an internet service provider, we offer our customers ISP services and as a reseller we offer internet access. Our ISP services offering includes email accounts, home WiFi networking, anti-virus and site filtering based on the customer's restriction definition, and other value added internet services. Furthermore, we offer an advanced set of communications services that house web servers and related software and provide connectivity to the Internet for business customers. See "Item 3D.2 Telecommunications industry consolidation - Uncertain future of the ISP market".

- ILD services. As an international long distance provider we offer our residential and business customers international telephony services including direct international dialing services, international and domestic pre-paid and post-paid calling cards and call-back services. In addition, we offer our business customers international toll-free numbers and an international cellular service that offers fixed rates on calls from anywhere in the world.

- Transmission. We provide fixed-line transmission and data capacity services. Our fixed-line capacity also includes capacity which we lease from other land-line telecommunications service providers. The services we offer include primarily connectivity services by which we provide high quality, dedicated, point-to-point connection for business customers and telecommunications providers, as well as fixed-line services to business customers.

- VoB. This service allows users to make and receive telephone calls over the Internet through an internet connection. We offer traditional voice services to residential and business customers throughout Israel. Our service includes Quality of Service, which ensures high quality voice transmission regardless of the load on the internet connection, and a home gateway which is unique in the Israeli market for its range of sophisticated functionalities, including call "hijack" between the customer's fixed and mobile telephone lines.

4B.6.4 Handsets

We provide handsets to our subscribers, usually with rebates on usage. Following the launch of our HSPA network, most of our handset sales were smartphone handsets that enable customers to use content services with high-speed rates of data transmission, cellular modems and lap-tops with HSPA embedded data cards and tablets.

4B.6.1 Tariff Plans

As of December 31, 2011, approximately 72% of our cellular subscriber base (approximately 2,282,000 subscribers) subscribed to post-paid tariff plans, and 28% (approximately 894,000 subscribers) subscribed to pre-paid tariff plans.

Our post-paid cellular business tariff plans offer features attractive to business users such as charging fees based on airtime usage without adding the interconnect charges imposed by other cellular and fixed-line providers for calls made by our subscribers that terminate on third party networks, and providing discounts for calls to designated numbers within a subscriber's calling circle. In addition, we usually offer rebates on usage to customers joining these cellular tariff plans.

The elements of our cellular tariff plans for post-paid private customers are packaged and marketed in various ways to create tariff packages attractive to target markets, including families, military, teens, students and other sectors. Our cellular tariff plans for private customers feature a certain number of free minutes for calls made between family members and special discounts on tariffs for calls among a limited number of family members or friends. They also offer limited handset subsidies. Based on an amendment to our license, standard subscriber agreements with private customers may be for a maximum period of 18 months. However, as of February 2011, our private customers subscriber agreements no longer have any commitment period. Under our pre-paid plans, upon purchase of a SIM card or phone card or prepayment by credit card, customers can use our network, including some of our value-added services, without the need to register with us or enter into any contract. Our pre-paid plans enable us to compete in the pre-paid cellular services market.

We also offer tariff plans that allow our subscribers to limit their maximum monthly usage.

For our Fixed-Line Services, we have a wide range of diverse plans to meet the needs of the various sub- markets. In the ILD services market we have tariff plans based on call destinations and level of use. We also offer pre-paid plans for our various services. Our Internet Service prices are based on bandwidth. Our VoB packages are based on minutes of use for both fixed-line as well as cellular services.

4B.6.2 International Roaming

Israelis are frequent travelers, and Israel is a highly visited country. According to the Israel Central Bureau of Statistics, in 2011, more than 4 million overseas departures of Israelis were recorded, and almost 3.6 million people visited Israel during 2011. Roaming allows a mobile phone subscriber to place and to receive calls while in the coverage area of a network to which he or she does not subscribe and to be billed for such service by his or her home network. Facilitating international roaming was a primary design goal of the GSM system from its inception. A GSM roamer can therefore expect to enjoy substantially the same services, features and security while traveling as he does at home. We consider international roaming to be a significant source of revenue. The Ministry of Communications may introduce new regulations that would limit our revenues from roaming services. See "Item 4B. Regulation-4.6 Hearings and Examinations" and also "Item 3D.1Risks Relating to the Regulation of Our Industry - Recent and potential future regulation and negotiation of roaming tariffs, both within Israel and elsewhere, may increase our roaming expenses, decrease our roaming revenues and prevent us from raising our tariffs. If our competitors, including new entrants into the telecommunications market, can deliver a more cost effective roaming service or more sophisticated roaming services, then our subscribers may migrate to those competitors and our results of operations could be adversely affected." for risks relating to the regulation of roaming tariffs.

At December 31, 2011, we had commercial roaming relationships with 424 operators in 183 countries or jurisdictions and 215 3G roaming agreements in 100 countries. We also have agreements with satellite operators, providing global coverage, requiring the use of unique handsets. Creating roaming relationships with multiple operators in each country increases potential incoming roaming revenue for us and gives our subscribers more choice in coverage, services and prices in that country.

The 3G roaming agreements enable our 3G roamers to initiate video calls, high speed data and video and audio content while abroad. Since we operate our GSM services on the 900 MHz band, which is the most widely-used band among GSM operators worldwide in terms of handsets, and also on the 1800 MHz band, all of our roaming enabled subscribers may roam to most countries where we have roaming capability using their own handsets without modification. In some countries cellular networks use either the 1900 MHz band of GSM or other technologies (GSM 850, CDMA or UMTS) with which we have established international roaming. Our subscribers who own dual or tri-band handsets that work on GSM 1900 as well as GSM 900 may also use their own handsets in countries that deploy GSM 1900 frequency with networks using GSM 1900. Other subscribers who advise us of their intention to visit those countries are either loaned free of charge a compatible handset into which they insert their SIM, thus retaining their own phone number, phone book and all other regular features, or are given the option to rent such handsets at their destination upon their arrival.

4B.6.3 Value-Added Services

Cellular Services. In addition to standard GSM value-added services, including voice mail, Short Message Service ("SMS"), fax mail, call waiting, call forwarding, caller identification and conference calling, we offer a variety of additional value-added services including among others, various content services, GPS, mail services, backup and synchronizing services, visual voice mail and vehicle fleet management. These services and others are important to our business as they create differentiating factors and increase customer usage and satisfaction. We continuously track all major market developments regarding value-added network services, and we intend to implement and offer those services that are likely to be popular with customers and which would add value to our business.

Fixed-line Services. In addition to standard fixed-line value-added services, we offer a variety of additional value-added services defense and security services for the computer and e-mail that include among others, parental monitoring control, firewall, web hosting, anti-virus and site filtering based on the customer's restriction definition, and other value added internet services including hosting, cloud based hosted services and virtual switchboard.

4B.6.6 Customer Service

Our customer support and service provides several channels for our customers: call centers, walk-in centers and self-service support, which includes Interactive Voice Response ("IVR"), web-based services and automated SMS.

Call Centers. Guided by our aim to provide high quality service, our call-center services are divided into several sub-centers: customer segment (business, private and pre-paid) and specialized support and services (finance, network, international roaming and data transfer related issues). The call center services are provided in several languages.

Walk-in Centers. We currently operate 34 service and sales centers across Israel. These centers provide a face-to-face, uniformly designed, contact channel and offer all services that we provide to customers: sales, handset upgrade, handset maintenance and other services (such as finance, rate-plan changes and subscription to new services). Lease agreements for our retail stores and service centers are for periods of two to five years. We have the option to extend the lease agreements for different periods including the initial lease period. See also note 21 to our consolidated financial statements.

Self-Service. We provide our cellular customers with various self-service channels, such as IVR, web-based services, services via SMS and services via WAP. These channels provide general and specific information, including tariff plans, account balance, billing-related information and roaming tariffs. They also provide customers with information regarding trouble shooting and handset operation, and enable customers to activate services and to download content.

All of our service channels are monitored and analyzed regularly in order to ensure the quality of our services and to detect areas that require improvement.

Management Systems. Our management systems are certificated and monitored by IQC (The Institute for Quality and Control, an RVA accredited Certification Body authorized by Bureau Veritas Quality International) to the appropriate international standards:

- ISO 9001:2008, which focuses on fulfillment of clients and legal requirements;
- ISO 14001:2004, which coordinates our commitment to habitat and environment; and
- OHSAS 18001:2007, which directs our efforts to provide a safe and healthy work environment at our premises.

4B.7 Sales and Distribution

We apply a multi-channel approach to target various market segments and to coordinate our sales strategy.

We distribute our services and products primarily through:

- direct sales channels, which consist of sales centers call centers and business sales representatives; and
- indirect sales channels, which consist of traditional networks of specialized dealers and non-traditional networks of retail chains and stores.

4B.7.1 Direct Sales Channels

Orange Sales and Service Centers: All of our walk-in centers in stores and malls serve as sales centers. The face-to-face contact enables customers to get the “feel and touch” of new handsets, tablets and services demonstrated by our representatives. The “feel and touch” approach enables us also to promote in particular our 3G products and services.

Direct Sales Force: Our sales force is comprised of service and sales representatives.

- A team of regional representatives and customer account managers, located in regional offices, supports small to medium-sized businesses.
- A team of corporate representatives and customer account managers who support large corporate customers.
- A “door to door” sales-force located in regional offices focuses on individual and small business customers.
- A telemarketing department conducts direct sales by phone (to private and business customers), initiates contacts with prospective customers and coordinates appointments for the sales representatives.

Our sales force undergoes regular training to improve their skills of selling advanced solutions such as cellular data, intranet extension and connectivity, virtual private networks, location based services, m2m services, and other value-added services that appeal to corporate customers.

In addition, as of December 31, 2011, we have 34 Orange stands in shopping centers throughout the country, as well as eight shops that specialize in sales and handset upgrades.

4B.7.2 Indirect Sales Channels

At December 31, 2011, we had agreements with 27 traditional dealers providing 51 points of sale, selling a range of our products. The private dealer network is an important distribution channel because of its ability to attract existing cellular users to our network. Our dealer network focuses primarily on sales to individual customers and, to a lesser extent, small business customers. Most of our dealers specialize in sales for post-paid customers, and others specialize on sales for pre-paid customers and distribution of pre-paid handsets to sub-dealers. In addition, we have specific dealers that target different segments of the Israeli population with the appropriate style, language and locations. We provide regular training to employees of our dealers to update them on our products and services. Our dealer managers visit dealers on a regular basis to provide information and training, answer questions and solve any problems that may arise. We pay our dealers commissions, however, dealers are not entitled to commissions for any customers that terminate their service within 90 days of activation.

All indirect sales channels are supported by a specialized “dealer support” call center providing information, support and coordination of appointments of car-kit installations.

4B.8 Customer Contracts and Credit Policy

As of 2011, our standard subscriber agreements with most of our private subscribers are without commitment periods. Most of our business subscribers sign 36-month contracts. Subscribers are billed monthly for airtime charges and charges per services. All customers are supervised by daily reports in order to display exceptional usage. Roaming access for direct debit subscribers is subject to credit scoring by Partner’s credit supervisors with the assistance of outside credit agencies and may require additional guarantees or deposits.

Our subscribers pay for their services by credit card or by direct bank debit. All credit card accounts are subject to an initial maximum credit limit each month, which varies depending upon the type of credit card and for which we obtain prior approval from the card issuer. When a subscriber account reaches this limit, we may seek approval from the card issuer. If the card issuer does not grant the approval, we may require the subscriber to provide other means of payment or arrange an increase in the approved limit from his credit card issuer. If this does not occur, the subscriber’s usage may be limited or suspended until we receive a cash deposit or guarantee from the subscriber.

Most of our cellular subscribers pay for the handsets in 18 or 36 installments, which are charged directly to their credit card or to their monthly bill. If the subscriber opts to pay for the installment via his monthly bill, the outstanding installment payments are not secured. Subscribers acquiring more than ten handsets (or less in certain circumstances) are subject to a credit scoring review performed by Partner’s credit supervisors with the assistance of outside credit agencies. See "Item 4B Regulation 4.2 Regulatory Consumer Amendments".

4B.9 Our Network

We have built an extensive, resilient and advanced network system in Israel, allowing us to offer our services with extensive coverage and consistent high quality. During the years ended December 31, 2010 and 2011, we made capital expenditures of NIS 251 million and NIS 254 million ($66 million), respectively, in our network infrastructure, including optic fibers.

4B.9.1 Overview

Our network is a converged fixed and mobile telecommunications network. For mobile services we built a third generation wireless network, which offers full interactive multimedia capabilities. This technology brings wire-free networks significantly closer to the capabilities of fixed-line networks. Improvements in coding and data compression technology provide better voice quality and more reliable data transmission. UMTS is the global standard adopted for the implementation of third generation wireless telecommunications capable of data rates of 21 Mbps and is the 3G technology we use. HSPA is a technological enhancement to our 3G services that offers subscribers the ability to access our 3G services at higher speeds for downloading (HSDPA) and uploading (HSUPA) data.

4B.9.2 Infrastructure

As of December 31, 2011, our GSM network domain consisted of 1,949 macrobase transceiver stations, 105 microbase transceiver stations and 510 indoor transceiver stations, all linked to 35 base station controllers. The base station subsystem is controlled by 11 cellular switching centers. Base transceiver stations, cellular switching centers and base station controllers are interconnected by approximately 3,500 transmission links. Ericsson and Nokia -Siemens Networks (NSN) supply our base station controller and base transceiver station sites for our GSM and GPRS network.

As of December 31, 2011, our UMTS network domain consisted of 1,918 macrobase transceiver base stations, 42 microbase transceiver stations and 415 indoor transceiver stations, all linked to 17 radio network controllers. The base station subsystem is controlled by 8 mobile switching centers and 11 media gateways. The base transceiver stations, the mobile switching centers and the radio network controllers are interconnected by approximately 5,500 transmission links. As of January 2008, Ericsson is our sole 3G UTRAN and core network equipment supplier, and we are progressively replacing equipment purchased from other suppliers with Ericsson equipment.

Our fixed-line network domain consists of circuit-switched and Voice over Internet Protocol (VoIP) platforms. Nokia-Siemens Network, Sonus, Broadsoft and ACME Packet supplies our VoIP solution, whereas the circuits-switched services utilize the mobile switching center platforms alongside Sonus's switches. The International Long Distance network domain consists of Dialogic ILD Switch, together with NSN's Signaling Transit Point.

In addition, our network is interconnected with two public switched telephone companies, Bezeq and HOT, in several locations across Israel. Our network is also directly connected to the three cellular networks, the four Israeli international operators, the fixed-line telephone network of Paltel and the cellular network of Wataniya, and indirectly to the cellular network of Jawwal. Our transmission network is made up of leased lines from Bezeq and other operators and our own microwave links and fiber optic infrastructure. Currently approximately 50% of our transmission network consists of leased lines. Our fiber-optic and microwave transmission network enables us to reduce our transmission costs as well as to provide our business customers with bundled services of data and voice transmission and fixed-line services. Currently, our transmission network has more than twelve hundreds kilometers of fiber optics and more than fourteen hundred kilometers of microwave links.

Our GSM and UMTS radio networks covered 99% of the Israeli population at year-end 2011. We are continuing to expand and improve the coverage, capacity and quality of our UMTS network.

4B.9.3 Network Design

Our primary network design objective is to further expand and improve our network to provide high voice, video and packet quality, service reliability, high capacity and high coverage quality. In formulating our network design objectives, we have been guided by our business strategy to continue to broaden the highest quality network. The quality parameters that we seek to satisfy are those that we believe are important to phone users: voice quality, high data rate packet sessions, low “blocked call” rate, low “dropped call” rate and deep indoor penetration, especially in densely populated areas or areas of special commercial interest. The two main examined parameters used to measure network performance for voice and packet data are the setup call success rate and the dropped calls rate.

With these quality parameters in mind, we rolled out our UMTS/HSPA network starting in 2004, which shares locations with the GSM sites. In December 2007, we signed an agreement with LM Ericsson Israel Ltd. (Ericsson”) for the replacement of third party 3G radio equipment existing in our network, and in October 2010, we signed an agreement with Ericsson for the upgrade of our existing fixed-mobile network and the deployment of our fourth generation network. Ericsson is currently the main supplier of our network. See “Item 10C. Material Agreements”.

We use monitoring probes and counters to ensure network quality.

Our transmission network design confers the following benefits: (i) necessary bandwidth for GSM and UMTS/HSPA services; (ii) resilience; (iii) use of high transmission rate back-bone routes based on Synchronous Digital Hierarchy; and (iv) the ability to utilize a new generation of sophisticated technology to optimize the system and increase capacity where necessary. Our switching architecture is based on two transit switches connected to all of our systems and platforms.

In our Fixed-Line business we offer telephony lines using VoB technology, PRI voice trunks, Internet Sevices, data transmission and ILD services targeting households and business customers in the Israeli market. These services are provided over third parties’ existing network infrastructure as well as our own partial infrastructure. In order to provide the Fixed-line Services in the residential market, we developed a home gateway box (smartbox), that provides the customer with a setup of a home network WiFi based on the protocol 802.11n, FXS and DECT supported phones, and built-in firewall. This solution enables us to provide services to our customers such as call “hijack” which allows customers to retrieve incoming mobile line calls on their fixed line, improved email accounts, anti-virus and site filtering based on the customer’s restriction definition.

4B.9.4 Spectrum Allocation and Capacity

Spectrum availability is limited and is allocated by the Ministry of Communications through a licensing process. Pursuant to the terms of our license and subsequent allocations, we were allocated 2x10.4 MHz in the 900 MHz frequency band, of which 2x4.8 MHz are shared with Jawwal which operates in the West Bank and the Gaza Strip. See “Item 3D. Risk Factors- We may be required to terminate the use of certain spectrum or to share with another operator some of the spectrum we are currently using on an exclusive basis. We may not be allocated sufficient spectrum band or any spectrum at all needed in order to provide 4th generation (4G) services. These requirements may adversely affect our network quality and capacity as well as our results of operations" for a discussion of the risks associated with regulatory developments in spectrum allocation.

We were also allocated two additional bands of spectrum: 2 x 10 MHz of GSM 1800 spectrum and 2 x 10 MHz and 1 x 5 MHz of UMTS/HSDPA third generation in the 2100 MHz frequency band. We operate GSM 1800 MHz band base transceiver stations that enhance the capacity of our GSM 900 MHz network, and improve our GSM 900 MHz network’s quality.

4B.9.5 Enabling Systems

Our UMTS network offers advanced applications and services including, among others, a UMTS content portal offering a variety of services such as live TV channels, games, maps and directions application, wide range of music (MP3) services. We have installed a video gateway and a streaming server, enabling us to offer our customers a range of video services on UMTS handsets.

4B.9.6 Site Procurement

Once a new coverage area has been identified, our technical staff determines the optimal base station location and the required coverage characteristics. The area is then surveyed to identify network sites. In urban areas, typical sites are building rooftops. In rural areas, masts are usually constructed. Technical staffs also identify the best means of connecting the base station to the network, for example, via leased or owned and operated microwave links or wired links leased from Bezeq. Once a preferred site has been identified and the exact equipment configuration for that site decided, we begin the process of obtaining necessary approvals.

The erection of most of these network sites requires building permits from local or regional authorities, as well as a number of additional permits from governmental and regulatory authorities, such as:

- erection and operating permits from the Ministry of Environmental Protection;
- permits from the Civil Aviation Authority, in certain cases; and
- permits from the Israeli Defense Forces.

See “Item 4B Regulation- 7 Network Site Permits” for a description of the approvals that are required for the erection and operation of network sites and the requirement to provide indemnification undertakings to local committees.

4B.9.7 Suppliers

Ericsson, together with its affiliates, is a major supplier of GSM equipment with cellular switching centers, base station controllers, base transceiver stations, transit transmission centers, operation support systems and transmission systems equipment. Ericsson is also our major supplier of GPRS network equipment, including GPRS support nodes and gateway GPRS support nodes and UMTS infrastructure equipment, and our sole supplier for our 3G network. In 2010 we entered into an agreement with Ericsson for the upgrade of our existing networks and the deployment of our fourth generation network in Israel. As a result, Ericsson will gradually become our sole supplier of radio equipment and our main supplier of our other network infrastructures. See “Item 10C. Material Contracts”.

Nokia-Siemens, together with its subsidiaries and/or its associated companies also supplies us base station controllers, base transceiver stations and network management system equipment, as well as equipment for our NGN network and 2G cellular telecommunications network. Nokia-Siemens also supplies us with switches for the fixed-line telephony services based on Internet Protocol ("IP").

Bezeq supplies the Company with fixed-line transmission services for connecting traffic between approximately 50% of the Company’s sites and its switches.

The HOT Group supplies the Company with interconnect lines between the broadband backbone and the ISP backbone.

Alcatel provides the Company with a pre-paid system that allows subscribers to pay set amounts in advance and thereby allows subscribers to manage their expenses for services.

In 2009, we entered into an agreement with Apple for the purchase and resale of iPhone handsets in Israel. See “Item 10C. Material Contracts”. During 2011, Apple was a major supplier of the Company’s handsets (i-Phone).

During 2011, we purchased all of our Samsung handsets from Scailex. See “Item 7B.3 Transactions with Affilates–Agreements with affiliates of Scailex”.

Med Nautilus supplies the Company with transmission services through its submarine infrastructure which connects us to all major Western European countries and to the United States. See “Item 10C. Material Contracts”.

Sonus Networks Inc. and Broadsoft Inc. supply the Company with fixed-line telephony switches.

Juniper Networks Ireland Ltd. supplies ISP infrastructure to the Company including routers and security solutions.

We continue to purchase certain network components from various other key suppliers. We believe that our network suppliers’ price structure is competitive with industry standards. See also “Item 3D.1 We depend on a limited number of suppliers for our handsets and network equipment. Our results of operations could be adversely affected if our suppliers fail to provide us with adequate supplies of handsets and network equipment. Our results of operations could be adversely affected if our suppliers fail to provide us with adequate supplies of handsets and network equipment or maintenance support on a timely basis.”

4B.10 Interconnection

All telecommunications providers with general licenses in Israel have provisions in their licenses requiring them to connect their networks with all other telecommunications networks in Israel. Currently, our network is connected directly with all other telecommunications networks operating in Israel.

We are currently operating without any formal interconnect agreements with Bezeq. Day-to-day arrangements with Bezeq substantially conform to a draft interconnect agreement negotiated with Bezeq. Bezeq is required by law not to discriminate against any licensed telecommunications operator in Israel with respect to the provision of interconnect services. We currently pay Bezeq an interconnection fee based on a tariff structure set forth in the Interconnection Regulations (Telecommunications and Broadcasts) (Fees for Interconnection) (2000).

We have formal interconnect agreements with all Israeli cellular and with the other fixed-line and voice over cellular companies. The interconnect tariffs are set forth in the Interconnection Regulations (Telecommunications and Broadcasts) (Fees for Interconnections) 2000 that impose a uniform call interconnect tariff for all cellular telephone operators.

Our network is connected directly to Paltel and Wataniya and indirectly to Jawwal, the Palestinian fixed-line and cellular operators. The interconnect tariffs are set out in a commercial agreement.

For a discussion of the Ministry of Communications’ reduction of interconnect tariffs see “Item 4B Regulation – 4.1 Reduction Of Interconnect Tariffs to Be Paid to Cellular Operators”.

We have written interconnect agreements or operating arrangements with all of the international service providers serving Israel. The regulated cellular interconnect tariff for incoming international calls was updated to NIS 0.069 per minute; in line with the updates in cellular interconnect tariffs for incoming domestic calls, effective January 2012.

Two of our subsidiaries have a domestic fixed-line license. Our subsidiaries are connected, directly with all other telecommunication networks operating in Israel. The interconnection fees are set by the Interconnection Regulations (Bezeq and Broadcasts) (Fees for Interconnection) 2000.

4B.11 Competition

An overview of our principal competitors and of some aspects of the competitive environment for telecommunications services is set forth below. For further information regarding the impact of regulation and regulatory changes on competition, including measures to enable new service providers to enter the market, and the competitive pressures arising from the development of full-service telecommunications providers and new technologies, see “Item 3D.1 Risks Relating to the Regulation of Our Industry - We operate in a highly regulated telecommunications market which limits our flexibility in managing our business and may materially and adversely affect our business and results of operations.” and “Item 3D.2 Risks Relating to Our Business Operations - Competition resulting from consolidation in the telecommunications industry, the expanded offerings of full service telecommunications groups, and new entrants into the mobile telecommunications market, despite its current saturation, as well as other actual and potential changes in the competitive environment and communications technologies, may cause an increase in subscriber acquisition and retention costs and a decrease in tariffs, and may reduce our subscriber base and increase our churn rate, each of which could adversely affect our business and results of operations”.

Competitors in Cellular Services

There are currently four cellular telephone network operators in Israel: Partner, Cellcom, Pelephone and MIRS, with one additional MVNO operator – Rami Levy Hashikma Communications Marketing Ltd., ("Rami Levy") which operates using the Pelephone network. We compete principally on the basis of telecommunications service quality, brand identity, variety of handsets, tariffs, value-added services and the quality of customer services.

The table below sets forth an estimate of each operator’s share of total subscribers in the Israeli cellular market at December 31, 2007, 2008, 2009, 2010 and 2011.

| Market Share* | 2007 | | 2008 | | 2009 | | 2010 | | 2011 | |
|---|---|---|---|---|---|---|---|---|---|---|
| Partner | 31.7 | % | 32 | % | 32 | % | 32 | % | 32 | % |
| Cellcom | 34.1 | % | 35 | % | 34 | % | 34 | % | 34 | % |
| Pelephone | 29.0 | % | 29 | % | 29 | % | 29 | % | 29 | % |
| MIRS | 5.2 | % | 4 | % | 5 | % | 5 | % | 5 | % |

* Based on information contained in published reports issued by, and public statements made by, Pelephone and Cellcom or by their respective shareholders and from Partner subscriber data. The number of subscribers of MIRS is based on the figures reported by HOT on July 25, 2011, in the valuation of MIRS performed by TASC, an Israeli consulting firm. The number of Pelephone subscribers includes the subscribers of Rami Levy.

Cellcom is an Israeli corporation that is traded both on the Tel Aviv stock exchange as well as NYSE. The company was founded in 1994 as the second cellular company in Israel and its major beneficial shareholder is Discount Investment Corporation Ltd, ("DIC"). DIC is a majority-owned subsidiary of IDB Development Corporation, which in turn is a majority-owned subsidiary of IDB Holding Corporation Ltd ("IDB"). The IDB group is one of the largest diversified business groups in Israel, whose indirect subsidiaries also operate in the Israeli communications market. In August 2011, Cellcom acquired Netvision Ltd. (“Netvision”), an Israeli operator of domestic fixed-line services using VoB technology, PRI, transmission and data communications services, ISP services and ILD. Cellcom operates nationwide cellular telephone networks based on GSM 1800 MHz/GPRS, EDGE and UMTS/HSDPA HSUPA technologies as well as fixed-line telephony, transmission and data services.

Pelephone is an Israeli corporation that is a wholly-owned subsidiary of Bezeq, Israel's largest telecommunications provider and the primary fixed-line operator that is controlled by B Communications Ltd., a company indirectly controlled by Shaul Elovitz, the controlling shareholder of Eurocom, which is the official distributor of the Nokia group in Israel. Bezeq and its subsidiaries offer fixed-line telephony services, cellular telephony services, PRI, internet broadband access, ISP services, transmission and data communications services, ILD services and multi channel television services. Pelephone, which was initially a non-GSM operator and had used CDMA-1x Real Time Technology, as well as the EVDO technology, launched in 2009 a UMTS/HSPA network, which has strengthened its ability to compete in the provision of high speed mobile internet, as well as inbound and outbound roaming services and have improved its competitive position in the market.

MIRS, an Enhanced Specialized Mobile Radio, or “trunking” network, holds a general license to operate as a mobile telephone operator. MIRS operates using an Enhanced Specialized Mobile Radio, or “trunking” iDEN network and has expressed its intention to roll out a WiMAX network subject to receiving a license. MIRS has also expressed its interest in upgrading its network to WiMAX technology. MIRS is held by the Altice Group, a French media group, controlled by Mr. Patrick Drahi, who also holds 45% of HOT, a multi channel television operator in Israel. HOT’s main areas of activity are multi channel television services, fixed-line telephony services, PRI, internet broadband access, transmission and data communications services as well as ISP services through its subsidiary HOT NET. In November 2011, HOT acquired all of the outstanding shares of MIRS. MIRS's cellular license was amended to include UMTS frequencies allocated subsequent to winning a Ministry of Communications’ tender offer for frequencies in the 2100 Mhz spectrum.

In addition, the Palestine Telecommunication Co. Ltd. (“Paltel”) operates a GSM mobile telephone network under the name “Jawwal” in the Palestinian Administered Areas, as well as a fixed-line network. Paltel’s GSM network competes with our network in some border coverage overlap areas. A second Palestinian operator, Wataniya Palestine Mobile Telecommunication Company ("Wataniya") launched its GSM network during 2009.

Several service providers offer competitive roaming solutions. The service is offered, inter alia, by the International Long Distance vendors as well as by specialized enterprises.

Recent regulatory developments causing new entrants into Cellular Services

The Ministry of Communications has granted MVNO licenses to a number of companies and is expected to grant additional MVNO licenses, which will further increase competition. Rami Levy began operations using a hosting agreement with Pelephone, in December 2011. Rami Levy is a subsidiary of a major Israeli discount supermarket chain. The other MVNO other operators are expected to launch their operations during 2012. See “Item 3D.1 Risks Related to the Regulation of Our Industry - We have been required to offer access to our cellular network infrastructure to other operators, which has enabled new competitors, such as MVNOs, to enter the market, reduce our ability to provide quality services to our subscribers and negatively affect our operating results”. In December 2011, we signed an agreement with Alon Cellular Ltd. ("Alon Cellular") with respect to Alon Cellular's use of Partner's network as an MVNO.

In September 2010, the Ministry of Communications published a tender for the allocation of UMTS frequency to additional infrastructure-based cellular operators in Israel. In April 2011, the tender was concluded and the UMTS frequencies were ultimately awarded to MIRS and Golan Telecom. Golan Telecom, is a privately owned company, owned by Michael Golan, Xavier Niel and the Parienti family and is expected to begin operations during 2012. Golan Telecom signed a national roaming agreement with Cellcom. Under the terms of their licenses, the companies which won the tender offer were required to pay a minimal fee as well as a guarantee for the balance to the Ministry of Communications before starting operations and to pay the balance of the fee to ensure compliance with the terms of the license after 5 years. However, as an incentive for these companies to rapidly build and expand their customer base, the final total amount of their fees and guarantees will be calculated according to the level of the coverage of their services and will be reduced as the level of coverage increases. We therefore anticipate that these new entrants into the mobile telecommunications market will aggressively seek to gain market share, which, in light of the current saturation of the Israeli cellular market, would result in loss of market share by existing companies, including Partner.

Selected new technologies affecting the competitive environment for Cellular Services

The Ministry of Communications has granted several service providers with a trial license to provide VoC services. For a discussion of the risks created by our competitive environment, including risks arising in connection with government measures to increase competition, see “Item 3D.1 Risks Related to the Regulation of Our Industry - We operate in a highly regulated telecommunications market which limits our flexibility in managing our business and may materially and adversely affect our business and results of operations."

Competitors in Fixed-line Services

In the fixed-line market, we compete with Bezeq, Israel's largest telecommunications provider and the primary fixed-line operator, HOT, the multi channel television operator in Israel, and other telecommunication services providers who are entering the fixed-line market. Bezeq holds 100% of the shares of Pelephone and Bezeq International, which may enable Pelephone and Bezeq and other affiliates of Bezeq to offer bundled services of fixed-line, mobile telephone and other telecommunication services, subject to regulatory approval. The HOT Group provides cellular telephony services (through MIRS), fixed-line telephony services, PRI, internet broadband access, ISP services, transmission and data communications services and multi channel television services. The Ministry of Communications granted HOT a license to provide ISP services through HOT-NET, a subsidiary of HOT, and permission to market bundled services subject to certain structural limitations between the companies in the group. In the future other holders of licenses to provide fixed-line telephone services may enter the mobile telecommunications services market via MVNO and increase the level of competition we face.

There are currently two major fixed ISP providers in Israel that we compete with since entering this market: Bezeq International and the Cellcom Group. The Company accounted for approximately 35% of the ISP market, while the majority of the remaining ISP market is held by Bezeq International and the Cellcom Group. See "Item 3D.2 Risks Relating to our Business Operations-- Competition resulting from consolidation in the telecommunications industry, the expanded offerings of full service telecommunications groups, and new entrants into the mobile telecommunications market, despite its current saturation, as well as other actual and potential changes in the competitive environment and communications technologies, may cause an increase in subscriber acquisition and retention costs and a decrease in tariffs, and may reduce our subscriber base and increase our churn rate, each of which could adversely affect our business and results of operations- Uncertain future of the ISP market".

In the ILD services market, we compete with Netvision, Bezeq International, 018 Xphone Ltd, 015 Hallo Ltd. and Telzar 019 Ltd.

See also “Item 4B.2 Special characteristics of the Fixed-Line Telecommunications Industry in Israel”.

4B.12 Information Technology

We depend upon a wide range of information technology systems to support network management, subscriber registration and billing, customer service and marketing and management functions. These systems execute critical tasks for our business, from rating and billing of calls, to monitoring our points of sale and network sites, to managing highly segmented marketing campaigns. As our subscriber base has grown, we have devoted resources to expanding and enhancing our information technology systems, including Customer Relations Management (“CRM”) systems, which have contributed to our customers’ satisfaction with our service, as well as updating our financial management and accounting system. We believe these systems are an important factor in our business success.

While many of our systems have been developed by third-party vendors, all of them have been modified and refined to suit our particular needs. In certain instances, we have developed critical information technology systems internally to meet our specific requirements. For example, significant segments of our CRM and business information infrastructure were developed internally and were designed to integrate our customer service outreach with our overall sales and marketing effort. In connection with our transformation into a diversified multi-service communications provider, we are considering upgrading or replacing our current billing and CRM systems with systems that are better suited to our current and future needs.

4B.13 Intellectual Property

We are the registered owners of the trademark "Partner" in Israel with respect to telecommunications-related devices and services, as well as additional trademarks. We have also registered several internet Web domain names, including, among others: www.partner.co.il and www.orange.co.il.

We have entered into a brand license agreement with Orange International Developments Limited, a subsidiary of Orange Limited, formerly Orange plc, further assigned to Orange Brand Services Limited, a member of the France Telecom Group ("Orange"). Under this agreement, we have the exclusive right to use the Orange brand in Israel. The term of the brand license agreement began on July 1, 1998. The license was royalty-free until June 2013; however, pursuant to an amendment to the brand license agreement entered into in January 2012, we have agreed to begin paying royalties in April 2012. Royalties payable will be based on a percentage of the Company's revenues from the provision of services offered under the Orange brand. Under the brand license agreement, we are required to comply with the Orange brand guidelines established by Orange. We have the right to use the Orange brand as long as we are able and legally eligible under the laws of Israel to offer telecommunications services to the public in Israel. However, the brand license agreement may be terminated by mutual agreement or by either party if it determines that the other party has materially breached the agreement and such breach has not been remedied within a certain time period. We have also entered into a brand support/technology transfer agreement with Orange Personal Communications Services Limited, further assigned to Orange. Under this agreement, Orange provides us with information and expertise to support the orange brand in Israel at an agreed cost. See "Item 3D.2 Risks Relating to Our Business Operations– Our marketing strategy relies on using the international Orange brand. If our brand license agreement terminates or is revoked, we will lose one of our main competitive strengths".

In addition, we are a full member of the GSMA Association. In conjunction with the promotion and operation of our GSM network, we have the right to use their relevant intellectual property, such as the GSM trademark and logo, security algorithms, roaming agreement templates, and billing transfer information file formats. We are eligible to remain a member of the GSMA Association for as long as we are licensed to provide GSM service.

REGULATION

4B Regulation- 1 Overview

We operate within Israel primarily under the Communications Law (Telecommunications and Broadcasting), 1982 (the "Telecommunications Law"), the Wireless Telegraphy Ordinance (New Version), 1972 (the "Wireless Telegraphy Ordinance"), the regulations promulgated by the Ministry of Communications and our license. The Ministry of Communications issues the licenses which grant the right to establish and operate mobile telephone and other telecommunication services in Israel, and sets the terms by which such services are provided. The regulatory framework under which we operate consists also of the Planning and Building Law, 1965, the Consumer Protection Law, 1981, and the Non-Ionizing Radiation Law, 2006. Additional areas of Israeli law may be relevant to our operations, including antitrust law, specifically the Restrictive Trade Practices Law, 1988, the Class Actions Law, 2006, and administrative law.

4B Regulation- 2 Telecommunications Law

The principal law governing telecommunications in Israel is the Telecommunications Law and related regulations. The Telecommunications Law prohibits any person, other than the State of Israel, from providing public telecommunications services without a license issued by the Ministry of Communications.

General licenses, which relate to telecommunications activities over a public network or for the granting of nationwide services or international telecommunications services, have been awarded to Bezeq, and to HOT, to four other cellular telephone operators besides Partner and to the international operators. In addition, the Ministry of Communications has recently granted MVNO licenses to a number of companies and is expected to grant additional MVNO licenses.

The Ministry of Communications has the authority to amend the terms of any license. The grounds to be considered in connection with such an amendment are government telecommunications policy, public interest, the suitability of the licensee to perform the relevant services, the promotion of competition in the telecommunications market, the level of service and changes in technology. The Ministry of Communications may also make the award of certain benefits, such as new spectrum, conditional upon the licensee’s consent to a license amendment. The Ministry of Communications also has the authority to revoke, limit or suspend a license at the request of the licensee or when the licensee is in breach of a fundamental condition of the license, when the licensee is not granting services under the license or is not granting services at the appropriate grade of service or when the licensee has been declared bankrupt or an order of liquidation has been issued with respect to the licensee. Public interest may also be grounds for the rescission or suspension of a license.

The Ministry of Communications, with the consent of the Ministry of Finance, may also promulgate regulations to determine interconnect tariffs, or formulae for calculating such tariffs. Moreover, the Ministry of Communications may, if interconnecting parties fail to agree on tariffs, or if regulations have not been promulgated, set the interconnect tariff based on cost plus a reasonable profit, or based on each of the interconnecting networks bearing its own costs.

The Telecommunications Law also includes certain provisions which may be applied by the Ministry of Communications to general licensees, including rights of way which may be accorded to general licensees to facilitate the building of telecommunications networks or systems and a partial immunity against civil liability which may be granted to a general licensee, exempting the licensee, inter alia, from tort liability with the exception of direct damage caused by the suspension of a telecommunications service and damage stemming from intentional or grossly negligent acts or omissions of the licensee. The Ministry of Communications has applied the partial immunity provisions to us, including immunity in the event that we cause a mistake or change in a telecommunication message, unless resulting from our intentional act or gross negligence. The Ministry of Communications initiated a review to re-evaluate the scope of the immunity provisions.

The Ministry of Communications is authorized to impose significant monetary sanctions on a license holder that breaches a provision of its license, which breach causes, or may cause, significant harm to the public or to competition.

Frequency Fees. Under the Telegraph Regulations, the Company is committed to pay an annual fixed fee for each frequency used. The Company paid a total amount of approximately NIS 55 million, NIS 59 million for the years 2009, 2010 respectively. For the year 2011, the company paid an amount of NIS 11 million which is after a deduction of amounts the Company was eligible to receive in accordance with a Court's decision; the amount due before the reduction was NIS 58 million. See also note 20 to our consolidated financial statements.

Royalties. Pursuant to the Telecommunication (Royalties) Regulations, 2001, we must pay royalties to the State of Israel every quarter based on our chargeable revenues, as defined in the regulation, from mobile telephone services (including, among other, airtime, monthly subscription fees, roaming services and non-recurring), on a cumulative basis, excluding value-added tax. Revenues for purposes of royalty calculation also exclude revenues transferred to other telecommunications license holders, bad debts, payments for roaming services to foreign mobile telephone operators and certain other revenues. The regulation provided a rate of 4% in 2003 and a rate of 3.5% in 2004 and 2005. In November 2004, the Ministry of Communications announced that from January 2006 the rate of royalties payments would be reduced annually by 0.5% to a level of 1%. For 2006 the rate was 3%, for 2007 the rate was 2.5%, for 2008 the rate was 2%, for 2009 the rate was 1.5% and for 2010 (and the following years) it was to be 1%. In January 2011, the regulations were amended by a temporary order, so that the royalty rate was increased to 1.75% (instead of 1%) in 2011 and 2.5% (instead of 1%) in 2012 and thereafter. The temporary order will be effective until the earlier of December 31, 2012, or the date on which the Director of the Ministry of Communications shall publish a formal notice that one of the following has occurred: (1) a cellular operator has begun to provide national roaming service; (2) an MVNO has begun to operate and the total market share of all MVNOs is at least 5%. When the temporary order terminates, the royalty rate will revert back to 1%. This temporary order does not apply to international operators, special fixed-line operators and MVNOs. Following a petition filed by the Company and two other cellular operators with the Supreme Court of Justice, in July 2011 against the temporary order, the State decided to accept the arrangement that was proposed by the Court, which had already been accepted by the petitioners, according to which (i) the royalty rate set in the temporary order for 2012 will be 1.75% instead of 2.5%; and (ii) beginning in 2013, the rate will be 0%. The arrangement is subject to the amendment of the relevant regulations and their approval by the finance committee of the parliament. During a hearing that was held in January 2012, the finance committee refused to approve the amendment and requested another hearing that has not yet been set. We have received a letter from the Ministry of Communications clarifying that as of the date of their letter, the royalty rate for 2012 is 2.5%.

4B Regulation- 3 Fair Competition and Antitrust Law

Provisions prohibiting Partner from engaging in anti-competitive practices can be found in our license and in the licenses of the other telecommunications operators, in the various telecommunications regulations and in the

Restrictive Trade Practices Law. Our license emphasizes the principle of granting users equal access to the systems of each of the operators upon equitable terms. The Telecommunications Law also provides certain protection against disruption of telecommunications services.

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The Restrictive Trade Practices Law is the principal statute concerning restrictive practices, mergers and monopolies. This law prohibits a monopoly from abusing its market position in a manner that might reduce competition in the market or negatively affect the public. The law empowers the Commissioner of Restrictive Trade Practices to instruct a monopoly abusing its market power to perform certain acts or to refrain from certain acts in order to prevent the abuse. Bezeq has been declared a monopoly in certain markets, a ruling it failed to challenge successfully.

The Israeli Commissioner of Restrictive Trade Practices expressed his view in the past, that the cellular telephone industry in Israel operates as an oligopoly and in July 2011 the Israeli Parliament approved an amendment to the Restrictive Trade Practices Law. See "Item 3D.1 Risks Related to the Regulation of Our Industry - We operate in a highly regulated telecommunications market which limits our flexibility in managing our business and may materially and adversely affect our business and results of operations".

4B Regulation- 4 Regulatory Developments

See also “Item 3D.1 Risks Relating to the Regulation of Our Industry” for a discussion of how recent regulatory developments create risks for our financial condition, business and results of operations.

4B Regulation- 4.1 Reduction Of Interconnect Tariffs to Be Paid to Cellular Operators

In September 2010, the interconnect tariffs payable to Israeli cellular operators by other Israeli telecommunications operators were as follows:

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

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

The tariffs do not include VAT and will be updated annually on January 1 of each year starting January 1, 2011 as follows: the tariffs will be linked to the CPI, using the average annual CPI for the year 2009 (as defined by the Israeli Central Bureau of Statistics) as the basic CPI. Accordingly, the CPI-adjusted tariff per minute effective January 1, 2011 is NIS 0.0728 and effective January 1, 2012 is NIS 0.0690, and the CPI-adjusted tariff for sending SMS messages effective January 1, 2011 is NIS 0.0017, and effective January 1, 2012 is NIS 0.0016.

The tariffs will also be increased by the percentage of royalties payable to the Ministry of Communications by the operator. See also note 1 to our consolidated financial statements.

The direct impact on annual service revenues of the reduction in 2011 in voice and SMS interconnect tariffs was a reduction of approximately NIS 1,075 million. The direct impact on EBITDA of the reduction in 2011 in voice and SMS interconnect tariffs was a reduction of approximately NIS 427 million.

4B Regulation- 4.2 Regulatory Consumer Amendments

After conducting a hearing process, in December 2010 the Ministry of Communications amended the conditions of the licenses of all the cellular telecommunication companies in Israel to include consumer amendments that became effective during 2011. The amendments include, among other matters, a requirement to include a summary of the main terms of the commitment agreement on the front page of the agreement, a prohibition to charge subscribers for services that they did not expressly sign up for, a requirement to allow subscribers to choose whether they wish to be open or blocked for various content services by filling out an appropriate form, the provision of information in the monthly bill of business subscribers regarding the commitment period and exit fees that will need to be paid if the business subscriber terminates the agreement and the regulation of the manner of ordering services over the internet.

As part of an amendment to the Telecommunications Law, effective February 2011, subscribers with commitment agreements for no more than 100 telephone lines that terminate a commitment agreement during the commitment period may not be charged a penalty that exceeds 8% of the subscribers' average monthly bill for operator's services until termination, multiplied by the balance of the remaining number of months in the commitment period. In addition, such subscribers may not be denied benefits to which they would have been entitled had they not terminated the commitment agreement. For commitment agreements signed prior to February 1, 2011, these new provisions will apply to subscribers with no more than 50 telephone lines. In addition, the cellular operators are prohibited from demanding immediate full payment of the remaining installments for the handsets upon the subscribers' breach of the commitment period, and the subscribers are allowed to continue to pay out the installments in accordance with the dates and amounts they would have paid had they not terminated the agreement. The Israeli Parliament has recently approved a bill that amends the Telecommunications Law prohibiting cellular operators from imposing exit fees at all upon certain subscribers who terminate a commitment agreement during the commitment period. The bill is expected to become effective April 1, 2012.

In August 2011, an additional amendment to the Telecommunications Law was enacted with respect to exit fees charged from subscribers of various other telecommunications operators, according to which new subscribers may not be charged exit fees while existing subscribers with average monthly bills lower than NIS 5000, may be charged exit fees of no more than 8% of the subscribers' average monthly bill for operator's services until termination, multiplied by the balance of the remaining number of months in the commitment period.

As part of an amendment to the Telecommunications Law, effective January 2011, cellular companies are prohibited from selling locked handsets for use only with the company's SIM card and must agree to unlock all handsets they have sold in the past, free of charge. It was further resolved, that this provision will not apply to a subscriber or group of subscribers that requested from the cellular operator in a specific and detailed request that this provision not apply to them.

4B Regulation- 4.3 LTE Spectrum Allocation

With respect to the allocation of additional frequencies for mobile operators, for the next mobile generation (4G), Long Term Evolution ("LTE"), in addition to the possibility that spectrum for 4G may not be allocated at all by the Ministry of Communications to any operator, if allocations do take place and spectrum is allocated to our competitors and not to us, or if the spectrum allocated to us is insufficient to provide quality 4G services, this may put us at a disadvantage compared to our competitors and, it may harm our ability to migrate to the next generation technologies. An inefficient LTE spectrum allocation could be any of the following scenarios – (i) Insufficient allocated bandwidth preventing maximization of technological capabilities, (ii) allocation is executed later than end of year 2012 in a manner that delays our LTE launch, or (iii) allocated spectrum is not in our existing frequency bands (e.g. 2500 MHz rather than 1800 MHz) which, on the one hand, requires much higher investments in order to use it (e.g. Antennae, Power units, etc.) and, on the other hand, significantly limits our ability to vacate 2G frequencies and reallocate them for 3G and 4G options.

4B Regulation- 4.4 Securities Administrative Enforcement

An amendment to the Israeli Securities laws, which came into force in January 2011, established administrative enforcement measures for handling certain violations of certain securities and securities-related laws supervised by the Israeli Securities Authority, or ISA. This amendment allows the ISA to impose various civil enforcement measures, including financial sanctions, payment to the harmed party, prohibition of the violator from serving as an executive officer for a certain period of time, annulment or suspension of licenses, approvals and permits granted under such laws and an agreed settlement mechanism as an alternative for a criminal or administrative proceeding. In case of a violation by a corporation, the amendment provides for additional responsibility of the chief executive officer in some cases, unless certain conditions have been met, including the existence of procedures for the prevention of the violation, as part of an internal enforcement plan. The Company is prohibited from insuring, paying or indemnifying directors or senior officers for financial sanctions imposed on them in accordance with this amendment subject to certain exemptions set forth in the law. The Company has begun implementing an internal enforcement plan in accordance with this amendment.

4B Regulation- 4.5 Network Neutrality

In July 2009, the Ministry of Communications published an instruction to cellular operators and ISPs in Israel to maintain “network neutrality” by avoiding any limitation on applications or protocol usage on the Internet or any other action which might be considered discriminatory against content providers or which might harm consumers. As part of an amendment to the Telecommunications Law, new provisions regarding this matter became effective as of January 2011.See "Item 3D. Risk Factors- We operate in a highly regulated telecommunications market which limits our flexibility in managing our business and may materially and adversely affect our business and results of operations".

4B Regulation-4.6 Hearings and Examinations

The Ministry of Communications and other regulators have also conducted hearings and examinations on various matters related to our business, such as:

- The Ministry of Communications is evaluating the cost of roaming and may introduce new regulations that would limit fees charged by Israeli cellular companies for calls made by the customers of foreign network operators while they are in Israel and using our network, as well as for calls made by our own customers using their handsets abroad. The Ministry of Communications has requested additional and more specific international roaming data from the cellular companies. Because we consider roaming charges to be a significant source of revenue, such regulatory limits could adversely affect our revenues.

- The Ministry of Communications and the Council for Cable TV and Satellite Broadcasting have published a public hearing in order to determine whether there is a need to regulate the provision of video services over the internet which might compete with multiple channel television services. In October 2011 the Ministry of Communications published its recommendations that included conditions for the adoption of suitable regulation and monitoring of television broadcasts over the internet and the establishment of a continuing implementation team in order to update the existing regulation in the existing broadcasting market and to apply regulation to television broadcasts over the internet.

- On August 31, 2009, the Ministry of Communications announced that it would conduct a public hearing process regarding the regulation of broad band access services over cellular networks. Currently, a customer who obtains broad band access services over a cellular network must purchase both the broad band infrastructure and the ISP services from the cellular operator (which has itself entered into an agreement with an ISP provider), whereas a customer who obtains broad band access services over a fixed line network can purchase the broad band infrastructure and the ISP services from different vendors. The Ministry of Communications is examining the current method by which broad band access services based on cellular networks are provided to customers and has asked for public comments with regard to the current framework, as well as regarding possible alternative regulatory frameworks. As a result of this hearing, new regulations regarding broad band access services over cellular services could be introduced. We cannot assure you that, if introduced, such regulations would not adversely affect our business or operating results. See “Item 3D.1 Risks Relating to the Regulation of Our Industry – We operate in a highly regulated telecommunications market which limits our flexibility in managing our business and may materially and adversely affect our business and results of operations”.

- In March 2010, the Ministry of Communications began conducting a hearing in order to allow exclusive general licensees, mobile radio telephone licensees, and domestic fixed-line licensees to supply VoB services to subscribers that are abroad, through a telephone number that will be allocated to them by the licensee. The licensees submitted their positions to the Ministry of Communications. In December 2011, the Ministry of Communications amended the licenses of the land-line and exclusive general fixed-line licensees to allow them to supply VoB services through an

Israeli phone number also to their subscribers abroad.

- In December 2010, the Ministry of Communications published a hearing regarding the granting of VoC licenses either as part of MVNO licenses or by granting a general special license for the provision of national fixed telecommunication services. The Company submitted its response in January 2011.

- The Ministry of Communications is conducting a re-assessment of the frequency fees set forth in the law in order to support effective allocation and the utmost utilization of the frequencies.

- In January 2011, the Ministry of Communications published a hearing regarding the pricing of international calls to mobile phone destinations. The Israeli international calls operators currently set higher rates for international calls to mobile phone destinations than those for fixed line destinations. In this consultation the Ministry proposes to regulate the price difference between international calls to mobile phone destinations and those for fixed line destinations in one of two possible manners: (1) setting a uniform maximal surcharge for international calls to mobile destinations to be added to the cost of a call to fixed line destinations in each country or (2) requiring the mobile telephony operators to set a uniform call fee for both types of destinations to each foreign country.

- In November 2011, the Ministry of Communications published a hearing regarding a proposed regulation related to the underwater international telecom connection from Israel, proposing certain limitations on the agreements with Med Nautilus, Partner's provider, which shall, among other effects, limit the discounts and capacity Med Nautilus may provide to the Company, in order to provide new company protections for Tamares Telecom, a new company which has recently laid an underwater cable, to facilitate Tamares’ entry into the fixed line telecommunications market. More specifically, the Ministry of Communications may set, for a specified period of time, the minimum tariffs which Tamares’ main competitor, Med Nautilus, may charge its customers, including Partner, as well as maximum capacity which it may offer its customers, thus creating a place in the market for Tamares at rates which will protect its new business.

- In December 2011, the Ministry of Communications published a hearing for internet access providers regarding various consumer matters, similar to the hearing held for cellular telecommunication companies. The topics of the hearing include among other matters, the content of subscriber agreements and the manner in which they are executed, the obligation to document specific customer service requests, the obligation to record each phone transaction and submit to the Ministry of Communications upon its request, the obligation to document each phone conversation between a customer and a customer services representative and setting rules for the provision of cash rebates for overcharging by the telecommunications services providers, the manner in which subscribers and the Ministry of Communications are notified of price changes and others. The adoption of more of these provisions may limit Partner's flexibility in operations and competing for customers and may also increase operating costs.

- In December 2011, the Ministry of Communications published a hearing regarding a new regulation for the provision of internet broadband access service ("ADSL") by Bezeq, to subscribers that are not Bezeq's telephony service customers. The Ministry expressed its opinion that the existing pricing of Bezeq creates a consumer and competitive problem. Following the hearing, the Ministry has instructed that as of April 5, 2012, Bezeq to refrain from charging its customers a monthly sum of NIS 25 that is currently charged to subscribers for "ADSL only service" in addition to the monthly sum, charged to all its customers, for the ADSL service itself. In addition, the Ministry determined that Bezeq will price the ADSL service that is provided to all its customers such that it will include its relative portion of the network access cost, however the prices that will be set for the ADSL service shall be uniform in such a manner that Bezeq will not be allowed to set a different price for the ADSL service when the customer also consumes telephony service from Bezeq. This reform, removes yet another barrier in the fixed line market and will allow VOB operators to compete with Bezeq.

- ILITA-The Israeli Law, Information and Technology Authority, a data protection regulator, has circulated initial draft guidelines aimed at the cellular operators. The guidelines, if adopted as currently drafted, would require operators to adopt elaborate mechanisms for seeking users' consent to the collection and processing of personal information, which may affect the extent to which we can collect and process information.

On July 15, 2010 the following governmental resolutions were passed:

- The Ministry of Communications shall examine the possibility of shortening the commitment period for subscribers so that they do not exceed 12 months.

- An inter-ministry committee headed by the director of the Ministry of Communications shall be established to submit recommendations regarding a model for cellular infrastructure sharing, including necessary statutory amendments and submit such recommendations for the government's approval. In July 2011 the committee published its recommendations which included a requirement to allow cellular site sharing as a condition for obtaining a building permit for the construction of new cellular sites or for the modification of existing cellular sites, while providing preference and leniencies to the new UMTS operators. It was further recommended that The Ministry of Communications will be authorized to exempt site sharing in case of engineering or technological prevention. These recommendations, if enacted, shall have a negative impact on our ability to construct new cellular sites and to modify existing cellular sites and may adversely affect the Company's existing network, the network future expansion and the Company's result of operations.

- An inter-ministry committee shall be established to examine the implementation of vacating frequencies for 4th generation cellular activities including frequencies in the 2,500 MHz-2,700 MHz, while examining the possibility for compensation. The committee is expected to submit a summary document by December 25, 2011 that will examine the advantages of introducing 4G technology in light of the possible risks to the public health, if any were to be found.

- In order to increase transparency in the cellular market, and facilitate the consumers' ability to choose telecommunication services, the Minister of Communications shall conduct periodic comparisons between the service prices of the cellular operators and bring this to the public's attention on the ministry's website. The ministry should publish on its website at the beginning of each year a report regarding the service levels and prices provided to cellular subscribers including changes in price levels, consumer complaint details that were received by the ministry regarding the activity of a cellular operator and details of breaches and monetary sanctions imposed by the ministry on cellular operators.

- In August 2011, a law proposal was published that was meant to set a mechanism that would allow the Ministry of Communications to impose financial sanctions on a licensee based on two parameters: the annual income of the violator and the degree of severity of the violation. The Company submitted its response in September 2011. The proposal has recently passed a first reading in the Parliament. If the law proposal passes, it could increase the variety of monitoring and enforcement measures of the Ministry of Communications towards the licensees.

4B Regulation 4.7 Public Committee to examine the fixed-line telecommunications sector

In February 2010, a public committee was appointed by the Ministries of Communications and Finance to examine the fixed–line telecommunications sector ("the Hayek Committee").

In October 2011, the Hayek Committee published its recommendations according to which: (1) the supervision over Bezeq's retail tariffs will be determined based on the system of a maximum tariff, and not the system of a constant tariff, This would be executed immediately, independent of any other issue stated in the document. The ministers will be updated on a regular basis regarding the development of competition in the market, and will receive a detailed report every six months, in order to allow intervention in case of a decline in the rate of the competition. The tariffs will be examined every three years; (2) holders of general fixed line licenses will provide services and allow the use of the infrastructure required to facilitate the activity of other license holders in providing services to end-customers; (3) wholesale service tariffs shall be set by the regulator. Until such time, each wholesale service tariff shall be fixed, regardless of consumer's characteristics and shall not exceed 75% of the average retail price offered by the fixed-line general licensee with the largest market share in the private internet infrastructure sector during July to September 2011. This arrangement shall apply for six months from its approval by the Minister of Communications. The Minister of Communications may extend the period only by six months;

In addition, the Hayek Committee decided that (1) the structural separation requirement imposed on the fixed-line general licensees shall be abolished and replaced by accounting separation between the services that these licensees provide and the infrastructures. This change will became effective upon the earlier of either the passage of a period of six months from the signing of wholesale agreements or from the beginning of provision of wholesale services as set in the said agreements. If agreements are not reached regarding the said wholesale services, the structural separation shall be cancelled when wholesale tariffs will be set by the regulator. In addition, the transfer of information between the retail and wholesale divisions of each of the companies will be prohibited; (2) if no wholesale market is established within 24 months from the publish date of the committee recommendations, the regulator shall resume structural separation between the infrastructure of fixed-line general licensees and services provided to end users.

The Hayek Committee also decided that broadband access service will be provided immediately in a manner that will enable operation and control by the service provider who can manage the service, and is not the owner of the infrastructure. The infrastructure provider will be required to provide all that is needed apart from the line itself, in order to allow the transparency required for the control and management of the service.

With respect to the telecommunications initiative on the electricity company's infrastructure, the Hayek Committee recommended applying to the entity that will be established as part of the initiative, regulatory rules similar to the rules set for the provision of wholesale services, as they will be applied to other fixed-line general licensees, with the necessary technological adjustments. The implementation of the recommendations, either in whole or in part, is subject to its approval by the Minister of Communications and other additional legislative processes.

4B Regulation- 4.8 Integrated Tender Committee For UMTS Frequency Allocation For An Additional Cellular Operator and National Roaming

Further to a tender committee that was appointed by the Ministry of Communications in May 2010 to allocate UMTS frequency to additional cellular operators, in September 2010, the Ministry of Communications published a UMTS frequencies allocation tender offer in the 2100 Mhz spectrum for two additional cellular operators. Participation in the Tender was allowed only for new operators and MIRS. Other existing cellular operators were not allowed to participate. Four companies submitted tender offers and the UMTS frequencies were ultimately awarded to MIRS (whose license was amended accordingly) and Golan Telecom Ltd. ("Golan Telecom"), that was granted a license in December 2011. The Tender did not set a completion date for the network deployment. In order to reduce entry barriers while penetrating the cellular service market, the winners shall be awarded various benefits and leniencies, such as low minimum license fee and a reduction mechanism of the license fee offered to the winner (to the minimum fee set) based on the market share gained by the winner in the private sector over 5 years after being awarded the license.

In accordance with an amendment to the Telecommunications Law, the existing cellular operators will be required to allow the new operators use of the public telecommunication networks of the existing cellular operators for a period of 7 years from when the Ministry of Communications has confirmed that the new operator has begun providing cellular service not through roaming, to an area with at least 10% of the population and to an area that is at least 40% populated within 4 years of the grant of the license. Each of these periods can be extended by no more than 3 years by the Ministers of Communications and Finance.

Until the Minister of Communications, with the approval of the Minister of Finance proposes regulations that determine national roaming tariffs, and no later than February 1, 2012, the existing cellular operators will only be allowed to charge the new operators prices that do not exceed the new interconnect tariffs. With regards to cellular data, the price per Mb shall not exceed 65% of the maximum price per minute for regular calls.

This regulatory initiative may increase the likelihood of additional new competitors in the mobile telephone market in Israel. Our capacity is limited, and if we will be required to share our sites and infrastructure with other operators, as a result of the Ministry of Communications' decision of this hearing, the services to our subscribers may be harmed or we may be required to invest additional capital in order to enable additional use of our network.

4B Regulation- 4.9 MVNOs

The Ministry of Communications granted MVNO licenses to a number of companies which is expected to increase competition in the market. These operators are expected to launch their operations during 2012 while one operator began operating in December 2011. Two of our competitors have signed agreements with MVNOs to offer access to their network structure. In December 2011, we signed an agreement with Alon Cellular with respect to Alon Cellular's use of Partner's network as an MVNO.

4B Regulation- 4.10 Tender of the Electricity Company

The Ministries of Finance, National Infrastructures and Communications and the Israeli Electric Corporation the Israeli national electric company published in October 2011 a tender to identify an investor for the Electric Company's telecommunications project. Together with the investor, the Electric Company would establish a new internet broadband access infrastructure (two such infrastructures already exist in Israel, owned by Bezeq and HOT Telecommunications Systems Ltd, respectively). The new internet broadband access infrastrcuture company would be controlled by the investor and held jointly with the Electric Company and would ultimately be awarded a telecommunications license by the Ministry of Communications. If the new company is allowed to sell services to end users (retail) and not just to other providers of telecommunications services (wholesale), it would enter into direct competition with other companies offering internet broadband access services, such as Partner, which may have an adverse affect on our business, operating results and financial condition.

4B Regulation- 4.11 Prohibition of linkage between the sale of handsets and the provision of various benefits regarding cellular services.

Following the removal of transition barriers between the cellular companies and various publications in the media with respect to this matter, there has been an increase in customers joining the Company as subscribers while purchasing their handsets from either other cellular telecommunications operators or from another handset supplier and to benefit from the same cellular advantages which the Company offers to subscribers who purchase their handsets from them. This provision has contributed to the increase in churn of post-paid subscribers, and its affect may increase.

In addition, effective January 1, 2013, cellular operators will be prohibited from linking any cellular benefits to the purchase of handsets from any source.

4B Regulation- 4.12- Prohibition of Sale of Locked Handsets

The Ministry of Communications has also increased competition by facilitating the migration of subscribers among cellular companies by prohibiting cellular companies from selling locked handsets for use only with the company's SIM card and requiring them to agree to unlock all handsets they have sold in the past, free of charge.

4B Regulation- 4.13.Import of Handsets.

Further to a previous amendment to the Telecommunications Law that significantly facilitated the import of cellular handsets to Israel by exempting certain mobile radio telephone handsets that meet the conditions set by the Minister of Communications, from receiving a type approval, and handset commerce that meets the said conditions set by the Minister of Communications, being exempt from a commerce license, in an effort to increase competition and to reduce cellular handset prices in the market, in June 2011, the procedures with respect to the import of cellular handsets were further amended to facilitate the import of cellular handsets to Israel in order to further increase competition in this field. See "Item 3D. Risk Factors-Competition resulting from consolidation in the telecommunications industry, the expanded offerings of full service telecommunications groups, and new entrants into the mobile telecommunications market, despite its current saturation, as well as other actual and potential changes in the competitive environment and communications technologies, may cause an increase in subscriber acquisition and retention costs and a decrease in tariffs, and may reduce our subscriber base and increase our churn rate, each of which could adversely affect our business and results of operations-sale of handsets".

4B Regulation- 4.14 Parliament Law Proposals

The following parliamentary law proposals are currently pending in the Israeli Parliament with respect to proposed amendments to the Telecommunications Law:

- A proposal to unify the tariff for sending an SMS message regardless of the length of the message or number of characters.

- A proposal to allow customers who purchased monthly "banks" of minutes, SMSs, or data to accumulate the unutilized balance for later use.

- A proposal to prohibit cellular operators from imposing exit fees at all upon certain subscribers who terminate a commitment agreement during the commitment period.

In addition, a new parliamentary law proposal with respect to notification of the dangers of cellular phone usage has recently passed a preliminary reading in the Parliament. The proposed law would impose various obligations on sellers of cellular phones, cellular phone licensees as well as governmental ministries to notify the public of the dangers of cellular phone usage in various manners among others, by including a health warning on the handset screen before use as well as daily SMS warnings regarding possible radiation damage. In addition the law proposes to obligate the cellular companies to allocate 15% of their advertising budget to advertising that promotes safe and measured cellular phone usage. If the law proposal will pass, it could affect cellular phone usage and adversely affect the Company's revenues.

4B Regulation- 4.15 Accessibility for Disabled Persons

The Company has been notified that the Labor, Welfare and Health Committee of the Israeli Parliament is conducting proceedings regarding the enactment of accessibility regulations based on the Equality Law for Disabled Persons. Such regulations will address issues including physical accessibility to our customer service centers as well as to information such as forms, pamphlets and telephone customer services. We believe that the costs required to comply with such regulations may be significant. The regulations under discussion allow relief to disabled persons against non-compliant companies of NIS 50,000 without having to prove damages and may provide grounds for class actions. The proceedings are in its final stages and are expected to be concluded in the near future.

4B Regulation- 5 Our Mobile Telephone License

On April 7, 1998, the Ministry of Communications granted to us a general license to establish and operate a mobile telephone network in Israel. The Ministry of Communications amended our license in February 2002 to include the provision of 3G services by us and extended our mobile telephone license through 2022.

Under the terms of the amended license, we have provided a $10 million guarantee to the State of Israel to secure the Company’s adherence to the terms of the license.

On March 9, 2005, our license was further amended. The principal elements of this amendment are as follows:

- Our founding shareholders and their approved substitutes must hold, in the aggregate, at least 26% of each of our means of control. Furthermore, the maintenance of at least 26% of our means of control by our founding shareholders and their approved substitutes allows Partner to be protected from a license breach that would result from a transfer of shares for which the authorization of the Ministry of Communications was required, but not obtained.

- Israeli entities from among our founding shareholders and their approved substitutes must hold at least 5% of our issued and outstanding share capital and of each of our means of control. “Israeli entities” are defined as individuals who are citizens and residents of Israel and entities formed in Israel and controlled, directly or indirectly, by individuals who are citizens and residents of Israel, provided that indirect control is only through entities formed in Israel, unless otherwise approved by the Israeli Prime Minister or Minister of Communications.

- At least 10% of our Board of Directors must be appointed by Israeli entities, as defined above, provided that if the Board of Directors is comprised of up to 14 members, only one such director must be so appointed, and if the Board of Directors is comprised of between 15 and 24 members, only two such directors must be so appointed.

- Matters relating to national security shall be dealt with only by a Board of Directors committee that has been formed for that purpose. The committee includes at least 4 members, of which at least one is an external director. Only directors with the required clearance and those deemed appropriate by Israel's General Security Service may be members of this committee. Resolutions approved by this committee shall be deemed adopted by the Board of Directors.

- The Ministry of Communications shall be entitled to appoint an observer to the Board of Directors and its committees, subject to certain qualifications and confidentiality undertakings.

In March 2007, our license was further amended. Among the changes was a requirement not to provide access to services, whether from Partner or a content supplier, if the subscriber has not specifically requested access to such service and for which there is a significant charge to the subscriber. We must also inform subscribers that they have the ability to block access to such services.

4B Regulation- 5.1 Term. Our license authorizes us on a non-exclusive basis to establish and operate a mobile telephone network in Israel. A mobile telephone network is a wireless telephone network through which mobile telephone service is provided to the public. Our license allocates to us specified frequencies and telephone numbers. Our license was originally valid for a period of ten years (until April 2008), but has been extended until 2022.

The license may be extended for an additional six-year period upon our request to the Ministry of Communications, and a confirmation from the Ministry of Communications that we have met the following performance requirements:

- observing the provisions of the Telecommunications Law, the Wireless Telegraphy Ordinance, the regulations and the provisions of our license;

- acting to continuously improve our mobile telephone services, their scope, availability, quality and technology, and that there has been no act or omission by us harming or limiting competition in the mobile telephone sector;

- having the ability to continue to provide mobile telephone services of a high standard and to implement the required investments in the technological updating of our system in order to improve the scope of such services, as well as their availability and quality; and

- using the spectrum allocated to us efficiently, compared to alternative applications.

At the end of this additional six-year period, we may request renewal of our license for successive six-year periods thereafter, subject to regulatory approval.

4B Regulation- 5.2 Contracting with Customers. Pursuant to our license, our standard agreement with customers must receive the Ministry of Communications' approval. We have submitted our standard agreement to the Ministry of Communications for approval pursuant to our license. To date, we have not received any comments from the Ministry of Communications regarding this agreement.

4B Regulation- 5.3 Tariffs. Our license requires us to submit to the Ministry of Communications our tariffs (and any changes in our tariffs) before they enter into effect. Our license allows us to set and change our tariffs for outgoing calls and any other service without approval of the Ministry of Communications. However, the Ministry of Communications may intervene in our tariffs if it finds that our tariffs unreasonably harm consumers or competition.

4B Regulation- 5.4 Payments. Our license specifies the payments we may charge our subscribers. These include one-time installation fees, fixed monthly payments, airtime fees, payments for the use of other telecommunication systems, payments for handset maintenance and payments for additional services. In some of our tariff plans we have chosen to charge only for airtime and use of services. See “Item 4B.6 Services and Products–Tariff Plans.”



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4B Regulation- 5.5 Interconnection. Like the licenses of Pelephone, Cellcom and MIRS, our license requires that we interconnect our mobile telephone network to other telecommunications networks operating in Israel, including that of Bezeq and other domestic fixed-line operators, the other mobile telephone operators and the international operators.

Conversely, we must allow other network operators to interconnect to our network. See “Item 4B.10 Interconnection.”

4B Regulation- 5.6 Service Approval. The Ministry of Communications has the authority to require us to submit for approval details of any of our services (including details concerning tariffs). In addition, we are required to inform the Ministry of Communications prior to the activation of any service on a specified list of services.

4B Regulation- 5.7 Access to Infrastructure. The Ministry of Communications has the power to require us, like the other telephone operators in Israel, to offer access to our network infrastructure to other operators. We may also be required to permit other operators to provide value-added services using our network.

4B Regulation- 5.8 Universal Service. We are required to provide any third generation service with the same coverage as our existing network within 24 months from the commercial launch of each such service.

4B Regulation- 5.9 Territory of License. Our license authorizes us to provide mobile telephone services within the State of Israel as well as offer roaming services outside the State of Israel. In May 2000, we were also granted a license from the Israeli Civil Administration, to provide mobile services to the Israeli populated areas in the West Bank. The license is effective until April 7, 2013. The provisions of the general license described above, including as to its extension, generally apply to this license, subject to certain modifications. We believe that we will be able to receive an extension to this license upon request.

4B Regulation- 5.10 License Conditions. Our license imposes many conditions on our conduct. We must at all times be a company registered in Israel. Our license may not be transferred, mortgaged or attached without the prior approval of the Ministry of Communications. We may not sell, lease or mortgage any of the assets which serve for the implementation of our license without the prior approval of the Ministry of Communications, other than in favor of a banking corporation which is legally active in Israel, and in accordance with the conditions of our license.

Our license provides that no direct or indirect control of Partner may be acquired, at one time or through a series of transactions, and no means of control may be transferred in a manner which results in a transfer of control, without the consent of the Ministry of Communications. Furthermore, no direct or indirect holding of 10% or more of any means of control may be transferred or acquired at one time or through a series of transactions, without the consent of the Ministry of Communications. In addition, no shareholder of Partner may permit a lien to be placed on shares of Partner if the foreclosure on such lien would cause a change in the ownership of 10% or more of any of Partner’s means of control unless such foreclosure is made subject to the consent of the Ministry of Communications. For purposes of our license, “means of control” means any of:

- voting rights in Partner;
- the right to appoint a director or managing director of Partner;
- the right to participate in Partner’s profits; or
- the right to share in Partner’s remaining assets after payment of debts when Partner is wound up.

Each of our ordinary shares and ADSs is considered a means of control in Partner.

In addition, Partner, any entity in which Partner is an Interested Party, as defined below, an Office Holder, as defined below, in Partner or an Interested Party in Partner or an Office Holder in an Interested Party in Partner may not be a party to any agreement, arrangement or understanding which may reduce or harm competition in the area of mobile telephone services or any other telecommunications services.

In connection with our initial public offering, our license was amended to provide that our entering into an underwriting agreement for the offering and sale of shares to the public, listing the shares for trading, and depositing shares with the depositary or custodian will not be considered a transfer of any means of control, as defined below. Pursuant to the amendment, if the ADSs (or other "traded means of control," that is, means of control which have been listed for trade or offered through a prospectus and are held by the public) are transferred or acquired in breach of the restrictions imposed by the license with respect to transfer or acquisition of 10% or more of any means of control, we must notify the Ministry of Communications and request the Ministry's consent within 21 days of learning of the breach. In addition, should a shareholder, other than a founding shareholder, breach these ownership restrictions, or provisions regarding acquisition of control or cross-ownership or cross-control with other mobile telephone operators or shareholdings or agreements which may reduce or harm competition, its shareholdings will be marked as exceptional shares and will be converted into dormant shares, as long as the Ministry's consent is required but not obtained, with no rights other than the right to receive dividends and other distributions to shareholders, and to participate in rights offerings.

The dormant shares must be registered as dormant shares in our share registry. Any shareholder seeking to vote at a general meeting of our shareholders must notify us prior to the vote, or, if the vote is by deed of vote, must so indicate on the deed of vote, whether or not the shareholder's holdings in Partner or the shareholder's vote requires the consent of the Ministry of Communications due to the restrictions on transfer or acquisition of means of control, or provisions regarding cross-ownership or cross-control with other mobile telephone operators or shareholders. If the shareholder does not provide such certification, his instructions shall be invalid and his vote not counted.

The existence of shareholdings which breach the restrictions of our license in a manner which could cause them to be converted into dormant shares and may otherwise provide grounds for the revocation of our license will not serve in and of themselves as the basis for the revocation of our license so long as:

- the founding shareholders or their approved substitutes of Partner continue to hold in the aggregate at least 26% of the means of control of Partner;
- our Articles of Association include the provisions described in this paragraph;
- we act in accordance with such provisions;
- our Articles of Association provide that an ordinary majority of the voting power at the general meeting of Partner is entitled to appoint all the directors of Partner other than external directors.

The amendment of our license providing for the dormant share mechanism does not apply to our founding shareholders.

The provisions contained in the amendment to our license are also contained in our Articles of Association. In addition, our Articles of Association contain similar provisions in the event the holdings of shares by a shareholder breaches ownership limits contained in our license.

4B Regulation- 5.11 Revoking, limiting or altering our license. Our license contains several qualifications that we are required to meet. These conditions are designed primarily to ensure that we maintain at least a specified minimum connection to Israel. Other eligibility requirements address potential conflicts of interest and cross-ownership with other Israeli telecommunications operators. The major eligibility requirements are set forth below. A failure to meet these eligibility requirements may lead the Ministry of Communications to revoke, limit or alter our license, after we have been given an opportunity and have failed to remedy it.

- Founding shareholders or their approved substitutes must hold at least 26% of the means of control of Partner.

- Israeli entities from among our founding shareholders and their approved substitutes must hold at least 5% of our issued share capital and of each of our means of control.

- The majority of our directors, and our general manager, must be citizens and residents of Israel.

- Neither the general manager of Partner nor a director of Partner may continue to serve in office if he has been convicted of certain legal offenses.

- No trust fund, insurance company, investment company or pension fund that is an Interested Party in Partner may: (a) hold, either directly or indirectly, more than 5% of any means of control in a competing mobile radio telephone operator without having obtained a permit to do so from the Ministry of Communications, or (b) hold, either directly or indirectly, more than 5% of any means of control in a competing mobile radio telephone operator in accordance with a permit from the Ministry, and in addition have a representative or appointee who is an Office Holder in a competing mobile radio telephone operator, unless it has been legally required to do so, or (c) hold, either directly or indirectly, more than 10% of any means of control in a competing mobile radio telephone operator, even if it received a permit to hold up to 10% of such means of control.

- No trust fund, insurance company, investment company or a pension fund that is an Interested Party in a competing mobile radio telephone operator may: (a) hold, either directly or indirectly, more than 5% of any means of control in Partner, without having obtained a permit to do so from the Ministry of Communications; or (b) hold, directly or indirectly, more than 5% of any means of control in Partner in accordance with a permit from the Ministry of Communications, and in addition have a representative or appointee who is an Office Holder in Partner, unless it has been legally required to do so; or (c) hold, either directly or indirectly, more than 10% of any means of control in Partner, even if it received a permit to hold up to 10% of such means of control.

- Partner, an Office Holder or Interested Party in Partner, or an Office Holder in an Interested Party in Partner does not control a competing mobile radio telephone operator, is not controlled by a competing mobile radio telephone operator, by an Office Holder or an Interested Party in a competing mobile radio telephone operator, by an Office Holder in an Interested Party in a competing mobile radio telephone operator, or by a person or corporation that controls a competing mobile radio telephone operator.

Our license may also be revoked, limited or altered by the Ministry of Communications if we have failed to uphold our obligations under the Telecommunications Law, the Wireless Telegraphy Ordinance or the regulations, or have committed a substantial breach of the license conditions. Examples of the principal undertakings identified in our license in this connection are:

- We have illegally ceased, limited or delayed any one of our services;

- Any means of control in Partner or control of Partner has been transferred in contravention of our license;

- We fail to invest the required amounts in the establishment and operation of the mobile radio telephone system in accordance with our undertakings to the Ministry of Communications;

- We have harmed or limited competition in the area of mobile radio telephone services;

- A receiver or temporary liquidator is appointed for us, an order is issued for our winding up or we have decided to voluntarily wind up; or

- Partner, an Office Holder in Partner or an Interested Party in Partner or an Office Holder in an Interested Party of Partner is an Interested Party in a competing mobile radio telephone operator or is an Office Holder in a competing mobile radio telephone operator or in an interested party in a competing mobile radio telephone operator without first obtaining a permit from the Ministry of Communications to do so or has not fulfilled one of the conditions included in such permit. See "Item 4B Regulation–5.13 Our Permit Regarding Cross Ownership."

In addition, our amended license, like the licenses of our competitors, provides that if we participate in a future tender for a mobile telecommunications license, we may be required by the terms of a new tender, if we win such tender, to transfer our network to another operator according to terms which the Ministry of Communications may decide upon and to cease providing mobile telephony services.

4B Regulation- 5.12 Change in license conditions. Under our license, the Ministry of Communications may change, add to, or remove conditions of our license if certain conditions exist, including:

- A change has occurred in the suitability of Partner to implement the actions and services that are the subject of our license.

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A change in our license is required in order to ensure effective and fair competition in the telecommunications sector.

- A change in our license is required in order to ensure the standards of availability and grade of service required of Partner.

- A change in telecommunications technology justifies a modification of our license.
- A change in the electromagnetic spectrum needs justifies, in the opinion of the Ministry of Communications, changes in our license.
- Considerations of public interest justify modifying our license.
- A change in government policy in the telecommunications sector justifies a modification of our license.
- A change in our license is required due to its breach by Partner.

During an emergency period, control of Partner's mobile radio telephone system may be assumed by any lawfully authorized person for the security of the State of Israel to ensure the provisions of necessary service to the public, and some of the spectrum granted to us may be withdrawn. In addition, our license requires us to supply certain services to the Israeli defense and security forces. Furthermore, certain of our senior officers are required to obtain security clearance from Israeli authorities.

For the purposes of this discussion, the following definitions apply:

- "Office Holder" means a director, manager, company secretary or any other senior officer that is directly subordinate to the general manager.
- "Control" means the ability to, directly or indirectly, direct the activity of a corporation, either alone or jointly with others, whether derived from the governing documents of the corporation, from an agreement, oral or written, from holding any of the means of control in the corporation or in another corporation, or which derives from any other source, and excluding the ability derived solely from holding the office of director or any other office in the corporation. Any person controlling a subsidiary or a corporation held directly by him will be deemed to control any corporation controlled by such subsidiary or by such controlled corporation. It is presumed that a person or corporation controls a corporation if one of the following conditions exist: (1) such person holds, either directly or indirectly, fifty percent (50%) or more of any means of control in the corporation; (2) such person holds, either directly or indirectly, a percentage of any means of control in the corporation which is the largest part in relation to the holdings of the other Interested Parties in the corporation; or (3) such person has the ability to prevent the taking of business decisions in the corporation, with the exception of decisions in the matter of issuance of means of control in a corporation or decisions in the matters of sale or liquidation of most businesses of the corporation, or fundamental changes of these businesses.
- "Controlling Corporation" means a company that has control, as defined above, of a foreign mobile radio telephone operator.
- "Interested Party" means a person who either directly or indirectly holds 5% or more of any type of means of control, including holding as an agent.

4B Regulation- 5.13 Our Permit Regarding Cross Ownership

Our license generally prohibits cross-control or cross-ownership among competing mobile telephone operators without a permit from the Ministry of Communications. In particular, Partner, an Office Holder or an Interested Party in Partner, as well as an Office Holder in an Interested Party in Partner may not control or hold, directly or indirectly, 5% or more of any means of control of a competing mobile radio telephone operator. Our license also prohibits any competing mobile radio telephone operator or an Office Holder or an Interested Party in a competing mobile radio telephone operator, or an Office Holder in an Interested Party in a competing mobile radio telephone operator or a person or corporation that controls a competing mobile radio telephone operator from either controlling, or being an Interested Party in us.

However, our license, as amended on April 14, 2002 also provides that the Ministry of Communications may permit an Interested Party in Partner to hold, either directly or indirectly, 5% or more in any of the means of control of a competing mobile radio telephone operator if the Ministry of Communications is satisfied that competition will not be harmed, and on the condition that the Interested Party is an Interested Party in Partner only by virtue of a special calculation described in the license and relating to attributed holdings of shareholders deemed to be in control of a corporation.

4B Regulation- 6 Other Licenses

Domestic Fixed-line License. In January, 2007, the Ministry of Communications granted Partner Land-Line Communication Solutions Limited Partnership, which is fully owned by the Company, a license for the provision of domestic fixed-line telecommunications services. The license expires in twenty years but may be extended by the Ministry of Communications for successive periods of ten years provided that the licensee has complied with the terms of the license and has acted consistently for the enhancement of telecom services and their enhancement. The licensee deposited a bank guarantee in the amount of NIS 10 million with the Ministry of Communications upon receiving the license which shall be used to secure the licensee's obligations under the License. The general conditions of the mobile telephone license described above, generally apply to this license, subject to certain modifications. In addition to any 10% share transfer requiring the prior approval of the Ministry of Communications, the license additionally requires approval prior to a third party acquiring the ability to exercise significant influence over us. In this context, holding 25% of our means of control is presumed to confer significant influence. The license was amended in February 2007 to grant us the right to offer VoB services using the infrastructure of Bezeq and HOT to access customers and to provide them with fixed-line telephony service. The License was further amended in July 2007 to incorporate the provision of transmission and data communications services that were previously provided for under a transmission license that was granted in July 2006. In March 2009, we were also granted a domestic fixed-line license to provide fixed-line services to the Israeli populated areas in the West Bank. The license is effective until March 2019.

012 Smile was also granted a similar domestic fixed-line license by the Ministry of Communications in December 2005 for 20 years that may be extended under similar conditions as our domestic fixed-line license.

ISP License. In March 2001, we received a special license granted by the Ministry of Communications, allowing us through our own facilities to provide internet access to fixed-line network customers. The license was renewed in April 2008 and is valid until April 2013. We began supplying commercial ISP services beginning in January 2009. We were also granted a special license to provide ISP services to the Israeli populated areas in the West Bank.

012 Smile was also granted a similar ISP license by the Ministry of Communications in December 2009 that is valid until December 2014.

International Long Distance License. In December 2009, the Ministry of Communications granted 012 Smile, a license for the provision of International Long Distance services. The license expires in twenty years but may be extended by the Ministry of Communications for successive periods of ten years provided that the licensee has complied with the terms of the license and has acted consistently for the enhancement of telecom services and their enhancement.

NTP License. In February 2007 we received a special license granted by the Ministry of Communications allowing us to provide certain telecom services, including providing and installing equipment and cabling, representing the subscriber with local fixed operators, and establishing and operating control facilities within a subscriber's premises. The license is valid until February 2017.

012 Smile was also granted a similar NTP license by the Ministry of Communications in December 2009 that is valid until December 2014.

Other Licenses. The Ministry of Communications has granted us a trade license pursuant to the Wireless Telegraphy Ordinance. This license regulates issues of servicing and trading in equipment, infrastructure and auxiliary equipment for our network. We have also been granted a number of encryption licenses that permit us to deal with means of encryption, as provided in the aforementioned licenses, within the framework of providing mobile radio telephone services to the public.

4B Regulation- 7 Network Site Permits

4B Regulation- 7.1 Permits of the Ministry of Environmental Protection

On January 1, 2006, the Non-Ionizing Radiation Law (5766-2006), which replaced the Pharmacists (Radioactive Elements and Products) Regulations, 1980 regarding matters that pertain to radiation from cellular sites, was enacted. This law defines the various powers of the Ministry of Environmental Protection as they relate, inter alia, to the grant of permits for network sites and sets standards for permitted levels of non-ionizing radiation emissions and reporting procedures. Pursuant to this law, most of which entered into effect on January 1, 2007, a request for an operating permit from the Ministry of Environmental Protection with respect to either new sites or existing sites would require a building permit for such site(s). The Ministry of Environmental Protection has adopted the International Radiation Protection Agency’s standard as a basis for the consents it gives for the erection and operation of our antennas. This standard is an international standard based upon a number of years of scientific study.

If we will continue to face difficulties in obtaining building permits from the local planning and building committee, we may fail to obtain also operation permits from the Ministry of Environmental Protection. Operation of a network site without a permit from the Ministry of Environmental Protection may result in criminal and civil liability to us or to our officers and directors.

4B Regulation- 7.2 Local Building Permits

The Planning and Building Law requires that we receive a building permit for the construction of most of our antennas. The local committee or local licensing authority in each local authority is authorized to grant building permits, provided such permits are in accordance with National Building Plan No. 36 which came into effect on June 15, 2002. The local committee is made up of members of the local municipal council. The local committee is authorized to delegate certain of its powers to subcommittees on which senior members of the local authority may sit.

The local committee examines the manner in which an application for a building permit conforms to the plans applying to the parcel of land that is the subject of the application, and the extent to which the applicant meets the requirements set forth in the Planning and Building Law. The local committee is authorized to employ technical, vista, and aesthetic considerations in its decision-making process. The local committee may grant building permits that are conditioned upon the quality of the construction of the structure, the safety of flight over the structure, and the external appearance of the structure. Every structure located on a certain parcel of land must satisfy the requirements and definitions set forth in the building plan applicable to such parcel.

On January 3, 2006, the National Council for Planning and Building added a new requirement for obtaining a building permit for network sites: the submission of an undertaking to indemnify the local committee for claims relating to the depreciation of the surrounding property value as a result of the construction or existence of the antenna.

A decision by a local committee not to grant a building permit may be appealed to the District Appeals Committee. A person harmed by the ruling of the District Appeals Committee may have such ruling examined judicially by means of an administrative petition to the District Court sitting as an Administrative Affairs Tribunal.

4B Regulation- 7.3 National Building Plan No. 36

National Building Plan No. 36 which came into effect on June 15, 2002 regulates the growth of telecommunications infrastructure in Israel. Chapter A of National Building Plan No. 36 sets forth the licensing, view, flight safety and electromagnetic radiation requirements for the construction of mobile radio telephone infrastructure. National Building Plan No. 36 also adopts the radiation emission standards set by the International Radiation Protection Agency which were also previously adopted by the Ministry of Environmental Protection. We believe that we currently comply with these standards. National Building Plan No. 36 is in the process of being changed. On June 1, 2010, the National Council for Planning and Building approved the National Building Plan No. 36/A/1 version that incorporates all of the amendments to National Building Plan No. 36 ("the Amended Plan").

Current proposed changes impose additional restrictions and/or requirements on the construction and operation of network sites and could, if adopted, harm our ability to construct new network sites, make the process of obtaining building permits for the construction and operation of network sites more cumbersome and costly, and may delay the future deployment of our network.

Under the Non-Ionizing Radiation Law, the National Council for Planning and Building was granted the power to determine the level of indemnification for reduction of property value to be undertaken as a precondition for a cellular company to obtain a building permit for a new or existing network site. As a result, the National Council for Planning and Building has decided that until National Building Plan 36 is amended to reflect a different indemnification amount, cellular companies will be required to undertake to indemnify the building and planning committee for 100% of all losses resulting from claims against the committee. Thus, at present, in order to obtain a building permit for a new or existing network site, we must provide full indemnification for the reduction of property value.

The Amended Plan sets forth the indemnification amounts as a percentage of the value of the depreciated property claims in accordance with the manner in which the licenses were granted as follows: If the license was granted in an expedited licensing route, which is intended for installations that are relatively small in accordance with the Amended Plan criteria, then the cellular companies will be required to compensate the local planning committees in an amount of 100% of the value of the depreciated property claim. If the license was granted in a regular licensing route, which is intended for larger installations in accordance with the Amended Plan criteria, then the cellular companies will be required to compensate the local planning committees in an amount of 80% of the value of the depreciated property claim. The Amended Plan is subject to governmental approval, in accordance with the Planning and Building Law. It is unknown when the government intends to approve the Amended Plan,

These recent developments may have a material adverse effect on our financial condition and results of operations, as well as plans to expand and enhance network coverage. For more information, see "Item 3D.1 Risks Relatinig to the Regulation of Our Industry – In connection with certain building permits, we may also be required to indemnify planning committees in respect of claims against them relating to the depreciation of property values that result from the granting of permits for network sites".

4B Regulation- 7.4 Wireless access devices

We have set up several hundred small communications devices, called wireless access devices, pursuant to a provision in the Telecommunications Law which we and other participants in cellular telecommunications, believe exempts such devices from the need to obtain a building permit. Beginning in 2008, following the filing of a claim that the exemption does not apply to cellular communications devices, the Attorney General filed an opinion regarding this matter stating that the exemption does apply to wireless radio access devices under certain conditions and instructed the Ministry of Interior to prepare regulations setting conditions that would limit the exemption to extraordinary circumstances. Following the instruction of the Attorney General, several inter-ministerial discussions and hearings have taken place without agreement being reached as tothe final version of the regulations. The approval of the regulations was brought to the Economic Committee where the regulations were not approved. The chairman of the Economic Committee advised that he intended to meet with representatives of the relevant governmental ministries in an effort to seek a version of the regulations that would be acceptable by all committee members. Following two petitions that were filed with the High Court of Justice opposing the Attorney General's recommendation that the exemption apply under certain conditions, on September 16, 2010, the Supreme Court issued an interim order prohibiting further construction of wireless access devices in cellular networks in reliance on the exemption from the requirement to obtain a building permit; On February 15, 2011, the Supreme Court narrowed the scope of the interim injunction so that repair or replacement of existing wireless access devices is permitted under certain conditions that will be determined in a judgment. If a definitive court judgment holds that the exemption does not apply to cellular devices at all or if the regulations finally approved do not apply the exemption to wireless access devices, or only under limited conditions, this could adversely affect the Company's existing network and network build-out. As a result, we may be required to remove existing devices and would not be able to install new devices on the basis of the exemption. Our network capacity and coverage would then be negatively impacted, which could have an adverse effect on our revenue and results of operations.

4B Regulation- 7.5 Other Approvals

The construction of our antennas may be subject to the approval of the Civil Aviation Administration which is authorized to ensure that the construction of our antennas does not interfere with air traffic, depending on the height and location of such antennas. The approval of the Israeli Defense Forces is required in order to coordinate site frequencies so that our transmissions do not interfere with the communications of the Israel Defense Forces.

We, like other cellular telephone operators in Israel, provide repeaters, also known as bi-directional amplifiers, to subscribers seeking an interim solution to weak signal reception within specific indoor locations. In light of the lack of a clear policy of the local planning and building authorities, and in light of the practice of the other cellular telephone operators, we have not requested permits under the Planning and Building Law for the repeaters. However, we have received from the Ministry of Communications an approval to connect the repeaters to our communications network. We have also received from the Ministry of Environmental Protection, the permits that are necessary for the repeaters.

In addition, we construct and operate microwave links as part of our transmission network. The various types of microwave links receive permits from the Ministry of Environmental Protection in respect of their radiation level. Based on an exemption in the Telecommunications Law, we believe that building permits are not required for the installation of most of these microwave links on rooftops, but if in the future the courts or the relevant regulator determine that building permits are necessary for the installation of these sites, it could have a negative impact on our ability to deploy additional microwave links, and could hinder the coverage, quality and capacity of our transmission network and our ability to continue to market our Fixed-Line Services effectively.

We have received approval from the Ministry of Communications for selling and distributing all of the handsets and other terminal equipment we sell. The Ministry of Environmental Protection also has authority to regulate the sale of handsets in Israel, and under the new Non-Ionizing Radiation Law, certain types of devices, which are radiation sources, including cellular handsets, have been exempted from requiring an approval from the Ministry of Environmental Protection so long as the radiation level emitted during the use of such handsets does not exceed the radiation level permitted under the Non-Ionizing Radiation Law. Since June 15, 2002, we have been required to provide information to purchasers of handsets on the Specific Absorption Rate ("SAR") levels of the handsets as well as its compliance with certain standards pursuant to a regulation under the Consumer Protection Law. 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. While, to the best of our knowledge, the handsets that we market comply with the applicable laws that relate to acceptable SAR levels, we rely on the SAR published by the manufacturer 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 and not for each and every 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.

Under a December 2005 amendment to this procedure, in the event that the SAR level is not measured after the repair of a handset, the repairing entity is required to notify the customer by means of a label affixed to the handset that the SAR may have been altered following the repair, in accordance with the provisions relating to the form of such label set forth in the procedure. A consultant had been retained by the Ministry of Communications to formulate a recommendation regarding the appropriate manner to implement the procedure for repairing handsets but to date the Ministry of Communications has not yet issued any guidelines and given the continued delay we are informing our customers that there may be changes in the SAR levels.

In November 2005, a new procedure was adopted by the Ministry of Communications with regard to the importation, marketing, and approval for 2G and 2.5G handsets. Prior to the implementation of the new procedure, suppliers of 2G and 2.5G handsets in Israel were required to obtain an interim, non-binding approval of the handset type from the relevant cellular telephone operators before receiving final approval from the Ministry of Communications to supply such handsets in Israel to such operators. Under the new procedure, handsets that have already received the internationally recognized Global Certification Forum approval prior to their importation into Israel are now exempt from the requirement of receiving an interim, non-binding approval from the relevant cellular telephone operators in Israel. This could expose us to the risk that handsets not reviewed and approved by us may interfere with the operation of our network. The new procedures described above do not apply to 3G handsets, which still require cellular telephone operators to grant an interim, non-binding approval to the Ministry of Communications before the Ministry grants its final approval in all circumstances.

In addition, this procedure also called for repaired handsets to comply with all applicable standards required for obtaining handset type approval, including standards relating to the safety, electromagnetic levels, and SAR levels.

4C. Organizational Structure

We currently have five wholly-owned subsidiaries, Partner Future Communications 2000 Ltd., an Israeli corporation; Partner Net Ltd., an Israeli corporation; Partner Land-Line Communications Solutions LLP, an Israeli limited partnership; Partner Business Communications Solutions, LLP, an Israeli limited partnership; and, since March 3, 2011, 012 Smile. 012 Smile has two wholly-owned subsidiaries, 012 Telecom Ltd. and 012 Global Inc., both Israeli corporations. Partner Future Communications 2000 Ltd. serves as the general partner and the Company serves as the limited partner of each of the limited partnerships. On October 28, 2009, we became a subsidiary of Scailex. See “Item 3D.3 45.94% of our shares and voting rights are indirectly controlled by a single shareholder”.

4D. Property, Plant and Equipment

Headquarters

We lease our headquarter facilities in Rosh Ha-ayin, Israel, in three sites with a total of approximately 57,362 gross square meters (including parking lots). The leases for each site have different lengths and specific terms, but we believe that our current office facilities are adequate for the foreseeable future, and that we will be able to extend the leases or obtain alternate or additional facilities, if needed, on acceptable commercial terms. In the beginning of 2010 an amendment to the lease agreements for its headquarters facility in Rosh Ha'ayin was signed, according to which the lease term is until the end of 2016, and the Company has an option to shorten the lease period to the end of 2014. The rental payments are linked to the Israeli CPI. We also, lease six call centers in Haifa, Jerusalem, Rehovot, Ashdod, and Beer-Sheva and other small call centers in Israel. An additional 832 square meter call center in Beer Sheva was transferred to 012 Smile in September 2011.The leases for each site have different lengths and specific terms, and we have plans to expand some of the call centers in the near future on acceptable commercial terms however we believe that our current call center facilities are adequate for the foreseeable future, and that we will be able to extend the leases or obtain alternate or additional facilities, if needed, on acceptable commercial terms.

Network

For a description of our telecommunications network, see "Item 4B.9 Our Network" above.

We lease most of the sites where our mobile telecommunications network equipment is installed throughout Israel. At December 31, 2011, we had 2,692 network sites (including micro-sites). The lease agreements relating to our network sites are generally for periods of two to three years. We have the option to extend the lease periods up to ten years (including the original lease period).

The erection and operation of most of these network sites requires building permits from local or regional zoning authorities, as well as a number of additional permits from governmental and regulatory authorities, and we have had difficulties in obtaining some of these permits. Difficulties obtaining required permits could continue and therefore affect our ability to maintain cell network sites. In addition, as we grow our subscriber base and seek to improve the range and quality of our services, we need to further expand our network, and difficulties in obtaining required permits may delay, increase the costs or prevent us from achieving these goals in full. See "Item 3D.1 Risk Factors – Risks Relating to the Regulation of Our Industry" and "Item 4B Regulation".

Service Centers and Points of Sale

Lease agreements for our retail stores and service centers are for periods of two to five years. We have the option to extend the lease agreements for different periods of up to sixteen additional years (including the original lease period). The average size of our retail stores and service center is approximately 350 square meters. See also note 21 to our consolidated financial statements.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

## ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following operating and financial review and prospects are based upon and should be read in conjunction with our financial statements and selected financial data, which appear elsewhere in this report. You should also read the risk factors appearing in Item 3D of this annual report for a discussion of a number of factors that affect and could affect our financial condition and results of operations.

### 5A. Operating Results

#### 5A.1 Overview

#### 5A.1.1 Key Financial and Operating Data

The table below sets forth a summary of selected financial and operating data for the years ended December 31, 2009, 2010 and 2011 (IFRS).

| | Year ended December 31, | | |
|---|---|---|---|
| | 2009 | 2010 | 2011 |
| Revenues (NIS million) | 6,079 | 6,674 | 6,998 |
| Operating profit (NIS million) | 1,701 | 1,860 | 1,036 |
| Income before taxes (NIS million) | 1,525 | 1,679 | 742 |
| Net profit (NIS million) | 1,141 | 1,243 | 443 |
| Capital expenditures (NIS million) | 522 | 435 | 468 |
| Cash flow provided by operating activities net of investment activities (NIS million) | 1,021 | 1,472 | 485 |
| Cellular Subscribers (end of period, thousands) | 3,042 | 3,160 | 3,176 |
| Annual cellular churn rate (%) | 18 % | 21 % | 29 % |
| Average monthly usage per cellular subscriber (MOU) (in minutes) | 364 | 366 | 397 |
| Average monthly revenue per cellular subscriber (ARPU) (NIS) | 151 | 148 | 111 |

#### 5A.1.2 Business Developments in 2011

The financial and operating results for the year 2011 reflect the challenging market conditions, the effects of regulatory changes as well as the increased competition in the cellular market.

Annual service revenues totaled NIS 5,224 million (US$ 1,367 million) in 2011, decreasing by 8% from NIS 5,662 million in 2010. Service revenues for the cellular segment in 2011 were NIS 4,248 million (US$ 1,112 million) decreasing by 24% from NIS 5,575 million in 2010. Service revenues for the fixed line segment reached NIS 1,127 million (US$ 295 million) in 2011, compared with NIS 164 million in 2010. 012 Smile contributed NIS 866 million (US$ 227 million) to the fixed line segment service revenues, following its first-time consolidation in Partner starting on March 3, 2011. Excluding 012 Smile’s contribution, total service revenues (for both segments) decreased by 23%. This decrease mainly reflected the decrease in interconnect tariffs whose direct impact on annual service revenues was a reduction of approximately NIS 1,075 million. Excluding the impact of the reduction in interconnect tariffs and 012 Smile's contribution, service revenues would have decreased by approximately 4%, which mainly reflected price erosion due to an increase in the intensity of competition in the cellular market, as well as a decrease in the profitability of roaming services.

In 2011, approximately 16,000 net active cellular subscribers joined the Company, compared with approximately 118,000 net additions in 2010. The significant decrease in annual net additions reflected the intensification of competition in the market which led to an increase in churn, as explained below.

The annual churn rate for cellular subscribers in 2011 was 29%, an increase of 8 percentage points compared with 21% in 2010. The increase in the churn rate largely reflected the intensification of competition in the market following the introduction of regulatory limitations on subscriber exit fines starting in February 2011, leading to a significant increase in the voluntary churn of post-paid subscribers. The high churn rate also continues to reflect the high churn rate of pre-paid subscribers and subscribers with collection problems.

Our share of the cellular market at year-end 2011 is estimated to be unchanged at 32%.

The monthly average revenue per cellular subscriber (ARPU) for the year 2011 was NIS 111 (US$ 29), a decrease of approximately 25% from NIS 148 in 2010. The annual decrease reflects mainly the impact of the reduction in interconnect tariffs which had a direct negative impact on ARPU of approximately NIS 26, as well as the downward pressure on prices as a result of the highly intense competition in the cellular market.

The monthly average minutes of use per subscriber (MOU) for cellular subscribers in 2011 was 397 minutes, an increase of 8% compared with the MOU of 366 minutes in 2010. This increase largely reflected the continued growth in the popularity of cellular tariff plans which offer large quantities of minutes for a fixed monthly price. The increase occurred despite the continued rise in the mobile broadband subscriber base as a percentage of the total cellular subscriber base, which puts downward pressure on the MOU since these subscribers do not generate significant airtime use.

The number of local fixed-lines reached approximately 292,000 lines at the end of 2011, compared with approximately 69,000 lines at the end of 2010. The ISP subscriber base was approximately 632,000 as of the end of 2011, compared with approximately 60,000 at the end of 2010. The growth in the number of local fixed-lines and the ISP subscriber base reflected the consolidation of the subscribers of 012 Smile following its first-time consolidation in Partner starting March 3, 2011.

5A.1.3 Acquisition of 012 Smile

On March 3, 2011, the Company completed the acquisition of all of the issued and outstanding shares of 012 Smile Telecom Ltd. ("012 Smile"), from Merhav-Ampal Energy Ltd. ("Ampal"). 012 Smile is an Israeli private company, which provides international long distance services, internet services and local telecommunication fixed-line services (including telephony services using VoB). 012 Smile had revenues of approximately NIS 1,112 million during the 11 months starting February 1, 2010, the date on which 012 Smile's business activities began to operate under a new company.

The purchase price for the acquisition of 012 Smile was NIS 650 million which included the acquisition of all of the outstanding shares of 012 Smile and a loan from the previous shareholder to 012 Smile. As part of the acquisition, we also guaranteed the bank loans and other bank guarantees, which were provided to 012 Smile, in a total amount of approximately NIS 800 million. According to the purchase agreement, 012 Smile assigned to Ampal the right to receive payments due from a third party in an amount of approximately NIS 40 million.

At the time of the acquisition, the purchase assumed an enterprise value for 012 Smile of approximately NIS 1.45 billion. This included fixed assets, intangible assets of customer relations, brand name, Rights of Use ("ROU") of international transmission cables and goodwill. 012 Smile is financed principally through long term bank loans totaling approximately NIS 500 million that have an index (Israeli consumer price index) linked rate of 3.42% with a final maturity at the end 2019.

Impairment of Fixed Line Assets and Goodwill.

During December 2011, Bezeq International Ltd. completed the installation of an underwater cable between Israel and Italy and began commercial use thereafter. In addition, Tamares Telecom Ltd. was in the final stages of laying another underwater cable which was completed in January 2012, allowing new communication channels between Israel and Western Europe. The additional capacity significantly increased the level of competition in the market for international connectivity services that, until December 2011, had been comprised of a sole monopoly supplier. The increased competition in the market for international connectivity services during the fourth quarter of 2011 that lead to a sharp decline in prices and the Company's expectations for increased competition in the retail ISP market, that would lead to a decrease in prices and market share, indicated the need to perform an impairment test on certain assets of the fixed-line segment.The impairment test was performed by management with the assistance of an independent assessor, Giza Singer Even Ltd., with the recoverability of the relevant assets being assessed based on value-in-use calculations. As a result of the testing, impairment charges in a total amount of NIS 235 million were recognized for the fixed-line business:

a) Trade name by NIS 14 million, recorded in selling and marketing expenses;

b) Customer relationships by NIS 73 million, recorded in selling and marketing expenses; and

c) Right of use by NIS 148 million, recorded in the cost of revenues.

In addition, the Company's Management performed, as required, its annual impairment review of goodwill, with the assistance of Giza Singer Even Ltd., again assessing recoverability of fixed-line segment assets based on value-in-use calculations. As a result of the impairment test, the Company recorded an impairment charge to goodwill in respect of the fixed-line business units in the amount of NIS 87 million in 2011. The total impact of the impairment charges on operating profit in 2011 was a reduction of NIS 322 million. The total impact on net profit, including the resulting increase in deferred tax assets, net, of NIS 11 million, was a reduction of NIS 311 million.

In addition, the Company recorded an impairment of fixed-line subscriber acquisition costs in the total amount of NIS 27 million in the second half of 2011, following an amendment to the Telecommunications Law which limits subscriber exit fines in the fixed line market.

See notes 12 and 14 to our consolidated financial statements included herein.

See also “Item 3D.2 Risks Relating to Our Business Operations -- We face operational and legal risks associated with the integration of 012 Smile Telecom Ltd.” and note 5 to our consolidated financial statements included herein

5A.1.4 Agreement for the Upgrade of Our Existing Networks and the Deployment of Fourth Generation Network in Israel

On October 25, 2010, the Company signed an agreement with LM Ericsson Israel Ltd. ("Ericsson") for the upgrade of its existing networks and the deployment of a fourth generation network in Israel (the "Agreement"). The Agreement includes the upgrade, replacement and the expansion of certain parts of the Company's existing cellular and fixed-line networks and the maintenance of its networks, including enhancement of the Company's abilities with respect to the cellular and fixed line ISP services it provides. The commercial operation of the fourth generation network by the Company is subject to the allocation of the relevant frequencies by the Ministry of Communications.

The term of the Agreement is until December 31, 2014, whereas the replacement of the Company's switches and radio equipment is scheduled to be carried out by the end of the year 2013.

The total net amount, following all discounts and settlements, some of which are conditional, that the Company will be required to pay for the capital expenditure and maintenance services is approximately $100 million (approximately NIS 360(*) million). Payments will be made in quarterly installments throughout the term of the Agreement. See "Item 5F. Contractual Obligations". The Company allocates the net amount between capital expenditures and maintenance based on their relative fair values. The amount relating to support and maintenance is approximately $12 million (NIS 43 million (*). The transaction resulted in accelerated depreciation of the replaced equipment, throughout the replacement period, whereas the main impact of the accelerated depreciation was recorded during the year 2011. The Company recorded accelerated depreciation of NIS 16 million in the fourth quarter of 2010 and of NIS 67 million in 2011. As of December 31, 2011, the depreciated cost of fixed assets that the Company intends to replace is approximately NIS 30 million.

(*) The transaction is denominated in USD and translated above into NIS using the exchange rate as of the transaction date October 25, 2010 (1 USD = 3.599 NIS).

5A.1.5 Capital Reduction

On February 22, 2010, the District Court approved the application submitted by the Company for a capital reduction distribution in the total amount of NIS 1.4 billion (exceeding the surpluses for distribution) to the Company's shareholders ("the capital reduction"). Following the District Court's approval, a total amount of NIS 1.4 billion, which amounted to approximately NIS 9.04 per share, was paid on March 18, 2010, to shareholders and ADS holders of record on March 7, 2010, resulting in a reduction of shareholders' equity by an equal amount.

5A.1.6 Intentions of Principal Shareholder

On February 1, 2012, Scailex, our principal shareholder, filed an immediate report stating that its Board of Directors resolved to appoint Deutsche Bank and Lazard Freres to advise Scailex to propose potential purchasers and to formulate a deal structure in any transaction regarding Scailex itself and/or Scailex's holding in Partner and the joining of a significant partner to Partner, including the possibility of transforming Partner or Scailex into a private company. See "Item 3D.3 Risks Related to Our Principal Shareholder".

5A.1.7 Significant regulatory developments

Rate of royalty payments. In 2010, the Company benefitted from a scheduled reduction in its royalty payments set by the Telecommunications Regulations from 1.5% in 2009 to 1% in 2010. Royalty payments in 2011 were increased to 1.75% and in 2012 and thereafter will be were to be 2.5% of net revenues, following an amendment to the Telecommunications Regulations by a temporary order. The temporary order will be effective until the Director of the

Ministry of Communications shall publish a formal notice that one of the following has occurred: (1) a cellular operator has begun to provide national roaming service; or (2) an MVNO has begun to operate and the total market share of all MVNOs is at least 5%. If one of the above occurs, the royalty rate will revert back to 1%. This amendment does not apply to international operators, special fixed line operators and MVNOs.This temporary order does not apply to international operators, special fixed line operators and MVNOs.

Following a petition filed by the Company and two other cellular operators with the Supreme Court of Justice, in July 2011, the State decided to accept the court's suggestion, which had already been accepted by the petitioners, according to which the royalty rate for 2012 will be 1.75% (subject to the above-mentioned terms with respect to the temporary order), and starting in 2013, the rate will be 0%. The decision of the State is pending an amendment of the relevant regulations and its approval by the relevant parliamentary committee.

Other regulatory developments. For further information regarding developments which may have an impact on our operating results, see “Item 3D.1 Risks Relating to the Regulation of Our Industry ” and “Item 4B. Business Overview – Regulation”.

5A.1.8 Revenues

We derive revenues from the sale of both services and equipment.

Our principal source of revenues is from the sale of cellular network services, primarily network airtime usage fees, and content and data fees (including SMS) as well as interconnect fees from other operators, fees for roaming, services and fees for extended handset warranty.

The fixed line business segment derives revenues from a number of services provided over fixed line networks including transmission services, PRI lines for business sector customers, VoB telephony services and ISP services.

Cellular equipment revenues are derived from sales of cellular handsets, datacards, modems, tablets and laptops, related equipment, car kits and accessories.

For the fixed line business segment, equipment revenues include domestic routers, smartboxes and DECT phones, as well as related accessories.

We recognize revenues from network services (cellular, fixed-line and ISP) at the time we provide the service to the subscriber. We recognize revenues from equipment only upon delivery and the transfer of ownership to the subscriber.

5A.1.9 Cost of Revenues

The principal components of our cost of revenues are:

- Cost of handsets, accessories and ISP related equipment
- Payments to transmission, communication and content providers
- Depreciation, amortization and impairment charges
- Wages and employee benefits expenses and car maintenance
- Operating lease, rent and overhead expenses
- Cost of handling, replacing or repairing handsets
- Impairment of deferred expenses – right of use
- Network and cable maintenance

- Payments to ISPs
- Car kit installation, IT support, and other operating expenses

- Royalty expenses
- Amortization of rights of use
- Other

5A.1.10 Selling and Marketing Expenses

The principal components of our selling and marketing expenses are:

- Wages and employee benefits expenses and car maintenance
- Impairment of intangible assets
- Advertising and marketing
- Selling commissions, net
- Depreciation and amortization
- Other

5A.1.11 General and Administrative Expenses

The principal components of our general and administrative expenses are:

- Wages and employee benefits expenses and car maintenance
- Bad debts and allowance for doubtful accounts
- Credit card and other commissions
- Professional fees
- Depreciation
- Other

5A.1.12 Other Income, Net

The principal components of our other income, net, are:

- Unwinding of trade receivables
- Other income
- Capital loss from sale of property and equipment

5A.1.13 Finance Costs, Net

The principal components of our financial expenses are:

- Interest expenses
- Linkage expenses to CPI
- Net foreign exchange rate losses
- Interest costs in respect of liability for employee rights upon retirement
- Factoring costs, net
- Fair value loss from derivative financial instruments, net
- Other finance costs

The principal components of our financial income are:

- Fair value gain from derivative financial instruments, net
- Interest income from cash equivalents
- Expected return on plan assets
- Net foreign exchange rate gains
- Other finance income

5A.1.14 Key Cellular Business Indicators (Operating Data)

Our primary key cellular business indicators are described below. These indicators are widely used in the cellular telephone service industry to evaluate performance.

- average monthly revenue per subscriber (ARPU);
- average monthly minutes of usage per subscriber (MOU); and
- churn rate.

5A.1.15 Critical Accounting Estimates and Judgments

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

5A.1.15.a. Critical accounting estimates and assumptions

Useful economic lives of assets

The useful economic lives of the Company's assets are an estimate determined by management. The Company defines useful economic life of its assets in terms of the assets' expected utility to the Company. This estimation is based on assumptions of future changes in technology or changes in the Company's intended use of these assets, and experience of the Company with similar assets, and legal or contract periods where relevant. The assets estimated economic useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. See also note 2 (f) and note 2(g) to our consolidated financial statements.

Impairment tests of assets with finite useful economic lives

For the purpose of impairment testing of assets with finite useful lives the assets are grouped to the lowest levels for which there are separately identifiable cash flows (CGUs). The Company's management estimates the assets recoverable amount, which is the higher of an asset's fair value less costs to sell and value in use. The value-in-use calculations require management to make estimates of the projected future cash flows from the continuing use of the CGU and also to choose a suitable discount rate which represents market estimates for the time value of money and the specific risks relating to the CGU. Determining the estimates of the future cash flows is based on management's past experience and management's best estimate for the economic conditions that will exist over the remaining useful economic life of the CGU. See also note 2(j) to our consolidated financial statements.

As a result of the impairment test, the Company recorded in 2011 an impairment charge to certain assets in an amount of NIS 262 million, based on the key assumptions described in note 12(b) to our consolidated financial statements.

Allowance for doubtful accounts

See note 2(m) to our consolidated financial statements in respect of accounting for allowance for doubtful accounts.

Uncertain tax positions

The assessment of amounts of current and deferred taxes requires the Company's management to take into consideration uncertainties that its tax position will be accepted and of incurring any additional tax expenses. This assessment is based on estimates and assumptions based on tax laws and the Company's past experience. It is possible that new information will become known in future periods that will cause the final tax outcome to be different from the amounts that were initially recorded, such differences will impact the current and deferred income tax assets and liabilities in the period in which such determination is made. See also note 2(v) to our consolidated financial statements.

Business combinations

The Company is required to allocate the purchase price of entities and activities acquired in business combinations on the basis of the fair value of acquired assets and liabilities assumed. The Company uses external and internal valuations to determine the fair value. Goodwill represents the excess of the consideration transferred over the net fair value of the identifiable assets acquired, and identifiable liabilities and contingent liabilities assumed. The valuations include management estimations and assumptions for future cash flow projections from the acquired business and selection of models to compute the fair value of the acquired components and their depreciation periods. See also note 5 to our consolidated financial statements.

Purchase price allocation

The Company allocates the purchase price between property and equipment and maintenance costs where they are purchased in a single transaction based on their estimated relative fair values. See also note 2(f) to our consolidated financial statements.

Impairment tests of goodwill

For the purpose of goodwill impairment testing, the goodwill is allocated to CGUs or groups of CGUs that are expected to benefit from the synergies of the business combination. Such allocation represents the lowest level at which the goodwill is monitored for internal management purposes and is not larger than an operating segment. The recoverable amounts of CGUs to which goodwill has been allocated have been determined based on the value-in-use calculations. These calculations require management to make estimates of the projected future cash flows from the continuing use of the CGU and also to choose a suitable discount rate which represents market estimates for the time value of money and the specific risks relating to the CGU. Determining the estimates of the future cash flows is based on management past experience and management best estimate for the economic conditions that will exist over the remaining useful economic life of the CGU. As a result of the impairment test, the Company recorded in 2011 an impairment charge to goodwill in an amount of NIS 87 million, based on the key assumptions described in note 12(c) to our consolidated financial statements included herein.

Sensitivity analysis: an increase of 1% in the weighted average pre-tax discount rate in respect of the ISP/VOB and ILD group of CGUs rate would have resulted in an additional impairment charge of approximately NIS 61 million, assuming all other factors constant. A decrease of 1% in the weighted average growth rate in respect of the ISP/VOB and ILD group of CGUs would have resulted in an additional impairment charge of approximately NIS 42 million, assuming all other factors constant. Any adverse changes in one of the key assumptions will cause additional impairment charges.

See also note 2(i) and note 12(c) to our consolidated financial statements.

The impairment test was based on assessments of financial performance and future strategies in light of current and expected market and economic conditions. Trends in the economic and financial environment, competition and regulatory authorities' decisions, or changes in competitors' behavior in response to the economic environment may affect the estimate of recoverable amounts. See also note 2(j) to our consolidated financial statements included herein.

5A.1.15.b. Critical judgments in applying the Company's accounting policies

Provisions for legal claims and litigations

Provisions are recorded when a loss is considered probable and can be reasonably estimated. Judgment is necessary in the assessing the likelihood that a pending claim or litigation against the Company will succeed, or a liability will arise, and to quantify the possible range of final settlement. These judgments are made by management with the support of internal specialists, or with the support of outside consultants such as legal counsel. Because of the inherent uncertainties in this evaluation process, actual results may be different from these estimates.

Revenue from services recognition

The Company recognizes service revenues based upon minutes and seconds used, net of credits and adjustments for service discounts. Because the Company's billing cycles use cut-off dates, which for the most part do not coincide with the Company's reporting periods, the Company is required to make estimates for service revenues earned but not yet billed at the end of each reporting period. These estimates are based primarily upon actual unbilled usage of the Company's network by the customers, and also on historical data and trends. Actual billing cycle results depend on subscriber usage and rate plan mix, from the results estimated at the end of each period.

Regarding determination whether the Company is acting as a principal or as an agent see note 2(s)(1) to our consolidated financial statements.

Sales of equipment with accompanying services

The Company made judgments to determine that certain sales of equipment with accompanying services constitute an arrangement with multiple deliverables that are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole, and accordingly, consideration received is allocated to each deliverable based on the relative fair value of the individual element. See also note 2(s)(2) to our consolidated financial statements.

Deferred tax assets

Deferred tax assets are recognized to the extent that their utilization is probable. The utilization of deferred tax assets will depend on whether it is probable that sufficient and suitable taxable profits will be available in the future, against which the reversal of the temporary differences can be deducted, taking into account any legal restrictions on the length of loss-carryforward period. Various factors are used to assess the probability of the future utilization of deferred tax assets, including past operating results, operational plans, loss-carryforward periods, and tax planning strategies. See also note 27 to our consolidated financial statements included herein.

5A.2.1 Results of Consolidated Operations for the Year Ended December 31, 2011 Compared to the Year Ended December 31, 2010

On March 3, 2011, Partner concluded the acquisition of 012 Smile, an Israeli operator of international telecommunications services and local fixed line services and a provider of internet services. See “Item 4A. History and Development of the Company” and “Acquisition of 012 Smile” above. The consolidated results of 2011 therefore include the results of 012 Smile from March 3, 2011, forward.

Composition of revenues and cost of revenues

| | New Israeli Shekels Year ended December 31, | |
|---|---|---|
| | 2010 | 2011 |
| | In millions | |
| Service revenues | 5,662 | 5,224 |
| Equipment revenues | 1,012 | 1,774 |
| Total revenues | 6,674 | 6,998 |
| | | |
| Cost of revenues – Services | 3,307 | 3,570 |
| Cost of revenues – Equipment | 786 | 1,408 |
| Total Cost of revenues | 4,093 | 4,978 |
| Gross profit | 2,581 | 2,020 |

Revenues. Partner achieved total net revenues of NIS 6,998 (US$ 1,831 million) in 2011, an increase of 5% from NIS 6,674 million in 2010. Partner's total revenues for 2011 (excluding inter-company revenues) included a contribution of 012 Smile after first-time consolidation of NIS 888 million (US$ 232 million). Excluding 012 Smile, Partner's revenues decreased by 8% in 2011 compared with 2010.

Revenues from services. Annual service revenues totaled NIS 5,224 million (US$ 1,367 million) in 2011, a decrease of 8% from NIS 5,662 million in 2010.

Excluding 012 Smile's contribution of NIS 866 million (US$ 227 million), total annual service revenues decreased by 23% in 2011 compared to 2010. This decrease mainly reflected the impact of regulatory changes, which imposed a 71% reduction in interconnect voice tariffs and a 94% reduction in the interconnect SMS tariff starting January 1, 2011. The direct impact of these reductions in interconnect tariffs in 2011 was to reduce annual service revenues by approximately NIS 1,075 million. Excluding both 012 Smile's contribution and the impact of the reductions in interconnect tariffs, service revenues would have decreased by approximately 4% in 2011 compared to 2010, reflecting principally price erosion due to an increase in the intensity of competition in the cellular market, as well as a decrease in revenues from roaming services. See "Item 3D.1 Risks Relating to the Regulation of our Industry" and "Item 3D.2 Risks Relating to our Business Operations" for a discussion of regulatory, business and technological factors intensifying competition and putting downward pressure on prices

Revenues from equipment. Equipment revenues in 2011 were NIS 1,774 million (US$ 464 million), increasing by 75% from NIS 1,012 million in 2010.

The increase largely reflected an increase in the average revenue per equipment device sold, primarily due to the higher proportion of high-value smartphones sold.

Gross profit. Gross profit in 2011 totaled NIS 2,020 million (US$ 528 million).

Gross profit before the impact of the impairment of rights of use in the amount of NIS 148 million, totaled NIS 2,168 million (US$ 567 million), a decrease of 16% from NIS 2,581 million in 2010. Excluding 012 Smile's contribution of NIS 215 million, the decrease in gross profit before the impact of the impairment of rights of use was 24% or NIS 628 million. The impact of the reduction in interconnect tariffs explains approximately NIS 427 million of the decrease in gross profit with the remainder largely reflecting price erosion of cellular services, partially offset by an increase of 56% in the gross profit from cellular equipment sales

Impairment of Goodwill. In the fourth quarter of 2011, the Company recognized an impairment loss for goodwill related to the purchase of 012 Smile in the amount of NIS 87 million (US$ 23 million).

Other income, net. Other income, net, totaled NIS 105 million (US$ 27 million) in 2011, compared to NIS 64 million in 2010, an increase of 64%, mainly reflecting an increase in recognized deferred revenue from handset payment installment plans related to the overall increase in revenues from equipment sales.

Operating profit. Operating profit for 2011 was NIS 1,036 million (US$ 271 million). Operating profit before the total impact of the impairments described above in the amount of NIS 322 million, totaled NIS 1,358 million (US$ 355 million) in 2011, a decrease of 27% from NIS 1,860 million in 2010.

Operating profit for the cellular segment decreased by 32%, and operating profit before the total impact of the impairments of NIS 322 million for the fixed line segment, increased from an operating loss of NIS 24 million in 2010 to an operating profit of NIS 71 million in 2011, reflecting both the contribution of 012 Smile after first time consolidation, and an increase in operating profit from other fixed line services.

Financial expenses, net. Financial expenses, net, for 2011 were NIS 294 million (US$ 77 million), an increase of 62% compared with NIS 181 million in 2010. This largely reflected an increase in interest expenses resulting from the increase in the average debt level in 2011 compared to 2010 by approximately NIS 1.5 billion, largely related to the acquisition of 012 Smile.

Profit before income tax. Profit before income taxes for 2011 was NIS 742 million (US$ 194 million), a decrease of 56% from NIS 1,679 million in 2010.

Income taxes on profit.  Income taxes on profit for 2011 were NIS 299 million (US$ 78 million), a decrease of 31% from NIS 436 million in 2010.

The effective tax rate for 2011 was 40%. Before the total impact of the impairments of NIS 322 million, partially offset by the resulting increase in deferred tax assets, net, of NIS 11 million, the effective tax rate for 2011 was 29% compared with 26% for 2010. As part of the Economic Efficiency Law that was enacted in July 2009, the Israeli corporate tax rate was scheduled to be reduced by one percent each year from a rate of 26% in 2009 to a rate of 20% in 2015, and then to a rate of 18% from 2016. As a result, the Israeli corporate tax rate was reduced from a rate of 25% in 2010 to 24% in 2011. On December 6, 2011 the Tax Burden Distribution Law (legislations amendments) was published in the law records. The law set the corporate tax rate at 25% starting in 2012, and cancelled the continuation of the gradual reduction in corporate tax to 18% by 2016 as described above. As a result of the change in the future corporate tax rate, our deferred tax liability has increased in the amount of approximately NIS 12 million as of December 31, 2011. As explained above, the Israeli corporate tax rate is expected to remain at the level of 25% in 2012. However, the Company's effective tax rate is expected to be slightly higher mainly due to nondeductible expenses.

See Note 27 (b) to our consolidated financial statements.

Net profit. Net profit in 2011 was NIS 443 million (US$ 116 million), a decrease of 64% from NIS 1,243 million in 2010. Net profit before the impact of the impairment in the amount of NIS 311 million, was NIS 754 million (US$ 197 million) in 2011, a decrease of 39% from NIS 1,243 million in 2010. Based on the weighted average number of shares outstanding during 2011, basic (reported) earnings per share or ADS, was NIS 2.85 (US$ 0.75), a decrease of 65% from NIS 8.03 in 2010.

EBITDA. EBITDA totaled NIS 2,178 million (US$ 570 million) in 2011, a decrease of 15% compared with NIS 2,570 million in 2010. EBITDA for the cellular segment was NIS 1,896 million (US$ 496 million) in 2011, decreasing by 26% from NIS 2,558 million in 2010. EBITDA for the fixed line segment was NIS 282 million (US$ 74 million) in 2011, compared with NIS 12 million in 2010, an increase of NIS 270 million, of which 012 Smile contributed NIS 198 million.

EBITDA as reviewed by the Chief Operator Decision Maker ("CODM"), represents earnings before interest (finance costs, net), taxes, depreciation, amortization and impairment charges, as a measure of operating profit. EBITDA is not a financial measure under IFRS and may not be comparable to other similarly titled measures for other companies. EBITDA may not be indicative of the Company's historic operating results nor is it meant to be predictive of potential future results. For a reconciliation of EBITDA with our audited financial data, see Note 6 in the consolidated financial statements for 2011 included in this annual report.

5A.2.2 Results of Operation by Segment for the Year Ended December 31, 2011 Compared to the Year Ended December 31, 2010

The consolidation of 012 Smile into Partner's financial results following its acquisition on March 3, 2011, had a significant impact on the results of the Fixed-line Segment, as set forth below, but did not affect the results of the Cellular Segment.

| | New Israeli Shekels<br>Year ended December 31, 2011<br>In millions | | | |
|---|---|---|---|---|
| | Cellular segment | Fixed line segment | Elimination | Consolidated |
| Segment revenue - Services | 4,219 | 1,005 | | 5,224 |
| Inter-segment revenue - Services | 29 | 122 | (151) | |
| Segment revenue - Equipment | 1,748 | 26 | | 1,774 |
| Total revenues | 5,996 | 1,153 | (151) | 6,998 |
| | | | | |
| Segment cost of revenues – Services | 2,601 | 969* | | 3,570 |
| Inter-segment cost of revenues- Services | 122 | 29 | (151) | |
| Segment cost of revenues - Equipment | 1,379 | 29 | | 1,408 |
| Cost of revenues | 4,102 | 1,027 | (151) | 4,978 |
| Gross profit | 1,894 | 126 | | 2,020 |
| | | | | |
| Operating expenses | 712 | 290* | | 1,002 |
| Impairment of goodwill | | 87 | | 87 |
| Other income, net | 105 | | | 105 |
| Operating profit (loss) | 1,287 | (251) | | 1,036 |
| Adjustments to presentation of EBITDA | | | | |
| –Depreciation and amortization | 590 | 182 | | 772 |
| –Impairment of intangible assets, deferred expenses and goodwill | | 349 | | 349 |
| –Other | 19 | 2 | | 21 |
| EBITDA | 1,896 | 282 | | 2,178 |
| | | | | |
| Reconciliation of EBITDA to profit before tax | | | | |
| - Depreciation and amortization | | | | (772) |
| Impairment of intangible assets, deferred expenses and goodwill | | | | (349) |
| - Finance costs, net | | | | (294) |
| - Other | | | | (21) |
| Profit before income tax | | | | 742 |

* Including impairment charges, see note 12 to our consolidated financial statements.

| | Year ended December 31, 2010 In millions | | | |
|---|---|---|---|---|
| | Cellular segment | Fixed line segment | Elimination | Consolidated |
| Segment revenue - Services | 5,555 | 107 | | 5,662 |
| Inter-segment revenue - Services | 20 | 57 | (77) | |
| Segment revenue - Equipment | 987 | 25 | | 1,012 |
| Total revenues | 6,562 | 189 | (77) | 6,674 |
| Segment cost of revenues – Services | 3,174 | 133 | | 3,307 |
| | | | | |
| Inter-segment cost of revenues- Services | 57 | 20 | (77) | |
| Segment cost of revenues - Equipment | 751 | 35 | | 786 |
| Cost of revenues | 3,982 | 188 | (77) | 4,093 |
| Gross profit | 2,580 | 1 | | 2,581 |
| Operating expenses | 760 | 25 | | 785 |
| Other income | 64 | | | 64 |
| Operating profit (loss) | 1,884 | (24) | | 1,860 |
| Adjustments to presentation of EBITDA | | | | |
| –depreciation and amortization | 633 | 36 | | 669 |
| - Impairment of intangible assets | 16 | | | 16 |
| –other | 25 | | | 25 |
| EBITDA | 2,558 | 12 | | 2,570 |
| | | | | |
| Reconciliation of EBITDA to profit before tax : | | | | |
| - Depreciation and amortization | | | | (669) |
| Impairment of intangible assets | | | | (16) |
| - Finance costs, net | | | | (181) |
| - Other | | | | (25) |
| Profit before tax | | | | 1,679 |

5A.2.2.1 Cellular Services Business Segment

The impairment charge on fixed-line assets in 2011 in connection with the 012 Smile acquisition did not have any impact on the results for the cellular segment.

Revenues earned by the cellular business segment amounted to NIS 5,996 million (US$ 1,569 million) in 2011, a decrease of 9% compared to NIS 6,562 million in 2010 (including inter-segment revenues), reflecting a decrease in revenues from services which was partially offset by an increase from revenues from equipment.

Revenues from services. In 2011, service revenues from the Company's cellular business segment totaled NIS 4,248 million (US$ 1,112 million), representing a decrease of 24% from NIS 5,575 million in 2010. This decrease mainly reflected a 71% reduction in the interconnect voice tariff and a 94% reduction in the interconnect SMS tariff from January 1, 2011. The direct impact of the reduction in interconnect tariffs was a reduction of approximately NIS 1,075 million in service revenues in 2011. Excluding the impact of the reduction in interconnect tariffs, service revenues would have decreased by approximately 4%, which mainly reflected price erosion due to an increase in the intensity of competition in the cellular market, as well as a decrease in the profitability of roaming services.These negative trends were partially offset by growth in the cellular postpaid subscriber base of approximately one percent, on an average basis over 2011, and by growth in the cellular prepaid subscriber base of approximately 5%, on an average basis over 2011.

In addition, significant growth in the popularity of smartphones supported average monthly revenue per cellular subscriber ("ARPU") levels by generating revenue growth in revenues from data and content services.

Revenues from cellular data and content services excluding SMS in 2011 totaled NIS 666 million (US$ 174 million) or 16% of cellular service revenues, in 2011, increasing by 4 % compared with NIS 638 million or 11 % of cellular service revenues in 2010. SMS service revenues totaled NIS 456 million (US$ 119 million) in 2011, an increase of 18% compared with NIS 387 million in 2010, and the equivalent of 11% of cellular service revenues, compared with 7% in 2010.  The 2010 figures in these comparisons reflect a change in the methodology that occurred in 2011 for allocating revenues from bundled packages between airtime revenues and content revenues, as well as an adjustment to the Company's allocation of credits between the different services.

Pre-paid subscribers accounted for service revenues of approximately NIS 500 million (US$ 131 million) in 2011.

Revenues from equipment. Equipment revenues from the Company's cellular business segment totaled NIS 1,748 million (US$ 457 million) in 2011, an increase of 77% compared with equipment revenues of NIS 987 million in 2010. The increase largely reflected an increase in the average revenue per equipment device, mainly due to the higher proportion of high-value smartphones sold.

Gross profit from services.  Gross profit from cellular services in 2011 was NIS 1,525 million (US$ 399 million), decreasing by 35% compared with NIS 2,344 million in 2010. This decrease mainly reflected the direct negative impact of the interconnect tariff reduction on profit in the amount of approximately NIS 443 million, as well as the reduction in service revenues as described above. In addition, the decrease reflected an increase in interconnect expenses related to the growth in outgoing voice minutes and also higher payroll expenses related to the increase in the customer service workforce during the year.

Gross profit from equipment. The gross profit from the cellular business segment equipment was NIS 369 million (US$ 97 million) in 2011, an increase of 56% compared with a gross profit of NIS 236 million in 2010, attributable largely to an increase in unit profitability. During 2011, the total amount of cellular equipment subsidies, net, that was capitalized was NIS 12 million, compared with NIS 51 million in 2010, reflecting the impact of the limitations on subscriber exit fines which came into effect in February 2011 on handset subsidies.

Gross profit. The overall gross profit from the cellular business segment was NIS 1,894 million (US$ 496 million) in 2011, compared with NIS 2,580 million in 2010, a decrease of 27%.

Selling, marketing and general and administrative expenses. The cellular segment's selling, marketing, general and administrative expenses amounted to approximately NIS 712 million (US$ 186 million) in 2011, a decrease of 6% from NIS 760 million in 2010. The decrease reflected a decrease in marketing and advertising expenses and the impact of a one-time reduction in bad debts and doubtful accounts expenses recorded in the second quarter of 2011, which were partially offset by higher salary expenses and selling commissions, and increased depreciation expenses.

Other income, net. Other income, net, totaled NIS 105 million (US$ 27 million) in 2011, increasing by 64% from NIS 64 million in 2010 mainly reflecting an increase in recognized deferred revenue from handset payment installment plans related to the increase in revenues from equipment sales.

Operating profit. As a result of the above, operating profit from the segment's activities totaled NIS 1,287 million (US$ 337 million) in 2011, compared with NIS 1,884 million in 2010, a decrease of 32%.

The impairment recorded in 2011 did not impact the results of the cellular segment.

EBITDA. EBITDA for the cellular segment was NIS 1,896 million (US$ 496 million) in 2011, representing a decrease of 26% from NIS 2,558 million in 2010. The decrease in EBITDA largely reflected the direct impact of the reduction in interconnect tariffs which reduced cellular segment EBITDA by approximately NIS 443 million, together with the cellular service price erosion as described above, partially offset by the increase in gross profit from cellular equipment sales.

5A.2.2.2 Fixed Line Services Business Segment

Revenues earned by the fixed-line business segment amounted to NIS 1,153 million (US$ 302 million) in 2011, compared to NIS 189 million in 2010 (including inter-segment revenues), reflecting principally the contribution of 012 Smile after first time consolidation in the amount of NIS 970 million (US$254 million) in 2011. Fixed line segment revenues excluding 012 Smile were NIS 183 million (US$ 48 million), a decrease of 3% compared with 2010.

Revenues from services. Fixed line business segment service revenues (including inter-segment revenues) reached NIS 1,127 million (US$ 295 million) compared with NIS 164 million in 2010. Revenues in 2011 included a contribution of 012 Smile after first-time consolidation starting March 3, 2011, in the amount of NIS 947 million. Fixed-line segment service revenues excluding 012 Smile were NIS 180 million (US$ 47 million), an increase of 10% compared with NIS 164 million in 2010. The increase reflected revenue growth from both residential and business fixed line services.

Revenues from equipment. Equipment revenues from the Company's fixed line business segment totaled NIS 26 million (US$ 7 million) in 2011, remaining at a level similar to NIS 25 million in 2010.

Gross profit from services. For the fixed line segment, the gross profit from services (including intersegment activity) was NIS 129 million (US$ 34 million) in 2011, compared with NIS 11 million in 2010.

Gross loss from equipment. The gross loss from the fixed line business segment equipment sales was NIS 3 million (US$ 1 million) in 2011, compared with a gross loss of NIS 10 million in 2010.

Gross profit. The overall gross profit from the fixed line business segment was NIS 126 million (US$ 33 million) in 2011, compared with NIS 1 million in 2010.

The cost of revenues for the fixed-line services segment included expenses in the amount of NIS 148 million that were recorded following the impairment charge on rights of use for international fiber optic lines. Excluding the impact of this impairment charge, gross profit for the fixed line segment was NIS 274 million (US$ 72 million) in 2011 compared with NIS 1 million in 2010, including gross profit of NIS 215 million contributed by 012 Smile. Gross profit for the fixed line segment was positively affected by the acquisition of 012 Smile, and the impact of the reduction in interconnect expenses for calls to cellular operators following the reduction in cellular interconnect tariffs effective as of January 2011, partially offset by an impairment in the amount of NIS 27 million recorded in the second half of 2011 related to subscriber acquisition costs capitalized in prior periods (in addition to the impairment of the rights of use). The impairment in subscriber acquisition costs was recorded following an amendment to the Telecommunications Law which limits subscriber exit fines in the fixed line market.

Selling, marketing and general and administrative expenses. The fixed line segment's selling, marketing, general and administrative expenses amounted to approximately NIS 290 million (US$ 76 million), compared to NIS 25 million in 2010, an increase of NIS 265 million.

The selling and marketing expenses for the fixed-line services segment included expenses in the amount of NIS 87 million that were recorded following the impairment charge on a trade name (NIS 14 million) and on customer relationships (NIS 73 million). Excluding the impact of these impairment charges, selling, marketing, general and administration expenses for the fixed-line services segment were NIS 203 million (US$ 53 million) in 2011, compared to NIS 25 million in 2010, an increase of NIS 178 million. The increase reflected additional expenses following the acquisition of 012 Smile in the amount of NIS 187 million in 2011, partially offset by lower salary expenses, selling commissions, and marketing and advertising expenses.

Impairment loss for goodwill. As explained in "Item 5A.1.3 Acquisition of 012 Smile", in 2011, we recorded an impairment charge to goodwill related to the purchase of 012 Smile in the amount of NIS 87 million (US$ 23 million).

Operating loss. Operating loss from the segment's activities totaled NIS 251 million (US$ 66 million) in 2011.

Operating profit for the fixed line segment, before the total impact of the impairments in the amount of NIS 322 million, was NIS 71 million (US$ 19 million) in 2011, of which 012 Smile contributed an operating profit of NIS 29 million. Excluding 012 Smile's contribution, operating profit increased by NIS 66 million in the year, from an operating loss of NIS 24 million in 2010 to a profit of NIS 42 million (US$ 11 million) in 2011.

EBITDA. EBITDA for the segment was NIS 282 million (US$ 74 million) in 2011, compared with NIS 12 million in 2010. 012 Smile's contribution after first time consolidation to EBITDA in 2011 was NIS 198 million. Excluding 012 Smile's contribution, EBITDA for the fixed line segment in 2011 totaled NIS 85 million (US$ 22 million), compared with NIS 12 million in 2010. The EBITDA margin for the fixed line segment in 2011 was 24% of total fixed line segment revenues.

Results of Consolidated Operations for the Year Ended December 31, 2010 Compared to the Year Ended December 31, 2009

Composition of revenues and cost of revenues

| | New Israeli Shekels Year ended December 31, | |
|---|---|---|
| | 2009 | 2010 |
| | In millions | |
| Service revenues | 5,424 | 5,662 |
| Equipment revenues | 655 | 1,012 |
| Total revenues | 6,079 | 6,674 |
| | | |
| Cost of revenues – Services | 3,206 | 3,307 |
| Cost of revenues – Equipment | 564 | 786 |
| Total Cost of revenues | 3,770 | 4,093 |
| Gross profit | 2,309 | 2,581 |

In order to reflect a change in the approach of management, the allocation of revenues and cost of revenues between services and equipment within the cellular segment has changed, effective starting with the fourth quarter of 2010. Total profit for the cellular and fixed line segments separately remains unchanged. The figures for 2009 in the above table have not been reclassified. However, had the allocation been applied to 2009, service revenues would have been higher by NIS 22 million and equipment revenues would have been lower by the same amount. For the cost of revenues, had the allocation been applied to 2009, the cost of service revenues would have been lower by NIS 46 million and the cost of equipment sales revenues would have been higher by the same amount. The figures and discussion presented below assumes a retroactive application of the reallocation from 2009.

Revenues. Partner achieved total net revenues of NIS 6,674 in 2010, an increase of 9.8% from NIS 6,079 million in 2009.

Revenues from services. Annual service revenues totaled NIS 5,662 million in 2010, an increase of 4.0% from NIS 5,446 million in 2009. This assumes a retroactive application of the reallocation of revenues between services and equipment within the cellular segment that occurred in 2010 (see above).

The increase mainly reflected growth in cellular segment service revenues from the continued expansion of the cellular subscriber base, which grew by approximately 4.3% on an average basis in 2010, as well as continued growth in revenues from the use of data and content services and renewed growth in roaming activity after the decline in 2009. These increases more than offset the impact of the ongoing tariff erosion due to the fiercely competitive cellular market.

Fixed line segment service revenues (including inter-segment revenues) increased by 86.4% to NIS 164 million for 2010 from NIS 88 million for 2009, attributable mainly to an increase in revenues from growth in the ISP and fixed line telephony services subscriber base and in inter-segment revenues.

Cellular data and content revenues excluding SMS increased by 16.0% in 2010 to NIS 622 million, compared with NIS 536 million in 2009 and represented 11.0% of service revenues in 2010 compared with 9.9 % of service revenues in 2009.

Revenues from SMS message services in 2010 totaled NIS 498 million, accounting for 8.8% of service revenues, up by 32.1% from NIS 377 million, or 7.0% of service revenues, in 2009.

The growth in content and data services (including SMS) partially reflected the continued growth in sales of bundled voice, SMS and data packages, for which the revenues are allocated according to the quantities that are offered in the packages.

Revenues from equipment. Equipment revenues in 2010 were NIS 1,012 million, increasing by 59.9% from NIS 633 million in 2009. This assumes a retroactive application of the reallocation of revenues between services and equipment within the cellular segment that occurred in 2010 (see above).

The increase in revenues reflected an increase in the average revenue per device sold, in part attributable to an increase in the proportion of sales of smartphones and 3G devices. In addition, the increase in average revenue per device reflected the increased practice of selling handsets through installment plans under which the subscriber obtains rebates, which are dependent upon the level of the subscriber's monthly service usage. Under this practice, the full price of the handset is recorded at the time of sale, whilst the subsequent rebates are recorded over a period of up to 36 months.

As a result of the increase in average revenues per device, there was a significant reduction in the number of devices capitalized which in turn led to a reduction in the level of equipment revenues that were capitalized from NIS 241 million in 2009 to NIS 83 million in 2010.

Gross profit. Gross profit in 2010 totaled NIS 2,581 million, an 11.8% increase from NIS 2,309 million in 2009. Gross profit for the cellular segment increased by 9.0% from NIS 2,366 million in 2009 to NIS 2,580 million in 2010. Gross profit for the fixed line segment increased from a gross loss of NIS 57 million in 2009 to a gross profit of NIS 1 million in 2010.

Gross profit from services. The annual gross profit from services was NIS 2,355 million in 2010, an increase of 3.0% from NIS 2,286 million in 2009. This assumes a retroactive application of the reallocation of revenues between services and equipment within the cellular segment that occurred in 2010 (see above).

For the cellular segment, the gross profit from services (including inter-segment activity) was NIS 2,344 million in 2010, compared with NIS 2,324 million in 2009, an increase of 0.8%. The increase reflected the higher service revenues, largely offset by an increase in the cost of service revenues of 5.0%. Cost of service revenues increased primarily due to an increase of approximately NIS 93 million in depreciation and amortization expenses. This increase was mainly due to approximately NIS 70 million of additional amortization expenses for capitalized subscriber acquisition and retention costs resulting from the commencement of capitalization from the beginning of 2009. A one-time impairment of NIS 16 million of expenses of capitalized subscriber acquisition and retention costs was also recorded in the fourth quarter of 2010 as a result of an amendment to the Telecommunications Law which imposes restrictions on subscriber exit fines.

In addition, the Company recorded accelerated depreciation expenses in the amount of NIS 16 million related to network equipment to be replaced following the agreement signed with LM Ericsson Israel Ltd. in October 2010 for the upgrade, replacement and the expansion of the cellular and fixed line networks.

Interconnect expenses also increased markedly in 2010, reflecting the higher cellular subscriber base, and the increased usage per cellular user.

These increases in the cost of revenues were partially offset by the impact of two legal developments:

First, following a Supreme Court decision in December 2010 which fully accepted the Company's petition against the Ministry of Communications regarding the amount of frequency fees owed by the Company for allocated frequencies, frequency fee expenses were reduced by approximately NIS 50 million in the fourth quarter of 2010. Second, in 2009, the Company made a provision in the amount of approximately NIS 30 million for a demand by the Ministry of Communications for frequency fee payments with respect to the Company's past use of a frequency band. The demand was settled in March 2010 for the same amount as the provision.

In addition, the Company benefitted from a scheduled reduction in its royalty payments set by the Telecommunications Regulations from 1.5% in 2009 to 1% in 2010.

For the fixed line segment, the gross profit from services (including intersegment activity) was NIS 11 million in 2010, compared with a gross loss of NIS 38 million in 2009. The increase in profit was attributable to increases in profits from both existing services including transmission services and Primary Rate Interface ("PRI") lines for business sector customers, as well as an increase in profits from the ISP and fixed line telephony services that were launched at the beginning of 2009, as a result of the continuing growth in the subscriber base of these services and an increase in intersegment revenues.

Gross profit from non-capitalized equipment sales. The gross profit from non-capitalized equipment sales was NIS 226 million in 2010, compared with NIS 23 million in 2009. This assumes a retroactive application of the reallocation of revenues between services and equipment within the cellular segment that occurred in 2010 (see above).

The increase was attributable to an increase in the average profit per equipment sale. The total amount of equipment subsidies that were capitalized in 2010 was NIS 51 million, a decrease from NIS 169 million of equipment subsidies capitalized in 2009.

Selling, marketing and general and administrative expenses. Selling, marketing, general and administrative expenses amounted to NIS 785 million in 2010, an increase of 16.0% from NIS 677 million in 2009. The increase was mainly attributed to higher salary expenses and selling costs, together with increased marketing and advertising expenses, partially offset by a reduction in bad debts and doubtful accounts expenses. The total amount of selling expenses capitalized in 2010 was NIS 21 million, compared with NIS 29 million in 2009.

The increase in expenses occurred despite a reduction in the selling, marketing, general and administrative expenses related to the fixed line segment, which decreased by 51.0%, from NIS 51 million in 2009 to NIS 25 million in 2010. The decrease largely reflected lower marketing and advertising expenses related to the ISP and fixed line telephony services that were launched in 2009.

Other income, net. Other income, net, totaled NIS 64 million in 2010, decreasing by 7.2% from NIS 69 million in 2009. The decrease primarily reflected a one-time provision in the amount of approximately NIS 6 million made in the third quarter of 2010 with respect to a lawsuit.

Operating profit. As a result of the above, the Company recorded an operating profit of NIS 1,860 million in 2010, a 9.3% increase from NIS 1,701 million in 2009. The fixed line segment contributed 53% of the annual increase in operating profit and the cellular segment contributed 47%.

Financial expenses, net. Financial expenses, net, for 2010 were NIS 181 million, an increase of 2.8% from NIS 176 million in 2009. The increase was primarily attributable to an increase in interest expenses resulting from our higher debt level which was partially offset by an increase in currency gains from movements of both the US dollar and the Euro against the Israeli Shekel.

Profit before income tax. Profit before income taxes for 2010 was NIS 1,679 million, an increase of 10.0% from NIS 1,525 million in 2009.

Income taxes on profit for 2010 were NIS 436 million, an increase of 13.5% from NIS 384 million in 2009.

The effective tax rate for 2010 was 26.0% compared with 25.2% for 2009.

Net profit. Net profit in 2010 was NIS 1,243 million and earnings per diluted share were NIS 7.95, representing an 8.9% increase from net profit of NIS 1,141 million and earnings per diluted share of NIS 7.37 in 2009.

EBITDA. EBITDA for 2010 increased by NIS 266 million or 11.5%, reaching NIS 2,570 million, or 38.5% of total revenues, compared with NIS 2,304 million, or 37.9% of total revenues, in 2009.

EBITDA for the cellular segment was NIS 2,558 million in 2010, increasing by 7.2% from NIS 2,387 million in 2009. EBITDA for the fixed line segment was NIS 12 million in 2010, compared with a loss of NIS 83 million in 2009, providing a contribution to EBITDA growth of NIS 95 million (36% of the total consolidated growth). The increase in EBITDA was attributed primarily to the reduction of the loss from the ISP and fixed line telephony services which were launched at the beginning of 2009.

Results of Operations by Segment for the Year Ended December 31, 2009

(See table above for the results by segment for the year ended December 31, 2010)

| | New Israeli Shekels Year ended December 31, 2009 In millions | | | |
|---|---|---|---|---|
| | Cellular segment | Fixed line segment | Elimination | Consolidated |
| Segment revenue - Services | 5,369 | 55 | | 5,424 |
| Inter-segment revenue - Services | 11 | 33 | (44) | |
| Segment revenue - Equipment | 628 | 27 | | 655 |
| Total revenues | 6,008 | 115 | (44) | 6,079 |
| Segment cost of revenues – Services | 3,091 | 115 | | 3,206 |
| Inter-segment cost of revenues- Services | 33 | 11 | (44) | |
| Segment cost of revenues - Equipment | 518 | 46 | | 564 |
| Cost of revenues | 3,642 | 172 | (44) | 3,770 |
| Gross profit (loss) | 2,366 | (57) | | 2,309 |
| Operating expenses | 626 | 51 | | 677 |
| Other income | 69 | | | 69 |
| Operating profit (loss) | 1,809 | (108) | | 1,701 |
| Adjustments to presentation of EBITDA | | | | |
| –depreciation and amortization | 552 | 25 | | 577 |
| –other (1) | 26 | | | 26 |
| EBITDA | 2,387 | (83) | | 2,304 |
| Reconciliation of EBITDA to profit before tax : | | | | |
| - Depreciation and amortization | | | | (577) |
| - Finance costs, net | | | | (176) |

| | |
|---|---|
| - Other (1) | (26 ) |
| Profit before tax | 1,525 |

(1) Mainly employee share based compensation expenses.

In order to reflect a change in the approach of management, the allocation of revenues and cost of revenues between services and equipment within the cellular segment has changed, effective starting with the fourth quarter of 2010. Total profit for the cellular and fixed line segments separately remains unchanged. The figures for 2009 in the above table have not been reclassified. However, had the allocation been applied to 2009, service revenues would have been higher by NIS 22 million and equipment revenues would have been lower by the same amount. For the cost of revenues, had the allocation been applied to 2009, the cost of service revenues would have been lower by NIS 46 million and the cost of equipment sales revenues would have been higher by the same amount. The figures and discussion presented below assumes a retroactive application of the reallocation from 2009.

Cellular Business Services Segment

Revenues from services. In 2010, service revenues from the Company's cellular business segment totaled NIS 5,575 million, representing an increase of 3.2% from NIS 5,402 million in 2009. This assumes a retroactive application of the reallocation of revenues between services and equipment within the cellular segment that occurred in 2010 (see above). These revenues included approximately NIS 20 million of inter-segment revenues in 2010, compared with NIS 11 million in 2009.

The increase mainly reflected the continued expansion of the cellular subscriber base which grew by approximately 4.3% on an average basis in 2010, as well as continued growth in revenues from the use of data and content services and renewed growth in roaming activity after the decline in 2009. These increases more than offset the impact of the ongoing tariff erosion due to the fiercely competitive cellular market

Revenues from equipment. Equipment revenues from the Company's cellular business segment totaled NIS 987 million in 2010, compared with equipment revenues of NIS 606 million in 2009. This assumes a retroactive application of the reallocation of revenues between services and equipment within the cellular segment that occurred in 2010 (see above).

The increase in revenues reflected an increase in the average revenue per device sold, in part attributable to an increase in the proportion of sales of smartphones and 3G devices. In addition, the increase in average revenue per device reflected the increased practice of selling handsets through installment plans under which the subscriber obtains rebates, which are dependent upon the level of the subscriber's monthly service usage. In this practice, the full price of the handset is recorded at the time of sale, whilst the subsequent rebates are recorded over a period of up to 36 months.

As a result of the increase in average revenues per device, there was a significant reduction in the number of devices capitalized, which in turn led to a reduction in the level of equipment revenues that were capitalized from NIS 241 million in 2009 to NIS 83 million in 2010.

In addition, the Company benefitted from a scheduled reduction in its royalty payments set by the Telecommunications Regulations from 1.5% in 2009 to 1% in 2010.

Gross profit from equipment. The gross profit from the cellular business segment equipment revenues was NIS 236 million in 2010, compared with a gross profit of NIS 42 million in 2009. This assumes a retroactive application of the reallocation of revenues between services and equipment within the cellular segment that occurred in 2010 (see above).

The increase was attributable to an increase in the average profit per equipment sale. The total amount of equipment subsidies that were capitalized in 2010 was NIS 51 million, a decrease from NIS 169 million of equipment subsidies capitalized in 2009.

Gross profit. The overall gross profit from the cellular business segment was NIS 2,580 million in 2010, compared with NIS 2,366 million in 2009, an increase of 9.0%.

Selling, marketing and general and administrative expenses. The cellular segment's selling, marketing, general and administrative expenses amounted to approximately NIS 760 million in 2010, an increase of 21.4% from NIS 626 million in 2009. The increase was mainly attributed to higher salary expenses and selling costs, together with increased marketing and advertising expenses, partially offset by a reduction in bad debts and doubtful accounts expenses. The total amount of selling expenses capitalized in 2010 was NIS 21 million, compared with NIS 29 million in 2009.

Other income, net. Other income, net, totaled NIS 64 million in 2010, decreasing by 7.2% from NIS 69 million in 2009. The decrease primarily reflected a one-time provision in the amount of approximately NIS 6 million made in the third quarter of 2010 with respect to a lawsuit.

Operating profit. As a result of the above, operating profit from the segment's activities totaled NIS 1,884 million in 2010, compared with NIS 1,809 million in 2009, an increase of 4.1%.

EBITDA for the segment was NIS 2,558 million in 2010, representing an increase of 7.2% from NIS 2,387 million in 2009.

Fixed-Line Business Services Segment

Revenues from services. Fixed line business segment service revenues (including inter-segment revenues) increased by 86.4% to NIS 164 million for 2010 from NIS 88 million for 2009, attributable mainly to an increase in revenues from growth in the ISP and fixed line telephony services subscriber base and an increase in inter-segment revenues.

Revenues from equipment. Equipment revenues from the Company's fixed line business segment totaled NIS 25 million in 2010, a decrease of 7.4% compared with NIS 27 million in 2009. The decrease primarily reflected a decrease in the number of new activations.

Gross profit from services. For the fixed line segment, the gross profit from services (including intersegment activity) was NIS 11 million in 2010, compared with a gross loss of NIS 38 million in 2009. The increase in profit was attributable to increases in profits from both existing services including transmission services and Primary Rate Interface ("PRI") lines for business sector customers, as well as an increase in profits from the ISP and fixed line telephony services that were launched at the beginning of 2009, as a result of the continuing growth in the subscriber base of these services.

Gross loss from equipment. The gross loss from the fixed line business segment equipment revenues was NIS 10 million in 2010, compared with NIS 19 million in 2009. The reduction in gross loss was primarily related to a decrease in the average cost of equipment devices for ISP and fixed line telephony subscribers.

Gross profit. The overall gross profit from the fixed line business segment was NIS 1 million in 2010, compared with a gross loss of NIS 57 million in 2009. The decrease in the gross loss was attributable to improved profitability of both existing services including transmission service and PRI line, as well as of the ISP and fixed line telephony services that were introduced in 2009.

Selling, marketing and general and administrative expenses. The fixed line segment's selling, marketing, general and administrative expenses amounted to approximately NIS 25 million in 2010, a decrease of 51.0% from NIS 51 million in 2009. The decrease largely reflected a decrease in marketing and advertising expenses related to the ISP and fixed line telephony services that were launched in 2009.

Operating loss. Operating loss from the segment's activities totaled NIS 24 million in 2010, compared with a loss of NIS 108 million in 2009, a decrease of 77.8%.

EBITDA for the segment was NIS 12 million in 2010, compare with a loss of NIS 83 million in 2009. The increase in EBITDA was attributed primarily to the narrowing of the loss from the ISP and fixed line telephony services which were launched at the beginning of 2009.

5A.3 Seasonality

Our service revenues and profitability show some seasonal trends over the year, but the overall impact is not considered to be material. Generally, airtime minutes and consequently airtime revenues are affected by the number of monthly work days and daylight hours in the day, which varies throughout the year. In addition, airtime revenues are lower in February, which is a shorter than average month, and during the Jewish holiday period, but are higher in the summer months as a result of roaming charges from increased travel abroad by subscribers and from foreign roamers using our network. There is no assurance that these trends will continue in the future.

| | Three months ended | | | |
|---|---|---|---|---|
| NIS in millions | March 31 | June 30 | Sept. 30 | Dec. 31 |
| Service Revenues | | | | |
| 2009 | 1,298 | 1,360 | 1,389 | 1,377 |
| 2010 | 1,360 | 1,412 | 1,457 | 1,432 |
| 2011 | 1,212 | 1,360 | 1,366 | 1,286 |

5A.4 Impact of Exchange Rate Fluctuations and Inflation

Substantially all of our revenues and a majority of our operating expenses are denominated in shekels. However, in recent years, approximately one quarter of our operating expenses (excluding depreciation), including a substantial majority of our handset purchases, were linked to non-shekel currencies, mainly the US dollar. These expenses related principally to the acquisition of handsets, where the price paid by us is based mainly on US dollars. In addition, a substantial majority of our capital expenditures (including with respect to our networks) are incurred in, or linked to, non-shekel currencies, mainly the US dollar. We hedge a portion of our foreign currency commitments. See “Item 11. Quantitative and Qualitative Disclosures About Market Risk”.

Our current borrowings are in shekels, and most of our financial debt is linked to the consumer price index. If the CPI increases, we may not be permitted to raise our tariffs in a manner that would fully compensate for any increase in our financial expenses. In 2011, the CPI increased 2.6 %, causing expenses of NIS 77 million in our financial expenses, net, compared to a CPI increase of 2.3% in 2010, which caused expenses of NIS 54 million in financial expenses, net. The CPI for each month is published on the 15th day of the following month; references above to the annual change in CPI for a given year is the change from the CPI published on the 15th day of December of the preceding year to the CPI published on the 15th day of December of the relevant year, which for the purposes of this annual report, covers the twelve months beginning January 1 through December 31 of the year in question.

5B. Liquidity and Capital Resources

The discussion below first describes our financial indebtedness (Notes payable, long-term bank loans and credit facilities, and total financial debt) and capital expenditures, then our dividend payment, and finally our main sources of liquidity.

Following the acquisition of 012 Smile (see “Item 4A. History and Development of the Company” and “Item 5A.1.3 Acquisition of 012 Smile”, the Company’s consolidated total financial debt increased from approximately NIS 3.7 billion to approximately NIS 5.2 billion. Under the acquisition agreement, the Company paid NIS 650 million that was financed by issuance of additional Notes Series C in an amount of NIS 463 million (as further described under “Notes payable” below) and cash on hand. In addition, the Company guaranteed 012 Smile’s indebtness of approximately NIS 580 million (see “Item 5E. Off-balance Sheet Arrangements”).

5B.1 Notes payable:

Series A Notes due 2012. In March 2005, we completed the offering of our Notes due 2012, raising NIS 2.0 billion in a public offering in Israel. Of these, notes having an aggregate principal amount of approximately NIS 36.5 million were purchased by our wholly owned subsidiary Partner Future Communications 2000 Ltd., or PFC. PFC also received an additional allocation of notes having an aggregate principal amount of NIS 500 million. The notes that PFC received pursuant to this additional allocation do not confer the right to receive any payment whatsoever on account of principal or interest until they are first sold by PFC. To date, no such notes have been sold to third parties. The notes due 2012 are listed on the Tel Aviv Stock Exchange, and members of our Board of Directors and senior management may have purchased a portion of the Series A Notes due 2012 through stock exchange transactions.

Quarterly repayments of principal and interest on the Series A Notes due 2012 are made in twelve installments, beginning in June 2009 and ending in March 2012. Principal and interest payments on the Series A Notes due 2012 are linked to the consumer price index for the month of February 2005 with annual interest on the notes equal to 4.25% adjusted according to the CPI.

The notes are rated ilAA- by Standard and Poor’s Maalot, and Aa3 with a negative forecast by Midroog, two of Israel’s rating agencies. The Company was rated ilAA-/negative by Standard and Poor’s Maalot. Therefore, the Series A Notes interest remained unchanged.

The principal payment to be made in 2012 on our Notes Series A due 2012, based on the CPI at December 31, 2011 is NIS 393 million. As of April 1, 2012, the notes will have reached maturity and been fully paid, and no further payments of principal or interest will be due.

Series B Notes due 2016. On November 29, 2009 the Company issued to Israeli institutional investors approximately NIS 448 million of unsecured non-convertible Series B Notes through a private placement in Israel. The notes are linked (principal and interest) to increases in the Israeli CPI for the month of October 2009. The principal amount of Series B Notes is repayable in four equal annual installments between 2013 and 2016 and bears interest at annual rate of 3.4%. The interest is payable on a semi-annual basis. The Notes have been rated ilAA-, on a local scale, by Standard & Poor’s Maalot.

Until May 31, 2010, the Notes were not listed for trading on the TASE and during that period we undertook the following: (i) to pay additional interest at an annual rate of 0.6% until a prospectus or a shelf offering report was published for the listing for trade of the Notes on the TASE; (ii) to make a one-time additional interest payment at an annual rate of 0.25% in the event there is a downgrade in the rating of the Notes from the date of the downgrade announcement by the rating agency and until a prospectus or a shelf offering report is published for the listing of the Notes for trading on the TASE. If the rating of the Notes was further downgraded, no additional interest payments were to be made following such subsequent downgrades; (iii) a negative pledge (subject to certain carve-outs); and (iv) to undertake additional events of default of the Notes, as follows: (a) the rating of the Notes in Israel decreases below BBB (by Standard & Poor’s Maalot or an equivalent rating by another rating agency) on a local scale; and (b) we fail to comply with its existing financial covenants.

Since June 1, 2010, the Notes have been listed for trading on the TASE. As a result we ceased paying additional interest at an annual rate of 0.6% and, from such date, the annual interest rate is 3.4%. Furthermore, all such undertakings listed above have been terminated; however, in the event the Notes are deregistered from the TASE (except deregistration resulting from a merger or debt arrangement), such undertakings will become effective again (except the undertaking listed in subparagraph (ii) above). Members of our Board of Directors and senior management may have purchased a portion of the Series B Notes due 2016 through stock exchange transactions.

The table below sets forth the payments of principal to be made on our Series B Notes due 2016, based on the CPI at December 31, 2011.

| | NIS in millions |
|---|---|
| Principal payments due in: | |
| 2013 | 118 |
| 2014 | 118 |
| 2015 | 118 |
| 2016 | 118 |
| | |
| Total | 472 |

Series C Notes due 2018. On April 25, 2010, the Company issued to the public in Israel approximately NIS 200 million of unsecured non-convertible Series C Notes through a public offering in Israel. The notes are linked (principal and interest) to increases in the Israeli CPI for the month of March 2010. The principal amount of Series C

Notes is repayable in three equal annual installments between 2016 and 2018 and bears interest at an annual rate of 3.35%. The interest is payable on a semi-annual basis. The Series C Notes due 2018 are listed on the TASE, and members of our Board of Directors and senior management may have purchased a portion of the Series C Notes due 2018 through stock exchange transactions.

On February 24, 2011, it was agreed with classified institutional investors in Israel that we would issue in a private placement an additional principal amount of approximately NIS 444 million of Series C Notes (approximately USD 116 million) (the “Additional Notes”). The terms of the Additional Notes are identical to the terms of the currently outstanding Series C Notes previously issued to the public pursuant to the Shelf Offering Report and the Shelf Prospectus. Pursuant to our agreement with classified institutional investors in Israel, the Additional Notes were issued to such investors for an aggregate consideration of approximately NIS 463 million (approximately USD 121 million), representing a price of NIS 1.043 per NIS 1 principal amount of the Additional Notes. The value of the principal issued, including CPI linkage difference and accumulated interest to be paid to that date was approximately NIS 463 million.

On February 24, 2011, Standard & Poor's Maalot announced that it assigned its 'ilAA-' rating to the expansion of Notes Series C of up to new Israeli Shekel (NIS) 500 million par value, to be issued by Partner Communications Company Ltd. (ilAA-/Negative).

The rating reflects Standard & Poor's assessment that the expansion of the Notes Series C does not negatively affect Partner's financial risk profile, and/or Partner's ratings on the existing bond issues, assuming that Partner will continue to maintain what Standard & Poor considers as "adequate" liquidity.

The Additional Notes were issued on March 1, 2011, and were consequently listed for trade on the Tel Aviv Stock Exchange.

The sale and/or transfer of the Additional Notes are subject to the limitations on re-sale of securities set forth in Article 15C of the Israeli Securities Law of 1968 (the "Law") and the Securities Regulations (Details with respect to Articles 15A-15C of the Law) of 2000 applicable to investors of the type specified in the first supplement to the Law.

The table below sets forth the payments of principal to be made on our Series C due Notes 2018, based on the CPI at December 31, 2011.

| | NIS in millions |
|---|---|
| Principal payments due in: | |
| 2016 | 227 |
| 2017 | 227 |
| 2018 | 227 |
| Total | 681 |

Series D due Notes 2021. On April 25, 2010, the Company issued to the public in Israel approximately NIS 400 million of unsecured non-convertible Series D Notes through a public offering in Israel. The principal amount of Series D Notes is repayable in five equal annual installments between 2017 and 2021 and is not linked to the CPI. The Series D Notes bear a floating interest that is based on the yield of 12 month government bonds ('Makam') issued by the government of Israel and updated quarterly plus additional annual interest of 1.2%. The interest is payable quarterly. The interest rates which applied to interest paid for 2010 and 2011 (in annual terms, and including the additional interest of 1.2%) were as follows: from the issuance date to June 30, 2010: 3.4%; from July 1, 2010 to September 30, 2010: 3.288%; from October 1, 2010 to December 31, 2010: 3.616%; from January 1, 2011 to March 31, 2011: 3.67%; from April 1, 2011 to June 30, 2011: 4.47%; from July 1, 2011 to September 30, 2011: 4.72%; from October 1, 2011 to December 31, 2011: 4.15%. The Series D Notes due 2021 are listed for trading on the TASE.

On May 4, 2011, the Company issued an additional NIS 146 million in principal amount of Series D Notes in a public offering in Israel (the "Additional Notes"). The terms of the Additional Notes are identical to the terms of the previously issued outstanding Series D Notes. The Additional Notes were issued with a price per unit (each unit comprised of NIS 1,000 par value) of NIS 992. The Additional Notes were listed for trading on the TASE. The Notes have been rated ilAA-, on a local scale, by Standard & Poor's Maalot.

Members of our Board of Directors and senior management may have purchased a portion of the Series D Notes due 2021 through stock exchange transactions.

The table below sets forth the payments of principal to be made on our Notes Series D due 2021, as of December 31, 2011.

| | NIS in millions |
|---|---|
| Principal payments due in: | |
| 2017 | 109 |
| 2018 | 109 |
| 2019 | 109 |
| 2020 | 109 |
| 2021 | 109 |
| Total | 545 |

Series E Notes due 2017. On April 25, 2010, the Company issued to the public in Israel approximately NIS 400 million of unsecured non-convertible Notes Series E notes through a public offering in Israel. The principal amount of Notes Series E notes is repayable in five equal annual installments between 2013 and 2017 and is not linked. The principal bears a fixed interest at a rate of 5.5% repayable on a semi-annual basis. The Series E Notes due 2017 are listed on the TASE, and members of our Board of Directors and senior management may have purchased a portion of the Series E Notes due 2017 through stock exchange transactions.

On May 4, 2011 the Company issued an additional NIS 535 million in principal amount of Series E Notes in a public offering in Israel (the "Additional Notes"). The terms of the Additional Notes are identical to the terms of the previously issued outstanding Series E Notes. The Additional Notes were issued with a price per unit (each unit comprised of NIS 1,000 par value) of NIS 996. The Additional Notes were listed for trading on the TASE. The Notes have been rated ilAA-, on a local scale, by Standard & Poor's Maalot.

The table below sets forth the payments of principal to be made on our Series E Notes due 2017, as of December 31, 2011.

| | NIS in millions |
|---|---|
| Principal payments due in: | |
| 2013 | 186 |
| 2014 | 187 |
| 2015 | 187 |
| 2016 | 187 |
| 2017 | 187 |
| Total | 934 |

5B.2 Long-term Bank Loans and Credit Facilities:

1. On November 24, 2009, a new facility ("Facility D") was established with a leading commercial bank in the amount of NIS 700 million for a maximum period of 3 years, at a wholesale interest rate plus a margin of 0.85%, effective from January 1, 2010. The facility is used for short term financing. The wholesale interest rate of the bank as of December 31, 2010 and 2011 was 2.15% and 2.9% per year respectively. The Company is charged a commitment

fee of 0.4% per year for undrawn amounts. As of December 31, 2011, no amounts had been drawn under this credit facility. During 2011, the Company used part of this credit facility to refinance part of 012 Smile's bank borrowings and for other operational needs. In addition, 012 Smile obtained a credit facility from a leading bank in the amount of NIS 80 million, which the bank is committed to until December 31, 2012. As of December 31, 2011, this credit facility is partially used to secure bank guarantees by 012 Smile.

2. On November 11, 2010, a new long-term loan was established with a leading Israeli commercial bank in the amount of NIS 500 million. The loan is linked (principal and interest) to the Israeli CPI. The principal amount is repayable in three equal annual installments between 2016 and 2018 and bear interest at an annual rate of 2.75%. The interest is payable on a semi-annual basis. This loan has replaced bank facilities C and E which were cancelled. The Company may, at its discretion, at any time, prepay the loan, in whole or in part, subject to the following conditions: the amount to be prepaid shall not be less than NIS 5 million; and the Company shall reimburse the bank for any loss sustained by the bank, if any, as a result of the prepayment in an amount equal to the actual financing costs of the bank arising from such prepayment.

3. On December 28, 2009, a new long-term loan was established with a leading commercial bank in the amount of NIS 300 million for a period of 4 years, bearing variable interest at the rate of the Israeli Prime interest rate minus a margin of 0.35%. The interest is payable quarterly and the principal is payable in one payment at the end of the loan period. The Israeli Prime interest rate as of December 31, 2010 and 2011 was 3.5% and 4.25% per year respectively. The Israeli Prime interest rate is determined by the Bank of Israel and updated on a monthly basis. The Company may, at its discretion, at any time, prepay the loan, in whole or in part, provided that the Company shall reimburse the bank for losses sustained by the bank, as a result of the prepayment calculated according to provisions detained in the loan agreement. The loan contract requires that at any time the loan principal will not exceed 20% of all bank credits, loans, facilities (both utilized and committed facilities) and any other indebtedness of the company to the banks.

4. On June 9, 2010, a new long-term loan was established with a leading commercial bank in the amount of NIS 250 million for a period of 10 years, bearing fixed interest at the rate of 5.7%. The principal and interest are payable annually. The Company may, at its discretion, at any time, prepay the loan, in whole or in part, subject to the following conditions: the amount to be prepaid shall not be less than NIS 5 million; and the Company shall reimburse the bank for any loss sustained by the bank, if any, as a result of the prepayment in an amount equal to the increase in the financing costs of the bank arising from such prepayment.

5. On June 8, 2010, a new long-term loan was established with a leading commercial bank in the amount of NIS 250 million for a period of 10 years, bearing fixed interest at the rate of 5.7%. The principal and interest are payable annually. The Company may, at its discretion, at any time, prepay the loan, in whole or in part, provided that the Company shall reimburse the bank for any loss sustained by the bank, if any, as a result of the prepayment in an amount equal to the increase in the financing costs of the bank arising from such prepayment.

6. On May 8, 2011, a new long-term loan was established with a leading Israeli commercial bank, in the principal loan amount of NIS 400 million, bearing a variable interest rate equal to the Prime Rate minus margin of 0.025%, per annum. The Israeli Prime interest rate as of December 31, 2011, was 4.25% per year. The interest is payable every three months. The Principal is payable in four installments, as follows: NIS 24 million on May 8, 2012, NIS 112 million on May 8, 2014, NIS 112 million on May 8, 2015, and NIS 152 million on May 8, 2019.

7. On March 3, 2011, the Company completed the acquisition of all of the issued and outstanding shares of 012 Smile from Merhav-Ampal Energy Ltd. (“Ampal”). As part of 012 Smile acquisition, the Company guaranteed bank loans and other bank guarantees, which have been provided to 012 Smile, in a total amount of approximately NIS 800 million.

   On April 10, 2011, 012 Smile prepaid its long term bank loans and obtained a new loan from a leading Israeli bank in a principal amount of NIS 500 million, bearing an annual interest of 3.42%. The interest is payable quarterly, and the loan is linked to the CPI (principal and interest). The principal is payable as follows (linked to the CPI as of December 2011): NIS 31 million on December 31, 2012, NIS 142 million on December 31, 2014, NIS 142 million on December 31, 2015, and NIS 194 million on December 31, 2019. 012 Smile may, at its discretion, at any time, prepay the loan, in all or in part, provided that 012 Smile shall reimburse the bank for losses sustained by the bank (excluding loss deriving from loss of future income), as a result of the prepayment. As a result of the bank loan prepayment mentioned above, and in respect of 012 Smile's credit facility described in paragraph 1 above, the bank guarantee the Company has provided to 012 Smile has decreased to NIS 580 million as of December 31, 2011.

Financial covenants: In connection with Credit Facility D and the long-term bank loans, the Company undertook to comply with financial covenants, whose principal provisions consist of maintaining compliance with two ratios:

(1) the ratio of (a) the amount of all financial obligations of the Company including bank guarantees that the Company has undertaken ("Total Debt") to (b) Earnings Before Interest costs, Tax, Depreciation, Amortization and impairment charges ("EBITDA") after deducting Capital Expenditures shall not exceed 6.5 (the ratios as of December 31, 2010 and 2011 were 1.83 and 3.14, respectively); and

(2) the ratio of (a) Total Debt to (b) the EBITDA of the Company shall not exceed 4 (the ratios as of December 31, 2010 and 2011 were 1.47 and 2.42, respectively).

As used above, “EBITDA” is defined as the sum of (a) the net income before extraordinary items, (b) the amount of tax expenses set against the net profits including, without double counting, any provisions for tax expenses, (c) amortization and depreciation expenses, and (d) any finance costs net. “Capital Expenditures” is defined as any expenditure which is classified as “fixed and intangible asset” in the Company’s consolidated financial statements.

The covenants are measured every six months on an annualized basis of twelve months and are based on the financial results for the preceding period of twelve months. At December 31, 2010 and 2011, the Company was in compliance with all covenants stipulated for the years then ended, respectively.

The Company does not expect that the acquisition of 012 Smile, including any indebtedness acquired as a result of the acquisition or as part of the acquisition financing or re-financing, or through the operation of the guarantees on 012 Smile’s indebtedness which it provided, will cause it not to be in compliance with any of its financial covenants.

Negative pledge: As part of the credit facilities, the Company provided a negative pledge undertaking (i.e., not to pledge any of its assets to a third party), except for a number of exceptions that were agreed upon, including pledge (other than by way of floating charge) in favor of a third party over specific assets or rights of the Company, securing obligations no greater than NIS 100 million in aggregate.

5B.3 Total Net Financial Debt.

At December 31, 2011, total net financial debt (total current and non-current borrowings including capital lease obligations less cash and cash equivalents) amounted to NIS 4,642 million, compared to NIS 3,395 million at December 31, 2010. The increase in net financial debt compared with 2010 principally reflected debt incurred in connection with the acquisition of 012 Smile (approximately NIS 1.45 billion) which was partially offset by free cash flow.

At December 31, 2011, the current portion of our total financial debt amounted to NIS 701 million, as compared to NIS 764 million at December 31, 2010, and was composed of the amounts set forth in the table below. We intend to fund the repayment of the current portion of our Notes payable in 2012, bank loans and interest through new bank loans and utilization of our credit facilities, the issuance or sale of corporate notes, available cash or operational cash flow, or a combination of one or more of these resources.

| Current Portion Payable in 2012 as of December 31, 2011 | NIS in millions |
|---|---|
| Principal on notes payable | 393 |
| Principal on long term bank loans | 105 |

| | |
|---|---|
| Principal on capital lease | 2 |
| Interest on notes payables | 116 |
| Interest on long term bank loans | 85 |
| Total | 701 |

Capital Expenditures. The cellular telephone business is highly capital intensive, requiring significant capital to acquire a license and to construct a mobile telecommunications network. The capital requirements of our network are determined by the coverage desired, the expected call and data traffic and the desired quality and variety of services. Cellular network construction costs are mainly related to the number of cells in the service area, the number of radio channels in the cell and the switching equipment required.

Our capital expenditures represent additions to property and equipment and computer software. In the year ended December 31, 2009, 2010 and 2011, our capital expenditures amounted to approximately NIS 522 million, NIS 435 million and NIS 468, respectively, and were principally related to our cellular network.

In view of the continuing upgrade of the transmission and mobile networks in advance of fourth generation implementation, as well as investments in enhancing the existing business support systems in preparation for their upgrade, the level of investments in fixed assets, including the fixed-line network, is expected to reach approximately NIS 650 million in 2012, and is expected to be funded principally through cash from operations. See also "Item 5A. Operating Results - Agreement for the Upgrade of Our Existing Networks and the Deployment of Fourth Generation Network in Israel").

Dividend payments. For the year ending December 31, 2011, the Company distributed dividends which in the aggregate amounted to approximately NIS 350 million, or NIS 2.25 per share. See note 23(c) to our consolidated financial statements.

Cash dividends are paid in Israeli currency. For further information, see "Item 8A. Consolidated Financial Statements and other Financial Information - Dividend Distribution Policy".

5B.4 Main sources of liquidity

- Cash on hand;
- Operating cash flows, net of cash flow from investing activities; and
- Existing credit facilities.

Cash on hand. At December 31, 2011, we had NIS 532 million in cash on hand, compared to NIS 321 million at December 31, 2010.

Operating cash flows. Cash generated from operations, decreased by 20% from NIS 1,958 million in 2010 to NIS 1,570 million (US$ 411 million) in 2011. This decrease was mainly explained by the decrease in profit before depreciation and amortization. Operating working capital increased by NIS 266 million in 2011 compared with an increase of NIS 194 million in 2010. The increase primarily reflected the increase in trade receivables explained by the different payment terms for handset sales between the Company and its customers; while the Company generally has short payment terms from its handset suppliers, our customers generally pay for handsets under 36 month installment plans according to Company policy.

Existing credit facilities. Our Credit Facility D and 012 Smile's Credit Facility are described above under "Long-term Bank Loans and Credit Facilities".

We believe that funds from our operations, together with funds available under our two current credit facilities, new bank loans, the issuance or sale of corporate notes and our cash on hand, will provide us with enough liquidity and resources to fund our expected capital expenditure needs, repayment of our notes, as well as our obligations under our financing agreements, our license payments and our other material commitments, at least for the next 12 months. However, the actual amount and timing of our future requirements may differ materially from our estimates. See "Item 3D.2 Risks Relating to Our Business Operations – We may not be able to fulfill our dividend policy in the future. If we implement our current dividend policy, we might reduce our future cash reserves, which may require us to borrow additional money." and "- Our business results may be affected by a recurrence of a recession." for a discussion of uncertainties regarding raising additional debt.

5C. Research and Development, Patents and Licenses

We are primarily a user rather than a developer of technology. Accordingly, we did not engage in any significant research and development activities during the past three years.

## 5D. Trend Information

### 5D.1 Recent developments

During December 2011, Bezeq International Ltd. completed the installation of an underwater cable between Israel and Italy and began commercial use thereafter. In addition, Tamares Telecom Ltd. was in the final stages of laying another underwater cable which was completed in January 2012, allowing new communication channels between Israel and Western Europe. The additional capacity significantly increased the level of competition in the market for international connectivity services that, until December 2011, had comprised a sole monopoly supplier. The increased competition in the market for international connectivity services during the fourth quarter of 2011 that lead to a sharp decline in prices and the Company's expectations for increased competition in the retail ISP market that would lead to a decrease in prices and market share, indicated the need to perform an impairment test on certain assets of the fixed-line segment. See also “Item 5A.1.3 Acquistion of 012 Smile”.

On February 1, 2012, Scailex, our principal shareholder, filed an immediate report stating that its Board of Directors resolved to appoint Deutsche Bank and Lazard Freres to advise Scailex to propose potential purchasers and to formulate a deal structure in any transaction regarding Scailex itself and/or Scailex's holding in Partner and the joining of a significant partner to Partner, including the possibility of transforming Partner or Scailex into a private company. See “Item 3D.3 Risks Related to Our Principal Shareholder”.

See also recent regulatory developments in “Item 4B. Business Overview-Regulation-Regulatory Developments” and “Item 3D.1 Risks Relating to the Regulation of Our Industry”.

### 5D.2 Outlook

The financial and operating results for the year 2011 reflected challenging market conditions, the effects of regulatory changes as well as the increased competition in the cellular market, and we expect these trends to continue in 2012. See “Item 3D Risk Factors”.

The Company’s commitment to the highest level of customer service in the telecommunications market, as well as its commitment to all stakeholders - employees, customers, and shareholders - requires the Company to prepare and act accordingly, while maintaining the company's assets and enhancing the improvement of operational processes. During the month of December 2011, the Company launched the “Orange Clear” campaign, which included new tariff plans and changes to the Company's Customer Service to improve interaction with customers. Partner also continues to develop new services, such as TV services for tablets and smartphones, in order to enhance the customer experience.

During the fourth quarter of 2011, the Company began the process of adjusting the level of workforce to a level appropriate to the Company’s objectives and market conditions. Over the fourth quarter, the Company reduced approximately 700 full-time equivalent positions; mainly through a reduction in new recruits; and during the months of January and February 2012, the Company reduced a further approximately 400 full-time equivalent positions. These adjustments will impact the Company’s results mostly in the year 2012.

In addition, during the fourth quarter of 2011, the structural separation between the Company and 012 Smile was terminated and the process of merging the fixed-line businesses of Partner and of 012 Smile commenced. The Company is currently in the process of integrating some of the headquarter activities, including human resources, finance, legal, procurement and logistics, under one management structure. This process is designed to maximize operating synergies and to enhance the organizational and managerial focus required for dealing with the market challenges over both the short and the long term.

Regarding capital expenditures, the Company is accelerating investments in the fixed-line transmission network and upgrading the cellular and fixed-line networks in anticipation of the implementation of 4G technologies. The Company expects that by the end of 2012, approximately 1,500 cellular sites will be LTE-ready. Regarding business support systems, the Company is currently implementing a recovery plan for the existing systems in anticipation of their upgrade. The level of investment in fixed assets, including the fixed network, is expected to reach approximately NIS 650 million in 2012, and is expected to be funded principally through cash from operations.

The statements above under this section regarding trends are “forward-looking” statements. We have based these forward-looking statements on our current knowledge and our present beliefs and expectations regarding possible future events. These forward-looking statements are subject to risks, uncertainties and assumptions about Partner, consumer habits and preferences in mobile telephone usage, trends in the Israeli telecommunications industry in general, possible regulatory and legal developments and trends in general economic conditions. For a description of some of the risks we face, see “Item 3D. Key Information – Risk Factors”, “Item 4. Information on the Company”, “Item 5. Operating and Financial Review and Prospects” and “Item 8A. Consolidated Financial Statements and Other Financial Information – Legal and Administrative Proceedings”. In light of these risks, uncertainties and assumptions, the forward-looking events discussed above might not occur, and actual results may differ materially from the results anticipated.

5E. Off-Balance Sheet Arrangements

As of December 31, 2011 Partner has guaranteed NIS 500 million of bank loans and NIS 80 million of a credit facility, both with respect to the financial indebtedness of 012 Smile. See “Item 5A. Operating Results-Acquisition of 012 Smile” and “Item 5B.2.Long-term Bank Loans and Credit".

Other than such guarantees, there are no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

5F. Aggregate Contractual Obligations

Set forth below are our contractual obligations and other commercial commitments as of December 31, 2011:

| | | Payments Due by Period (NIS in millions) | | | |
|---|---|---|---|---|---|
| Contractual Obligations | Total | less than 1 year | 1-3 years | 3-5 years | more than 5 years |
| Long-Term Debt* | | | | | |
| Notes Series A | 393 | 393 | – | – | – |
| Notes Series B | 472 | – | 236 | 236 | – |
| Notes Series C | 681 | & | | | |