

MATAV CABLE SYSTEMS MEDIA LTD

Form 6-K

November 30, 2004

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**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 6-K**

REPORT OF FOREIGN ISSUER

Pursuant to Rule 13a-16 or 15d-16 of  
the Securities Exchange Act of 1934

For the month of November 2004

**Matav Cable Systems Media Ltd.**

(Translation of registrant's name into English)

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

(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F  Form 40-F

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes  No

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**Matav Cable Systems Media Ltd.**

(Registrant)

30 November 2004

BY: /S/ Amit Levin

Amit Levin  
Chief Executive Officer

Print the name and title of the signing officer under his signature

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Attached please find a translation of Matav Cable Systems Media Ltd, third quarter 2004 financial report, edited according to the Israeli securities authority regulations. This financial report was attached as part of Dankner Investments Ltd. (holder of 20% in Matav) third quarter 2004 financial results, released on November 30, 2004.

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MATAV CABLE SYSTEMS MEDIA LTD.

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

AS OF SEPTEMBER 30, 2004

IN NIS

UNAUDITED

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n **Kost Forer Gabbay & Kasierer**  
3 Aminadav St.  
Tel-Aviv 67067, Israel

n Phone: 972-3-6232525  
Fax: 972-3-5622555

The Board of Directors

Matav Cable Systems Media Ltd.

Re: Review report of unaudited interim consolidated financial statements  
for the nine-month and three-month periods ended September 30, 2004

At your request, we have reviewed the interim consolidated balance sheet of Matav Cable Systems Media Ltd. as of September 30, 2004 and the related interim consolidated statements of operations, changes in shareholders' equity and cash flows for the nine-month and three-month periods then ended. Our review was made in accordance with procedures established by the Institute of Certified Public Accountants in Israel. These procedures included reading the above mentioned interim consolidated financial statements, reading minutes of meetings of the shareholders and of the board of directors and its committees, and making inquiries of persons responsible for financial and accounting matters.

We have been furnished with reports of other accountants in respect of the review of the interim financial statements of a jointly controlled entity, whose assets constitute approximately 5.2% of total consolidated assets as of September 30, 2004, and whose revenues constitute approximately 0.89% and approximately 0.63% of total consolidated revenues for the nine-month and three-month periods then ended, respectively. In addition, we have been furnished with reports of other accountants in respect of the review of an affiliate and a partnership, the investments in which on the equity basis of accounting as of September 30, 2004 totaled approximately NIS 87,675 thousand, and the equity in the earnings for the nine-month and three-month periods then ended totaled approximately NIS 11,064 thousand and NIS 4,740 thousand, respectively.

A review is substantially less in scope than an audit in accordance with generally accepted auditing standards in Israel, and accordingly, we do not express an opinion on the interim consolidated financial statements.

Based on our review and the reports of other accountants, we are not aware of any material modifications that should be made to the interim consolidated financial statements in order for them to be in conformity with generally accepted accounting principles in Israel and with the Securities Regulations (periodic and Immediate Reports), 1970.

We draw attention to the matter described in Note 5 of the interim financial statements regarding claims filed against the Company and its subsidiaries and other contingent liabilities.

Tel-Aviv, Israel  
November 29, 2004

**KOST FORER GABBAY & KASIERER**  
A Member of Ernst & Young Global

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## CONSOLIDATED BALANCE SHEETS

|   | September 30,           |                         | December 31,     |
|---|-------------------------|-------------------------|------------------|
|   | 2004                    | 2003                    | 2003             |
|   | Unaudited               |                         | Audited          |
| NIS in thousands                              |                         |                         |                  |
|   | Reported <sup>(1)</sup> | Adjusted <sup>(2)</sup> |                  |
| <b>ASSETS</b>                                 |                         |                         |                  |
| <b>CURRENT ASSETS:</b>                        |                         |                         |                  |
| Cash and cash equivalents                     | 10,277                  | 6,529                   | 37,948           |
| Trade receivables                             | 81,765                  | 65,482                  | 83,151           |
| Other accounts receivable                     | 14,974                  | 15,341                  | 19,765           |
|   | <u>107,016</u>          | <u>87,352</u>           | <u>140,864</u>   |
| <b>INVESTMENTS AND LONG-TERM RECEIVABLES:</b> |                         |                         |                  |
| Investments in affiliates and in partnership  | 89,029                  | 45,339                  | 66,807           |
| Investment in another company                 | -                       | 16,241                  | 16,241           |
| Long-term loans granted to employees          | -                       | 443                     | -                |
| Investment in limited partnerships            | 1,626                   | -                       | 2,057            |
| Rights to broadcast movies and programs       | 29,994                  | -                       | 34,927           |
| Other accounts receivable                     | 602                     | -                       | 885              |
|   | <u>121,251</u>          | <u>62,023</u>           | <u>120,917</u>   |
| <b>FIXED ASSETS:</b>                          |                         |                         |                  |
| Cost  | 2,085,502               | 2,026,518               | 2,028,447        |
| Less - accumulated depreciation               | 1,254,051               | 1,116,361               | 1,151,622        |
|   | <u>831,451</u>          | <u>910,157</u>          | <u>876,825</u>   |
| <b>OTHER ASSETS AND DEFERRED CHARGES, NET</b> |                         |                         |                  |
|   | <u>3,272</u>            | <u>4,876</u>            | <u>3,946</u>     |
|   | <u>1,062,990</u>        | <u>1,064,408</u>        | <u>1,142,552</u> |

(1) See Note 2.

(2) Adjusted to the NIS of December 2003.

The accompanying notes are an integral part of the interim consolidated financial statements.

## CONSOLIDATED BALANCE SHEETS

|   | September 30,           |                         | December 31,     |
|---|-------------------------|-------------------------|------------------|
|   | 2004                    | 2003                    | 2003             |
|   | Unaudited               |                         | Audited          |
| NIS in thousands  |                         |                         |                  |
|   | Reported <sup>(1)</sup> | Adjusted <sup>(2)</sup> |                  |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                       |                         |                         |                  |
| <b>CURRENT LIABILITIES:</b>                                       |                         |                         |                  |
| Credit from banks and others                                      | 430,909                 | 531,793                 | 435,403          |
| Current maturities of debentures                                  | 34,107                  | 33,802                  | 33,701           |
| Trade payables  | 97,722                  | 70,681                  | 94,699           |
| Jointly controlled entity - current accounts                      | 15,274                  | 17,639                  | 17,690           |
| Other accounts payable  | 208,632                 | 99,499                  | 158,982          |
|   | <u>786,644</u>          | <u>753,414</u>          | <u>740,475</u>   |
| <b>LONG-TERM LIABILITIES:</b>                                     |                         |                         |                  |
| Long-term loans from banks and others                             | 114,863                 | 113,922                 | 127,403          |
| Debentures  | 33,182                  | 66,231                  | 66,145           |
| Customer deposits for converters, net of accumulated amortization | 21,725                  | 27,020                  | 25,675           |
| Accrued severance pay, net  | 2,208                   | 1,009                   | 2,106            |
|   | <u>171,978</u>          | <u>208,182</u>          | <u>221,329</u>   |
| <b>SHAREHOLDERS' EQUITY:</b>                                      |                         |                         |                  |
| Share capital:  | 48,899                  | 48,882                  | 48,882           |
| Additional paid-in capital  | 375,538                 | 386,291                 | 375,538          |
| Accumulated deficit   | (320,069)               | (304,977)               | (243,672)        |
|   | <u>104,368</u>          | <u>130,196</u>          | <u>180,748</u>   |
| Less - Company shares held by subsidiary                          | -                       | 27,384                  | -                |
|   | <u>104,368</u>          | <u>102,812</u>          | <u>180,748</u>   |
|   | <u>1,062,990</u>        | <u>1,064,408</u>        | <u>1,142,552</u> |

(1) See Note 2.

(2) Adjusted to the NIS of December 2003.

The accompanying notes are an integral part of the interim consolidated financial statements.

November 29, 2004

Date of approval of the  
financial statementsMeir Serbernik  
Chairman of the BoardAmit Levin  
Chief Executive OfficerShalom Bronstein  
Chief Financial Officer





## CONSOLIDATED STATEMENTS OF OPERATIONS

|  | Nine months ended<br>September 30, |                         | Three months ended<br>September 30, |                         | Year ended<br>December<br>31, |
|--|------------------------------------|-------------------------|-------------------------------------|-------------------------|-------------------------------|
|  | 2004                               | 2003                    | 2004                                | 2003                    | 2003                          |
|  | Unaudited                          |                         |                                     |                         | Audited                       |
| NIS in thousands (except per share amounts)  |                                    |                         |                                     |                         |                               |
|  | Reported <sup>(1)</sup>            | Adjusted <sup>(2)</sup> | Reported <sup>(1)</sup>             | Adjusted <sup>(2)</sup> | Adjusted <sup>(2)</sup>       |
| Revenues   | 444,140                            | 402,533                 | 145,612                             | 137,821                 | 545,480                       |
| Operating expenses:  |                                    |                         |                                     |                         |                               |
| Depreciation   | 109,402                            | 121,469                 | 35,894                              | 40,079                  | 160,521                       |
| Other  | 243,981                            | 228,606                 | 76,585                              | 76,523                  | 306,165                       |
|  | 353,383                            | 350,075                 | 112,479                             | 116,602                 | 466,686                       |
| Gross profit   | 90,757                             | 52,458                  | 33,133                              | 21,219                  | 78,794                        |
| Selling, marketing, general and<br>administrative expenses:                            |                                    |                         |                                     |                         |                               |
| Selling and marketing  | 50,055                             | 29,446                  | 18,673                              | 9,921                   | 43,954                        |
| General and administrative   | 34,136                             | 33,841                  | 13,606                              | 10,727                  | 42,659                        |
|  | 84,191                             | 63,287                  | 32,279                              | 20,648                  | 86,613                        |
| Operating income (loss)  | 6,566                              | (10,829)                | 854                                 | 571                     | (7,819)                       |
| Financial expenses, net  | 40,464                             | 67,301                  | 11,973                              | 21,766                  | 83,958                        |
| Other income (expenses), net   | (46,594)                           | (4,424)                 | (27,868)                            | (3,085)                 | 80,996                        |
| Loss before taxes on income  | (80,492)                           | (82,554)                | (38,987)                            | (24,280)                | (10,781)                      |
| Taxes on income  | 6,888                              | -                       | 6,888                               | -                       | 35,576                        |
| Loss after taxes on income   | (87,380)                           | (82,554)                | (45,875)                            | (24,280)                | (46,357)                      |
| Equity in earnings of affiliates and a<br>partnership, net                             | 10,983                             | 15,799                  | 4,724                               | 4,605                   | 40,907                        |
| Loss   | (76,397)                           | (66,755)                | (41,151)                            | (19,675)                | (5,450)                       |
| Loss per NIS 1 par value of Ordinary<br>share (in NIS)                                 | (2.60)                             | (2.30)                  | (1.40)                              | (0.67)                  | (0.19)                        |
| Weighted average number of Ordinary<br>shares issued and outstanding (in<br>thousands) | 29,359                             | 29,093                  | 29,364                              | 29,533                  | 29,347                        |

- (1) See Note 2.
- (2) Adjusted to the NIS of December 2003.

The accompanying notes are an integral part of the interim consolidated financial statements.

## STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

## Nine months ended September 30, 2004 (unaudited)

|  | Share capital | Additional paid-in capital | Accumulated deficit | Total    |
|--|---------------|----------------------------|---------------------|----------|
| Reported NIS in thousands (1)          |               |                            |                     |          |
| Balance at the beginning of the period | 48,882        | 375,538                    | (243,672)           | 180,748  |
| Exercise of stock options by employees | 17            | -                          | -                   | 17       |
| Loss                                   | -             | -                          | (76,397)            | (76,397) |
| Balance at the end of the period       | 48,899        | 375,538                    | (320,069)           | 104,368  |

## Nine months ended September 30, 2003 (unaudited)

|  | Share capital | Additional paid-in capital | Accumulated deficit | Less - Company shares held by subsidiary | Total    |
|--|---------------|----------------------------|---------------------|--|----------|
| Adjusted NIS in thousands (2)                  |               |                            |                     |  |          |
| Balance at the beginning of the period         | 48,882        | 401,329                    | (238,222)           | (64,917)                                 | 147,072  |
| Sale of Company's shares held by subsidiary *) | -             | (15,038)                   | -                   | 37,533                                   | 22,495   |
| Loss   | -             | -                          | (66,755)            | -  | (66,755) |
| Balance at the end of the period               | 48,882        | 386,291                    | (304,977)           | (27,384)                                 | 102,812  |

(1) See Note 2.

(2) Adjusted to the NIS of December 2003.

\*) Reclassified

The accompanying notes are an integral part of the interim consolidated financial statements.

## STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

## Three months ended September 30, 2004 (unaudited)

|  | Share capital | Additional paid-in capital | Accumulated deficit | Total    |
|--|---------------|----------------------------|---------------------|----------|
| Reported NIS in thousands (1)          |               |                            |                     |          |
| Balance at the beginning of the period | 48,899        | 375,538                    | (278,918)           | 145,519  |
| Loss                                   | -             | -                          | (41,151)            | (41,151) |
| Balance at the end of the period       | 48,899        | 375,538                    | (320,069)           | 104,368  |

## Three months ended September 30, 2003 (unaudited)

|  | Share capital | Additional paid-in capital | Accumulated deficit | Less - Company shares held by subsidiary | Total    |
|--|---------------|----------------------------|---------------------|--|----------|
| Adjusted NIS in thousands (2)                  |               |                            |                     |  |          |
| Balance at the beginning of the period         | 48,882        | 398,609                    | (285,302)           | (57,649)                                 | 104,540  |
| Sale of Company's shares held by subsidiary *) | -             | (12,318)                   | -                   | 30,265                                   | 17,947   |
| Loss   | -             | -                          | (19,675)            | -  | (19,675) |
| Balance at the end of the period               | 48,882        | 386,291                    | (304,977)           | (27,384)                                 | 102,812  |

## Year ended December 31, 2003 (audited)

|   | Share capital | Additional paid-in capital | Accumulated deficit | Less - Company shares held by subsidiary | Total   |
|---|---------------|----------------------------|---------------------|--|---------|
| Adjusted NIS in thousands (2)               |               |                            |                     |  |         |
| Balance at the beginning of the year        | 48,882        | 401,329                    | (238,222)           | (64,917)                                 | 147,072 |
| Sale of Company's shares held by subsidiary | -             | (25,791)                   | -                   | 64,917                                   | 39,126  |
| Loss  | -             | -                          | (5,450)             | -  | (5,450) |
| Balance at the end of the year              | 48,882        | 375,538                    | (243,672)           | -  | 180,748 |

(1) See Note 2.

(2) Adjusted to the NIS of December 2003.

\*) Reclassified

The accompanying notes are an integral part of the interim consolidated financial statements.



## CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | Nine months ended<br>September 30, |                         | Three months ended<br>September 30, |                         | Year ended<br>December 31, |
|---|------------------------------------|-------------------------|-------------------------------------|-------------------------|----------------------------|
|   | 2004                               | 2003                    | 2004                                | 2003                    | 2003                       |
|   | Unaudited                          |                         |                                     |                         | Audited                    |
|   | NIS in thousands                   |                         |                                     |                         |                            |
|   | Reported <sup>(1)</sup>            | Adjusted <sup>(2)</sup> | Reported <sup>(1)</sup>             | Adjusted <sup>(2)</sup> | Adjusted <sup>(2)</sup>    |
| <u>Cash flows from operating activities:</u>  |                                    |                         |                                     |                         |                            |
| Loss  | (76,397)                           | (66,755)                | (41,151)                            | (19,675)                | (5,450)                    |
| Adjustments to reconcile loss to net cash provided by operating activities (a)  | 174,941                            | 123,847                 | 82,621                              | 41,333                  | *) 101,604                 |
| Net cash provided by operating activities   | 98,544                             | 57,092                  | 41,470                              | 21,658                  | 96,154                     |
| <u>Cash flows from investing activities:</u>  |                                    |                         |                                     |                         |                            |
| Investment in limited partnerships<br>Jointly controlled entity,<br>proportionally consolidated for the<br>first time (b) | (58)                               | -                       | (29)                                | -                       | -                          |
| Purchase of fixed assets  | (68,541)                           | (39,273)                | (31,726)                            | (7,358)                 | 1,980                      |
| Repayment of long-term loans<br>granted to affiliate  | -                                  | 292                     | -                                   | 155                     | 292                        |
| Proceeds from sale of<br>investments in affiliate   | -                                  | -                       | -                                   | -                       | 114,440                    |
| Proceeds from sale of fixed assets  | 983                                | 224                     | 449                                 | 59                      | 1,700                      |
| Long-term loan granted for purchase of<br>fixed assets  | -                                  | -                       | -                                   | -                       | (1,394)                    |
| Proceeds of long-term loans granted for<br>purchase of fixed assets   | 278                                | -                       | -                                   | -                       | -                          |
| Investment in partnership   | (6,076)                            | -                       | (4,482)                             | -                       | -                          |
| Net cash provided by (used in) investing<br>activities  | (73,414)                           | (38,757)                | (35,788)                            | (7,144)                 | 60,376                     |
| <u>Cash flows from financing activities:</u>  |                                    |                         |                                     |                         |                            |
| Exercise of stock options by employees  | 17                                 | -                       | -                                   | -                       | -                          |
| Sale of Company's shares<br>held by subsidiary  | -                                  | 22,495                  | -                                   | 17,947                  | 39,126                     |
| Receipt of long-term loans from banks<br>and others   | 3,662                              | -                       | 2,662                               | -                       | 31,676                     |
| Repayment of long-term loans to banks<br>and others   | (28,053)                           | (56,562)                | (5,609)                             | (5,658)                 | (73,522)                   |
| Redemption of debentures  | (34,107)                           | (33,802)                | (34,107)                            | (33,802)                | *) (33,802)                |
| Short-term bank credit, net   | 5,680                              | 48,459                  | 12,519                              | 12,817                  | (89,664)                   |
| Net cash used in financing activities   | (52,801)                           | (19,410)                | (24,535)                            | (8,696)                 | (126,186)                  |

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|  | Nine months ended<br>September 30, |         | Three months ended<br>September 30, |       | Year ended<br>December 31, |
|--|------------------------------------|---------|-------------------------------------|-------|----------------------------|
|  |                                    |         |                                     |       |                            |
| Increase (decrease) in cash and cash equivalents | (27,671)                           | (1,075) | (18,853)                            | 5,818 | 30,344                     |
| Cash and cash equivalents at beginning of period | 37,948                             | 7,604   | 29,130                              | 711   | 7,604                      |
| Cash and cash equivalents at end of period       | 10,277                             | 6,529   | 10,277                              | 6,529 | 37,948                     |

(1) See Note 2.

(2) Adjusted to the NIS of December 2003.

\*) Reclassified.

The accompanying notes are an integral part of the interim consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

|  | Nine months ended<br>September 30, |                         | Three months ended<br>September 30, |                         | Year ended<br>December 31, |
|--|------------------------------------|-------------------------|-------------------------------------|-------------------------|----------------------------|
|  | 2004                               | 2003                    | 2004                                | 2003                    | 2003                       |
|  | Unaudited                          |                         |                                     |                         | Audited                    |
|  | NIS in thousands                   |                         |                                     |                         |                            |
|  | Reported <sup>(1)</sup>            | Adjusted <sup>(2)</sup> | Reported <sup>(1)</sup>             | Adjusted <sup>(2)</sup> | Adjusted <sup>(2)</sup>    |
| (a) <u>Adjustments to reconcile loss to net cash provided by operating activities:</u>             |                                    |                         |                                     |                         |                            |
| Income and expenses not involving cash flows:  |                                    |                         |                                     |                         |                            |
| Write-off investment in another company  | 16,241                             | -                       | -                                   | -                       | -                          |
| Equity in earnings of affiliates and a partnership, net  | (16,146)                           | (15,799)                | (6,826)                             | (4,605)                 | (40,907)                   |
| Depreciation and amortization  | 110,757                            | 123,514                 | 36,653                              | 40,693                  | 171,820                    |
| Deferred taxes, net  | 5,163                              | -                       | 2,102                               | -                       | (15,630)                   |
| Severance pay, net   | 102                                | 1,325                   | (68)                                | 242                     | 1,685                      |
| Earnings from sale of shares of affiliates   | -                                  | -                       | -                                   | -                       | (96,662)                   |
| Loss (gain) from sale of fixed assets  | (349)                              | (46)                    | (155)                               | (8)                     | 1,428                      |
| Linkage differences on principal of debentures   | 1,550                              | 644                     | 119                                 | (8)                     | *) 456                     |
| Linkage differences on principal of long-term loans from banks, other and accounts receivable, net | 1,682                              | (2,595)                 | 24                                  | 984                     | (3,647)                    |
|  | <u>119,000</u>                     | <u>107,043</u>          | <u>31,849</u>                       | <u>37,298</u>           | <u>18,543</u>              |
| Changes in operating asset and liability items:  |                                    |                         |                                     |                         |                            |
| Decrease (increase) in rights to broadcast movies and programs                                     | 4,933                              | -                       | (4,088)                             | -                       | -                          |
| Decrease (increase) in trade receivables   | 1,386                              | 3,215                   | (643)                               | 3,561                   | 9,718                      |
| Decrease (increase) in other accounts receivable   | 4,791                              | 2,665                   | 268                                 | (1,615)                 | (29)                       |
| Increase (decrease) in trade trade payables  | 6,710                              | (13,909)                | 17,075                              | 5,628                   | (1,832)                    |
| Increase (decrease) in jointly controlled entity - current account                                 | (2,416)                            | 14,957                  | 4,281                               | 4,625                   | 15,008                     |
| Increase (decrease) in other accounts payable  | 44,487                             | 7,665                   | 35,683                              | (6,844)                 | 59,330                     |
| Increase (decrease) in customer deposits for converters, net                                       | (3,950)                            | 2,211                   | (1,804)                             | (1,320)                 | 866                        |
|  | <u>55,941</u>                      | <u>16,804</u>           | <u>50,772</u>                       | <u>4,035</u>            | <u>83,061</u>              |



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| Nine months ended<br>September 30, |         | Three months ended<br>September 30, |        | Year ended<br>December 31, |
|------------------------------------|---------|-------------------------------------|--------|----------------------------|
| 174,941                            | 123,847 | 82,621                              | 41,333 | 101,604                    |

(1) See Note 2.

(2) Adjusted to the NIS of December 2003.

\*) Reclassified.

The accompanying notes are an integral part of the interim consolidated financial statements.

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## CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | Nine months ended<br>September 30, |                         | Three months ended<br>September 30, |                         | Year ended<br>December 31, |
|---|------------------------------------|-------------------------|-------------------------------------|-------------------------|----------------------------|
|   | 2004                               | 2003                    | 2004                                | 2003                    | 2003                       |
|   | Unaudited                          |                         |                                     |                         | Audited                    |
|   | NIS in thousands                   |                         |                                     |                         |                            |
|   | Reported <sup>(1)</sup>            | Adjusted <sup>(2)</sup> | Reported <sup>(1)</sup>             | Adjusted <sup>(2)</sup> | Adjusted <sup>(2)</sup>    |
| (b) <u>Jointly controlled entity, proportionally consolidated for the first time:</u> |                                    |                         |                                     |                         |                            |
| Net working capital (except for cash and cash equivalents)                            | -                                  | -                       | -                                   | -                       | 38,745                     |
| Fixed assets, net   | -                                  | -                       | -                                   | -                       | (1,142)                    |
| Investment in limited partnerships  | -                                  | -                       | -                                   | -                       | (2,057)                    |
| Rights to broadcast movies and programs   | -                                  | -                       | -                                   | -                       | (34,927)                   |
| Long-term liabilities   | -                                  | -                       | -                                   | -                       | 737                        |
| Investment in affiliate   | -                                  | -                       | -                                   | -                       | 624                        |
|   | -                                  | -                       | -                                   | -                       | 1,980                      |
| (c) <u>Significant non-cash activities:</u>   |                                    |                         |                                     |                         |                            |
| Purchase of fixed assets against loans from suppliers                                 | 11,793                             | 16,482                  | 11,793                              | 16,482                  | 35,512                     |

(1) See Note 2.

(2) Adjusted to the NIS of December 2003.

The accompanying notes are an integral part of the interim consolidated financial statements.

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 1:- GENERAL**

These financial statements have been prepared in a condensed format as of September 30, 2004, and for the nine months and three months then ended ( interim financial statements ). These financial statements should be read in conjunction with the Company's audited annual financial statements and accompanying notes as of December 31, 2003 and for the year then ended.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES**

- a. The interim financial statements have been prepared in accordance with generally accepted accounting principles for the preparation of financial statements for interim periods, as prescribed in Accounting Standard No. 14 of the Israel Accounting Standards Board.

The significant accounting policies and methods of computation followed in the preparation of the interim financial statements are identical to those followed in the preparation of the latest annual financial statements, except as described below.

- b. Discontinuance of the adjustment of financial statements for the effects of inflation and financial reporting in reported amounts:

In 2001, the Israel Accounting Standards Board published Accounting Standard No. 12 with respect to the discontinuance of the adjustment of financial statements ( Standard No. 12 ). According to this Standard (as amended by Accounting Standard No. 17), the adjustment of financial statements for the effects of inflation should be discontinued beginning January 1, 2004. The Company applied the provisions of the Standard, and accordingly, the adjustment for the effects of inflation was discontinued as from January 1, 2004.

1. Starting point for the preparation of financial statements:

- a) In the past, the Company prepared its financial statements on the basis of the historical cost convention, adjusted for the changes in the general purchasing power of the Israeli currency based on the changes in the Israeli Consumer Price Index ( Israeli CPI ). These adjusted amounts, as included in the financial statements as of December 31, 2003 (the transition date), served as a starting point for nominal financial reporting beginning January 1, 2004. Additions made after the transition date are included at nominal values.
- b) The amounts for non-monetary assets do not necessarily represent realizable value or current economic value, but only the reported amounts for those assets.
- c) In the financial statements cost represents cost in the reported amount (see 2 below).
- d) All comparative data for previous periods are presented after adjustment for the Israeli CPI as of the transition date (the Israeli CPI for December 2003).

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (cont.)**

## 2. Financial statements in reported amounts:

## a) Definitions:

*Adjusted amount* historical nominal amount adjusted for the Israeli CPI as of December 2003, according to the provisions of Opinions No. 23 and No. 36 of the Institute of Certified Public Accountants in Israel.

*Reported amount* adjusted amount as of the transition date, plus additions in nominal values after the transition date and less amounts deducted after the transition date. The amounts deducted after the transition date are in historical nominal values, adjusted amounts as of the transition date or in a combination of historical nominal values and adjusted amounts as of the transition date, according to the relevant situation.

## b) Balance sheet:

- 1) Non-monetary items are presented in reported amounts.
- 2) Monetary items are presented in nominal values as of the balance sheet date.
- 3) The carrying value of investments in investees is determined based on the financial statements of these companies in reported amounts.

## c) Statement of operations:

- 1) Income and expenses relating to non-monetary items are derived from the change in the reported amount between the opening balance and the closing balance.
- 2) Other items in the statement of operations are presented in nominal values.
- 3) Equity in the results of operations of investees is determined based on the financial statements of these companies in reported amounts.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (cont.)

3. Following are data regarding the Israeli CPI and the exchange rate of the U.S. dollar:

| As of                         | Israeli CPI | Exchange rate of<br>one U.S. dollar |
|-------------------------------|-------------|-------------------------------------|
|                               | Points *)   | NIS                                 |
| September 30, 2004            | 107.4       | 4.482                               |
| September 30, 2003            | 106.6       | 4.441                               |
| December 31, 2003             | 106.2       | 4.379                               |
| Change during the period      | %           | %                                   |
| September 2004 (nine months)  | 1.2         | 2.4                                 |
| September 2004 (three months) | (0.2)       | (0.3)                               |
| September 2003 (nine months)  | (1.5)       | (6.2)                               |
| September 2003 (three months) | (1.0)       | 3.0                                 |
| December 2003 (12 months)     | (1.9)       | (7.6)                               |

\*) The index on an average basis of 2000 = 100.

c. The financial statements of an investee under joint control, Hot Vision Ltd. ( Hot Vision ), were consolidated by the proportionate consolidation method effective December 31, 2003.

## NOTE 3:- EFFECT OF NEW ACCOUNTING STANDARD BEFORE IMPLEMENTATION

In July 2004, Accounting Standard No. 19 Taxes on Income ( the Standard ) was approved by the Israel Accounting Standards Board. The Standard prescribes the principles for recognition, measurement, presentation and disclosure of taxes on income in the financial statements.

The principal changes pursuant to the Standard in relation to the principles presently applied are the recognition of deferred taxes in respect of temporary differences arising when the currency used for financial reporting purposes is different from the currency used for tax purposes, and the recognition of deferred taxes in respect of temporary differences relating to land.

The Standard is effective in respect of financial statements relating to periods beginning on or after January 1, 2005. Changes resulting from adoption of the Standard should be recorded by including the cumulative effect in the statement of operations as of the beginning of the period in which the Standard is adopted.

The Company estimated that, the effect of the new Standard on the financial position operating results and cash flows of the Company is not expected to be material.

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE4:- COOPERATION AMONG THE CABLE COMPANIES AND CONDUCTING NEGOTIATIONS FOR THE ACQUISITION OF THE CABLE OPERATIONS AND ASSETS OF TEVEL ISRAEL INTERNATIONAL COMMUNICATIONS LTD. ( TEVEL )***Cooperation among the cable companies:*

In 2001, the cable companies filed applications for merger, among them, to various regulators. In March 2002, an approval was received from the Council for Cable and Satellite Broadcasting (hereinafter the Council) for the merger of the cable companies operations and it was amended in February 2003.

In April 2002, the approval for the proposed merger was received from the Controller of Restrictive Business Practices ( the Controller). In April, June, November and December 2003, the Controller extended the validity of his approval to the merger until the earlier of December 15, 2004 or the consummation of the merger.

The Controller's conditions to the merger include, inter alia, conditions concerning: (1) separation between the cable infrastructure and the broadcasting activity of the merged companies; (2) allowing access to and use of cable broadcasting infrastructure to owners of licenses to operate CATV systems; (3) the ownership structures of the merged companies; (4) restrictions as to the purchase of content and interest in the channels; (5) provisions concerning non prevention of competitive infrastructures development; (6) restrictions on parties that are related to the merged companies, including in connection with acting as officers in the merged company and the transfer of business information; (7) the commitment to supply fixed telephone services to the public in Israel over the cable infrastructure on time and scope not below that was determined in the approval of the Controller to the merger. (8) the provision of a bank guarantee (by all the Cable companies) in the amount of 15 million dollars in an unqualified wording that will satisfy the Controller as collateral for the fulfillment of the Controller's conditions.

According to the Controller's conditions to the merger as extended, most of which already apply in light of the mutual cooperation between the companies, it was determined, inter alia, that the merged infrastructure company ( infrastructure company ) of the cable companies has to commercially supply telephony services over cable infrastructure that compete with those of Bezeq to the public in Israel no later than by November 20, 2004.

The investment in telephony will be in an amount not less than NIS 350 million to be completed in stages as follows: until June 30, 2004 the infrastructure company will invest an amount not less than NIS 105 million; until June 30, 2005 the infrastructure company will make an additional investment of not less than NIS 140 million; until June 30, 2006 the infrastructure company will invest an amount not less than NIS 105 million and any other amount as far as it will be required in order to implement the business plan for the provision of telephony services which fully compete with the telephony services of Bezeq. Also, the Controller fixed a minimum quantity for the years 2005 - 2007 relative to the number of telephony subscribers of the infrastructure company.

Hot Telecom Limited Partnership ( the partnership ) was established by the cable companies in Israel in November 2003 in order to establish and to operate internal communication services over the cable infrastructure.

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE4:- COOPERATION AMONG THE CABLE COMPANIES AND CONDUCTING NEGOTIATIONS FOR THE ACQUISITION OF THE CABLE OPERATIONS AND ASSETS OF TEVEL ISRAEL INTERNATIONAL COMMUNICATIONS LTD. ( TEVEL ) (cont.)**

On November 25, 2003, the Ministry of Communications granted to the partnership an internal operator license to provide fixed internal Bezeq services including telephony services, access services to Internet suppliers, infrastructure services to distribute cable television services, data communications and digital transmission. The internal operator license granted for a period of 20 years, and the Minister of Communication is entitled to extend the license for additional periods of 10 years each.

The partnership will serve as the infrastructure company of the cable companies therefore it is required to comply with conditions that were determined by the Controller as detailed above.

From the date of the approval of the Controller to the merger (April 2002) and thereafter, the cable companies cooperate in most of their areas of activity and from 2003 the activity is carried out under the brand name HOT.

On November 19, 2003, the cable companies, including the Company, filed a request to the Controller for an exemption from the requirement to receive an approval of a Restrictive Arrangement as such term is defined under Section 14 of the Restrictive Business Practice Law, commencing November 16, 2003 and until the earlier of the consummation of merger procedures between the cable companies, or November 15, 2004.

The said request for an exemption was filed in connection with the above ongoing cooperation among the cable companies, inter alia, in the field of multi-channel cable broadcasting, including in the field of marketing, production and purchase of content and channels, and for the establishment and provision of fixed telecommunication services, including a service of access to high speed internet over cables and fixed telephony services.,

On December 17, 2003, the Controller granted the cable companies, including the Company, an exemption for a period of one year from approving of a Restrictive Arrangement in connection with said cooperation. The grant of the exemption is subject to the conditions as detailed in the Controller's approval to the merger dated April 2002, and subject to other conditions, including inter alia, that the cable companies will not take any irreversible step which shall prevent independent and separate action from any of them if the merger is not consummated and that, until December 15, 2004, the cable companies will not perform any cooperation that is irreversible.

According to the position of the Supervisor of the Banks at the Bank of Israel, the merger of the cable companies and the formation of a merged cable entity constitutes a deviation from the directives of the Bank of Israel and of Proper Bank Management Directives of the Supervisor of the Banks, regarding inter alia, the restriction on Group of Borrowers, as such term is defined in the Proper Bank Management Directives. The above position of the Supervisor has an impact as to the issue of giving loans by banking corporations and as to the issue of allocation of the merged company debts, inter alia, to the big shareholder (directly and indirectly) of the Company.

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 4:- COOPERATION AMONG THE CABLE COMPANIES AND CONDUCTING NEGOTIATIONS FOR THE ACQUISITION OF THE CABLE OPERATIONS AND ASSETS OF TEVEL ISRAEL INTERNATIONAL COMMUNICATIONS LTD. ( TEVEL ) (cont.)**

Based on the aforesaid, and due to the difficulties arising from the position of the Supervisor of the Banks and the provisions of Proper Bank Management Directives there is no certainty whether the merger will be actually completed and if it will be completed when it will actually occur and what will be its structure. The Company's management is examining any and all alternatives in order to continue to preserve the existing cooperation between the cable companies, including the examination of possible acquisition of Tevel's subscribers and assets in the multi channel television and access to high speed internet as detailed below.

In addition, the cable companies have preliminary discussion with MIRS, Israel's fourth wireless operator, concerning the possibility of investment by the Israeli cable television operators in MIRS.

In order to strengthen the cooperation of the three Israeli cable television operators, The Company, Tevel group and Golden Channels group agreed in June 2004 to perform an operational merger. To this effect, a joint management was recently appointed to oversee the operational merger of the marketing, sales, engineering, customer service, operations and information systems activities of the three cable companies. The Company's activity in areas of multi channel television services and internal operator services will be subject to decisions taken by the joint management of the merged operations.

Negotiations for the acquisition of the cable operations and assets of Tevel group International Communications Ltd. (Tevel):

According to immediate reports of the Company from November 11, 2004 and November 23, 2004 the Company announced that it has concluded preliminary discussions regarding the acquisition by the Company of the assets of Tevel. It is currently contemplated that as part of the transaction, Tevel will be allotted shares representing approximately 26% of the Company's share capital, thereby diluting the shareholdings of all other company shareholders. In addition, following the transaction, the Company will assume certain of Tevel's debts. The transaction is based on a valuation which assumes a per subscriber value of \$1,500 for each of the subscribers of both the Company and Tevel an agreed upon value for the Company's shares in Partner, and financial obligations of the merged company of approximately \$535 million.

It is contemplated that the Company will be granted, for no additional consideration an option to acquire Tevel's shares in the Company. The parties have not yet reached an understanding on the term and exercise price of such option. In addition, it is contemplated that Tevel will not sell its 35% stake in Golden Channels to the Company, as part of the transaction. Rather, the company and Tevel will grant each other five year call/put options regarding such interest for an agreed upon price, which will be based on a formula that also assumes a \$1,500 per subscriber value, minus the relevant financial obligations.

Simultaneously with the termination of the transaction, assuming it will, the Company will enter into new financing agreements with the banks, regarding the debt of the merged company as well as the future financing of its operations.

The parties have not signed any of the transaction documents, and the transaction is subject to the conclusion of the negotiations, the execution of the transaction documents, due diligence examination and regulatory and other approvals.



**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 5:- COMMITMENTS, CONTINGENT LIABILITIES AND GUARANTEES**

## a. Contingent and liabilities:

## 1. Claims and petitions for approval of class actions:

- a) On April 22, 1999, a lawsuit and motion to approve the claim as a class action were filed against the Company with the Tel-Aviv-Jaffa District Court pursuant to Article 46a of the Restrictive Business Practices Law, 1988 by a subscriber of the Company who seeks approval as class action, thereby representing all of the members of the class allegedly included in such action.

In the claim, it is alleged that the Company constitutes a monopoly, and that it adversely exploits its position in the market, in a manner which is, or may be, damaging to the general public, inter alia, by setting and collecting unreasonable and unfair prices for the services it provides.

If the class action is approved, the court will be requested to require the Company to reduce the subscriber fees that it collects and to pay its subscribers compensation in connection with the subscriber fees collected from May 10, 1996 to April 1, 1999. In this context, the petitioner claims that he has sustained damages in a sum of reported NIS 1,387 and further claims that the sum of compensation due to all of the members of the class included in the class action, if approved, amounts to reported NIS 360 million. In addition, the subscriber is also claiming compensation with respect to the damages caused to all of the members included in the class action, if approved, from the date of filing the lawsuit to the date judgment is rendered. In addition, the petitioner is claiming for a mandatory injunction according to which the Company will be obliged to reduce the service fee, which it charges from its subscribers.

The Company filed an objection to the motion to approve the claim as a class action inter alia, on the grounds that the claim and the motion lack any merits, because of the fact that the petitioner has disregarded the high investments made in infrastructure and equipment, because of the fact that the franchise granted to the Company for CATV broadcasts, is limited in time, because of the fact that the comparisons made by the plaintiff between the Company and foreign companies dealing in CATV broadcasts in countries where the situation is very different, are not relevant to the Company's modus operandi, and because of the fact that the subscriber fees are subject to supervision and are highly regulated.

At the beginning of the hearing on the request, it was stated that the clarification of the request will be joined with similar requests that were filed against the cable companies Tevel, Golden Channels and Idan (however, in the meantime, this condition changed, see below).

After the unification of proceedings and pursuant to the arrangement reached by the parties and which was validated as a court decision, it was agreed that the Court will preliminarily decide with respect to the legal threshold claims that were raised by the Company (and other cable companies).

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 5:- COMMITMENTS, CONTINGENT LIABILITIES AND GUARANTEES**

On August 21, 2003, the Court rendered its decision to reject the arguments of the Company (and of the other cable companies) and determined that the expenses with respect to the proceedings will be taken into account at the end of the proceedings.

In that decision the Court has determined, among other things, that the immunity stated in article 6 to Torts Ordinance is not granted to the cable companies and that the decision of the Restrictive Trade Practices Court that was granted in the past does not constitute a binding precedent or Court's ruling toward the plaintiffs in said procedure. Nevertheless, according to a procedural settlement reached by the parties, the Court will have to rule on other issues and parties arguments which were detailed in the request to approve the claim as a class action and the responses of the cable companies in that issue.

In a pre-trial hearing held on November 26, 2003, it was determined that the hearing of the proceedings against the various cable companies will be separated and that the first to be heard is the request to approve a class action which was filed against the Company. As agreed upon by the parties and validated in the court ruling, the Company is permitted to present complementary opinion and affidavits and that the plaintiff may present counter opinion and affidavits. On June 24, 2004, the Company filed complementary opinion and affidavits. The plaintiff has to file counter opinion and declarations until the end of December 2004.

The Company's request to strike certain parts of the petitioner's affidavits was dismissed. On July 11, 2004, the petitioner submitted requests to strike certain parts of the affidavit of the Chief Executive Officer of the Company (CEO) and of an opinion submitted in respect of the Company. Following the petitioner's motion, the court ordered to remove the opinion and strike several sections from the Chief Executive Officer's affidavit. Hearing was scheduled to February 7, 2005.

According to the opinion of the Company's management, based on the opinion of its legal counsels, since the claim and the motion to approve it as a class action, and the Company's response to the claim and the motion, raise complex, factual and legal questions that have not yet been resolved in Israeli case law, and for which there are no precedents that are based on similar facts, it is not possible to estimate the chances of the claim. Therefore, no provision was recorded in respect to the aforesaid claim in the Company's financial statements.

- b) On August 28, 2002, a motion was filed to approve the filing of a class action against the cable companies on behalf of the residents of peripheral settlements. The claim is for indemnification in respect to these settlements not being connected to the cable networks with the elapse of six years from the date on which the franchises were granted (the Request to Approve the Claim as a Class Action). The compensation requested from the Company amounts to about NIS 139 million, upon filling the claim.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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**NOTE 5:- COMMITMENTS, CONTINGENT LIABILITIES AND GUARANTEES (cont.)**

In view of a rejection of a lawsuit identical in substance to this claim, the Company and Golden Channels have presented a request to dismiss the claim without prejudice. The petitioners presented a reply to the request to dismiss the claim without prejudice and the Company and Golden Channels presented their reply to the petitioners reply. In addition, the Company and Golden Channels presented a reply to the Request to Approve the Claim as a Class Action. The petitioners request to join the hearing as creditors of Tevel's creditors composition was dismissed by the court. No date was scheduled for a hearing.

According to the opinion of the Company's management, based on the opinion of its legal counsels, at present, it is not possible to estimate the chances of the request and, therefore, no provision was recorded in respect to the aforesaid claim in the Company's financial statements.

- c) On December 3, 2002 a claim was filed by seven Israeli residents, who requested recognition of their action as representing 1,050,000 subscribers of the cable companies. According to the claim, the cable companies violated the terms of the approval given to them by the Council for the transmission of the pay sport channel, since they did not maintain certain programs in the original sport channel which is part of the basic package offered to subscribers. The plaintiffs requested the Court to instruct all three cable companies to compensate the subscribers by a total sum of NIS 302 million as of the date of the motion and by an additional sum of NIS 25 million for each month from the date the claim was filed up to the date judgment is rendered by the Court. The Company's proportionate share based on to the subscribers ratio as of the balance sheet date, is NIS 80 million, in addition to a monthly amount of NIS 6.7 million accumulating from the date the claim was filed until a ruling is rendered (the Original Lawsuit).

On May 27, 2004, the Court denied the request for approval of class action without an order for expenses.

On July 5, 2004, the petitioners submitted an appeal to the Supreme Court, and the appeal was scheduled for summations

According to the opinion of the Company's management, based on the opinion of its legal counsels, who believe that, at present, it is not possible to estimate the chances of the appeal and, therefore, no provision was recorded in respect to the aforesaid claim in the Company's financial statements. The amount of the Original Lawsuit was calculated by the plaintiff based on the number of subscriber of each of the cable companies at the filing data of the claim.

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 5:- COMMITMENTS, CONTINGENT LIABILITIES AND GUARANTEES (cont.)**

- d) On June 29, 2003, a request to approve a class action was filed against the Company. The amount of the claim, as estimated by the petitioners, is approximately NIS 100 million, as of the date of the request. The claim consists of two causes of action. The first cause of action is not granting penetration discount as opposed to the directives of the franchise. The petitioners argue that the discount requested is by virtue of the terms of the franchise which determine that it is mandatory to grant a penetration discount at the rate of 10% of the price determined in ICP arrangement whereas, in practice, the Company granted its customers a penetration discount of 10% of the price set in the franchise.

The second cause of action is with respect of a limitation, which the Restrictive Trade Practices Court imposed on the increase of subscriber fees, where it prohibited the cable companies, including the Company, to increase, in real terms, the subscriber fees in excess of 1.9% per year ( the Ruling ).

The petitioners contend that the cable companies increased the subscriber fees a day after the Ruling was rendered and calculated the annual increase rate 1.9% from a starting price that was higher than the price that was determined as a starting price by the Restrictive Trade Practices Court.

On February 23, 2004, the Company submitted its response to this petition, whereby with respect to the first allegation of the petitioners, the Company clarified in its response that the clear and defined objective of the increase of the subscriber fees that was determined by the Restrictive Trade Practices Court was not a determination of new subscriber fees, as defined in the franchise.

The Company claimed that the Restrictive Trade Practices Court determined a ceiling for the increase only to prevent the cable companies from rolling over to the public the arrangement fee they were required to pay, by an immediate increase of the subscriber fees up to the ceiling. In addition, whereas the Company already granted a penetration discount of 10% in regions, which are the object of the claim prior to rendering the Ruling, the petitioners allegation implies that it was to grant a double discount than the one intended by the Minister of Communications, and such a conclusion is unreasonable and is not consistent with the provisions of the Ruling.

As to the second allegation of the petitioners, the Company responded that an increase of the subscriber fees a day after the Ruling was rendered, was only a result of linking the subscriber fees to the CPI, pursuant to the provisions of the franchise and the Bezeq Regulations (Franchises) 1987, and such an increase was permitted in ICP arrangement and pursuant to the Ruling.

Following a Court hearing, the claim was struck against payment of the plaintiffs expenses in an immaterial amount.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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**NOTE 5:- COMMITMENTS, CONTINGENT LIABILITIES AND GUARANTEES (cont.)**

## 2. Other claims:

- a) On December 31, 2003, Eshkolot the Israeli Artists Society for Performers Rights Limited ( Eshkolot ) filed a claim with the Tel Aviv Jaffa Court against the cable companies, including the Company, alleging non-payment of cash seeking a permanent injunction as well as a preliminary injunction and to give instructions to Tevel s trustee.

Eshkolot argues that since January 1, 2003, the cable companies broadcast programs which use the performers rights of the Israeli artists which are held by Eshkolot without Eshkolot s permission or consent and without paying any royalties whatsoever for this alleged use.

In the context of the claim, the Court was requested to instruct and affirm that Eshkolot is entitled to receive a such use payment of NIS 8,500 thousand as compensation for 2003 royalties (net of payments already transferred to Eshkolot) and that, from now on, in each year the cable companies will have to pay this amount including linkage differences and to update such royalties relative to the number of broadcasting minutes of protected performances increase. Additionally, Eshkolot requested to obligate the cable companies to pay the maximum statutory compensation, as set in the Copy Rights Law, in the total amount of NIS 24,320 thousand. Eshkolot also requested a permanent injunction order against the cable companies that will disallow to broadcast protected performances employing performers rights held by Eshkolot, unless an explicit authorization from Eshkolot was given.

Further, the Court was requested by Eshkolot to give a preliminary injunction which prohibits the cable companies to broadcast performances, employing performers rights held by Eshkolot, if an advance explicit and written authorization from Eshkolot does not exist, until the hearing and the decision in Eshkolot primary claim for compensation for violating performers rights and in the request of the permanent order against the cable companies.

On or about the filing of the lawsuit, the parties commenced negotiations in order to forward the case to arbitration. An arbitration agreement was entered into on May 2, 2004. Accordingly, On May 11, 2004, Eshkolot, on the consent of the parties, filed a motion to strike the proceedings in court in order to forward them to arbitration. On May 13, 2004, the Court approved the parties announcement on a settlement agreement pursuant to which the case shall be forwarded to arbitration proceeding and instructed to strike the lawsuit with no order for expenses. In addition, in context of the arbitration agreement, the parties agreed to strike the appeals that were filed by Eshkolot to the Restrictive Trade Practices Court, as detailed in the annual financial statements as of December 31, 2003, included in Notes 1(4)(b) and 15(b)(2)(d). On May 18, 2004 the Court ordered to strike the appeals with no order for expenses.

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 5:- COMMITMENTS, CONTINGENT LIABILITIES AND GUARANTEES (cont.)**

On June 2, 2004, a preliminary arbitration meeting was held in the framework of which the dates of submission of the letters of indictment was agreed. Accordingly, the letter of indictment in the arbitration in respect of Eshkolot was submitted as of June 25, 2004.

The amount of the claim, which significantly exceeds the amounts that were paid previously to Eshkolot by the cable companies under an agreement that was valid until 2002, is NIS 8.5 million for 2003 and a similar amount plus 10% for each of the years 2004-2006. Eshkolot argues that this is the appropriate royalty as implied in the Performers and Broadcasters Rights Law 1984, which is to be paid each year.

The statement of defense on behalf of the cable companies was filed on August 3, 2004. In the statement of defense, the cable companies refute Eshkolot's arguments, inter alia, concerning the scope of the use of its works and claim that in view of the various developments in the communications market in Israel, and particularly in view of entering of competitors to the market as Yes the royalty amount paid to Eshkolot should be decreased. It is further argued that Eshkolot is devoid of rights in certain musical works, in respect of which it made its claim, since the performing artists exclusively assigned their rights to production companies. The Company also claims that Eshkolot misused its monopolistic powers in the market, in order to impose unreasonable prices on its consumers.

On October 31, 2004, Eshkolot filed its direct testimonial affidavits. The cable companies are supposed to file their affidavits during January 2005.

According to the opinion of Company's management, based on the opinion of its legal counsel in view of the early stages of the proceeding, at this time, the prospects of the arbitration proceedings cannot be estimated. Nevertheless, the Company's management included in the financial statements a provision, which in its opinion, reflects adequately the Company's exposure in respect of this claim.

- b) On March 28, 2000, a claim was filed in the Tel-Aviv-Jaffa District Court against the cable companies, including the Company, by the Association for the International Collective Management of Audiovisual Works AGICOA, an international association of producers of cinema and television works.

The aggregate sum of the claim is not less than approximately \$ 170.2 million and for the purpose of court fees was limited to a sum of \$ 20 million.

AGICOA is an organization that represents numerous producers in a claim against the cable companies for the alleged breach of copyrights of the represented producers due to the re-transmission of programs by the cable television operators. AGICOA is also claiming unjust enrichment on the part of the cable television operators and that they be ordered to submit their accounts.

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 5:- COMMITMENTS, CONTINGENT LIABILITIES AND GUARANTEES (cont.)**

In the opinion of the Companies' s management, as was expressed in the statement of defense filed with the court on July 9, 2000, the claimant has no right to file a claim in Israel, which is in light of the restrictive Business Practices laws in Israel. In addition, the period of time on which the claim relies exceeds, at least partially, what is prescribed by law, due to the fact that the claimant did not properly prove the legitimacy of its rights claimed in the works and that the amount of the claim appears to apparently be groundless and exaggerated.

The dispute was transferred by the Court to mediation in the second quarter of 2001. The mediation was not successful and the matter was returned to the Court.

At a preliminary hearing held on June 18, 2002, the Court ruled to delay its decision in this matter pending resolution of the Israeli Supreme Court in a further hearing in another matter, the Tele Event case, which the Court believes will have material implication on all or part of this dispute.

On November 26, 2003, another preliminary hearing was held in which it was agreed that the date for completion of preliminary proceedings would be postponed until after the delivery of the judgment of the Supreme Court in the Tele Event case mentioned above. Since on June 16, 2004 the Supreme Court rendered the ruling of the Tele-Event, the parties agreed to finalize the preliminary proceedings until March 1, 2005.

The further hearing referred to by the Court was filed with respect to the ruling of the Supreme Court (presiding as an appellate court), which determined that the re-transmission of broadcasts as secondary broadcasts may also constitute an infringement of copyrights, if such broadcasts include copyrights owned by third parties who have not consented to their broadcast in Israel.

In the opinion of the Company' s management, based on the opinion of its attorneys, since the judicial proceedings are in initial stages, it is difficult to estimate at this stage the chances for the claim and, therefore, a provision was not recorded in respect to the aforesaid claim in the Company' s financial statements. In addition, in the opinion of the Company' s management based on the opinion of its legal counsel and despite the ruling in the matter of Tele Event, the Company has additional solid and well founded defense arguments.

- c) In July – September 1999, Tevel and Golden Channels and Co. ( Golden Channels ) entered into license agreements with the major studios (Columbia, Fox and Warner Bros. Television Distribution (Warner) to purchase contents (The agreements). The contents were placed, among others, in channels 3 and 4 and are produced by Hot Vision for all cable companies, and for channels for pay – Cinema 1, 2, 3 and cinema prime, that are produced by Avdar Silver Industries Ltd. ( Avdar ) for all of the cable companies.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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**NOTE 5:- COMMITMENTS, CONTINGENT LIABILITIES AND GUARANTEES (cont.)**

Agreements were entered into by and between Tevel, Golden Channels and Hot Vision, according to which, broadcasting rights for the above contents, were provided to Hot Vision. In addition, agreements were entered into by Avdar and all of the cable companies, pursuant to which the broadcast rights for the above pay channels were placed with Avdar.

- (a) On November 27, 2002, Warner Bros. International Television Distribution ( Warner ) filed a lawsuit against Tevel in a court in California seeking, inter alia, a monetary compensation of \$ 17 million ( Warner lawsuit in California ), on the grounds that the agreement from July 13, 1999, pursuant to which, Tevel (through which all the cable companies) acquired from Warner the rights to broadcast films, was breached and consequently was rescinded by Warner.

Following Warner lawsuit in California and other actions taken by Warner, on December 5, 2002, the trustee for Tevel group filed with the District Court in Tel Aviv a motion to instruct, among others, that Warner should take any measure necessary to discontinue the lawsuit in California and this in view, among others, of the stay of proceedings order that was granted with respect to Tevel, which prohibits the institution of new proceedings against Tevel without the approval of the District Court in Tel Aviv) and based on the proof of debt submitted by Warner to the trustee under the same cause of action.

On February 10, 2003, the court rendered its ruling on the trustee s motion. Pursuant to the ruling, the court dismissed Warner s position and accepted the motion. The court, inter alia, ruled that Warner instituted unlawful proceeding in the United States and under circumstances substantiating doubts as to its good faith, and such a proceeding cannot be materialized or enforced in the boundaries of the state of Israel. On March 25, 2003, the trustee rendered it decision of Warner s proof of debt, in which the majority of the proof was rejected. On April 24, 2003, Warner appealed to the district court on the issue of proof of debt and following decisions rendered on the appeal, on June 24, 2003, Warner filed an amended appeal on the trustee s decision in the matter of the proof of debt.

On October 21, 2003, the Supreme Court rejected Warner s appeal on the court s ruling of February 10, 2003, subject to the rights of Warner and the trustee to argue on the issue of the applicable law on the proof of debt and this is in the context of Warner s appeal on the trustee s decision on the proof of debt and instructed Warner to file an amended appeal in order to include the argument that Warner s lawsuit should be litigated under California law.



NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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**NOTE 5:- COMMITMENTS, CONTINGENT LIABILITIES AND GUARANTEES(cont.)**

The amended appeal was filed, in the context of which, Warner seeks the reversal of the trustee's decision on the proof of debt (which proved the debt for Warner in the amount of \$ 182 thousand only) and proved Warner a debt in the aggregate of \$ 17 million and alternatively \$ 12 million. The trustee and the Official Receiver filed its response to the appeal. Warner filed its response to the trustee's response and the Official Receiver.

On September 1, 2004, the Tel Aviv district court rejected the amended appeal with respect to the proof of debt determining that the Warner's appeal contradicts to the law and its entire substance is nothing but an attempt to generate high profit in an unjust and extraordinary manner at the expense of the ordinary creditors of Tevel.

In view of the extraordinary circumstances and scope of litigation, the Court ruled that Warner shall pay Tevel expenses and legal fees.

On October 5, 2004, Warner filed an appeal with the Supreme Court. Simultaneously with the filing of the said appeal, Warner filed, on that very day a motion for stay of performance with respect to the ruling of September 1, 2004, with the district court and an urgent motion for hearing the said motion.

On October 5, 2004, a ruling in the matter of the urgent motion seeking a hearing, was rendered according to which, the facts referred to in the motion for stay of performance were not supported by an affidavit and it was further determined that the motion is inappropriate to be heard ex parte and the case shall be scheduled for hearing. In addition, the court, in its decision, instructed that the trustee shall consider the stay of performance proceeding and shall act accordingly.

In view of the above decision, on October 12, 2004, Warner filed a motion to file an affidavit in support of the motion for stay of performance.

On November 24, 2004, the trustee filed its reply to the motion for stay of performance.

Decisions were not yet rendered in motion for stay of performance and motion to file an affidavit and a hearing was not yet scheduled for the appeal.

In Tevel's opinion, based on the opinion of the managers and legal advisors of Tevel, the prospects of Warner's appeal on the ruling of the district court, are remote.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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**NOTE 5:- COMMITMENTS, CONTINGENT LIABILITIES AND GUARANTEES (cont.)**

- (b) On December 9, 2002, Warner filed a lawsuit against Golden Channels with the district court in Los Angeles, California in the U.S. The lawsuit is seeking, inter alia, a monetary compensation on the grounds of breach of contract with Golden Channels dated July 13, 1999 and a lawsuit for declaratory remedies, as detailed in the complaint. On January 17, 2003, an amended complaint was filed in context of which, Warner was seeking, inter alia, to compel Golden Channels to pay compensation of at least \$ 16 million in addition to expenses. In addition, among others, declaratory remedies and an injunction were requested. On February 14, 2003, Golden Channels filed its answer and a counterclaim. In the context of the lawsuit, the parties also filed motions for preliminary injunctions. A hearing for the preliminary injunctions was held in March 2003. The court rejected all of the motions for preliminary injunctions. The evidential hearing for the complaint and the counterclaim was held during January 2004 and in February 2004 the parties filed their summaries. In Warner's post trial brief it requested compensation in the amount of approximately \$ 25 million. Golden channels requested compensation in the amount of approximately \$ 3.8 million..

On September 29, 2004, the district court in Los Angeles, California, ruled in favor of Warner. The district court awarded Warner damages in the amount of approximately \$19.3 million (excluding attorney fees) and rejected Golden Channels' counterclaims in the matter. In addition, it was agreed by the parties that Warner is entitled to interest differentials of an additional \$ 700 thousand until a ruling is rendered. Warner filed with the court a motion seeking a payment for legal expenses and fees in additional amount of \$ 2.5 million. The hearing of this motion is scheduled for January 3, 2005. Moreover, Golden Channels filed with the court a motion to reduce the amount of the ruling in an amount of \$ 600 thousand. A ruling in this matter has not yet been rendered.

Pursuant to an agreement among the Israeli cable television operators (including Golden Channels and the Company) and Hot Vision (see below), the Company is required to indemnify Golden Channels (through Hot Vision) for approximately 26.5% of the damages awarded to Warner, amounting to approximately \$ 5.1 million, excluding the Company's share in legal expenses, if and in the amount awarded in favor of Warner.

The Israeli cable television operators (including Golden Channels and the Company) are reviewing the district court's verdict and its implications and will consider whether to file an appeal with respect to the court's ruling.

In light of the abovementioned and taking into consideration the additional costs that may be incurred by Golden channels, the financial statements of the Company as of September 30, 2004, include a provision of NIS 29 million, in addition to the provision recorded by Hot Vision (see below).

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 5:- COMMITMENTS, CONTINGENT LIABILITIES AND GUARANTEES (cont.)**

- (c) On or about the filing date of the above lawsuits, Warner forfeited letters of credit it was granted by Golden Channels and Tevel in the amount of \$ 5 million each.

Further to the above lawsuits and a demand made by Tevel and Golden Channels, Hot Vision board of directors resolved that, in principle, Hot Vision shall bear the amounts borne or to be borne by Tevel and Golden Channels with respect of the forfeiture of letters of credit, as detailed above, and in respect of the aforesaid agreements with the major studios, including their termination and related expenses and/or in respect of legal proceedings taken as above, subject to indemnification by its shareholders to cover these amounts.

On June 30, 2003, Hot Vision and the cable companies signed an agreement for the indemnification of Hot Vision relating to all of the amounts that it shall bear in connection with the debt to major studios and expenses associated with the management of the above legal procedures ( the Indemnification Agreement ). According to the indemnification agreement, the cable companies are committed, one towards the other, to jointly finance through Hot Vision the debt to the major studios and expenses associated with the management of these legal procedures which were implemented until the date of the financial statements against certain of the cable companies as well as any other procedure between Tevel and/or Golden Channels and the major studios in connection with agreements which were signed and/or terminated with the major studios regarding content which was provided to channels 3 and 4. As for the pay channels (Cinema 1, 2, 3 and cinema prime), it was agreed that the amounts will be paid directly to Tevel. According to the Indemnification Agreement, the debt to the major studios contains amounts that Tevel and/or Golden Channels have to pay, as the case may be, to the major studios in connection with the legal proceedings associated with these agreements, including the amounts of new guarantees provided to the major studios, if so provided, and which the major studios will forfeit and legal fees that Tevel and/or Golden Channels will have to pay to the major studios, all by virtue of a judgment or a decree rendered in the context of the proceedings. The indemnification does not include amounts that are payable by the cable companies to Tevel and/or Golden Channels through Hot Vision and Avdar for purchase of content to channels 3 and 4 and to the pay channels (Cinema channel 1, 2, 3 and Cinema Prime).

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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**NOTE 5:- COMMITMENTS, CONTINGENT LIABILITIES AND GUARANTEES (cont.)**

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

In light of the abovementioned, Hot Vision recorded in its financial statements a provision of approximately NIS 8.7 (in addition to the provision that recorded by the Company as hereinabove) million in connection with the legal fees of the case of Warner against Golden Channels, as mentioned in section (b)(2) above. The Company's portion is approximately NIS 2.3 million.

- (d) In February 2004, a subsidiary of the Company received tax assessments for the years 1999-2001 (see Note (15)(b)(f)(2) in the financial statements as of December 31, 2003). In addition, in continuance to the dispute with the tax authorities as described in Notes 11b(1) and 15(b)(2)(g) in the financial statements as of December 31, 2003, a subsidiary of the Company received in May 2004 assessments for tax years 1998-2001 and a tax order for 2002.

The tax order for 2002 included a requirement to pay a tax amount of NIS 114 million (due to a dispute with the tax authorities - see also Note 11b(1)) which was fully provided in the financial statement as of December 31, 2003 and 2002.

With respect to the assessments for tax years 1998-2001 the subsidiary is required to pay additional amount of NIS 6.6 million (not including interest and CPI linkage). In addition, with respect to 2002 tax order a deficit penalty was imposed on the Company in the amount of NIS 18 million (including interest and CPI linkage), which was delayed until the date of approval of the financial statements.

In the reported period, the Company recorded in the financial statements a provision of approximately NIS 6.5 million with respect of the tax assessments that the Company and its subsidiary received for the years 1997-2001 (according to the above-mentioned and note 15(b)(2)(f) in the financial statement as of December 31, 2003) and this is in light of the discussions held with the tax authorities (an agreement had not signed yet) in connection with those tax assessments.

The above-mentioned provision was included in tax on income item.

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 5:- COMMITMENTS, CONTINGENT LIABILITIES AND GUARANTEES (cont.)**

Management's opinion, based on the evaluation of its external advisers, has well founded arguments against the assessments and the order and the mentioned penalty and therefore no provision has been made in the Company's accounts for the above-mentioned deficit penalty claim and the assessments and the order for tax years 1998-2002, except the above-mentioned provision.

- (e) The annual financial statements as of December 31, 2003, which were approved and signed on March 31, 2004, include in Note 15 information regarding additional contingent claims against the Company and its subsidiaries. As of the date of approval of the financial statements, no material changes occurred with respect to these other contingent claims.

3. Updating Partner's contingent liabilities:

- a) On August 9, 2004, the appeal that was lodged by Bezeq with the District Court on the Minister of Communication's decision (see Note 15(b)(2)(e)(7) in the financial statements as of December 31, 2003) was strike off.
- b) On September 14, 2004, a claim was filed against Partner, together with a motion to recognize this claim as a class action, alleging errors in client accounts, including charges in respect of access to Internet after the client requested to block the service, and in the recording of credit balances as charges. The plaintiff claims that Partner's clients have suffered damages in the amount of approximately NIS 173 million within a period of two years and that Partner is in violation of the Consumer Protection Law. Partner has not yet filed a response. At this stage, no hearings were held and unless and until the claim is recognized as a class action, Partner and its legal counsels are unable to evaluate the probability of success of such claim, and therefore no provision has been made.

- b. The internal operator license granted to Hot Telecom partnership includes, inter alia, license to provide access services to Internet suppliers, data communications and digital transmission, effective 2004.

As of the balance sheet date, the Internet activity has not yet been transferred to Hot Telecom partnership and is carried out by the cable companies, among which is the Company, by the consolidated partnership, The Company Infrastructures, which were engaged in providing this service prior to the grant of the internal operator license. As of October 2004, the internet activity of the business sector is carried out by the partnership.

In view of the above, the consolidated financial statements of the Company as of September 30, 2004, include the Internet activity that was provided by the Company and which has not yet been transferred to Hot Telecom partnership, as hereinabove. Regarding the internet activity of the private sector, the Company's management and the management of Hot Telecom partnership cannot estimate at this stage, the time at which, such activity is to be transferred to the partnership and whether a retroactive transfer will be carried out and the estimated financial implications on the Company in respect of the transfer of this activity.

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 5:- COMMITMENTS, CONTINGENT LIABILITIES AND GUARANTEES (cont.)**

In addition, The Company's management and the management of Hot Telecom partnership cannot estimate at this stage the possible effect of the non-transfer of such activity on the validity of the internal operator license. The partnership has notified the ministry of communications on the delay in the transfer of this activity.

- c. The Company provided a bank guarantee in the amount of \$ 532 thousand to secure the payments of the affiliate partnership Hot telecom to Lucent. (See Note 6i)

**NOTE 6:- SIGNIFICANT EVENTS DURING THE REPORTED PERIOD AND SUBSEQUENT EVENTS**

- a. On January 24, 2004, Delek Investments Properties Ltd. ( Delek ) purchased from Dankner Investments Ltd. ( Dankner ) 17.98% of the Company's outstanding Ordinary shares. In addition, Dankner granted Delek an option for two years to purchase additional shares of the Company constituting as of the date of the agreement 2% of the issued and outstanding share capital of the Company and the voting rights. On September 2, 2004, Delek exercised the abovementioned option.

On May 31, 2004, the members of the Dankner and Gineo families the controlling shareholders of Dankner, which was the Company's major shareholder, signed an agreement with Delek Real Estate Ltd. (a subsidiary of Delek) for the purchase of such shares, constituting 87.5% of the outstanding Ordinary shares of Dankner. On June 15, 2004, Delek Real Estate Ltd. purchased 25% of the issued share capital of Dankner.

On August 12, 2004, the Dankner and the Gineo families completed the transaction with Delek Real Estate Ltd., according to which Delek Real Estate Ltd. acquired approximately 87.5% of Dankner's outstanding Ordinary shares.

Following the transaction, the Delek Group has become The Company's major shareholder (40%). The Delek group holds directly and indirectly approximately 40 percent of The Company's outstanding shares, 20% of the shares through Delek and 20% through Dankner.

Following the transaction, eight board members resigned (six of them are members of the Dankner and the Gineo families). On August 15, 2004, three additional board members were appointed.

In continuation to Dankner's immediate reports regarding the tender offer of Delek Real Estate Ltd. To acquire the ordinary shares of Dankner held by the public, on November 25, 2004 Dankner reported that it was informed by Delek Real Estate Ltd. that acceptance offers were received for the tender offer at a rate of 10.45% of the issued share capital of Dankner. Upon the completion of the tender offer and the performance of an imposed purchase of the balance of the shares held by the public Dankner shall become a private company and its shares shall be delisted from trade in the stock exchange.

- b. On June 9, 2004, the court rejected the appeal filed by Yes against the decision by the Controller in regard to the approval of the merger of the cable companies without an order for expenses (see in addition, Note 1(4)(a) in the financial statements as of December 31, 2003).

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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**NOTE 6:- SIGNIFICANT EVENTS DURING THE REPORTED PERIOD AND SUBSEQUENT EVENTS (cont.)**

- c. In the reported period, 36,483 options of the 2003 plan were exercised to 13,750 shares of NIS 1 par value each and 37,235 options of the 2001 plan were exercised to 2,809 shares of NIS 1 par value each. On November 16, 2004, a special meeting of the Company's shareholders approved the grant of 302,205 stock options of the 2003 plan to the chairman of the Company's board of directors without consideration. The exercise price of the options is NIS 38 per share.
- d. On June 29, 2004, the Knesset passed the Amendment to the Income Tax Ordinance (No. 140 and Temporary Provision), 2004, which progressively reduces the tax rates applicable to companies from 35% in 2004 to a rate of 30% in 2007. The effect of the Amendment on the Company's taxes on income is not material.
- e. On July 29, 2004, Bezeq, the Israel Telecommunication Corp. Ltd. ( Bezeq ) submitted a petition for the granting of orders nisi and for the granting of an interim order, against the Government of Israel, the Minister of Communications and the Minister of Finance ( the respondents ) and against Hot Telecom Limited Partnership (owned by the Company and the other cable companies) ( Hot Telecom ), as a formal respondent.

The petition was based on an amendment to the Communications Regulations (Bezeq and Broadcasting) (Payments for Interconnection), 2000 ( the Interconnection Regulations ), specifically on interim Regulation No. 10. This regulation sets a Bill and Keep arrangement which applies between Bezeq and Hot Telecom as follows:

In spite of what is stated in regulation 2(c) to the interconnection regulations as phrased in regulation 4(4) to the interconnection regulations, Bezeq and the internal operator (except for a unique internal operator and Bezeq) will not make payments to each other for reciprocal communication links as stated in the aforesaid regulation, and each of them will bear their costs in this respect, all of which is if the following cumulative conditions are met:

1. Two years have not yet elapsed from the date of record (the date on which the internal operator commenced providing telephony services on a commercial basis, as the Minister of Communications informed the concerned license holders).
2. The difference between the total minutes of traffic originating in the internal operator's aforesaid network and their destination being the internal operator network of Bezeq and the total minutes of traffic originating in the internal operator's network of Bezeq and their destination being internal operator's aforesaid network does not exceed 1,050,000,000 minutes of traffic.

The petitions requested interim orders to delay the effective date of the arrangement until compensation to the petitioner is ensured in respect of loss of income, through amendment of the Bezeq (Royalties) Regulations, 2001, to enable the petitioner to set off the loss of income incurred and to cancel Regulation 10 that was enacted without authority and with discrimination against the petitioner.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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**NOTE 6:- SIGNIFICANT EVENTS DURING THE REPORTED PERIOD AND SUBSEQUENT EVENTS (cont.)**

In addition, an interim order was requested to maintain the current status until a decision is rendered with respect to the petition or until the petitioner's right to receive compensation for loss of income is determined fully and completely.

On August 11, 2004, the request for an interim order was rejected. Pursuant to the court's decision, Hot Telecom filed a preliminary response to the petition.

The hearing of the petition was scheduled to December 29, 2004.

- f. In the reported period, the Company recorded under "Other expenses" in its financial statements, a loss from the impairment of its investment in another company, Barak A.T.C. (1995) - International Communication Services Ltd. (Barak), in the amount of NIS 16,241 thousand. As of September 30, 2004, the Company holds 10% of the shares of Barak.

As of September 30, 2004, Barak recorded shareholders' deficiency of NIS 544 million and a working capital deficiency of NIS 179 million, derived mainly from classification of long-term bank liabilities as current liabilities as a result of Barak's noncompliance with part of the financial requirements.

In the opinion of Barak's management, in light of its positive cash flows from operating activities and the advanced negotiations with banks in connection with refinancing of Barak's debt, Barak will continue to operate as a going concern in the foreseeable future. Nonetheless, management of Barak points out that without arranging bank financing, as stated above, Barak will have difficulty to repay its liabilities in respect to the payment of the interest to holders of debentures that the company issued and the principal of the loan to banks that are repayable in November and December 2005, and even if decided after the balance sheet date to utilize the extension period contained in the terms of the debentures and defer the interest payment that was scheduled to be paid during November 2004 and this is for the purpose of exhausting the efforts of the business negotiations that are carried out for quite sometime between Barak's management and the representatives of the debenture holders.

In light of the deterioration in Barak's financial position, as stated above, and in light of the opening of the international communications segment to new competitors, and the granting of licenses to three additional operators, the Company's management decided to reexamine the value of its investment in shares of Barak.

The value of the investment in Barak, which was examined by an independent outside appraiser, was fixed in accordance with Accounting Standard No. 15, based on the capitalized cash flows of Barak at a capitalization rate of 12.5% per annum. The valuation was implemented under the assumption that Barak will arrange the abovementioned refinancing for purposes of repayment of the debentures issued and, accordingly, will continue to operate as a going concern. According to the valuation implemented by the appraiser, the estimated fair value of the interest in Barak is between zero and \$ 1 million only. For conservatism sake, management of the Company chose to present the investment according to the bottom range of the valuation and, therefore wrote down the entire amount of the investment, in the amount of approximately NIS 16 million, in shares of Barak.



**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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**NOTE 6:- SIGNIFICANT EVENTS DURING THE REPORTED PERIOD AND SUBSEQUENT EVENTS (cont.)**

- g. On July 9, 2004, Hot Telecom, the included partnership signed an agreement with an Israeli entity in the global Lucent Int. Group for the establishment of a telephony network based on the cable infrastructure. The agreement is a framework agreement for 100,000 subscribers and, in the first stage, orders will be issued for the establishment of a network for 24,000 telephony subscribers in consideration for an estimated amount of \$ 16.5 million. To secure the payments to Lucent, the partnership provided guarantee in amount of \$2 million through its partners including the company (see also Note 5c).

On November 25, 2004, Hot Telecom announced that it commences to provide commercial telephony services. In the first stage, the telephony services shall be provided in a format of "Soft Launch" in the context of which, customers participating in the experiment shall be transferred to the commercial network as well as customers addressed by Hot Telecom. The "Soft Launch" period is defined in a period of a few months containing thousands of customers.

- h. On November 18, 2004, the Ministry of Communications announced on regulatory changes as follows:
- a) A reduction in the rate of interconnects.
  - b) A reduction in the rate of termination of an SMS from the present rate.
  - c) The rates will be updated on a yearly basis, according to the consumer price index.
  - d) Billing units will be changed from 12 seconds to one-second units in the year 2008.

With respect to these regulatory changes the affiliate company Partner is presently considering steps in order to mitigate their adverse effect. These steps may include, among others, price increases, cost cutting and repackaging of product offerings. Depending on the success of these steps and other factors, such as general market conditions, these regulatory changes may have a negative impact on profitability, which could be material.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 7:- INFORMATION ABOUT BUSINESS SEGMENTS

|                               | Nine months ended<br>September 30, 2004 (unaudited) |             |                        |
|-------------------------------|---|-------------|------------------------|
|                               | Internet  | Cable<br>TV | Total-<br>consolidated |
| Reported NIS in thousands (1) |   |             |                        |
| Segment revenues              | 49,546  | 394,594     | 444,140                |
| Segment results               | 20,043  | (13,477)    | 6,566                  |
|                               | Nine months ended<br>September 30, 2003 (unaudited) |             |                        |
|                               | Internet  | Cable<br>TV | Total-<br>consolidated |
| Adjusted NIS in thousands     |   |             |                        |
| Segment revenues              | 22,698  | 379,835     | 402,533                |
| Segment results               | 5,772   | (16,601)    | (10,829)               |

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## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 7:- INFORMATION ABOUT BUSINESS SEGMENTS (cont.)

|                  | Three months ended<br>September 30, 2004 (unaudited) |             |                        |
|------------------|--|-------------|------------------------|
|                  | Internet   | Cable<br>TV | Total-<br>consolidated |
|                  | Reported NIS in thousands (1)                        |             |                        |
| Segment revenues | 17,135   | 128,477     | 145,612                |
| Segment results  | 7,601  | (6,747)     | 854                    |
|                  | Three months ended<br>September 30, 2003 (unaudited) |             |                        |
|                  | Internet   | Cable<br>TV | Total-<br>consolidated |
|                  | Adjusted NIS in thousands                            |             |                        |
| Segment revenues | 8,725  | 129,096     | 137,821                |
| Segment results  | 2,175  | (1,604)     | 571                    |
|                  | Year ended December 31, 2003 (audited)               |             |                        |
|                  | Internet   | Cable<br>TV | Total-<br>consolidated |
|                  | Adjusted NIS in thousands                            |             |                        |
| Segment revenues | 34,403   | 511,077     | 545,480                |
| Segment results  | 10,436   | (18,255)    | (7,819)                |

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