

Cellcom Israel Ltd.  
Form 20-F/A  
March 14, 2012

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

FORM 20-F/A

Amendment No. 1

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

OR

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

For the fiscal year ended December 31, 2011

OR

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

For the transition period from \_\_\_\_\_  
to \_\_\_\_\_

OR

- SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934  
Date of event requiring this shell company report .....

Commission file number 001-33271

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

ISRAEL  
(Jurisdiction of incorporation  
or organization)

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10 Hagavish Street, Netanya  
42140, Israel  
(Address of principal  
executive offices)

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

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

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

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

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

None  
(Title of Class)

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

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None  
(Title of Class)

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

As of December 31, 2011, the Registrant had outstanding 99,481,487 Ordinary Shares, par value NIS 0.01 per share.

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

If this report is an annual or transition report, indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.  Yes  No

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

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

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

U.S. GAAP

International Financial Reporting Standards as issued by the International Accounting Standards Board

Other

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

Item 17

Item 18

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

Yes       No

## EXPLANATORY NOTE

This Amendment No.1 on Form 20-F/A (the "Amendment") to our annual report on Form 20-F for the fiscal year ended December 31, 2011, filed on March 07, 2012 (the "2011 Annual Report on Form 20-F"), is being filed solely to correct a technical error regarding the audit report of the Independent Registered Public Accounting Firm, KPMG Somekh Chaikin, contained in our consolidated financial statements on pages F-2 and F-3 within the 2011 Annual Report on Form 20-F. As such, this Amendment revises Part II, Item 15 "Controls and Procedures" and Part III, Item 18 "Financial Statements", in each case solely to refer to the amended audit report. Item 19 is amended solely to reflect the exhibits filed with this Amendment.

Except with regard to the Items and exhibits specified above, we have made no changes to our 2011 Annual Report on Form 20-F and the disclosure in the report has not been updated to reflect events that have occurred since March 07, 2012, the date on which we originally filed the report. Accordingly, other than the Items and exhibits specified above, which are amended hereby, our 2011 Annual Report on Form 20-F continues to speak only as of March 07, 2012.

## AMENDMENTS

### ITEM 15. CONTROLS AND PROCEDURES

Item 15 on pages 165 and 166 of the 2011 Annual Report on Form 20-F is hereby deleted and replaced with the following:

#### Disclosure Controls and Procedures

Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended) as of December 31, 2011, have concluded that, as of such date, our disclosure controls and procedures were effective and ensured that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act is accumulated and communicated to our management, including our chief executive officer and chief financial officer, to allow timely decisions regarding required disclosure and is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms.

#### Management Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, the company's principal executive and principal financial officers and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting, as of December 31, 2011. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework.

Management has excluded Netvision, from its assessment of internal control over financial reporting as of December 31, 2011 because it was acquired by us during the third quarter of 2011. Total assets and total revenues of Netvision, which were consolidated in our financial statements, included elsewhere in this annual report, represents approximately 10.4%, or NIS 886 million (\$232 million) and 5.9%, or NIS 381 million (\$100 million), respectively, of the related consolidated financial statement amounts as of, and for the year ended, December 31, 2011.

Based on our assessment, management believes that as of December 31, 2011 our internal control over financial reporting is effective based on this criteria.

The effectiveness of management's internal control over financial reporting as of December 31, 2011 has been audited by the Company's independent registered public accounting firm, Somekh Chaikin, a member of KPMG International and their report as of March 6, 2012, herein expresses an unqualified opinion on the Company's internal control over financial reporting.

#### Attestation Report of the Registered Public Accounting Firm

Our independent registered public accounting firm have issued an audit report on the effectiveness of our internal control over financial reporting. This report is included in page F-2 of this Amendment.

#### Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the period covered by this annual report that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 18. FINANCIAL STATEMENTS

Item 18 on page 169 of the 2011 Annual Report on Form 20-F is hereby deleted and replaced with the following:

See pages F-1 through F-72 of this Amendment.

ITEM 19. EXHIBITS

| Exhibit Number | Description  |
|----------------|--|
| 1.1            | Updated Articles of Association and Memorandum of Association ††††   |
| 2.1            | Form of Ordinary Share Certificate†  |
| 4.1            | Series A Indenture dated December 21, 2005 and an addendum dated February 27, 2006 between Cellcom and Aurora Fidelity Trust Ltd. †  |
| 4.1.1          | Series A Debentures Trustee Replacement Agreement dated June 11, 2009. †††   |
| 4.2            | Series B Indenture dated December 21, 2005 and an addendum dated February 27, 2006 between Cellcom and Hermetic Trust (1975) Ltd. †  |
| 4.3            | Series C Indenture dated September 20, 2007, between Cellcom and Aurora Fidelity Trust Ltd. ††   |
| 4.3.1          | Series C Debentures Trustee Replacement Agreement dated June 11, 2009. †††   |
| 4.4            | Series D Indenture dated September 20, 2007, between Cellcom and Hermetic Trust (1975) Ltd. ††   |
| 4.5            | Series E Indenture dated March 31, 2009, between Cellcom and Hermetic Trust (1975) Ltd. †††  |
| 4.6            | Shelf Prospectus Indenture dated July 14, 2011, between Cellcom and Hermetic Trust (1975) Ltd. ††††  |
| 4.6.1          | Shelf Prospectus Indenture dated March 7, 2012, between Cellcom and Strauss Lazar Trust Company (1992) Ltd. ††††   |
| 4.6.2.         | Amendment and Addendum no. 1 to the Indenture from January 19, 2012, dated March 7, 2012, between Cellcom and Strauss Lazar Trust Company (1992) Ltd.††††                      |
| 4.7            | Amended 2006 Share Incentive Plan††††  |
| 4.8            | Registration Rights Agreement dated March 15, 2006 among Cellcom, Goldman Sachs International, DIC, DIC Communication and Technology Ltd. and PEC Israel Economic Corporation† |
| 4.9            | Amended Non-Exclusive General License for the Provision of Mobile Radio Telephone Services in the Cellular Method dated June 27, 1994††††                                      |
| 4.10           | Netvision Ltd. Merger Agreement††††  |

| Exhibit Number | Description   |
|----------------|---|
| 8.1            | Subsidiaries of the Registrant††††  |
| 12.1           | Certification of Principal Executive Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to §302 of the Sarbanes-Oxley Act *                            |
| 12.2           | Certification of Principal Financial Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to §302 of the Sarbanes-Oxley Act *                            |
| 13.1           | Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act * |
| 15             | Consent of Independent Registered Public Accounting Firm *  |

\* Filed herewith.

† Incorporated by reference to our registration statement on Form F-1 (registration no. 333-140030) filed with the SEC on January 17, 2007.

†† Incorporated by reference to our annual report on Form 20-F for the year 2007 filed with the SEC on March 18, 2008.

††† Incorporated by reference to our annual report on Form 20-F for the year 2009 filed with the SEC on March 2, 2010.

†††† Incorporated by reference to our annual report on Form 20-F for the year 2011 filed with the SEC on March 7, 2012.



SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F/A and that it has duly caused and authorized the undersigned to sign this Amendment to the annual report on its behalf.

Cellcom Israel Ltd.

By: /s/ Nir Sztern  
Name: Nir Sztern  
Title: President and Chief  
Executive Officer

Date: March 14, 2012

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To Board of Directors and Shareholders of  
Cellcom Israel Ltd.

We have audited the accompanying consolidated statements of financial position of Cellcom Israel Ltd. and subsidiaries (hereinafter – “the Company”) as of December 31, 2011 and 2010 and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for each of the years in the three-year period ended December 31, 2011. We also have audited the Company’s internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Cellcom Israel Ltd.’s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company and subsidiaries as of December 31, 2011 and 2010, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2011, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Cellcom Israel Ltd. acquired Netvision Ltd. during 2011, and management excluded from its assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2011, Netvision Ltd.'s internal control over financial reporting associated with total assets of NIS 886 million and total revenues constituting of NIS 381 million included in the consolidated financial statements of the Company as of and for the year ended December 31, 2011. Our audit of internal control over financial reporting of the Company also excluded an evaluation of the internal control over financial reporting of Netvision Ltd.

The accompanying consolidated financial statements as of and for the year ended December 31, 2011 have been translated into United States dollars ("dollars") solely for the convenience of the reader. We have audited the translation and, in our opinion, the consolidated financial statements expressed in New Israeli Shekels have been translated into dollars on the basis set forth in Note 2D to the consolidated financial statements.

Somekh Chaikin  
Certified Public Accountants (Isr.)  
Member Firm of KPMG International  
Tel Aviv, Israel  
March 6, 2012

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## Cellcom Israel Ltd. and Subsidiaries

## Consolidated Statements of Financial Position

|   |      | December<br>31, 2010 | December<br>31, 2011 | Convenience<br>translation<br>into US<br>dollar (Note<br>2D)<br>December<br>31, 2011 |
|---|------|----------------------|----------------------|--|
|   | Note | NIS<br>millions      | NIS<br>millions      | US\$<br>millions   |
| <b>Assets</b>   |      |                      |                      |  |
| Cash and cash equivalents   | 8    | 533                  | 920                  | 241  |
| Current investments, including derivatives  |      | 404                  | 290                  | 76   |
| Trade receivables   | 9    | 1,478                | 1,859                | 487  |
| Other receivables   | 9    | 64                   | 93                   | 24   |
| Inventory   | 10   | 104                  | 170                  | 44   |
| Total current assets  |      | 2,583                | 3,332                | 872  |
| Trade and other receivables   | 9    | 597                  | 1,337                | 350  |
| Property, plant and equipment, net  | 11   | 2,063                | 2,168                | 567  |
| Intangible assets, net  | 12   | 753                  | 1,680                | 440  |
| Deferred tax assets   | 28   | -                    | 40                   | 10   |
| Total non- current assets   |      | 3,413                | 5,225                | 1,367  |
| Total assets  |      | 5,996                | 8,557                | 2,239  |
| <b>Short term credit and current maturities of long term loans and debentures</b> |      |                      |                      |  |
| Trade payables and accrued expenses   | 17   | 348                  | 674                  | 176  |
| Current tax liabilities   | 13   | 716                  | 1,026                | 268  |
| Provisions  | 14   | 132                  | 69                   | 18   |
| Other payables, including derivatives   | 15   | 84                   | 148                  | 39   |
| Dividend declared   | 15   | 379                  | 547                  | 143  |
| Deferred tax liabilities  | 19   | -                    | 189                  | 49   |
| Total current liabilities   |      | 1,659                | 2,653                | 693  |
| Long-term loans from banks  | 17   | -                    | 19                   | 5  |
| Debt securities   | 17   | 3,913                | 5,452                | 1,427  |
| Provisions  | 14   | 17                   | 21                   | 5  |
| Other long-term liabilities   | 16   | -                    | 41                   | 11   |
| Liability for employee rights upon retirement, net                                | 18   | 1                    | 10                   | 3  |
| Deferred tax liabilities  | 28   | 65                   | 174                  | 46   |
| Total non- current liabilities  |      | 3,996                | 5,717                | 1,497  |
| Total liabilities   |      | 5,655                | 8,370                | 2,190  |
| Equity attributable to owners of the Company                                      | 19   |                      |                      |  |
| Share capital   |      | 1                    | 1                    | -  |
| Cash flow hedge reserve   |      | (21 )                | 7                    | 2  |
| Retained earnings   |      | 361                  | 175                  | 46   |
| Non-controlling interest  |      | -                    | 4                    | 1  |

|                              |       |       |       |
|------------------------------|-------|-------|-------|
| Total equity                 | 341   | 187   | 49    |
| Total liabilities and equity | 5,996 | 8,557 | 2,239 |

Date of approval of the financial statements: March 6, 2012.

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

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Cellcom Israel Ltd. and Subsidiaries

## Consolidated Statements of Income

|                                     |      | Year ended<br>December<br>31, 2009 | Year ended<br>December<br>31, 2010 | Year ended<br>December<br>31, 2011 | Convenience<br>translation<br>into US<br>dollar (Note<br>2D) Year<br>ended<br>December<br>31, 2011<br>US\$ |
|-------------------------------------|------|------------------------------------|------------------------------------|------------------------------------|--|
|                                     | Note | NIS millions                       | NIS millions                       | NIS millions                       | millions   |
| Revenues                            | 22   | 6,483                              | 6,662                              | 6,506                              | 1,703  |
| Cost of revenues                    | 23   | (3,333 )                           | (3,322 )                           | (3,408 )                           | (892 )   |
| Gross profit                        |      | 3,150                              | 3,340                              | 3,098                              | 811  |
| Selling and marketing expenses      | 24   | (716 )                             | (756 )                             | (990 )                             | (259 )   |
| General and administrative expenses | 25   | (660 )                             | (641 )                             | (685 )                             | (179 )   |
| Other expenses, net                 | 26   | (6 )                               | (5 )                               | (1 )                               | -  |
| Operating profit                    |      | 1,768                              | 1,938                              | 1,422                              | 373  |
| Financing income                    |      | 151                                | 106                                | 116                                | 30   |
| Financing expenses                  |      | (370 )                             | (336 )                             | (409 )                             | (107 )   |
| Financing expenses, net             | 27   | (219 )                             | (230 )                             | (293 )                             | (77 )  |
| Profit before taxes on income       |      | 1,549                              | 1,708                              | 1,129                              | 296  |
| Taxes on income                     | 28   | (367 )                             | (417 )                             | (304 )                             | (80 )  |
| Profit for the year                 |      | 1,182                              | 1,291                              | 825                                | 216  |
| Attributable to:                    |      |                                    |                                    |                                    |  |
| Owners of the Company               |      | 1,182                              | 1,291                              | 824                                | 216  |
| Non-controlling interests           |      | -                                  | -                                  | 1                                  | -  |
| Profit for the year                 |      | 1,182                              | 1,291                              | 825                                | 216  |
| Earnings per share                  |      |                                    |                                    |                                    |  |
| Basic earnings per share (in NIS)   | 19   | 12.01                              | 13.04                              | 8.28                               | 2.17   |
| Diluted earnings per share (in NIS) | 19   | 11.90                              | 12.98                              | 8.28                               | 2.17   |

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

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Cellcom Israel Ltd. and Subsidiaries

## Consolidated Statements of Comprehensive Income

|  | Year<br>ended<br>December<br>31, 2009<br>NIS<br>millions | Year<br>ended<br>December<br>31, 2010<br>NIS<br>millions | Year<br>ended<br>December<br>31, 2011<br>NIS<br>millions | Convenience<br>translation<br>into US<br>dollar (Note<br>2D) Year<br>ended<br>December<br>31, 2011<br>US\$<br>millions |
|--|--|--|--|--|
| Profit for the year  | 1,182  | 1,291  | 825  | 216  |
| Net change in fair value of cash flow hedges transferred to profit or loss | (14 )  | (10 )  | 20   | 5  |
| Changes in fair value of cash flow hedges, net of income tax               | (2 )   | 9  | 13   | 3  |
| Income tax on other comprehensive income                                   | 4  | 3  | (5 )   | (1 )   |
| Other comprehensive income for the year, net of income tax                 | (12 )  | 2  | 28   | 7  |
| Total comprehensive income for the year                                    | 1,170  | 1,293  | 853  | 223  |
| Total comprehensive income attributable to:                                |  |  |  |  |
| Owners of the Company  | 1,170  | 1,293  | 852  | 223  |
| Non-controlling interests  | -  | -  | 1  | -  |
| Total comprehensive income for the year                                    | 1,170  | 1,293  | 853  | 223  |

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



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Cellcom Israel Ltd. and Subsidiaries

## Consolidated Statements of Changes in Equity

|  | Share capital | Attributable to owners of the Company |                   |          | Non-controlling interests | Total equity | Convenience translation into US dollar (Note 2D) |
|--|---------------|---------------------------------------|-------------------|----------|---------------------------|--------------|--|
|  |               | Capital reserve                       | Retained earnings | Total    |                           |              | US\$ millions                                    |
|  | NIS millions  |                                       |                   |          |                           |              | US\$ millions                                    |
| Balance as of January 1, 2009                                | 1             | (11 )                                 | 400               | 390      | -                         | 390          | 102  |
| Other comprehensive income for the year, net of tax          | -             | (12 )                                 | -                 | (12 )    | -                         | (12 )        | (3 )   |
| Profit for the year  | -             | -                                     | 1,182             | 1,182    | -                         | 1,182        | 309  |
| Share based payments   | -             | -                                     | 1                 | 1        | -                         | 1            | -  |
| Dividend paid in cash  | -             | -                                     | (1,187 )          | (1,187 ) | -                         | (1,187 )     | (311 )   |
| Balance as of December 31, 2009                              | 1             | (23 )                                 | 396               | 374      | -                         | 374          | 97   |
| Other comprehensive income for the year, net of tax          | -             | 2                                     | -                 | 2        | -                         | 2            | 1  |
| Profit for the year  | -             | -                                     | 1,291             | 1,291    | -                         | 1,291        | 338  |
| Share based payments   | -             | -                                     | 1                 | 1        | -                         | 1            | -  |
| Cash dividend paid   | -             | -                                     | (1,327 )          | (1,327 ) | -                         | (1,327 )     | (347 )   |
| Balance as of December 31, 2010                              | 1             | (21 )                                 | 361               | 341      | -                         | 341          | 89   |
| Other comprehensive income for the year, net of tax          | -             | 28                                    | -                 | 28       | -                         | 28           | 7  |
| Profit for the year  | -             | -                                     | 824               | 824      | 1                         | 825          | 216  |
| Share based payments   | -             | -                                     | 6                 | 6        | -                         | 6            | 2  |
| Dividend paid in cash  | -             | -                                     | (827 )            | (827 )   | -                         | (827 )       | (216 )   |
| Declared dividend  | -             | -                                     | (189 )            | (189 )   | (1 )                      | (190 )       | (50 )  |
| Non-controlling interests in respect of business combination | -             | -                                     | -                 | -        | 4                         | 4            | 1  |

(see note 7)

Balance as of December

|          |   |   |     |     |   |     |    |
|----------|---|---|-----|-----|---|-----|----|
| 31, 2011 | 1 | 7 | 175 | 183 | 4 | 187 | 49 |
|----------|---|---|-----|-----|---|-----|----|

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

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Cellcom Israel Ltd. and Subsidiaries

## Consolidated Statements of Cash Flows

|  | Year<br>ended<br>December<br>31, 2009<br>NIS<br>millions | Year<br>ended<br>December<br>31, 2010<br>NIS<br>millions | Year<br>ended<br>December<br>31, 2011<br>NIS<br>millions | Convenience<br>translation<br>into US<br>dollar (Note<br>2D) Year<br>ended<br>December<br>31, 2011<br>US\$<br>millions |
|--|--|--|--|--|
| <b>Cash flows from operating activities</b>                    |  |  |  |  |
| Profit for the year  | 1,182  | 1,291  | 825  | 216  |
| Adjustments for:   |  |  |  |  |
| Depreciation and amortization                                  | 755  | 724  | 738  | 193  |
| Share based payment  | 1  | 1  | 6  | 2  |
| Loss on sale of property, plant and equipment                  | 6  | 5  | -  | -  |
| Income tax expense   | 367  | 417  | 304  | 80   |
| Financing expenses, net  | 219  | 230  | 293  | 77   |
| Other expenses   | -  | -  | 2  | 1  |
| <b>Changes in operating assets and liabilities:</b>            |  |  |  |  |
| Change in inventory  | (105 )   | -  | (67 )  | (18 )  |
| Change in trade receivables (including long-term amounts)      | (69 )  | 172  | (585 )   | (153 )   |
| Change in other receivables (including long-term amounts)      | 2  | (6 )   | 61   | 16   |
| Changes in trade payables, accrued expenses and provisions     | 152  | (42 )  | 146  | 38   |
| Change in other liabilities (including long-term amounts)      | (4 )   | (16 )  | (52 )  | (14 )  |
| Proceeds from (payments for) derivative hedging contracts, net | 21   | (16 )  | (14 )  | (4 )   |
| Income tax paid  | (447 )   | (380 )   | (325 )   | (85 )  |
| Net cash from operating activities                             | 2,080  | 2,380  | 1,332  | 349  |
| <b>Cash flows from investing activities</b>                    |  |  |  |  |
| Acquisition of property, plant, and equipment                  | (404 )   | (441 )   | (333 )   | (87 )  |
| Acquisition of intangible assets                               | (173 )   | (180 )   | (99 )  | (26 )  |
| Acquisition of activity  | -  | (108 )   | -  | -  |
| Acquisition of subsidiary, net of cash acquired (see note 7)   | -  | -  | (1,458 )   | (382 )   |
| Change in current investments, net                             | (212 )   | (154 )   | 197  | 52   |
| Proceeds from (payments for) other derivative contracts, net   | 8  | (17 )  | 1  | -  |
| Gain on sale of property, plant and equipment                  | 2  | 2  | 3  | 1  |
| Interest received  | 5  | 9  | 33   | 9  |
| Net cash used in investing activities                          | (774 )   | (889 )   | (1,656 )   | (433 )   |

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

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Cellcom Israel Ltd. and Subsidiaries

## Consolidated Statements of Cash Flows (cont'd)

|  | Year<br>ended<br>December<br>31, 2009<br>NIS<br>millions | Year<br>ended<br>December<br>31, 2010<br>NIS<br>millions | Year<br>ended<br>December<br>31, 2011<br>NIS<br>millions | Convenience<br>translation<br>into US<br>dollar (Note<br>2D) Year<br>ended<br>December<br>31, 2011<br>US\$<br>millions |
|--|--|--|--|--|
| Cash flows from financing activities                                   |  |  |  |  |
| Proceeds from derivative contracts, net                                | 33   | 34   | 11   | 3  |
| Receipt (repayment) of long term loans from banks                      | 8  | (8 )   | (4 )   | (1 )   |
| Repayment of debentures  | (332 )   | (343 )   | (354 )   | (93 )  |
| Proceeds from issuance of debentures, net of issuance costs            | 989  | -  | 2,165  | 566  |
| Dividend paid  | (1,186 )   | (1,319 )   | (858 )   | (225 )   |
| Interest paid  | (190 )   | (225 )   | (245 )   | (64 )  |
| Net cash from (used in) financing activities                           | (678 )   | (1,861 )   | 715  | 186  |
| Cash balance presented under assets held for sale (see notes 9 and 15) | -  | -  | (4 )   | (1 )   |
| Changes in cash and cash equivalents                                   | 628  | (370 )   | 387  | 101  |
| Cash and cash equivalents as at the beginning of the year              | 275  | 903  | 533  | 140  |
| Cash and cash equivalents as at the end of the year                    | 903  | 533  | 920  | 241  |

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

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 1 - Reporting Entity

Cellcom Israel Ltd. ("the Company") is a company incorporated and domiciled in Israel and its official address is 10 Hagavish Street, Netanya 42140, Israel. These consolidated financial statements of the Company as at December 31, 2011 are comprised of the Company and its subsidiaries ("the Group"). The Group operates and maintains a cellular mobile telephone system and provides cellular and landline telecommunications services in Israel. As of September 1, 2011, following the completion of the acquisition of Netvision Ltd. ("Netvision", see note 7, regarding acquisition of subsidiary), the Group also provides internet services (ISP) and international calls services. The Company is a consolidated subsidiary of Discount Investment Corporation (the parent company "DIC"). The Company's ultimate parent company is Ganden Holdings Ltd., and Mr. Nochi Dankner is the ultimate controlling shareholder.

Note 2 - Basis of Preparation

A. Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs), as issued by the International Accounting Standards Board (IASB). The Company adopted IFRSs for the first time in 2008, with the date of transition to IFRSs being January 1, 2007 (hereinafter - "the date of transition").

These consolidated financial statements were approved by the Board of Directors on March 6, 2012.

B. Functional and presentation currency

These consolidated financial statements are presented in New Israeli Shekels ("NIS"), which is the Group's functional currency, and are rounded to the nearest million. NIS is the currency that represents the primary economic environment in which the Group operates.

C. Basis of measurement

These consolidated financial statements have been prepared on the basis of historical cost except for following assets and liabilities: current investments and derivative financial instruments that are measured at fair value through profit or loss, inventory is measured at the lower of cost or net realizable value, deferred tax assets and liabilities, assets and liabilities in respect of employee benefits and provisions.

For further information regarding the measurement of these assets and liabilities see note 3 regarding significant accounting policies.

The value of non monetary assets and equity items that were measured on the basis of historical cost were adjusted for changes in the general purchasing power of the Israeli currency - NIS, based upon changes in the Israeli Consumer Price Index ("CPI") until December 31, 2003, as until that date the Israeli economy was considered hyperinflationary.

D. Convenience translation into U.S. dollars ("dollars" or "\$")

For the convenience of the reader, the reported NIS figures as of December 31, 2011, have been presented in dollars, translated at the representative rate of exchange as of December 31, 2011 (NIS 3.821 = US\$ 1.00). The dollar amounts presented in these financial statements should not be construed as representing amounts that are receivable or payable in dollars or convertible into dollars, unless otherwise indicated.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 2 - Basis of Preparation (cont'd)

E. Use of estimates and judgments

The preparation of the consolidated financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

The preparation of accounting estimates used in the preparation of the Group's financial statements requires management to make assumptions regarding circumstances and events that involve considerable uncertainty. Management of the Group prepares the estimates on the basis of past experience, various facts, external circumstances, and reasonable assumptions according to the pertinent circumstances of each estimate.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. Information about estimates, uncertainty and critical judgments about provisions and contingencies are described in notes 14 and 31. In addition, information about critical estimates, made while applying accounting policies and that have the most significant effect on the consolidated financial statements are described below:

Trade and other receivables

The financial statements include an impairment loss in trade and other receivables which properly reflect, according to management's estimation, the potential loss from non recoverable amounts. The Group provides for impairment loss based on its experience in collecting past debts, as well as on information on specific debtors. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loss component established for groups of similar assets in respect of losses that have been incurred but not yet identified. The collective loss allowance is determined based on historical data of payment statistics for similar financial assets. See also note 21.

Impairment loss and useful life of assets

The Group regularly reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. See also note 3I.

The useful economic life of the Group's assets is determined by management at the time the asset is acquired and regularly reviewed for appropriateness. The Group defines useful life of its assets in terms of the assets' expected utility to the Group. This judgment is based on the experience of the Group with similar assets. The useful life of licenses is based on the duration of the license agreement. See also notes 3D and 3F.

Impairment of goodwill

The Group reviews a cash generating unit containing goodwill for the purpose of testing it for impairment at least once a year. Determining the recoverable amount requires management to make an estimate of the projected future cash flows from the continuing use of the cash-generating unit and also to choose a suitable discount rate for those cash flows which represents market estimates as for the time value of the money and the specific risks that are related to the cash-generating unit. Determining the estimates of the future cash flows is based on management past experience and management best estimates as for the economic conditions that will exist over the rest of the remaining



useful life of the cash generating unit. Further details are given in note 3I.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 2 - Basis of Preparation (cont'd)

Business combinations

The Group is required to allocate the acquisition cost of entities and activities through business combinations on the basis of the fair value of the acquired assets and assumed liabilities. The Group uses external and internal valuations to determine the fair value. The valuations include management estimates and assumptions as for future cash flow projections from the acquired business and selection of models to compute the fair value of the acquired components and their depreciation period. Management estimate influences the balance of the acquired assets and assumed liabilities and the depreciation and amortization in the consolidated statements of income. Management estimates as for the future cash flow and the useful life of the acquired assets may be different than the actual results.

Share based payments

Options granted to employees are measured using the Black-Scholes model. The expected life used on the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioral considerations. See also note 20.

Legal claims

In estimating the likelihood of outcome of legal claims filed against the Company and its investees, the companies of the Group rely on the opinion of their legal counsel. These estimates are based on the legal counsel's best professional judgment, taking into account the stage of proceedings and historical legal precedents in respect of the different issues. Since the outcome of the claims will be determined in courts, the results could differ from these estimates. See also note 31.

Uncertain tax positions

When assessing amounts of current and deferred taxes, the Group takes into consideration the effect of the uncertainty that its tax positions will be accepted and of the Group incurring any additional tax and interest expenses. The Group is of the opinion that the cumulative tax liability is fair for all the years in respect of which final tax assessments have not yet been received, based on an analysis of a number of matters including interpretations of tax laws and the Group's past experience. This assessment is based on estimates and assumptions that may also include assessments and exercising judgment regarding future events. It is possible that new information will become known in future periods that will require the Group to change its estimate regarding the tax liability that was recognized, and any such changes will be expensed immediately in that period.

F. Newly adopted accounting standards during the period

1. IAS 24 (2009) Related Party Disclosures (hereinafter – "the Standard"). The new standard includes changes in the definition of a related party and changes with respect to disclosures required by entities related to government. The Standard is effective from January 1, 2011. For the purpose of applying the Standard for the first time, the Group mapped its relationships with related parties. The Standard has no material impact on the Group's consolidated financial statements.
2. Amendment to IFRS 7 Financial Instruments: Disclosures - Clarification of disclosures (hereinafter – "the Amendment") – The Amendment added a declaration that the interaction between the qualitative and quantitative

disclosures enables the users of the financial statements to better assess the Group's exposure to risks arising from financial instruments. Furthermore, the clause stating that quantitative disclosures are not required when the risk is immaterial was removed, and certain disclosure requirements regarding credit risk were amended while others were removed. The Amendment is implemented from annual periods beginning on January 1, 2011. The required disclosures were included in the consolidated financial statements. For further details see note 21, regarding financial instruments.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies

These consolidated financial statements have been prepared according to International Financial Reporting Standards as issued by the IASB and their related interpretations (IFRSs), that are in effect or otherwise available for early adoption at December 31, 2011.

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

A. Basis of consolidation

These consolidated financial statements include consolidation of the financial statements of the Company and entities controlled by the Company. Control exists when a company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. All inter-company transactions and balances were eliminated upon consolidation.

1. Business combinations

The Group implements the acquisition method to all business combinations. The acquisition date is the date on which the acquirer obtains control over the acquiree. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are currently exercisable are taken into account. The Group exercises discretion in determining the acquisition date and whether control has been obtained.

The Group recognizes goodwill at acquisition according to the fair value of the consideration transferred including any amounts recognized in respect of rights that do not confer control in the acquiree less the net amount of the identifiable assets acquired and the liabilities assumed.

On the acquisition date the acquirer recognizes a contingent liability assumed in a business combination if there is a present obligation resulting from past events and its fair value can be reliably measured.

The consideration transferred includes the fair value of the assets transferred to the previous owners of the acquiree, the liabilities incurred by the acquirer to the previous owners of the acquiree and equity instruments that were issued by the Group.

When share-based payment awards (replacement awards) are required to be exchanged for awards held by the acquiree's employees (acquiree's awards) and relate to past services, then all or a portion of the amount of the acquirer's replacement awards is included in measuring the consideration transferred in the business combination. This determination is based on the market-based value of the replacement awards compared with the market-based value of the acquiree's awards and the extent to which the replacement awards relate to past and/or future service. The unvested portion of the replacement award that is attributed to post-acquisition services is recognized as a compensation cost following the business combination.

Costs associated with the acquisition that were incurred by the acquirer in the business combination such as: finder's fees, advisory, legal, valuation and other professional or consulting fees, other than those associated with an issue of debt or equity instruments connected to the business combination, are expensed in the period the services are received.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

2. Subsidiaries

Subsidiaries are entities controlled by the parent company. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Non-controlling interests comprise the equity of a subsidiary that cannot be attributed, directly or indirectly, to the parent company. Profit or loss and each component of other comprehensive income are attributable to the owners of the parent company and to non-controlling interests.

B. Foreign currency transactions

Transactions in foreign currencies are translated to NIS at the prevailing foreign exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies as of the reporting date are translated to NIS at the prevailing foreign exchange rate at that date. Foreign exchange differences arising on translation are recognized in profit and loss. Non-monetary assets and liabilities that are measured in terms of historical cost in foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currency that are stated at fair value are translated to NIS at the prevailing foreign exchange rates at the date the fair value was determined.

C. Financial instruments

Financial instruments are recognized when the Group enters into the contractual terms of the instrument. Financial instruments are initially measured at fair value. After the initial recognition, financial instruments are measured at fair value or amortized cost. Financial assets are derecognized when the contractual rights of the Group to the cash flows deriving from the financial asset expire, or when the Group transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Sales and acquisitions of financial instruments are recognized on the transaction date, in which the Group turns into a side to the instrument's contractual conditions, i.e., the date in which the Group is obligated to sell or purchase the instrument. Financial liabilities are derecognized when the Group's contractual obligations expire, or when it is settled or cancelled.

1. Non derivative financial instruments

Non derivative financial instruments are comprised of cash and cash equivalents, investments in debt securities, trade receivables, other receivables, loans and borrowings, debentures, trade payables and other payables. Non derivative financial instruments other than investments in debt securities are measured after initial recognition at amortized cost using the effective interest method and less any impairment loss, if relevant. Investments in debt securities are measured at fair value through profit or loss.

Cash and cash equivalents

Cash and cash equivalents comprise of cash balances available for immediate use and call deposits. Cash equivalents comprise short-term highly liquid investments (with original maturities of three months or less) that are readily

convertible into known amounts of cash and are exposed to insignificant risks of change in value. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

2. Derivative financial instruments

The Group holds derivative financial instruments to hedge its foreign currency and CPI risks exposures. Embedded derivatives are separated from the host contract and carried at fair value when (1) the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, (2) a separate, stand-alone instrument with the same terms would meet the definition of a derivative, and (3) the combined instrument is not measured at fair value through profit or loss.

Derivatives are initially recognized at fair value; transaction costs that can be attributed are recognized to profit and loss when incurred. Subsequent to initial recognition, derivatives are measured at fair value. Changes in fair value are accounted for as follows:

Cash flow hedges

Changes in the fair value of the derivative hedging instrument designated as a cash flow hedge are recognized directly in comprehensive income to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognized in profit and loss.

If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognized in comprehensive income remains there until the forecasted transaction occurs or is no longer expected to occur. The amount recognized in comprehensive income is transferred to profit and loss in the same period that the hedged item affects profit and loss.

Economic Hedges

Hedge accounting is not applied to derivative instruments that economically hedge monetary assets and liabilities denominated in foreign currencies or linked to the CPI. Changes in the fair value of such derivatives are recognized in profit and loss as part of foreign currency gains and losses.

Separable embedded derivatives

Changes in fair value of separable embedded derivatives are recognized immediately in profit and loss.

3. Financial instruments linked to the Israeli CPI that are not measured at fair value

The carrying amount of a financial instrument and the payments derived from it are revalued in each period according to the actual rate of change in the CPI.

4. Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognized as a deduction from equity, net of any tax effects.





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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

D. Property, plant and equipment

Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labor, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment.

When major parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Changes in the obligation to dismantle and remove the items and to restore the site on which they are located, other than changes deriving from the passing of time, are added or deducted from the cost of the asset in the period in which they occur. The amount deducted from the cost of the asset shall not exceed the balance of the carrying amount on the date of change, and any balance is recognized immediately in profit or loss.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognized net within "other expenses, net" in profit or loss.

The cost of replacing part of a fixed asset item is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of day-to-day servicing are recognized in profit or loss as incurred.

Depreciation is a systematic allocation of the depreciable amount of an asset over its useful life.

An asset is depreciated from the date it is ready for use, meaning the date it reaches the location and condition required for it to operate in the manner intended by management.

Depreciation is recognized in profit or loss on a straight-line basis. If the property, plant and equipment consist of several components with different estimated useful lives, the individual significant components are depreciated over their individual useful lives. The annual depreciation rates are as follows:

|                               | %     |
|-------------------------------|-------|
| Communication network         | 5-20  |
| Control and testing equipment | 15-25 |
| Vehicles                      | 15-33 |

|                                |       |
|--------------------------------|-------|
| Computers and hardware         | 15-33 |
| Furniture and office equipment | 6-15  |

Leasehold improvements are depreciated over the shorter of their estimated useful lives or the expected lease terms.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

E. Rights of use of communication lines

The Group implements IFRIC 4, "Determining Whether an Arrangement Contains a Lease", which defines criteria for determining at the beginning of the arrangement, whether the right to use asset constitutes a lease arrangement.

According to IFRIC 4, as mentioned above, acquisition transactions of irrevocable rights of use of underwater cables capacity are treated as service receipt transactions. The amount which was paid for the rights of use of communication lines, is amortized on a straight-line basis over the period stated in the agreements, including the option period, which constitutes the estimated useful life of those capacities.

F. Intangible assets

Intangible assets consist of goodwill, assets recognized during business combination, licenses, computer software costs, information systems and deferred expenses.

1. Goodwill that arises upon the acquisition of subsidiaries is presented as part of intangible assets. For information on measurement of goodwill at initial recognition, see paragraph A(1) of this note.

In subsequent periods goodwill is measured at cost less accumulated impairment losses.

2. Other intangible assets are measured at cost less accumulated amortization and accumulated impairment losses and including direct costs necessary to prepare the asset for its intended use.
3. Certain direct and indirect development costs associated with internally developed information system software, and payroll costs for employees devoting time to the software projects, incurred during the application development stage, are capitalized. The costs are amortized using the straight-line method beginning when the asset is substantially ready for use. Costs incurred during the research stage and after the asset is substantially ready for use are expensed as incurred.
4. Deferred expenses in respect of commissions and handset subsidies regarding the acquisition of new subscribers are recognized as intangible assets, if the costs can be measured reliably, are incremental to the contract, there is a control over resources and the existence of future economic benefits and directly attributable to obtaining a specific subscriber. If the costs do not meet the aforementioned criteria, they are recognized immediately as expenses.
5. Subsequent expenditure is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure, including expenditure on internally generated goodwill and brands, is recognized in profit or loss as incurred.
6. Amortization is calculated using the straight-line method, except for a certain intangible asset recognized during business combination, which is amortized according to the economic benefit expected from this asset each period. If the intangible assets consist of several components with different estimated useful lives, the individual

significant components are amortized over their individual useful lives. The annual amortization rates are as follows:

|                       |                       |
|-----------------------|-----------------------|
| Licenses              | (mainly<br>5-6%6%)    |
| Information systems   | 25%                   |
| Software              | 15-25%                |
| Customer relationship | approximately 6 years |

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

Goodwill has an indefinite useful life and is not systematically amortized but tested for impairment at least once a year.

Deferred expenses are amortized over an 18 month period which represents the expected life of the contractual relationship with the subscriber.

Amortization methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

The Group examines the useful life of an intangible asset that is not periodically amortized at least once a year in order to determine whether events and circumstances continue to support the decision that the intangible asset has an indefinite useful life.

G. Non-current assets and disposal groups held for sale or distribution

Non-current assets (or groups of assets and liabilities for disposal) that are expected to be recovered primarily through sale or distribution rather than through continuing use are classified as held for sale or distribution. This applies also to when the Group is obligated to a sale plan that involves losing control over a subsidiary, whether or not the Group will retain any non-controlling interests in the subsidiary after the sale.

Immediately before classification as held for sale or distribution, the assets (or components of a disposal group) are remeasured in accordance with the Group's accounting policies. Thereafter, generally, the assets (or disposal group) are measured at the lower of their carrying amount and fair value less cost to sell.

H. Inventory

Inventory of cellular phone equipment, accessories and spare-parts are stated at the lower of cost or net realizable value. Cost is determined by the moving average method.

The cost of inventory which serves the line of communication is determined on a "first-in, first-out" basis.

The Group periodically evaluates the condition and age of inventories and makes provisions for impairment of inventories accordingly.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

I. Impairment

1. Non-derivative financial assets

A non-derivative financial asset which is not presented at fair value through profit or loss is reviewed for impairment when objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset. An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate of that asset. All impairment losses are recognized in profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost, the reversal is recognized in profit or loss.

2. Property, plant and equipment and intangible assets

At each reporting date, the Group reviews the carrying amounts of its property, plant and equipment and finite lived intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group groups together all of the assets that cannot be tested individually into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit") and estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Cash-generating units to which goodwill has been allocated are aggregated so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes. When goodwill is not monitored for internal reporting purposes, it is allocated to operating segments (before the aggregation of similar segments) and not to a cash-generating unit (or group of cash-generating units) lower in level than an operating segment.

Goodwill acquired in a business combination is allocated to groups of cash-generating units that are expected to benefit from the synergies of the combination, see further details in note 3F.

The recoverable amount is the higher of value in use and fair value less cost to sell. Value in use is determined by discounting of expected future cash flows method, using a pre-tax discount rate.

In calculating the net present value of the future cash flows, certain assumptions are required to be made in respect of highly uncertain matters including management's expectations of future revenues, timing and quantum of future capital expenditure, long term growth rates of subscribers and discount rates, to reflect the risks involved.

An impairment loss is recognized if the carrying amount of an asset or cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then

to reduce the carrying amounts of the other assets in the cash-generating unit on a pro rata basis.

As regards cash-generating units that include goodwill, an impairment loss is recognized when the carrying amount of the cash-generating unit, after adjustment for goodwill, exceeds its recoverable amount.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, not to exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit and loss. Impairment loss in respect of goodwill is not reversed.

J. Employee benefits

1. Post employment benefits

Part of the Group's liability for post employment benefits is covered by a defined contribution plan financed by deposits with insurance companies or with funds managed by a trustee. Obligation of contribution to defined contribution pension plan is recognized as an expense in profit and loss in the periods during which services are rendered by employees. In addition, there is a liability for a defined post employment benefit plan that is determined using actuarial assessment techniques. Calculation of the liability involves, among others, regarding the capitalization rates, anticipated return on the assets, the rate of the increase in salary and the rates of employee turnover. There is material uncertainty in respect to these estimates because of the long-term programs, see note 18.

2. Short term benefits

Short term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognized for the amount expected to be paid if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

3. Share based payments

The grant date fair value of options granted to employees is recognized as salaries and related expenses, with a corresponding increase in retained earnings, over the period that the employees become unconditionally entitled to the options. The amount recognized as an expense is adjusted to reflect the actual number of share options that vest.

Fair value is measured using the Black-Scholes model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioral considerations and that are expected to vest to shares.

K. Provisions

A provision is recognized if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the

obligation. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the reporting date.

A provision for claims is recognized if, as a result of a past event, the Group has a present legal or constructive obligation and it is more likely than not that an outflow of economic benefits will be required to settle the obligation and the amount of obligation can be estimated reliably.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

A provision for onerous contracts is recognized when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract.

L. Revenue

Revenues derived from services, including airtime, internet services (ISP), international calls services, fixed local calls, interconnect and roaming revenues, are recognized when the services are provided, in proportion to the stage of completion of the transaction and all other revenue recognition criteria are met.

A contract with a customer to sale handset, usually includes an engagement to provide future services. Usually, the sale of handset to the customer is executed with no contractual obligation of the client to consume services in a minimal amount for a predefined period. As a result, the Group refers to the sale transaction as a separate transaction and recognizes revenue from sale of handset upon delivery of the handset to the customer. Revenue from services is recognized and recorded when the services are provided.

In case the customer is obligated towards the Group to consume services in a minimal amount for a predefined period, the contract is characterized as a multiple element arrangement and thus, revenue from sale of handset is recorded in an amount not higher than the fair value of the said handset, which is not contingent upon delivery of additional components (such as services) and is recognized upon delivery to the customer and when the criteria for revenue recognition are met. The Group determines the fair value of the individual elements based on prices at which the deliverable is regularly sold on a standalone basis, after considering volume discounts where appropriate.

The Group recognizes revenue from providing services in connection with software transactions, the results of which are reliably estimable, according to the stage of the completion of the transaction at the reporting date.

The Group, among others, offers value added services including voice mail, text and multimedia messaging, as well as downloadable wireless data applications, including ring tones, music, games, and other informational content. Generally, these enhanced features and data applications generate additional service revenues through monthly subscription fees or increased usage through utilization of the features and applications. Other optional services, such as equipment extended warranty plans are also provided for a monthly fee and are either sold separately or bundled and included in packaged rate plans. Revenues from enhanced features and optional services are recognized when earned.

Revenues from long-term credit arrangements are recognized on the basis of the present value of future cash flows, discounted according to market interest rates at the time of the transaction. The difference between the original credit and its present value is recorded as interest income over the credit period.

Prepaid wireless airtime sold to customers is recorded as deferred revenue prior to the commencement of services and is recognized when the airtime is used or expires.

When the Group acts as an agent or an intermediary without bearing the risks and rewards resulting from the transaction, revenues are presented on a net basis (as a profit or a commission). However, when the Group acts as a principal supplier and bears the risks and rewards resulting from the transaction, revenues are presented on a gross basis, distinguishing the revenue from the related expenses. Costs of revenues mainly include ongoing license fees, interconnection and roaming expenses, cell site

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Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

leases, depreciation and amortization charges and technical repair and maintenance expenses directly related to services rendered.

M. Lease payments

Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease.

N. Financing income and expenses

Financing income is comprised of interest income on cash deposits, interest income on installment sales and from investment in debt securities. Interest income is recognized in the consolidated statement of income as it accrues using the effective interest method.

Financing expenses are comprised of interest and indexing expenses on loans and debentures and unwinding of the discount on provisions. All borrowing costs are recognized in profit and loss using the effective interest method.

Foreign currency, investment in debt securities and hedging instruments gains and losses that are recognized in profit or loss are reported on a net basis.

O. Income tax expense

Income tax comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination, or are recognized directly in equity or in other comprehensive income to the extent they relate to items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted at the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

P. Earnings per share

The Company presents basic and diluted earnings per share ("EPS") data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit and loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees.

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Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

Q. Advertising expenses

Advertising costs are expensed as incurred.

R. New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective, and have not been applied in preparing these consolidated financial statements:

1. IFRS 10 Consolidated Financial Statements (hereinafter – “IFRS 10”). IFRS 10 replaces the requirements of IAS 27 Consolidated and Separate Financial Statements and the requirements of SIC-12 Consolidation – Special Purpose Entities with respect to the consolidation of financial statements, so that the requirements of IAS 27 will continue to be valid only for separate financial statements.

IFRS 10 introduces a new single control model for determining whether an investor controls an investee and should therefore consolidate it. This model is implemented with respect to all investees. According to the model, an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with that investee, has the ability to affect those returns through its power over that investee and there is a link between power and returns.

IFRS 10 is applicable retrospectively (with a certain relief) for annual periods beginning on or after January 1, 2013. Early adoption is permitted providing that disclosure is provided and that the entire new suite of standards is early adopted, meaning also the additional standards that were issued at the same time – IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Involvement with Other Entities, IAS 27 (2011) and IAS 28 (2011).

The Group is examining the effect of adopting IFRS 10 on its financial statements.

2. IFRS 11 Joint Arrangements (hereinafter – “IFRS 11”). IFRS 11 replaces the requirements of IAS 31 Interests in Joint Ventures (hereinafter – IAS 31) and amends part of the requirements in IAS 28 Investments in Associates.

IFRS 11 defines a joint arrangement as an arrangement over which two or more parties have joint control (as defined in IFRS 10). Joint arrangements are divided into two types: a joint operation and a joint venture.

IFRS 11 is applicable retrospectively for annual periods beginning on or after January 1, 2013, but there are specific requirements for retrospective implementation in certain cases. Early adoption is permitted providing that disclosure is provided and that the entire new suite of standards is early adopted, meaning also the additional standards that were issued at the same time – IFRS 10 Consolidated Financial Statements, IFRS 12 Disclosure of Involvement with Other Entities, IAS 27 (2011) and IAS 28 (2011).

The Group is examining the effect of adopting IFRS 11 on its financial statements.

3. IFRS 12 Disclosure of Involvement with Other Entities (hereinafter – “IFRS 12”). IFRS 12 contains extensive disclosure requirements for entities that have interests in subsidiaries, joint arrangements (i.e. joint operations or

joint ventures), associates and unconsolidated structured entities.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

IFRS 12 is applicable for annual periods beginning on or after January 1, 2013. Early adoption is permitted providing that the entire new suite of standards is early adopted, meaning also the additional standards that were issued at the same time – IFRS 11 Joint Arrangements, IFRS 10 Consolidated Financial Statements, IAS 27 (2011) and IAS 28 (2011).

Nevertheless, it is permitted to voluntarily provide the additional disclosures required by IFRS 12 prior to its adoption without early adopting the other standard.

The Group is examining the effect of adopting the standards on its financial statements.

4. IFRS 13 Fair Value Measurement (hereinafter – “IFRS 13”). IFRS 13 replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. IFRS 13 does not introduce new requirements to measure assets or liabilities at fair value.

IFRS 13 applies to assets, liabilities and an entity’s own equity instruments that, under other IFRSs, are required or permitted to be measured at fair value or when disclosure of fair value is provided. Nevertheless, IFRS 13 does not apply to share based payment transactions within the scope of IFRS 2 Share-Based Payment and leasing transactions within the scope of IAS 17 Leases.

IFRS 13 does not apply to measurements that are similar to but are not fair value (such as the measurement of the net realizable value of inventory, in accordance with IAS 2 Inventories, and the measurement of value in use, in accordance with IAS 36 Impairment of Assets).

IFRS 13 is applicable prospectively for annual periods beginning on or after January 1, 2013. Earlier application is permitted with disclosure of that fact. The disclosure requirements of IFRS 13 need not be applied in comparative information for periods before initial application.

The Group is examining the effect of adopting IFRS 13 on its financial statements.

5. Amendment to IAS 1, Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income (hereinafter - “the Amendment”). The Amendment changes the presentation of items of other comprehensive income (hereinafter – “OCI”) in the financial statements, so that items of OCI that may be reclassified to profit or loss in the future, would be presented separately from those that would never be reclassified to profit or loss. Additionally, the Amendment changes the title of the Statement of Comprehensive Income to Statement of Profit or Loss and Other Comprehensive Income. However, entities are still allowed to use other titles. The Amendment is effective for annual periods beginning on or after July 1, 2012. The amendment will be applied retrospectively. Early adoption is permitted providing that disclosure is provided. The Group is examining the effect of adopting the Amendment on its financial statements.
6. Amendment to IAS 19, Employee Benefits (hereinafter – “the Amendment”). The Amendment introduces a number of changes to the accounting treatment of employee benefits.

The key changes are as follows:

- The Amendment requires immediate recognition of past service costs regardless of whether the benefits have vested or not.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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Note 3 - Significant Accounting Policies (cont'd)

- The calculation of net financing income or expense will be determined by applying the discount rate used to measure the defined benefit obligation to the net defined benefit liability (asset). Accordingly, calculation of actuarial gains or losses will also change.
- The Amendment changes the definitions of short-term employee benefits and of other long term employee benefits, so that the distinction between the two will depend on when the entity expects the benefits to be wholly settled, rather than when settlement is due.
- The Amendment enhances the disclosure requirements for defined benefit plans, in an effort to provide better information about the characteristics of defined benefit plans and the risks that entities are exposed to through participation in those plans.
- The definition of termination benefits has been clarified in accordance with IAS 37, Provisions, Contingent Liabilities and Contingent Assets, so that termination benefits are recognized at the earlier of when the entity recognizes costs for a restructuring that includes the payment of termination benefits, and when the entity can no longer withdraw the offer of the termination benefits.

The Amendment is applicable retrospectively (excluding certain exceptions stated in the Amendment) for annual periods beginning on or after January 1, 2013. Early adoption is permitted providing that disclosure is provided.

The Group is examining the effect of adopting the Amendment on its financial statements.

7. Amendment to IFRS 7 Financial Instruments: Disclosures, Transfers of Financial Assets (hereinafter - "the Amendment") - The Amendment introduces new disclosure requirements regarding transfers of financial assets, including disclosures for:

Financial assets that were not derecognized in their entirety, including disclosures of the risks and rewards associated with these assets, the relationship between the transferred assets and the associated liabilities, the restrictions on the Group's use of the assets and so forth; and

Financial assets that were derecognized in their entirety but the entity has a continuing involvement in them, including the carrying amount and fair value that represents the Group's involvement in these assets, the Group's maximum exposure to losses from these assets, an analysis of the undiscounted cash flows as well as the gain or loss from the transfer of the asset and the income or expense arising from the Group's continuing involvement in the asset.

The Amendment is effective for annual periods beginning on or after July 1, 2011. The disclosures required in the Amendment are not required for periods presented in comparative information that began before the Amendment came into effect. Early application is permitted with disclosure.

The Group is examining the effect of adopting the Amendment on its financial statements.

8. Amendment to IFRS 7 Financial Instruments: Disclosures and to IAS 32 Financial Instruments: Presentation - Offsetting of Financial Assets and Financial Liabilities (hereinafter - “the Amendment to IFRS 7” and “the Amendment to IAS 32”, respectively). The Amendment to IAS 32 clarifies that an entity currently has a legally enforceable right to set-off amounts that were recognized if that right is not contingent on a future event; and it is enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and all its counterparties. The Amendment to IFRS 7 contains new disclosure requirements for financial assets and liabilities that are offset in the statement of financial position; or are subject to master netting agreements or similar agreements.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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## Note 3 - Significant Accounting Policies (cont'd)

The Amendment to IFRS 7 is effective for annual periods beginning on or after January 1, 2013. The Amendment to IAS 32 is effective for annual periods beginning on or after January 1, 2014. The Amendments are to be applied retrospectively. Early application of the Amendment to IAS 32 is permitted subject to the concurrent application of Amendment to IFRS 7.

The Group is examining the effect of adopting the amendments on its financial statements.

9. IFRS 9 (2010), Financial Instruments (hereinafter – “the Standard”) – This Standard is one of the stages in a comprehensive project to replace IAS 39 Financial Instruments: Recognition and Measurement (hereinafter - IAS 39) and it replaces the requirements included in IAS 39 regarding the classification and measurement of financial assets and financial liabilities.

In accordance with the Standard, there are two principal categories for measuring financial assets: amortized cost and fair value, with the basis of classification for debt instruments being the entity’s business model for managing financial assets and the contractual cash flow characteristics of the financial asset. In accordance with the Standard, an investment in a debt instrument will be measured at amortized cost if the objective of the entity’s business model is to hold assets in order to collect contractual cash flows and the contractual terms give rise, on specific dates, to cash flows that are solely payments of principal and interest. All other debt assets are measured at fair value through profit or loss. Furthermore, embedded derivatives are no longer separated from hybrid contracts that have a financial asset host. Instead, the entire hybrid contract is assessed for classification using the principles above. In addition, investments in equity instruments are measured at fair value with changes in fair value being recognized in profit or loss. Nevertheless, the Standard allows an entity on the initial recognition of an equity instrument not held for trading to elect irrevocably to present fair value changes in the equity instrument in other comprehensive income where no amount so recognized is ever classified to profit or loss at a later date. Dividends on equity instruments where revaluations are measured through other comprehensive income are recognized in profit or loss unless they clearly constitute a return on an initial investment.

The Standard generally preserves the instructions regarding classification and measurement of financial liabilities that are provided in IAS 39. Nevertheless, unlike IAS 39, IFRS 9 (2010) requires as a rule that the amount of change in the fair value of financial liabilities designated at fair value through profit or loss, other than loan grant commitments and financial guarantee contracts, attributable to changes in the credit risk of the liability, be presented in other comprehensive income, with the remaining amount being included in profit or loss. However, if this requirement aggravates an accounting mismatch in profit or loss, then the whole fair value change is presented in profit or loss. Amounts thus recognized in other comprehensive income may never be reclassified to profit or loss at a later date. The new standard also eliminates the exception that allowed measuring at cost derivative liabilities that are linked to and must be settled by delivery of an unquoted equity instrument whose fair value cannot be reliably measured. Such derivatives are to be measured at fair value.

The Group decided to early adopt the Standard from the first quarter of 2012.

In the opinion of the Group, the new standards will not have a material effect on the financial statements.



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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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## Note 4 - Determination of fair values

A number of the Group's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and / or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

## A.Fixed assets

The fair value of fixed assets recognized as a result of a business combination is based on market values. The market value of fixed assets is the estimated amount for which a fixed asset could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction wherein the parties each acted knowledgeably. The market value of items of plant, equipment, fixtures and fittings is based on quoted market prices for similar items, when available, and on replacement costs when such quotes are unavailable. Depreciated replacement cost estimates reflect adjustments for physical deterioration as well as functional and economic obsolescence of the fixed asset.

## B.Intangible assets

The fair value of trademarks acquired in a business combination is based on the discounted estimated royalty payments that have been avoided as a result of the trademark being owned. The fair value of customer relationships acquired in a business combination is determined using the multi-period excess earnings method, whereby the subject asset is valued after deducting a fair return on all other assets that are part of creating the related cash flows.

The fair value of other intangible assets is based on the discounted cash flows expected to be derived from the use and eventual sale of the assets.

## C.Inventories

The fair value of inventories acquired in a business combination is determined based on the estimated selling price in the ordinary course of business less the estimated costs of completion and sale, and a reasonable profit margin based on the effort required to complete and sell the inventories.

## D. Trade and other receivables

The fair value of trade and other receivables is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date.

## E. Current investments and derivatives

The fair value of forward exchange contracts is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity of the contract using a risk-free interest rate (based on government bonds).

The fair value of interest rate swaps is based on broker quotes. Those quotes are tested for reasonableness by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date. The fair value of investments in debt securities is based on quoted market prices.

## F. Non-derivative financial liabilities

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date. The fair value of marketable debentures is determined by reference to the quoted closing asking price at the reporting date.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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## Note 4 - Determination of fair values (cont'd)

## G. Share- based payment transactions

Fair value of employee stock options is measured using the Black-Scholes formula. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behavior), expected dividends, and the risk-free interest rate (based on government bonds). Service and non-market performance conditions attached to the transactions are not taken into account in determining fair value.

## Note 5 - Financial Risk Management

The Group is exposed to credit, liquidity and market risks as part of its normal course of business. The Group's risk management objective is to monitor risks and minimize the possible influence that results from this exposure, according to its evaluations and expectations of the parameters that affect the risks. The Group uses derivative instruments in order to partially hedge its exposure to foreign currency exchange rate and interest rate fluctuations. See also note 21.

## Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers. Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. The Group conducts credit evaluations on receivables over a certain amount, and requires financial guarantees against them. Management monitors outstanding receivable balances and the financial statements include appropriate allowances for estimated irrecoverable amounts. The Group is exposed to credit risk arising mainly from its operation in Israel. The Group invests in high ranked Israeli government and institutional debt securities. The Group's cash and cash equivalents are maintained with major banking institutions in Israel. At the reporting date, there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivatives, in the consolidated statement of financial position. Financial instruments that could potentially subject the Group to credit risks consist primarily of trade receivables. Credit risk with respect to these receivables is limited due to the composition of the subscriber base, which includes a large number of individuals and businesses.

## Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and extreme conditions, without incurring unacceptable losses or risking damage to the Group's reputation. The Group's policy is to ensure that it has sufficient cash and cash equivalents to meet expected operational expenses, including financial obligations.

## Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

## Interest rate risk

The Group is exposed to fluctuations in the interest rate, including changes in the CPI, as the majority of its borrowings are linked to the CPI. As part of its risk management policy the Group has entered into forward contracts that partially hedge the exposure to changes in the CPI.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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## Note 5 - Financial Risk Management (cont'd)

## Currency risk

The Group's operating income and cash flows are exposed to currency risk, mainly due to handset and network related acquisitions and its roaming activity. The Group also manages bank accounts that are denominated in a currency other than its respective functional currency, primarily USD and Euro. As part of its risk management policy the Group uses forward and option contracts to partially hedge the exposure to fluctuations in foreign exchange rates.

## Capital management

The Group's capital management aim is to ensure a sound and efficient capital structure which takes into consideration, among others, the following factors:

A gearing ratio that supports the Group's cash flow needs with respect to its potential cash flow generation, supporting its dividend policy, while maintaining a net debt to EBITDA (earnings before interest (financing expenses, net), taxes, other income and expenses, depreciation and amortization and share based payments) ratio that meets the industry standards. The Group considers net debt to EBITDA ratio to be an important measure for investors, analysts, and rating agencies. This ratio is a non-GAAP figure not governed by International Financial Reporting Standards and its definition and calculation may vary from one Group to another. The Group's debt consists of short and long term debentures traded publicly in the Tel Aviv Stock Exchange.

## Note 6 - Operating segments

Until August 31, 2011 the Company operated as a one operating segment. From September 1, 2011 and following the completion of the merger of Netvision Ltd. to be a wholly owned subsidiary of the Company, the Group has identified two reportable segments, as described below, which are the Group's strategic business units. The strategic business unit's allocation of resources and evaluation of performance are managed separately. The operating segments were determined based on internal management reports reviewed by the Group's chief operating decision maker (CODM). The CODM does not examine assets or liabilities for those segments and therefore, they are not presented.

—Cellcom – the segment includes Cellcom Israel Ltd. and its subsidiaries, excluding Netvision Ltd. and its subsidiaries.

— Netvision – the segment includes Netvision Ltd. and its subsidiaries.

The accounting policies of the reportable segments are the same as described in note 3 regarding significant accounting policies.

Information regarding the results of each reportable segment is included below based on the internal management reports that are reviewed by the CODM.

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Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 6 - Operating segments (cont'd)

|                                       | Year ended December 31,<br>2011<br>NIS millions |            |  |              |
|---------------------------------------|---|------------|--|--------------|
|                                       | Cellcom   | Netvision* | Reconciliation<br>for<br>consolidation | Consolidated |
| Revenues                              | 6,125   | 381        | -                                      | 6,506        |
| Inter-segment revenues                | 7   | 19         | (26 )                                  | -            |
| Interest income                       | 92  | 1          | -                                      | 93           |
| Interest expenses                     | (286 )  | -          | -                                      | (286 )       |
| EBITDA**                              | 2,084   | 83         | -                                      | 2,167        |
| Reconciliation of reoportable segment |   |            |  |              |
| EBITDA to net profit                  |   |            |  |              |
| Depreciation and amortization         | (652 )  | (40 )      | (46 )                                  | (738 )       |
| Taxes on income                       | (313 )  | (2 )       | 11                                     | (304 )       |
| Financing income                      |   |            |  | 116          |
| Financing expenses                    |   |            |  | (409 )       |
| Other expenses                        |   |            |  | (1 )         |
| Share based payments                  |   |            |  | (6 )         |
| Net profit                            | 821   | 39         | (35 )                                  | 825          |

\* Netvision segment represents results of operations for the four month period commencing September 1, 2011 (see note 7).

\*\*EBITDA as reviewed by the CODM, represents earnings before interest (financing expenses, net), taxes, other income and expenses, depreciation and amortization and share based payments, as a measure of operating profit. EBITDA is not a financial measure under IFRS and cannot be compared to other similarly titled measures in other companies.

## Note 7 - Acquisition of Subsidiary

## Business combination

On August 31, 2011 (the "date of acquisition"), the merger transaction of Netvision to be a wholly owned subsidiary of the Company (hereinafter - "the Acquisition"), was completed. Netvision is primarily engaged with providing

Internet service, international landline telephone service, as well as providing local landline telephony services. As a result of the merger, the Company holds 100% of the merged company, Netvision, and commencing with the date of acquisition, Netvision it is fully consolidated in the Company's financial statements.

Following the acquisition of Netvision, the Group believes it will be able to provide its customers an additional variety of communication services, which will strengthen its position as a communication group which provides wide answer to customer's cellular and wireline needs.

Since the acquisition date and until December 31, 2011, Netvision contributed NIS 374 million (net of intercompany revenues) and NIS 4 million to the Group's revenues and net income, respectively (after depreciation of Purchase Price Allocation, net in a total amount of NIS 35 million).

According to management's estimates and assumptions, if the acquisition had occurred on January 1, 2011, consolidated revenues would have been NIS 7,257 million and consolidated profit for the year would have been NIS 799 million. In determining these amounts, management has assumed that the fair value adjustments that arose on the date of acquisition, would have been the same if the acquisition had occurred on January 1, 2011.

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Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 7 - Acquisition of Subsidiary (cont'd)

The following summarizes the major classes of consideration transferred, and the recognized amounts of assets acquired and liabilities assumed at the acquisition date:

## Consideration transferred

|   | NIS<br>millions |
|---|-----------------|
| Cash                                      | 1,570           |
| Share-based awards - cost of past service | 8               |
| Total consideration transferred           | 1,578           |

## Replacement of share-based payment awards

According to the terms of the merger agreement, the Company committed to exchange share-based payment awards held by employees of Netvision for cash consideration.

The Company recognized NIS 8 million as part of the cost of the business combination on the basis of the portion of awards that can be attributed to services provided before the business combination. An amount of NIS 2 million is recognized as post-acquisition compensation cost over the service period.

## Identifiable assets acquired and liabilities assumed

## Summary of assets acquired and liabilities assumed at acquisition date:

|                                 | NIS<br>millions |
|---------------------------------|-----------------|
| Trade and other receivables     | 599             |
| Inventory                       | 5               |
| Intangible assets               | 1,099           |
| Deferred tax liabilities        | (44 )           |
| Property, plant and equipment   | 180             |
| Trade and other payables        | (326 )          |
| Credit and loans                | (45 )           |
| Provisions                      | (10 )           |
| Net assets acquired             | 1,458           |
| Cash acquired                   | 120             |
| Total consideration transferred | 1,578           |

The acquisition is accounted for using the acquisition method. The Company allocated the total purchase price to assets acquired and liabilities assumed using estimates of their fair values and amortization periods.

The intangible assets which were recognized during the acquisition, mainly consist of goodwill in the amount of approximately NIS 753 million, and customer relationship in the amount of approximately NIS 277 million, which is amortized over its useful life of approximately 6 years.

Goodwill was calculated as a residual value of the consideration that was paid, net of the assets that were identified at the time of the acquisition.

The goodwill is attributable mainly to the synergies expected to be achieved from integrating Netvision into the Group's communication business and the skills and technical talent of the acquiree's work force (see also note 12 regarding intangible assets, net). None of the goodwill recognized is expected to be deductible for tax purposes.

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Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 7 - Acquisition of Subsidiary (cont'd)

## Acquisition-related costs

The Company incurred acquisition-related costs of NIS 8 million mainly related to consulting fees, legal fees and due diligence costs. These costs have been included in general and administrative expenses in the statement of income.

## Note 8 - Cash and Cash Equivalents

## Composition

|               | December 31, |              |
|---------------|--------------|--------------|
|               | 2010         | 2011         |
|               | NIS millions | NIS millions |
| Bank balances | 32           | 14           |
| Call deposits | 501          | 906          |
|               | 533          | 920          |

The Group's exposure to interest rate risk and sensitivity analysis for financial assets and liabilities is disclosed in note 21.

## Note 9 - Trade and Other Receivables

## Composition

|   | December 31 |          |
|---|-------------|----------|
|   | 2010        | 2011     |
|   | NIS         | NIS      |
|   | millions    | millions |
| Current                                   |             |          |
| Trade Receivables*                        |             |          |
| Open accounts                             | 486         | 524      |
| Checks and credit cards receivables       | 221         | 250      |
| Accrued income                            | 115         | 148      |
| Current maturity of long-term receivables | 656         | 937      |
|   | 1,478       | 1,859    |
| Other Receivables                         |             |          |
| Prepaid expenses                          | 49          | 60       |
| Other                                     | 15          | 6        |
| Assets held for sale                      | -           | 27       |
|   | 64          | 93       |
|   | 1,542       | 1,952    |
| Non-current                               |             |          |
| Trade receivables*                        | 523         | 980      |
| Rights of use of communication lines      | -           | 259      |
| Deposits and other receivables            | 55          | 56       |



|       |       |       |
|-------|-------|-------|
| Other | 19    | 42    |
|       | 597   | 1,337 |
|       | 2,139 | 3,289 |

\* Net of allowance for doubtful debts.

The Group is exposed to credit risks and impairment losses related to trade and other receivables as disclosed in note 21.

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Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 10 - Inventory

## A. Composition

|             | December 31, |              |
|-------------|--------------|--------------|
|             | 2010         | 2011         |
|             | NIS millions | NIS millions |
| Handsets    | 68           | 137          |
| Accessories | 14           | 14           |
| Spare parts | 22           | 19           |
|             | 104          | 170          |

B. Inventories of handsets, accessories and spare-parts as at December 31, 2011 and December 31, 2010 are presented net of a provision for impairment and inventory write off in the amount of NIS 19 million and NIS 8 million, respectively.

## Note 11 - Property, Plant and Equipment, Net

|   | Communication<br>network<br>NIS millions | Control<br>and<br>testing<br>equipment<br>NIS<br>millions | Vehicles<br>NIS<br>millions | Computers,<br>furniture<br>and office<br>equipment<br>NIS<br>millions | Leasehold<br>improvements<br>NIS<br>millions | Total<br>NIS<br>millions |
|---|--|---|-----------------------------|---|--|--------------------------|
| Cost  |  |   |                             |   |  |                          |
| Balance at January 1, 2010                  | 5,927                                    | 342   | 32                          | 863   | 216  | 7,380                    |
| Additions                                   | 319                                      | 20  | 14                          | 47  | 20   | 420                      |
| Disposals                                   | (121 )                                   | -   | (4 )                        | (14 )   | -  | (139 )                   |
| Balance at December 31, 2010                | 6,125                                    | 362   | 42                          | 896   | 236  | 7,661                    |
| Business combination*                       | 577                                      | -   | 19                          | 444   | 60   | 1,100                    |
| Additions                                   | 291                                      | 14  | 7                           | 69  | 5  | 386                      |
| Disposals                                   | (17 )                                    | (1 )  | (4 )                        | (11 )   | -  | (33 )                    |
| Reclassification to assets held<br>for sale | (1 )                                     | -   | -                           | (4 )  | -  | (5 )                     |
| Balance at December 31, 2011                | 6,975                                    | 375   | 64                          | 1,394   | 301  | 9,109                    |
| Accumulated Depreciation                    |  |   |                             |   |  |                          |
| Balance at January 1, 2010                  | 4,202                                    | 261   | 10                          | 661   | 150  | 5,284                    |
| Depreciation for the year                   | 342                                      | 21  | 4                           | 64  | 15   | 446                      |

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|  |        |      |      |       |     |        |
|--|--------|------|------|-------|-----|--------|
| Disposals                                | (119 ) | -    | (2 ) | (11 ) | -   | (132 ) |
| Balance at December 31, 2010             | 4,425  | 282  | 12   | 714   | 165 | 5,598  |
| Business combination*                    | 493    | -    | 6    | 376   | 45  | 920    |
| Depreciation for the year                | 343    | 20   | 7    | 71    | 16  | 457    |
| Disposals                                | (15 )  | (1 ) | (3 ) | (11 ) | -   | (30 )  |
| Reclassification to assets held for sale | (1 )   | -    | -    | (3 )  | -   | (4 )   |
| Balance at December 31, 2011             | 5,245  | 301  | 22   | 1,147 | 226 | 6,941  |
| Carrying amounts                         |        |      |      |       |     |        |
| At January 1, 2010                       | 1,725  | 81   | 22   | 202   | 66  | 2,096  |
| At December 31, 2010                     | 1,700  | 80   | 30   | 182   | 71  | 2,063  |
| At December 31, 2011                     | 1,730  | 74   | 42   | 247   | 75  | 2,168  |

\* As part of the acquisition, property, plant and equipment, net in the amount of NIS 180 million, has been acquired (see note 7).

In the ordinary course of business, the Group acquires property, plant and equipment in credit. The cost of acquisitions, which has not yet been paid at the reporting date, amounted to NIS 157 million.

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Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 12 - Intangible Assets, Net

| Cost  | Licenses<br>NIS<br>millions | Information<br>Systems<br>NIS<br>millions | Software<br>NIS<br>millions | Deferred<br>Expenses<br>NIS<br>millions | Goodwill<br>NIS<br>millions | Customer<br>Relationship<br>and Other<br>NIS<br>millions | Total<br>NIS<br>millions |
|---|-----------------------------|---|-----------------------------|---|-----------------------------|--|--------------------------|
| Balance at January 1,<br>2010               | 550                         | 684                                       | 336                         | 350                                     | -                           | -  | 1,920                    |
| Additions                                   | -                           | 80  | 19                          | 114                                     | 77                          | 25   | 315                      |
| Disposals                                   | -                           | -   | -                           | (122 )                                  | -                           | -  | (122 )                   |
| Balance at December<br>31, 2010             | 550                         | 764                                       | 355                         | 342                                     | 77                          | 25   | 2,113                    |
| Business combination*                       | 6                           | 40  | -                           | -                                       | 753                         | 322  | 1,121                    |
| Additions                                   | -                           | 69  | 13                          | 6                                       | -                           | -  | 88                       |
| Disposals                                   | -                           | (18 )                                     | -                           | (296 )                                  | -                           | -  | (314 )                   |
| Reclassification to<br>assets held for sale | -                           | (3 )                                      | -                           | -                                       | -                           | -  | (3 )                     |
| Balance at December<br>31, 2011             | 556                         | 852                                       | 368                         | 52                                      | 830                         | 347  | 3,005                    |
| Accumulated<br>Amortization                 |                             |   |                             |   |                             |  |                          |
| Balance at January 1,<br>2010               | 197                         | 512                                       | 260                         | 240                                     | -                           | -  | 1,209                    |
| Amortization for the<br>year                | 30                          | 69  | 30                          | 139                                     | -                           | 5  | 273                      |
| Disposals                                   | -                           | -   | -                           | (122 )                                  | -                           | -  | (122 )                   |
| Balance at December<br>31, 2010             | 227                         | 581                                       | 290                         | 257                                     | -                           | 5  | 1,360                    |
| Business combination*                       | 3                           | 19  | -                           | -                                       | -                           | -  | 22                       |
| Amortization for the<br>year                | 28                          | 80  | 25                          | 79                                      | -                           | 48   | 260                      |
| Disposals                                   | -                           | (18 )                                     | -                           | (296 )                                  | -                           | -  | (314 )                   |
| Reclassification to<br>assets held for sale | -                           | (3 )                                      | -                           | -                                       | -                           | -  | (3 )                     |
| Balance at December<br>31, 2011             | 258                         | 659                                       | 315                         | 40                                      | -                           | 53   | 1,325                    |
| Carrying amounts                            |                             |   |                             |   |                             |  |                          |

|                      |     |     |    |     |     |     |       |
|----------------------|-----|-----|----|-----|-----|-----|-------|
| At January 1, 2010   | 353 | 172 | 76 | 110 | -   | -   | 711   |
| At December 31, 2010 | 323 | 183 | 65 | 85  | 77  | 20  | 753   |
| At December 31, 2011 | 298 | 193 | 53 | 12  | 830 | 294 | 1,680 |

\* As part of the acquisition, intangible assets, net in the amount of NIS 1,099 million, have been acquired (see note 7).

A. Impairment testing for cash-generating unit containing goodwill

For the purpose of impairment testing, goodwill is allocated to Netvision, which represents the lowest level within the Group, at which goodwill is monitored for internal management purposes, which is not higher than the operating segments, reported in note 6 regarding operating segments.

The aggregate carrying amount of goodwill allocated to Netvision is as follows:

|           |   |
|-----------|---|
|           | December<br>31<br>2011<br>NIS<br>millions |
| Netvision | 753                                       |

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## Note 12 - Intangible Assets, Net (cont'd)

The recoverable amount of Netvision was based on its value in use and was determined by discounting the expected future cash flows to be generated from the continuing use. The recoverable amount of Netvision was determined to be higher than its carrying amount and thus, no impairment loss has been recognized.

## B. Key assumptions used in calculation of recoverable amount

Key assumptions used in the calculation of recoverable amounts are discount rates and terminal value growth rates. These assumptions are as follows:

|           | After-tax<br>discount rate | Terminal value<br>growth rate<br>2011 |
|-----------|----------------------------|---------------------------------------|
| Netvision | 13.0%                      | 1.5%                                  |

## (1) After-tax discount rate

The after-tax discount rate of Netvision was based on Netvision's weighted average cost of capital.

Netvision's after-tax discount rate was based on the risk-free rate for 15-year NIS denominated debentures issued by the Israeli government, in addition to the average risk premium of the capital market multiplied by the relative risk factor of Netvision (Beta), reflecting the sensitivity of the investment value to fluctuations in the capital market as a whole.

The after-tax discount rate as mentioned above, represents a pre-tax discount rate of 17.6%.

## (2) Terminal value growth rate

Netvision has cash flows for 5 years, as included in its discounted cash flow model. The long-term growth rate has been determined as 1.5%. This rate reflects the assumption that in the long term Netvision's growth will be lower than the inflation in the State of Israel and that, in the light of long term trends of Netvision's prices erosion and in the light of technology developments and competition in the markets in which Netvision operates.

## (3) Sensitivity to changes in assumptions

The estimated recoverable amount of Netvision exceeds its carrying amount by approximately NIS 7 million. Management has identified two key assumptions for which there reasonably could be a possible change that could cause the carrying amount to exceed the recoverable amount. The table below shows the amount that these two assumptions are required to change individually in order for the estimated recoverable amount to be equal to the carrying amount.

|                         |      |
|-------------------------|------|
|                         | 2011 |
|                         | %    |
| After-tax discount rate | 13.1 |

Terminal value growth rate

1.4

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Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 13 - Trade Payables and Accrued Expenses

## Composition

|                  | December 31  |              |
|------------------|--------------|--------------|
|                  | 2010         | 2011         |
|                  | NIS millions | NIS millions |
| Trade payables   | 267          | 554          |
| Accrued expenses | 449          | 472          |
|                  | 716          | 1,026        |

## Note 14 - Provisions

|                                       | Dismantling<br>and<br>restoring<br>sites<br>NIS<br>millions | Litigations<br>NIS<br>millions | Other legal<br>obligations<br>NIS<br>millions | Other<br>NIS<br>millions | Total<br>NIS<br>millions |
|---------------------------------------|---|--------------------------------|---|--------------------------|--------------------------|
| Balance as at January 1, 2011         | 17  | 22                             | 58  | 4                        | 101                      |
| Business combination                  | -   | 10                             | -   | -                        | 10                       |
| Provisions made during the period     | 4   | 39                             | 19  | -                        | 62                       |
| Provisions reversed during the period | (1 )  | (4 )                           | -   | -                        | (5 )                     |
| Unwind of discount                    | 1   | -                              | -   | -                        | 1                        |
| Balance as at December 31, 2011       | 21  | 67                             | 77  | 4                        | 169                      |
| Non-current                           | 21  | -                              | -   | -                        | 21                       |
| Current                               | -   | 67                             | 77  | 4                        | 148                      |
|                                       | 21  | 67                             | 77  | 4                        | 169                      |

## Dismantling and restoring sites

The Group is required to incur certain costs in respect of a liability to dismantle and remove assets and to restore sites on which the assets were located. These dismantling costs are calculated on the basis of the identified costs for the current financial year, extrapolated for future years using the best estimate of future trends in prices, inflation, etc, and are discounted at a risk-free rate. Forecast of estimated site departures or asset returns is revised in light of future changes in regulations or technological requirements.

## Litigations

The Group is involved in a number of legal and other disputes with third parties. The Group's management, after taking legal advice, has established provisions which take into account the facts of each case. The timing of cash outflows associated with legal claims cannot be reasonably determined. For detailed information regarding legal proceedings against the Group, refer to note 31.



**Other legal obligations**

Provisions for other legal obligations include various obligations that are derived either from a constructive obligation or legislation for which there is a high uncertainty regarding the timing and amount of future expenditure required for settlement.

**Other**

Include provisions for warranties, as well as a variety of other items for which the individually recognized amounts are largely not material.

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Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 15 - Other Payables, Including Derivatives

## Composition

|                                    | December 31  |                      |
|------------------------------------|--------------|----------------------|
|                                    | NIS millions | 2011<br>NIS millions |
| Employees and related liabilities  | 110          | 182                  |
| Government institutions            | 38           | 17                   |
| Interest payable                   | 163          | 248                  |
| Accrued expenses                   | -            | 26                   |
| Deferred revenue                   | 50           | 44                   |
| Derivative financial instruments   | 18           | 11                   |
| Liability for assets held for sale | -            | 19                   |
|                                    | 379          | 547                  |

## Note 16 - Other Long-term Liabilities

## Composition

|   | December 31          |                      |
|---|----------------------|----------------------|
|   | 2010<br>NIS millions | 2011<br>NIS millions |
| Long-term liabilities to trade payables                             | -                    | 24                   |
| Deferred revenue in respect of rights of use of communication lines | -                    | 6                    |
| Derivative financial instruments                                    | -                    | 11                   |
|   | -                    | 41                   |

## Note 17 - Debentures and Loans from Banks

This note provides information about the contractual terms of the Group's interest-bearing loans and debentures, which are measured at amortized cost. For more information about the Group's exposure to interest rate, foreign currency and liquidity risk, see note 21.

|                          | December 31          |                      |
|--------------------------|----------------------|----------------------|
|                          | 2010<br>NIS millions | 2011<br>NIS millions |
| Non- current liabilities |                      |                      |
| Debentures               | 3,913                | 5,452                |

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|  |       |       |
|--|-------|-------|
| Loans from banks                                 | -     | 19    |
|  | 3,913 | 5,471 |
| Current liabilities                              |       |       |
| Current maturities of debentures                 | 348   | 658   |
| Current maturities of long-term loans from banks | -     | 16    |
|  | 348   | 674   |

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Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 17 - Debentures and loans from banks (cont'd)

## Terms and debt repayment schedule

The terms and conditions of long-term loans and debentures are as follows:

|   | Currency | Nominal<br>interest rate |   | Year of<br>maturity | December, 31 2010 |                    | December, 31 2011 |                    |
|---|----------|--------------------------|---|---------------------|-------------------|--------------------|-------------------|--------------------|
|   |          |                          |   |                     | Face<br>value     | carrying<br>amount | Face<br>value     | carrying<br>amount |
| Loans from banks  | NIS      | 4.80-6.00%               |   | 2012-2015           | -                 | -                  | 35                | 35                 |
| Debentures (Series<br>A) - linked to the<br>Israeli CPI | NIS      | 5.00                     | % | 2012                | 473               | 537                | 237               | 276                |
| Debentures (Series<br>B) - linked to the<br>Israeli CPI | NIS      | 5.30                     | % | 2017                | 925               | 1,052              | 925               | 1,079              |
| Debentures (Series<br>C) - linked to the<br>Israeli CPI | NIS      | 4.60                     | % | 2013                | 181               | 202                | 108               | 124                |
| Debentures (Series<br>D) - linked to the<br>Israeli CPI | NIS      | 5.19                     | % | 2017                | 1,507             | 1,685              | 2,423             | 2,824              |
| Debentures (Series<br>E) - unlinked                     | NIS      | 6.25                     | % | 2017                | 789               | 785                | 1,799             | 1,807              |
| Total interest-<br>bearing liabilities                  |          |                          |   |                     | 3,875             | 4,261              | 5,527             | 6,145              |

## Debentures

In December 2005, the Company issued NIS 1,037 million principal amount of debentures (Series A) to institutional investors at par value. The debentures are payable in nine equal semi-annual installments, on July 5 of each of the years 2008 through 2012 and on January 5 of each of the years 2009 through 2012. The debentures bear annual interest of 5.00%. The interest is to be paid on January 5 of each of the years 2007 through 2012 and on July 5 of each of the years 2006 through 2012 for the six-month period ended on the day prior to each date as stated. Both the principal amount and interest are linked to the CPI for November 2005.

In December 2005, the Company issued NIS 715 million principal amount of debentures (Series B) to institutional investors at par value. The debentures are payable in five equal annual installments, on January 5 of each of the years 2013 through 2017. The debentures bear annual interest of 5.30%. The interest is to be paid on January 5 of each of the years 2007 through 2017 for the twelve-month period ended on the day prior to each date as stated. Both the principal amount and interest are linked to the CPI for November 2005.

In May 2006, the Company issued to institutional investors additional Series A debentures in the aggregate principal amount of NIS 28 million, in exchange for consideration of NIS 29 million, and additional Series B debentures in the

aggregate principal amount of NIS 210 million in exchange for consideration of NIS 221 million.

In October 2007, the Company issued Series C debentures to the public in the aggregate principal amount of NIS 245 million in exchange for net consideration of NIS 244 million. The debentures are payable in nine semi-annual installments, on March 1 and September 1 of each of the years 2009 through 2012, and on March 1, 2013. The debentures bear annual interest of 4.60%. The interest is to be paid in semi-annual installments on March 1 and September 1 of each of the years 2008 through 2012 and on March 1, 2013. Both the principal amount and interest are linked to the CPI for August 2007.

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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## Note 17 - Debentures and loans from banks (cont'd)

In October 2007, the Company issued Series D new debentures to the public in the aggregate principal amount of NIS 827 million in exchange for net consideration of NIS 823 million. The debentures are payable in five equal annual installments, on July 1 of each of the years 2013 through 2017. The debentures bear annual interest of 5.19%. The interest is to be paid in annual installments on July 1 of each of the years 2008 through 2017. Both the principal amount and interest are linked to the CPI for August 2007.

In February 2008, the Company issued, in a private placement to institutional investors, additional debentures of Series C, in a principal amount of NIS 81 million and additional debentures of Series D, in a principal amount of approximately NIS 494 million, in exchange for total consideration of NIS 600 million.

In April 2009, the Company issued additional Series D debentures to the public in Israel in the aggregate principal amount of approximately NIS 186 million in exchange for total consideration of approximately NIS 215 million.

In April 2009, the Company issued debentures to the public in Israel of a new Series E in the aggregate principal amount of approximately NIS 789 million in exchange for total consideration of approximately NIS 785 million. The Series E debentures are payable in six equal annual installments on January 5 of each of the years 2012 through 2017. The debentures bear annual interest of 6.25%. The interest is to be paid in annual installments on January 5 of each of the years 2010 through 2017. Both the principal amount and interest are without any linkage.

The debentures were offered and sold in 2009 pursuant to a shelf prospectus that the Company filed in March 2009 with the Israeli Securities Authority and the Tel Aviv Stock Exchange. The shelf prospectus allowed the Company, until March 2011, to offer and sell debt, equity and warrants in Israel, from time to time, subject to a supplemental shelf offering report describing the terms of the securities offered and the specific details of the offering.

In March 2011, the Company issued additional Series D debentures to the public in Israel in an aggregate principal amount of approximately NIS 294 million in exchange for total consideration of approximately NIS 383 million, representing an effective interest rate of 2.23% per annum, linked to the Israeli CPI.

In March 2011, the Company issued additional Series E debentures to the public in Israel in an aggregate principal amount of approximately NIS 632 million in exchange for total consideration of approximately NIS 658 million, representing an effective interest rate of 5.47% per annum, without linkage.

The debentures were offered and sold pursuant to a supplemental shelf offering report that the Company filed in March 2011 with the Israeli Securities Authority and the Tel Aviv Stock Exchange. The offering was made pursuant to the Company's shelf prospectus from March, 2009.

In July 2011, the Company filed a shelf prospectus with the Israeli Securities Authority and the Tel Aviv Stock Exchange. The shelf prospectus will allow the Company, from time to time, to offer and sell debt, equity, warrants and tradable papers in Israel, in one or more offerings, subject to a supplemental shelf offering report, in which the Company will describe the terms of the securities offered and the specific details of the offering.

In August, 2011, the Company issued additional Series D debentures to the public in Israel in an aggregate principal amount of approximately NIS 622 million in exchange for total consideration of

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Cellcom Israel Ltd. and Subsidiaries

Notes to the Consolidated Financial Statements

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## Note 17 - Debentures and loans from banks (cont'd)

approximately NIS 743 million, representing an effective interest rate of 4.03% per annum, linked to the Israeli CPI.

In August, 2011, the Company issued additional Series E debentures to the public in Israel in an aggregate principal amount of approximately NIS 378 million in exchange for total consideration of approximately NIS 398 million, representing an effective interest rate of 5.81% per annum, without linkage.

The debentures were offered and sold pursuant to a supplemental shelf offering report that the Company filed in August 2011 with the Israeli Securities Authority and the Tel Aviv Stock Exchange. The offering was made pursuant to the Company's shelf prospectus dated July 2011.

The Company used and intends to use the net proceeds from the offering for the acquisition of Netvision (see note 7) and general corporate purposes, which may include financing its operating and investing activity, refinancing of outstanding debt under its debentures, and continued dividend distributions as customary in the Company, subject to the decisions of the Company's board of directors from time to time.

## Note 18 - Liability for Employee Rights Upon Retirement, Net

## A. Defined contribution plan

1. The Group's liability for severance pay for its Israeli employees is calculated pursuant to Israeli Severance Pay Law. The Group's liability is mostly covered by monthly deposits with severance pay funds, insurance policies and by an accrual on the consolidated statements of financial position. For most of the Group's employees, the payments to pension funds and to insurance companies exempt the Group from any obligation towards its employees, in accordance with Section 14 of the Severance Pay Law. Accumulated amounts in pension funds and in insurance companies are not under the Group's control or management and accordingly, neither those amounts nor the corresponding accrual for severance pay are presented in the consolidated statement of financial position. The obligation of the Group, under law and labor agreements, to pay severance pay employees who are not covered by the pension or insurance plans as mentioned above, is NIS 10 million and NIS 1 million for the years ended December 31, 2011 and 2010, respectively, as included in the consolidated statement of financial position, under Liability for employee rights upon retirement, net. The calculation for this liability is based on salary components that according to management's estimation create the liability for severance pay.
2. The severance pay expenses for the years ended December 31, 2011, 2010 and 2009 were approximately NIS 36 million, NIS 35 million and NIS 32 million, respectively.
3. In January 2008, under an expansion order issued by the Israeli Ministry of Industry, Commerce and Labor, all Israeli employers are obligated to contribute to pension plans amounts equal to a certain percentage of the employee's wages, for all employees, after a certain minimum employment period. The Group complies with this order. Other employees are entitled to contribution to a pension plan, which shall increase gradually until 2014 and up to 6% of the employee's wages, and additional identical contribution for severance pay.





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## Notes to the Consolidated Financial Statements

## Note 18 - Liability for Employee Rights Upon Retirement, Net (cont'd)

## B. Defined benefit plan

In a subsidiary which was acquired in 2011 (see note 7), the portion of the severance payments which is not covered by deposits in defined contribution plans, as aforementioned, is accounted for by the Group as a defined benefit plan, according to which a liability for employee benefits is recognized and in respect of which, the Group deposits amounts in central severance pay funds and in appropriate insurance policies. The total liability as at December 31, 2011 is NIS 28 million. The fair value of the plan assets, the severance pay fund, is NIS 23 million.

## Note 19 - Capital and reserves

## Share capital

|                                | 2009    | 2010    | 2011    |
|--------------------------------|---------|---------|---------|
|                                |         | NIS     |         |
| Issued and paid at January 1   | 983,493 | 988,957 | 994,647 |
| Exercise of share options      | 5,464   | 5,690   | 167     |
| Issued and paid at December 31 | 988,957 | 994,647 | 994,814 |

The share capital is comprised of ordinary shares of NIS 0.01 par value each.

At December 31, 2011, the authorized share capital was comprised of 300 million ordinary shares (December 31, 2010, 2009- 300 million each). The holders of ordinary shares are entitled to receive dividends as declared.

The calculation of basic earnings per share was based on the profit attributable to ordinary share holders and the weighted average number of ordinary shares outstanding (98,644,434, 98,979,544 and 99,476,671, during the years 2009 and 2010 and 2011, respectively). The calculations of diluted earnings per share was based on the profit attributable to ordinary shares and the weighted average number of ordinary shares in the basic earnings per share in addition of 872,600, 501,247 and 1,073,633 incremental shares (NIS 0.01 par value each) that would be issued resulting from exercise of all options for the years ended December 31, 2009, 2010, 2011, respectively.

At December 31, 2011, 975 thousand options (2010 and 2009: 0 thousand and 27 thousand options, respectively) were excluded from the diluted weighted average number of ordinary shares calculation as their effect would have been anti-dilutive.

The average market value of the Company's shares for purposes of calculating the dilutive effect of share options was based on quoted market prices for the period that the options were outstanding.

## Dividends

Dividends declared and paid during the reported period are as follows:

2011  
NIS millions

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|  |       |
|--|-------|
| 2.60 NIS per share paid in April 2011        | 303   |
| 3.05 NIS per share paid in July 2011         | 292   |
| 2.93 NIS per share paid in October 2011      | 232   |
| 2.33 NIS per share declared in November 2011 | 189   |
|  | 1,016 |

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Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 19 - Capital and reserves (cont'd)

|   | 2010         |
|---|--------------|
|   | NIS millions |
| 2.60 NIS per share paid in March 2010     | 257          |
| 3.64 NIS per share paid in June 2010      | 360          |
| 3.13 NIS per share paid in October 2010   | 310          |
| 4.03 NIS per share paid in December 2010  | 400          |
|   | 1,327        |
|   |              |
|   | 2009         |
|   | NIS millions |
| 2.75 NIS per share paid in March 2009     | 270          |
| 3.36 NIS per share paid in June 2009      | 330          |
| 3.05 NIS per share paid in September 2009 | 300          |
| 2.90 NIS per share paid in December 2009  | 287          |
|   | 1,187        |

On March 6, 2012, subsequent to the end of the reporting period, the Company's Board of Directors declared a cash dividend in the amount of NIS 0.72 per share, totaling approximately NIS 72 million, to be paid on May 17, 2012, to all of the Company's shareholders of record at the end of the trading day in the NYSE on May 2, 2012.

## Note 20 - Share-based payments

- A. In September 2006, the Company's Board of Directors approved a share based incentive plan ("the plan") for employees, directors, consultants and sub-contractors of the Company and the Company's affiliates. The plan has an initial pool of 2,500,000 shares from which options and restricted stock units (RSUs) could be granted.
- B. In October and November 2006, the Company granted options to purchase an aggregate of 2,414,143 ordinary shares at an exercise price of \$12.60 per share. Among those grants were options to purchase up to 450,000 ordinary shares granted to the Chairman of the Company's Board of Directors and an additional 450,000 options to the Company's Chief Executive Officer. The remainder of the option grants was made to other Company senior employees. Options not exercised within 6 years of the grant date, will expire.
- C. In March 2007, the Company granted to senior employees options to purchase an aggregate of 30,786 ordinary shares at an exercise price of \$12.60 per share according to the terms of the Plan. As a result of a dividend adjustment mechanism, the exercise price for all these options was adjusted to \$0 per share as of December 31, 2011 (\$0 per share as of December 31, 2010).
- D. In August 2008, the Company granted to senior employees options to purchase an aggregate of 27,500 ordinary shares at an exercise price of \$25 per share according to the terms of the Plan. As a result of a dividend adjustment mechanism, the exercise price for these options was adjusted to \$13.89 per share as of December 31, 2011 (\$16.77 as of December 31, 2010).



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## Notes to the Consolidated Financial Statements

## Note 20 - Share-based payments (cont'd)

- E. In August 2009, the Company granted to senior employees options to purchase an aggregate of 74,164 ordinary shares at an exercise price of \$24.65 per share according to the terms of the plan. As a result of a dividend adjustment mechanism, the exercise price for these options was adjusted to \$16.61 per share as of December 31, 2011 (\$19.49 as of December 31, 2010).
- F. In November 2010, the Company granted to a senior employee options to purchase an aggregate of 12,000 ordinary shares at an exercise price of \$27.92 per share under the terms of the plan. As a result of a dividend adjustment mechanism, the exercise price for these options was adjusted to \$23.92 per share as of December 31, 2011 (\$26.8 as of December 31, 2010).
- G. In May 2011, the Company's board of directors resolved to enlarge the initial pool of options or RSUs of the Company's 2006 Share Incentive Plan from 2,500,000, by 1,400,000 options or RSUs and the Company granted to senior employees options to purchase an aggregate of 1,060,000 ordinary shares at an exercise price of \$31.74 per share according to the terms of the plan. As a result of a dividend adjustment mechanism, the exercise price for these options was adjusted to \$29.72 per share as of December 31, 2011.

| Grant date/employees entitled   | Number of instruments<br>In thousands | Vesting conditions                                      | Contractual life of options |
|---|---------------------------------------|---|-----------------------------|
| Share options granted in October-November 2006 to managers and senior employees | 2,414                                 | Four equal installments over four years of employment   | 6 years                     |
| Share options granted in March 2007 to senior employees                         | 31                                    | Four equal installments over four years of employment   | 6 years                     |
| Share options granted in August 2008 to senior employees                        | 27                                    | Four equal installments over four years of employment   | 6 years                     |
| Share options granted in August 2009 to senior employees                        | 74                                    | Four equal installments over four years of employment   | 6 years                     |
| Share options granted in November 2010 to senior employees                      | 12                                    | Four equal installments over four years of employment   | 6 years                     |
| Share options granted in May 2011 to senior employees                           | 1,060                                 | Three equal installments over three years of employment | 4.5 years                   |

The total compensation expense during the year ended December 31, 2011, related to the options granted is NIS 6 million (2010 - NIS 1 million, 2009 - NIS 1 million).

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The changes in the balances of the options were as follows:

|   | Number of<br>options<br>2009 | Weighted<br>average<br>of exercise<br>price<br>(US<br>Dollars) | Number<br>of<br>options<br>2010 | Weighted<br>average<br>of exercise<br>price<br>(US<br>Dollars) | Number of<br>options<br>2011 | Weighted<br>average<br>of exercise<br>price<br>(US<br>Dollars) |
|---|------------------------------|--|---------------------------------|--|------------------------------|--|
| Balance as at January 1                           | 1,274,863                    | 6.86   | 704,674                         | 6.19   | 116,132                      | 17.20  |
| Granted during the year                           | 74,164                       | 23.86  | 12,000                          | 27.36  | 1,060,000                    | 30.65  |
| Forfeited during the year                         | (7,759 )                     | 5.59   | (7,395 )                        | 2.74   | (100,125 )                   | 29.90  |
| Exercised during the year                         | (636,594 )                   | 4.26   | (593,147 )                      | 1.11   | (19,111 )                    | 2.70   |
| Total options outstanding as at<br>December 31    | 704,674                      | 6.19   | 116,132                         | 17.20  | 1,056,896                    | 29.10  |
| Total of exercisable options as at<br>December 31 | 11,450                       | 12.59  | 26,936                          | 13.40  | 43,189                       | 16.68  |

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## Notes to the Consolidated Financial Statements

## Note 20 - Share-based payments (cont'd)

The weighted average of the remaining contractual life of options outstanding as at December 31, 2011, is 4 years and 3 months (as at December 31, 2010- 4 years and 3 months).

|  | 2009       | 2010       | 2011      |
|--|------------|------------|-----------|
| Fair value of share options and assumptions: |            |            |           |
| Fair value at grant date                     | \$ 8.82    | \$ 10.83   | \$ 4.84   |
| Fair value assumptions:                      |            |            |           |
| Share price at grant date                    | \$ 27.88   | \$ 33.27   | \$ 31.58  |
| Exercise price                               | \$ 24.65   | \$ 27.92   | \$ 31.74  |
| Expected volatility (weighted average life)  | 30.28 %    | 28.85 %    | 24.35 %   |
| Option life (expected weighted average life) | 4.25 years | 3.75 years | 2.3 years |
| Risk free interest rate                      | 2.5 %      | 3.42 %     | 0.7 %     |

## Note 21 - Financial Instruments

## Credit risk

## Exposure to credit risk

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

|   | December<br>31<br>2010<br>NIS<br>millions | December<br>31<br>2011<br>NIS<br>millions |
|---|---|---|
| Trade receivables including long term amounts           | 1,999                                     | 2,839                                     |
| Loans and other receivables including long term amounts | 76  | 96  |
| Investment in debt securities                           | 386                                       | 266                                       |
| Cash and cash equivalents                               | 533                                       | 920                                       |
| Forward exchange contracts on foreign currencies        | 5   | 24  |
| Forward exchange contracts on CPI                       | 13  | -   |
|   | 3,012                                     | 4,145                                     |



The maximum exposure to credit risk of financial assets at the reporting date by type of counterparty is:

|  | December<br>31<br>2010<br>NIS<br>millions | December<br>31<br>2011<br>NIS<br>millions |
|--|---|---|
| Receivables from subscribers                       | 1,894                                     | 2,793                                     |
| Receivables from distributors and other operators  | 105                                       | 44  |
| Investment in government of Israel debt securities | 244                                       | 143                                       |
| Investment in institutional debt securities        | 142                                       | 123                                       |
| Cash and cash equivalents                          | 533                                       | 920                                       |
| Other  | 94  | 122                                       |
|  | 3,012                                     | 4,145                                     |

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## Notes to the Consolidated Financial Statements

## Note 21 - Financial Instruments (cont'd)

## Impairment losses

The aging of financial assets at the reporting date was as follows:

|                             | Gross Impairment<br>2010 |                 | Gross Impairment<br>2011 |                 |
|-----------------------------|--------------------------|-----------------|--------------------------|-----------------|
|                             | NIS<br>millions          | NIS<br>millions | NIS<br>millions          | NIS<br>millions |
| Not past due                | 2,822                    | 4               | 3,977                    | 9               |
| Past due less than one year | 180                      | 71              | 202                      | 69              |
| Past due more than one year | 299                      | 214             | 277                      | 233             |
|                             | 3,301                    | 289             | 4,456                    | 311             |

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

|                                    | 2010<br>NIS<br>millions | 2011<br>NIS<br>millions |
|------------------------------------|-------------------------|-------------------------|
| Balance at January 1               | 218                     | 289                     |
| Business combination               | -                       | 38                      |
| Impairment loss recognized         | (35 )                   | (97 )                   |
| Increase in doubtful debt expenses | 106                     | 81                      |
| Balance at December 31             | 289                     | 311                     |

The allowance accounts in respect of trade receivables is used to record impairment losses unless the Group is satisfied that no recovery of the amount owing is possible; at that point the amount considered irrecoverable is written off against the trade receivable directly.

## Liquidity risk

The following are the maturities of contractual of financial liabilities and other non contractual liabilities, including estimated interest payments and excluding the impact of netting agreements:

| December 31, 2011 | Carrying<br>amount | Contractual<br>Cash<br>flows | 1st year | 2nd year<br>NIS millions | 3rd year | 4-5 years | More<br>than<br>5 years |
|-------------------|--------------------|------------------------------|----------|--------------------------|----------|-----------|-------------------------|
| Debentures*       | (6,358 )           | (7,246 )                     | (986 )   | (1,403 )                 | (1,302 ) | (2,429 )  | (1,126 )                |

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|   |          |          |          |          |          |          |          |
|---|----------|----------|----------|----------|----------|----------|----------|
| Trade and other payables                | (1,443 ) | (1,443 ) | (1,443 ) | -        | -        | -        | -        |
| Forward exchange contracts on CPI       | (22 )    | (22 )    | (11 )    | (2 )     | (7 )     | (2 )     | -        |
| Credit and loans from banks             | (35 )    | (35 )    | (16 )    | (9 )     | (5 )     | (5 )     | -        |
| Long term liabilities to trade payables | (35 )    | (35 )    | (13 )    | (12 )    | (8 )     | (2 )     | -        |
|   | (7,893 ) | (8,781 ) | (2,469 ) | (1,426 ) | (1,322 ) | (2,438 ) | (1,126 ) |

\* Including accrued interest on debentures.

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## Notes to the Consolidated Financial Statements

## Note 21 - Financial Instruments (cont'd)

## Liquidity risk (cont'd)

| December 31, 2010                                | Carrying amount | Contractual Cash flows | 1st year     | 2nd year | 3rd year | 4-5 years | More than 5 years |
|--|-----------------|------------------------|--------------|----------|----------|-----------|-------------------|
|  |                 |                        | NIS millions |          |          |           |                   |
| Debentures                                       | (4,424 )        | (5,235 )               | (573 )       | (688 )   | (901 )   | (1,610 )  | (1,463 )          |
| Trade and other payables                         | (826 )          | (826 )                 | (826 )       | -        | -        | -         | -                 |
| Forward exchange contracts on foreign currencies | (17 )           | (17 )                  | (17 )        | -        | -        | -         | -                 |
| Forward exchange contracts on CPI                | (1 )            | (1 )                   | (1 )         | -        | -        | -         | -                 |
|  | (5,268 )        | (6,079 )               | (1,417 )     | (688 )   | (901 )   | (1,610 )  | (1,463 )          |

The following table indicates the periods in which the cash flows associated with derivatives that are cash flow hedges are expected to occur:

|                             | Carrying amount | Contractual Cash flows | 1st year     | 2nd year | 3rd year | 4-5 years | More than 5 years |
|-----------------------------|-----------------|------------------------|--------------|----------|----------|-----------|-------------------|
|                             |                 |                        | NIS millions |          |          |           |                   |
| December 31, 2011           |                 |                        |              |          |          |           |                   |
| Forward exchange contracts: |                 |                        |              |          |          |           |                   |
| Assets                      | 19              | 19                     | 19           | -        | -        | -         | -                 |
| Liabilities                 | -               | -                      | -            | -        | -        | -         | -                 |
|                             | 19              | 19                     | 19           | -        | -        | -         | -                 |
| December 31, 2010           |                 |                        |              |          |          |           |                   |
| Forward exchange contracts: |                 |                        |              |          |          |           |                   |
| Assets                      | -               | -                      | -            | -        | -        | -         | -                 |
| Liabilities                 | (13 )           | (13 )                  | (13 )        | -        | -        | -         | -                 |
|                             | (13 )           | (13 )                  | (13 )        | -        | -        | -         | -                 |



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## Notes to the Consolidated Financial Statements

## Note 21 - Financial Instruments (cont'd)

## Liquidity risk (cont'd)

The following table indicates the periods in which the cash flows associated with derivatives that are cash flow hedges are expected to impact profit or loss:

|                             | Carrying<br>amount | Contractual<br>Cash<br>flows | 1st year | 2nd year<br>NIS millions | 3rd year | 4-5 years | More<br>than<br>5 years |
|-----------------------------|--------------------|------------------------------|----------|--------------------------|----------|-----------|-------------------------|
| December 31, 2011           |                    |                              |          |                          |          |           |                         |
| Forward exchange contracts: |                    |                              |          |                          |          |           |                         |
| Assets                      | 19                 | 19                           | 19       | -                        | -        | -         | -                       |
| Liabilities                 | -                  | -                            | -        | -                        | -        | -         | -                       |
|                             | 19                 | 19                           | 19       | -                        | -        | -         | -                       |
| December 31, 2010           |                    |                              |          |                          |          |           |                         |
| Forward exchange contracts: |                    |                              |          |                          |          |           |                         |
| Assets                      | -                  | -                            | -        | -                        | -        | -         | -                       |
| Liabilities                 | (13 )              | (13 )                        | (13 )    | -                        | -        | -         | -                       |
|                             | (13 )              | (13 )                        | (13 )    | -                        | -        | -         | -                       |

## Currency risk and CPI

The Group's exposure to foreign currency risk and CPI was as follows based on notional amounts:

|  | December 31, 2010  |                                  |          | December 31, 2011  |                                  |          |
|--|--|----------------------------------|----------|--|----------------------------------|----------|
|  | In or<br>linked<br>to foreign<br>currencies<br>(mainly<br>USD) | linked<br>to CPI<br>NIS millions | unlinked | In or<br>linked<br>to foreign<br>currencies<br>(mainly<br>USD) | linked<br>to CPI<br>NIS millions | unlinked |
| Current assets                             |  |                                  |          |  |                                  |          |
| Cash and cash equivalents                  | 13   | -                                | 520      | 13   | -                                | 907      |
| Current investments, including derivatives | -  | 230                              | 174      | 24   | 159                              | 107      |

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|   |        |          |        |        |          |          |
|---|--------|----------|--------|--------|----------|----------|
| Trade receivables   | -      | -        | 1,478  | 38     | -        | 1,821    |
| Other receivables, including derivatives                    | -      | 14       | -      | -      | 2        | 31       |
| <b>Non- current assets</b>                                  |        |          |        |        |          |          |
| Long-term receivables                                       | -      | 19       | 564    | -      | 20       | 1,023    |
| <b>Current liabilities</b>                                  |        |          |        |        |          |          |
| <b>Current maturities of debentures and long-term loans</b> |        |          |        |        |          |          |
| Trade payables and accrued expenses                         | (101 ) | -        | (615 ) | (284 ) | -        | (742 )   |
| Other current liabilities, including derivatives            | -      | (114 )   | (177 ) | -      | (148 )   | (539 )   |
| <b>Non- current liabilities</b>                             |        |          |        |        |          |          |
| Long-term loans from banks                                  | -      | -        | -      | -      | -        | (19 )    |
| Debentures  | -      | (3,128 ) | (785 ) | -      | (3,945 ) | (1,507 ) |
| Non- current other liabilities                              | (88 )  | (3,327 ) | 1,159  | (230 ) | (4,281 ) | 763      |

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## Notes to the Consolidated Financial Statements

## Note 21 - Financial Instruments (cont'd)

## Currency risk and CPI (cont'd)

The Group's exposure to linkage and foreign currency risk in respect of derivatives is as follows:

|  | December 31, 2011                  |                                 |                   |            |
|--|------------------------------------|---------------------------------|-------------------|------------|
|  | Currency/<br>linkage<br>receivable | Currency/<br>linkage<br>payable | Notional<br>Value | Fair value |
|  | NIS millions                       |                                 |                   |            |
| Instruments not used for hedging                 |                                    |                                 |                   |            |
| Forward exchange contracts on foreign currencies | USD                                | NIS                             | 204               | 5          |
| Forward exchange contracts on CPI                | CPI                                | NIS                             | 1,825             | (22)       |
| Foreign currency purchase options                | USD                                | NIS                             | 150               | 1          |
| Foreign currency sell options                    | NIS                                | USD                             | 227               | -          |
| Instruments used for hedging                     |                                    |                                 |                   |            |
| Forward exchange contracts on foreign currencies | USD                                | NIS                             | 293               | 19         |

|  | December 31, 2011                  |                                 |                   |            |
|--|------------------------------------|---------------------------------|-------------------|------------|
|  | Currency/<br>linkage<br>receivable | Currency/<br>linkage<br>payable | Notional<br>Value | Fair value |
|  | NIS millions                       |                                 |                   |            |
| Instruments not used for hedging                 |                                    |                                 |                   |            |
| Forward exchange contracts on foreign currencies | USD                                | NIS                             | 169               | (1)        |
| Forward exchange contracts on CPI                | CPI                                | NIS                             | 1,325             | 12         |
| Foreign currency purchase options                | USD                                | NIS                             | 444               | 2          |
| Foreign currency sell options                    | NIS                                | USD                             | 56                | -          |
| Instruments used for hedging                     |                                    |                                 |                   |            |
| Forward exchange contracts on foreign currencies | USD                                | NIS                             | 270               | (13)       |

Following is data regarding the CPI and currency exchange rate:

| December<br>31<br>2009 | December<br>31<br>2010 | December<br>31<br>2011 |
|------------------------|------------------------|------------------------|
|------------------------|------------------------|------------------------|



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|                              |       |       |       |    |     |   |
|------------------------------|-------|-------|-------|----|-----|---|
| CPI (in points)              | 206.2 | 211.7 | 216.3 |    |     |   |
| Exchange rate of US\$ in NIS | 3.775 | 3.549 | 3.821 |    |     |   |
|                              | 2009  | 2010  | 2011  |    |     |   |
| Change in %                  |       |       |       |    |     |   |
| CPI                          | 3.9   | %     | 2.7   | %  | 2.2 | % |
| Exchange rate of US\$ to NIS | (0.7  | %)    | (6.0  | %) | 7.7 | % |

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## Notes to the Consolidated Financial Statements

## Note 21 - Financial Instruments (cont'd)

## Currency risk and CPI (cont'd)

## Sensitivity analysis

A change of the CPI as at December 31, 2011 and 2010 would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2010.

|                        | Change |   | Equity<br>NIS<br>millions | Net<br>income<br>NIS<br>millions |
|------------------------|--------|---|---------------------------|----------------------------------|
| December 31, 2011      |        |   |                           |                                  |
| Increase in the CPI of | 2.0    | % | (37 )                     | (37 )                            |
| Increase in the CPI of | 1.0    | % | (18 )                     | (18 )                            |
| Decrease in the CPI of | (1.0)  | % | 18                        | 18                               |
| Decrease in the CPI of | (2.0)  | % | 37                        | 37                               |
| December 31, 2010      |        |   |                           |                                  |
| Increase in the CPI of | 2.0    | % | (30 )                     | (30 )                            |
| Increase in the CPI of | 1.0    | % | (15 )                     | (15 )                            |
| Decrease in the CPI of | (1.0)  | % | 15                        | 15                               |
| Decrease in the CPI of | (2.0)  | % | 30                        | 30                               |

Sensitivity of change in foreign exchange rate is immaterial as at December 31, 2011 and 2010.

## Interest rate risk

## Profile

At the reporting date the interest rate profile of the Group's interest-bearing financial instruments, not including derivatives, was:

|                           | Carrying amount         |                         |
|---------------------------|-------------------------|-------------------------|
|                           | 2010<br>NIS<br>millions | 2011<br>NIS<br>millions |
| Fixed rate instruments    |                         |                         |
| Financial assets          | 899                     | 1,188                   |
| Financial liabilities     | (4,261 )                | (6,141 )                |
|                           | (3,362 )                | (4,953 )                |
| Variable rate instruments |                         |                         |
| Financial assets          | 28                      | 6                       |
| Financial liabilities     | -                       | (3 )                    |

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## Notes to the Consolidated Financial Statements

## Note 21 - Financial Instruments (cont'd)

## Fair value sensitivity analysis for fixed rate instruments

A change of interest rates at the reporting date would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

|                             | Equity           |                  |                  |                  | Profit or loss   |                  |                  |                  |
|-----------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
|                             | 1.0%<br>increase | 1.0%<br>decrease | 0.5%<br>increase | 0.5%<br>decrease | 1.0%<br>increase | 1.0%<br>decrease | 0.5%<br>increase | 0.5%<br>decrease |
|                             | NIS millions     |                  |                  |                  | NIS millions     |                  |                  |                  |
| December 31, 2011           |                  |                  |                  |                  |                  |                  |                  |                  |
| Fixed rate instruments      | (7 )             | 7                | (4 )             | 4                | (7 )             | 7                | (4 )             | 4                |
| Cash flow sensitivity (net) | (7 )             | 7                | (4 )             | 4                | (7 )             | 7                | (4 )             | 4                |

|                             | Equity           |                  |                  |                  | Profit or loss   |                  |                  |                  |
|-----------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
|                             | 1.0%<br>increase | 1.0%<br>decrease | 0.5%<br>increase | 0.5%<br>decrease | 1.0%<br>increase | 1.0%<br>decrease | 0.5%<br>increase | 0.5%<br>decrease |
|                             | NIS millions     |                  |                  |                  | NIS millions     |                  |                  |                  |
| December 31, 2010           |                  |                  |                  |                  |                  |                  |                  |                  |
| Fixed rate instruments      | (9 )             | 9                | (4 )             | 4                | (9 )             | 9                | (4 )             | 4                |
| Cash flow sensitivity (net) | (9 )             | 9                | (4 )             | 4                | (9 )             | 9                | (4 )             | 4                |

## Cash flow sensitivity analysis for variable rate instruments

A change of interest rates at the reporting date would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

|                             | Equity           |                  |                  |                  | Profit or loss   |                  |                  |                  |
|-----------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
|                             | 1.0%<br>increase | 1.0%<br>decrease | 0.5%<br>increase | 0.5%<br>decrease | 1.0%<br>increase | 1.0%<br>decrease | 0.5%<br>increase | 0.5%<br>decrease |
|                             | NIS millions     |                  |                  |                  | NIS millions     |                  |                  |                  |
| December 31, 2011           |                  |                  |                  |                  |                  |                  |                  |                  |
| Variable rate instruments   | 1                | (1 )             | -                | -                | 1                | (1 )             | -                | -                |
| Interest rate swaps         | -                | -                | -                | -                | -                | -                | -                | -                |
| Cash flow sensitivity (net) | 1                | (1 )             | -                | -                | 1                | (1 )             | -                | -                |

December 31, 2010

|                             |   |   |   |   |   |   |   |   |
|-----------------------------|---|---|---|---|---|---|---|---|
| Variable rate instruments   | - | - | - | - | - | - | - | - |
| Interest rate swaps         | - | - | - | - | - | - | - | - |
| Cash flow sensitivity (net) | - | - | - | - | - | - | - | - |

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## Notes to the Consolidated Financial Statements

## Note 21 - Financial Instruments (cont'd)

## Fair Values

## Fair values versus carrying amounts

The fair values of financial assets and liabilities, together with the carrying amounts shown in the balance sheet, are as follows:

|  | December 31, 2010 |            |  | December 31, 2011 |            |  |  |
|--|-------------------|------------|--|-------------------|------------|--|--|
|  | Carrying amount   | Fair value | Interest rates used for determining Fair value | Carrying amount   | Fair value | Interest rates used for determining Fair value |  |
|  | NIS millions      |            |  | NIS millions      |            |  |  |
| <b>Assets</b>  |                   |            |  |                   |            |  |  |
| Cash and cash equivalents                                    | 533               | 533        |  | 920               | 920        |  |  |
| Current investments, Including derivatives                   | 404               | 404        |  | 290               | 290        |  |  |
| Trade receivables, net                                       | 1,478             | 1,478      |  | 1,859             | 1,859      |  |  |
| Other receivables  | 14                | 14         |  | 33                | 33         |  |  |
| Long-term receivables  | 583               | 583        | 3.5 %  | 1,043             | 1,043      | 5.2 %  |  |
| <b>Current liabilities</b>                                   |                   |            |  |                   |            |  |  |
| Credit and current maturities of long-term loans             | -                 | -          |  | (16 )             | (16 )      |  |  |
| Trade payables and accrued expenses                          | (716 )            | (716 )     |  | (1,026 )          | (1,026 )   |  |  |
| Other current liabilities, including derivatives             | (128 )            | (128 )     |  | (439 )            | (439 )     |  |  |
| Long-term loans from banks                                   | -                 | -          |  | (19 )             | (19 )      |  |  |
| <b>Non- current liabilities</b>                              |                   |            |  |                   |            |  |  |
| Debentures including current maturities and accrued interest | (4,424 )          | (4,585 )   |  | (6,358 )          | *(6,001)   |  |  |
| Other long- term liabilities                                 | -                 | -          |  | (35 )             | (35 )      |  |  |
|  | (2,256 )          | (2,417 )   |  | (3,748 )          | (3,391 )   |  |  |

\* The fair value of marketable debentures is determined by reference to the quoted closing asking price at the reporting date.

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## Notes to the Consolidated Financial Statements

## Note 21 - Financial Instruments (cont'd)

## Fair Values (cont'd)

## Fair value hierarchy

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

Level 1: quoted prices (unadjusted) in active markets for identical instruments.

Level 2: inputs other than quoted prices included within Level 1 that are observable, either directly or indirectly.

Level 3: inputs that are not based on observable market data (unobservable inputs).

|   | December 31, 2011          |                            |                            | Total<br>NIS<br>millions |
|---|----------------------------|----------------------------|----------------------------|--------------------------|
|   | Level 1<br>NIS<br>millions | Level 2<br>NIS<br>millions | Level 3<br>NIS<br>millions |                          |
| Financial assets at fair value through<br>profit or loss      |                            |                            |                            |                          |
| Current investments in debt<br>securities                     | 266                        | -                          | -                          | 266                      |
| Derivatives   | -                          | 24                         | -                          | 24                       |
| Total assets  | 266                        | 24                         | -                          | 290                      |
| Financial liabilities at fair value<br>through profit or loss |                            |                            |                            |                          |
| Derivatives   | -                          | (22 )                      | -                          | (22 )                    |
| Total liabilities   | -                          | (22 )                      | -                          | (22 )                    |

There have been no transfers during the year between Levels 1 and 2.

|   | December 31, 2010          |                            |                            | Total<br>NIS<br>millions |
|---|----------------------------|----------------------------|----------------------------|--------------------------|
|   | Level 1<br>NIS<br>millions | Level 2<br>NIS<br>millions | Level 3<br>NIS<br>millions |                          |
| Financial assets at fair value through<br>profit or loss      |                            |                            |                            |                          |
| Current investments in debt<br>securities                     | 386                        | -                          | -                          | 386                      |
| Derivatives   | -                          | 18                         | -                          | 18                       |
| Total assets  | 386                        | 18                         | -                          | 404                      |
| Financial liabilities at fair value<br>through profit or loss |                            |                            |                            |                          |

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|                   |   |       |   |       |
|-------------------|---|-------|---|-------|
| Derivatives       | - | (18 ) | - | (18 ) |
| Total liabilities | - | (18 ) | - | (18 ) |

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## Notes to the Consolidated Financial Statements

## Note 22 - Revenues

## Composition

|   | Year ended December 31 |              |              |
|---|------------------------|--------------|--------------|
|   | 2009                   | 2010         | 2011         |
|   | NIS millions           | NIS millions | NIS millions |
| Revenues from equipment                   | 751                    | 802          | 1,747        |
| Revenues from services:                   |                        |              |              |
| Cellular voice services                   | 4,471                  | 4,391        | 2,879        |
| Cellular content and value added services | 882                    | 1,112        | 1,167        |
| Internet services                         | -                      | -            | 216          |
| International long distance services      | -                      | -            | 96           |
| Other services                            | 379                    | 357          | 401          |
| Total revenues from services              | 5,732                  | 5,860        | 4,759        |
| Total revenues                            | 6,483                  | 6,662        | 6,506        |

## Note 23 - Cost of Revenues

## Composition

|                                      | Year ended December 31 |              |              |
|--------------------------------------|------------------------|--------------|--------------|
|                                      | 2009                   | 2010         | 2011         |
|                                      | NIS millions           | NIS millions | NIS millions |
| According to source of income:       |                        |              |              |
| Cost of revenues from handsets       | 690                    | 651          | 1,282        |
| Cost of revenues from services       | 2,643                  | 2,671        | 2,126        |
|                                      | 3,333                  | 3,322        | 3,408        |
| According to its components:         |                        |              |              |
| Cost of revenues from handsets       | 690                    | 651          | 1,282        |
| Rent and related expenses            | 333                    | 330          | 333          |
| Salaries and related expenses        | 163                    | 176          | 240          |
| Fees to other operators and others   | 1,007                  | 1,112        | 630          |
| Cost of value added services         | 391                    | 376          | 270          |
| Depreciation and amortization        | 489                    | 472          | 442          |
| Royalties and fees (see note 30(1)b) | 154                    | 110          | 133          |
| Other                                | 106                    | 95           | 78           |
|                                      | 2,643                  | 2,671        | 2,126        |
|                                      | 3,333                  | 3,322        | 3,408        |

## Note 24 - Selling and Marketing Expenses

## Composition

|                                  | Year ended December 31 |              |              |
|----------------------------------|------------------------|--------------|--------------|
|                                  | 2009                   | 2010         | 2011         |
|                                  | NIS millions           | NIS millions | NIS millions |
| Salaries and related expenses    | 333                    | 376          | 412          |
| Commissions                      | 96                     | 90           | 237          |
| Advertising and public relations | 99                     | 84           | 95           |
| Depreciation and amortization    | 65                     | 75           | 104          |
| Other                            | 123                    | 131          | 142          |
|                                  | 716                    | 756          | 990          |

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## Notes to the Consolidated Financial Statements

## Note 25 - General and Administrative Expenses

## Composition

|   | Year ended December 31 |              |              |
|---|------------------------|--------------|--------------|
|   | 2009                   | 2010         | 2011         |
|   | NIS millions           | NIS millions | NIS millions |
| Salaries and related expenses             | 145                    | 147          | 169          |
| Depreciation and amortization             | 200                    | 177          | 192          |
| Rent and maintenance                      | 75                     | 68           | 72           |
| Data processing and professional services | 56                     | 55           | 76           |
| Allowance for doubtful accounts           | 94                     | 106          | 81           |
| Other                                     | 90                     | 88           | 95           |
|   | 660                    | 641          | 685          |

## Note 26 - Other Expenses, Net

## Composition

|   | Year ended December 31 |              |              |
|---|------------------------|--------------|--------------|
|   | 2009                   | 2010         | 2011         |
|   | NIS millions           | NIS millions | NIS millions |
| Capital loss from sale of property, plant and equipment | 6                      | 5            | -            |
| Other - net   | -                      | -            | 1            |
| Other expenses, net                                     | 6                      | 5            | 1            |

## Note 27 - Financing Income and Expenses

## Composition

|   | Year ended December 31 |              |              |
|---|------------------------|--------------|--------------|
|   | 2009                   | 2010         | 2011         |
|   | NIS millions           | NIS millions | NIS millions |
| Interest income on deposits   | 15                     | 27           | 34           |
| Interest income from installment sale transactions                                | 50                     | 45           | 65           |
| Net foreign exchange gain   | 5                      | 14           | -            |
| Net change in fair value of financial assets at fair value through profit or loss | 81                     | 20           | 17           |
| Financing income  | 151                    | 106          | 116          |
| Interest expenses on long term liabilities  | (229 )                 | (232 )       | (286 )       |
| Linkage expenses to CPI on long term liabilities                                  | (141 )                 | (78 )        | (91 )        |
| Net change in fair value of derivatives   | -                      | (26 )        | (19 )        |

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|   |        |        |        |
|---|--------|--------|--------|
| Net loss from exchange rate differences             | -      | -      | (13 )  |
| Financing expenses                                  | (370 ) | (336 ) | (409 ) |
| Net financing expenses recognized in profit or loss | (219 ) | (230 ) | (293 ) |

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Notes to the Consolidated Financial Statements

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## Note 28 - Income Tax

## A. Details regarding the tax environment of the Group

## (1) Amendments to the Income Tax Ordinance and the Land Appreciation Tax Law

(a) On July 14, 2009, the Israeli parliament passed the Economic Efficiency Law (Legislation Amendments for Implementation of the 2009 and 2010 Economic Plan) - 2009, which provided, inter alia, an additional gradual reduction in the company tax rate to 18% as from the 2016 tax year. In accordance with the aforementioned amendments, the company tax rates applicable as from the 2009 tax year are as follows: In the 2009 tax year - 26%, in the 2010 tax year - 25%, in the 2011 tax year - 24%, in the 2012 tax year - 23%, in the 2013 tax year - 22%, in the 2014 tax year - 21%, in the 2015 tax year - 20% and as from the 2016 tax year the company tax rate will be 18%.

On December 5, 2011 the Israeli parliament approved the Law to Change the Tax Burden (Legislative Amendments) - 2011. According to the law the tax reduction that was provided in the Economic Efficiency Law, as aforementioned, will be cancelled and the company tax rate will be 25% as from 2012.

Current taxes for the periods reported in these financial statements are calculated according to the tax rates specified in the Economic Efficiency Law.

Deferred tax balances as at December 31, 2011 are calculated in accordance with the tax rates specified in the Law to Change the Tax Burden, at the tax rate expected on the date of reversal. The effect of the change in the tax rate on the financial statements as at December 31, 2011 is reflected in an increase of NIS 33 million in the deferred tax liability against deferred tax expenses of NIS 33 million.

(b) On February 4, 2010 Amendment 174 to the Income Tax Ordinance - Temporary Order for Tax Years 2007, 2008 and 2009 was published in the Official Gazette (hereinafter - "the Temporary Order"). In accordance with the Temporary Order, Israeli Accounting Standard No. 29 regarding the adoption of International Financial Reporting Standards (IFRS) (hereinafter - "Standard 29") shall not apply when determining the taxable income for the 2007-2009 tax years even if it was applied when preparing the financial statements. On January 12, 2012 Amendment 188 to the Income Tax Ordinance was published, which amended the Temporary Order, in a manner that Standard 29 shall not apply also when determining the taxable income for 2010 and 2011.

## (2) Taxation under inflation

The Income Tax Law (Adjustments for Inflation) - 1985 (hereinafter - the Law) is effective as from the 1985 tax year. The Law introduced the concept of measurement of results for tax purposes on a real (net of inflation) basis.

On February 26, 2008 the Israeli parliament enacted the Income Tax Law (Adjustments for Inflation) (Amendment No. 20) (Restriction of Effective Period) - 2008 (hereinafter - the Amendment). In accordance with the Amendment, the effective period of the Adjustments Law terminated at the end of the 2007 tax year and as from the 2008 tax year the provisions of the law no longer apply, other than the transitional provisions intended at preventing distortions in the tax calculations.

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Cellcom Israel Ltd. and Subsidiaries

## Notes to the Consolidated Financial Statements

## Note 28 - Income Tax (cont'd)

In accordance with the Amendment, as from the 2008 tax year, income for tax purposes is no longer adjusted to a real (net of inflation) measurement basis. Furthermore, the depreciation of inflation immune assets and carried forward tax losses are no longer linked to the CPI, so that these amounts are adjusted until the end of the 2007 tax year after which they ceased to be linked to the CPI. The effect of the Amendment to the Adjustments Law is reflected in the calculation of current and deferred taxes as from 2008.

## B. Composition of income tax expense (income)

|  | Year ended December 31, |          |          |
|--|-------------------------|----------|----------|
|  | 2009                    | 2010     | 2011     |
|  | NIS                     | NIS      | NIS      |
|  | millions                | millions | millions |
| Current tax expense (income)                   |                         |          |          |
| Current year                                   | 423                     | 462      | 288      |
| Adjustments for prior years, net               | 6                       | (18 )    | -        |
| Changes in accounting policy                   | (1 )                    | -        | -        |
| Total current tax expenses                     | 428                     | 444      | 288      |
| Deferred tax expense (income)                  |                         |          |          |
| Creation and reversal of temporary differences | (20 )                   | (27 )    | (17 )    |
| Change in tax rate                             | (41 )                   | -        | 33       |
| Total deferred tax expenses (income)           | (61 )                   | (27 )    | 16       |
| Income tax expense                             | 367                     | 417      | 304      |

## C. Income tax recognized directly in equity

|   | Year ended December 31, 2011 |              |            |
|---|------------------------------|--------------|------------|
|   | Before tax                   | Tax expenses | Net of tax |
|   | NIS                          | NIS          | NIS        |
|   | millions                     | millions     | millions   |
| Hedging transactions – equity component | 37                           | (9 )         | 28         |

|  | Year ended December 31, 2010 |              |            |
|--|------------------------------|--------------|------------|
|  | Before tax                   | Tax expenses | Net of tax |

|   | NIS<br>millions | NIS<br>millions | NIS<br>millions |
|---|-----------------|-----------------|-----------------|
| Hedging transactions – equity component | 3               | (1 )            | 2               |

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## Notes to the Consolidated Financial Statements

## Note 28 - Income Tax (cont'd)

|   | Year ended December 31, 2009 |                             | Net of tax<br>NIS millions |
|---|------------------------------|-----------------------------|----------------------------|
|   | Before tax<br>NIS millions   | Tax benefit<br>NIS millions |                            |
| Hedging transactions – equity component | (16 )                        | 4                           | (12 )                      |

## D. Reconciliation between the theoretical tax on the pre-tax profit and the tax expense:

|  | Year ended December 31, |                         |  | 2011<br>NIS<br>millions |
|--|-------------------------|-------------------------|--|-------------------------|
|  | 2009<br>NIS<br>millions | 2010<br>NIS<br>millions |  |                         |
| Profit before taxes on income                            | 1,549                   | 1,708                   |  | 1,129                   |
| Primary tax rate of the Group                            | 26 %                    | 25 %                    |  | 24 %                    |
| Tax calculated according to the Group's primary tax rate | 403                     | 427                     |  | 271                     |
| Additional tax (tax saving) in respect of:               |                         |                         |  |                         |
| Non-deductible expenses                                  | 3                       | 2                       |  | 4                       |
| Taxes in respect of previous years                       | 6                       | (18 )                   |  | -                       |
| Effect of changes in tax rate                            | (41 )                   | -                       |  | 33                      |
| Other differences, including inflation differences       | (4 )                    | 6                       |  | (4 )                    |
| Income tax expense                                       | 367                     | 417                     |  | 304                     |

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## Notes to the Consolidated Financial Statements

## Note 28 - Income Tax (cont'd)

## E. Deferred tax assets and liabilities

## (1) Recognized deferred tax assets and liabilities

Deferred taxes are calculated according to the tax rate anticipated to be in effect on the date of reversal as stated above.

The movement in deferred tax assets and liabilities is attributable to the following items:

|   | Allowance<br>for<br>doubtful<br>debts<br>NIS<br>millions | Property,<br>plant and<br>equipment<br>and<br>intangible<br>assets<br>NIS<br>millions | Hedging<br>transactions<br>NIS<br>millions | Carry<br>forward tax<br>deductions<br>and losses<br>NIS<br>millions | Other<br>NIS<br>millions | Total<br>NIS<br>millions |
|---|--|---|--|---|--------------------------|--------------------------|
| Balance of deferred tax asset<br>(liability) as at January 1, 2011                      | 64   | (164 )  | 7  | -   | 28                       | (65 )                    |
| Changes recognized in profit or<br>loss   | (9 )   | 17  | -  | (5 )  | 14                       | 17                       |
| Changes recognized in equity  | -  | -   | (9 )                                       | -   | -                        | (9 )                     |
| Effect of change in tax rate  | 10   | (55 )   | -  | 4   | 8                        | (33 )                    |
| Business combinations (see note<br>7)   | 13   | (80 )   | -  | 23  | -                        | (44 )                    |
| Deferred tax asset (liability) as<br>at December 31, 2011                               | 78   | (282 )  | (2 )                                       | 22  | 50                       | (134 )                   |
| Deferred tax asset  | 78   | 18  | -  | 22  | 50                       | 168                      |
| Offset of balances  |  |   |  |   |                          | 128                      |
| Deferred tax asset in statement<br>of financial position as at<br>December 31, 2011     |  |   |  |   |                          | 40                       |
| Deferred tax liability  | -  | (300 )  | (2 )                                       | -   | -                        | (302 )                   |
| Offset of balances  |  |   |  |   |                          | (128 )                   |
| Deferred tax liability in<br>statement of financial position<br>as at December 31, 2011 |  |   |  |   |                          | (174 )                   |

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## Notes to the Consolidated Financial Statements

## Note 28 - Income Tax (cont'd)

|   | Allowance<br>for<br>doubtful<br>debts<br>NIS<br>millions | Property,<br>plant and<br>equipment<br>and<br>intangible<br>assets<br>NIS<br>millions | Hedging<br>transactions<br>NIS<br>millions | Carry<br>forward tax<br>deductions<br>and losses<br>NIS<br>millions | Other<br>NIS<br>millions | Total<br>NIS<br>millions |
|---|--|---|--|---|--------------------------|--------------------------|
| Balance of deferred tax asset<br>(liability) as at January 1, 2010                      | 57   | (159 )  | 8  | -   | 3                        | (91 )                    |
| Changes recognized in profit or<br>loss   | 7  | (5 )  | -  | -   | 25                       | 27                       |
| Changes recognized in equity  | -  | -   | (1 )                                       | -   | -                        | (1 )                     |
| Balance of deferred tax asset<br>(liability) as at December 31,<br>2010                 | 64   | (164 )  | 7  | -   | 28                       | (65 )                    |
| Deferred tax asset  | 64   | -   | 7  | -   | 28                       | 99                       |
| Offset of balances  |  |   |  |   |                          | 99                       |
| Deferred tax asset in statement<br>of financial position as at<br>December 31, 2010     |  |   |  |   |                          | -                        |
| Deferred tax liability  | -  | (164 )  | -  | -   | -                        | (164 )                   |
| Offset of balances  |  |   |  |   |                          | (99 )                    |
| Deferred tax liability in<br>statement of financial position<br>as at December 31, 2010 |  |   |  |   |                          | (65 )                    |

## (2) Unrecognized deferred tax liability

As at December 31, 2011 a deferred tax liability for temporary differences related to an investment in subsidiaries was not recognized because the decision as to whether to incur the liability rests with the Group and it is satisfied that it will not be incurred in the foreseeable future.

## F. Tax loss carryforwards and other temporary differences

As of December 31, 2011 Netvision and its subsidiaries have tax loss carryforwards and capital loss carryforwards in a total amount of NIS 145 million. In respect of these losses and in respect of other temporary deductible differences,

the Group recorded in the consolidated financial statement deferred tax asset, net, in the amount of NIS 40 million.

G. Tax assessments

The Company has received final tax assessments up to and including the year ended December 31, 2008 (the 2008 tax year).

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## Note 29 - Operating Leases

Non-cancelable operating lease rentals are payable as follows:

|                            | December 31<br>2011<br>NIS millions |
|----------------------------|-------------------------------------|
| Less than one year         | 301                                 |
| Between one and five years | 752                                 |
| More than five years       | 395                                 |
|                            | 1,448                               |

During the year ended December 31 2011, NIS 298 million (including linkage to CPI in the amount of NIS 5.1 million) was recognized as expenses in respect of operating leases in the consolidated statements of income (2010 - NIS 284 million, including linkage to CPI in the amount of NIS 4.9 million; 2009 - NIS 251 million, including linkage to CPI in the amount of NIS 5.7 million).

Major operating lease and service agreements:

- a. Office buildings and warehouses - there are lease agreements for periods of up to 18 years.
- b. Switching stations - there are lease agreements for switching station locations for periods of up to 21 years and 7 months.
- c. Cell sites - there are lease agreements for cell sites for periods of up to 16 years.
- d. Service centers, retail stores and stands - there are lease agreements for service and installation centers and stands for periods of up to 16 years and 8 months.
- e. Transmission services for cell sites and switches up to 6 years.
- f. Motor vehicles - lease for a period of 3 years.
- g. Rights of use of international communication lines - there are lease agreements for a period of up to 13 years.

## Note 30 - Commitments

1. The Group has commitments regarding the license it was granted in 1994, most of which are:

- a. Not to pledge any of the assets used to execute the license without the advance consent of the Ministry of Communications.

b. To pay the State of Israel (the State) royalties equal (in 2011) to 1.75% of the Company's revenues generated from cellular telecommunications services, less payments transferred to other license holders for interconnect fees or roaming services, sale of handsets and losses from bad debts in respect of royalty-bearing services and revenues collected for other license holder. The rate of these royalties has decreased in recent years, from 4.5% in 2002, to 4% in 2003, to 3.5% in 2004 and 2005, to 3% in 2006, to 2.5% in 2007, to 2% in 2008, to 1.5% in 2009 and to 1% in 2010. In January 2011, the applicable regulations

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Notes to the Consolidated Financial Statements

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## Note 30 - Commitments (cont'd)

were amended to increase the royalties payable by cellular operators only, for the years 2011 and 2012, commencing January 19, 2011, to 1.75% in 2011 and 2.5% in 2012, unless certain circumstances occur. In March 2011, the Company, and two other cellular operators have filed a petition with the Israeli Supreme Court against the Ministries of Finance and Communications in that regard. In July 2011 the State announced it accepts the Supreme Court's suggestion to set the royalties' rate to 1.75% in 2011 and 2012 (subject in the above circumstances) and to 0% starting 2013. The state reserved its right to charge royalties or other payments by primary legislation. An amendment to the regulations requires the approval of the Israeli Parliament.

c. Netvision's International Long Distance license determines that Netvision will have to pay royalties to the State from Netvision's revenues which derive from international Bezeq services, less payments that are transferred to other communication operators in respect of interconnect, payments to a foreign supplier in respect of outgoing calls, bad debt expenses in respect of royalty-bearing services and revenues which are collected for other license holder. In 2011, the rate of such royalties was 1% of the taxable income, as defined in the Communication Regulations (Bezeq and Transmissions)(Royalties), 2011. This rate is expected to apply in 2012 as well.

d. The Company's shareholders' joint equity, combined with the Company's equity, shall not amount to less than \$200 million. Regarding this stipulation, a shareholder holding less than 10% of the rights to the Company's equity is not taken into account.

The Group is in compliance with the above conditions.

2. In September 2005, the Company signed an agreement with Ericsson Israel Ltd. according to which the Company will acquire a UMTS radio access network and ancillary products and services. The Company was obligated to purchase maintenance services for 5 years from the launch of the system (until 2011) and the Company has an option to purchase maintenance services for 20 years from the launch of the systems (until 2026), including all the required services for establishment and maintenance of the system (including receipt of updates and upgrades for the system). The aggregate scope of the agreement is USD 27.5 million payable over five years. In December 2011, the Company entered into an addendum to the agreement for the purchase of upgraded UMTS /HSPA products and related services, under similar terms. The Company obligated in such amendment to purchases of at least USD 12 million in 2012. Under the agreement the parties generally have limited liability for direct damages of up to 40% of the value of the agreement.

3. In July 2001, the Company signed an agreement with Nokia Israel Communications Ltd., for the purchase of a GSM/GPRS system (the agreement was assigned to Nokia-Siemens Networks Israel Ltd., or Nokia Siemens, in 2007). The Company was also granted an option to purchase GSM 800, EDGE, UMTS and ancillary systems. In 2002, the Company exercised the option to purchase an EDGE system, and in 2005, the Company purchased a UMTS core system, under similar terms. In May 2011, the Company entered into an addendum to the agreement for the purchase of radio equipment to the UMTS/HSPA network and related products and additional services to the network. Nokia Siemens is obligated to offer the Company maintenance services for 15 years from execution of the said addendum (until 2026). Under the agreement, the parties generally have limited liability for direct damages of up to 10% of the value of the agreement.



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## Note 30 - Commitments (cont'd)

4. Be'eri Printers provides the Company's printing supplies and invoices as well as the distribution, packaging and delivery of invoices and other mail to the postal service distribution centers. The Company entered into an agreement with Be'eri Printers - Limited Partnership and with Be'eri Technologies (1977) Ltd., or together Be'eri, for printing services in August 2003.

Under the terms of the agreement, the Company committed to purchase from Be'eri a minimum monthly quantity of production and distribution services which may be reduced if the Company modifies its printed invoice delivery policy. The agreement is valid until December 2013.

5. As at December 31, 2011, the Group has commitments to purchase equipment for the communication network, cellular telephone equipment and systems and software maintenance, at an amount estimated at NIS 413 million.

6. In July 2010, the Company entered into an agreement with Amdocs (Israel) Limited, or Amdocs Israel, for the provision of operation, maintenance, management and development services for its billing system, which were previously performed partly by Amdocs UK and Amdocs Israel and partly by the Company's employees. Amdocs Israel is obligated to provide the Company with such services for a period of eight years (until August 2018), and after 30 months from entering into this agreement the Company has the option to terminate the agreement subject to the provision of prior written notice and payment of certain amounts. Under the agreement, the parties generally have limited liability for direct damages of up to the value of the agreement for each year subject to certain additional exceptions to the limitation.

7. In October 2010, the Company entered into a long-term agreement for the enlargement of the current techno-logistic center, including its new central laboratory, in Netanya, Israel, and the lease thereof. The leased property covers approximately 11,000 square meters. The lease is for a term of ten years starting August 1, 2011 and is renewable for an additional period of 5 years, at the Company's option. In case the Company does not exercise the option it shall be required to pay approximately NIS 11 million.

8. In December 2010, the Company entered into an agreement with Ashdod Energy Ltd., expected to construct a private power plant fueled by natural gas in Israel, by the end of 2013. Under the agreement the Company committed to purchase electricity for the earlier of a period of 15 years from commencement of operations of the power plant or until January 2028, subject to the Company's right to terminate the agreement after 8 years from the commencement of operations of the power plant under certain conditions.

9. In the years 2003 through 2011, Netvision entered into a number of agreements with Mediterranean Nautilus Ltd. and Mediterranean Nautilus (Israel) Ltd., or together Med Nautilus. Pursuant to its agreements with Med Nautilus, Netvision purchased rights of use, or IRU, of certain telecommunications capacities on Med Nautilus' communication cables, as well as maintenance and operation services relating to these cables. The agreements include options pursuant to which Netvision may expand the purchased capacity. The term of the agreement with respect to part of the capacity purchased from MedNautilus is until May 2027. Netvision has the option to terminate agreements with respect to parts of the capacity in 2017 and 2022. The remainder of the obligation to Med Nautilus in respect of rights of use of international communication lines from all existing agreements as of December 31, 2011 is NIS 243 million.

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## Note 30 - Commitments (cont'd)

10. In August 2010, Netvision entered into an agreement with Bezeq that regulates the provision of the internet connectivity services by Bezeq to Netvision internet network. In November 2011, the agreement was updated and was extended until the end of 2014. Under this agreement, Netvision obligated to purchase minimum bandwidth capacities which Bezeq undertook to provide Netvision, in consideration to a price that reflects a considerable decrease in comparison to the previous price per giga-byte unit.

## Note 31 - Contingent Liabilities

In the ordinary course of business, the Group is involved in various lawsuits against it. The costs that may result from these lawsuits are only accrued for when it is more likely than not that a liability, resulting from past events, will be incurred and the amount of that liability can be quantified or estimated within a reasonable range. The amount of the provisions recorded is based on a case-by-case assessment of the risk level, while events that occur in the course of the litigation may require a reassessment of this risk. The Group's assessment of risk is based both on the advice of its legal counsels and on the Group's estimate of the probable settlements amounts that are expected to be incurred, if such settlements will be agreed by both parties. The provision recorded in the financial statements in respect of all lawsuits against the Group amounted to NIS 67 million (see also note 14 regarding provisions).

Described hereunder are the outstanding lawsuits against the Group, classified into groups with similar characteristic. The amounts presented below are calculated based on the claims amounts as of the date of their submission to the Group.

|    |                 |
|----|-----------------|
| 1. | Consumer claims |
|----|-----------------|

In the ordinary course of business, lawsuits have been filed against the Group by its customers. These are mostly requests for approval of class action lawsuits, particularly concerning allegations of illegal collection of funds, unlawful conduct or breach of license, or a breach of agreements with customers, causing monetary and non-monetary damage to them. As of December 31, 2011, the amounts claimed from the Group by its customers sum up to NIS 4,161 million. In addition, there are other lawsuits, the amount claimed in which has not been quantified if certified as class actions and in respect of which the Group has an additional exposure to the above mentioned.

Of all claims, there are claims which sum up to a total of NIS 26 million and other claims in respect of which claim amount has not been specified, which at this early stage it is not possible to assess their chances of success.

In respect of lawsuits with a total claim amount of NIS 191 million or which have not been quantified, settlement agreements in immaterial amounts to the Company or requests for withdrawal, in which procedures have not been completed yet. The Company recorded proper provisions in respect of the settlement agreements which have been filed.

After the end of the reporting period, additional lawsuits against the Company have been filed to courts for a total sum of NIS 2,761 million and another lawsuit for approximately NIS 361 million, has been filed against the Company and other defendants together, in which the plaintiffs have not specified the amount claimed from the Company. At this early stage it is not possible to assess their chances of success.

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## Note 31 - Contingent Liabilities (cont'd)

After the end of the reporting period, claims against the Group, which sum up to a total of approximately NIS 116 million, have been rejected or deleted.

Described hereunder are the outstanding consumer purported class actions against the Group broken down by amount claimed if the lawsuit is certified as class action, as of the date of approval of these financial statements:

| Claim amount                  | Number of claims | Total claims amount (NIS millions) |
|-------------------------------|------------------|------------------------------------|
| Up to NIS 100 million         | 32               | 1,083                              |
| NIS 100-500 million           | 11               | 2,251                              |
| NIS 500 million-NIS 1 billion | 1                | 817                                |
| Unquantified claims           | 7                | -                                  |

In 2011, the court ruled against the Company in a class action as follows:

In March 2008, a purported class action lawsuit was filed against the Company in the District Court of Central Region, by plaintiffs alleging to be the Company's subscribers in connection with allegations that the Company has unlawfully charged its subscribers for providing them with call details records. In August 2009, the District Court of Central Region approved a request to certify a lawsuit as a class action, relating to an allegation that the Company breached the agreements with its subscribers by charging them for a call detail service the Company previously provided free of charge, without obtaining their consent. The total amount claimed was estimated by the plaintiffs to be approximately NIS 440 million. In December 2011, the Court decided against the Company, accepted the allegation and ordered the Company to repay its customers the sum charged for the service in the amount of approximately NIS 22 million plus interest and linkage differences from the date of each payment made by the subscribers, an amount of NIS 200,000 to be paid to the plaintiffs and a fee for the plaintiffs' attorney equal to 10% of the sum to be repaid plus VAT. In January 2012, the Company has appealed the judgment with the Supreme Court and the execution of the judgment was stayed until the appeal is decided. The Company has recorded a provision for the entire sum in our financial statements.

In 2010, the court approved a lawsuit as class action, as follows:

In November 2010, the District Court of Tel Aviv-Jaffa approved a request to certify a lawsuit as a class action, relating to an allegation that Netvision, the Company's wholly owned subsidiary and two other long distance providers, misled the purchasers of certain prepaid cards for long distance calls bought between 2004 and 2008 in relation to certain bonus minutes and reduced certain minutes in certain circumstances. The total amount claimed from all the defendants was estimated by the plaintiffs to be approximately NIS 2.2 billion, of which approximately NIS 818 million was attributed to Netvision. In December 2010, the defendants filed a request for appeal with the Supreme Court challenging the decision and in March 2011 the district court's decision was stayed. A similar purported class action was filed against the defendants in February 2012, as detailed below.

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## Note 31 - Contingent Liabilities (cont'd)

Described hereunder are the outstanding purported class actions against the Group, in which the amount claimed, if the lawsuit is certified as class action is NIS 1 billion or more:

In February 2012, after the end of the reporting period, a purported class action lawsuit was filed against Netvision and certain other long distance operators in the District Court in Tel-Aviv Jaffa, by a plaintiff alleging that the defendants mislead the purchasers of certain international prepaid cards in connection with the amount of minutes included in certain calling cards. The total amount which is claimed from the Company was assessed by the plaintiffs in approximately NIS 2.7 billion (and from any other defendant). At this early stage it is not possible to assess their chances of success.

2. Environmental claims

In the ordinary course of business, lawsuits have been filed against the Group in issues related to the environment, including lawsuits regarding non-ionizing radiation from cellular handsets and lawsuits in connection with the Company's sites. These are mostly requests for approval of class actions, relating to allegations for unlawful conduct or breach of license causing monetary and non-monetary damage (including claims for future damages).

As of December 31, 2011, the amounts that are claimed from the Group under the said claims sum up to a total of approximately NIS 7.8 billion.

Described hereunder is the number of outstanding purported class actions concerning environmental issues, broken down by the amount claimed, if the lawsuit is certified as class action, as of the date of approval of these financial statements:

| C l a i m<br>amount        | Number of<br>claims |
|----------------------------|---------------------|
| NIS 1 billion<br>and above | 4                   |

Described hereunder are the outstanding purported class actions against the Group, in which the amount claimed if the lawsuit is certified as class action, is above NIS 1 billion:

- a. In December 2007, a purported class action lawsuit was filed against the Company (and two other cellular operators) in the District Court of Tel Aviv-Jaffa, by plaintiffs alleging to be residing next to cell sites of the defendants which the plaintiffs allege were built in violation of the law. The plaintiffs allege that the defendants have created environmental hazards by unlawfully building cell sites and therefore demand that the defendants will compensate the public for damages (other than personal damages, such as depreciation of property and/or health related damages which are excluded from the purported class action), dismantle existing unlawfully built cell sites and refrain from unlawfully building new cell sites. If the lawsuit is certified as a class action, the compensation



claimed from the defendants is estimated by the plaintiffs to be NIS 1 billion.

b. In March 2010, a purported class action lawsuit was filed against the Company and another cellular operator, in the District Court of Tel-Aviv-Jaffa by two plaintiffs alleging to be subscribers of the defendants, in connection with allegations that the defendants breached their license by failing to purchase insurance against monetary liability which the defendants may suffer due to bodily damages that allegedly may be caused by cellular radiation.

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## Note 31 - Contingent Liabilities (cont'd)

The plaintiffs request the court to award compensation in an amount equal to the insurance premiums allegedly payable for insuring such liability (estimated by the plaintiffs to be NIS 300 million per year per defendant) for the past seven years and to order the defendants to purchase such insurance coverage in the future. If the lawsuit is certified as a class action, the total amount claimed is estimated by the plaintiffs to be approximately NIS 4.2 billion, out of which NIS 2.1 billion is attributed to the Company individually.

c. In May 2010, a purported class action lawsuit was filed against the Company (and the three other Israeli cellular operators) in the District Court of Central Region, by four plaintiffs alleging to be subscribers of the defendants. The plaintiffs allege that the defendants unlawfully and in violation of their license and agreements with their subscribers fail to construct cell sites in a sufficient quantity, scope and coverage in order to provide cellular services in the requisite quality; fail to test, repair and notify the subscribers that non-ionizing radiation level for repaired handsets may exceed the manufacturer's specifications and the maximum level allowed by law; fail to inform and caution the subscribers of the risks related to the manner of carrying the handset and its distance from the subscriber's body; all of which allegedly increase the level of non-ionizing radiation and health risks to which the subscribers are exposed. In September 2010, at the Company and two other cellular operators' request, the Court instructed the transfer of this purported class action to the Tel-Aviv-Jaffa District Court, to be heard by the Judge hearing the purported class action filed against the Company in December 2007 (by plaintiffs alleging that the Company and the two other Israeli cellular operators have created environmental hazards by unlawfully building cell sites). If the lawsuit is certified as a class action, the total amount claimed from the Company is estimated by the plaintiffs to be approximately NIS 3.68 billion (the total amount claimed from the four defendants is estimated by the plaintiffs to be approximately NIS 12 billion).

d. In June 2011, a purported class action lawsuit was filed against the Company and three other cellular operators in the District Court of Tel-Aviv-Jaffa, by an Israeli citizen, in connection with the allegation that the defendants mislead customers who buy accessories for carrying cellular handsets or do not disclose to them relevant data concerning radiation hazards associated with the usage of accessories for carrying cellular handsets, allegedly contrary to the cellular handsets manufacturers' instructions and warnings and the Israeli Ministry of Health' recommendations.

Thereafter, the plaintiff also requested interim remedies to prevent further sale of such accessories by the Company and two other defendants (the forth allegedly doesn't sell such accessories) or to require them to take necessary precautionary measures, including by complying with alleged disclosure duties and by ceasing alleged misleading, which were rejected by the court in October 2011. In July 2011, at the request of the Company, the purported class action was transferred to be heard by the Judge hearing the purported class action filed against the Company and three other cellular operators in May 2011, by the same plaintiff and three other plaintiffs, raising similar questions.

The total amount claimed from the Company, if the lawsuit is certified as a class action, is estimated by the plaintiff to be approximately NIS 1 billion (out of a total sum of approximately NIS 2.7 billion against all defendants), substantially all for non monetary damages.



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Note 31 - Contingent Liabilities (cont'd)

3. Employees, subcontractors, suppliers, authorities and others claims

In the ordinary course of business, lawsuits have been filed against the Group by employees, subcontractors, suppliers, authorities and others which deal mostly in claims for breach of provisions of the law governing termination of employment and obligatory payments to employees, claims for breach of agreements and patent infringement and compulsory payments to authorities.

As of December 31, 2011, the amounts that are claimed from the Group under the said claims total approximately NIS 55 million.

Liens and guarantees

As part of issuance of the Series A and B debentures (see note 17), the Company committed not to create liens on its assets so long as the debentures have not been fully repaid, except for a fixed lien on assets for purposes of securing credit that will permit acquisition of those assets.

The Group has given bank guarantees as follows:

- a. To the Government of Israel (to guarantee performance of the License) - U.S. \$10 million.
- b. To the Government of Israel (to guarantee performance of the Licenses of the Group ) - NIS 31 million.
- c. To suppliers, government institutions and other - NIS 53 million.

Liens (Netvision)

To guarantee liabilities of Netvision towards banks, floating pledges on the plant, equipment, financial assets, property and rights and fixed pledges on the equipment, share capital and goodwill of Netvision, have been recorded.

Also, there is a current pledge on the property, assets and rights of Netvision, a pledge on a deposit account of Netvision and a fixed pledge on its unpaid share capital and goodwill.

Netvision committed towards certain banks, not to create pledges on its assets (Negative Pledge), except for certain exceptions.

The loans from banks balance, guaranteed by the said pledges, as at December 31, 2011, is NIS 35 million.

Note 32 - Regulation and Legislation

1. In September 2010, the Ministry of Communications announced its decision to amend the regulations which determine the interconnect fees paid to cellular operators in Israel, as follows:

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

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## Note 32 - Regulation and Legislation (cont'd)

- the maximum interconnect tariff payable by a cellular operator for sending an SMS message to another cellular network was reduced from the previous tariff of NIS 0.0285 to NIS 0.0016 from January 1, 2011; to NIS 0.0015 from January 1, 2012; to NIS 0.0014 from January 1, 2013; and to NIS 0.0013 from January 1, 2014. The tariffs do not include VAT and will be updated annually from January 1, 2011, based on the change in the Israeli CPI published in November of the year preceding the update date from the average annual Israeli CPI for 2009. The tariffs will also be increased by the percentage of royalties payable to the Ministry of Communications by the operator. As a result of these updates, including the increase of the royalties the Group pays to the Ministry of Communications, the current maximum interconnect tariffs are NIS 0.0728 per minute for the completion of a call on another cellular network and NIS 0.0017 for a completion of an SMS message to another cellular network.

In June 2011, a petition filed by the Company regarding the interconnect tariffs reduction was dismissed with prejudice with the Company's consent.

This reduction had a material adverse effect on the Company's results of operation in 2011. The Company has taken and intends to continue to take measures in order to reduce as much as possible the adverse effects of such reduction, through revenue enhancement as well as cost reduction measures, but cannot offer any assurance that these measures will be successful.

2. In July 2009, the Communications Law was amended to include an MVNO license. In January 2010, the regulations necessary for the grant of an MVNO license were promulgated. As of the balance sheet date the Ministry of Communications granted nine MVNO licenses one of which was returned. Under the Communications Law, in the event that a MVNO and the cellular operator, will not have reached an agreement as to the provision of service by way of MVNO within six months from the date the MVNO has approached the cellular operator, and if the Ministry of Communications together with the Ministry of Finance determine that the failure to reach an agreement is due to unreasonable conditions imposed by the cellular operator, the Ministry of Communications may intervene in the terms of the agreement, including by setting the price of the service. The operation of MVNO operators in the cellular market and unfavorable terms and consideration for the service (such as equal or based on the Interconnect tariff), may result in material adverse effect on the Group's results of operations. In 2011 five MVNO's have entered into hosting agreements, one of which (Home Cellular) has entered into an agreement with the Company.
3. In March 2010 the Israeli Ministry of Interior Affairs submitted a draft regulation setting substantial limitations on the ability to construct radio access devices based on the exemption from obtaining a building permit, for the approval of the Economy Committee of the Israeli Parliament. The proposed limitations will render the construction of radio access devices based on the exemption practically impossible. In September 2010, the Israeli Supreme Court issued an interim order prohibiting further construction of radio access devices in cellular networks in reliance on the exemption (requested in two petitions filed in July 2008 and June 2009). The interim order, which was issued pursuant to the Israeli Attorney General's request, will be in effect until the enactment of the proposed regulations or other decision by the court. A further decision of the Supreme Court in February 2011, states that the order will not apply to the replacement of existing radio access devices under certain conditions.

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## Note 32 - Regulation and Legislation (cont'd)

In September 2011, the Supreme Court allowed Mirs and Golan to construct radio access devices in reliance on the exemption, under certain limitations, until July 31, 2012 and in December 2011 the Supreme court extended this period with regard to Golan until November 6, 2012. The Company's application to relax the interim order against the Company was denied.

4. National Zoning Plan 36 includes guidelines for constructing cell sites in order to provide cellular broadcasting and reception communications coverage throughout Israel, while preventing radiation hazards and minimizing damage to the environment and landscape. However, National Zoning Plan 36 is in the process of being revised. Current proposed changes will impose additional restrictions and requirements on the construction and operation of cell sites. In June 2010, the proposed changes were approved by the National Council for Planning and Building and submitted for the approval of the Government of Israel. If the proposed changes are approved by the Israeli Government they will harm the Group's ability to construct new cell sites, make the process of obtaining building permits for the construction and operation of cell sites more cumbersome and costly, could adversely affect the Group's existing network and may delay the future deployment of its network.
5. In December 2010, the Communications Law was amended to reduce the early termination fees in pricing plans that include a commitment to a predefined period, in the cellular market. In accordance with the amendment, as of February 1, 2011, early termination fees are calculated based on the subscriber's average monthly bill, resulting in a negligible fee. The reduced Early Termination Fees apply to customers with less than a certain amount of phone lines. The reduction applies to existing as well as new pricing plans. In August 2011, the Communications Law was amended to annul early termination fees in all other communications markets. The reduction and annulment of early termination fees has led to the offering of packages at lower average revenue per minute and resulted in accelerated price erosion, materially increased churn rate and increased subscriber acquisition and retention costs due to materially increased rate of gross recruitment of subscribers.
6. In December 2010, the Communication Law was amended to allow national roaming for new operators and Mirs Communications Ltd. ("Mirs"), one of the existing four cellular companies. Following the amendment, if a new operator or Mirs and the hosting operator have not reached an agreement as to the terms of the service (including the consideration), for any reason, until the service is to commence (after certain criteria is met) the service will be provided for the then prevailing interconnect tariff (in case of a call and for data services - 65% of the interconnect tariff per 1 mega) and subsequently (but no later than February 1, 2012) shall be determined by the Ministry of Communications with the consent of the Minister of Finance and applied retroactively. In April 2011 and December 2011 Mirs and Golan, respectively, were awarded UMTS operator licenses including authorization for national roaming on the existing cellular networks. In September 2011, Mirs entered a national roaming agreement with Pelephone and in October 2011, the Company entered a national roaming agreement with Golan. Additional UMTS operators and unfavorable terms and consideration for the service may result in material adverse effect on the Company's results of operations.
7. In October 2011, the public committee appointed by the Ministry of communications to examine Bezeq's tariffs structure and tariffs for wireline wholesale services and to review the possible annulment of the structural limitations currently imposed on Bezeq and its subsidiaries, published its recommendations. The recommendations



include: (1) The creation of an effective

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Cellcom Israel Ltd. and Subsidiaries

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## Note 32 - Regulation and Legislation (cont'd)

wholesale telecommunications access markets in Israel- Bezeq and Hot will allow other operators which do not own an infrastructure, to use their infrastructure in order to provide services to end users. The terms of such services will be agreed by the operators, or by the regulator, if no wholesale market has evolved within a certain period.

(2) annulment of structural separation in the communication market - Structural separation imposed on the holders of landline general licenses, shall be annulled, other than as to multichannel television (which will be annulled only after internet based TV market is available), within 6 months from the earlier of the execution of a wholesale agreement or the provision of wholesale services, or upon wholesale tariffs setting by The Ministry of Communications, and replaced by accounting separation and restrictions on information transfer between the retail and wholesale divisions of the landline general license holders. If no wholesale market is established within 2 years, the regulator will resume structural separation between infrastructure and end-user services of landline general license holders. (3) change of the supervision on Bezeq retail tariffs to setting maximum tariffs rather than the current setting of fixed tariffs. (4) wholesale tariffs to be set by the regulators shall be maximum tariffs, based on a cost plus basis in order to induce investments in the wholesale wireline market and shall be reviewed by the regulator every 3 years. Until such tariffs shall be set, the tariff shall be fixed, regardless of customer's traits and amount to 75% of Bezeq's average retail price for private customers, during July to September 2011. This tariff will be in place for 6 months, with a maximum extension of additional 6 months (5) landline operators who hold general licenses (such as Bezeq and Hot) will deposit autonomous bank guarantees in substantial amounts to guarantee the existence of a wholesale market. (6) The provision of broadband access by Israel Electric Corporation, or IEC, should be promoted in order to increase competition and should be regulated the same as Bezeq and Hot. The implementation of the recommendations, in whole or in part, is subject to the adoption thereof by the Minister of Communications and further legislative proceedings.

While an effective wholesale wireline market will enhance the Group's ability (including through Netvision) to compete and extend its service offering, the recommendations regarding the structural separation and Bezeq's tariffs supervision may have a material adverse effect on Netvision's results of operation.

8. In January 2012, a bill proposing to set gradually increasing financial sanctions on communication operators, for breach of their licenses, the amount of which shall be calculated as a percentage of the operator's income and based on the gravity of the breach passed the preliminary enacting stage in the Israeli Parliament. Such bill, if adopted, is expected to substantially increase the Ministry of Communications' usage of such sanctions. Substantial sanctions will harm the Group's results of operations.

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## Notes to the Consolidated Financial Statements

## Note 33 - Related Parties

| A.                               | Balance sheet | December 31  | December 31  |
|----------------------------------|---------------|--------------|--------------|
|                                  |               | 2010         | 2011         |
|                                  |               | NIS millions | NIS millions |
| Current assets                   |               | 1            | 150          |
| Current liabilities              |               | 5            | 2            |
| Long-term liability - debentures |               | 267          | 214          |

## B. Transactions with related and interested parties executed in the ordinary course of business at regular commercial terms:

|                  | Year ended December 31 |              |              |
|------------------|------------------------|--------------|--------------|
|                  | 2009                   | 2010         | 2011         |
|                  | NIS millions           | NIS millions | NIS millions |
| Income:          |                        |              |              |
| Revenues         | 32                     | 33           | 26           |
| Expenses:        |                        |              |              |
| Cost of revenues | 77                     | 74           | 43           |
| Other            | 16                     | 8            | 18           |

In the ordinary course of business, from time to time, the Group purchases, leases, sells and cooperates in the sale of goods and services or otherwise engages in transactions with entities that are members of the IDB group or other interested or related parties.

The Group has examined said transactions and believes them to be on commercial terms comparable to those that the Group could obtain from/ provide to unaffiliated parties.

## C. Key management personnel compensation (including directors)

In addition to their salaries, the Group also provides non-cash benefits to executive officers (such as a car, medical insurance, etc.), and contributes to a post-employment defined benefit plan on their behalf.

The Group has undertaken to indemnify the Group's directors and officers, as well as certain other employees for certain events listed in the indemnifications letters given to them. The aggregate amount payable to all directors and

officers and other employees who may have been or will be given such indemnification letters is limited to the amounts the Group receives from the Group's insurance policy plus 30% of the Group's shareholders' equity as of December 31, 2001 or NIS 486 million, adjusted for changes in the Israeli CPI.

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## Note 33 - Related Parties (cont'd)

Executive officers also participate in the Group's share option program (see note 20 regarding share-based payments).

Key management personnel compensation is (including directors) comprised of:

|                              | Year ended December 31 |              |              |
|------------------------------|------------------------|--------------|--------------|
|                              | 2009                   | 2010         | 2011         |
|                              | NIS millions           | NIS millions | NIS millions |
| Short-term employee benefits | 5                      | 6            | 11           |
| Share-based payments         | -                      | -            | -            |
|                              | 5                      | 6            | 11           |

## D. An agreement with DIC

In October 2006, the Company entered into an agreement with DIC pursuant to which DIC provides the Company with advisory services in the areas of management, finance, business and accountancy in consideration of NIS 2 million per year linked to the Israeli CPI for June 2006. This agreement is for a term of one year and is automatically renewed for one-year terms (however any extension thereof after December 31, 2014 will require the approvals of the parties organs according to the Israeli Companies Law), unless either party provides 60 days prior notice to the contrary.

## E. An agreement with Netvision 013 Barak

In July 2007, the Company entered into an agreement with Netvision 013 Barak (a subsidiary of Netvision, see note 7) pursuant to which Netvision 013 Barak will provide the Company with interconnect and roaming services. In January 2011, the agreement was amended and extended. From January 2011 to August 31, 2011, Netvision 013 Barak provided the Company interconnect and roaming services in the amount of NIS 27 million. The agreement is renewable once a year until the end of 2013.