

Cellcom Israel Ltd.
Form 20-F
March 12, 2007

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

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2006

OR

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

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

For the transition period from _____ to _____

Commission file number 001-33271

CELLCOM ISRAEL LTD.

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

ISRAEL

(Jurisdiction of incorporation or organization)

10 Hagavish Street, Netanya 42140, Israel

(Address of principal executive offices)

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

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

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

None

(Title of Class)

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

None

(Title of Class)

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

As of December 31, 2006, the Registrant had outstanding 97,500,000 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 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 financial statement item the Registrant has 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

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INTRODUCTION

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

Presentation of Financial and Share Information

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in Israel, or Israeli GAAP, and, unless otherwise indicated, all financial data and discussions related to such data are based upon financial statements prepared in accordance with Israeli GAAP. The principal differences between the accounting principles applied by us under Israeli GAAP and generally accepted accounting principles in the United States, or U.S. GAAP, are discussed in note 28 to our consolidated annual financial statements included elsewhere in this annual report.

Unless we indicate otherwise, U.S. dollar translations of the NIS amounts presented in this annual report are translated using the rate of NIS 4.225 to \$1.00, the representative rate of exchange as of December 31, 2006 as published by the Bank of Israel.

The information in this annual report gives effect to a 10-for-1 share split and a distribution of approximately 84.5 ordinary shares to all shareholders for each outstanding ordinary share, both of which were effected on October 12, 2006, in order to avoid the need to issue fractional shares upon the exercise of options.

Trademarks

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

Industry and Market Data

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

Special Note Regarding Forward-Looking Statements

We have made statements under the captions “Item 3.D - Risk Factors,” “Item 4 - Information on the Company,” “Item 5 - Operating and Financial Review and Prospects,” and in other sections of this annual report that are forward-looking statements. In some cases, you can identify these statements by forward-looking words such as “may,” “might,” “will,” “should,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “predict,” “potential” or “continue,” the negative of these terms or comparable terminology. These forward-

looking statements, which are subject to risks, uncertainties and assumptions about us, may include projections of our future financial performance, our anticipated growth strategies and anticipated trends in our business. These statements are only predictions based on our current expectations and projections about future events. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the results, level of activity, performance or achievements expressed or implied by the forward-looking statements, including those factors discussed under the caption entitled “Item 3.D - Risk Factors.” You should specifically consider the numerous risks outlined under “Item 3.D - Risk Factors.”

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

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA

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

The selected data presented below under the captions “Income Statement Data,” and “Balance Sheet Data” for, and as of the end of, each of the years in the five-year period ended December 31, 2006, are derived from the consolidated financial statements of Cellcom Israel Ltd. and subsidiaries, which financial statements have been audited by Somekh Chaikin, an independent registered public accounting firm and a member firm of KPMG International. The consolidated financial statements as of December 31, 2006, 2005 and 2004, and for each of the years in the three-year period ended December 31, 2006, and the report thereon, are included elsewhere in this annual report. The selected data should be read in conjunction with the consolidated financial statements, the related notes, and the independent registered public accounting firm’s report which contains emphasis paragraphs regarding the convenience translation of the consolidated financial statements as of and for the year ended December 31, 2006 into US dollars solely for the convenience of the reader and, as explained below,

reporting periods prior to January 1, 2004 have been adjusted for the changes in the general purchasing power of the Israeli currency.

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

Pursuant to Israeli GAAP, until December 31, 2003, we prepared our financial statements on the basis of historical cost adjusted for the changes in the general purchasing power of Israeli currency, the NIS, based upon changes in the Israeli CPI. Accordingly, among other things, non-monetary items (such as fixed assets) were adjusted based on the changes in the Israeli CPI from the Israeli CPI published for the month in which the transaction relating to the asset took place up to the Israeli CPI at the date of the balance sheet. Starting January 1, 2004, the adjustment of financial statements for the impact of the changes in the purchasing power of the Israeli currency was discontinued. The adjusted amounts included in the financial statements as of December 31, 2003 constitute the starting point for the nominal financial report as of January 1, 2004. Any additions made from January 1, 2004 are included at their nominal values.

The selected information also includes certain items in accordance with U.S. GAAP. Israeli GAAP differs in certain significant respects from U.S. GAAP. For a summary of certain significant differences, see note 28 to our consolidated financial statements included elsewhere in this annual report.

For your convenience, the following tables also contain U.S. dollar translations of the NIS amounts presented at December 31, 2006, translated using the rate of NIS 4.225 to \$1.00, the representative rate of exchange on December 31, 2006 as published by the Bank of Israel.

	Year Ended December 31,					
	2002	2003	2004	2005	2006	2006 (In \$)
(In NIS millions, except per share data)						
Income Statement						
Data:						
Revenues	5,135	5,261	5,600	5,114	5,622	1,330
Cost of revenues	3,111	3,075	3,302	3,133	3,326	787
Selling and marketing expenses	651	613	661	623	656	155
General and administrative expenses	678	682	684	656	659	156
Operating income	695	891	953	702	981	232
Financial income (expense), net	(5)	(216)	(45)	24	(155)	(37)
Other income (expenses), net	(5)	1	1	(11)	(5)	(1)
Income tax	266	245	292	232	304	72
Net income	419	431	617	483	517	122
Basic and diluted net income per share	4.30	4.42	6.33	4.95	5.30	1.25
Weighted average ordinary shares outstanding	97,500,000	97,500,000	97,500,000	97,500,000	97,500,000	97,500,000

U.S. GAAP Data(2):

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Net income	—	441	620	491	494	117
Basic and diluted earnings	—	4.52	6.36	5.04	5.07	1.20
Other Data:						
EBITDA(3)	1,652	1,890	1,914	1,643	1,864	441
Capital expenditures	1,073	658	739	747	521	123
Dividends declared per share(1)	—	—	—	34.87	4.41	1.04
Net cash provided (used) by operating activities	1,285	1,393	1,471	1,272	1,477	349
Net cash provided (used) in investing activities	(1,557)	(508)	(852)	(619)	(633)	(150)

Year Ended December 31,

	2002	2003	2004	2005	2006	2006 (In \$)
(In NIS millions, except per share data)						
Net cash provided (used) by financing activities	436	(603)	(1,068)	1,114	(2,560)	(605)
Subscribers(4)	2,468	2,300	2,450	2,603	2,884	
Period churn rate(5)	11.2%	27.3%	19.9%	15.0%	16.8%	
ARPU (in NIS)(6)	166	162	174	151	151	36

Year Ended December 31,

	2002	2003	2004	2005	2006
(In NIS millions)					
Balance Sheet Data:					
Cash	171	454	5	1,772	56
Working capital	(67)	(361)	(138)	1,909	237
Total assets	6,047	5,907	5,311	7,016	4,926
Shareholders' equity	2,114	2,545	3,161	3,649	307
U.S. GAAP Data(2):					
Total assets	—	—	5,610	11,100	8,998
Shareholders' equity	—	—	3,312	4,490	4,134

- (1) All dividends declared were paid in cash in the year ended December 31, 2006.
- (2) Under U.S. GAAP, DIC's acquisition of our shares in 2005 is treated as a purchase that requires a revaluation of our assets and liabilities, leading to increased amortization expense of intangible assets, offset by decreased depreciation expense of tangible assets under U.S. GAAP. In addition, we were required to push down certain DIC debt and the interest expense relating to such debt incurred to finance the acquisition until it was repaid in early 2006, leading to increased financial expense under U.S. GAAP. See note 28 to our consolidated financial statements. As a result of this accounting treatment, U.S. GAAP data presented for the year ended and as at December 31, 2005 and for the year ended and as at December 31, 2006 are not comparable with the data presented for the previous periods.
- (3) EBITDA is a non-GAAP measure and is defined as income before financial income (expenses), net; other income (expenses), net; income tax; depreciation and amortization. We present EBITDA as a supplemental performance measure because we believe that it facilitates operating performance comparisons from period to period and company to company by backing out potential differences caused by variations in capital structure (most particularly affecting our interest expense given our recently incurred significant debt), tax positions (such as the impact on periods or companies of changes in effective tax rates or net operating losses or, most recently, our provision for tax expenses) the age of, and depreciation expenses associated with, fixed assets (affecting relative depreciation expense and, until December 31, 2003, the effects of adjusting for changes in the general purchasing power of the Israeli currency as discussed above). EBITDA should not be considered in isolation or as a substitute for operating income or other statement of operations or cash flow data prepared in accordance with GAAP as a measure of our profitability or liquidity. EBITDA does not take into account our debt service requirements and other commitments, including capital expenditures, and, accordingly, is not necessarily indicative of amounts that may be available for discretionary uses. In addition, EBITDA, as presented in this annual report, may not be comparable to similarly titled measures reported by other companies due to differences in the way that these measures are calculated.

The following is a reconciliation of net income to EBITDA:

	Year Ended December 31,				
	2002	2003	2004	2005	2006
	(In NIS millions)				
Net income	419	431	617	483	517
Financial expense (income), net	5	216	45	(24)	155
Other expenses (income)	5	(1)	(1)	11	5
Income taxes	266	245	292	232	304
Depreciation and amortization	957	999	961	941	883
EBITDA	1,652	1,890	1,914	1,643	1,864

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

We also revised our subscriber calculation methodology in 2003 and 2005 but in each case have not restated prior subscriber data to conform to the new presentation. We estimate that the change in methodology in 2003 led to a decrease in our reported subscriber numbers of approximately 300,000 and the change in methodology in 2005 led to an increase in our reported subscriber numbers of approximately 84,000.

- (5) Churn rate is defined as the total number of voluntary and involuntary permanent deactivations in a given period expressed as a percentage of the number of subscribers at the beginning of the period. Involuntary permanent deactivations relate to subscribers who have failed to pay their arrears for the period of six consecutive months. Voluntary permanent deactivations relate to subscribers who terminated their use of our services.
- (6) Average monthly revenue per subscriber (ARPU) is calculated by dividing revenues from cellular services for the period by the average number of subscribers during the period and by dividing the result by the number of months in the period. Revenues from inbound roaming services are included even though the number of subscribers in the equation does not include the users of those roaming services. Inbound roaming services are included because ARPU is meant to capture all service revenues generated by a cellular network, including roaming services. Revenues from sales of extended warranties are included because they represent recurring revenues generated by subscribers, but revenues from sales of handsets, repair services and transmission services are not. We, and industry analysts, treat ARPU as a key performance indicator of a cellular operator because it is the closest meaningful measure of the contribution to service revenues made by an average subscriber.

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

	Year Ended December 31,					
	2002	2003	2004	2005	2006	2006 (in\$)
	(In NIS millions, except number of subscribers and months)					
Revenues	5,135	5,261	5,600	5,114	5,622	1,330
less revenues from equipment sales	502	498	646	565	636	150
less other revenues*	10	22	21	38	61	14
adjustments to the Israeli CPI**	(32)	(62)	—	—	—	—
Revenues used in ARPU calculation (in NIS millions)	4,655	4,803	4,933	4,511	4,925	1,166
Average number of subscribers	2,336,264	2,477,316	2,368,919	2,489,453	2,717,133	
Months during period	12	12	12	12	12	12
ARPU (in NIS, per month)	166	162	174	151	151	36

* Other revenues includes revenues from repair services and transmission services.

** Pursuant to Israeli GAAP, until December 31, 2003, we prepared our financial statements on the basis of historical cost adjusted for the changes in the general purchasing power of Israeli currency, the NIS, based upon changes in the Israeli CPI. We reverse these adjustments in presenting ARPU.

If the change in methodology of calculating our subscriber base had not changed in July 2006, ARPU for the year ended December 31, 2006 would have been NIS 153.

Exchange Rate Information

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

Month	High (NIS)	Low (NIS)
September 2006	4.394	4.297
October 2006	4.302	4.238
November 2006	4.331	4.247
December 2006	4.234	4.176
January 2007	4.260	4.187
February 2007	4.254	4.183

On March 8, 2007 the daily representative rate of exchange between the NIS and U.S. dollar as published by the Bank of Israel was NIS 4.211 to \$1.00.

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

Year	Average (NIS)
2002	4.736
2003	4.512
2004	4.483
2005	4.503
2006	4.442

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

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

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

Risks Related to our Business

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

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

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

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

- reduce tariffs, including interconnect and roaming tariffs, limit our ability to vary charging units or otherwise intervene in the pricing policies for our products and services;
- regulate the termination of predefined term agreements, including requiring us to disconnect subscribers once the initial term expires;
 - impose new safety or health-related requirements;
 - impose additional restrictions on the construction and operation of cell sites;
 - impose restrictions on the provision of content services;
 - limit or otherwise intervene with the services or products that we may sell; or
 - set higher service standards.

See “Item 4.B – Business Overview - Government Regulations Our Principal License.”

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

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

As a result of an amendment to the Communications Law in March 2005, cellular and landline telephone operators were required to implement number portability by September 1, 2006. Number portability would permit our subscribers to change to another network operator without having to change their telephone numbers. Despite efforts to introduce the requisite technology and coordinate the transition to number portability by September 1, 2006, currently none of the cellular or landline operators has implemented number portability. We, and two other cellular operators, Pelephone Communications Ltd., or Pelephone, and Partner Communications Company Ltd., or Partner, have filed a petition with the Israeli High Court of Justice for the issuance of an order to the Government of Israel and the Ministry of Communications to show cause for their failure to act immediately in order to initiate an amendment to the Communications Law postponing the deadline for the implementation of number portability. If a reasonable extension to the deadline is not effected or other adequate relief is not granted, we may be exposed to substantial sanctions and legal claims, including class actions by subscribers. See “Item 8 - Financial Information - Legal Proceedings—Purported class actions” for additional details on a purported class action filed against us in that respect.

In 2005, our license was amended to regulate charging for SMS messages sent outside our network, which, under one interpretation of the amendment, may lead to claims of our not being in compliance with our license. To date, we have fulfilled the license requirements, even under this potential interpretation, with respect to SMS messages sent to subscribers of one other cellular operator. However, due to technological difficulties which we and our competitors face and have not yet been resolved, we may face claims, if such interpretation of

the amendment prevails, of not having implemented the amendment with respect to SMS messages sent to subscribers of two other operators. We had notified the Ministry of Communications of our technological inability to fully implement the amendment, if it is so interpreted. The Ministry of Communications had proposed an amendment to our license to resolve this problem, which we believe is unsatisfactory because it does not change the charging criteria but mainly proposes certain customer notification requirements. Until such time as the cellular operators develop the necessary interfaces or our license is amended, we may be exposed, if such an interpretation prevails, to substantial sanctions and legal claims.

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

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

We have experienced difficulties in obtaining some of these consents and permits, particularly in obtaining building permits for cell sites from local planning and building authorities. As of December 31, 2006, we operated approximately 10% of our cell sites without building permits or applicable exemptions. Although, in relation to approximately 6.5% of our cell sites we are in the process of seeking to obtain building permits or to modify them to satisfy applicable exemptions, we may not be able to obtain all the necessary permits or make the necessary modifications. Approximately 23% of our cell sites operate without building permits in reliance on an exemption from the requirement to obtain a building permit, mainly for radio access devices. Our reliance upon the exemption for radio access devices has been unsuccessfully challenged by local planning and building authorities in the courts. However, such challenges, and other claims asserting that those cell sites do not meet other legal requirements continue. In addition, we operate other cell sites in a manner that is not fully compatible with the building permits issued for these cell sites which may, in some cases, constitute grounds for termination of their lease agreements or claims for breach of such agreements. Our rooftop microwave sites and repeaters operate in reliance upon an exemption from the requirement to obtain a building permit. Substantially all of our outdoor microwave sites are rooftops. It is unclear whether other types of repeaters require a building permit. Our reliance on an exemption from the requirement to obtain building permits for the microwave sites and repeaters has not, to date, been subject to judicial challenge. Operation of a cell site or other facility without a building permit or not in accordance with other legal requirements may result in the issuance of a demolition order for the cell site or other facility or the bringing of criminal charges against us and our officers and directors. Certain of our cell sites have been subject to demolition orders. In addition, criminal charges have been brought against us and our officers and directors in connection with cell sites that were alleged to have been constructed without the required permits. As of December 31, 2006, 27 cell sites are the subject of criminal proceedings; demolition orders have been granted with respect to eight cell sites while the remaining 19 cell sites are the subject of further litigation. Certain of our officers and directors are also named in a number of these criminal proceedings as defendants. Should any of our officers or directors be found guilty of an offence, although this has not occurred to date, they may face monetary penalties and a term

of imprisonment. Our sites may be the subject of further demolition orders and we or our officers and directors may face further criminal charges.

Pursuant to the Israeli Non-Ionizing Radiation Law, 2006, which is effective, for the most part, as of January 1, 2007, the granting or renewal of an operating permit by the Ministry of Environmental Protection for a cell site or other facility is subject to the receipt of a building permit or the facility being exempt from the requirement to obtain a building permit. Should we fail to obtain building permits for our cell sites or other facilities, including in the event that our reliance upon an exemption from the requirement to obtain building permits for these cell sites and other facilities is found invalid, the Ministry of Environmental Protection will not grant or renew our operating permits for those cell sites and other facilities. Operating a cell site or a facility without an operating permit could subject us and our officers and directors to criminal, administrative and civil liability.

The draft Non-Ionizing Radiation Regulations published by the Ministry of Environmental Protection in November 2006 propose additional restrictions in relation to the operation of cell sites and other facilities. If these restrictions are adopted in their current draft format, they will, among other things, limit our ability to construct new sites and renew operating permits for a number of our existing sites, specifically in residential areas.

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

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

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

In January 2006, the law was amended to require an applicant, as a precondition to obtaining a cell site construction permit from a planning and building committee, to provide a letter to the committee indemnifying it for possible depreciation claims. As of December 31, 2006, we have provided over 45 indemnification letters to local planning and building committees. Calls upon our indemnities may have a material adverse effect on our financial condition and results of operations. Further, if we are required to make substantial payments under the indemnity letters, it could trigger a default under our credit facility. We may also decide to demolish or relocate existing cell sites to less favorable alternatives and to construct new cell sites in alternative, less suitable locations or not at all, due to the obligation to provide indemnification. As a result, our existing service may be impaired or the expansion of our network coverage could be limited.

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

despite the absence of an indemnification letter. This practice increases the risk that we may be exposed to material liability as a result of depreciation claims.

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

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

Handsets, accessories and various types of cell sites are known to be sources of non-ionizing radiation emissions. While, to the best of our knowledge, the handsets that we market comply with the applicable legislation that relate to acceptable “specific absorption rate,” or SAR, levels, we rely on the SAR levels published by the manufacturers of these handsets and do not perform independent inspections of the SAR levels of these handsets. As the manufacturers’ approvals refer to a prototype handset, we have no information as to the actual level of SAR of the handsets throughout the lifecycle of the handsets, including in the case of handset repair. See “Item 4.B - Business Overview - Government Regulations—Handsets.” Concerns regarding cell sites have already caused us difficulties in obtaining or renewing leases for cell sites. If health concerns over non-ionizing radiation increase, any adverse findings in new studies of non-ionizing radiation are published or if non-ionizing radiation levels are found to be higher than the standards set for handsets and cell sites, consumers may be discouraged from using cellular handsets and regulators may impose additional restrictions on the construction and operation of cell sites or handset usage. See the discussion of the draft Non-Ionizing Radiation Regulations above in “We may not be able to obtain permits to construct and operate cell sites.” As a result, we may experience increased difficulty in obtaining leases for new cell site locations or renewing leases for existing locations (although, in total we have experienced renewal problems with approximately 5% of our cell site leases each year); we may be exposed to property depreciation claims; we may lose revenues due to decreasing usage of our services; we may be subject to increased regulatory costs; and we may be subject to health-related claims for substantial sums. We have not obtained insurance for these potential claims. An adverse outcome to, or settlement of, any litigation against us or any other provider of cellular services could have a material adverse effect on our results of operations, financial condition or prospects.

We face intense competition in all aspects of our business.

The Israeli cellular telephone market is highly competitive. We compete for subscribers with three other cellular operators. While we enjoy the largest market share, estimated to be 34.4% as of December 31, 2006, two of our competitors, Partner and Pelephone, enjoy estimated market shares of 31.9% and 28.7% respectively, with MIRS Motorola Communications Ltd., or MIRS, estimated to have a market share of 5%. The current competitive pressure in the Israeli market results primarily from the highly penetrated state of the market. See “Item 4.B – Business Overview - The Telecommunications Industry

in Israel.” This means that market growth is limited and cellular operators compete intensely to retain their own subscribers and attract those of their competitors. Any of the following developments in our market is expected to increase competition further and may result in a loss of subscribers, increased subscriber acquisition and retention costs and ultimately reduced profitability for us:

- the implementation of number portability, as it would eliminate one of the deterrents to switching between cellular operators;
- Pelephone’s offering of certain services jointly with its parent company, Bezeq, the incumbent landline operator; although Bezeq and Pelephone may not offer integrated or combined packages of cellular and landline telephone and other telecommunication services currently, the Ministry of Communications has stated that once Bezeq’s share of the Israeli landline telephone market falls below 85% (Bezeq does not publish its market share), it would be permitted to offer certain services jointly with its subsidiaries subject to regulatory limitations;
- the entry into the Israeli cellular market by mobile virtual network operators, or MVNOs, could increase competition and thus may adversely affect our revenues; the government has authorized an examination of the desirability of introducing MVNO operation in Israel; the findings and recommendations are expected to be published in May 2007; and
- a proposed amendment to the Israeli Restrictive Trade Practices Law, 1988 to grant the Commissioner of Restrictive Trade Practices broader authority to take action against oligopolies where there is insufficient competition, including the authority to issue orders to remove or to ease entry or transfer barriers, should the Commissioner conclude that this would increase competition; if the Commissioner were to decide that the Israeli cellular market was oligopolistic and insufficiently competitive, this could limit our freedom to manage our business, increase the competitive pressures that we face and adversely affect our results of operations.

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

In order to attract and retain the maximum number of subscribers in our highly competitive market, we design specific calling plans to suit the preferences of various subscriber groups. We require sophisticated information systems to record accurately subscriber usage pursuant to the particular terms of each subscriber’s plan as well as accurate database management and operation of a very large number of calling plans. From time to time, we have detected some discrepancies between certain calling plans and the information processed by our internal information systems, such as applying an incorrect rebate or applying an incorrect tariff to a service resulting in a higher charge. We have invested substantial resources to refine and improve our information and control systems and ensure that our new calling plans are appropriately processed by our information systems; we have also taken steps to remedy the identified discrepancies and have established reserves where the discrepancies are quantifiable. Despite our substantial investments, we may experience discrepancies in the future due to the multiplicity of our plans and the scope of the processing tasks. Further, while we invest substantial efforts in monitoring our employees and third-

party distributors and dealers that market our services, it is possible that some of our employees, distributors or dealers may offer terms and make (or fail to make) representations to existing and prospective subscribers that do not fully conform to applicable law, our license or the terms of our calling plans. As a result of these discrepancies, we may be subject to subscribers' claims, including class action claims, and substantial sanctions for breach of our license that may materially adversely affect our results of operations.

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

We provide services to millions of subscribers on a daily basis. As a result of the scope and magnitude of our operations we are subject to the risk of a large number of lawsuits, including class action suits by consumers with respect to billing and other practices. These actions may be costly to defend and could result in significant judgments against us. The Israeli Class Actions Law, 2006 and the 2005 amendment to the Israeli Consumer Protection Law, 1981 include provisions that expand the causes of action for which a class of litigants may bring suit, including with regard to any damages allegedly incurred prior to the effective date of these laws, reducing the minimal requirements for certification of a class action lawsuit and reducing the qualifications required to be a lead plaintiff in a class action lawsuit. These laws may increase the number of requests for certification of class actions against us, our legal exposure and our legal costs in defending against such suits, which as a result may materially and adversely affect our financial results. Currently, we are engaged in a number of purported class action suits as a defendant, some of which are for substantial amounts. For a summary of certain material legal proceedings, see "Item 8 - Financial Information - Legal Proceedings."

We are subject to the risk of intellectual property rights claims against us, including in relation to innovations we develop ourselves. These claims may require us to initiate or defend protracted and costly litigation, regardless of the merits of these claims. If any of these claims succeed, we may be forced to pay damages or may be required to obtain licenses for the infringing product or service. If we cannot obtain all necessary licenses on commercially reasonable terms, we may be forced to stop using or selling the products and services, which could adversely affect our ability to provide certain services and products.

We may be subject to increased regulation in respect of handset sales.

The Ministry of Communications is considering adopting changes to the licenses of the cellular operators that would prohibit cellular operators from offering calling plans that include handset subsidies to subscribers who purchase their handsets from the operators, unless the same terms are also offered to subscribers who purchase their handsets elsewhere. If such proposed changes are adopted, this would impair our ability to offer handsets to our subscribers at subsidized prices or in conjunction with attractive calling plans. This may lead to difficulties in selling advanced handsets that have the potential to generate high content-related revenues, which in turn may reduce our potential revenues or require higher subscriber acquisition costs and adversely affect our results of operations.

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

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

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

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

- our founding shareholder, Discount Investment Corporation Ltd., or DIC (or its transferee or transferees, if approved in advance by the Ministry of Communications as “founding shareholders”), must own at least 26% of each of our means of control;
- Israeli citizens and residents among our founding shareholders (or their approved transferees) must own at least 20% of our outstanding share capital and each of our other means of control (DIC has agreed to comply with this requirement);
- a majority of our directors must be Israeli citizens and residents;
- at least 20% of our directors must be appointed by Israeli citizens and residents among our founding shareholders; and
- we are required to have a committee of our Board of Directors that deals with matters relating to state security, which must be comprised of at least four directors (including an external director) having the requisite security clearance by Israel’s General Security Service.

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

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

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

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

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

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

The cellular market is known for rapid and significant technological change. Our current technologies, including our 3.5G technologies, may be overtaken rapidly, requiring us to invest in alternative technologies to remain competitive. Further, technologies such as satellite-based personal communications services, wireless broadband access services such as WiMAX, and other technologies that have the capacity to handle cellular calls may enter our market and compete with traditional cellular providers, thus further intensifying the competition we face requiring us to reduce prices, thus adversely affecting our results of operations.

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

We rely on agreements to provide roaming capability to our subscribers in many areas outside Israel. As of December 31, 2006, we had roaming arrangements with over 470 cellular providers in 171 countries around the world. However, as we cannot control the quality of the service that they provide, it may be inferior to the quality of service that we provide. Equally, our subscribers may not be able to use some of the advanced features that they enjoy when making calls on our network. Some of our competitors may be able to obtain lower roaming rates than we do because they may have larger call volumes or because of their affiliations with other international cellular operators. If our competitors’ providers can deliver a higher quality or a more cost effective roaming service, then subscribers may migrate to those competitors and our results of operation could be adversely affected. Further, we may not be able to compel providers to participate in our technology migration and enhancement strategies. As a result, our ability to implement technological innovations could be adversely affected if these overseas providers are unable or unwilling to cooperate with the further development of our network or if they cease to provide services comparable to those we offer on our network.

In addition, in 2006, the European Union declared that it is considering regulating roaming tariffs. To our knowledge, following such declaration, several operators in Europe agreed to reduce roaming tariffs among themselves. Should such operators decide to reduce roaming tariffs with us as well, this could reduce the revenues we derive from our roaming services and adversely affect our profitability and results of operations.

Our substantial debt increases our exposure to market risks, may limit our ability to incur additional debt that may be necessary to fund our operations and could adversely affect our financial stability.

As of December 31, 2006, our total indebtedness was approximately NIS 3,197 million (\$757 million). Our credit facility and the indentures governing our debentures currently permit us to incur additional indebtedness, subject to maintaining certain financial ratios and other restrictions contained in our credit facility. Our substantial debt could adversely affect our financial condition by, among other things:

- increasing our vulnerability to adverse economic, industry or business conditions, including increases in prevailing interest rates, particularly because our debentures are linked to the Israeli CPI, and our credit facility bears interest at a variable rate;
- limiting our flexibility in planning for, or reacting to, changes in our industry and the economy in general;
- requiring us to dedicate a substantial portion of our cash flow from operations to service our debt, thus reducing the funds available for operations and future business development; and
- limiting our ability to obtain additional financing to operate, develop and expand our business.

Our freedom to operate our business is limited as a result of certain restrictive covenants contained in our credit facility and our indentures.

Our credit facility contains a number of restrictive covenants that limit our operating and financial flexibility. These covenants include, among other things, limitations on liens (also contained in the indentures governing our debentures), on the incurrence of indebtedness, on the provision of loans and guarantees and on acquisitions, dispositions of assets, mergers and other changes of control. Our credit facility also contains covenants regarding maintaining certain levels of financial ratios during the term of the facility, including as a condition to the distribution of dividends. Our ability to continue to comply with these and other obligations depends in part on the future performance of our business. Such obligations may hinder our ability to finance our future operations or the manner in which we operate our business. In particular, any non-compliance with performance-related covenants and other undertakings of our credit facility and debentures could result in an acceleration of our outstanding debt under our credit facility and debentures and restrict our ability to obtain additional funds, which could have a material adverse effect on our business, financial condition or results of operations. Further, our inability to maintain the financial ratios required under our credit facility for the distribution of dividends may limit our ability to distribute dividends.

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

A substantial amount of our cash payments are incurred in, or linked to, non-NIS currencies. In particular, in 2005 and 2006, payments in U.S. dollars or linked to the U.S. dollar represented approximately 19% and 26%, respectively, of total cash outflow. These payments included capital expenditures, cell site rental fees, payments to equipment suppliers

and, in 2006, payments of principal and interest on our credit facility. As almost all of our cash receipts are in NIS, any devaluation of the NIS against those non-NIS currencies in which we make payments, particularly the U.S. dollar, will increase the NIS cost of our non-NIS denominated or linked expenses and capital expenditures.

We engage in currency hedging transactions to reduce the impact on our cash flows and results of operations of these currency fluctuations. We recognize freestanding derivative financial instruments as either assets or liabilities in our balance sheet and we measure those instruments at fair value. However, accounting for changes in the fair value of a derivative instrument, such as a currency hedging instrument, depends on the intended use of the derivative instrument and the resulting designation. For a foreign exchange derivative instrument designated as a cash flow hedge, the effective portion of the derivative instrument is initially reported as a component of our shareholders' equity and subsequently recognized in our income statement as the hedged item affects earnings. For derivative instruments that are not designated as cash flow hedges, changes in fair value are recognized in our income statement without any reference to the change in value of the related budgeted expenditures. These differences could result in fluctuations in our reported net income on a quarterly basis.

Further, since the principal amount of, and interest that we pay on our debentures are linked to the Israeli CPI, any increase in the Israeli CPI will increase our financial expenses and could adversely affect our results of operations.

We may not be able to fulfill our dividend policy in the future.

In February 2006, we adopted a dividend policy targeting a payout ratio of at least 75% of our net income under Israeli GAAP in each calendar year, subject to any applicable law, our license and contractual obligations and provided that such distribution would not be detrimental to our cash needs or to any plans approved by our Board of Directors. Our credit facility limits our ability to pay dividends, including by limiting our distribution of dividends in respect of any financial year so that any distributions based on retained earnings accumulated since January 1, 2006, do not exceed the lesser of (a) 75% of our aggregate net income from January 1, 2006 to the date of distribution and (b) the aggregate "eligible dividend amount" from January 1, 2006 to the date of distribution, the "eligible dividend amount" being the lesser of (i) our net income for each financial year and (ii) the excess of free cash flow over 110% of total debt service for each financial year. In addition, we are also permitted to make distributions out of the expected approximately NIS 285 million (\$67 million) adjustment to retained earnings referred to below in "Item 5 - Operating and Financial Review and Prospects — Overview — New Israeli accounting standard affecting measurement of fixed assets." Our license requires that we and our 10% shareholders maintain at least \$200 million of combined shareholders' equity. See "Item 5 - Operating and Financial Review and Prospects—Liquidity and Capital Resources—Debt service." Dividend payments are not guaranteed and our Board of Directors may decide, in its absolute discretion, at any time and for any reason, not to pay dividends.

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

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

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

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

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

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

In addition, pursuant to the "Guidelines for Sound Bank Administration" issued by the Israeli Supervisor of Banks, the amount that an Israeli bank may lend to one group of borrowers and to each of the six largest borrowers of such banking corporation is limited. Since we are a member of IDB's group of borrowers, these guidelines may limit the ability of Israeli banks to lend money to us, although this has not occurred to date.

Risks Relating to Operating in Israel

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

Our operations, our network and some of our suppliers are located in Israel. Accordingly, political, economic and military conditions in Israel may directly affect our business. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors. Any hostilities involving Israel or the interruption or curtailment of trade within Israel or between Israel and its trading partners

could adversely affect our operations and could make it more difficult for us to raise capital. Since September 2000, terrorist violence in Israel has increased significantly and negotiations between Israel and Palestinian representatives have effectively ceased. The establishment in 2006 of a government in the Palestinian Authority by representatives of the Hamas militant group has created additional unrest and uncertainty in the region. Further, Israel was recently engaged in an armed conflict with Hezbollah, a Lebanese Islamist Shiite militia group, which involved thousands of missile strikes and disrupted most day-to-day civilian activity in northern Israel. Any armed conflicts, terrorist activities or political instability in the region would likely negatively affect business conditions and could harm our results of operations, including following termination of such conflicts due to a decrease in the number of tourists visiting Israel.

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

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

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

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

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

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

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

It may be difficult to enforce a U.S. judgment against our officers, our directors and us or to assert U.S. securities law claims in Israel.

We are incorporated under the laws of the State of Israel. Service of process upon us and upon our directors and officers and the Israeli experts named in this annual report, all of whom reside outside the United States, may be difficult to obtain within the United States. Furthermore, because all of our assets and all of our directors and officers are located outside the United States, any judgment obtained in the United States against us or any of our directors and officers may not be collectible within the United States.

Additionally, it may be difficult to assert U.S. securities law claims in original actions instituted in Israel. Israeli courts may refuse to hear a claim based on a violation of U.S. securities laws because Israel is not the most appropriate forum to bring such a claim. In addition, even if an Israeli court agrees to hear a claim, it may determine that Israeli law and not U.S. law is applicable to the claim. If U.S. law is found to be applicable, the content of applicable U.S. law must be proved as a fact, which can be a time-consuming and costly process. Certain matters of procedure will also be governed by Israeli law. There is little binding case law in Israel addressing these matters.

Risks Relating to Our Ordinary Shares

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

As of February 28, 2007, DIC holds, directly and indirectly, approximately 59% of our outstanding share capital. Pursuant to a shareholders agreement among DIC and certain of our minority shareholders, who in the aggregate own 5.5% of our ordinary shares, DIC has been granted voting rights in respect of those shares. In addition to DIC's shareholdings and such additional voting rights, it has the right to appoint the 20% of our directors that we are required by our license and articles of association to have appointed by Israeli citizens and residents among our founding shareholders. Accordingly, subject to legal limitations, DIC has control over all matters requiring shareholder approval, including the election and removal of our directors and the approval of significant corporate transactions. This concentration of ownership could delay or prevent proxy contests, mergers, tender offers, open-market purchase programs or other purchases of our ordinary shares that might otherwise give our shareholders the opportunity to realize a premium over the then-prevailing market price for our ordinary shares.

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

A substantial number of our ordinary shares could be sold into the public market, which could depress our share price.

The market price of our ordinary shares could decline as a result of sales by our existing shareholders of ordinary shares in the market or the perception that these sales could occur. Most of our shareholders will have an opportunity to sell their shares for the first time following the expiration of the 180-day lock-up period agreed to between these shareholders and the underwriters of our initial public offering. These factors could also make it difficult for us to raise additional capital by selling shares.

As of the date of this annual report, we have 97,500,000 ordinary shares outstanding. Of these shares, approximately 40,000,000 shares are freely transferable without restriction or registration under the Securities Act of 1933, as amended, or the Securities Act, except for any shares purchased by one of our existing "affiliates," as that term is defined in Rule 144 under the Securities Act. Approximately 57,500,000 shares are held by our affiliates and may be sold in the public market only if registered or if they qualify for an exemption from registration under Rule 144 of the Securities Act.

In general, under Rule 144 as currently in effect, beginning 90 days after listing of our ordinary shares on the New York Stock Exchange on February 9, 2007, a person, or persons whose shares are aggregated, who is our affiliate, is entitled to sell within any three-month period a number of shares that does not exceed the greater of 1% of our then-outstanding ordinary shares, which will equal 975,000 shares immediately after such listing, or the average weekly trading volume of our ordinary shares on the New York Stock Exchange during the four calendar weeks preceding the filing of a notice of the sale on Form 144. Sales under Rule 144 are also subject to manner of sale provisions, notice requirements and the availability of current public information about us. We are unable to estimate the number of shares that will be sold under Rule 144 since this will depend on the market price for our ordinary shares, the personal circumstances of the shareholder and other factors.

In addition, we have 2,500,000 shares reserved for issuance upon the exercise of outstanding options; the options are subject to vesting schedules but vesting will be accelerated upon certain events including any sale by IDB that leads to any reduction in IDB's ownership below 50.01%. We intend to register these shares by filing a registration statement on Form S-8.

We have not yet evaluated our internal control over financial reporting in compliance with Section 404 of the Sarbanes-Oxley Act.

We are required to comply with the internal control evaluation and certification requirements of Section 404 of the Sarbanes-Oxley Act by the end of our 2007 fiscal year. We have only recently begun the process of determining whether our existing internal control over financial reporting systems is compliant with Section 404. If it is determined that we are not in compliance with Section 404, we may be required to implement new internal control procedures and re-evaluate our financial reporting. We may experience higher than

anticipated operating expenses as well as outside auditor fees during the implementation of these changes and thereafter. Further, we may need to hire additional qualified personnel in order for us to be compliant with Section 404. If we are unable to implement these changes effectively or efficiently, it could harm our operations, financial reporting or financial results and could result in our conclusion that our internal controls over financial reporting are not effective.

ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

Our History

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

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

Our principal founding shareholders were DIC, a subsidiary of IDB, which prior to September 2005 indirectly held approximately 25% of our share capital, and BellSouth Corporation and the Safra brothers of Brazil, which together indirectly held approximately 69.5% of our share capital and voting rights in respect of an additional 5.5% of our share capital. IDB acquired the stakes of BellSouth and the Safra brothers in September 2005 and, following the sale of minority stakes to four groups of investors in 2006 and the sale of shares as part of our initial public offering in February 2007, IDB currently indirectly holds approximately 59% of our share capital and the voting rights in respect of an additional 5.5% of our share capital.

Following the acquisition by IDB in 2005, IDB put in place a new management team, including Ami Erel, the Chairman of our Board of Directors, who had previously been President and CEO of Bezeq, Amos Shapira, our Chief Executive Officer, who had been CEO of Kimberly-Clark's Israeli subsidiary and El Al Airlines, and Tal Raz, our Chief Financial Officer, one of the founders and formerly a director of Partner, one of our principal competitors. Our new management team has already implemented a series of initiatives to drive our growth, including the continued enhancement of our distinctive brand, a greater focus on customer service and new sales campaigns.

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

Principal Capital Expenditures

Our accrual capital expenditure in 2004, 2005 and 2006 amounted to NIS 739 million, NIS 747 million and NIS 521 million, respectively. Accrual capital expenditure is defined as

investment in fixed assets and other assets, such as spectrum licenses, during a given period. For the periods under review, a key focus of our capital investment has been the introduction of our 1800MHz GSM/GPRS/EDGE network and the build out of our UMTS/HSDPA network. With the completion of these projects, we do not intend to embark on any significant capital expenditure programs during 2007.

B. BUSINESS OVERVIEW

General

We are the leading provider of cellular communications services in Israel in terms of number of subscribers, revenues and EBITDA for the year ended December 31, 2006. Upon launch of our services in 1994, we offered significantly lower prices for cellular communications services than the incumbent provider and transformed the nature of cellular telephone usage in Israel, turning it into a mass market consumption item. We surpassed the incumbent cellular operator and became the market leader in terms of number of subscribers in 1998 and, despite the entry of two additional competitors, we have continued since then to have the highest number of subscribers. As of December 31, 2006, we provided services to approximately 2.884 million subscribers in Israel with an estimated market share of 34.4%. Our closest competitors have estimated market shares of 31.9% and 28.7%, respectively. In the year ended December 31, 2006, we generated revenues of NIS 5,622 million (\$1,330 million), EBITDA of NIS 1,864 million (\$441 million), and operating income of NIS 981 million (\$232 million). See note 3 to the table in "Item 3.A - Selected Financial Data" for a definition of EBITDA.

We offer a broad range of cellular services through our cellular networks covering substantially all of the populated territory of Israel. These services include basic and advanced cellular telephone services, text and multimedia messaging services and advanced cellular content and data services. We also offer international roaming services in 171 countries as of December 31, 2006. We offer our subscribers a wide selection of handsets from various leading global manufacturers, as well as extended warranty and repair and replacement services. We also offer landline transmission and data services to business customers and telecommunications operators and, since July 2006, we offer landline telephony services to selected businesses.

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

	Year Ended December 31,				
	2002	2003	2004	2005	2006
Subscribers (end of period) (in thousands)(1)	2,468	2,300	2,450	2,603	2,884
Revenues (in NIS millions)	5,135	5,261	5,600	5,114	5,622

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

We also revised our subscriber calculation methodology in 2003 and 2005 but in each case have not restated prior subscriber data to conform to the new presentation. We estimate that the change in methodology in 2003 led

to a decrease in our reported subscriber

numbers of approximately 300,000 and the change in methodology in 2005 led to an increase in our reported subscriber numbers of approximately 84,000.

The Telecommunications Industry in Israel

The following table sets forth selected macro statistics about Israel at and for the year ended December 31, 2005:

Population (millions)	6.99
GDP (\$ billions)	123.7
GDP per capita (\$)	17,900
Exports of goods & services (\$ billions)	56.8
CPI change	2.4%
Long-term local currency sovereign credit rating by S&P	A+
Unemployment rate (December 31, 2005)	8.8%

Source: OECD, 2005 and Ministry of Finance of Israel, 2006.

The size of Israeli telecommunications services revenues in 2005 was approximately NIS 24 billion and telecommunications spending was approximately 4.4% of GDP, higher than in other developed economies such as the European Union and the United States. Telecommunications services consist of five main segments, which, except for landline services, are highly competitive. We estimate that, of the total telecommunications services revenues in 2005, approximately 57% was comprised of cellular services, approximately 24% was local landline voice and Internet services, approximately 6% was international voice services and approximately 13% was multichannel television services.

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

Cellular Services

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

The Israeli cellular market is highly penetrated. The market reached an estimated penetration rate (the ratio of cellular subscribers to the Israeli population) at December 31, 2006, of approximately 118%, representing approximately 8.4 million cellular subscribers.

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

	December 31,			
	2003	2004	2005	2006
Total subscribers (millions)	6.6	7.2	7.8	8.4
Cellular penetration (%)	98	105	112	118

Source: Reported by Cellcom, Partner and Pelephone. Cellcom estimates for MIRS as MIRS does not disclose operating information.

There are currently four cellular operators in Israel: Cellcom, Partner, Pelephone, and MIRS. We estimate that the distribution of cellular subscribers among these operators as of December 31, 2006 was: Cellcom (34.4%), Partner (31.9%), Pelephone (28.7%) and MIRS (5%). Subscriber data are based on public information except for MIRS, which is based on our estimate. However, there is no uniform method of counting subscribers.

We are majority-owned by DIC, a subsidiary of IDB, and started operations at the end of 1994. Partner is majority-owned by Hutchinson Whampoa Ltd. and started operations in 1998. Pelephone is a wholly-owned subsidiary of Bezeq and started operations in 1986. The major controlling shareholder of Bezeq following its privatization in 2005 is a consortium comprised of Saban Capital Group (controlled by the media entrepreneur Haim Saban), Apax Partners (the international private equity firm) and Arkin Communications (controlled by the Israeli businessman Mori Arkin). MIRS, wholly owned by Motorola, had its license upgraded from push-to-talk to a cellular license in February 2001.

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

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

Key characteristics of the Israeli cellular services market

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

High cellular telephone penetration. The estimated penetration rate in Israel as of December 31, 2006 was 118%. Penetration rate is calculated by dividing the total number of subscribers by the Israeli population. The Israeli population does not include foreign workers and Palestinian subscribers who are included in the number of subscribers. The number of subscribers may also include subscribers to more than one network including those in the process of switching networks. As a result, the effective penetration rate after adjustment for these factors is likely to be somewhat lower than 118%.

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

Favorable geography and high population density around a few urban centers. Israel covers a small area of territory of approximately 8,000 square miles (20,700 square kilometers). In addition, Israel is relatively flat and dry. Moreover, the population tends to

be concentrated in a small number of geographical locations. These characteristics facilitate efficient network roll out.

High cellular voice usage. The average cellular voice usage per subscriber in Israel is more than 300 minutes per month, which is higher than the average cellular voice usage per subscriber in most developed economies.

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

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

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

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

Low annual churn rates. The average annual churn rate in Israel was 16% in 2006, which is lower than the churn rates in other developed economies.

Landline Services

Voice Services

Bezeq operates approximately 2.9 million lines and provides local services. The second largest competitor in landline telephony services is HOT Telecom, or HOT, jointly owned by the three Israeli cable TV operators, which started landline operations in late 2003. HOT's network has been upgraded to offer Internet, data and voice services.

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

There are four new players that have entered this market recently, including us and Partner.

Broadband and Internet services

Israeli broadband services are characterized by high growth and high penetration levels. The Ministry of Communications estimates that at the end of 2005, there were 1.1 million subscribers, and the household penetration rate was 52%. Also, approximately 99% of Bezeq's lines enabled broadband services in 2004.

The dominant broadband access technologies are ADSL and cable. The first ADSL services were launched by Bezeq in 2000 and currently represent a 65% share of broadband connections. Cable modems, which account for the rest of the market, have been available since 2002.

Transmission and landline data services are provided by Bezeq, HOT, Med-1 (whose operations were recently acquired by Partner) and us. These services are provided to business customers and to telecommunications operators.

Internet access is currently provided by five major Internet service providers, or ISPs: NetVision (an indirect subsidiary of IDB), Barak (an indirect subsidiary of IDB Group which recently merged with Netvision), Bezeq International (a wholly-owned subsidiary of Bezeq), Internet Gold and Golden Lines (Internet Gold and Golden Lines recently announced a merger), and some other niche players. All these major providers are also suppliers of international voice services.

International voice services

International voice services in Israel have been open for competition since December 1996. Until then, Bezeq International was the only supplier of such services. Bezeq International was created as a wholly-owned subsidiary of Bezeq in 1994 as part of the Israeli government's initiative to separate the major operations of the incumbent operator. Barak and Golden Lines were allocated international voice services licenses and started operating at the beginning of 1997, enabling them to compete with Bezeq International. In April 2004, further competition was introduced in international voice services through the issuance of new licenses to NetVision, Internet Gold and Xfone Communications. Today there is no single dominant player in this market, and competition is very intense.

Multichannel television

The multichannel pay-TV market is also highly penetrated with levels above those of most developed economies. Multichannel pay-TV services are provided by HOT and by YES, a subsidiary of Bezeq.

Competitive Strengths

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

- *Unique combination of leading market position and strong operational momentum.* We estimate that in the last year, we have achieved market-leading subscriber and revenue growth while steadily strengthening our operating margins. Leveraging a series of brand, customer service and content initiatives and a rationalization of our management structure, our new senior management team has managed to solidify Cellcom's leading market position

as reflected in our subscriber base, revenues and EBITDA while controlling capital expenditures.

- *Strong and distinctive own brand.* Our established brand enjoys strong recognition in Israel. Since 2004, we have made the enhancement of our image among consumers a top priority and have invested substantial resources to position Cellcom as a local cellular company with a warm personal touch. Our focus on music and music-related content services, particularly our “Cellcom Volume” initiative, is our leading marketing theme and one that associates us with the important growth opportunity presented by advanced cellular content and data services.
- *Transmission infrastructure and landline services.* We have an advanced fiber-optic transmission infrastructure that consists of approximately 1,300 kilometers of inland fiber-optic cable, which, together with our complementary microwave-based infrastructure, connects the majority of our cell sites and provides for substantially all of our backhaul services. Our transmission infrastructure significantly reduces our operational reliance on Bezeq, the incumbent landline operator in Israel, while also saving us substantial infrastructure-leasing cash costs. As our transmission network has transmission and data capacity in excess of our own backhaul needs, and covers the majority of Israel’s business parks, we offer transmission and data services to business customers and telecommunications providers. In addition, since July 2006, following the receipt of a landline transmission, data and telephony services license, we offer landline telephony services to selected businesses.
- *Strategic relationship with a leading group of local and international shareholders.* Our ultimate parent company, IDB, is one of the largest business groups in Israel. We enjoy access, through our management services agreement, to the senior management of the IDB group, who are some of the most experienced managers in Israel. These managers, including veterans of the Israeli telecommunications market, provide us with financial, managerial and strategic guidance. In 2006, our shareholder base was broadened as a result of IDB’s sale of minority stakes to a series of highly regarded international and local financial investors, including affiliates of Goldman Sachs, Bank Leumi, Migdal Group and the First International Bank of Israel.
- *Strong management team.* Since IDB acquired control of us in September 2005, we have put in place a team of seasoned managers with significant experience and solid track records in previous managerial positions. Our Chairman, Mr. Ami Erel, is a veteran of the Israeli communications market and previously served as the chief executive officer of Bezeq. Our chief executive officer, Mr. Amos Shapira, has been chief executive officer of Kimberly-Clark’s Israeli subsidiary and of El Al Airlines, where he was credited with its successful restructuring and improvements in customer service. Our chief financial officer, Mr. Tal Raz, has extensive experience in the Israeli cellular market, as he was involved in the formation of one of our main competitors, Partner, and served as a member of its board of directors. Under the leadership of Messrs. Erel, Shapira and Raz, we have demonstrated

significant improvements in our operating results and believe that we are well positioned to continue this trend and to execute our business strategy.

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

Business Strategy

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

- *Maximize customer satisfaction, retention and growth.* Our growth strategy is focused on retaining our subscribers and expanding the selection of services and products we offer to our subscribers in order to enhance customer satisfaction and increase average revenues per user, or ARPU. We strive to continually improve and enhance the flexibility of our customer service to shorten the time required to fulfill subscriber requests. From December 2005 to December 2006, despite a reduction in our overall workforce, our number of positions in units that deal directly with our customers (such as sales and service), which we call customer-facing positions remained steady. In addition to providing quality customer service, we also strive to retain our subscribers and attract new subscribers by offering them advanced handsets, handset upgrades, attractive calling plans and value-added services. In 2006, we introduced a “churn lab” that identifies subscribers at high risk of churn and seeks to preemptively approach them with tailored solutions to maintain their satisfaction with our services.
- *Grow and develop our Internet, content and data services.* The usage of cellular content and data services in Israel is currently relatively low compared to western European countries and we believe that we have significant growth potential in this field. We intend to continue to invest in the deployment of our high speed UMTS/HSDPA network, which covered 80% of the populated territory of Israel at the end of 2006, in order to permit higher-quality and higher-speed multimedia content transmission. We also plan to expand our content and data services, products and capabilities through in-house expertise and strategic relationships with leading cellular content providers. For example, in 2006 we introduced “Cellcom Heep,” a Web 2.0 portal that permits cellular and PC users to upload, review and rate user-generated content and in 2004 we introduced our “Cellcom Volume” initiative that featured, among other things, the introduction of our cellular music portal.
- *Grow roaming revenues.* We have experienced steady growth in roaming revenues since 2003 and believe that roaming presents an important source of future revenue and profit growth for us. As of December 31, 2006, we have GSM roaming agreements with over 470 operators in 171 countries, of which 53 operators in 30 countries are also 3G operators, and we aim to increase our number of relationships. In particular, we intend to pursue additional

agreements with 3G operators, allowing our and their subscribers to benefit from advanced content and data services when traveling.

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

· *Optimize our cost structure.* We intend to continue our efforts to control costs so that we can improve profitability while also improving the quality of our services. For example, from December 2005 to December 2006, we reduced our non-customer facing positions by over 18%, including higher-cost temporary workers, while our customer-facing positions remained steady. In addition, having already built our own fiber-optic and microwave infrastructure reduces our operating cash costs, as our network maintenance costs and microwave spectrum fees are lower than the lease costs to rent backhaul capacity from Bezeq. We intend to continue to focus on identifying further opportunities to manage our costs without reducing the quality of our service.

· *Capitalize on our existing infrastructure to selectively provide landline telephony services.* Our 1,300 kilometer inland fiber-optic network and our microwave infrastructure provide us with the ability to offer cost-efficient landline telecommunications solutions. We hold a license to operate a landline service in Israel and, since July 2006, we offer our landline telephony service to selected businesses.

Services and Products

We provide cellular communications services to approximately 2.884 million subscribers, including basic cellular telephony services and value-added services as well as handset sales. Not all services are supported by all handsets or by all of our networks. In addition, we offer transmission and data services to business customers and telecommunications operators and, since July 2006, we have been offering our landline telephony service to selected businesses.

We offer our cellular subscribers a variety of calling plans, designed to adapt to their particular characteristics and changing needs. We adapt our calling plans for the different types of usage - personal or business - and the number of users associated with the subscriber. For example, we offer discounted rates on the weekend for soldiers, Israeli music services to youth and discounted rates on calls among members of the same family. We offer two methods of payment: pre-paid and post-paid. Pre-paid services are offered to subscribers who pay for our services prior to obtaining them, usually by purchasing our "Talkman" pre-

paid cards or “virtual” Talkman cards. Post-paid services are offered to subscribers who are willing to pay for our services through banking and credit arrangements, such as credit cards and direct debits. Many of our post-paid subscribers are able to terminate their relationship with us at any time and some of them do not pay a monthly fee.

Basic cellular telephony services

- Our principal service is basic cellular telephony. In addition we offer many other services with enhancements and additional features to our basic cellular telephony service. These services include voice mail, cellular fax, call waiting, call forwarding, caller identification, conference calling, “Push-and-Talk” service (which allows subscribers to initiate a call with one or more other persons using a designated button in their handset without having to dial a number), “Talk 2” (two handsets sharing the same number, thus allowing our subscribers to own both a handset and a car phone), additional number service (enables our subscribers to add a second phone number to their handset) and collect call service (a unique service protected by our U.S. patent).
- We also offer both an outbound roaming service to our subscribers when traveling outside of Israel and an inbound roaming to visitors to Israel who can “roam” into our network. Roaming allows cellular subscribers, while using their own cell phone number (and handset, in most cases) and being billed by their provider, to place and receive calls and text messages while in the coverage area of a network to which they do not subscribe. Where available, subscribers can also benefit from other cellular services such as advanced data and content services. As of December 31, 2006, we had commercial roaming relationships with over 470 operators in 171 countries based on the standard agreements of the GSM organization (an umbrella organization in which all the cellular operators operating with GSM technology are members). This enables our subscribers to enjoy our services in almost the entire world. Most of our GSM subscribers who use these roaming services abroad can use their own handset and others can borrow or rent, depending upon the period of time, a suitable handset from us. In addition, as of December 31, 2006, we had 3G roaming arrangements with 53 of these operators, enabling our 3G roamers to participate in video calls and use high-speed data, video and audio content services in 30 countries. Roaming is an increasingly important revenue stream to us due to the large inbound tourism industry in Israel and extensive overseas travel by Israelis.

Value-added services

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

Cellcom Volume. This music-related marketing initiative is focused not just on providing a rich downloadable content consisting of ringtones, video tones, true tones and songs in MP3 format through our popular cellular music portal, but also on promoting Israeli music and local musicians and supporting youth music centers. In addition, handsets supporting music content, as well as other merchandising, are marketed under the “Cellcom Volume” service. Complementary services provided through Cellcom Volume include “Fun Dial,” which enables our subscribers to have callers listen to our subscribers’ favorite music instead of the regular ringing tone while waiting to be connected, and “Gift Song,” which enables subscribers to send songs to friends with a personally recorded introduction.

Cellcom Heep. This innovative portal enables our subscribers and other cellular and landline Internet users to upload, review and rate user-generated content by using Web 2.0 technology.

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

Cellcom i-mode. This is a cellular Internet service developed by NTT DoCoMo, a Japanese operator and developer of sophisticated cellular multimedia technology, that enables our subscribers with designated handsets to obtain information and content from designated Internet sites in a friendly, easy-to-use manner.

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

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

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

Location-based services. We offer a number of location-based services. “Where are you?” is a location-based service that allows one subscriber to locate another subscriber, subject to the latter’s prior approval, such as a parent and child. “Cellcom Navigator” is a service provided through a third party that enables our subscribers to receive real-time travel directions and visual data regarding their position using global positioning system, or GPS, technology.

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

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

Handsets

We sell a wide selection of handsets designed to meet individual preferences. Prices of handsets vary based on handset features, calling plans and special promotions. We offer a variety of handsets from world-leading brands such as Motorola, Nokia, Samsung and Sony-Ericsson. All of the handset models we sell offer Hebrew language displays in addition to English. We are also required to provide cellular phone services to subscribers who did not purchase their handsets from us, provided that the handset model has been approved for use by the Ministry of Communications. We offer our subscribers an extended handset warranty for their handsets as well as repair and replacement services in approximately 40 walk-in centers.

Landline services

In addition to our cellular services, we provide landline telephony, transmission and data services, using our 1,300 kilometers of inland fiber-optic infrastructure and complementary microwave links. We have offered transmission and data services since 2001. We received a license to offer landline telephone service in April 2006 and, since July 2006, have been offering this service to selected businesses.

Network and Technology

General

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

Our "third generation" UMTS/HSDPA, or high-speed downlink packet data access, technology, offers full interactive multimedia capabilities with current data rates of up to 1.5Mbps on the downlink path and up to 384Kbps on the uplink path. This network, considered to be a "3/3.5G" technology, is a network that uses the same core as, with its access facilities in some cases co-located with the cell sites of, our existing GSM/GPRS/EDGE network. Our UMTS/HSDPA network covers more than 80% of the populated territory in Israel. By 2007, this network is expected to enable transmission of up

to 14.4Mbps on the downlink path and up to 1.8Mbps on the uplink path. Moreover, our UMTS/HSDPA network supports new types of services that require higher throughput and lower delay, such as video conferencing.

Our “second generation” GSM/GPRS/EDGE 1800MHz network allows for voice calls, data transmission and multimedia services, like video streaming and video live (using the EDGE technology), although at slower speeds than our UMTS/HSDPA network. Our GSM/GPRS/EDGE technology is an advanced second-generation technology and considered to be a “2.75G” technology. It enables us to deliver multimedia and services at speed rates that are higher than the rates offered through regular “second generation” digital cellular technology. Packet data rates vary from 50 Kbps to 200 Kbps, depending mainly on handset capabilities. In addition, in the case of coverage gaps and for services supported by our GSM/GPRS/EDGE technology, the network provides an adequate fallback and capacity relief for our UMTS/HSDPA network by means of smart features and network load sharing. Over 90% of our traffic uses our GSM/GPRS/EDGE and UMTS/HSDPA networks, with substantially all of that traffic using the GSM/GPRS/EDGE network.

We also have a separate network using our initial TDMA 850MHz wireless technology, which is widely used as a “second generation” technology in North and South America. Less than 10% of our traffic uses this network. This technology supports voice calls and low rate data services known as CSD (circuit switch data) and CDPD (cellular digital packet data). Our TDMA network, which is based on Nortel technology, is maintained and operated by our engineers and technicians. Operating costs for this network are low and we expect that it will not require additional capital expenditures.

Our transmission network is comprised of 1,300 kilometers of inland advanced fiber-optic cables that, together with our microwave infrastructure, enable us to provide our customers with telephony and high speed and high quality transmission and data services. Our transmission network is strategically deployed in order to cover the major portion of Israel’s business parks and permits us to provide our own backhaul services while reducing our need to lease capacity from Bezeq, the incumbent landline operator in Israel.

Infrastructure

We have built an extensive, durable and advanced cellular network system, enabling us to offer high-quality services to substantially the entire Israeli populated territory. Since maintaining a high-quality network is a basic element in our business strategy, we seek to satisfy quality standards that are important to our subscribers, such as high voice quality, high data rate packet sessions, low “blocked call” rate (calls that fail because access to the network is not possible due to insufficient network resources), low “dropped call” rate (calls that are involuntarily terminated) and deep indoor coverage. As a result, we have made substantial capital expenditures and expect to continue to make capital expenditures on our network system. As of December 31, 2006, we had invested an aggregate of NIS 7.157 billion (\$1.694 billion) on our network infrastructure since our inception in 1994.

We cover 80% of the populated areas of Israel with our UMTS/HSDPA network. Our UMTS/HSDPA network is mostly co-located with our GSM/GPRS/EDGE network. The suppliers of our UMTS/HSDPA network are Ericsson Israel (for the 3G radio access network) and Nokia (for our core network).

Our GSM/GPRS/EDGE network currently covers substantially all of the Israeli populated territory, and is being continually expanded to support capacity growth. We are currently selectively enhancing and expanding our GSM/GPRS/EDGE network, primarily in urban areas, by adding infrastructure to improve outdoor and indoor coverage. Our GSM/GPRS/EDGE network was supplied and is maintained by Nokia Israel.

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

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

Network design

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

Our primary objective going forward is to complete the build-out of our UMTS/HSDPA network and achieve quality and coverage parameters similar to those in our other networks. At the same time we intend to continue to perform extensive optimization work to provide our subscribers with maximum capability to support video and other high-bandwidth content.

Network performance

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

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

Spectrum allocation

Spectrum availability in Israel is limited and is allocated by the Ministry of Communications through a licensing process. We have been allocated 2x10 MHz in the 850 MHz frequency band for our TDMA network, and 2x17 MHz in the 1800 MHz frequency

band for our GSM/GPRS/EDGE network. In addition, the Ministry of Communications awarded us 2 x 10 MHz and 1 x 5 MHz in the 1900 - 2200 MHz frequency band for our UMTS third generation FDD and TDD spectrums, respectively. Currently, we are not making use of our TDD spectrum due to the unavailability of equipment that can support this spectrum. We believe that our available spectrum is sufficient for our needs.

Cell site construction and licensing

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

Suppliers

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

We entered into our agreement with Nokia Israel Communications Ltd., or Nokia Israel, in July 2001 for the purchase of our GSM/GPRS system. We were also granted an option to purchase GSM 800, EDGE, UMTS and ancillary systems. In 2002, we exercised our option to purchase an EDGE system, and in 2005, we purchased a UMTS core system, under similar terms. We are obligated to purchase maintenance services from Nokia Israel for five years from the final acceptance of the GPRS system (until 2007). Thereafter, Nokia Israel is obligated to offer us maintenance services for 15 years from final acceptance (until 2017). Under the agreement, the parties generally have limited liability for direct damages of up to 10% of the value of the agreement.

We use Telcordia’s intelligent platform, or “IN,” to provide services to our TDMA, GSM/GPRS/EDGE and UMTS networks, allowing us, at minimal cost, to internally develop sophisticated services with a short time-to-market that are customized to local market requirements. We have also deployed Comverse’s Intelligent Peripheral, which enables us to develop services with rich voice interaction, such as Caller Name Announcement, Call Back

and Fun Dial. Our IN platform supports all existing IN protocols, which allows us to provide (subject to applicable roaming agreements) advanced roaming services, including Virtual Home Environment, abbreviated dialing, unified access to voice mail, VPN, local number format from subscribers' phone book and call screening.

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

Transmission Network

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

Our optical transmission network is deployed from Nahariya in the north to Beer Sheva in the south and Afula and Jerusalem in the east. The fiber-optic network reaches most of the business parks in the country and is monitored by a fault-management system that performs real-time monitoring in order to enable us to provide our subscribers with high quality service. In order to efficiently complete our transmission network's coverage to the entire country, we use a microwave network as a complementary solution in those areas that are not served by our fiber-optic network. As of December 31, 2006, we had deployed more than 1,940 microwave links to both our cell sites and subscribers.

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

Information technology

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

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

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

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

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

Sales and Marketing

Sales

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

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

We operate directly, using our sales force and service personnel, approximately 40 physical points of sale and service, mostly located in shopping centers and other frequently visited locations to provide our subscribers with easy and convenient access to our products and services. We record approximately 175,000 subscriber applications per month in our direct points of sale and service.

We also distribute our products and services indirectly through a chain of dozens of dealers who operate in over 130 points of sale throughout Israel. Our dealers are compensated for each sale based on qualitative and quantitative measures. We closely monitor the quality of service provided to our subscribers by our dealers. In our efforts to penetrate certain sectors of our potential subscriber base, we select dealers with proven expertise in marketing to such sectors.

Telephonic sales. Telephonic sales efforts target existing and potential subscribers who are interested in buying or upgrading handsets and services. When approached by a customer, our sales representatives (both in-house and outsourced) offer such customer a variety of products and services.

Door-to-door sales. The door-to-door sales team is comprised of approximately 350 dealers' sales representatives. All the members of our door-to-door sales team go through extensive training by us prior to commencing their work. We target the door-to-door subscribers based on market surveys that we regularly conduct. All information derived from our market surveys is uploaded into a database. Once a potential customer is identified, we contact the potential customer and schedule a meeting with a member of our door-to-door sales team.

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

Marketing

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

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

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

In recruiting new subscribers, we are focused on current and potential high value customers, such as students, and subscribers who influence family and business purchasing decisions, such as teenagers and senior executives. We leverage our extensive interactions with our customers, which we estimate to be approximately 800,000 unique customer applications per month, to provide the requested services and also to cross- and up-sell products and services according to customer needs and usage trends to increase customer satisfaction, loyalty and revenues. In addition, we offer loyalty rewards, such as video subscriptions and tickets to concerts, performances and movies, from time to time.

We regularly advertise in all forms of media, in promotional campaigns and in the sponsorship of major entertainment events. For example, through our music-related "Cellcom Volume" marketing initiative, we promote the sale of music-related services through our cellular music portal, we promote both Israeli music and local musicians as well as support youth music centers aimed at enabling underprivileged youth to discover and develop their musical talents. Our marketing and branding campaign has been very successful and highly acclaimed among the Israeli public, and our "Cellcom Volume" initiative in particular have provided us with a high visibility association with music content services. Out of 13 surveys conducted in 2005 by *Globes*, the leading Israeli business newspaper, our advertisements were selected as the "most memorable and beloved" eight times.

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

Customer Care

Our customer service unit is our main channel for preserving the long-term relationship with our subscribers. We focus on customer retention through the provision of quality service and customer care. In order to achieve this goal, we systematically monitor and analyze our subscribers' preferences, characteristics and trends by developing and analyzing sophisticated databases. We then adopt services that are aimed to respond to subscribers' needs and preferences. In addition, subscribers are encouraged to subscribe to additional value-added services, such as cellular Internet and content services, in order to enhance customer satisfaction and increase ARPU. During 2006, we implemented an application that provides a customer service representative a one-screen solution which unifies comprehensive customer data from our various systems, thus shortening the time required to provide service and improve service quality. We constantly review our performance by conducting surveys among our subscribers in order to ensure their satisfaction with our services and to improve them as necessary.

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

Call centers. In order to provide quick and efficient responses to the different needs of our various subscribers, our call-center services are divided into several sub-centers: finance; network; international roaming; and data transfer. The call center services are provided in four languages: Hebrew, Arabic, English and Russian. We regularly monitor the performance of our call centers. Based on our internal reviews, the average waiting time for subscribers who contact our call center is well under a minute. If calls go unanswered for longer than our guidelines require, a flashing light is automatically activated in our corporate headquarters, alerting management to the delay. We currently operate call centers in four locations throughout Israel, one of which is outsourced. On average, we respond to one million calls every month. During peak hours our call centers have the capability to respond to 700 customer calls simultaneously.

Walk-in centers. As of December 31, 2006, we operate approximately 40 service and sales centers, covering almost all the populated areas of Israel. These centers provide a walk-in contact channel and offer the entire spectrum of services that we provide to our subscribers and potential subscribers, including handsets and accessories, sales upgrades, maintenance and other services, such as finance, calling-plan changes and subscriptions to new services. These stores are mostly located in central locations, such as popular shopping malls. Our walk-in centers also provide our subscribers with onsite express repair services, performed by highly skilled technicians, a concept rarely seen in most western European countries. This enables a subscriber to deposit a handset with our repair lab and receive the repaired handset, on average, within one hour. If a repair service is expected to take longer, we provide the subscriber with a substitute handset.

Self-services. We provide our subscribers and potential subscribers with various self-service channels, such as interactive voice response, or IVR, web-based services and service using SMS. These channels provide general and specific information, including calling plans, account balance, billing-related information and roaming tariffs. They also provide subscribers information regarding trouble shooting and

handset-operation, and enable subscribers to activate and deactivate services and to download content.

Churn Lab. In 2006, we introduced an innovative “churn lab,” aimed at reducing churn. The churn lab is part of our call center operations. Based on various factors and analytical tools, we identify and analyze high-quality subscribers whom we consider to be at a high risk of churn. Then, in order to retain them, we preemptively approach these subscribers with specially trained customer care representatives and offer them solutions previously successfully tested on a sample group of subscribers with similar characteristics, such as enhanced services at attractive prices and handset upgrades.

Our business sales force and back office personnel also provide customer care to our business customers.

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

Be’eri Printers provides our printing supplies and invoices as well as the distribution, packaging and delivery of invoices and other mail to the postal service distribution centers. We entered into an agreement with Be’eri Printers - Limited Partnership and with Be’eri Technologies (1977) Ltd., or together Be’eri, for printing services in August 2003. Under the terms of the agreement, we committed to purchase from Be’eri a minimum monthly quantity of production and distribution services which may be reduced if we modify our printed invoice delivery policy. The agreement is valid until 2008.

Competition

There is substantial competition in all aspects of the cellular communications market in Israel and we expect this to continue in the future due to the highly penetrated state of our market. We compete for market and revenue share with three other cellular communication operators: Partner, which is majority owned by Hutchison Whampoa; Pelephone, which is a wholly owned subsidiary of the incumbent landline provider, Bezeq; and MIRS, which is a wholly-owned subsidiary of Motorola.

Our estimated market share based on number of subscribers was 34.4% as of December 31, 2006. To our knowledge, the market shares at such time of Partner, Pelephone and MIRS were estimated to be approximately 31.9%, 28.7% and 5%, respectively. Since MIRS does not publish data on its number of subscribers, estimates of its market share are based on surveys.

The competition in our market is expected to increase further as a result of the implementation of number portability, which is likely to occur during 2007, as it will remove a deterrent to switching providers. In addition, subject to policy formation by the regulator, mobile virtual network operators may enter into agreements with cellular providers and enter into the market, increasing the competition. We may also face competition in the future from other providers of voice and data communications, including service providers that may offer WiMAX or WiFi wireless high speed data access.

We believe that the principal competitive factors include general brand perception, perceived price, customer service, and handset selection. In addition, content and other

value-added services constitute a potential growth engine for increasing revenues from subscribers and are also an important factor in selecting a cellular provider.

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

marketing and brand