MATAV CABLE SYSTEMS MEDIA LTD
Form 20-F
June 30, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

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

For the fiscal year ended December 31, 2002
Commission file number: 0-28556

MATAV CABLE SYSTEMS MEDIA LTD.

(Exact name of Registrant as specified in its charter)

Israel
(Jurisdiction of incorporation or organization)

42 Pinkas Street
North Industrial Park
P.O. Box 13600
Netanya 42134
Israel
(Address of principal executive offices)

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

None

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

Title of Each Class

American Depositary Shares
Ordinary Shares*

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

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

None

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

Ordinary Shares of NIS 1.00 each	**30,203,917**

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

Yes x No o

Indicate by check mark which financial statement item the Registrant has elected to follow:

Item 17 o Item 18 x

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INTRODUCTION

As used herein, references to we, our, us, Matav or the Company are references to Matav-Cable Systems Media Ltd. and to its significant subsidiaries, including, Matav Investments Ltd., Cable Systems Media Haifa-Hadera Ltd., Nonstop Internet (1999) Ltd., Matav Assets Ltd., Matav Infrastructure Ltd. and Matav Infrastructure 2001,L.P., all of which are wholly owned subsidiaries, and Nonstop Ventures, Ltd.

In this document, references to $, US$, US dollars and dollars are to United States dollars and references to NIS and shekels are Israeli Shekels. This annual report contains translations of NIS amounts into US dollars at specified rates solely for the convenience of the reader. No representation is made that the amounts referred to in this annual report as convenience translations could have been or could be converted from NIS into US dollars at these rates, at any particular rate or at all. The translations of NIS amounts into US dollars appearing throughout this annual report have been made at the representative exchange rate on December 31, 2002 of NIS 4.737= US$1.00 as published by the Bank of Israel, unless otherwise specified. See Item 3A. Key Information Selected Financial Data Exchange Rate Data.

We maintain our financial books and records in shekels and present our financial statements in conformity with generally accepted accounting principles in Israel, or Israeli GAAP. As applicable to our financial statements, Israeli GAAP and U.S. GAAP vary in certain respects, as described in Note 20 to the financial statements. We present our historical statements in shekels that have been adjusted to reflect changes in purchasing power due to changes in the Israeli consumer price index. Unless otherwise specified in this annual report, all financial data relating to us are presented in shekels adjusted to December 31, 2002 purchasing power (adjusted NIS). See Item 5A. Operating and Financial Review and Prospects Operating Results Impact of Inflation and Exchange Rate Fluctuations and Note 15 to the financial statements.

FORWARD-LOOKING STATEMENTS

This annual report includes forward-looking statements within the meaning of Section 27A of the US Securities Act of 1933, as amended, Section 21E of the US Securities Exchange Act of 1934, as amended, and the safe harbor provisions of the US Private Securities Litigation Reform Act of 1995. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to risks, uncertainties and assumptions about us.

Words such as believe, anticipate, expect, intend, seek, will, plan, could, may, project, goal, target and similar identify forward-looking statements but are not the only way we identify these statements. All statements other than statements of historical fact included in this annual report, including the statements in the sections of this annual report entitled Item 3D. Key Information Risk Factors, Item 4. Information on the Company and Item 5. Operating and Financial Review and Prospects and located elsewhere in the annual report regarding our future performance, plans to increase revenues or margins or preserve or expand market share in existing or new markets, reduce expenses and any statements regarding other future events or our future prospects, are forward-looking statements.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including all the risks discussed in Item 3D. Key Information Risk Factors, Item 4. Information on the Company and Item 5. Operating and Financial Review and Prospects . In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this annual report might not occur.

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

3A. Selected Financial Data

The following table sets forth our selected consolidated financial data as at and for each of the years in the five-year period ended December 31, 2002. The selected consolidated financial data for the years ended December 31, 1998, 1999, 2000, 2001 and 2002 are based on consolidated financial statements that have been prepared in accordance with Israeli generally accepted accounting principles, or GAAP. As applied to our consolidated financial statements, Israeli GAAP and U.S. GAAP vary in certain respects, as described in Note 20 to the consolidated financial statements.

We were incorporated on June 28 1987. The selected consolidated financial data set forth below should be read in conjunction with Item 5. Operating and Financial Review and Prospects , and the financial statements and notes thereto included elsewhere in this report on Form 20-F. The financial data for the year ended as at December 31, 2002 have been translated into US dollars using the representative rate of exchange of the US dollar to the New Israeli Shekel, as published by the Bank of Israel, at December 31, 2002 (NIS4.737 = US$1.00). The translation is solely for convenience and should not be construed as a representation that Israeli currency amounts actually represent, or could be converted into US dollars.

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	1998	1999	2000	2001	2002	2002
	NIS (in thousands) *	**NIS (in thousands) ***	**NIS (in thousands) ***	**NIS (in thousands) ***	**NIS (in thousands) ***	**$ (in thousands)***
Revenues	450,217	490,743	483,791	478,362	505,009	106,609
Operating income (loss)	172,350	117,239	(62,796)	(132,333)	(100,567)	(21,230)
Financial expenses, net	24,828	9,431	34,984	53,083	(49,008)	(10,346)
Other income (expenses) net	(849)	448,672	1,026	3,111	283,859	59,924
Income (loss) before taxes on income	146,673	556,480	(96,754)	(182,305)	134,284	28,348
Equity in earnings (losses) of affiliated companies, net	(22,243)	(154,159)	(131,024)	(80,329)	11,119	2,347
Net income (loss), under Israeli GAAP	71,841	340,479	(227,952)	(262,192)	34,471	7,277
Net income (loss) per ordinary share, under Israeli GAAP	2.64	11.38	(7.88)	(9.09)	1.19	0.25
Net income (loss) per ADS, under Israeli GAAP	5.27	22.78	(15.77)	(18.18)	2.39	0.50
Weighted average number of shares outstanding in thousands, basic, under Israeli GAAP	27,232	29,899	28,914	28,834	28,860	28,860
ADS shares outstanding in thousands, basic - under Israeli GAAP	13,616	14,950	14,457	14,417	14,430	14,430
Net income (loss), under US GAAP		218,319	(223,616)	(219,761)	36,134	7,628
Net income (loss) per ordinary share, under US GAAP		8.01	(7.81)	(7.50)	1.25	0.26
Net income (loss) per ADS, under US GAAP		16.03	(15.63)	(15.00)	2.50	0.53
Weighted average number of shares outstanding in thousands, basic, under US GAAP		17,243	28,604	29,286	28,860	28,860
ADS shares outstanding in thousands, basic, under US GAAP		13,622	14,302	14,643	14,430	14,430
Capital expenditures	69,157	135,286	400,149	270,058	115,564	24,396
Balance Sheet Data:						
Fixed assets, net	605,316	645,401	929,878	1,058,035	1,010,961	213,418
Total assets, net	888,643	1,164,775	1,185,409	1,206,479	1,154,276	243,672
Short-term credit (including current maturities of bank loans and debentures)	178,375	50,929	254,455	572,152	558,325	117,865
Long-term bank loans	3,409	1,747	237,783	189,731	144,801	30,568
Debentures	203,004	174,113	145,217	135,002	101,363	21,399
	419,443	546,362	374,760	114,430	149,882	31,641

Shareholders equity under Israeli GAAP						
Shareholders equity under US GAAP	0	416	305,593	104,512	141,694	29,912
EBITDA	260,522	207,182	45,359	261	57,820	12,206

* The data set forth in the table above is expressed in NIS or US dollars, as applicable, except for data forth in the table regarding numbers of shares and ADSs, as applicable.

Exchange Rate Data

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

	1998	1999	2000	2001	2002	2003(2)
Average(1)	3.76	4.14	4.077	4.214	4.736	4.641
High	4.37	4.29	4.198	4.416	4.994	4.924
Low	3.54	4.01	3.967	4.041	4.437	4.373
End of period	4.16	4.15	4.041	4.416	4.737	4.373

(1) Calculated based on the average of the exchange rates on the last day of each month during the relevant period.
(2) Through May 31, 2003.

	December 2002	January 2003	February 2003	March 2003	April 2003	May 2003
High	4.791	4.898	4.924	4.858	4.671	4.577
Low	4.632	4.737	4.810	4.687	4.521	4.373

At May 31, 2003, the representative rate of exchange was NIS 4.373 per US dollar, as published by the Bank of Israel.

Changes in the exchange rate between the shekel and the US dollar could affect our financial results.

Payment of Dividends to Shareholders

Our board of directors decided, on January 14, 1998, to distribute an interim cash dividend to our shareholders who held shares on February 15, 1998, in the nominal amount of NIS 2.5828 (approximately US$0.72) per ordinary share, for a total nominal amount of NIS 70 million, paid to the shareholders on March 2, 1998. Distribution of this dividend was approved as a final dividend for the year 1997 at our annual general meeting of shareholders held on November 18, 1998.

Our board of directors decided, on October 29, 1998, to distribute an interim cash dividend to our shareholders who held shares on November 18, 1998, in the nominal amount of NIS 2.9377 (approximately US$0.62) per ordinary share, for a total nominal amount of NIS 80 million, paid to the shareholders on December 3, 1998. Distribution of this dividend was approved as a final dividend for the years 1994, 1995 and 1996 at our annual general meeting of shareholders held on November 18, 1998.

Our board of directors decided, on December 27, 1999, to distribute an interim cash dividend to our shareholders who held shares on January 11, 2000, in the nominal amount of NIS 7.576 (approximately US$1.82) per ordinary share, for a total nominal amount of NIS 208.3 million paid to the shareholders on January 26, 2000. Distribution of this dividend was approved as a final dividend for the year 1999 at our annual general meeting of shareholders held on December 31, 2000. No dividends were declared in 2001 and 2002.

3B. CAPITALIZATION AND INDEBTEDNESS.

Not applicable.

3C. Reasons for the Offer and Use of Proceeds.

Not applicable.

3D. Risk Factors

In order to operate our business, we must have valid Licenses.

We conduct our operations pursuant to: two general non exclusive Cable Broadcast Licenses granted by the Council of Cable and Satellite Broadcasting on April 30, 2002; a general non-exclusive Telecommunications Infrastructure License granted by the Minister of Communications, on March 27, 2002; and a special Broadcasting HeadEnd License granted by the Minister of Communications on May 2, 2002.

The Cable Broadcast Licenses and the Telecommunications Infrastructure License are effective for a period of fifteen years and can be extended by additional ten-year periods if the Council (in respect of the Cable Broadcast Licenses), or the Minister (in respect of the Telecommunications Infrastructure License) determine that we have:

- complied with the terms and conditions of our Licenses and the applicable law and regulations;
- complied with the instructions of the Council and the Minister;
- continuously acted in a manner to improve our broadcasts, the technology of the broadcasts and the scope, availability and quality of our telecommunications services and our network technology;
- the ability to continue to provide the broadcasts and to invest in improvements of the broadcasts in the future, and the ability to continue to provide the telecommunications services and make necessary investments in order to update our technology and the scope, availability and quality of our telecommunications services; and
- continued to comply with the conditions upon which our Licenses have been granted.

Our Broadcasting HeadEnd License is valid for so long as our Cable Broadcast Licenses remain in force, but in any event no later than May 30, 2017, although we may apply for an extension of the Broadcasting HeadEnd License beyond this date.

In order to ensure compliance with our obligations pursuant to our Cable Broadcast and Telecommunications Infrastructure Licenses, applicable law and regulatory bodies, we have provided a bank guarantee in the amount of $10 million to the Minister of Communications (in respect of our Telecommunications Infrastructure License), and a bank guarantee in the amount of NIS 9 million to the Council (in respect of our Cable Broadcast Licenses). Each of the Minister and the Council has the authority to exercise the guarantees in the event that the Licensee does not fulfill its obligations, and to cover any damage, loss or cost that the Council, the Minister or the government may incur as a result of any breach of our obligations under the Licenses, and to ensure any payments by the Licensee, including royalty payments and payments of fines imposed by the Council or the Minister. The exercise of the guarantee does not derogate from the authority of the Council or the Minister to cancel the Licenses, to amend the terms and conditions of the Licenses or to impose other sanctions including fines for certain stipulated breaches or actions.

The Council or the Minister have the authority to amend the terms of our Licenses at any time, and, in relation to the Cable Broadcast Licenses, the Council must take into account any prejudice to the Licensee. Further, the Licenses may be cancelled for material breach of its provisions, or non-compliance with legal requirements, or non-remedy of a non-material breach. The Telecommunications Infrastructure License can further be cancelled by the Minister for non-supply of services, non-fulfillment of the conditions of receipt of the Licenses, breach of the restrictions upon the means of control of the Licensee entities, breach of cross ownership restrictions or breach of obligations to provide information to the Minister. We are also required to meet certain requirements pursuant to the Telecommunications Infrastructure License regarding the laying down of infrastructure.

Although we believe that we are currently in compliance with all material requirements of our Licenses, the interpretation and application of the standards used to measure these requirements may not be certain, and disagreements may arise in the future between us and the Minister of Communications or the Council.

We are subject to special regulatory restrictions applicable to monopolies, which limit our ability to control the conduct of our business.

On November 8,1999, the Controller of Restrictive Business Practices declared that we, and all the other cable television operators in Israel, constitute a monopoly in the provision of multi-channel cable television services in our then respective franchise areas (which are the same areas in which we operate pursuant to our current Licenses). On December 28, 1999, we filed an appeal of this declaration in the Restrictive Business Practices Court, which has not yet been decided. Until the appeal is finally resolved, and if the Controller of Restrictive Business Practices declaration is not dismissed, we are subject to the supervision of the Restrictive Business Practices Authority, in addition to the existing supervision of the Minister of Communications and the Council, including in the areas of pricing, quality of broadcasting services, agreements with our subscribers, agreements with content providers and the use of our cable television network. There can be no assurance that the declaration of the Controller of Restrictive Business Practices will be dismissed.

In February 2003, the other Israeli cable television operators and us agreed on a final version of an agreement, which sets forth the structure and conditions of a merger between us and the other Israeli cable television operators. This merger agreement, upon its signing, will be added to and broaden the terms of the previous arrangement between the parties executed on December 31, 2001 (further to previous arrangements between the parties that were cancelled and replaced). In the event that a merger with the other cable television operators in Israel is completed, the merged entities shall be subject to the supervision of the Controller of Restrictive Business Practices, and in addition, may be also subject to the above-mentioned restrictions as a monopoly.

The telecommunications industry in Israel is highly regulated which limits our flexibility to manage our business.

Our business is subject to regulation under the Telecommunications Law regarding, among other things:

licenses;

royalties and other payments to the government to be paid by licensees;

content and scope of programming;

the subscriber charges set by cable television operators for their cable television services;

our cable infrastructure that will become the public telecommunications network; and

the nature of telecommunications services.

Changes in laws, regulations or government policy affecting our business activities could adversely affect our business and operations. In the event that we notify the Council that we wish to reduce the scope of the Basic Package for analog subscribers, we may be instructed to reduce the price charged for such package. The Minister of Communications also has the authority to intervene and set minimum and maximum charges to our subscribers in the event that he determines that our charges are not reasonable, or are harmful to competition. We cannot assure you that the Minister of Communications will not intervene in relation to the amounts we charge our subscribers.

As a result of the changing regulatory environment we have lost the competitive advantage we previously enjoyed as a holder of exclusive franchises, and we face competition from a variety of sources. This has lowered the entry barriers for potential new competitors and may affect our ability to provide services to our subscribers.

The Israeli telecommunications market is in a state of transition, moving to a more liberalized environment in which various markets are being gradually opened to competition. Amendments to the Telecommunications Law replaced the previous system of exclusive franchises by general non-exclusive licenses. The licenses we have received (and the terms of the approvals we have received from the regulatory authorities with regards to the proposed merger between the Israeli cable television operators), have significantly reduced the barriers to entry to our market and impose conditions upon us that allow our competitors to access our subscribers.

In January 1999, the Ministry of Communications granted a license for the provision of television broadcasts to subscribers in Israel via satellite to D.B.S. Satellite Services (1998) Ltd., commonly known as YES . Bezeq Israel Telecommunications Corporation Ltd. is a controlling shareholding of YES. YES began to operate and market its broadcasts in July 2000. Bezeq is a government company, which has a monopoly over the provision of domestic fixed line telephony services, data transmission services, access to high-speed Internet and telecommunications infrastructure. Bezeq has great financial resources, which it may place at the disposal of YES, thereby allowing YES to offer its services at low prices and use aggressive marketing strategies with which we may not be able to successfully compete. We also have an obligation to lease our Inside Wiring to YES, and YES is under a reciprocal obligation to us, pursuant to directives issued by the Minister of Communications. Such competition from YES has affected our income, reduced the number of subscribers and caused us increased expenses, mainly in marketing and programming. In particular, the purchase power of YES has materially raised the cost of purchase of content from the major producer companies (namely Warner Brothers, Universal, Buena Vista, Paramount, MGM, Columbia and Twentieth Century Fox).

The Telecommunications Law, as amended, our Licenses and the terms of the approvals we have received to date from the regulatory authorities with regards to the proposed merger of the Israeli cable television operators, also impose upon us an unbundling obligation, the purpose of which is to encourage competition. The obligation both allows other broadcasting licensees access to our subscribers, through our network infrastructure, on terms that are not inferior to the terms provided by our Telecommunications Infrastructure Licensee to our Cable Broadcast Licensees; and also allows other telecommunications licensees (who may therefore be providers of, among other things, other value added services) to have access to our infrastructure. Further, pursuant to the terms of the approvals we have received in relation to the proposed merger between the Israeli cable television operators, in the event that the Controller considers there to be a material regression in competition in the multi channel television market we may be instructed to allow YES, or other broadcast licensees, usage of our network infrastructure to all potential subscribers, and not only to our subscribers, so long as our cable network infrastructure reaches their premises. (If YES ceases to operate due to insolvency, this will be deemed to be a material regression in competition in the multi channel television market and we may be instructed to allow YES or its successor usage of our network infrastructure as mentioned above).

Pursuant to our Licenses and the law, we are obliged to reserve and allow one sixth of our broadcasting network capacity for broadcasts of channels produced by special cable broadcast licensees to our subscribers. According to the Telecommunications Law, as amended, without derogating from the general unbundling obligation referred to above, and taking into account the said obligation with regards to reserving one sixth of our network capacity, the Minister has the authority to direct the Telecommunications Infrastructure Licensee to designate network capacity for the transmission of broadcast and other telecommunications services of a third party.

We cannot anticipate how and to what extent these obligations shall affect our income and expenses, or our subscriber base in the future.

We provide a service of access to High Speed Internet over cable, which faces significant competition.

Since April 2002, we provide a service of access to High Speed Internet over cable. We have incurred considerable capital expenditure preparing for the provision of this service and anticipate that we shall continue to invest in the improvement and maintenance of this service in the future. However, we face significant competition from the government owned Bezeq and may face competition in the future from other well placed competitors. There is no assurance of the level of return on our investments in this service.

We may face competition from other existing technologies in broadcasting and infrastructure that may be implemented in Israel, or new technologies that could reduce the appeal of our services.

While we believe that our existing technologies allow us to effectively compete with other existing technologies implemented in Israel, we may face competition from existing technologies that may be implemented in Israel. We cannot anticipate whether, and to what extent if at all, future changes in technology will materially affect the continued use of fiber optic and coaxial cabling technologies that we employ. We may also face competition from technologies in development or that may be implemented in the future, such as LMDS, wireless local loop in the fields of data over cable and telephony, and video on demand and personal video recorder (or PVR) services that may be deployed over digital subscriber line (or DSL) and satellite platforms. We cannot predict what will be the effect of existing, emerging and future technological changes on the viability or competitiveness of our system. Accordingly, we cannot assure you that the technologies we currently employ, or shall employ in the future, will not become obsolete or subject to competition from new technologies in the future.

The cable television industry is subject to regulation and antitrust review in respect of the programming offerings that it provides, which limits our ability to independently select programming, and causes us significant expenses and investments in the development of programming.

In 1989, together with the other two Israeli cable television operators, we established a company named I.C.P. Israel Cable Television Programming Company Ltd., or ICP , for the purpose of jointly purchasing and producing content for our local cable channels. Prior to the approval of the Controller of Restrictive Business Practices to the proposed merger of the Israeli cable television operators, the validity of ICP s activity was subject to the approval of both the Council and the Restrictive Business Practices Authorities. Under the approval of the Controller of Restrictive Business Practices to the proposed merger of the Israeli cable television operators, it is no longer necessary for the activity of ICP to be subject to the approval of the Restrictive Business Practices Court. Should the merger not be consummated, the activity of ICP shall continue to be also subject to the supervision of the Restrictive Business Practices Authorities.

The Council s approval to the activity of ICP, which has been extended a number of times, is subject to certain conditions, one of which is that the cable television operators allow YES to broadcast channels produced, under the ICP settlement by ICP or the independent producers (namely, family, sport, movies and children s channels) for consideration, during the approval period, with the exception of certain original local productions. These channels are among the most widely viewed channels in Israel. The obligation upon us to allow direct broadcasting of these channels by YES expires upon the earlier of either: December 31, 2003 (regarding the family, movie and sports channels), and March 1, 2003 (regarding the children s channel); or the date on which YES has at least 500,000 subscribers, after which YES may request an extension.The obligation regarding the children s channel has since expired. YES broadcasts the family channel produced by ICP. YES ceased to broadcast the movie channel produced by ICP on June 30, 2002. The terms and conditions of the approvals of the Council and Controller of Restrictive Business Practices to the proposed merger also impose significant restrictions on the activity of the merged entity in relation to all areas of our business, including programming, marketing and broadcasting.

The Council s approval of the activity of ICP, together with other Council decisions allowing us to broadcast local channels, obligated the cable television operators (including ourselves) to invest an aggregate sum of up to approximately $33.7 million per year in original local productions, each in proportion to each operator s relative share of the total number of cable television subscribers in Israel. Amendments to the Telecommunications Law stipulate that in place of such yearly obligation, investments in local productions should equal between 8% and 12% of the annual income of the cable television operators from subscription fees. Pursuant to these amendments, the Council has the authority to fix the percentage from the 8%-12% range, while taking into account the economic status of the cable television operators in the field of cable broadcasts. In accordance with the Council s decision of June 2002, as amended in September 2002 and May 2003, each Cable Broadcast Licensee is required to allocate to production or purchase of locally produced broadcasts, a percentage of its annual income derived from subscriber fees for the year preceding the year of the investment, as follows: (i) commencing April 30, 2002 (the date of the grant of the Cable Broadcast License) and until the end of 2005, at least 8% of such income; and commencing 2006 and thereafter, as to be determined by the Council prior to the end of June 2005; and (ii) in the event a Cable Broadcast License is granted to the merged entity of the Israeli cable television operators, the Council shall determine, prior to the end of June 2005, the rate of the amounts that shall be allocated to local productions by the Cable Broadcast Licensee as of 2006. For this latter purpose, the Council shall consider, among other things, the financial condition of the Licensees in connection with their broadcast activities and the contribution of the merger to the improvement of the financial condition of the Licensees.

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Each of the Israeli cable television operators, including us, is also still under a continuing obligation, as set forth in our Cable Broadcast Licenses, to fulfill programming obligations which remain outstanding pursuant to the previous franchises, including the obligation to invest in local productions. According to our Cable Broadcast Licenses, we may notify the Council of our intention to remove certain channels from our Basic Packages and to transmit those channels within the Premium Broadcastings that we offer our digital subscribers in our tiering system. In such event, the Council has the authority to recommend to the Ministry of Communications that our analog subscriber fees for the Basic Package be reduced. This could have a material impact on our revenues, if the fees received from other sources do not compensate for the loss of such fees.

Our financial condition may be affected by the market price of one of the cellular telecommunications companies authorized to operate in Israel, in which we have invested.

We hold approximately 7.42% of the outstanding share capital of Partner Communications Company Ltd., the shares of which are publicly traded on the Nasdaq National Market, the London Stock Exchange and the Tel Aviv Stock Exchange, and Partner s debentures are listed for trade on the Luxembourg Stock Exchange. Partner holds a license to provide cellular telecommunications services in Israel, and is currently one of the two operators in Israel to use the global system for mobile telecommunications, or GSM, on a fully commercial basis, a comprehensive digital standard for the operation of all elements of a cellular telephone system. Partner faces intense competition from other cellular telecommunications service operators in Israel and the Palestinian operator, Jawaal, and also faces competition from fixed line operators in Israel, currently Bezeq Israel Telecommunications Corporation Ltd. The market price of Partner s shares has been and may continue to be volatile in response to conditions of the global securities markets in general and the communications and technology sectors in particular. The foregoing and other factors could cause the market price of Partner s shares to fluctuate unpredictably, and could adversely affect the market price of Partner s shares.

Partner s results are reflected in our financial statements through December 31, 2002 on an equity accounting basis and consequently have a material effect on our financial results. Approximately 72% of our current holdings in Partner are pledged to banks under pledges unlimited in sum, to cover Partner s liabilities in respect of its loans from the banks.

We cannot assure you that Partner will be able to successfully compete against existing or new competitors in the field of cellular telecommunications, or that Partner s systems and business plan will be adequate, efficient and capable of performing in light of the large number of material factors that may affect its future operations and prospects.

We may incur expenses in connection with our shareholdings in an Israeli international telecommunications service provider.

We hold a 10% share ownership interest in Barak I.T.C. (1995) The International Telecommunications Services Corp. Ltd., which holds a license to provide international telecommunications services in Israel. Barak competes with two other licensed international telecommunications service providers, and two additional substantial Internet service providers. One of these competitors is Bezeq International Ltd., which is a subsidiary of the domestic telecommunications service provider, Bezeq Israel Telecommunications Corporation Ltd., which until recently had a sole monopoly. As a result of this connection, Bezeq International Ltd. has stronger name recognition, long - standing customer relations, and significantly greater financial and technical resources than the other competitors in the international telecommunications market, including Barak.

Users of international telecommunications services may subscribe for the services of any provider in Israel, and may change their choice, at any time. In addition, a user may select the services of any of the providers on a call-by-call basis. As a result, regular subscribers of Barak may not necessarily use Barak services exclusively.

The Israeli government may grant additional licenses for the establishment and operation of international telecommunications systems in Israel. Such competitors may be larger than Barak or have greater financial resources, better technology or services, and Barak may not be able to successfully compete with them. This may have the impact of reducing Barak s market share. Furthermore, the international telecommunications market is characterized by rapidly changing technology and customer requirements, new industry standards and frequent new product and service introductions. If Barak is unable to anticipate and keep pace with these changes, it may lose market share. Barak s performance or market penetration might not be enhanced and our investment in Barak might not be fruitful.

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We are controlled by a small number of shareholders.

At May 31, 2003, our principal shareholders were the beneficial owners of approximately 80% of our outstanding ordinary shares. Our principal shareholders except Ma ariv Modein Publishing House Ltd. are parties to a shareholders agreement, which relates to, among other things, the election of our directors. Subject to applicable law and the provisions of the shareholders agreement, our principal shareholders have the ability to determine the election of all of our directors, and to direct our policies, including the payment of dividends, and can control the outcome of substantially all matters that may be brought before our shareholders.

We may not be able to obtain additional capital in order to implement our business plans on favorable terms, and may have a dilutive effect on our shareholders.

Our existing capital resources may not be adequate to satisfy our financial needs in order to implement our business plans, for the next 12 months. Our financial needs in that period will be subject to, among other things: our ability to successfully provide our services; the need to upgrade our network to provide added value services; the need to implement the buildout of our infrastructure in peripheral areas; and the needs of companies in which we have significant investments, such as Partner, Barak and, if the proposed merger shall be consummated, the merged entity.

Any future equity or debt financing, if available, may be on terms that are not favorable to us, and in the event of equity financing, could result in dilution of our shareholders interests. Although our principal shareholders have made loans and contributed equity to us in the past, they are not contractually obligated to do so in the future.

We commenced negotiations with the banks regarding an increase of our credit lines. These negotiations were ceased due to the proceedings in connection with the proposed merger of the Israeli cable television operators, however we may recommence these negotiations depending on the progress of the merger or should the merger proceedings cease to continue. Should we recommence such negotiations, there is no assurance that we shall reach an agreement with the banks and receive such increased credit lines. In the event that we are granted increased credit lines to meet our financial needs, there can be no assurance that we would be able to obtain terms which are favorable to us, or which are not significantly expensive, in light of current market conditions.

Our industry is subject to rapid technological changes that will cause us to incur capital expenditures in order to remain competitive.

In order to provide advanced communication services, we have incurred significant capital expenditures expanding the cable network bandwidth from 550 MHz to 860 MHz. We have a technological advancement plan for deployment of additional two-way services, expansion of fiber optic cable networks and a digital broadcasting system or advanced data over cable platform. We also aim to improve the network in terms of redundancy and manageability, by closing fiber rings, enhancing the powering and telemetry measures, and downsizing the fiber nodes. Such enhancements are necessary to allow us to provide telecommunication services at a Telco-Grade quality of service, which is the standard commonly used by telephone companies to grade availability and quality of services.

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

Our financial statements are presented in shekels, adjusted to reflect changes in the Israeli consumer price index. Consequently, all shekel amounts set forth in our historical financial statements are adjusted each time that we publish new financial statements in order to reflect changes in the Israeli consumer price index as of the date of the latest balance sheet presented. See Note 2 to the financial statements. Since we may be unable, or not permitted to raise our rates and fees pursuant to our Licenses in a manner that would fully compensate for any increase in the Israeli consumer price index, inflation in Israel may have a material adverse impact upon us. Our financial expenses are also affected by inflation, such that high rates of inflation cause a decrease in the real value of our unlinked assets, which in turn, causes an increase in our financial expenses. Likewise, high rates of inflation cause a decrease in the real value of our unlinked liabilities, which in turn, causes a decrease in our financial expenses.

Substantially all of our revenues and a minority of our operating expenses are denominated in shekels, and on the other hand, substantially all of our programming expenses, certain other expenses and most of our capital expenditures are denominated or linked to foreign currency. Thus, any devaluation of the shekel against the US dollar (or other foreign currencies), will also increase the shekel cost of our non-shekel denominated or linked expenses. Such increase may have an adverse impact upon our operating results, which may be material. Our borrowings are mostly in Israeli shekels.

Our ordinary shares and ADSs are listed for trading on different markets and this may result in price variations.

Our ordinary shares are listed for trading on the Tel Aviv Stock Exchange, or TASE, and our ADSs are listed for trading on the Nasdaq Stock Market, or Nasdaq. Each ADS represents two ordinary shares. Trading in our ordinary shares and ADSs on these markets is made in different currencies (US dollars on Nasdaq and NIS on TASE), and at different times (resulting from different time zones, different trading days and different public holidays in the United States and Israel). Actual trading volume on Nasdaq or the TASE could be insignificant and as such could be subject to volatility. The trading prices of our ordinary shares and ADSs on these two markets often differ, resulting from the factors described above, as well as differences in exchange rates. Any decrease in the trading price of our ordinary shares on the TASE could cause a decrease in the trading price of our ADSs on Nasdaq, and any decrease in the trading price of our ADSs on Nasdaq could cause a decrease in the trading price of our ordinary shares on the TASE.

We are subject to the political, economic and military conditions in Israel.

We are incorporated and based in, and currently derive almost all our revenues from markets within, the State of Israel. As a result, the political, economic and military conditions in Israel directly influence us. Hostilities involving Israel, the interruption or curtailment of trade between Israel and its trading partners, political instability within Israel or its neighboring countries, a significant downturn in the economic or financial condition of Israel and changes in Israeli laws and regulations, including taxation, are likely to cause our revenues to fall and harm 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 and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Since October 2000, there has been an increased level of hostilities and violence between Israel and the Palestinians, which has adversely affected the peace process and has negatively influenced our relationship with several Arab countries. The future effect of this deterioration and violence on the Israeli economy and our operations is unclear. From time to time Israeli companies or companies doing business with Israeli companies have been subject to an economic boycott initiated by several Arab countries. This boycott or similar restrictive laws or policies directed towards Israel or Israeli business could adversely affect us. Ongoing violence between Israel and its Arab neighbors and Palestinians, or any other hostilities involving or threatening Israel, may have a material adverse effect on our business, financial condition or results of operations.

Due to, principally, a continuing budget deficit of the Israeli government and the slow down of the Israeli economy in recent years, the Israeli parliament approved, on May 29, 2003, an economic plan that entails, among other things, budget cuts in various sources of government spending, the increase of various tax liabilities and cuts in various social benefits. It is not known at this stage what impact the implementation of the approved economic plan would have on the Israeli economy. Since we are located in, and currently derive almost all our revenues from markets within Israel, economic events in Israel, or uncertainties associated with such events, could adversely affect our operations and financial results.

Some of our directors, officers and employees are currently obligated to perform annual reserve duty. Generally, male adult citizens and permanent residents of Israel under the age of between 45 and 50, unless exempt, may be required to perform up to approximately 36 days of military reserve duty annually. Certain reserve soldiers may be required to serve more. Additionally, all such reservists are subject to being called to active duty at any time under emergency circumstances. While we have operated effectively under these requirements since we began operations, we cannot assess the full impact of these requirements on our workforce and business if conditions should change, and we cannot predict the effect of any expansion or reduction of these obligations on us.

Provisions of our Licenses and Israeli law could delay, prevent or make difficult a merger or acquisition or a change of control of us and therefore depress the market price of our shares.

Our Cable Broadcast Licenses, Infrastructure License and HeadEnd License include restrictions regarding changes of means of control of the Licensees.

The Israeli Companies Law generally requires that a merger be approved by a company s board of directors and by a majority of the shares voting on the proposed merger. Unless a court rules otherwise, the statutory merger will not be deemed approved if a majority of the ordinary shares held by shareholders other than the potential merger partner (or by any person who holds 25% or more of the shares of capital stock or the right to appoint 25% or more of the directors of the potential merger partner) vote against the merger. Upon the request of any creditor of a party to the proposed merger, a court may delay or prevent the merger if it concludes that there is a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy its obligations. In addition, a merger may not be completed unless at least 70 days have passed since the filing of the merger proposal with the Israeli Registrar of Companies.

In certain circumstances an acquisition of shares in a public company must be made by means of a tender offer if, as a result of the acquisition, the purchaser will become a 25% or 45% shareholder of the company (unless there is already a 25% or a majority shareholder of the company, respectively). If, as a result of an acquisition, the acquirer will hold more than 90% of a company s shares, the acquisition must be made by means of a tender offer for all of the shares. The described restrictions could prevent or make more difficult to acquire us, which could depress our share price.

Additionally, Israeli tax law treats some acquisitions, such as stock-for-stock exchanges between an Israeli company and a foreign company less favorably than U.S. tax laws. For example, Israeli tax law may, under certain circumstances, subject a shareholder who exchanges his ordinary shares for shares in another corporation to taxation prior to the sale of the shares received in such stock-for-stock swap.

These provisions of our Licenses and of the Israeli corporate and tax law (and the uncertainties surrounding such laws) may have the effect of delaying, preventing or making more difficult a merger or acquisition or change of control of us, and depress the market price of our ordinary shares which otherwise might rise as a result of such a change of control.

It may be difficult to (i) enforce a U.S. judgment against us, our officers and directors and our Israeli auditors, (ii) assert U.S. securities laws claims in Israel, and (iii) serve process on substantially all of our officers and directors and these accountants.

We are incorporated in Israel. Substantially all of our executive officers and directors and our Israeli auditors are nonresidents of the United States, and a substantial portion of our assets and the assets of these persons are located outside the United States. Therefore, it may be difficult for a shareholder or holder of our ADS s, or any other person or entity, to enforce a U.S. court judgment based upon the civil liability provisions of the U.S. federal securities laws in an Israeli court against us or any of those persons or to effect service of process upon those persons in the United States. Additionally, it may be difficult for a shareholder or holder of our ADS s, or any other person or entity, to enforce civil liabilities under U.S. federal securities laws pursuant to original actions instituted in Israel.

We and the other cable television operators have agreed on the terms of a merger. The merger might not be consummated, and if it is, we might not be able to realize any anticipated benefits from the merger.

In February 2003, we and the other Israeli cable television operators agreed on a final version of an agreement outlining the structure and conditions of a merger between us and the other Israeli cable television operators and their subsidiaries (further to previous arrangements between the parties). This merger agreement, upon its signing, will be added to and broaden the terms of the previous arrangement between the parties executed on December 31, 2001 (further to previous arrangements between the parties that were cancelled and replaced). In the event any terms of these agreements shall conflict, the terms of the latter agreement of February 2003 shall prevail. To date, the final merger agreement has not been signed.

Prior to the merger we will need to reach an understanding with the major Israeli banks, which are creditors of the parties to the merger. The merger must also receive approvals under applicable law, including the approvals of the Council, the Income Tax Commission, the Controller of Restrictive Business Practices, and by the Israeli court, after receiving the approvals of certain creditors and the relevant corporate bodies of the relevant parties. To date, approvals have been granted, subject to terms and conditions, from the Council, the Controller of Restrictive Business Practices and the Income Tax Commission. Subject to the final terms of the merger, further approval of the Income Tax

Commission to the merger may be required. One of the issues outstanding to date in connection with the consummation of the merger is regarding the position of the Supervisor of the Banks of the Bank of Israel in connection, among other things, with the matter of certain limitations under Israeli banking laws.

The objectives of the merger are, among other things, to enable the merged company to provide additional telecommunications services, to increase our ability to effectively compete with Bezeq Israel Telecommunications Corporation Ltd., and to effect substantial cost savings. There can be no assurance that the merger will be consummated. In the event that the merger is not consummated, it will be more difficult to realize these objectives and to compete. In addition, should the merger not be consummated, our operating expenses and marketing expenses may increase, since we may no longer benefit from reduced programming and advertising costs, which result from the current joint purchase of content and joint advertising campaign of the three Israeli cable television operators.

If the merger is consummated, there can be no assurance whether: (i) the conditions of the merger will enable the merged entity to successfully compete; (ii) there will be a successful integration between the merged entities; and (iii) the combined entity will be able to compete effectively against current or future competitors and will realize the anticipated benefits of the merger.

If the merger is consummated, we face the following risks:

We are indirectly controlled by certain members of the Dankner family, who also own indirectly 11.63% of Bank Hapoalim Ltd.,the largest bank in Israel, and which constitute part of the controlling group of Bank Hapoalim Ltd., which own approximately 45.18% of the Bank. We are consequently subject to restrictions under Israeli banking laws concerning credit, consents and limitations with Bank Hapoalim. The restrictions to which we are subject may therefore apply to the merged entity. Additionally, Bank Hapoalim is a creditor of the other companies who are parties to the proposed merger, and will therefore be a creditor of the merged entity.

As a result of the merger, we may be characterized as a passive foreign investment company, and as a result our U.S. shareholders may suffer adverse tax consequences. Generally, if for any taxable year 75% or more of our gross income is passive income, or at least 50% of our assets are held for the production of, or produce, passive income, we may be characterized as a passive foreign investment company for U.S. federal income tax purposes. This characterization could result in adverse U.S. tax consequences to our shareholders, including having gain realized on the sale of our shares be treated as ordinary income, as opposed to capital gain income, and having potentially punitive interest charges apply to such sales proceeds. U.S. shareholders should consult with their own U.S. tax advisors with respect to the U.S. tax consequences of investing in our ordinary shares.

As a result of the merger, we may be deemed to be an investment company under the Investment Companies Act of 1940. A significant part of our assets may constitute investment securities as defined in the Investment Company Act. If we were deemed to be an investment company, then we would be required to be registered as such. In that case there would be a substantial risk that we would be in violation of the Investment Company Act because of the practical inability of a non-U.S. company to register under the Investment Company Act. If we were deemed to be an unregistered investment company under the Investment Company Act, our contracts may be voidable, we might not be allowed to offer securities in the United States, and we may also be subject to other materially adverse consequences.

The sums that will be deemed to have been borrowed by the merged entity may exceed the maximum borrowing limit of a single borrower under the Israeli banking laws, which might materially restrict the ability of the merged entity to receive loans from Israeli banks. In addition, we, the merged entity and the other parties to the merger may be subject to additional limitations with connection to receipt of loans from Israeli banks due to restrictions under Israeli Banking laws pertaining to the maximum borrowing by a group of borrowers.

The goodwill contributed to the merged entity by the merging entities could result in accounting expenses under Israeli GAAP in the years following the consummation of the merger that would reduce our shareholders equity and would have an adverse effect on the public market for our shares and ADS s, and negatively affect our ability to pay dividends to our shareholders. A material reduction in our shareholders equity could cause our shares to be delisted from the Tel Aviv Stock Exchange and Nasdaq National Market.

For the merger, including certain ancillary actions performed in the framework of the merger, to qualify, pursuant to the approval of the Israeli Income Tax Commission to the merger, as a tax-free transaction under Sections 103, 104 and 105 of the Israeli Income Tax Ordinance, the merging entities and their respective shareholders (including us) are required to comply with certain restrictions until December 31, 2003, including restrictions on certain issuances of shares of the merged entity and restrictions on the number of shares that may be sold by the shareholders of the merged entity. In addition, the merged entity may not sell a majority of the assets (as defined in the Income Tax Ordinance) transferred to it by the merging entities during this restricted period, and no actions, transfers, provision of guarantees or any other activities may be performed between the merged entity and the other entities that participated in the merger, including their respective shareholders. In the event that any of these conditions or restrictions are not complied with, the tax exemption may be retroactively cancelled and the merger may be subject to tax, plus a consumer price index linkage adjustment and interest. These restrictions may deter an acquisition of the merged entity, and prevent us from selling or disposing of our shares in the merged entity. Additionally, subject to the final terms of the merger, further approval of the Income Tax Commission to the merger may be required and additional conditions or restrictions may be imposed on the merged entity, the merging entities and their respective shareholders.

The terms and conditions of the approvals that we have received to date to the merger affect the ability of the merged entity to manage its business, and restrict the ability of the merged entity to utilize any potential competitive advantage it may otherwise have.

In the event that the Controller of Restrictive Business Practices considers there to be a material regression in the multi channel television market as a result of the consummation of the merger, he has the power to oblige the merged entity to allow other broadcast license holders (including YES) usage of the network infrastructure to access all potential subscribers, and not only to the subscribers of the merged entity.

A condition of the approval of the Controller of Restrictive Business Practices to the merger is an obligation upon the merged entity to begin to supply fixed line telephony services over cable infrastructure to the Israeli public within a year of receipt of its infrastructure license and no later than two years of the date of the approval. The merged infrastructure entity is obligated to invest in fixed line telephony cable infrastructure an aggregate of not less than NIS350 million, to be completed in accordance with predetermined stages throughout 2002 to 2005, as set forth in the approval. To date, we are unable to anticipate exactly how much our pro rata portion of such investment obligation will be.

The approval of the Controller of Restrictive Business Practices to the merger is conditional upon the provision of a bank guarantee in the amount of $15 million to ensure compliance with the terms of the approval. In the event that the Controller of Restrictive Business Practices decides, in his discretion, that there has been a material breach of the terms of the approval, he may fully exercise the guarantee. We have provided our pro rata portion of this guarantee, in the amount of $3.75 million.

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The financial situation of the other Israeli cable television operators has an impact upon our business.

On April 22, 2002, Tevel Israel International Ltd., one of the other Israeli cable television operators filed a motion for stay of proceedings, which is one of the procedures available to an insolvent company in Israel. The stay of proceedings was granted by the Court on April 23, 2002, and is currently valid until July 2, 2003. The Court appointed a Trustee for the duration of the period of the stay of proceedings. The legal implication of the stay of proceedings, is that it is not possible for a claim to be brought against Tevel during the period of the stay, and all past debt incurred by Tevel prior to April 22, 2002, shall be dealt with in accordance with a creditors arrangement to be proposed by the Trustee, assuming that such credit arrangement shall be approved by the Court. The Trustee is responsible, among other things, for the management of Tevel during the period of the stay. The approval of the Court is required in order for Tevel to participate as a party to the merger.

The current financial situation of Tevel, and any possible future deterioration of Tevel, has an impact upon our business and our day to day operations, including causing an increase in our respective pro rata portion of costs of content, which may have a material adverse affect upon our financial statements. Further, it may affect the possibility of the consummation of the proposed merger between the Israeli cable television operators, and the conditions that the creditors of the companies that are parties to the merger may impose.

Our previous franchises required us to meet certain milestones with respect to cable access to potential customers in the areas covered by our Licenses, which if not met, could expose us to litigation or administrative actions.

Our previous exclusive franchises contained specific construction milestones with respect to regions within a franchise area that must be passed by the cable television network by specified dates. We substantially completed the installation of the regional cable transmission network in all our operating areas, and believed that completing portions of the buildout requirements in peripheral regions in the operating areas would be substantially more expensive, on a per-subscriber basis than in the metropolitan areas. Therefore we did not fully complete buildout requirements in certain peripheral regions. Our current Licenses require us to connect any applicant to purchase cable television broadcasts within 14 days, from the application date, and in the event that the network does not reach an applicant s premises, within 3 months. The Ministry of Communications or exceptional committee may allow an exception regarding the time schedule to connect applicants, or the obligation to connect every applicant.

We are subject to a lawsuit and have been subject to other lawsuits in the past, and may be exposed to additional lawsuits in the future, by residents of communities that are not, or were not, connected to the cable television network, seeking to force us to implement the build-out of our network in their communities, or compensation for being prevented from receiving cable television services. See Item 8A. Consolidated Statements and Other Financial Information - Legal and Arbitration Proceedings .

We face intense competition, which may intensify in the future and impede our ability to regain profitability.

Increased competition in the multi channel television market in recent years has caused, among other things, a rise in costs, especially programming costs, a reduction in our revenues resulting from loss of subscribers, and an inability to raise our subscriber fees. This has contributed to our losses for the years 2000, 2001 and 2002. There is no assurance that we will be able to regain profitability in the foreseeable future, especially in an increasingly competitive environment.

Our substantial leverage could adversely affect our financial health.

In the years 2000, 2001and 2002, we incurred intensive capital expenditures related to the continued construction of our cable television network and other technological projects, and operating losses, which have increased our indebtedness, resulting in our becoming significantly highly leveraged.

Our ability to meet our debt obligations will depend on whether we can successfully implement our strategy, as well as on financial, competitive, regulatory and technical factors, including some factors that are beyond our control. If we are unable to generate sufficient cash flow from operations to meet principle and interest payments on our debt, we may have to refinance all or part of our indebtedness.

We cannot assure you that any such refinancing would be possible on terms that we could accept or that we could obtain additional financing. If refinancing were not possible or if additional financing were not available, we may have to sell our assets under circumstances that might not yield the highest prices, or default on our debt obligations.

ITEM 4. INFORMATION ON THE COMPANY

4A. History and Development of theCompany

We were incorporated in Israel under the laws of the State of Israel on June 28, 1987. Our principal executive offices are located at 42 Pinkas Street, North Industrial Area, Netanya 42134 Israel (telephone: 972-9-860-2160). Our website address is www.matav.co.il. Our agent for service of process in the United States is Puglisi & Associates, 850 Library Avenue, Suite 204, P.O. Box 885, Newark, Delaware 19715.

We are one of three operators and providers of broadband cable television services in Israel. Our cable television services are marketed under the name Matav Digital .

Prior to the grant of our licenses in 2002, we operated pursuant to five exclusive franchises granted to us by the Ministry of Communications to provide cable television services in franchise areas, which covered approximately 25% of Israel s households. As of December 31, 2002 we provided cable television services to approximately 26% of all cable television subscribers in Israel. We own substantially all of our cable television network infrastructure. Our exclusive franchises covered four operating areas, three of which included the major metropolitan areas of Bat-Yam Holon, Haifa, and Netanya Hadera, and one of which served the less densely populated area of the Galilee. Our subscriber penetration is highest in the metropolitan operating areas.

We began serving cable television subscribers in 1990. The total number of our cable television subscribers was approximately 286,600 on December 31, 1999, in comparison to approximately 275,000 as of December 31, 2002. Cable television subscriber penetration has decreased by approximately 11.0% during the same period. Since April 2002, we offer a commercial service of access to High Speed Internet over cable, pursuant to our Telecommunications Infrastructure License. Our aggregate revenue has increased from approximately NIS 490.7 million on December 31, 1999 to approximately NIS 505.0 million as of December 31, 2002 (including revenue from cable television and access to High Speed Internet subscribers). During the same period, our operating income and net income has decreased from approximately NIS 117.2 million and net income of approximately NIS 340.5 million for the year ended December 31, 1999 to an operating loss of approximately NIS 100.6 million and net income of approximately NIS 34.5 million for the year ended December 31, 2002. EBITDA has decreased from approximately NIS 207.2 million for the year ended December 31, 1999 to approximately NIS 57.8 million for the year ended December 31, 2002.

Through December 31, 2002 we have invested approximately NIS 2025.2 million (approximately US$ 427.5 million) in the build-out of our cable television network within our license areas and in other fixed assets.

We operate both directly and through subsidiaries in various fields of telecommunications. We have adopted a growth strategy that combines core activities in the multi-channel television market, based on state-of-the-art technology, with the use of cable television infrastructure. We are able to provide data over cable and other supplementary services.

We have expanded our telecommunications activities by investing in Barak I.T.C. (1995) The International Telecommunications Services Corp. Ltd., an international telephony service provider in Israel, and in Partner Communications Company Ltd., the third of four licensed providers of mobile cellular telephone services in Israel, and one of the two providers using the global system for mobile telecommunications, a comprehensive digital standard for the operation of all elements of a cellular telephone system, known as GSM.

Until April 2002, we beneficially held approximately 15.2% of Partner s issued and outstanding shares. Pursuant to the sale of approximately half of our shares in Partner in April 2002, we are now the beneficial owners of approximately 7.42% of Partner s issued and outstanding share capital.

We, together with other of our shareholders, formed Nonstop Ventures Ltd. for the purpose of investing in start-up companies, which engage in the fields of Internet, cable television, data telecommunications, applications, content, infrastructure and Internet Protocol telephony. As of November 2002, we own 50% of the issued share capital of Nonstop Ventures.

Important events in the development of the cable television and telecommunications industry, and our business

Overview

Television broadcasting in Israel began in 1967 through one off-air government controlled channel, known as Channel 1. In 1993, private operators commenced regular commercial broadcasts of a second off-air channel, known as Channel 2, and later, a further channel, the Israeli Knesset Channel (Channel 33). In April 2000, the Ministry of Communications approved the establishment of a second commercial channel (Channel 10), which began broadcasting at the beginning of 2002.

During the early 1980 s, several unlicensed operators installed cable television systems in limited areas throughout Israel. In 1986, the Telecommunications Law was amended to restrict transmission of television broadcasts by cable other than pursuant to licenses granted by the Ministry of Communications under the Telecommunications Law.

In 1989, we, together with the other cable television operators, formed I.C.P. Israel Cable Programming Company Ltd., or ICP , for the purpose of jointly purchasing and producing our local cable channels, which then consisted of four channels: family, movies, sport, and children. The culture & science channel was later added. Today, ICP creates, produces and acquires content for only two channels (family and movies), and independent producers produce the other three channels in accordance with the Restrictive Business Practices Court decision in 1996 regarding the ICP settlement (as extended).

In 1990, the Ministry of Communications began issuing exclusive franchises to operate cable television systems in various geographical areas in Israel. Each franchise paired a densely populated metropolitan area with a less densely populated rural area to ensure that smaller rural communities would also receive cable television services. The construction of the nationwide cable television network infrastructure began in late 1989 and, based on the number of homes passed with cable infrastructure, approximately 93% of the our network had been completed by at the end of 2002.

Pursuant to amendments to the Telecommunications Law in 2001 the exclusive franchises were replaced by a system of general non exclusive long term broadcast licenses, broadcasting HeadEnd licenses, and general non exclusive telecommunications infrastructure licenses, all of which we have been granted.

Direct Broadcasting by Satellite and Developments regarding YES

On January 5, 1998, the Israeli parliament approved an amendment to the Telecommunications Law, allowing the Ministry of Communications to give licenses for distribution of direct broadcast by satellite (DBS) services to subscribers. The Ministry of Communications granted D.B.S. Satellite Services (1998) Ltd., or YES , a license for the provision of television broadcasts to subscribers via satellite, and YES commenced DBS broadcasting in July 2000. The development of competition to cable television services from the commencement of DBS broadcasting has adversely affected our business. Following a dispute arising out of the grant of the license to YES, and recognition by the government of our ownership of the cable television network infrastructure, the cable television operators entered into an agreement with the State of Israel dated July 2001, in which the cable television operators, including us, undertook not to bring any claim in the future regarding the grant of a license to YES, and to make certain payments to the government over a 12 year period, commencing January 1, 2003. In consideration, we received recognition by the government of our ownership of the cable television network infrastructure.

On September 13, 2000, we, together with the other Israeli cable television operators, entered into an agreement with YES, under which we and the other cable television operators granted YES a non-exclusive permit to use our Inside Wiring for the transfer of satellite broadcasts (multi-channel television and interactive channels only); and YES granted the cable television operators a non-exclusive permit to use its Inside Wiring for the transfer of cable television broadcasts (including any other service provided by the cable television operators). This agreement has since been terminated by YES, and, in place of that agreement, in September 2001 the Minister of Communications issued administration directives, which were amended effective as of February 3, 2002, governing the reciprocal use of Inside Wiring between the cable television operators and YES. The directives establish instructions regarding the procedures of transition of cable television subscribers to become subscribers to YES and vice versa. These directives also provide that YES shall pay monthly fees to the relevant cable television operators for the use of their Inside Wiring, and that the cable television operators will pay fees to YES for the use of its Inside Wiring. The directives stipulate what such amounts should be. In addition the Minister of Communications has the authority to issue directives regarding the common use of the Inside Wiring by both YES and by the cable television operators, with regard to the provision of different services by each party. The Ministry of Communications conducted a hearing regarding the common use of Inside Wiring. To date, the Ministry has not issued directives regarding this matter.

In addition, the Telecommunications Law, as amended, permits a person, in residential premises, to purchase from the Licensee the Inside Wiring installed in his premises.

Digital Broadcasting

We commenced digital broadcasting in July 2001, pursuant to approvals from the Council and the Ministry of Communications. These approvals allowed us to broadcast in a digital format our analog basic package channels and Pay-Per-View services, as well as other channels that have been subsequently approved for digital broadcast. These approvals include authorization to provide electronic program guide services, commonly referred to as EPG services .

We informed the Ministry of Communications that we would provide digital set-top boxes to our subscribers according to actual demand as follows: up to 100,000 set-top boxes will be provided in 2001; 70,000 in 2002, and 60,000 in 2003. The remainder is to be provided during the year 2004. As of May 2003, we have provided approximately 189,000 set-top boxes to our subscribers. We have already purchased approximately 210,000 set-top boxes (including 6,000 one way only set-top boxes). In October 2002, we and our subsidiary Cable Systems Media Haifa - Hadera Ltd. entered into a Term Sheet with Advent Digital Broadcast Ltd., a company incorporated in the British Virgin Islands, pursuant to which we will purchase 40,000 digital set-top boxes, to be provided in four equal portions, commencing December 1, 2002, and until August 1, 2003, for a total purchase price of $5.2 million. To date, 20,000 digital set-top boxes have been purchased from Advent Digital Broadcast Ltd. The Term Sheet shall bind the parties until such time that they shall enter into a definitive agreement. A definitive agreement has not been signed to date.

Tiering

On May 10, 2001, we received from the Council the approval to provide digital broadcasting services in a tiering system. The original approval included only a few channels. To date, most of the channel packages and other channels for which we requested approval by the Council have been approved, and services according to the tiering system began in July 2001.

As of December 2002, we and the other two Israeli cable television operators offer unified tiering packages, in the framework of which we changed the structure of the tiering packages we offer to our digital subscribers and the channels included in such packages. For a list of our channels and packages and the combinations of packages we offer as part of our tiering system, see Item 4B. Item 4B: Products and Services - Premium Broadcastings .

Pay-Per-View and Near Video on Demand

We began offering Pay-Per-View services in October 2000. We received from the Ministry of Communications a permit to provide Near Video On Demand services in the digital platform, although we have not yet begun to offer these services to our customers. Pay-Per-View and Near Video On Demand services are governed by our Cable Broadcast Licenses.

Internet Services

In 1999, we commenced specific operations targeted to the provision of access to High Speed Internet over cable services. However, at that time, we had not received the required license for providing such services, and therefore decided that we should provide Internet services (as an Internet service provider) using simple dial up access. We received a license to provide ordinary dial up Internet services in February 2000, and we commenced such services in April 2000. In parallel, we began to offer our subscribers access to High Speed Internet over cable on a trial basis, pursuant to a trial license.

On November 6, 2000, the Ministry of Communications granted Bezeq a license to supply High Speed Internet services using ADSL technology. Since, at that time, we had not received a license to supply access to High Speed Internet over cable services as a licensed Internet service provider, we decided to provide Internet services via Bezeq s ADSL. By April 2001, we had reached a share of approximately 20% of the Internet services market.

In May 2001, due to the fact that, among other things, we had not received the required license for providing access to High Speed Internet over cable services, we decided to cease our Internet operations. On June 3, 2001, we entered into an agreement with Bezeq International Ltd., an Israeli Internet service provider, and a subsidiary company of Bezeq, whereby Bezeq International would supply dial-up Internet services to our paying customers, other than those customers participating in the access to High Speed Internet over cable trial, and they will cooperate so that these customers will become customers of Bezeq International. Pursuant to the agreement with Bezeq International, 16,000 of our Internet dial up customers were transferred to Bezeq in consideration of $1.25 million.

The access to High Speed Internet over cable trials were continued during 2000, 2001 and the first quarter of 2002. On March 27, 2002, we received our Telecommunications Infrastructure License, which allows us to provide, among other things, access to High Speed Internet over cable services. After receipt of our Telecommunications Infrastructure License, the trials were discontinued and we began to offer (including to subscribers of the trial services) our commercial service of access to High Speed Internet over cable, which we launched on April 8, 2002. As of May 31, 2003, we provide access to High Speed Internet over cable services to approximately 33,000 subscribers.

Ownership of Cable Infrastructure and Payments to the State of Israel

In light of the contention of the Ministry of Finance according to which, following the expiration of the cable television operators franchises, the cable television operators should pay the State of Israel an appropriate consideration for the grant of a right to continue to provide multi channel television services to subscribers, as well as other telecommunications services over the cable network, under the licensing regime, the cable television operators, including ourselves, came to an agreement with the State of Israel dated July 2001, in which we undertook, among other things, to make certain payments to the government over a 12 year period, and in consideration, each cable television operator received recognition by the government of ownership of its respective cable television network infrastructure. Subsequent amendments to the Telecommunications Law adopted that payment arrangement. The material terms of the agreement provided that:

Each cable television operator shall make payments to the government over a period of 12 years commencing on January 1, 2003, equal to its pro rata portion of a sum determined by multiplying certain accumulated income of all the cable television operators, including certain income derived from the use of cable infrastructure, by a percentage which is between 0% and 4%, increasing gradually according to the amount of the certain income. In the July 2001 agreement, it was agreed that our pro rata portion would be 24.1%, until agreed differently by all of the cable television operators; and

Each cable television operator shall pay the State of Israel in the 12-year period up to 12% of its income from the sale of any activity related to the cable infrastructure or a right related to such activity, and the sale of certain assets as set forth in the agreement. The Israeli government (subject to payment of payments by the cable television operators) undertook not to assert any rights or claims regarding the ownership of the cable infrastructure.

As a result, each cable television operator is deemed to own all the rights regarding the cable network infrastructure in its license areas, and the right to operate it is subject to applicable law, following the expiration of the previous franchises. The terms of our Telecommunications Infrastructure License stipulate that upon termination of the Telecommunications Infrastructure License, in the event that we are unable to reach an agreement with a potential purchaser of our infrastructure within 6 months, then an arbitrator shall be appointed who shall impose a valuation calculated according to the value of the infrastructure, on a going concern basis and according its economic value.

The July 2001 agreement, and its codification into law due to the amendments to the Telecommunications Law, shall continue to be in effect if the cable television operators consummate the merger.

In March 2003 the cable television operators approached the Israeli Ministry of Finance with a request to defer for one year the commencement of payments due under the July 2001 agreement, and this matter is currently under discussion. In a meeting with the Israeli Ministry of Finance on April 30, 2003, the Ministry of Finance demanded that should the merger of the Israeli television operators be consummated, the July 2001 agreement will be adjusted to correspond with the new organizational structure following the merger, such that the merged cable infrastructure entity shall also become a party to the July 2001 agreement, and the provisions of such agreement regarding the proportional amounts of the cable television operators in the joint consideration to be paid to the State of Israel under such agreement shall be adjusted such that the merged cable broadcast entity and the merged infrastructure entity shall be severally and jointly responsible for the entire joint consideration due under such agreement.

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Proposed Merger of the Israeli Cable Television Operators

In February 2003, the other Israeli cable television operators and us agreed on a final version of an agreement outlining the structure and conditions of a merger between us and the other Israeli cable television operators. This merger agreement, upon its signing, will be added to and broaden the terms of the previous arrangement between the parties executed on December 31, 2001 (further to previous arrangements between the parties that were cancelled and replaced). The purpose of the merger, among other things, is to enable us to provide additional telecommunications services, to increase our ability to compete successfully with Bezeq in the domestic fixed line telephony field, to cooperate in various areas, including purchase of content, marketing, sales and unified networks and effect substantial cost savings. The consummation of the merger agreement is subject to reaching an understanding with the major Israeli banks and the other creditors of the merging entities, and approvals required under applicable law, including the approvals of the Income Tax Commission, the Council, the Controller of Restrictive Business Practices and the Israeli court. To date, we have received approvals, subject to terms and conditions, from the Council, the Controller of Restrictive Business Practices and the Income Tax Commission. Subject to the final terms of the merger, further approval of the Income Tax Commission to the merger may be required. (See Item 4B. Information on the Company Business Overview - Arrangement for a Merger of Cable Television Operators).

Domestic Fixed Communications

On September 17, 2002, the Minister of Communications adopted the recommendations (subject to certain changes) of a committee formed by the Ministry for the establishment of policies and rules for the opening of competition in the field of domestic fixed communications, as the guiding policies in this field. The main purpose of the committee was to improve the benefits of the consumer in the field of domestic fixed communications, specifically by removing limitations for competition in this area. In accordance with the recommendations of the committee, among other things, the merger of the cable television operators and the entrance of the merged entity to the domestic telephony market, create opportunities for the opening of competition in the domestic fixed line telephony services market. For information regarding the provision of telephony services by the merged entity, see Item 4B. Information on the Company - Business Overview -Agreement for a Merger of the Cable Television Operators - Approval of the Controller of Restrictive Business Practices to the Merger - Interests in telephony services Regarding international telecommunication service providers (which include Barak I.TC. (1995) The General International Telecommunications Services Corp. Ltd.), the committee recommended, among other things, that the exclusivity period of these companies shall be extended until January 2004, subject to the condition that the international telecommunication rates shall not be increased during the extension period. In accordance with the Minister s decision, the Ministry shall act, during the extension period, such that international telecommunication services may be provided by new operators as of January 2004.

In order to implement the committee s recommendations, the Israeli parliament approved an amendment to the Telecommunications Law at the end of May 2003. Under the said amendment, as of September 1, 2004, the Minister may grant a special general license for domestic fixed telecommunications services without imposing on the holders of such licenses the obligation to provide their services to the entire public throughout the entire country or in any specifically defined area in Israel.

The adoption of the committee s recommendations may cause, among other things, the increase of competition in the telephony field of domestic fixed communications as of August 2004 and may increase competition in the international fixed line telephony services.

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4B. Business Overview

We operate digital and analog cable television systems and provide a variety of channels and programs as one of three cable television operators in Israel. In addition we provide access to High Speed Internet over cable services. We believe that Israel is and will continue to be an attractive environment in which to provide cable television services for the following reasons:

Multi Channel Cable Television Market. As of December 31, 2002, there were approximately 1.84 million homes passed in Israel, with a penetration rate of approximately 58%. The high penetration rate for multi channel cable television services in Israel is attributable to the high penetration of televisions, multiple televisions and home video cassette recorders in homes, the fact that only three off-air channels in Hebrew are currently broadcast from Israel, and also to the demand for additional Hebrew language (including subtitled and dubbed) programs.

Growth in Subscriber Base. Between 2000 to 2002, the population of Israel grew at an average rate of approximately 2.3% per year.

Diverse Population. The cultural and linguistic diversity of Israel s population has created a large pool of potential cable television subscribers with different viewing needs. From 1991 through the end of 2002, approximately 895,000 new immigrants arrived in Israel, representing approximately 57% of the increase in Israel s population during that period. In addition, a substantial portion of Israel s population consists of first or second-generation immigrants, many of which we believe continue to speak the language of their country of origin and maintain strong cultural ties to that country.

Growth in the Number of Channels and Diversity of Content. We provide our subscribers with the most widely viewed cable television broadcasts in Israel. We continually aim to increase the number of channels we provide and improve the diversity of content, in accordance with the perceived requirements of our subscriber base. The following are the new channels that we provide since January 1, 2000, most of which are subtitled or dubbed in Hebrew or Russian, which we believe promotes viewer interest in cable television in Israel. The list is up to date as of May 31, 2003.

Since March 2000, the classical music channel (Mezzo);
Since February 2000, a new children s channel for preschoolers (Hop Channel);
Since June 2000, the American sport channel (ESPN) and the TV movie channel (Hallmark), the British entertainment channel (BBC Prime)
Since August 2000, the Cartoon Channel, the classic movie channel (TCM);
Since September 2000, the Russian classic movie channel (Nashe Kino);
Since November 2000, the action channel (AXN);
Since March 2001, the children s channel (Fox Kids), the Indian entertainment channel (Zee TV), the Romanian entertainment channel (Pro TV);
Since May 2001, the youth channel (BIP), and the 40 audio music channels;
Since July 2001, the European culture channel, (ARTE); the action channel, (Reality); the Arabic family, sport, children movie and music channels, (ART 1, 2, 3 4 and 5), the entertainment channel, (E!); the History Channel; the movie channels (Cinema 1, 2 and 3), the movie channel (MGM);
Since August 2001, the Adventure channel (Adventure 1);
Since September 2001, the lifestyle channel, (Good Life) and two extra home cinema digital channels;
Since November 2001, the telenovella channel (Viva Platina);
Since December 2001, the sports channels (Sport 5+) and (NBA);
Since January 2002, the general channel (Channel 10);
Since March 2002, the life style channel (Ego) the movie channel (Cinema Prime); and four music channels (MTV Base , MTV 2 , MTV Hits , and VH1 Classic);
Since April 2002, the Russian movie channel (MF);
Since June 2002, the IBA Arab channel (the Middle East Channel);
Since July 2002, the news channel (Fox News);
Since November 2002, the general Russian channel (Israel Plus) and the sports channel (Eurosportnews);
Since December 2002, the economics channel (CNBC), the sports channel (Fox Sport) and 4 regional radio channels;

Since February 2003, the Russian channel (NTV Mir) and the sports channel (the Teams channel);
Since March 2003, the Russian History channel (History Russian); and
Since April 2003, the Judaism channel (Techelet).

We hold an option, exercisable in our discretion, to purchase 50% of an interactive youth application (named T.J.) that serves as a portal to our Youth Package , which we began to operate in November 2002.

Digital Broadcasting Services. In July 2001, we began to provide digital broadcasting services, as well as our analog broadcasting services. We offer our digital subscribers the digital Basic Package, and they may purchase all or part of any of the Premium Broadcastings.

For additional information see Item 4B: Products and Services-Basic Packages and Item 4B: Premium Broadcastings .

Pay-Per-View, Near Video on Demand. On September 14, 2000, we received a three-year permit, replacing a previous one, from the Ministry of Communications to provide Pay-Per-View and Near Video On Demand services, and in February 2001, a permit to provide Near Video on Demand services on the digital platform. These services are now governed by our Cable Broadcast Licenses. We have offered Pay-Per-View services since October 2000, which are commenced by digital and analog HeadEnd equipment and received at the subscriber s premises by analog and digital set-top boxes. We have not yet begun to offer Near Video On Demand Services.

Interactive Services. Since September 2001, we provide the following interactive services to our digital subscribers: Games Channels, Horoscopes, Weather and Classifieds. Since February 2002, we provide an entertainment programming guide service. Since November 2002, we operate an interactive youth application (T.J.) that serves as a portal to our Youth Package , which includes a multi-optional interactive screen. Interactive applications have been integrated into the Ego channel, since July 2002, and the Good Life channel, since August 2002. Since August 2002 we provide an interactive invoice service. Since December 2002, we provide our digital subscribers SMS and T-Mail messaging services through the use of the television screen and set-top box of the subscriber. Since December 2002, we began to implement an interactive voting application, which allows our subscribers to participate in television votes conducted on certain programs through the use of the subscriber set-top box. Since January 2003, we began to implement an interactive commercial application. Since February 2003, we began an interactive messaging service to subscribers, which allows us to send messages to subscribers regarding broadcasts and services in connection with broadcasts. During March 2003 and April 2003, as a result of the security situation in Israel at such time we provided an interactive portal to certain channels that include news and news updates, known as the Situation Room . Subject to the receipt of the relevant regulatory approvals, we intend to provide additional interactive services in the future, including the integration of interactive applications into additional channels, additional games channels, an interactive lottery and soccer lottery. We currently offer our digital subscribers Games Channels also on a pay-per-play basis (pay per game) or pay-per-use basis (pay per defined duration of time played), the use of which may be limited by the subscriber (for the purpose of parental control), on the basis of a predetermined maximum monthly fee.

Access to High Speed Internet Over Cable Services. On April 8, 2002, as part of our competitive activity in the telecommunications market, we began to provide access to High Speed Internet over cable services through our infrastructure, pursuant to our Telecommunications Infrastructure License.

Technologically Advanced Infrastructure. Due to the relatively recent buildout of the cable television industry in Israel, operators utilize advanced technologies, such as broadband, hybrid fiber optic/coaxial, or HFC, cable networks and digital video broadcasting, or DVB, platforms. The main benefits of using such technologies are the potential for greater capacity, increased functionality, improved broadcasting quality, and development of two-way communication based services. We installed and utilize a DVB platform, and previously upgraded our HFC network into a full two-way expanded bandwidth plant. We successfully employ an access to High Speed Internet over cable platform. Based on our infrastructure, we plan to gradually implement more service layers, such as video on demand and personal video recorder (or PVR) services, enhanced television interactive applications and other services (which utilize the cable television platform upon other alternative platforms).

Integrated Fiber-Optic Network. The broadband networks of the three cable television operators in Israel are connected through nationwide fiber optic cable links. This interconnection among the cable television operators creates an opportunity, subject to regulatory approvals, to develop and provide subscribers throughout Israel with services such as telecommunications using the already installed cable television networks.

Services to the Business Sector. We are currently preparing for the commencement of the provision of additional communication services designated to businesses, including Internet Protocol Visual Private Network (or IP VPN) and symmetrical broadband services for the business sector.

Strategy

Our mission is to leverage our cable television infrastructure and market share to be a leader in the Israeli information, telecommunications and entertainment industry. In order to achieve our mission, we are implementing strategies designed to:

- increase our value-added services offerings to our subscribers;
- expand into other telecommunications activities;
- enter into mergers, acquisitions and strategic alliances to add to our offering and expand our market share.

Competitive Strengths

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

state-of-the-art technology and an advanced network and infrastructure which we own entirely including two-way broadband transmission, HFC cables, and a fully digitalized broadcasting system.

a diversified and rich selection of programming content;

high quality of broadcasting service and support for customers;

as of December 31, 2002, a large customer base which contains approximately 275,000 subscribers, constituting a penetration rate of approximately 60% in our license areas;

a highly experienced and dedicated management team and staff;

built in technological unique advantages, such as wide bandwidth, 2-way communication, one pipe for various, multiple services, segmented network (which allows reuse of bandwidth and implementation of narrowcast and Unicast services); and

reasonable fees for our cable television broadcast offerings and access to High Speed Internet over cable services, and for other services.

Availability and Sources of Programming

The increasing availability of cable television in Israel has provided an attractive alternative to the limited off-air television programming and the use of video cassette recorders and DVDs. We offer our analog and digital subscribers a single tier of certain channels (within the framework of the analog and digital basic broadcast packages, known as the Basic Packages), and we offer our digital subscribers the possibility for additional channels and packages in their license areas (within the framework of our Premium Broadcastings). For information regarding the channels and packages included in the Basic Packages and the Premium Broadcastings, see Item 4B: Products and Services - Basic Packages and Item 4B: Products and Services - Premium Broadcastings . A significant amount of the most popular channels available to cable television operators in Israel is provided by I.C.P. and by independent producers. The three cable television operators in Israel currently provide the same program scheduling on most of the channels in each of their license areas, enabling subscribers throughout Israel to watch the same program at the same time.

We aim to diversify and improve the content quality we provide to our subscribers. We do so by adding new broadcasting channels and enriching the existing ones. For example, we provide subscribers with broadcasts of the English football Premier League, the U.S. National Basketball Association League, the European Football Association Champion League, the French Open and films and popular series from leading major studios around the world. In addition, we offer our subscribers new interactive applications.

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Products and Services

Overview of our Cable Television Services

We offer cable television analog and digital subscribers a single tier of basic service (within the framework of the analog and digital Basic Packages). We offer our digital subscribers the possibility for additional channels and packages (within the framework of our Premium Broadcastings) and services. Similar services to those we offer our digital subscribers are also offered by YES.

Subscribers are offered access to a variety of Hebrew language programming (including original, subtitled and dubbed), a home shopping channel, off-air channels originating in Israel and other selected countries, and satellite television channels. We charge subscribers an initial installation fee of approximately NIS 85 plus VAT, and a monthly subscription fee for the analog and the digital Basic Packages of approximately NIS 144 plus VAT. We also require a deposit of approximately NIS 84 plus VAT, for the regular analog set-top box (for those subscribers without cable-ready televisions), or NIS 169 plus VAT, for the addressable analog set-top box, and a deposit of approximately NIS 254 plus VAT, for the digital set top box. We partially refund the deposit when the set-top box is returned. The refund amount (which is linked to the Israeli consumer price index) is reduced to reflect 10% annual depreciation for each year or portion of a year in which the subscriber used the set-top box. In accordance with an amendment to regulations promulgated under the Telecommunications Law approved by the Economic Committee of the Israeli parliament on June 16, 2003, the deduction from the deposit for the set-top box shall be 10% of the value of the set-top box. Alternatively, our subscribers may elect to lease the set-top box for a monthly fee that ranges between NIS 10 and NIS 15 including VAT.

We also charge subscribers fees for reconnection, installation of additional outlets in subscribers households; and provision of cable television services on the additional outlets. These fees are all subject to value added tax at a rate of 18%.

Programming

We currently transmit programming on varying numbers of channels in our operating areas, which consists of off-air channels, satellite channels, dedicated channels, and other channels, all as more fully detailed below, including in the tables of the analog and digital Basic Packages and in the table which sets forth those additional channels and packages that are included within the Premium Broadcastings which we provide to digital subscribers in the tiering system. For discussion of our risks related to programming, see Item 3. Risk Factors , and for a discussion of certain of our costs associated with programming, see Item 5. Operating Financial Review and Prospects Operating Expenses .

Off-Air Channels. The off-air channels we transmit to our subscribers include the Israel Broadcast Authority channels (Channels 1 and 33), the Middle East Channel, the commercial channels (Channels 2 and 10), the general Russian Channel, as well as other off-air channels, which broadcast from other selected countries. Although subscribers can receive transmission of these off-air channels through a household antenna or a satellite dish, the antennae located on our HeadEnds enable subscribers to obtain superior picture and sound quality.

We are not required to pay royalties with respect to off-air channel broadcasts. We and the other cable television operators have agreed, however, to pay royalties to certain organizations representing Israeli performing artists with respect to copyrighted materials broadcasted by the cable television operators. For the years ended December 31, 2000, 2001 and 2002, we paid royalties to such organizations of approximately NIS 2.8 million, NIS 2.8 million, and NIS 3.0 million, respectively.

Satellite Channels. We transmit to our subscribers broadcasts of foreign and Israeli television channels which we receive at our HeadEnds via satellite. We pay fees for the right to transmit certain of these broadcasts. The portion of these fees for which we are responsible is based on the number of our subscribers in a given payment period. We have not received permission to transmit the respective broadcasts from all foreign satellite television operators whose broadcasts we transmit. However, pursuant to our Licenses, and subject to the permission of the Council, our freedom to remove channels from the Basic Packages is limited. The broadcasting regulations, as amended, prohibit the broadcasting of channels or programs without the consent of the original broadcaster. Furthermore, there can be no assurance that the satellite television operators to whom we do not currently make payments will not request payments from us in the future. In addition, a lawsuit was filed against us in connection with these matters. See Item 8A. Consolidated Statements and Other Financial Information - Legal and Arbitration Proceedings .

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Other Channels: We broadcast a wide variety of additional channels, including those channels listed in the Basic Packages tables below, and those pursuant to our tiering, Pay-Per-View and interactive services.

On May 30, 2001 we commenced broadcasting of the adult content channels. From October 2001, pursuant to amendments to the Telecommunications Law and Council decisions, we transmitted adult content channels by way of Pay-Per-View only. Pursuant to further amendments to the Telecommunications Law, broadcasts that include abominable material in the meaning of the Israeli Penal Law, 1977, and which include certain content as set forth in the Telecommunications Law, is prohibited as of August 2002. Following such further amendment, we ceased to transmit adult content channels also by way of Pay-Per-View. On June 12, 2003, the Council resolved to approve the broadcast of the Playboy channel, subject to certain conditions and limitations, under which, among other things, the Playboy channel will be transmitted only at certain stipulated times and offered to digital subscribers as a separate pay channel and not as part of the digital Basic Package. We have commenced broadcasts of the Playboy channel pursuant to and in accordance with the conditions and limitations set forth in the Council s latter decision. Such conditions and limitations stipulate that, among other things, the Playboy channel will be transmitted only at certain stipulated times and offered to digital subscribers as a separate pay channel and not as part of the digital Basic Package; Cable Broadcast Licensees are required to take reasonable measures to ensure that the channel shall be purchased only by subscribers over the age of 18; the channel will be coded such that access will be available only by a personal code; and Cable Broadcast Licensees are required to transmit during the transmission of the channel certain broadcasts regarding the prohibition on exposure of children and youth to the channel. For information regarding a petition filed in the Israeli Supreme Court of Justice by the producers of the Playboy channel, see Item 8A: Consolidated Statements and Other Financial Information - Legal and Arbitration Proceedings .

Locally Produced Programming. In 1989, together with the other Israeli cable television operators, we established a company named ICP Israel Cable Television Programming Company Ltd., for the purpose of jointly purchasing and producing content for our local channels. Today, ICP creates, produces and acquires content for two channels (family and movies). We have approximately 25% ownership interest in ICP and make payments to it based on the number of our subscribers. For the years ended December 31, 2000, 2001 and 2002, we paid ICP approximately NIS 60.7 million, NIS 71.0 million and NIS 62.9 million, respectively.

Under the Telecommunications Law, we are required to allocate between 8% and 12% of our annual income derived from subscriber fees to production or purchase of original locally produced broadcasts, and the Council has the authority to fix the percentage from the 8%-12% range, while taking into account the economic status of the cable television operators in the field of cable broadcasts. For information regarding the Council s decisions in connection with this matter, see Item 4B. Information on the Company Business Overview - The Telecommunications Law and Our Licenses - Specific Terms and Conditions of our Cable Broadcast Licenses - Broadcasts and Programming .

Under the Telecommunications Law, we are required to provide up to one-sixth of our network capacity for broadcasting, to holders of special cable television licenses for specific channels. In addition, we have allocated programming time to broadcasting by local community organizations and the public educational channel, which we are obliged to broadcast according to the Telecommunications Law. With the exception of the broadcasts by local community organizations and the public educational channel, all such special cable television licensees are required to pay for the use of our network capacity. In the event that a merger between the Israeli cable television operators is consummated, we shall be under an obligation to allow other broadcast license holders to have access to our network infrastructure, within three months from the date so requested by the other licensee or producer. According to the approval of the Controller for Restrictive Business Practices to the proposed merger, if we are unable to reach a commercial agreement with such broadcast licensee or producer within 60 days, the matter must be referred to arbitration and the arbitrator must act in accordance with the instructions of the Controller of Restrictive Business Practices.

Local News Broadcasts. Our licenses also require that we provide periodic local news broadcasts in each license area. The content of our local news and local community programs varies in our operating areas. In accordance with the Council s decisions of December 2002 and February 2003, a Cable Broadcasting Licensee may produce local news broadcast for seven license areas through an external producer, subject to the Council s approval. Accordingly, we and the other two Israeli cable television operators entered into an agreement dated January 5, 2003, as amended on March 5, 2003, with Today s Cable News the Local News Company Ltd., commonly referred to as JCS , whereby JCS shall produce local news for the cable television operators for their respective areas in consideration of NIS 42.48 million per annum (linked to the Israeli consumer price index and subject to adjustments). The payment of the consideration will be divided between the 3 cable television operators, in proportion to the number of their respective subscribers. Of this consideration, we are required to pay NIS 11 million. Under the agreement, the cable television operators undertook, among other things, to provide JCS exclusive use of a production studio for the production of the local news in consideration of approximately NIS 12.3 million per annum (linked to the Israeli consumer price index plus VAT). The consideration received for use of the production studio will be divided between the 3 cable television operators, in proportion to the number of their respective subscribers. Of this consideration, we will be entitled to approximately NIS 3.2 million. The agreement is for an initial period of 5 years, and may be extended by the cable television operators for additional periods. The agreement with JCS was approved by the Council on March 6, 2003. The effectiveness of the agreement with JCS is subject to the approval of the Controller for Restrictive Business Practices, to the extent such approval is required, and on February 20, 2003, the parties requested the approval of the Controller. To date, the approval of the Controller to the JCS agreement has not been received.

Commercial Advertising and Dedicated Channels. According to the Telecommunications Law, the Council may grant special licenses to independent producers of specific dedicated cable television channels, and such channels may be entitled to offer commercial advertising. The Economic Committee of the Knesset decided on January 27, 1998, that such dedicated channels will be: an Arabic channel, a Jewish traditional channel, two news channels, an Israeli music channel and one channel or more in foreign languages for new immigrants arriving to Israel. In 2001 and 2002, the Council selected winning bids for the tender for a News Channel, a general Russian channel and an Israeli music channel, all of which will be permitted to broadcast commercials. The general Russian Channel commenced broadcasts as of November 2002. As yet, the News Channel and the Israeli music channel have not commenced broadcasts.

Currently Channel 2, Channel 10 and the general Russian Channel are the only locally produced channels (which have commenced broadcasting) that have permits to air commercials. Some foreign satellite channels also air commercials. Permits have also been granted to special broadcast licensees as described above, namely the News Channel and the Israeli music channel, which have not commenced broadcasts to date. In addition to the prohibition on broadcasting commercials on our local channels, the Telecommunications Law, as amended, prohibits the broadcasting of commercials on channels that the Council has decided are targeted mainly to the Israeli public, without the prior approval of the Council. The Council has set certain criteria regarding these stipulations.

The approval of the Controller of Restrictive Business Practices to the merger of the Israeli cable television operators provides, among other things, that if the merged broadcasting entity receives approval to air advertisements on its channels, then the Controller shall have the power to impose additional restrictions upon the entity. We have no assurance that the merged entity shall receive any such approval.

Basic Packages

In accordance with our Broadcasting License, we must provide each of our subscribers (analog and digital) basic broadcasts that shall include:

Israel s channels 1 and 33 and the Middle East Channel, of the Israeli Broadcasting Authority;

the commercial channels (Channel 2 & 10);

the Israeli educational channel;

dedicated channels pursuant to the Telecommunications Law (which currently only include the Shopping and Russian Channels, but may in the future also include the News and Music Channels that have won tenders, and other channels that have yet to be tendered);

regional news and community broadcastings;

channels of special cable broadcast licensees according to the Council s instructions, on the digital service only (none of which exist to date); and

the EPG service, on the digital service only.

Our Cable Broadcast Licenses stipulate that, in the event that we wish to reduce the scope of the basic broadcasts, we must request the Council s approval. In the event that the scope of the analog basic broadcasts has been reduced, the Council may instruct us (subject to the approval of the Minister) to reduce the price for such reduced package to an amount determined by the Council. In such case, we would be entitled to present our position to the Council prior to it rendering its decision.

Our Cable Broadcast Licenses stipulate that we may not charge our analog subscribers for the basic broadcasts more than approximately NIS 148 plus VAT, in the Holon/Bat Yam and Haifa/Hadera regions, approximately NIS 140 plus VAT, in the Sea of Galilee/Netanya region, and approximately NIS 141 plus VAT, in the Golan/Sefat and Kiryat Shemoneh region. Additionally, we may not charge our analog subscribers for a movie provided on Pay-Per-View basis more than approximately NIS 15 plus VAT, per broadcast. Such fees may be linked to the Israeli consumer price index from February 2002. Our Cable Broadcast Licenses do not stipulate fees for digital subscribers. Under regulations promulgated pursuant to the Telecommunications Law, we may determine our subscriber fees for digital subscribers (including the basic broadcasts package). Such fees that we set for our digital subscribers must be reasonable, and the Minister may direct us to amend such fees if he finds, among other things, that they are harmful to competition, discriminatory or misleading. The Council s approval to the proposed merger of the Israeli cable television operators stipulates, as a condition to the merger, that we, or the merged entity, will be subject to a maximum subscriber fee for both the digital and analog basic broadcasts packages of NIS 156 incl. VAT, linked to the combined index, that includes the Israeli consumer price index of December 2001 (published January 15, 2002) and the US dollar exchange rate as published by the Bank of Israel, or any other index as shall be determined in regulations. The effectiveness of the Council s approval regarding the said linkage to the combined index is subject to the amendment of the applicable regulations promulgated under the Telecommunications Law. To date, the Ministry has not adopted such an amendment.

The Council has determined that all channels in the Basic Package on our digital platform must be included in the Basic Package on our analog platform, unless otherwise authorized by the Council.

Digital Basic Package

The following table lists information regarding the Basic Package that we offer to our digital subscribers as of May 31, 2003.

Channel	**Description**	**Language**[(1)]
Mosaic	Split-screen showing all channels	
Channel 3	Entertainment	Hebrew
Movies	Cinema Movies	Hebrew
Sport	Local and intentional games & Competition	Hebrew
Children	Cartoons, movies & other children entertainment	Hebrew
MTV	Europe video music	English
Channel 8	Culture, Science & Education	Hebrew & Russian

Channel 9	Local news & others-general	Hebrew
Israel 10	Third national channel	Hebrew
Israel 1	First national channel	Hebrew
Israel 33	Israeli parliament channel	Hebrew
CNN	World news	English
Sky news	World news	English
BBC World	Collection of BBC best programs	English
ORT- Russia	Russian channel	Russian
RTR Russia	Russian channel	Russian
NASHA KINO	Russian Channel	Russian
RTV Int	Russian Channel	Russian
NTV MIR	Russian Channel	Russian
National Geographic	Localized channel of NGC	Hebrew
Star World	Entertainment	English
Shopping	Israeli shopping channel	Hebrew
Israel 2	Second national channel	Hebrew
Education	Israeli educational channel	Hebrew
SAT 3	German channel	German
RTL	German channel	German
TV5	French channel	French
France 2	French channel	French
Arte	Culture	French
Euro sport	European sport broadcasting	English
VH-1	Video Music	English
TVE	Spanish channel	Spanish
RETE 4	Italian channel	Italian
TRT 1	Turkey 1	Turkish
TRT 2	Turkey 2	Turkish
INTERSTAR	Turkish channel	Turkish
DUNA TV	Hungarian channel	Hungarian
Emergency (2)	Emergency communications	Hebrew
SAT 1	German channel	German
LBC	Arabic channel	Arabic
Viva	Teledrama Channel	Hebrew
Fashion TV	Fashion TV	French
MEZZO	Classic Music Channel	French
Hop	Children Channel	Hebrew
Hallmark	Series and Movies	Hebrew/Russian
BBC Prime	English channel	English/ Hebrew
AXN	Action	Hebrew
TCM	Movies	English/ Hebrew
ESPN	Sport	English
CARTOON	Cartoons, movies & other Children entertainment	English
TV 7 -TUNIS	Tunisian channel	Arabic
Jordan Arabic	Jordanian channel	Arabic
Morocco	Moroccan national channel	Arabic
Egypt	Egyptian national channel	Arabic
METV	Free Lebanon television	Arabic/English
MBC	Arabic channel	Arabic
Almustakble	Entertainment	Arabic
Saudia	National	Arabic

Channel	**Description**	**Language[(1)]**
Syria	National	Arabic
Aljazeera	News	Arabic
Dubai	National	Arabic
Middle East Channel	General	Arabic

EPG	User Guide	Hebrew/English /Russian
User Guidance Channel	User Guidance Channel	Hebrew /Russian
13 Radio Channels	Music, News General	Hebrew /Russian

(1) Originated, subtitled or dubbed, as indicated.

(2) Operates only during emergencies.

Analog Basic Package

The following table lists information regarding the Basic Package that we offer to our analog subscribers as of May 31, 2003.

Channel	**Description**	**Language**(1)	*Bat-Yam/ Holon*	*Haifa*	*Netanya/ Hadera*	*Golan*	*Arab section*	*Galilee*
Mosaic	Split-screen showing all channels		ü	ü	ü	ü	ü	ü
Channel 3	Entertainment	Hebrew	ü	ü	ü	ü	ü	ü
Movies	Cinema Movies	Hebrew	ü	ü	ü	ü	ü	ü
Sport	Local and intentional games & Competition	Hebrew	ü	ü	ü	ü	ü	ü
Children	Cartoons, movies & other Children entertainment	Hebrew	ü	ü	ü	ü	ü	ü
MTV	Europe video music	English	ü	ü	ü	ü	ü	ü
Channel 8	Culture, Science & Education	Hebrew/ Russian	ü	ü	ü	ü	ü	ü
Local channel	Local news & others	Hebrew	ü	ü	ü	ü	ü	ü
TVE	Spanish channel	Spanish	ü	ü	ü	ü	ü	ü
Israel 10	Third national channel	Hebrew	ü	ü	ü	ü	ü	ü
Israel 1	First national channel	Hebrew	ü	ü	ü	ü	ü	ü
CNN	World news	English	ü	ü	ü	ü	ü	ü
Sky news	World news	English	ü	ü	ü	ü	ü	ü
ORT- Russia	Russian channel	Russian	ü	ü	ü	ü	ü	ü
RTR Russia	Russian channel	Russian	ü	ü	ü	ü		ü
National Geographic	Localized channel of NGC	Hebrew	ü	ü	ü	ü	ü	ü
Star World	Entertainment	English	ü	ü	ü	ü		ü
RETE 4	Italian channel	Italian	ü	ü	ü	ü	ü	ü
Shopping	Israeli shopping channel	Hebrew	ü	ü	ü	ü	ü	ü
Israel 2	Second national channel	Hebrew	ü	ü	ü	ü	ü	ü
Education	Israeli educational channel	Hebrew	ü	ü	ü	ü	ü	ü
SAT 3	German channel	German		ü		ü	ü	ü
RTL	German channel	German	ü	ü	ü			ü
Jordan Arabic	Jordanian channel	Arabic	ü	ü	ü	ü		ü
TV Guide	TV broadcasting programs	Hebrew	ü	ü	ü	ü		
Morocco	Moroccan national channel	Arabic	ü	ü	ü	ü	ü	ü
Egypt	Egyptian national channel	Arabic	ü	ü	ü	ü	ü	ü
METV	Free Lebanon television	Arabic/ English	ü	ü	ü	ü	ü	ü
MBC	Arabic channel	Arabic	ü	ü	ü	ü	ü	ü
Israel 33	Israeli parliament channel	Hebrew	ü	ü	ü	ü	ü	ü
TV5	French channel	French	ü	ü	ü			ü
France 2	French channel	French	ü	ü	ü	ü		ü
Euro sport	European sport broadcasting	English	ü	ü	ü		ü	ü
VH-1	Video Music	English	ü	ü	ü	ü	ü	ü
TRT1	Turkey 1	Turkish	ü		ü			
TRT2	Turkey 2	Turkish	ü					
DUNA TV	Hungarian channel	Hungarian	ü	ü	ü	ü		ü
INTERSTAR	Turkish channel	Turkish	ü	ü	ü	ü	ü	ü

Emergency (2)	Emergency communications	Hebrew						
TV 7 -TUNIS	Tunisian channel	Arabic		ü	ü		ü	
SAT 1	German channel	German	ü	ü	ü	ü	ü	ü

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Channel	Description	Language[1]	*Bat-Yam/ Holon*	*Haifa*	*Netanya/ Hadera*	*Golan*	*Arab section*	*Galilee*
LBC	Arabic channel	Arabic		ü		ü	ü	
Viva	Teledrama Channel	English / Hebrew	ü	ü	ü	ü	ü	ü
Fashion TV	Fashion TV	French	ü	ü	ü	ü		ü
MEZZO	Classic Music Channel	French	ü	ü	ü	ü	ü	ü
Hop	Children Channel	Hebrew	ü	ü	ü	ü	ü	ü
RTV Int.	Russian Channel	Russian	ü	ü	ü	ü		ü
Hallmark	Series and Movies	English/ Hebrew	ü	ü	ü	ü	ü	ü
BBC Prime	English channel	English/ Hebrew	ü	ü	ü	ü	ü	ü
AXN	Action	English/ Hebrew	ü	ü	ü	ü	ü	ü
TCM	Movies	English/ Hebrew	ü	ü	ü	ü	ü	ü
ESPN	Action	English	ü	ü	ü	ü	ü	ü
CARTOON	Cartoons, movies & other Children entertainment	English	ü	ü	ü	ü	ü	ü
NASHA KINO	Russian Channel	Russian	ü	ü	ü	ü	ü	ü
Almustakble	Entertainment	Arabic					ü	
Saudi	National	Arabic					ü	
ART 1	Family	Arabic					ü	
ART 2	Sport	Arabic					ü	
ART 3	Children	Arabic					ü	
ART 4	Movies	Arabic					ü	
ART 5	Music	Arabic					ü	
Syria	National	Arabic						