# "BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

## INTERIM CONSOLIDATED FINANCIAL STATEMENTS

## JUNE 30, 2002

**Interim Consolidated Financial Statements as at June 30, 2002 (unaudited)**

## Contents

**The Board of Directors of**
**"Bezeq" - The Israel Telecommunications Corp. Limited**

Dear Sirs,

**Re: Review of the Unaudited Interim Consolidated Financial Statements for the Six Month and Three Month Periods Ended June 30, 2002**

At your request we have reviewed the interim consolidated balance sheet of "Bezeq" - The Israel Telecommunication Corp. Limited and its subsidiaries as at June 30, 2002, as well as the interim consolidated statement of operations, the interim statement of changes in shareholders' equity and the interim consolidated statement of cash flows for the six month and the three month periods then ended.

Our review was carried out in accordance with procedures prescribed by the Institute of Certified Public Accountants in Israel. The procedures included, inter alia, reading the said financial statements, reading the minutes of meetings of the shareholders and of the Board of Directors and its committees, as well as making inquiries of persons responsible for financial and accounting matters.

Reports of other auditors were furnished to us which relate to the review of the interim financial statements of subsidiaries, whose assets as at June 30, 2002, constitute approximately 17.5% of the total assets included in the interim consolidated balance sheet and whose revenues constitute approximately 33.8% and 37.8% of the total revenues included in the interim consolidated statement of operations for the six months and the three months, respectively, then ended. Furthermore, the data contained in the interim consolidated financial statements, which relate to the net asset value of the Company's investments in affiliated companies and its equity in their results, is based on interim financial statements which were reviewed by other auditors.

As the review is limited in scope and does not constitute an audit in accordance with generally accepted auditing standards, we do not express an opinion on the interim consolidated financial statements.

In the course of our review, including reviewing the reports of other auditors as mentioned above, nothing came to our attention which would indicate the necessity of making material changes in the said interim financial statements in order for them to be in conformity with generally accepted accounting principles and in accordance with the provisions of Section 4 of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

We draw attention to the uncertainties relating to the following matters, for which the maximum possible exposure is significant:

1. The anticipated opening of the communications sector to competition, changes in tariffs and their effect on the Company's financial position and operating results as described in Note 1.

2. A program of early retirement, as described in Note 6.

3. Claims made against the Company and against investee companies, as described in Note 7A.

4. The financial position of an affiliated company, the need for additional financing which is significantly higher than the financing needs defined in the financing agreement between the affiliated company and banking corporations and agreements in principle reached as at the date of these financial statements between the affiliated company, its shareholders and the banking corporations. As described in Note 4A the continuation of the activities of the affiliated company is dependent upon the execution of the agreements in principle reached with the banking corporations regarding increasing the credit facilities and upon additional loans to be received from the shareholders. The assessment of the affiliated company's management as to the likelihood of resolution of the required financing is included in the aforementioned note.

Somekh Chaikin
Certified Public Accountants (Isr.)
A member firm of KPMG International

August 27, 2002

**Interim Consolidated Balance Sheet**

In adjusted shekels of June 2002

| | June 30 2002 (Unaudited) | June 30 2001 (Unaudited) | December 31 2001 (Audited) |
|---|---|---|---|
| | NIS thousands | NIS thousands | NIS thousands |
| **Current assets** | | | |
| Cash and cash equivalents | **1,659,071** | 1,318,447 | 1,385,079 |
| Short-term investments | **404,639** | 284,240 | 468,412 |
| Trade receivables | **1,759,067** | 1,433,674 | 1,793,493 |
| Other receivables and debit balances | **447,252** | 438,742* | 308,107* |
| Inventory | **193,996** | 169,403 | 123,341 |
| | **4,464,025** | 3,644,506 | 4,078,432 |
| **Materials and spare parts** | **156,673** | 216,018 | 161,369 |
| **Investments and long-term receivables** | | | |
| Investments, deposits and debit balances | **1,845,614** | 1,644,165 | 1,786,817 |
| Investments in investee companies | **468,357** | 398,681 | 490,111 |
| | **2,313,971** | 2,042,846 | 2,276,928 |
| **Fixed assets** | | | |
| Cost | **30,455,590** | 31,849,870 | 29,940,033 |
| Less - accumulated depreciation | **20,156,082** | 20,121,621 | 19,057,319 |
| | **10,299,508** | 11,728,249 | 10,882,714 |
| **Other assets** | | | |
| Deferred charges and other assets | **329,280** | 411,987 | 361,841 |
| Deferred taxes | **440,382** | 357,486* | 476,156* |
| | **769,662** | 769,473 | 837,997 |
| | **18,003,839** | | 18,237,440 |

| | June 30 2002 (Unaudited) | June 30 2001 (Unaudited) | December 31 2001 (Audited) |
|---|---|---|---|
| | NIS thousands | NIS thousands | NIS thousands |
| **Current liabilities** | | | |
| Bank credit | **228,009** | 733,265 | 450,247 |
| Current maturities of: | | | |
| Long-term bank loans | **667,088** | 1,103,405 | 592,008 |
| Other debentures | **201,089** | 247,966 | 198,483 |
| Trade payables | **1,052,812** | 871,797 | 1,082,853 |
| Employee severance benefits | **230,004** | 355,403 | 279,511 |
| Other current liabilities | **1,158,223** | 1,025,252* | 1,227,859 |
| | **3,537,225** | 4,337,088 | 3,830,961 |
| **Long-term liabilities** | | | |
| Long-term loans | **2,539,210** | 2,341,414 | 2,672,277 |
| Other debentures | **2,738,065** | 2,612,197 | 2,683,275 |
| Employee severance benefits | **1,304,753** | 1,369,681* | 1,356,283 |
| Deferred revenues | **53,185** | 70,008 | 61,690 |
| | **6,635,213** | 6,393,300 | 6,773,525 |
| **Contingent liabilities** | | | |
| **Shareholders' equity** | **7,831,401** | 7,670,704 | 7,632,954 |
| | **18,003,839** | | 18,237,440 |

| | | |
|---|---|---|
| Ido Dissentshik | Ilan Biran | Oren Lieder |
| Chairman of the Board | Chief Executive Officer | Chief Financial Officer |

* Reclassified

Date of approval of the financial statements: August 27, 2002

The notes to the financial statements are an integral part thereof.

**Interim Consolidated Statement of Operations**

In adjusted shekels of June 2002

| | For the six-month period ended June 30 | | For the three-month period ended June 30 | | For the year ended December 31 |
|---|---|---|---|---|---|
| | 2002 (Unaudited) | 2001 (Unaudited) | 2002 (Unaudited) | 2001 (Unaudited) | 2001 (Audited) |
| | NIS thousands | | NIS thousands | | NIS thousands |
| **Revenues from telecommunications services (Note 8)** | **4,113,646** | 4,350,926 | **2,052,002** | 2,151,749 | 8,665,350 |
| **Costs and expenses** | | | | | |
| Operating and general expenses (Note 9) | **2,278,289** | 2,367,706 | **1,137,725** | 1,235,178 | 4,748,966 |
| Depreciation (see also Note 5) | **1,157,118** | 1,380,729 | **578,793** | 682,834 | 2,760,097 |
| Royalties to the Government of Israel | **132,600** | 147,912 | **66,096** | 61,832 | 287,420 |
| | **3,568,007** | 3,896,347 | **1,782,614** | 1,979,844 | 7,796,483 |
| Operating income | **545,639** | 454,579 | **269,388** | 171,905 | 868,867 |
| **Financing income (expenses), net** | **(71,914)** | (54,891) | **(27,068)** | 1,225 | (153,152) |
| Earnings after financing income (expenses), net | **473,725** | 399,688 | **242,320** | 173,130 | 715,715 |
| **Other income (expenses), net** | **5,604** | 24,746 | **3,854** | 7,419 | (106,886) |
| Earnings before income tax | **479,329** | 424,434 | **246,174** | 180,549 | 608,829 |
| **Income tax** | **(155,935)** | (180,528) | **(86,596)** | (74,774) | (245,117) |
| Earnings after income tax | **323,394** | 243,906 | **159,578** | 105,775 | 363,712 |
| **Equity in losses of affiliates** | **(126,497)** | (81,025) | **(73,687)** | (17,648) | (241,572) |
| **Minority share in losses of a consolidated company** | **1,550** | 3,621 | **84** | 1,545 | 6,612 |
| Net earnings | **198,447** | 166,502 | **85,975** | 89,672 | 128,752 |
| **Primary and diluted earnings per NIS 1 par value of common shares (in NIS)** | **0.082** | 0.069 | **0.036** | 0.037 | 0.053 |

The notes to the financial statements are an integral part thereof.

**Interim Statement of Changes in Shareholders' Equity**
In adjusted shekels of June 2002

| | Share capital | Capital reserve for distribution of bonus shares | Capital reserve - share premium | Capital reserve in respect of transactions between the Company and a controlling shareholder | Retained earnings | Total |
|---|---|---|---|---|---|---|
| | NIS thousands | | | | | |
| **Six months ended June 30, 2002** | | | | | | |
| Balance as at December 31, 2001 (audited) | **6,222,435** | – | **954,400** | **38,429** | **417,690** | **7,632,954** |
| Net earnings (unaudited) | – | – | – | – | **198,447** | **198,447** |
| Balance as at June 30, 2002 (unaudited) | **6,222,435** | – | **954,400** | **38,429** | **616,137** | **7,831,401** |
| **Three months ended June 30, 2002** | | | | | | |
| Balance as at April 1, 2002 (unaudited) | **6,222,435** | – | **954,400** | **38,429** | **530,162** | **7,745,426** |
| Net earnings (unaudited) | – | – | – | – | **85,975** | **85,975** |
| Balance as at June 30, 2002 (unaudited) | **6,222,435** | – | **954,400** | **38,429** | **616,137** | **7,831,401** |
| **Six months ended June 30, 2001** | | | | | | |
| Balance as at December 31, 2000 (audited) | 4,470,921 | 1,723,141 | 887,371 | 38,429 | 310,915 | 7,430,777 |
| Net earnings (unaudited) | – | – | – | – | 166,502 | 166,502 |
| Conversion of convertible debentures (unaudited) (1) | 6,396 | – | 67,029 | – | – | 73,425 |
| Distribution of bonus shares (unaudited) | 1,745,118 | (1,723,141) | – | – | (21,977) | – |
| Balance as at June 30, 2001 (unaudited) | 6,222,435 | – | 954,400 | 38,429 | 455,440 | 7,670,704 |
| **Three months ended June 30, 2001** | | | | | | |
| Balance as at April 1, 2001 (audited) | 6,222,435 | – | 954,400 | 38,429 | 365,768 | 7,581,032 |
| Net earnings (unaudited) | – | – | – | – | 89,672 | 89,672 |
| Balance as at June 30, 2001 (unaudited) | 6,222,435 | – | 954,400 | 38,429 | 455,440 | 7,670,704 |
| **Year ended December 31, 2001** | | | | | | |
| Balance as at December 31, 2000 (audited) | 4,470,921 | 1,723,141 | 887,371 | 38,429 | 310,915 | 7,430,777 |
| Net earnings (audited) | – | – | – | – | 128,752 | 128,752 |
| Conversion of convertible debentures (audited) (1) | 6,396 | – | 67,029 | – | – | 73,425 |
| Distribution of bonus shares | 1,745,118 | (1,723,141) | – | – | (21,977) | – |
| Balance as at December 31, 2001 (audited) | 6,222,435 | – | 954,400 | 38,429 | 417,690 | 7,632,954 |

(1) 59,754,681 par value convertible debentures were converted into 5,904,612 ordinary shares with a par value of NIS 1 each.

The notes to the financial statements are an integral part thereof.

## Interim Consolidated Statement of Cash Flows

In adjusted shekels of June 2002

| | For the six-month period ended June 30 | | For the three-month period ended June 30 | | For the year ended December 31 |
|---|---|---|---|---|---|
| | 2002 (Unaudited) | 2001 (Unaudited) | 2002 (Unaudited) | 2001 (Unaudited) | 2001 (Audited) |
| | NIS thousands | | NIS thousands | | NIS thousands |
| **Cash flows provided by operating activities** | | | | | |
| Net earnings | **198,447** | 166,502 | **85,975** | 89,672 | 128,752 |
| Adjustments to reconcile net earnings to net cash flows provided by operating activities (see A below) | **1,144,527** | 1,448,255 | **561,665** | 630,855 | 3,289,954 |
| Net cash provided by operating activities | **1,342,974** | 1,614,757 | **647,640** | 720,527 | 3,418,706 |
| **Cash flows used in investing activities** | | | | | |
| Investment in fixed assets | **(549,832)** | (762,704) | **(244,962)** | (339,355) | (1,343,568) |
| Proceeds from disposal of fixed assets | **8,390** | 44,314 | **4,146** | 31,760 | 87,162 |
| Proceeds from disposal of investment in affiliated company | **111,408** | – | – | – | 31,597 |
| Investment in long-term deposits and investments | **(117,763)** | (1,104,340) | **(103,193)** | (9,379) | (1,171,991) |
| Proceeds from long-term deposits and investments | **126,996** | 11,180 | **92,928** | 6,962 | 38,880 |
| Decrease (increase) in short-term investments, net | **1,560** | (77,001) | **22,268** | (47,268) | (254,903) |
| Decrease (increase) in materials and spare parts | **1,140** | 30,288 | **(4,157)** | 40,061 | 51,979 |
| Investment in investee companies | **(223,605)** | (273,577) | **(133,478)** | (56,237) | (556,800) |
| Investment in other assets | **(86,394)** | (113,563) | **(30,147)** | (54,731) | (208,200) |
| Net cash used in investing activities | **(728,100)** | (2,245,403) | **(396,595)** | (428,187) | (3,325,844) |
| **Cash flows provided by financing activities** | | | | | |
| Issue of other debentures (after deduction of issue expenses) | **108,841** | 542,714 | **–** | – | 542,714 |
| Repayment of other debentures | **(177,962)** | | **(52,739)** | (22,233) | (240,546) |
| Receipt of long-term loans | **194,548** | 164,923 | **26,535** | 162,822 | 780,361 |
| Repayment of long-term loans | **(244,071)** | | **(132,130)** | (128,037) | (1,100,502) |
| Repayment of short-term bank credit, net | **(222,238)** | (59,198) | **(15,181)** | (187,113) | (342,216) |
| Net cash provided by (used in) financing activities | **(340,882)** | 296,687 | **(173,515)** | (174,561) | (360,189) |
| **Increase (decrease) in cash and cash equivalents** | **273,992** | (333,959) | **77,530** | 117,779 | (267,327) |
| **Cash and cash equivalents at the beginning of the period** | **1,385,079** | 1,652,406 | **1,581,541** | 1,200,668 | 1,652,406 |
| **Cash and cash equivalents at the end of the period** | **1,659,071** | 1,318,447 | **1,659,071** | 1,318,447 | 1,385,079 |

The notes to the financial statements are integral part thereof.

## Interim Consolidated Statement of Cash Flows (Contd.)

In adjusted shekels of June 2002

| | For the six-month period ended June 30 | | For the three-month period ended June 30 | | For the year ended December 31 |
|---|---|---|---|---|---|
| | 2002 (Unaudited) | 2001 (Unaudited) | 2002 (Unaudited) | 2001 (Unaudited) | 2001 (Audited) |
| | NIS thousands | | NIS thousands | | NIS thousands |
| **A – Adjustments to reconcile net earnings to net cash flows provided by operating activities** | | | | | |
| Revenues and expenses not involving cash flows: | | | | | |
| Depreciation (See also Note 5) | **1,157,118** | 1,380,729 | **578,793** | 682,834 | 2,760,097 |
| Provision for impairment of fixed assets | **–** | – | **–** | – | 108,453 |
| Deferred taxes | **50,876** | 5,557 | **25,283** | (10,202) | (124,290) |
| Company's equity in losses of investee companies, net | **126,497** | 81,025 | **73,687** | 17,648 | 241,572 |
| Minority share in losses of a consolidated company | **(1,550)** | (3,621) | **(84)** | (1,545) | (6,612) |
| Increase (decrease) in employee severance benefits, net | **(101,037)** | (2,064)* | **(58,249)** | 402* | (91,355) |
| Gain on disposal of fixed assets | **(5,471)** | (32,743) | **(3,975)** | (13,142) | (9,253) |
| Loss on disposal of investment in affiliated company | **–** | 3,699 | **–** | 3,699 | 3,699 |
| Erosion (appreciation) and interest on long-term deposits and investments | **(176,722)** | (18,730) | **(114,893)** | 64,471 | (210,779) |
| Erosion (appreciation) of short-term investments, net | **62,213** | (4,182) | **42,340** | (831) | (10,451) |
| Appreciation (erosion) of long-term liabilities: | | | | | |
| Other debentures | **126,517** | (101,852) | **121,249** | (80,142) | 17,607 |
| Long-term loans | **(11,486)** | 35,889 | **(53,639)** | (53,037) | 136,490 |
| Amortization of deferred expenses and other adjustments | **120,830** | 114,570 | **59,970** | 61,199 | 261,001 |
| Changes in current assets and liabilities : | | | | | |
| Decrease (increase) in trade receivables | **42,703** | 54,536 | **(41,307)** | 57,580 | (428,780) |
| Decrease (increase) in receivables and debit balances | **(28,316)** | 133,629 | **(70,481)** | 91,254 | 338,800 |
| Decrease (increase) in inventory | **(71,028)** | (21,999) | **(35,206)** | 15,455 | 23,622 |
| Increase (decrease) in trade payables | **(59,481)** | (158,412) | **33,597** | (142,639) | 84,978 |
| Increase (decrease) in other current liabilities | **(78,631)** | (12,537)* | **8,865** | (59,160)* | 208,709 |
| Decrease in deferred revenues | **(8,505)** | (5,239) | **(4,285)** | (2,989) | (13,554) |
| | **1,144,527** | 1,448,255 | **561,665** | 630,855 | 3,289,954 |
| **B - Non-cash transactions** | | | | | |
| Acquisition of fixed assets, other assets, materials and spare parts on credit | **146,230** | 241,250 | **146,230** | 241,250 | 174,087 |
| Sale of fixed assets on credit | **6,087** | 16,666 | **6,087** | 16,666 | – |

* Reclassified

The notes to the financial statements are an integral part thereof.

## NOTE 1 - GENERAL

**A.** The interim statements were prepared according to generally accepted accounting principles, applicable to the preparation of financial statements for interim financial statements. These statements should be read in conjunction with the Company's annual financial statements and accompanying notes as at December 31, 2001 and for the year then ended.

**B.** In the notes to the interim financial statements, the Company presents only the significant changes in its business and legal environment that occurred from the date of the latest annual financial statements until the date of these interim financial statements. The full and detailed description, including significant changes and developments which occurred in recent years, particularly in the field of cellular telephone services, international communication services, domestic communication services, the opening of these markets to competition and decisions of the Ministerial Committee for Privatization to reduce the State's holdings in the Company, appear in Note 1 to the Company's annual financial statements as at December 31, 2001. The significant changes that occurred from the date of those annual financial statements to the date of these financial statements, are as follows:

1. Effective as of January 1, 2002, payment of the access fees to the Company by the international telecommunications operators was cancelled, pursuant to the licenses of the operators, which stated that payment of the access fees would be cancelled at the end of 2001.

   As a result of cancellation of payment of the aforementioned access fees, commencing January 1, 2002 the Company's revenues from international telecommunications exclude access fees. The access fees included in the Group's revenues from international communications were approximately NIS 62 million in the six month period ended June 30, 2001, approximately NIS 33 million in the three month period then ended, and approximately NIS 124 million in the year ended December 31, 2001 (in the Company's revenues – approximately NIS 92 million, NIS 17 million and NIS 185 million, respectively).

2. On March 18, 2002 the Company received a draft amendment to its general license. The draft incorporates requirements and restrictions on the Company (some of which are reflected in the Telecommunications Law and/or the Telecommunications Order and/or in other laws, and some are new requirements/restrictions), as well as a broadening of existing requirements and restrictions on various matters. The Company submitted a document to the Ministry of Communications containing significant comments on the draft amendment of the license. The Company expressed its opinion that in the current situation, where on the one hand the Company has not completed its many comments on the draft license, and on the other hand the two committees which were set up to formulate recommendations concerning the rules and policies for opening fixed-line communications in Israel to competition and to examine and revise the Company's tariffs, have started their work, there is no point in advancing the hearing proceeding on the basis of the amendment which was submitted to the Company on the matter of the license, which was scheduled for the Company, nor any point in completing the amendment, so long as the two committees had not completed their work. (Since then, as described below, the committee with the mandate to formulate rules and policies for opening domestic fixed-line communications to competition has completed its work and submitted its recommendations to the Minister of Communications.) The Ministry of Communications did not accept the Company's position on this matter and the hearing concerning the draft general license has commenced.

3. On May 14, 2002, the Company's tariffs were changed. As part of the change, tariffs for various services were revised, *inter alia*, the call tariffs, installation fees and other services. The change in the call tariffs included an adjustment of peak and off-peak times and uniformity of the tariff for local calls and domestic long-distance calls at all hours of the day.

4. On August 8, 2002, the committee for formulating rules and policies for opening domestic fixed-line communications to competition submitted its recommendations to the Minister of Communications. The recommendations set out the proposed policy, the principles for opening domestic fixed-line communications to competition and recommendations for the removal of barriers to the entry of new operators.

**Notes to the Interim Consolidated Financial Statements as at June 30, 2002 (Unaudited)**

**NOTE 1 - GENERAL (CONTD.)**

The Company submitted its comments to the Minister of Communications on the committee's recommendations, wherein it expressed, *inter alia*, its position that adoption of the committee's recommendations concerning the structural separation, the universal service, the splitting of transmission service, data communication and infrastructure, and an immediate permit for the selective provision of those services, as well as comments on the supervision of the Company's tariffs, would have a severely adverse effect on the Company, consumers and the economy. The Minister of Communications has not yet announced his position on the committee's recommendations.

**NOTE 2 - ACCOUNTING POLICY**

The significant accounting policies used in preparation of the financial statements are the same as those applied in the preparation of the latest annual financial statements.

**NOTE 3 - FINANCIAL STATEMENTS IN ADJUSTED VALUES**

The financial statements were prepared on the basis of historical cost adjusted for changes in the general purchasing power of the Israeli currency. The changes that occurred in the Consumer Price index ("CPI") and in the exchange rates of the US dollar and the euro are as follows:

| | Consumer price index | Exchange rate US dollar | Exchange rate of the euro |
|---|---|---|---|
| | % | % | % |
| In the six month period ending: | | | |
| June 30, 2002 | 6.299 | 7.994 | 21.149 |
| June 30, 2001 | 1.098 | 3.068 | (6.235) |
| In the three month period ended: | | | |
| June 30, 2002 | 3.846 | 2.164 | 16.078 |
| June 30, 2001 | 1.605 | (0.644) | (4.390) |
| In the year ended December 31, 2001 | 1.397 | 9.279 | 3.845 |

**NOTE 4 - INVESTMENTS IN INVESTEE COMPANIES**

**A. D.B.S. Satellite Services (1998) Ltd. ("DBS")**

1. Further to Note 8(F) to the financial statements as at December 31, 2001, at the beginning of May 2002 the Company was issued additional shares in DBS, increasing the Company's holding in DBS to 45%. As a result of the increase in the percentage of its holding in DBS, a surplus cost of approximately NIS 267 million was generated to the Company which will be amortized over a period of 10 years.

   The Company's investment in DBS at the balance sheet date amounts to approximately NIS 980 million. The Company's share in the accumulated losses of DBS is approximately NIS 576 million, of which approximately NIS 105 million was recorded in the six month period ending June 30, 2002, and approximately NIS 54 million was recorded in the three month period then ended.

2. DBS expects considerable losses and negative cash flows during its first years of operation. The loss arising in the year 2001 amounted to approximately NIS 893 million and the loss in the six-month period ending June 30, 2002, amounted to approximately NIS 309 million. The negative cash flows from operating activities during 2001 amounted to approximately NIS 634 million, and during the six-month period ending June 30, 2002 approximately NIS 42 million. As a result of these losses, the deficit in working capital as at June 30, 2002 amounted to approximately NIS 1,531 million (including short-term bank credit of approximately NIS 1,030 million).

## NOTE 4 - INVESTMENTS IN INVESTEE COMPANIES (CONTD.)

### A. D.B.S. Satellite Services (1998) Ltd. ("DBS") (contd.)

3. On May 23, 2001, a financing agreement was signed between DBS and the banks ("the Financing Agreement"), stipulating, *inter alia*, preconditions for withdrawing funds from credit lines, including undertakings by DBS to meet certain contingent conditions and to comply with cumulative milestones and financial stipulations made ("the Conditions"). As at the date of approval of these financial statements, some of the aforementioned Conditions had not been met.

4. In addition, an economic study carried out by the banks revealed that in order to finance the operations of DBS, additional financing would be required which considerably exceeds the financing requirements defined in the Financing Agreement.

5. The Company, having provided a perpetual guarantee, is a guarantor regarding payment of the debts of DBS in favor of the banks. The guarantee is up to a maximum equal to the percentage of the Company's holding in DBS multiplied by the value of DBS as derived from disposal of the mortgaged shares of the remaining shareholders. If the Company joins the remaining shareholders in their disposal of the mortgaged shares, the amount of the guarantee will not exceed the amount received by the Company from the sale of its shares in DBS. The letter of guarantee includes numerous limitations on the Company relating to the disposal of its shares in DBS, and lists events of default that, should they occur, will allow the banks to foreclose on the guarantee.

6. At the beginning of May 2002, DBS and the banks signed an addendum to the Financing Agreement. On the same date, DBS signed a debenture in favor of the banks, and some of the shareholders pledged their rights in the shareholders' loans that they have extended or will extend to the company with a first ranking fixed charge. Concurrently, the Company undertook that in the event of realization of the securities provided by the shareholders, it will not be entitled to sue for or to receive from DBS any payment in connection with the shareholders' loans.

   The agreements reached with the banks require that DBS act to find a solution, with the consent of its shareholders and to the satisfaction of the banks, for obtaining the additional financing required for its operations and to present a business plan showing that it will be able to meet its undertakings towards the banks. If no such solution is found by June 30, 2002, the banks will be entitled to take the necessary steps, at their absolute discretion, for collecting all the amounts payable to them and to act in accordance with their rights in the event of default under the Financing Agreement.

   The banks continued, until June 30, 2002, to inject additional funds in accordance with the Financing Agreement, along with additional investments of the shareholders by way of shareholders' loans. As at the date of approval of these financial statements, DBS, its shareholders and the banks had formulated an agreement in principle concerning an increase in the credit together with additional investments of the shareholders in an amount which is not less than a sum equal to 150% of the amount to be injected by the banks. The above agreement has not yet been signed, and is subject, *inter alia*, to the preparation of documents and individual agreements and the approval of the authorized bodies of the parties. The shareholders are agreed that the additional credit should be made available to DBS before signing a financing agreement with the banks.

7. The sources of financing for the operations of DBS are shareholders' loans and lines of credit from banks. Loans from the Company to DBS are subject, *inter alia*, to the approval of the Ministerial Committee for Privatization ("the Committee"). As at the date of publication of the financial statements, the Committee had given its approval for the Company to increase its exposure up to the total of the percentage of its holding in DBS multiplied by 480 million dollars. Company Management believes that the Company will be required to seek the approval of the Committee for increasing the aforesaid amount.

**Notes to the Interim Consolidated Financial Statements as at June 30, 2002 (Unaudited)**

**NOTE 4 - INVESTMENTS IN INVESTEE COMPANIES (CONTD.)**

**A. D.B.S. Satellite Services (1998) Ltd. ("DBS") (contd.)**

8. The continuation of the activities of DBS are contingent upon implementation of the agreement in principle which was formulated by the banks for an increase in the credit facility, as described above, and upon receipt of additional loans from the shareholders.

   Management of DBS believes that there is a good chance that discussions between DBS, the shareholders and the banks will lead to implementation of the agreement in principle formulated with the banks and the shareholders for arranging the financial resources required by DBS in the coming year.

**B. Walla! Communications Ltd. ("Walla")**

Bezeq International Ltd. ("Bezeq International") invested in Walla, an Israeli company whose shares are listed on the Tel Aviv Stock Exchange and which provides Internet services and operates Internet portals.

On March 14, 2002, Walla issued a prospectus for a rights issue. Bezeq International invested approximately NIS 11,166,000 in exercise of the rights and a further NIS 3,287,000 in the acquisition of additional rights from the public and the exercise thereof. Subsequent to the exercise of the aforementioned rights, the acquisition from the public and an additional acquisition of shares from Walla's shareholders during the second quarter, Bezeq International's holding in Walla increased from 24.83% to 36.74%.

Under the investment agreement between Bezeq International and Walla, Bezeq International undertook to invest an additional $3 million, through itself or through a strategic investor. During 2002, Bezeq International extended loans amounting to approximately NIS 9,320,000 to Walla, of which NIS 8,520,000 was subsequent to the balance sheet date. The loans are linked to the CPI and are interest-free. Repayment of the loans will be on a date shortly after the date on which Bezeq International invests in Walla's share capital. During the second quarter Bezeq International recorded a reduction in the value of its investment in Walla by NIS 7,337,000. The balance of its investment in Walla reflects the fair value of Walla to Bezeq International based on the valuation of Walla which was prepared as part of the merger with IOL.

**C. Pelephone Communications Ltd. ("Pelephone")**

During the reporting period, the Company and Shamrock Holdings of California, Inc. each invested approximately NIS 147 million in Pelephone, representing an additional investment recorded as share premium, related to shares of Pelephone issued in the past.

**NOTE 5 - FIXED ASSETS**

In October 2001, pursuant to the Company's policy of periodically reviewing the useful lives of its assets, a committee was appointed to examine whether there was a need to revise the useful lives of the assets and make recommendations to Management. The review included only fixed assets of the Company and was based on the balance of its fixed assets as at December 31, 2001. On May 28, 2002, the Board of Directors of the Company resolved to adopt Management's recommendations that were based on the report of the committee.

According to the recommendations of the committee, which were based, *inter alia*, on technological changes, changes in the investment plan of the Company (including providing broadband Internet service in ADSL technology on the existing copper infrastructure), and based on customary practices among the world's communications companies, the remainder of the useful lives of certain investments in the Company's copper cable network was extended, effective from January 1, 2002, while conversely, the useful life of certain switching systems was shortened.

**NOTE 5 - FIXED ASSETS (CONTD.)**

The aforementioned changes reduced the depreciation charge of the Company during the six month period ending June 30, 2002, by approximately NIS 129 million and in the three month period then ended by approximately NIS 65 million and increased the Company's net earnings in the same periods by approximately NIS 82 million and NIS 41 million, respectively. In addition, earnings per share in the six month period ending June 30, 2002, increased by approximately NIS 0.034 per NIS 1 par value and in the three month period then ended earnings per share increased by approximately NIS 0.017 per NIS 1 par value.

Had the new depreciation rates been applied in 2001, the depreciation charges in that year would have been reduced by approximately NIS 228 (and for the six month period ended June 30, 2001, reduced by approximately NIS 114 million and for the three month period then ended reduced by approximately NIS 57 million), and the balance of the fixed assets would have increased by the same aforementioned amounts.

In addition, net earnings in 2001 would have increased by approximately NIS 146 million (during the six month period ended June 30, 2001 approximately NIS 73 million and during the three month period then ended approximately NIS 36 million). Earnings per share would have increased by NIS 0.06 (in the six month period ended June 30, 2001 by approximately NIS 0.03 and in the three month period then ended by approximately NIS 0.015) per NIS 1 par value.

**NOTE 6 - LIABILITY FOR EMPLOYEE SEVERANCE BENEFITS**

**1. Early retirement plan**

In September 2000, the Company reached an agreement with workers' representatives for extension of the 1997 collective agreement for early retirement. Under the agreement 1,770 additional employees would take early retirement from April 1, 2001 through December 31, 2006 (with an option to extend the final retirement date for certain employees through December 31, 2008).

The agreement also stated that the Company would be able to terminate the employment of employees in a compensation track, in excess of the aforementioned quota. In the opinion of the Company's Management, the possibility of additional employees retiring under the aforementioned track is low and accordingly, no provision was made in the financial statements.

Through June 30, 2002 approximately 260 employees took early retirement.

**2.** The pension fund through which the early retirement plan is implemented ("the Fund") was directed by the Capital Markets Division of the Ministry of Finance to fulfill an undertaking it made in connection with changing the retirement tracks of approximately 600 Company retirees, provided that the Company paid the Fund NIS 50 million. After the Fund undertook that no extra cost would be imposed on the Company, the Company notified the Fund that it should continue to implement the agreement which enabled transfer from one retirement track to another at no additional cost to the Company. As a result of the aforementioned, the Fund no longer allowed Company retirees to transfer retirement tracks and even stopped implementation of the agreement, in whole or in part, in relation to retirement benefits paid in respect of April 2002. In the opinion of the Company's Management, based on consultations with its legal advisers, it is unlikely that the Company will be charged any costs in connection with implementation of the agreement, and therefore it will insist on its implementation with no further payment to the Fund. Accordingly, no provision was made in the financials statements in respect of the above.

## NOTE 7 - CONTINGENT LIABILITIES

### A. CLAIMS

The Company and the investee companies have contingent liabilities in respect of which the maximum possible exposure is considerable. A detailed description of these contingent liabilities appears in Note 20A to the Company's financial statements for the year ended December 31, 2001. No significant changes occurred in contingent liabilities up to the date of the signing of these financial statements, except for the following:

1. Further to Note 20A(7) to the financial statements as at December 31, 2001 in the matter of a claim of a group of employees who were employed as temporary employees at the Ministry of Communications and were transferred to the Company when it commenced operations, the plaintiffs have withdrawn their consent to narrow the claim. The Labor Court may now rule whether it will approve the withdrawal of consent.

2. Further to Note 20A(11) to the financial statements as at December 31, 2001 in the matter of a class action in which the plaintiffs allege that the Company unlawfully collected money from its customers for certain services which it provides, on March 24, 2002 an application was filed to appeal the decision of the District Court to dismiss the application for approval of the claim as a class action. The decision concerning the application has not yet been given.

3. Further to Note 20A(18) to the financial statements as at December 31, 2001 in the matter of a claim and an application to approve the claim as a class action which were submitted to an affiliate, in which it is alleged that the affiliate is misleading consumers in its advertisements in connection with an offer to the consumer for the purchase of certain channels only, as well as with regard to the number of channels offered, on March 18, 2002 the parties signed a compromise agreement under which an application will be filed in court to strike the claim and the application for approval of the claim as a class action. In exchange, the affiliate will compensate the plaintiff in an amount that is not material.

4. Further to Note 20A(22) to the financial statements as at December 31, 2001 in the matter of providing a blocking service for all land-line subscribers of the Company against outgoing calls to cellular phone area codes as an automatic default, on April 26, 2002 a completion notice was filed by the State based on a report prepared by a team of experts who investigated the subject. The main points of the notice are that the consumer can attain his aim of "expense control" by other means and without need for blocking. In addition, the Company is liable to turn the blocking into a means for harming other operators and the competition, and therefore, for overall balance, the Minister of Communications decided not to permit the blocking. A response was filed by the petitioners. The Company has not yet filed its response.

5. Further to Note 20A(25) to the financial statements as at December 31, 2001 in the matter of a class action against Pelephone Communications Ltd. ("Pelephone") concerning the plaintiff's allegation that Pelephone collected surplus amounts from its subscribers for reciprocal connection fees, in contravention of the applicable regulations and/or its license, the parties reached a compromise arrangement which took effect on May 2, 2002, in which the District Court partially approved the claim as a class action while validating the compromise agreement as a judgement. The amount of the settlement deriving from the agreement is approximately NIS 6.6 million. The financial statements include a provision that the management of Pelephone believes to be appropriate.

6. Further to Note 20A(26) to the financial statements as at December 31, 2001 in the matter of a claim filed in the Ramallah District Court by the General Public Palestinian Communications Co. Ltd. against Pelephone and another company, as at the date of signing these financial statements, the processing of service of this claim was terminated by the Attorney General and it is no longer counted among the claims pending against Pelephone.

## NOTE 7 - CONTINGENT LIABILITIES (CONTD.)

### A. Claims (contd.)

7. On May 21, 2002 a statement of claim together with an application for its recognition as a class action were received at the Company's offices. The claim and application were filed in the Tel Aviv District Court against all the cellular companies in Israel, among them Pelephone (a proportionally consolidated company) and against the Company as a formal defendant.

   The plaintiffs, who contend that they are subscribers of the Company and one of the defendant cellular companies, allege in their claim that the defendant cellular companies collected and collect, unlawfully, payments for what are ostensibly cellular calls but which in fact are fixed-line calls in every respect. The reference is to calls initiated by Company subscribers to commercial entities that provide entertainment and information services and which made an agreement with the cellular companies. Even though these calls do not "consume airtime", the cellular companies collected payment for them in contravention of their licenses and of the law.

   The amount of the class action against the cellular companies is estimated at approximately NIS 600 million. It is noted that the Company recently approached the Ministry of Communications on this matter, requesting its intervention. The Company is studying the claim and based on consultations with its legal advisers, is unable at this stage, to estimate its chances and implications. Accordingly, no provision has been made in the financial statements in respect of this claim.

8. Further to Note 20A(31) to the financial statements as at December 31, 2001 in the matter of a report from the Ministry of Communications received at Bezeq International Ltd., a consolidated company, which calls into doubt the reliability of one of the main files which was transferred to the Ministry of Communications during the customer allocation process, at a meeting on June 26, 2002 the Company withdrew its petition upon the recommendation of the court.

   Subsequently, the Ministry of Communications submitted a revised version of the details of the supplementary questionnaire. The customer allocation process with the supplementary questionnaire commenced on July 1, 2002 and is scheduled for completion at the end of December 2002. The management of the consolidated company and its legal advisers are unable, at this stage, to estimate the results of this process.

9. On July 28, 2002, a claim together with an application for its recognition as a class action, which were filed in the Tel Aviv District Court against the Company was received at the Company offices. The plaintiffs, who contend that they are Company subscribers or use its services, allege in their claim that the Company unlawfully collects interest in arrears, as defined in a directive from the Accountant General concerning interest rates, in respect of arrears in payment for services provided by other communications service providers which are included in the invoice issued by the Company to its subscribers. According to the plaintiffs, the Company may collect such interest only in respect of arrears in payment for the telecommunication services provided by the Company itself. The plaintiffs further allege that the Company refrains from transferring the full amount of interest in arrears that it collects to the other communications providers. The plaintiffs are requesting restitution of the interest in arrears that the Company is alleged to have collected unlawfully. If approved as a class action, the total amount of the claim is estimated by the plaintiffs to be in the tens of millions of shekels. The Company, based on consultations with its legal advisers, is unable, at this stage, to estimate the outcome of the action, and no provision is included in the financial statements in respect thereof.

10. On June 23, 2002 the Company received at its offices a statement of claim that was filed in the Jerusalem District Court against the Company by the Development Authority, the Jewish National Fund and the State of Israel (Israel Lands Administration, the Ministry of Communications and the Ministry of Finance) (jointly referred to in this section as "the State").

## NOTE 7 - CONTINGENT LIABILITIES (CONTD.)

### A. Claims (contd.)

The claim sues for declaratory relief according to the interpretation of the "Asset Transfer Agreement" which was signed between the State and the Company in connection with the transfer of real estate ("the Real Estate") to the Company prior to the commencement of its operations in 1984, and the "Umbrella Contract" which was signed in 1993 in connection with some of those assets, requires, *inter alia*, the following conclusions:

a. The State is the sole and exclusive owner of the Real Estate and the Company has no rights in the ownership of the Real Estate and is not entitled to act as if it were the owner.

b. At most, the Company has a right to use the Real Estate, such right being limited by conditions and objectives that are defined in the aforementioned agreements and failing compliance with those conditions and objectives the Real Estate should be restored to the State immediately and unconditionally.

c. The State has the right to immediately deny the Company the use of the Real Estate leased to it in the bi-annual contracts referred to in the Asset Transfer Agreement, even where the Company is using the Real Estate for the purpose for which it was transferred as long as the State believes that there is another preferable use for the Real Estate and as long as alternative real estate is made available to the Company for continuation of the provision of services by the defendant as defined in the agreements and insofar as the defendant can prove that such real estate is needed.

d. The Company is required to immediately return to the State certain assets in the Rishpon region (480 dunams), in the Sakia region (1,300 dunams) and parts of parcels in the Givat Mordechai neighborhood and in Ramat Beit Hakerem in Jerusalem.

It is noted that this claim was filed following a broad dispute which arose in recent years between the Company and the State, concerning real estate which was transferred from the State to the Company prior to the start of operations in 1984, and is known as "the Real Estate Dispute". See Note 9B to the financials statements as at December 31, 2001.

The Company's position in this dispute is described in Note 9B to the financial statements as at December 31, 2001, and in the opinion of its legal advisers, the Company has worthy arguments to substantiate its position. Nevertheless, the Company is studying the claim and is unable to rely, at this stage, on the assessment of its legal advisers regarding the outcome and its overall implications.

**Notes to the Interim Consolidated Financial Statements as at June 30, 2002 (Unaudited)**

## NOTE 7 - CONTINGENT LIABILITIES (CONTD.)

### B. Forward Exchange Contracts

#### 1. Hedging Contracts (Forward)

| | Currency purchased | Currency payable | Final repayment date | Amounts receivable | Amounts payable |
|---|---|---|---|---|---|
| | | | | NIS millions | |
| **Contracts at predetermined interest rates** | | | | | |
| | Dollars | CPI-linked NIS | April 2004 | 618 | 633 |
| | Euro | CPI-linked NIS | February 2005 | 959 | 830 |
| **Contracts at predetermined exchange rate** (excluding premium/discount) | | | | | |
| | Dollars | NIS | December 2002 | 250 | 257 |
| | Euro | NIS | February 2003 | 499 | 421 |
| | CPI-linked NIS | NIS | June 2003 | 538 | 520 |

#### 2. Contracts not for hedging purposes

| | Currency purchased | Currency payable | Final repayment date | Amounts receivable | Amounts payable |
|---|---|---|---|---|---|
| | | | | NIS millions | |
| **Forward exchange contracts -** | Dollars | NIS | June 2003 | 2 | 67 |
| **Put options** | NIS | Dollar | December 2002 | 1 | 715 |
| **Call options** | NIS | Dollar | December 2002 | (21) | 715 |

**Notes to the Interim Consolidated Financial Statements as at June 30, 2002 (Unaudited)**

## NOTE 8 - REVENUES FROM TELECOMMUNICATION SERVICES

| | For the six month period ending June 30 | | For the three month period ending June 30 | | For the year ending December 31 |
|---|---|---|---|---|---|
| | **2002 (Unaudited)** | **2001 (Unaudited)** | **2002 (Unaudited)** | **2001 (Unaudited)** | **2001 (Audited)** |
| | NIS thousands | | NIS thousands | | NIS thousands |
| **Revenues from communication services -** | | | | | |
| Domestic fixed-line communications | **1,152,325** | 1,281,499 | **565,720** | 620,723 | 2,551,428 |
| Cellular telephone | **1,074,357** | 1,097,955 | **532,410** | 563,769 | 2,202,342 |
| Fixed fees | **1,054,507** | 1,104,446 | **525,816** | 548,035 | 2,204,602 |
| International communications and internet services (1) | **337,315** | 410,124 | **166,907** | 202,646 | 833,833 |
| Installation and sale of equipment to subscribers | **269,176** | 233,745 | **144,264** | 112,907 | 452,344 |
| Other | **64,786** | 68,950 | **31,756** | 29,878 | 126,669 |
| | **3,952,466** | 4,196,719 | **1,966,873** | 2,077,958 | 8,371,218 |
| Other revenues | **161,180** | 154,207 | **85,129** | 73,791 | 294,132 |
| | **4,113,646** | 4,350,926 | **2,052,002** | 2,151,749 | 8,665,350 |

(1) See Note 1B(1).

**Notes to the Interim Consolidated Financial Statements as at June 30, 2002 (Unaudited)**

## NOTE 9 - OPERATING AND GENERAL EXPENSES

| | For the six month period ending June 30 | | For the three month period ending June 30 | | For the year ending December 31 |
|---|---|---|---|---|---|
| | 2002 (Unaudited) | 2001 (Unaudited) | 2002 (Unaudited) | 2001 (Unaudited) | 2001 (Audited) |
| | NIS thousands | | NIS thousands | | NIS thousands |
| Salaries and related expenses | **1,014,074** | 1,017,800 | **500,893** | 514,696 | 2,038,654 |
| General expenses | **361,813** | 359,186 | **175,319** | 173,906 | 779,286 |
| Materials and spare parts | **289,829** | 259,832 | **157,639** | 138,947 | 540,497 |
| Cellular telephone expenses | **229,109** | 244,754 | **115,848** | 166,883 | 464,204 |
| Building maintenance | **186,531** | 208,573 | **92,180** | 100,844 | 405,685 |
| Services and maintenance by sub-contractors | **146,467** | 173,296 | **72,908** | 90,701 | 343,775 |
| International communications expenses | **64,179** | 115,800 | **30,040** | 53,225 | 212,481 |
| Vehicle maintenance expenses | **48,587** | 42,382 | **23,527** | 21,379 | 88,545 |
| Collection fees | **17,133** | 20,234 | **8,715** | 10,257 | 38,951 |
| | **2,357,722** | 2,441,857 | **1,177,069** | 1,270,838 | 4,912,078 |
| Less – salaries charged to investment in fixed assets | **79,433** | 74,151 | **39,344** | 35,660 | 163,112 |
| | **2,278,289** | 2,367,706 | **1,137,725** | 1,235,178 | 4,748,966 |

## NOTE 10 - TRANSACTIONS WITH INTERESTED AND RELATED PARTIES

Further to Note 28B to the financial statements as at December 31, 2001, the Company has reached an agreement with the Ministry of Defense in the name of the State of Israel for the provision of telecommunication services by the Company to the IDF.

The main points of the agreement are as follows:

1. The Company will provide the IDF with telecommunications services at a special inclusive discount of approximately 28% in relation to services that the Company provided to the IDF prior to signing the agreement and of 14% relating to services which did not exist or which the Company did not provide to the IDF prior to signing the agreement. Based on the volume of services that the Company provided to the IDF prior to the effective date of the agreement, the discount in respect of the services under the agreement does not differ significantly from the discount that was given pursuant to the memorandum of understanding under which the parties acted prior to signing the agreement.

2. The Ministry of Defense undertakes to purchase from the Company, services for which the consideration will be not less than approximately NIS 81.2 million (excluding VAT) for each year of the contract, and to order from the Company cabling and development works of communications infrastructures within IDF bases which are used for providing the Company's services, for which the consideration will be not less than 80% of the overall monetary value of the orders of the Ministry of Defense for such infrastructures in each year of the contract.

3. The agreement ends and exhausts all the disputes between the parties up to April 1, 2001, including the disputes which were brought before a special professional commission ("the Gabai Commission"), but excluding a dispute concerning a discount of 18% which the Ministry of Defense deducted from payments collected by the Company for other communications providers.

4. At the end of the term of the agreement, ownership of the infrastructures within the IDF base shall remain that of the Ministry of Defense while ownership of infrastructures outside IDF bases shall remain that of the Company.

5. The term of the contract commences on the date of signing the agreement, July 21, 2002, through March 31, 2005 (under the terms of the agreement, retroactive accounting will be effective as of April 1, 2001 and as a result of the aforementioned the Company expects to receive a rebate in a non-material amount).

## NOTE 11 - CONDENSED INTERIM FINANCIAL STATEMENTS OF THE COMPANY

### A. STATEMENTS OF OPERATIONS

| | For the six month period ending June 30 | | For the three month period ending June 30 | | For the year ending December 31 |
|---|---|---|---|---|---|
| | **2002 (Unaudited)** | **2001 (Unaudited)** | **2002 (Unaudited)** | **2001 (Unaudited)** | **2001 (Audited)** |
| | NIS thousands | | NIS thousands | | NIS thousands |
| **Revenues from telecommunication services (Note 11B)** | **2,835,980** | 3,177,737 | **1,401,220** | 1,570,121 | 6,265,969 |
| **Costs and expenses** | | | | | |
| Operating and general expenses (Note 11C) | **1,234,400** | 1,363,069 | **606,384** | 722,880 | 2,675,915 |
| Depreciation (See also Note 5) | **961,374** | 1,141,854 | **481,455** | 562,867 | 2,286,535 |
| Royalties to the Government of Israel | **94,450** | 102,176 | **46,473** | 46,498 | 201,240 |
| | **2,290,224** | 2,607,099 | **1,134,312** | 1,332,245 | 5,163,690 |
| Operating income | **545,756** | 570,638 | **266,908** | 237,876 | 1,102,279 |
| **Financing income (expenses), net** | **(75,649)** | (18,546) | **(30,217)** | 12,775 | (77,337) |
| Earnings after financing expenses | **470,107** | 552,092 | **236,691** | 250,651 | 1,024,942 |
| **Other income (expenses), net** | **5,246** | 20,482 | **3,776** | 716 | (2,660) |
| Earnings before income tax | **475,353** | 572,574 | **240,467** | 251,367 | 1,022,282 |
| **Income tax** | **(168,271)** | (199,978) | **(90,050)** | (78,117) | (368,600) |
| Earnings after income tax | **307,082** | 372,596 | **150,417** | 173,250 | 653,682 |
| **Company's equity in losses of investee companies** | **(108,635)** | (206,094) | **(64,442)** | (83,578) | (524,930) |
| Net earnings | **198,447** | 166,502 | **85,975** | 89,672 | 128,752 |

## Notes to the Interim Consolidated Financial Statements as at June 30, 2002 (Unaudited)

## NOTE 11 - CONDENSED INTERIM FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

### B. REVENUES FROM TELECOMMUNICATIONS SERVICES

| | For the six month period ending June 30 | | For the three month period ending June 30 | | For the year ending December 31 |
|---|---|---|---|---|---|
| | 2002 (Unaudited) | 2001 (Unaudited) | 2002 (Unaudited) | 2001 (Unaudited) | 2001 (Audited) |
| | NIS thousands | | NIS thousands | | NIS thousands |
| **Revenues from communications services** | | | | | |
| Domestic fixed-line communications | **1,164,991** | 1,293,238 | **573,206** | 626,660 | 2,580,520 |
| Cellular telephone | **315,012** | 369,986 | **151,116** | 197,521 | 710,308 |
| Fixed fees | **1,003,767** | 1,050,304 | **499,115** | 521,763 | 2,086,166 |
| International communications (1) | **73,615** | 173,728 | **33,646** | 87,557 | 348,208 |
| Installation and sale of equipment to subscribers | **80,856** | 75,937 | **41,200** | 35,599 | 148,591 |
| Other | **68,259** | 68,888 | **33,170** | 29,670 | 133,969 |
| | **2,706,500** | 3,032,081 | **1,331,453** | 1,498,770 | 6,007,762 |
| Other revenues | **129,480** | 145,656 | **69,767** | 71,351 | 258,207 |
| | **2,835,980** | 3,177,737 | **1,401,220** | 1,570,121 | 6,265,969 |

### C. OPERATING AND GENERAL EXPENSES

| | For the six month period ending June 30 | | For the three month period ending June 30 | | For the year ending December 31 |
|---|---|---|---|---|---|
| | 2002 (Unaudited) | 2001 (Unaudited) | 2002 (Unaudited) | 2001 (Unaudited) | 2001 (Audited) |
| | NIS thousands | | NIS thousands | | NIS thousands |
| Salaries and related expenses | **786,704** | 802,227 | **386,736** | 402,623 | 1,613,365 |
| General expenses | **147,617** | 131,935 | **71,276** | 69,720 | 302,382 |
| Materials and spare parts | **23,726** | 38,378* | **10,990** | 17,452 | 66,974 |
| Cellular telephone expenses | **17,602** | 74,946 | **8,265** | 74,946 | 91,873 |
| Building maintenance | **161,412** | 183,747 | **79,822** | 89,505 | 355,103 |
| Services and maintenance by sub-contractors | **114,993** | 145,597* | **57,672** | 74,651 | 286,755 |
| International communications expenses | **3,196** | 5,348 | **1,781** | 2,577 | 10,304 |
| Vehicle maintenance expenses | **41,511** | 34,990 | **20,496** | 16,958 | 73,673 |
| Collection fees | **17,072** | 20,052 | **8,690** | 10,108 | 38,598 |
| | **1,313,833** | 1,437,220 | **645,728** | 758,540 | 2,839,027 |
| Less - salaries charged to investments in fixed assets | **79,433** | 74,151 | **39,344** | 35,660 | 163,112 |
| | **1,234,400** | 1,363,069 | **606,384** | 722,880 | 2,675,915 |

* Reclassified
(1) See Note 1B(1)

**Notes to the Interim Consolidated Financial Statements as at June 30, 2002 (Unaudited)**

**NOTE 12 - CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD.**

**1. BEZEQ INTERNATIONAL LTD.**

**A. Balance sheet**

| | June 30 2002 | June 30 2001 | December 31 2001 |
|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS thousands | NIS thousands | NIS thousands |
| Current assets | **178,830** | 217,618 | 174,053 |
| Investments | **13,382** | 15,551 | 9,096 |
| Fixed assets | **428,414** | 401,360 | 431,280 |
| Other assets | **12,281** | 21,562 | 16,519 |
| | **632,907** | 656,091 | 630,948 |
| Current liabilities | **307,041** | 350,994 | 344,481 |
| Long-term liabilities | **201,046** | 204,605 | 205,530 |
| Quasi-capital receipt | **-** | 170,839 | 170,839 |
| Shareholders' equity (deficit) | **124,820** | (70,347) | (89,902) |
| | **632,907** | 656,091 | 630,948 |

**Notes to the Interim Consolidated Financial Statements as at June 30, 2002 (Unaudited)**

**NOTE 12 - CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD. (CONTD.)**

**1. BEZEQ INTERNATIONAL LTD. (CONTD.)**

**B. Statement of Operations**

| | For the six month period ending June 30 | | For the three month period ending June 30 | | For the year ending December 31 |
|---|---|---|---|---|---|
| | 2002 (Unaudited) | 2001 (Unaudited) | 2002 (Unaudited) | 2001 (Unaudited) | 2001 (Audited) |
| | NIS thousands | | NIS thousands | | NIS thousands |
| **Revenues from international telecommunications services** | **344,242** | 346,963 | **174,791** | 172,446 | 710,979 |
| **Operating expenses** | **189,844** | 270,881* | **93,762** | 133,225* | 525,436 |
| Gross profit | **154,398** | 76,082 | **81,029** | 39,221 | 185,543 |
| **Marketing expenses** | **69,401** | 62,099 | **33,763** | 28,547 | 129,529 |
| **General and administrative expenses** | **39,237** | 52,079* | **22,706** | 26,876* | 98,674 |
| | **108,638** | 114,178 | **56,469** | 55,423 | 228,203 |
| Operating income (loss) | **45,760** | (38,096) | **24,560** | (16,202) | (42,660) |
| **Financing income (expenses), net** | **10,194** | (6,577) | **4,144** | (3,277) | (11,533) |
| Earnings (loss) after financing, net | **55,954** | (44,673) | **28,704** | (19,479) | (54,193) |
| **Other income (expenses), net** | **8** | 4,607 | **(197)** | 6,232 | 4,235 |
| Earnings (loss) before income tax | **55,962** | (40,066) | **28,507** | (13,247) | (49,958) |
| **Income tax** | **(638)** | – | **(353)** | – | (3,208) |
| Earnings (loss) after income tax | **55,324** | (40,066) | **28,154** | (13,247) | (53,166) |
| **Company's equity in losses of an affiliated company** | **(11,441)** | (21,895) | **(9,645)** | (17,753) | (28,350) |
| Net earnings (loss) | **43,883** | (61,961) | **18,509** | (31,000) | (81,516) |

* Reclassified

**Notes to the Interim Consolidated Financial Statements as at June 30, 2002 (Unaudited)**

## NOTE 12 - CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD. (CONTD.)

### 2. PELEPHONE COMMUNICATIONS LTD.

### A. Balance sheet

| | June 30 2002 | June 30 2001 | December 31 2001 |
|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS thousands | NIS thousands | NIS thousands |
| Current assets | **1,313,139** | 1,136,641* | 1,099,539* |
| Long-term trade receivables | **157,142** | 96,845 | 99,879 |
| Investment in affiliate | **-** | 70 | - |
| Deferred income tax | **287,426** | 46,057* | 259,924* |
| Fixed assets, net | **2,587,226** | 2,983,912 | 2,681,870 |
| Other assets | **573,591** | 734,208 | 632,134 |
| | **4,918,524** | 4,997,733 | 4,773,346 |
| Current liabilities | **1,704,027** | 2,046,389 | 1,958,361 |
| Provision for losses of investee company | **3,764** | - | 3,960 |
| Minority rights | **13,311** | 14,624 | 12,758 |
| Long-term liabilities | **1,228,819** | 1,083,458* | 1,060,532 |
| Shareholders' equity | **1,968,603** | 1,853,262 | 1,737,735 |
| | **4,918,524** | 4,997,733 | 4,773,346 |

* Reclassified

**Notes to the Interim Consolidated Financial Statements as at June 30, 2002 (Unaudited)**

**NOTE 12 - CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD. (CONTD.)**

**2. PELEPHONE COMMUNICATIONS LTD. (CONTD.)**

**B. Statement of Operations**

| | For the six month period ending June 30 | | For the three month period ending June 30 | | For the year ending December 31 |
|---|---|---|---|---|---|
| | 2002 (Unaudited) | 2001 (Unaudited) | 2002 (Unaudited) | 2001 (Unaudited) | 2001 (Audited) |
| | NIS thousands | | NIS thousands | | NIS thousands |
| **Revenues from cellular services, sales and services** | **1,965,367** | 1,885,702 | **1,002,890** | 943,822 | 3,794,156 |
| **Cost of cellular services, sales and services** | **1,685,173** | 1,644,066 | **859,236** | 839,026 | 3,377,456 |
| Gross profit | **280,194** | 241,636 | **143,654** | 104,796 | 416,700 |
| **Sales and marketing expenses** | **257,238** | 257,356 | **126,047** | 123,502 | 539,883 |
| **General and administrative expenses** | **110,124** | 119,528 | **54,370** | 64,255 | 235,462 |
| | **367,362** | 376,884 | **180,417** | 187,757 | 775,345 |
| Operating loss | **(87,168)** | (135,248) | **(36,763)** | (82,961) | (358,645) |
| **Financing income (expenses), net** | **(7,448)** | (58,870) | **1,080** | (16,117) | (130,952) |
| **Other income (expenses), net** | **808** | 1,707 | **643** | 1,123 | (216,542) |
| Loss before income tax | **(93,808)** | (192,411) | **(35,040)** | (97,955) | (706,139) |
| **Tax benefit** | **27,505** | 28,538 | **8,505** | 1,522 | 242,402 |
| Loss after income tax | **(66,303)** | (163,873) | **(26,535)** | (96,433) | (463,737) |
| **Minority equity in losses of a consolidated company** | **3,099** | 7,242 | **166** | 3,089 | 13,224 |
| **Company's equity in earnings (losses) of an affiliate** | **19** | (3,614) | **124** | (1,439) | (8,140) |
| Net loss | **(63,185)** | (160,245) | **(26,245)** | (94,783) | (458,653) |