"BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

AS AT SEPTEMBER 30, 1999

(UNAUDITED)

Interim Consolidated Financial Statements as at September 30, 1999 (Unaudited)

Contents

Interim Consolidated Balance Sheets

In terms of shekels of September 1999

	September 30 1999 (Unaudited)	September 30 1998 (Unaudited)	December 31 1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current Assets			
Cash and cash equivalents	884,128	722,194	927,917
Short-term investments	450,516	393,087	384,016
Trade receivables	1,514,973	1,676,232*	1,545,394
Other receivables and debit balances	483,087	525,400	437,180
Inventory	113,053	48,611*	56,768*
	3,445,757	3,365,524	3,351,275
Materials and spare parts	225,215	246,092*	233,747*
Investments and long-term receivables			
Bank deposits and other investments	286,936	*286,467	315,073
Investments in investee companies	53,854	32,699	36,375
	340,790	319,166	351,448
Fixed assets			
Cost	29,551,571	29,327,662	28,531,002
Less - accumulated depreciation	16,609,142	15,394,789	14,681,490
	12,942,429	13,932,873	13,849,512
Other assets			
Deferred charges and other assets	175,146	25,843	22,675
Deferred taxes	362,823	338,102	308,826
	537,969	363,945	331,501
	17,492,160	18,227,600	18,117,483

* Reclassified

	September 30 1999 (Unaudited) NIS thousands	September 30 1998 (Unaudited) NIS thousands	December 31 1998 (Audited) NIS thousands
Current liabilities			
Short-term bank credit	206,554	-	-
Current maturities of:			
Debenture issued to the Government of Israel	699,804	924,519	936,903
Long-term bank loans	1,136,887	977,382	1,085,437
Other debentures	223,402	199,902	205,550
Trade payables	1,014,042	991,059	992,795
Dividend payable	301,565	-	-
Employee severance benefits	459,654	718,328	634,718
Other current liabilities	1,032,294	1,141,531	1,061,023
	5,074,202	4,952,721	4,916,426
Long-term liabilities			
Debenture issued to the Government of Israel	-	693,390	468,451
Long-term loans	3,381,348	3,591,319	3,602,923
Other debentures	1,258,254	1,137,836	1,208,126
Convertible debentures	254,232	413,685	417,504
Employee severance benefits	206,216	182,633	92,682
Deferred revenues	80,664	84,560	84,723
	5,180,714	6,103,423	5,874,409
Contingent liabilities (Note 7)			
Shareholders' equity	7,237,244	7,171,456	7,326,648
	17,492,160	18,227,600	18,117,483

Israel Tapoohi	Ilan Biran	Iris Stark	Oren Lieder
Chairman of the Board	CEO	Member of the Board	Chief Financial Officer

Date of approval of the financial statements: November 23, 1999.

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

Interim Consolidated Statement of Operations

In terms of shekels of September 1999

	For the nine months ended September 30		For the three months ended September 30		For the year ended December 31
	1999 (Unaudited)	1998 (Unaudited)	1999 (Unaudited)	1998 (Unaudited)	1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues from telecommunications services (Note 9)	6,720,309	7,060,428*	2,248,220	2,431,786*	9,395,585
Costs and expenses					
Operating and general expenses (Note 10)	3,706,165	3,724,985*	1,283,089	1,242,642*	4,886,482
Depreciation	2,025,953	1,882,313	677,829	633,373	2,497,384
Royalties to the Government of Israel	233,728	270,488	79,488	93,963	353,010
	5,965,846	5,877,786	2,040,406	1,969,978	7,736,876
Operating income	754,463	1,182,642	207,814	461,808	1,658,709
Financing expenses					
On debenture issued to the Government of Israel	46,845	65,272	10,428	12,725	101,218
Banks and others, net	218,763	208,053	66,478	39,874	352,458
	265,608	273,325	76,906	52,599	453,676
Earnings after financing expenses	488,855	909,317	130,908	409,209	1,205,033
Other income (expenses), net (Note 6)	(386,753)	83,722	(110,000)	-	37,897
Earnings before income tax	102,102	993,039	20,908	409,209	1,242,930
Income tax	(43,906)	(388,498)	(7,413)	(169,577)	(488,927)
	58,196	604,541	13,495	239,632	754,003
Equity in earnings (losses) of associated companies	(6,270)	2,759	(3,947)	756	6,438
Net earnings	51,926	607,300	9,548	240,388	760,441
Earnings per share per NIS 1 par value of ordinary shares (in NIS)	0.07	0.78	0.01	0.31	1.01

* Reclassified

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

Interim Statement of Changes in Shareholders' Equity

In terms of shekels of September 1999

	Share capital	Receipt from issue of option warrants	Capital reserve share premium	Capital reserve for transactions between the Company and a controlling shareholder	Retained earnings	Total
	NIS thousands					
Nine months ended September 30, 1999						
Balance as at December 31, 1998 (audited)	4,095,677	-	477,296	35,482	2,718,193	7,326,648
Net earnings (unaudited)	-	-	-	-	51,926	51,926
Proposed dividend	-	-	-	-	(301,565)	(301,565)
Conversion of convertible debentures (unaudited) (1)	15,171	-	145,064	-	-	160,235
Balance as at September 30, 1999 (unaudited)	4,110,848	-	622,360	35,482	2,468,554	7,237,244
Three months ended September 30, 1999						
Balance as at July 1, 1999 (unaudited)	4,109,623	-	610,440	35,482	2,760,571	7,516,116
Net earnings (unaudited)	-	-	-	-	9,548	9,548
Proposed dividend	-	-	-	-	(301,565)	(301,565)
Exercise of convertible debentures (unaudited) (2)	1,225	-	11,920	-	-	13,145
Balance as at September 30, 1999 (unaudited)	4,110,848	-	622,360	35,482	2,468,554	7,237,244
Nine months ended September 30, 1998						
Balance as at December 31, 1997 (audited)	4,059,430	-	199,801	5,528	1,957,752	6,222,511
Net earnings (unaudited)	-	-	-	-	607,300	607,300
Public issue (unaudited)	-	80,209	-	-	-	80,209
Issue to employees (unaudited)	4,615	-	35,638	-	-	40,253
Offer to employees (unaudited)	-	-	-	3,465	-	3,465
Compensation to the Company's employees from the State (unaudited)	-	-	-	26,489	-	26,489
Exercise of options (unaudited)	31,395	(80,209)	239,605	-	-	190,791
Conversion of convertible debentures (unaudited)	44	-	394	-	-	438
Balance as at September 30, 1998 (unaudited)	4,095,484	-	475,438	35,482	2,565,052	7,171,456
Three months ended September 30, 1998						
Balance as at July 1, 1998 (unaudited)	4,075,655	50,920	323,140	19,765	2,324,664	6,794,144
Net earnings (unaudited)	-	-	-	-	240,388	240,388
Compensation to the Company's employees from the State (unaudited)	-	-	-	15,717	-	15,717
Exercise of options (unaudited)	19,829	(50,920)	152,298	-	-	121,207
Balance as at September 30, 1998 (unaudited)	4,095,484	-	475,438	35,482	2,565,052	7,171,456

Interim Statement of Changes in Shareholders' Equity (Contd.)

In terms of shekels of September 1999

	Share capital	Receipt from issue of option warrants	Capital reserve share premium	Capital reserve for transactions between the Company and a controlling shareholder	Retained earnings	Total
	NIS thousands					
Year ended December 31, 1998						
Balance as at December 31, 1997 (audited)	4,059,430		199,801	5,528	1,957,752	6,222,511
Net earnings (audited)	-	-	-	-	760,441	760,441
Public issue (audited)	-	80,209	-	-	-	80,209
Issue to employees (audited)	4,615	-	35,638	-	-	40,253
Offer to employees (audited)	-	-	-	3,465	-	3,465
Compensation to the Company's employees from the State (audited)	-	-	-	26,489	-	26,489
Exercise of options (audited)	31,395	(80,209)	239,593	-	-	190,779
Conversion of convertible debentures (audited)	237	-	2,264	-	-	2,501
Balance as at December 31, 1998 (audited)	4,095,677	-	477,296	35,482	2,718,193	7,326,648

(1) 151,230,183 par value convertible debentures were converted into 14,943,694 ordinary shares with a par value of NIS 1 each.

(2) 12,289,070 par value convertible debentures were converted into 1,214,335 ordinary shares with a par value of NIS 1 each.

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

Interim Consolidated Statements of Cash Flows

In terms of shekels of September 1999

	For the nine months ended September 30		For the three months ended September 30		For the year ended December 31
	1999 (Unaudited)	1998 (Unaudited)	1999 (Unaudited)	1998 (Unaudited)	1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Cash flows generated by operating activities					
Net earnings	51,926	607,300	9,548	240,388	760,441
Adjustments to reconcile net earnings to net cash flows generated by operating activities (see A below)	1,865,413	1,535,399	806,112	517,444	2,241,029
Net cash inflow generated by operating activities	1,917,339	2,142,699	815,660	757,832	3,001,470
Cash flows generated by investing activities					
Acquisition of fixed and other assets	(1,102,954)	(1,329,643)	(353,178)	(432,486)	(1,853,915)
Proceeds from disposal of fixed assets	17,126	53,345	11,337	9,539	64,712
Investment in long-term deposits and investments	(16,193)	(42,014)*	(1,974)	(4,558)*	(87,540)
Proceeds from long-term deposits and investments	84,833	5,603*	27,210	585*	11,274
Increase in short-term investments, net	(66,431)	(18,177)	(86,027)	(8,013)	(8,183)
Materials and spare parts, net	(9,890)	3,414*	21,885	(1,327)*	87,337*
Investments in investee companies	(23,749)	-	(31)	-	4
Investment in other assets	(198,270)	-	(105,299)	-	-
Net cash outflow generated by investing activities	(1,315,528)	(1,327,472)	(486,077)	(436,260)	(1,786,311)
Cash flows generated by financing activities					
Repayment of debenture issued to the Government of Israel	(702,473)	(699,784)	(233,011)	(233,767)	(924,151)
Issue of other debentures (net of issue expenses)	260,876	-	-	-	68,780
Repayment of other debentures	(189,064)	(226,306)	(54,709)	(53,684)	(239,663)
Receipt of long-term loans	466,478	396,362	-	40,465	721,848
Repayment of long-term loans	(687,971)	(916,554)	(123,857)	(266,073)	(1,264,147)
Receipt (repayment) of short-term bank credit, net	206,554	(18,735)	97,029	(2,163)	(18,735)
Proceeds from issue of shares to employees (net of issue expenses)	-	26,377	-	-	26,377
Proceeds from issue of share options (net of issue expenses)	-	80,209	-	-	80,209
Proceeds from convertible debentures and options thereon (net of issue expenses)	-	408,953	-	79,015	405,807
Proceeds from exercise of options	-	190,791	-	121,207	190,779
Net cash outflow generated by financing activities	(645,600)	(758,687)	(314,548)	(315,000)	(952,896)
Increase (decrease) in cash and cash equivalents	(43,789)	56,540	15,035	6,572	262,263
Cash and cash equivalents at beginning of period	927,917	665,654	869,093	715,622	665,654
Cash and cash equivalents at end of period	884,128	722,194	884,128	722,194	927,917

* Reclassified

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

Interim Consolidated Statements of Cash Flows (contd.)

In terms of shekels of September 1999

	For the nine months ended September 30		For the three months ended September 30		For the year ended December 31
	1999 (Unaudited)	1998 (Unaudited)	1999 (Unaudited)	1998 (Unaudited)	1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
A - Adjustments to reconcile net earnings (loss) to net cash flows generated by operating activities					
Revenues and expenses not involving cash flows:					
Depreciation	2,025,953	1,882,313	677,829	633,373	2,497,384
Deferred taxes	(67,708)	118,448	(25,152)	16,560	163,299
Company's equity in losses (earnings) of investee companies, net	6,270	(2,759)	3,947	(756)	(6,438)
Provision for decrease in value	-	-	-	-	14,555
Increase (decrease) in employee severance benefits, net	(61,530)	(568,329)	20,203	(215,600)	(741,891)
Imputed salaries expense	-	43,830	-	15,717	43,830
Loss (gain) on disposal of fixed assets	(5,327)	(1,345)	(4,243)	1,691	(4,664)
Erosion (appreciation) of investment in long-term deposits	(37,873)	(58,588)*	(57,035)	(36,822)*	(70,848)
Erosion (appreciation) of and interest on short-term investments, net	(69)	6,172	2,037	1,839	5,247
Appreciation (erosion) of long-term liabilities:					
Debenture issued to the Government of Israel	(3,077)	(33,627)	(1,961)	(16,069)	(21,814)
Other debentures	(6,277)	(24,621)	(3,786)	(14,219)	(5,933)
Convertible debentures	(1,732)	(9,321)	(1,087)	(7,099)	(803)
Long-term loans	53,165	108,281	106,452	75,954	245,599
Amortization	45,571	5,884	19,426	2,351	8,297
Changes in asset and liability items:					
Decrease (increase) in trade receivables	31,859	(181,869)*	(34,295)	(68,797)*	(51,387)
Decrease (increase) in other receivables and debit balances	(36,264)	20,686*	(12,059)	25,302*	117,196
Increase in inventory	(81,497)	(16,794)*	(7,608)	(3,972)*	(24,948)*
Increase in trade payables	37,016	106,965	50,862	9,278	9,066
Increase (decrease) in other current liabilities	(29,008)	138,807*	74,302	98,200*	63,855
Increase (decrease) in deferred revenues	(4,059)	1,266	(1,720)	513	1,427
	1,865,413	1,535,399	806,112	517,444	2,241,029
B - Non-cash transactions					
Acquisition of fixed assets, materials and spare parts on credit	241,230	155,533	241,230	155,533	257,149
Proposed dividend	301,565	-	301,565	-	-

* Reclassified

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

Notes to the Interim Consolidated Financial statements as at September 30, 1999 (unaudited)

NOTE 1 - GENERAL

A. The interim statements have been prepared in accordance with generally accepted accounting principles, applicable to the preparation of interim periodic financial statements. These statements should be read in conjunction with the Company's annual financial statements and accompanying notes as at December 31, 1998 and for the year then ended.

B. The Company presents in the notes to the interim financial statements only the significant changes in its business and legal environment which occurred between the date of the previous annual financial statements and the date of these interim financial statements. The extensive and detailed description, including significant changes and updating which occurred in recent years, particularly in the fields of cellular services, international communications services, domestic communications services, the opening of these markets to competition, and the decisions of the Ministerial Committee for Privatization to reduce the State's holdings in the Company, appears in Note 1 to the Company's annual financial statements as at December 31, 1998. The significant changes which occurred from the date of the annual financial statements to the date of these financial statements are detailed below:

1. In connection with the opening of the domestic communications market to competition and determination of the Company's tariffs, the following developments occurred:

    a. As described in Note 1 to the financial statements as at December 31, 1998, according to the announcement of the Director General of the Ministry of Communications on March 1, 1999, the Ministers of Communications and Finance decided to adopt the recommendations of the committee for the determination of the Company's tariffs with certain changes. On March 22, 1999 the Minister of Communications sent a revised notice superseding that of March 1, 1999. The principal amendments as in the revised notice are as follows:

        (1) The reduction of the average general level of telecommunications tariffs for the new tariffs arrangement period will be 6.03%, in view of the rise in the rate of inflation, beyond that predicted by the committee.

        Taking into account that implementation of the new arrangement was postponed from January 1, 1999 to April 1, 1999, the tariff reduction for the remainder of 1999 alone will be 8.04%. In reality, owing to the fact that the increase in fixed fees took effect only on May 1, 1999 and not on April 1, 1999, the total reduction at April 1, 1999 amounted to 7.7% and the percentage which will be added on January 1, 2000 will be 1.72%.

        (2) The reduction factor for the Company's tariffs ("efficiency factor") will average 6% in 1999 and 7% in the year 2000. In the event that the Company shall request postponement of the rate adjustment during 2000 until January 1, 2001, there shall be no impediment to its doing so.

        This factor will be adjusted during the three years 2001-2003 to a rate between 3.5-8% according to the average rise in the Company's aggregate outputs for the years 1999-2000.

        (3) In order to enable the Company to compete in the Internet access market, it will be permitted to offer a reduced package for these services.

        (4) The Ministries of Communications and Finance will act to change the existing arrangement between the Israel Broadcasting Authority (IBA) and the Company so that within four years, the IBA's payments will cover the costs of the services it purchases from Bezeq, or an alternative solution.

    Commencing April 1, 1999 Company's tariffs were revised according to regulations approved by the Knesset Finance Committee. The main revisions are as follows:

    - The price of call units will be reduced by 21.34%.
    - Fixed fees per line will be increased by 16% (effective from May 1, 1999).

NOTE 1 - GENERAL (CONTD.)

B. (contd.)

- The interconnect fee for land to mobile calls passing through the Bezeq network will be reduced by 63%.
- Interconnect fees for international operators will be reduced by 63%.
- Data communication services, among them Sifranet services, will be increased by an average rate of 51.5%, and frame relay services by an average of 42%.

In accordance with the regulations, beginning January 1, 2000 the efficiency factor will be 7%. The regulations do not specify the mechanism of examination and adjustment of the efficiency factor as appears in the Minister's notice.

The Company submitted a proposal to the Ministry of Communications for a change in the method of charging for calls, the main thrust of which is the change from charging by meter pulses to charging by time. The Ministry of Communications has not yet approved the Company's proposal.

b. In February 1999, Section 50 of the Telecommunications Law, 5742-1982 was repealed. The section granted the Company exclusivity in providing national telecommunication services in a nationwide network of telephones under the General License. The repeal was effective on June 1, 1999; however, activities of new operators in the domestic fixed communications field will be possible only as of the date on which they will be granted licenses by the Ministry of Communications.

On August 22, 1999 the Government adopted two resolutions concerning the acceleration and increase of competition in the domestic communications field during 1999, and in the personal mobile communications (PCS) field during the year 2000.

As a result of the reduction of the Company's tariffs on April 1, 1999, the Company's tariffs were reduced by an average of approximately 8%. This led to a significant deterioration in the Company's business results. A further deterioration is expected as a result of the opening of the domestic fixed communications fields to full competition, in addition to the growing competition in the cellular field, which cannot be estimated at this time.

2. On May 11, 1999 the former Minister of Communications amended the licenses of the International Operators and the General License of the Company. The amendments determined that the registration and allocation of subscribers will be effected by the International Operators. In addition, beginning July 1, 1999, a random allocation will be made for those subscribers who have not chosen a particular International Operator. The random allocation will be effected on a one-time basis, where each of the International Operators will be allocated one third of the unassigned subscribers. It was further determined that the costs of effecting the random allocation shall be divided equally among the International Operators.

Following the above amendment, Bezeq International Ltd. and the Company petitioned the High Court of Justice. On September 26, 1999 a decision on the petitions was handed down, with the consent of the parties, according to which the allocation process would be carried out in the following two stages:

(1) Stage one - and not later than December 1, 1999 - an application will be made, with the wording to be determined by the Ministry of Communications, to all the non-allocated subscribers, requesting them to select one of the International Operators.

(2) Stage two - a subscriber who did not give notice of his choice of an International Operator will not have access to the dialing codes 00 and 188, but will have the option of using the individual codes of each operator ("012", "013", "014"). The second stage will be implemented by May 1, 2000 at the latest.

NOTE 1 - GENERAL (CONTD.)
B. (contd.)

The Court further decided that customers who were registered as subscribers by the other competing companies by the time of the referendum, would be considered to be allocated to those companies without need for the referendum. On the other hand, subscribers who had registered with Bezeq International Ltd. as part of the "Kesher Ham" campaign, would not be considered to be allocated to it. Moreover, the Court ruled "without expressing an opinion as to the case in question", that the competing companies would retain the right to sue for any damages allegedly caused them due to postponement of the date of allocating the customers to the International Operators.

Implementation of the allocation as ruled by the Court may have a material adverse effect on Bezeq International and its operations. Furthermore, the Company is expected to incur significant costs in implementing the technical operations for the allocation. According to the amendment to the Company's General License, the International Operators will bear this cost, excluding the cost for the preliminary allocation of the subscriber.

On November 4, 1999 the Minister of Communications signed an amendment to Bezeq International's license, whereby the company must present a $20 million bank guarantee for the fulfillment of all the conditions of its license. Bezeq International's management, based on the opinion of its legal counsel, believes that it is not obligated to present the above mentioned guarantee. As at the date of approval of the financial statements, the guarantee has not been presented.

The Company believes, based on the opinion of Bezeq International, that following changes in Bezeq International's business environment since the beginning of competition, there may be changes in the international telecommunications field, including, inter alia, tariffs, market share, and traffic ratio, which may result in a material decrease in the Group's financial results.

3. On May 12, 1999 the General Meeting of the Company resolved to approve changes in the Company's Bylaws, some of which will take effect immediately and some of which will be effective upon reduction of the State's holdings in the issued and paid up share capital of the Company to 50% or less.

In the Company's estimation, the result of the said provisions of the Bylaws is that even after the State's holdings decline to 50%, the Government will continue to control the Company so long as the State holds 10% or more of the Company's share capital, unless another entity will control the Company in accordance with the approval required by the Bezeq Order.

In January 1999 the Ministry of Communications notified the legal representatives of Cable & Wireless (Singapore) Pte Ltd. and Cable & Wireless Plc (hereinafter C & W) that the former Minister of Communications was considering a decision whereby the hedging and options transactions executed by C & W in Company securities were in violation of the terms of the permit and that it must remedy the violation by canceling the transactions.

In August 1999 the Minister of Communications notified the legal representative of C&W that despite having reached the conclusion that the above transactions constitute a breach of the terms of the permit, in view of the overall data and the circumstances relevant to the matter, he does not intend to deem the breach cause for termination of the permit, contingent upon C & W not making any further arrangement similar in nature to the above transactions. C & W was also requested by the Minister of Communications, in connection with increasing its holding in the Company beyond 13%, to provide the details of the Israeli subsidiary to which C & W's holdings would be transferred in accordance with the permit. This notice of the Minister of Communications enabled C & W to increase its holdings in the Company as of August 20, 1999 up to 20%, subject to the provisions of the permit it received and the provisions of the Bezeq Order.

NOTE 1 - GENERAL (CONTD.)
B. (contd.)

In October 1999 notice was give to the Company by C&W, according to which C&W had signed an agreement for the sale of 4.99% of the Company's issued share capital and the granting of an option for the purchase of additional shares, comprising 14.62% of the Company's issued share capital, under the conditions specified in the agreement.

4. In April 1999 a draft prospectus for a public issue of Company securities was submitted to the Securities Authority. Due to a dispute with the Israel Lands Administration (see Note 4B), the issue process was halted.

5. On October 20, 1999 the Ministerial Committee for Privatization reached a decision to require the Government Companies Authority, in coordination with the relevant government ministries, to submit to the Ministerial Committee for Privatization a proposal for the privatization of all the State's holdings in Bezeq, together with a document describing the considerations in determining the proportion of control to be sold.

   Following the above decision, on November 22, 1999 the Government Companies Authority submitted to the Company a proposal for the privatization of the Company by way of a private sale. The Company was requested, in accordance with Section 59B(c) of the Government Companies Law, 5735-1975 to submit to the Government Companies Authority the position of the Board of Directors of the Company on the proposed resolution, including the total percentage of share capital to be included in the sale, and with regard to the experience in the operation of communications services that would be required from those wishing to participate in the sale process.

   The Company is unable to assess if, when and how all or part of the State's shares in the Company will be sold.

NOTE 2 - ACCOUNTING POLICIES

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

B. As of January 1, 1999 Pelephone Communications Ltd. capitalizes its net direct costs in respect of sales to subscribers who have undertaken to remain Pelephone customers (a breach of the undertaking carries with it a fine as well as the cost of the asset's depreciation). These costs appear in the balance sheet as "other assets" and are amortized over the minimum subscription period, which is up to 36 months. The balance of the unamortized cost included in "other assets" in Pelephone's financial statements is NIS 318,541,000 (in the Consolidated financial statements NIS 159,271,000).

NOTE 3 - ADJUSTED FINANCIAL STATEMENTS

The financial statements are prepared on the basis of the historical cost convention adjusted for changes in the general purchasing power of the Israeli currency. Comparative data in the financial statements are presented in adjusted shekels of September 1999. Below are details of the changes which occurred in the Consumer Price Index and the exchange rate of the US dollar:

NOTE 3 - ADJUSTED FINANCIAL STATEMENTS (CONTD.)

	Consumer Price Index	US dollar exchange rate
	%	%
For the nine months ended:		
September 30, 1999	0.85	2.78
September 30, 1998	4.05	8.74
For the three months ended:		
September 30, 1999	1.24	4.91
September 30, 1998	1.79	4.85
For the year ended December 31, 1998	8.62	17.65

NOTE 4 - FIXED ASSETS

A. Depreciation policies

On May 12, 1999 the Board of Directors of the Company resolved to adopt Management's recommendations, which were based on the report of a firm of outside consultants to change its depreciation policies and rates of Company assets.

Pursuant to the resolution, the depreciation rates of a number of fixed asset items recorded in the Company's books were changed as of January 1, 1999. Among these, the depreciation rate of the switching exchanges was changed to 10% per annum (from 8.33%), and the depreciation rate of the Company's network was changed to 4% per annum (from 5%). As a result of implementation of the recommendations, the Company's depreciation expense increased by approximately NIS 157 million during the nine months ended September 30, 1999.

In the Company's opinion, these changes are expected to cause an increase in the Company's depreciation expense (not including depreciation expense in respect of new investments) of approximately NIS 200 million in 1999, and of approximately NIS 160 million, NIS 65 million and NIS 100 million in each of the three subsequent years, respectively.

Following these changes, the Company approached the Ministry of Communications, requesting approval for an increase in the Company's tariffs which it believes is necessitated by the change in its depreciation policies.

B. Real estate assets

As described in Note 9B to the financial statements as at December 31, 1998, the Company is in dispute with the Accountant General of the Ministry of Finance and with the Israel Lands Administration as to certain real estate assets transferred to the Company from the State of Israel upon commencement of the Company's operations.

On May 13, 1999, discussions were held between representatives of the Company and the Israel Lands Administration, in the presence of the Government Companies Authority, at the Attorney General's office. In the summary of the discussions, the Attorney General decided that a public offering could not be launched before clarification of the factual basis and the issues in dispute, so that the dispute could be settled in the appropriate manner. The Attorney General also instructed relevant government entities to prepare a detailed working paper defining which assets are the subjects of the dispute, their value, and the use being made of them today, and recommended that the parties negotiate in an attempt to settle the dispute as soon as possible. Representatives of the Company and the Israel Lands Administration have recently commenced negotiations.

NOTE 4 - FIXED ASSETS (CONTD.)

C. Billing and collection software

A software supplier developing a billing and collection system for the Company gave notice of its unwillingness to continue the project in its present format, in light of the considerable losses it will allegedly incur. The supplier proposed two other alternatives. The Company notified the supplier that it does not accept the above alternatives and that it insists that the supplier meet all of its undertakings as per the agreement. In response, the supplier notified the Company that the Company's demands exceed those stipulated in the original agreement and it therefore does not intend to meet the Company's demands. The Company notified the supplier that if the breaches of the agreement are not remedied, it will present the bank guarantees given by the supplier, in the amount of $19.8 million. On August 8, 1999, a decision of the court granting a temporary injunction as requested by the supplier was presented to the Company. In the decision, a temporary injunction was granted, forbidding the Company to present the bank guarantees given by the supplier. Concurrently, the supplier filed a claim against the Company concerning granting of a permanent injunction against presentation of the guarantees. On August 29, 1999, the Company sent the supplier notice of cancellation of the agreement owing to its breach by the supplier, and a demand for reimbursement of all the monies paid plus damages. On September 3, 1999 the supplier filed suit against the Company, requesting enforcement of the agreement between the parties, and a temporary injunction prohibiting the Company from committing to a third party for performance of the project. On October 11, 1999 the Court denied the supplier's petition. The supplier filed a request for permission to appeal to the Supreme Court, which was denied on November 9, 1999. On September 9, 1999 the Company filed suit against the supplier for the payment of approximately $18 million, in addition to the guarantees on which the Company wished to foreclose.

A secondary supplier in the project is demanding compensation in connection with the stoppage of the project, in the amount of approximately NIS 21 million. The parties are negotiating in order to reach a settlement.

It is not possible, at this time, to estimate the outcome of the above legal proceedings, but in the opinion of the legal advisers of the Company, the Company has good arguments in substantiation of its position. It is also not possible, at this stage, for the Company to estimate the full implications of the dispute on the processes of building the software system, the timetables for completion and the losses which the Company is liable to incur as a result, but the Company estimates that a delay in completing the system by the planned date, if any, is liable to cause it material damages.

As at the balance sheet date, the Company's investment in the billing and collection project amounts to approximately NIS 118 million, of which approximately NIS 100 million has been paid to the supplier and those working jointly with it on the project.

NOTE 5 - INVESTMENTS IN INVESTEE COMPANIES - CELLULAR COMMUNICATIONS PROJECT IN INDIA

In April 1999 a court in India ruled that out of the guarantees given by the Indian company in connection with payment of the license fees in the cellular project in India, an amount equal to 20% of the Indian company's debt in respect of non-payment of the said license fees would be forfeited. The Company subsequently paid its part of the guarantees, in the amount of approximately US $2.2 million. In light of the fact that the Indian company failed to provide additional guarantees in respect of full payment of the license fees in accordance with the court's decision, in June 1999 the balance of the guarantees was forfeited. The Company paid the balance of its part in the said guarantees, in the amount of approximately US $4 million.

NOTE 6 - LIABILITY FOR EMPLOYEE SEVERANCE BENEFIT

Plan for organizational change

As part of the Company's restructuring program , the implementation of the employee retirement plan is being continued. The number of employees currently expected to retire as part of the plan is higher than Company forecasts at the time of the plan's preparation, and amounts to approximately 2,050 employees instead of the forecasted 1,800. In fact, approximately 1,680 employees actually retired between January 1998 and September 30, 1999, and the remainder are expected to retire by the end of 1999. The financial statements include a provision of NIS 110 million for the adjustment of the expected cost of the updated retirement data.

Following the adoption of the recommendations of the committee for arrangement of the Company's tariffs by the Ministers of Finance and Communications (see Note 1B), on March 4, 1999 the Board of Directors directed the Company's Management to present to the Board, within 90 days, a proposed plan for preparing the Company in view of the adoption of the committee's recommendations. Management believes that implementation of an effective program in this context will require further change in the organizational structure of the Company, one of which will be a further reduction in the Company's workforce by means of a new retirement plan.

The Company is currently working on preparing a plan based on a material change in its organizational and operational concept, in a format similar to the change already made in several similar companies in the telecommunications arena upon their transition to functioning in a competitive environment. Preparation of the plan is a complex process which is likely to continue for another several months, and as at the balance sheet date the Company does not yet have a substantiated estimate of its possible cost.

In light of the above, and due to the need to prepare a preliminary estimate of the extent of the Company's preparation costs, the Company's Management has formulated a plan based on a number of changes which it believes can be implemented as part of its existing organizational and operational framework. The plan indicates a need for the retirement of approximately 530 employees, for which the Company has recorded a provision in its financial statements of approximately NIS 277 million, representing the estimated cost of this retirement plan.

It is the Company's intention, if possible and if found viable, to implement the new plan, while the plan for which the provision was created constitutes, at this stage, only an alternative option in case implementation of the new plan will be impossible or is postponed for a significant period of time. As mentioned, the cost of the new plan cannot be estimated at this time, and is likely to differ considerably from the cost of the plan for which the provision was made.

NOTE 7 - CONTINGENT LIABILITIES

A. Claims and Contingent Liabilities

The Company and the investee companies have contingent liabilities for which the maximum possible exposure is significant. A detailed description of these contingent liabilities appears in Note 20 to the Company's annual financial statements as at December 31, 1998. No significant changes occurred regarding these contingent liabilities until the date of signature of these statements, with the exception of the following:

1. Further to the dispute between the Company, Keren Makefet and the workers' union concerning the amount of the vacation payment component in the base salary for pension, on April 27, 1999 the Board of Directors approved an arrangement to revise the vacation payment component used in the calculation of the pension salary of "transferred employees" who retire in accordance with the Makefet Bylaws. The arrangement is contingent upon signature of a collective agreement which will settle the collective labor dispute, inter alia, in this matter, and a settlement agreement with Company pensioners who have filed suit against it in this matter,

NOTE 7 - CONTINGENT LIABILITIES (Contd.)

A. Claims and Contingent Liabilities (Contd.)

as well as with Company pensioners who are not party to the suit, by transforming the suit, by consent, into a class action. The said arrangement was approved in May 1999 by the Government Companies Authority. In July 1999 the aforesaid agreement was signed with the pensioners who filed the suit and the Labor Court gave the agreement the validity of a court judgment (See Note 20A(6) to the financial statements as at December 31, 1998.)

2. Further to the charge received by the Company for municipal taxes (as mentioned in Note 20A(19) to the financial statements as at December 31, 1998), at the end of March 1999, the Company received an amended 1998 municipal tax charge for the Company installation site known as the "Hillel Station", amounting to approximately NIS 28.2 million (the previous bill amounted to approximately NIS 40.5 million). The council has submitted to the Company a demand for payment of this alleged debt. After receipt of the demand, at the Company's request, the District Court issued an ex-parte temporary injunction preventing the initiation of debt collection proceedings, and the Company petitioned the court for declaratory relief regarding the illegality of the municipal tax charge. The Municipal Council petitioned the court requesting the cancellation of the above injunction. The petition has not yet been decided upon. Concurrently, the Municipal Council sent a 1999 municipal tax charge notice in the amount of NIS 23.4 million followed by a demand for payment of this alleged debt. On August 1, 1999 the Company received notice of a charge for the years 1991-1997 in an approximate amount of NIS 218.5 million and on October 7, 1999 the Company was issued a demand for payment of this debt as well. The Company submitted its objections relating to all of the above charges to the Director of the Municipality. The objections relating to the charges for the years 1998 and 1999 were dismissed by the Director of the Municipality. The Company has appealed these decisions, which have not yet been decided upon. In addition, the Director of the Municipality has not yet decided upon the Company's objection relating to the retroactive charge for the years 1991-1997. In the Company's opinion, based on the opinion of its legal advisers handling the demand on its behalf, there is a good chance that the demand for the years 1991-1997 will be cancelled in its entirety, since it is a retroactive demand. Alternatively, even if it is determined that a retroactive demand may be issued in such circumstances, there is a good chance of a considerable reduction of the demand. In respect of current demands for the years 1998-1999, there is a very good chance of a considerable and significant reduction of this charge as well. The financial statements include a provision which the Company and its advisers believe appropriate. The parties are negotiating to arrive at an arrangement on this matter.

3. In May 1999 a petition was submitted to the High Court of Justice against the Israel Broadcasting Authority, the Company, the Minister of Communications and the Commissioner for Environmental Radiation - Ministry of the Environment, for orders nisi and an interim injunction, concerning the operation of the radio station known as the "Hillel Station", in the absence (as alleged by the petitioners) of a permit from the Commissioner for Environmental Radiation to operate the station, and owing to the dispute which arose over the question of installing of a monitoring system in the station and the entity responsible for the financing of this system. The court determined that an interim injunction is unjustified and transferred the petition for hearing before a panel of three justices.

   On August 16, 1999, the Company received a copy of a notice from the Head of the Radiation Division at the Ministry of the Environment to the Broadcasting Authority, wherein the permit to operate the station was renewed subject to certain conditions detailed in the notice. On October 17, 1999 the head of the Radiation Division at the Ministry of the Environment notified the Company that he intends to revoke the permit since its terms were not fulfilled. On November 15, 1999, following a hearing in the High Court of Justice, the parties were granted an extension until the end of 1999 to fulfill the term for granting the permit.

4. Further to that mentioned in Note 20A(8) to the financial statements as at December 31, 1998 regarding the plaintiff's allegation that the tariffs for the services of Bezeq International in effect during the period from May 10, 1996 to July 8, 1997 were overpriced and unreasonable and exploitative of its status as a monopoly, on August 8, 1999, the District Court handed down its decision approving the claim as a class action. The amount of the action was estimated by the claimant at approximately NIS 885 million. On September 30, 1999, an application for the right to appeal the decision was submitted to the Supreme Court. The chances of the success of the

legal proceedings cannot be estimated at this time. No provision has been made in the financial statements in respect of this claim.

5. In July 1999 the Supreme Court rejected an appeal regarding a decision to dismiss a request to recognize a claim as a class action against Pelephone Communications Ltd., as mentioned in Note 20A(3) of the annual financial statements.

6. Further to that mentioned in Note 20A(16) to the financial statements as at December 31, 1998 regarding the claim in the matter of the Company's advertising campaign, dealing with the advantages of the use of a fixed line telephone from the home rather than a cellular telephone, the Court partially accepted the application to approve the action as a class action. The approval of the action as a class action was limited to a declaratory class action by virtue of the Consumer Protection Law, 5741-1981 only, as "misleading advertising". On October 31, 1999, the statement of defense was submitted in the class action. The chances of the success of the action cannot be estimated at this time. No provision has been made in the financial statements in respect of this claim.

7. A class action was filed in the District Court against Pelephone Communications Ltd. under the Consumer Protection Law, 5741-1981 and the Anti Trust Law, 5748-1988. The basis for the action is the alleged exploitation by Pelephone of its monopoly status, its exploitation of the desperate situation, and its misleading of consumers. If the claim is recognized as a class action, the amount claimed is estimated to be approximately NIS 16 billion. At this stage Pelephone and its legal advisors are unable to express any opinion regarding this action since it is still being studied. Accordingly, no provision has been made in the financial statements for this claim.

8. Further to that mentioned in Note 20A(7) to the financial statements as at December 31, 1998 regarding the claim submitted by a group of employees for declaratory relief in respect of pension rights, a decision was given on November 16, 1999. For the majority of the claimants, the decision constitutes an outright dismissal of their demands.

9. Regarding the dispute between the Company and the Accountant General of the Ministry of Finance and the Israel Lands Administration, see Note 4B.

10. Regarding the dispute between the Company and the supplier of billing and collections software, see Note 4C.

11. Regarding the claim of the Ministry of Communications for forfeiture of guarantees in India, see Note 5.

B. Effect of computer adaptation to the year 2000

The issue of the Year 2000 arises because many computerized systems use two digits instead of four for the year. Date-sensitive systems are liable to identify the year 2000 as 1900 or some other date, causing errors in processing data which includes dates in the year 2000. Furthermore, similar problems are likely to arise in systems which use the digits "99" in a date field as indication of something other than the year 1999. The effects of the Year 2000 issue may occur on January 1, 2000, or before or after that date.

The Company and investee companies are preparing for adaptation of their information systems currently in use to the Year 2000, and for this purpose they have entered into agreements with a number of companies. A considerable part of the companies' information systems is highly critical for their operations and therefore, failure to complete the adaptation in a timely and suitable manner is liable to cause errors in financial calculations relating to customers, significant disruptions in the information used by the companies in their day-to-day management, and serious damage to their activities.

A considerable part of the computer-embedded engineering systems of the Company and the investee companies is also highly critical for their operations, and require the implementation of adaptations for the Year 2000 transition. The companies are preparing to implement the adaptation, which entails a highly complex process and depends greatly on the cooperation of suppliers, including suppliers of infrastructures, and their ability to make timely adaptations. The companies are accelerating investments for the enhancement of some of the existing systems, which will include the adaptation to the Year 2000.

NOTE 7 - CONTINGENT LIABILITIES - (CONTD.)

B. Effect of computer adaptation to the year 2000 (Contd.)

Failure to complete the adaptation in a timely and/or appropriate manner is liable to cause damage to the operation of the companies' information and engineering systems in their telecommunications infrastructures, disruption in the operation of important parts of the companies' telephony infrastructures, and even a halt in their operations. The readiness of the companies' telecommunications systems depends also on the readiness of the telecommunications systems of their customers, particularly their large customers (other telecommunication providers, etc.).

The lack of readiness on the part of these customers could also cause damage to the telecommunications systems and other essential systems, loss of revenue and even monetary claims against them. It is impossible to guarantee that all aspects of the Year 2000 issue affecting the Company and the investee companies will be resolved fully and in a timely fashion.

The direct cost of the adaptation to the Year 2000 for the entire Group is estimated at this stage at approximately NIS 146 million, of which approximately NIS 79 million were expended as at September 30, 1999. In addition, there are indirect costs anticipated relating primarily to the additional staff hired by the Company for the adaptation work. In addition to these costs, an acceleration of investments in the engineering systems, initially estimated at approximately NIS 98 million, were required and have been expended as at September 30, 1999.

C. Forward exchange contracts

The Company has entered into forward exchange contracts as a hedge against exposure resulting from changes in the exchange rate of the US dollar in relation to changes in the CPI. As at September 30, 1999, the Company contracted to purchase approximately US $320 million (approximately NIS 1,451 million) for which it will pay approximately NIS 1,374 million linked to the CPI. The contracts mature on various dates, the last of which is September 2001. The Company also contracted to purchase approximately US $355 million (NIS 1,518 million) for which it will pay approximately NIS 1,521 million, at predetermined rates.

NOTE 8 - Share Capital

In a General Meeting held on May 12, 1999 it was resolved to approve an increase in the registered share capital of the Company from NIS 835,000,000 to NIS 910,000,000, by creating 75,000,000 ordinary shares with a par value of NIS 1 each, with rights equal to those of the existing ordinary shares of the Company, for the purpose of issuing securities as part of a public offering pursuant to a prospectus, in accordance with the decision of the Ministerial Committee for Privatization from August 4, 1998.

The above mentioned increase in capital requires the approval of the Ministerial Committee for Privatization in accordance with Section 11 of the Government Companies Law, 5735-1975. Following the Attorney General's decision barring a public offering due to the dispute concerning real estate assets (see Note 4B), the resolution was not submitted for the approval of the Ministerial Committee for Privatization.

NOTE 9 - REVENUES FROM TELECOMMUNICATIONS SERVICES

	For the nine months ended September 30		For the three months ended September 30		For the year ended December 31
	1999 (Unaudited)	1998 (Unaudited)	1999 (Unaudited)	1998 (Unaudited)	1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues from telephone services -					
Domestic calls	2,081,523	2,451,062	644,287	850,864	3,242,391
Cellular telephone	2,031,191	1,991,664	710,346	680,600	2,656,282
Fixed fees	1,321,252	1,185,340	472,414	410,001	1,566,275
International communications	649,029	817,193	217,853	292,126	1,078,692
Installation and sale of equipment to subscribers	367,541	359,613	117,126	112,142	503,281
Other	88,265	82,902	34,238	20,363	76,031
	6,538,801	6,887,774	2,196,264	2,366,096	9,122,952
Other revenues	181,508	172,654	51,956	65,690	272,633
	6,720,309	7,060,428	2,248,220	2,431,786	9,395,585

* Reclassified

NOTE 10 - OPERATING AND GENERAL EXPENSES

	For the nine months ended September 30		For the three months ended September 30		For the year ended December 31
	1999 (Unaudited)	1998 (Unaudited)	1999 (Unaudited)	1998 (Unaudited)	1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses	1,250,968	1,460,655	406,882	447,727	1,870,112
Cellular telephone expenses	961,269	814,543	358,894	275,097	1,085,880
International communications expenses	196,792	351,696	69,711	123,743	454,075
Materials and spare parts	211,599	214,833	65,793	73,219	287,207
Building maintenance	312,806	280,221	109,230	89,505	377,769
Services and maintenance by sub-contractors	347,948	308,454	121,191	116,995	427,472
General expenses	463,901	336,786	152,285	127,479	448,915
Vehicle maintenance expenses	46,281	46,752	17,643	14,017	62,685
Collection fees	31,704	33,390	10,292	11,284	42,871
	3,823,268	3,847,330	1,311,921	1,279,066	5,056,986
Less - salaries charged to investments in fixed assets	117,103	122,345	28,832	36,424	170,504
	3,706,165	3,724,985	1,283,089	1,242,642	4,886,482

* Reclassified

Note 11 - Condensed Financial Statements of Bezeq International Ltd. and Pelephone Communications Ltd.

1. BEZEQ INTERNATIONAL LTD.

A. Balance sheets

	September 30 1999 (Unaudited) NIS thousands	September 30 1998 (Unaudited) NIS thousands	December 31 1998 (Audited) NIS thousands
Current assets	546,530	772,336*	599,308
Investments	3,862	-	22,829
Fixed assets	297,377	289,220	295,210
Other assets	2,651	3,004	2,915
	850,420	1,064,560	920,262
Current liabilities	381,564	560,826*	436,704
Long-term liabilities	20,338	32,703	22,357
Quasi-capital receipt	157,731	157,731	157,731
Shareholders' equity	290,787	313,300	303,470
	850,420	1,064,560	920,262

B. Statements of Operations

	For the nine months ended September 30		For the three months ended September 30		For the year ended December 31
	1999 (Unaudited)	1998 (Unaudited)	1999 (Unaudited)	1998 (Unaudited)	1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues from international communications services	526,946	717,289*	179,492	242,427*	935,650
Operating expenses**	417,895	612,162*	150,502	195,866*	791,214
Gross profit	109,051	105,127	28,990	46,561	144,436
Marketing expenses	77,958	43,387*	25,126	15,112*	59,621
General and administration expenses	41,601	32,069*	17,511	10,921*	53,910
Operating income (loss)	(10,508)	29,671	(13,647)	20,528	30,905
Other (expenses) revenues	(4,012)	(1,769)*	(4,012)	890	(7,499)
Financing income, net	18,563	27,216	4,867	8,350	36,894
Earnings (loss) before income tax	4,043	55,118	(12,792)	29,768	60,300
Income tax	140	24,906	(5,063)	13,208	2,534
Net earnings (loss)	3,903	30,212	(7,729)	16,560	33,766

* Reclassified

** After a deduction of approximately NIS 40 million due to cancellation of provisions to the credit of "Bezeq" The Israel Telecommunication Corp. Limited

Note 11 - Condensed Financial Statements of Bezeq International Ltd. and Pelephone Communications Ltd. (contd.)

2. PELEPHONE COMMUNICATIONS LTD.

A. Balance sheets

	September 30 1999 (Unaudited) NIS thousands	September 30 1998 (Unaudited) NIS thousands	December 31 1998 (Audited) NIS thousands
Current assets	918,248	735,001	693,709
Long-term receivables	16,128	-	17,930
Fixed assets	2,660,309	2,311,481	2,417,852
Other assets	319,729	-	-
	3,914,414	3,046,482	3,129,491
Current liabilities	1,119,497	671,039	584,743
Long-term liabilities	844,692	449,356	592,883
Shareholders' equity	1,950,225	1,926,087	1,951,865
	3,914,414	3,046,482	3,129,491

B. Statements of Operations

	For the nine months ended September 30		For the three months ended September 30		For the year ended December 31
	1999 (Unaudited)	1998 (Unaudited)	1999 (Unaudited)	1998 (Unaudited)	1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Income from cellular services, sales and services	2,176,764	2,235,126	740,434	756,502	2,997,153
Cost of cellular services, sales and services	1,776,182	1,561,085	620,418	567,014	2,163,430
Gross profit	400,582	674,041	120,016	189,488	833,723
Sales and marketing expenses	211,617	181,170	82,546	54,821	229,381
General and administration expenses	137,149	121,321	52,263	39,682	160,816
	348,766	302,491	134,809	94,503	390,197
Income (loss) from ordinary operations	51,816	371,550	(14,793)	94,985	443,526
Financing expenses, net	46,180	14,296	24,490	1,631	29,402
Capital losses (gains)	353	(1,472)	600	(1,628)	5,132
Earnings (loss) before income tax	5,283	358,726	(39,883)	94,982	408,992
Income tax	6,923	133,396	(12,683)	36,227	158,227
Net earnings (loss)	(1,640)	225,330	(27,200)	58,755	250,765