“BEZEQ” THE ISRAEL TELECOMMUNICATION CORP. LIMITED

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

JUNE 30, 2008

(UNAUDITED)

The information contained in these financial statements constitutes a translation of the financial statements published by the Company. The Hebrew version was submitted by the Company to the relevant authorities pursuant to Israeli law, and represents the binding version and the only one having legal effect. This translation was prepared for convenience purposes only.

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Somekh Chaikin

8 Hartum Street, Har Hotzvim
PO Box 212, Jerusalem 91001
Israel

Telephone 972 2 531 2000
Fax 972 2 531 2044
Internet www.kpmg.co.il

The Board of Directors of
"Bezeq" - The Israel Telecommunication Corp. Limited

At your request, we have reviewed the condensed consolidated interim balance sheet of "Bezeq" - The Israel Telecommunication Corp. Limited (hereinafter "Company") at June 30, 2008, as well as the condensed consolidated interim statement of income, the condensed consolidated interim statement of recognised income and expense and the condensed consolidated interim statement of cash flows for the six-month and 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 investments in associates in which the Company's investments amount to approximately NIS 30 million at June 30, 2008, and the Company's share in the profits in respect thereof amount to approximately NIS 2.3 million and approximately NIS 696,000 for the six-month and three-month periods then ended.

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 condensed consolidated interim 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 to the said interim financial statements in order for them to be in conformity with standard IAS 34 – Interim Financial Reporting 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 continuing opening of the communications sector to competition, the changes in the communications market, and the effects of regulation on the Group's financial position and operating results, as described in Note 1.

2. Contingent claims made against the Group of which the exposure cannot yet be assessed or calculated, and other contingencies as described in Notes 7B and 7C.

3. The financial position of a subsidiary. As mentioned in Note 6A, as of June 30, 2008, the subsidiary meets the financial criteria set for it, following the amended stipulations in respect of 2008 placed upon it by the banks on March 5, 2008, and June 25, 2008 as adapted to the subsidiary's 2008 annual budget and to certain prescribed operational data. The continuation of the activity of the subsidiary is contingent on, *inter alia*, compliance with the conditions set for 2008 and/or further relief which may be received during the year. In the opinion of the management of the subsidiary, the financial resources at its disposal will be sufficient for the requirements of the subsidiary's operations in the coming year, based on the cash flow projections approved by the board of directors of the subsidiary.

Somekh Chaikin
Certified Public Accountants (Isr.)

August 20, 2008

Condensed Consolidated Interim Balance Sheets at

	June 30, 2008	June 30, 2007	December 31, 2007
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Assets			
Cash and cash equivalents	**740**	2,063	1,203
Investments and loans, including derivatives	**66**	1,008	389
Trade receivables	**2,497**	2,115*	2,403
Other receivables	**233**	231	247
Inventory	**186**	229	203
Current tax assets	**16**	12	11
Assets classified as available for sale	**23**	-	17
Total current assets	**3,761**	5,658	4,473
Trade and other receivables	**574**	498*	535
Investments and loans, including derivatives	**226**	279	233
Broadcasting rights	**278**	206*	243*
Property, plant and equipment	**5,971**	6,211	6,064
Intangible assets	**2,668**	2,541	2,526
Deferred and other expenses	**394**	363	367
Investments in associates accounted by the equity method	**30**	33	37
Deferred tax assets	**605**	789	678
Total non-current assets	**10,746**	10,920	10,683
Total assets	**14,507**	16,578	15,156

Condensed Consolidated Interim Balance Sheets at

	June 30, 2008 (Unaudited) NIS millions	June 30, 2007 (Unaudited) NIS millions	December 31, 2007 (Audited) NIS millions
Liabilities			
Loans and credit	**1,094**	4,187	1,913
Trade payables	**1,450**	1,333	1,533
Other payables, including derivatives	**742**	843*	745
Current tax liabilities	**75**	70	57
Deferred income	**32**	37	47
Provisions	**348**	332	392
Employee benefits	**446**	773*	705
Total current liabilities	**4,187**	7,575	5,392
Debentures	**3,941**	3,350	4,420
Obligations to banks	**1,102**	392	307
Loans from others	**147**	126	136
Loans provided by the minority in a subsidiary	**413**	599	375
Employee benefits	**259**	329	261
Deferred income and others	**13**	28	36
Provisions	**56**	54	57
Deferred taxes	**74**	-	-
Total non-current liabilities	**6,005**	4,878	5,592
Total liabilities	**10,192**	12,453	10,984
Shareholders' Equity			
Share capital	**6,132**	6,132	6,132
Reserves	**701**	681	681
Deficit	**(2,112)**	(2,089)	(2,268)
Total equity attributable to shareholders of the Company	**4,721**	4,724	4,545
Minority interest	**(406)**	(599)	(373)
Total shareholders' equity	**4,315**	4,125	4,172
Total shareholders' equity and liabilities	**14,507**	16,578	15,156

Shlomo Rodav	**Avi Gabbay**	**Alan Gelman**
Chairman of the Board	CEO	Deputy CEO and CFO

Date of approval of the financial statements: August 20, 2008.

* See Note 3C.

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

Condensed Consolidated Interim Statements of Income

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues (Note 10)	**6,186**	6,141	**3,086**	3,053	12,400
Costs and expenses					
Depreciation and amortisation	**851**	877	**422**	436	1,769
Salary	**1,201**	1,160	**585**	584	2,375
Operating and general expenses (Note 11)	**2,683**	2,833	**1,313**	1,410	5,841
Other operating expenses (income), net	**(13)**	44	**(34)**	52	79
	4,722	4,914	**2,286**	2,482	10,064
Operating income	**1,464**	1,227	**800**	571	2,336
Financing costs					
Financing expenses	**392**	321	**231**	159	796
Financing income	**(109)**	(190)	**(48)**	(85)	(487)
Net financing expenses	**283**	131	**183**	74	309
Profit after financing expenses	**1,181**	1,096	**617**	497	2,027
Equity in profits of investees accounted by the equity method	**2**	2	**1**	1	6
Profits before income tax	**1,183**	1,098	**618**	498	2,033
Income tax	**385**	373	**205**	158	672
Profit for the period	**798**	725	**413**	340	1,361
Attributable to:					
The shareholders of the Company	**835**	760	**437**	361	1,330
Minority interest	**(37)**	(35)	**(24)**	(21)	31
Profit for the period	**798**	725	**413**	340	1,361
Earnings per share					
Basic earnings per share (in NIS)	**0.32**	0.29	**0.17**	0.14	0.51
Diluted earnings per share (in NIS)	**0.32**	0.29	**0.17**	0.14	0.50

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

Condensed Consolidated Interim Statements of Recognised Income and Expense

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Net change in fair value of financial assets classified as available for sale	**-**	5	**-**	4	4
Net change in fair value of financial assets classified as available for sale transferred to profit and loss	**(5)**	-	**-**	-	-
Actuarial gains from a defined benefit plan (1)	**-**	-	**-**	-	14
Taxes in respect of income and expenses charged directly to equity	**1**	(2)	**-**	(1)	(4)
Foreign currency translation differences	**(11)**	-	**(11)**	-	-
Income and expenses recognised directly to equity	**(15)**	3	**(11)**	3	14
Profit for the period	**798**	725	**413**	340	1,361
Total recognised income and expenses for the period	**783**	728	**402**	343	1,375
Attributable to:					
The shareholders of the Company	**820**	763	**426**	364	1,344
Minority interest	**(37)**	(35)	**(24)**	(21)	31
Total recognised income and expenses for the period	**783**	728	**402**	343	1,375

(1) The Group does not recalculate its actuarial provisions in each interim reporting period unless there are significant changes in the benefit plan or fundamental changes in market terms during the interim period. As a result, there are no actuarial earnings or losses in the reporting period.

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

Condensed Consolidated Interim Statements of Cash Flows

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2008	**2007**	**2008**	**2007**	**2007**
	(Unaudited)	**(Unaudited)**	**(Unaudited)**	**(Unaudited)**	**(Audited)**
	NIS millions	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**
Cash flows from operating activities					
Profit for the period	**798**	725	**413**	340	1,361
Adjustments:					
Depreciation	**707**	741	**356**	365	1,482
Amortisation of intangible assets	**124**	126	**56**	66	270
Amortisation of deferred and other charges	**20**	10	**10**	5	17
Gain from decrease in holding in companies accounted by the equity method	**-**	-	**-**	-	1
Equity in earnings of associates accounted by the equity method	**(2)**	(2)	**(1)**	(1)	(6)
Net financing expenses	**320**	179*	**191**	161*	372
Net capital (gain) loss	**(19)**	(5)	**(18)**	11	(88)
Share-based payment transactions	**35**	-	**22**	-	-
Payments to a former senior officer	**-**	6	**-**	6	6
Income tax expenses	**385**	373	**205**	158	672
Payment in respect of clearance of derivative financial instruments, net	**(14)**	(4)*	**(4)**	(9)*	(9)
Change in inventory	**15**	(25)	**52**	22	(6)
Change in trade receivables	**(132)**	(109)	**(28)**	(96)	(437)
Change in other receivables	**(14)**	(25)	**39**	27	4
Change in other payables	**4**	38*	**(69)**	(18)*	(18)
Change in suppliers	**(277)**	(129)	**(134)**	(162)	36
Change in provisions	**(46)**	45	**(42)**	30	105
Change in broadcasting rights	**(35)**	(36)	**(7)**	(5)	(74)
Change in employee benefits	**(262)**	(192)	**(179)**	(107)	(300)
Change in deferred and other income	**(2)**	(3)*	**(3)**	(40)*	(11)
	1,605	1,713	**859**	753	3,377
Interest received	**34**	70	**15**	27	116
Dividend received	**2**	3	**2**	3	3
Income tax paid	**(228)**	(224)	**(100)**	(86)	(430)
Net cash from operating activities	**1,413**	1,562	**776**	697	3,066

* See Note 3C.

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

Condensed Consolidated Interim Statements of Cash Flows (Contd.)

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cash flows from investing activities					
Investment in intangible assets and deferred expenses	**(135)**	(105)	**(76)**	(43)	(273)
Proceeds from sale of property, plant and equipment and deferred expenses	**87**	121	**26**	97	177
Financial assets held for trade, net	**314**	7	**257**	(108)	647
Purchase of property, plant and equipment	**(617)**	(413)	**(310)**	(235)	(973)
Proceeds from sale of investments and long-term loans	**11**	33	**5**	26	66
Purchase of investments and long-term loans	**(4)**	-	**(4)**	-	(8)
Investment in an associated company	**(1)**	-	**-**	-	-
Net cash used for investment activities	**(345)**	(357)	**(102)**	(263)	(364)
Cash flows from financing activities					
Issue of debentures	**-**	757	**-**	757	1,814
Receipt of loans	**-**	50	**-**	50	50
Repayment of debentures	**(627)**	(97)	**(398)**	(15)	(1,927)
Repayment of loans	**(81)**	(149)	**(41)**	(80)	(840)
Short-term credit, net	**68**	(23)	**56**	9	(37)
Dividends paid	**(679)**	(2,100)	**(679)**	-	(2,860)
Interest paid	**(235)**	(198)	**(179)**	(123)	(389)
Receipt (payment) in respect of clearance of derivative financial instruments, net	**29**	(14)*	**25**	(2)*	77
Injections of a minority in a subsidiary	**4**	-	**4**	-	-
Net cash from (used for) financing activities	**(1,521)**	(1,774)	**(1,212)**	596	(4,112)
Net increase (decrease) in cash and cash equivalents	**(453)**	(569)	**(538)**	1,030	(1,410)
Cash and cash equivalents at the beginning of the period	**1,203**	2,632	**1,283**	1,033	2,632
Effect of fluctuations in the rate of exchange on cash balances	**(10)**	-	**(5)**	-	(19)
Cash and cash equivalents at the end of the period	**740**	2,063	**740**	2,063	1,203

* See Note 3C.

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

NOTE 1 – REPORTING ENTITY

A. Bezeq – The Israel Telecommunication Corp. Ltd. ("the Company") is a company domiciled in Israel whose shares are traded on the Tel Aviv Stock Exchange. The official address of the Company is 132 Menachem Begin Road, Tel Aviv. The condensed consolidated interim financial statements of the Company comprise those of the Company and its subsidiaries (jointly referred to as the "Group"), and the Group's interests in associates. The Group is a principal provider of communications services in Israel (see also Note 13 – Segment Reporting).

B. On October 11, 2005, control in the Company was transferred from the State to Ap.Sb.Ar. Holdings Ltd. and the Company ceased to be a government company. The Company was declared a monopoly in the main areas in which it operates. An appeal filed by the Company was pending in the Antitrust Court against the non-revocation of its monopoly status in the basic telephony field; however, at the suggestion of the court (in view of the time elapsed since it was filed), the Company consented to withdraw the appeal. All the segments of operation of the Group are subject to competition. The activities of the Group are, in general, subject to government regulation and control.

C. The Company is subject to various systems of laws that regulate and limit its business operations, including its tariffs, which are controlled by Sections 15 to 17 of the Communications Law. The tariffs of the Company's controlled services, which are set in regulations, are updated according to a linkage formula less a reduction factor, as laid down in the regulations and pursuant to the recommendations of public committees with a mandate to examine those tariffs. In March 2008 the Committee for Examining the Policy and Rules of Competition in Communications in Israel, submitted its recommendations to the Minister of Communications. On August 13, 2008, the Minister of Communications announced his decision to adopt the conclusions of the committee, subject to a number of changes and emphases, and they will become the policy guiding the Ministry in the years to come. The Minister's decision improves the level of regulatory clarity to some extent.

The intensifying competition and numerous changes in the communications market are expected to have an adverse effect on the business results of the Group, an effect that the Group is unable to estimate.

NOTE 2 – BASIS OF PRESENTATION

A. The condensed interim consolidated financial statements were prepared in accordance with the International Accounting Standard 34 – Interim Financial Reporting, and in accordance with Chapter 4 of the Securities (Periodic and immediate reports) Regulations, 5730-1970.

B. These reports do not contain all the information required in full annual financial statements, and should be reviewed in the context of the annual financial statements of the Company and its subsidiaries at December 31, 2007 and the year then ended, and their accompanying notes ("the annual financial statements"). The Group states in the notes to the interim financial statements only the material changes that have occurred in its business and legal environment from the date of the most recent annual financial statements until the date of these interim financial statements.

C. The condensed consolidated interim financial statements were approved by the Board of Directors on August 20, 2008.

NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICIES

The significant accounting policies applied in these condensed consolidated interim financial statements are consistent with those applied in the annual financial statements for the year ended December 31, 2007, except as mentioned in this note.

A. Initial application of accounting standards

Commencing January 1, 2008, the following international financial reporting standards came into force:

(1) Interpretation 11 of the International Financial Reporting Interpretations Committee (IFRIC 11) for *IFRS 2 – Group and Treasury Share Transactions*. The interpretation requires that a share-based payment in which the entity receives goods and services as consideration for its own equity instruments, be accounted for as equity-settled share-based payment, irrespective of the question of how the equity instruments were obtained. This interpretation did not materially affect the results of the Group's operations and its financial position.

(2) IFRIC 14 for IAS 19 – *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*. The interpretation clarifies when refunds and reductions in future contributions in connection with defined benefit assets must be seen as available, and provides instruction about the influence of minimum contribution requirements on those assets. The Interpretation relates to the question of when a minimum deposit requirement establishes a liability. This interpretation did not materially affect the results of the Group's operations and its financial position.

(3) The Group opted for early application of IAS 2 – *Share-Based Payment – Vesting and Cancellation*. The standard states that vesting terms are terms that determine whether the group receives the services for which the other part is entitled to share-based payment, and they are limited to terms of service and performance. Non-vesting terms will be reflected in the fair value of the grant on the grant date, and after the grant date the group will not revise the fair value in respect of those terms. In addition, the standard describes the treatment of non-compliance with non-vesting terms. The early application did not materially affect the results of the Group's operations and its financial position.

B. New standards prior to their application

A number of new standards, amendments to existing standards and interpretations have not yet come into force on June 30, 2008, and therefore were not applied in the preparation of these consolidated financial statements

Since publication of the last annual report, the following standards have been published:

(1) IAS 32 – *Financial Instruments: Presentation*, IAS1 – *Presentation of Financial Statements – Redeemable Financial Instruments and Obligations Arising on Liquidation.* According to these amendments, certain financial instruments and obligations arising on liquidation are to be classified as redeemable equity if certain criteria exist. In addition, appropriate disclosure is required for redeemable instruments classified as equity. The amendments will apply to annual periods commencing January 1, 2009, or thereafter. The amendments are not expected to have a material effect on the activities and financial position of the Group.

(2) IFRIC 13 – *Customer Loyalty Programs* – The interpretation deals with the accounting treatment of companies that grant benefits in customer loyalty programs (such as points or frequent flyer plans) at the time of purchase of goods or services. IFRIC 13 explains how companies should treat liabilities to supply goods or services in the future, free of charge or at a discount (benefits) to customers who expect to utilise the benefits. The interpretation applies to annual periods commencing July 1, 2008 or thereafter. The Group is considering the effects of the interpretation on its financial statements.

NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICIES (CONTD.)

B. New standards prior to their application (contd.)

(3) IFRIC 15 – *Agreements for the Construction of Real Estate* (in this sub-section – "the Interpretation"). The Interpretation provides guidelines for ascertaining whether real estate construction transactions are covered by IAS 18 – *Revenue*, whereby revenue from the construction of real estate will be recognized similarly, from the aspects of timing and character, to revenue from the sale of a product or service, or are covered by IAS 11 – *Construction Contracts*, whereby the revenue will be recognized according to the completion stage of the real estate asset. The Interpretation will apply to annual periods commencing January 1, 2009, or thereafter, and will be applied retrospectively. Early application is permissible, with disclosure. The Interpretation is not expected to affect the financial statements of the Group.

(4) IFRIC 16 – *Hedges of a Net Investment in a Foreign Operation* (in this sub-section – "the Interpretation"). The Interpretation relates to instances in which an investment is made in a foreign operation, and provides guidelines for hedging such an investment. The Interpretation relates, *inter alia*, to the nature of the hedged risk and the amount of the hedged item for which the hedging is designated, to the location of the hedging item in the group of companies, and to the accounting treatment of the capital fund on the date of disposal of the foreign operation.
This Interpretation applies to annual periods commencing October 1, 2008, or thereafter. Early application is permitted, with disclosure. Adoption of the interpretation is not expected to influence the financial statements of the Group.

(5) IAS 27 – *Consolidated and Separate Financial Statements* and IFRS 1 – *First-time Adoption of International Financial Reporting Standards*, Amended ("the Standards"). Under the Standards, after their amendment, a company that chooses the method of measuring the cost of its investments in subsidiaries, jointly-controlled companies and associates in separate (solo) financial statements, can measure those investments on the date of transition to IFRSs at the fair value according to IAS 39 or at their book value according to prior accepted accounting principles. In addition, a dividend received from subsidiaries, jointly-controlled companies and associates will be recognized as income in the separate financial statements of the investor company. Also, in certain cases, receipt of a dividend constitutes a sign of impairment of the investment in the investee company. The new Standards will apply to annual periods commencing January 1, 2009, or thereafter. Early application is permitted, for each standard separately, with disclosure. The changes attributed to IAS 27 will be applied prospectively. Adoption of the Standard is not expected to affect the consolidated financial statements.

(6) Improvements to IFRSs – As part of a project for amending the international standards, the IASB published and approved, in May 2008, 35 amendments to various international standards on a wide range of accounting issues. The importance of the amendments lies in their indicating the position of the IASB on those issues, and therefore they could affect the accounting treatment even prior to the date of their application. Most of the amendments will come into force for periods commencing January 1, 2009, or thereafter, with early adoption permitted, subject to the terms set out for each amendment and subject to the transition provisions relating to initial adoption of IFRSs. The Group is considering the effects of the aforementioned on its financial statements.

(7) Hedgeable items, Amendment to IAS 39 – *Financial Instruments: Recognition and Measurement* ("the Amendment"). The Amendment clarifies that changes in cash flows or changes in the fair value of a one-sided risk can be designated as a hedged item, i.e. a risk defined as a risk of exposure to fluctuations above or below a certain price or a defined variable. The Amendment also clarifies that an inflationary component can be designated as a separate risk, provided it is contractually specified in the cash flow of Index-linked debentures so that it can be identified separately and measured reliably, and if the other cash flows of the instrument are not affected by the inflationary component, the amendment should be retroactively applied to annual periods commencing on July 1, 2009, or thereafter. Early application is permitted, with disclosure. The Group is considering the effects on its financial statements.

NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICIES (CONTD.)

C. Classified amounts

The condensed consolidated interim financial statements include reclassification of certain amounts of the comparative figures of the relevant sections,, including the classification of broadcasting rights to non-current assets

D. Index-linked assets and liabilities not measured at fair value

Further to Note 3C(1) to the financial statements at December 31, 2007, concerning index-linked financial instruments – discussion of the matter by IFRIC resulted in the committee's decision that the provisions of IAS 39 (Financial Instruments: Recognition and Measurement) should be applied with discretion as to the most appropriate application of the standard's guidelines, and furthermore, the committee saw no justification for continuing its discussions of the matter. Nevertheless, the committee will refer the question to the IASB for review of the clarification or a broadening of the application guidelines of IAS 39. In light of the aforesaid, the value of index-linked financial assets and liabilities that are not measured at fair value, is revalued in each period according to the actual rate of rise in the Index.

E. Property, plant and equipment

On June 26, 2008, the Board of Directors of the Company resolved to approve Company implementation of the NGN project. At that date, the Board approved detailed planning of the project, setting-up of two areas as operational pilots, and the purchase of soft switches. The project will be implemented in modules with Company assessments on a regular basis, and after each stage of implementation it will reconsider the viability of continuing the project, looking at all the variable factors that could influence its viability and therefore the need to revise the project outline. The content, pace of performance and the amounts to be invested in the project, will be determined each year in the framework of the annual budget of the Company. Subsequent to the balance sheet date, an additional investment budget, in excess of the above, was approved for implementation in 2008, which includes, *inter alia*, management systems, equipment cabinets, MSAG systems, optical equipment and other items. The estimated life of part of the communications infrastructure that will be replaced in the project, will vary, and as a result, the Company's depreciation expenses for that part can be expected to be accelerated, and despite the pace of performance of the entire project, the lifetime could still change. It is expected that commencing in the second half of 2008, the Company's depreciation expense will increase by an average of about NIS 55 million per year up to and including 2010, and in 2011 – 2013 it will decrease by about NIS 20 million per year on average. The effect of the aforementioned is subject to changes in the pace of deployment of the new network and the scrap value of the copper cables, if any.

NOTE 4 – ESTIMATES

The preparation of interim financial statements requires Management to make judgments and use estimates, assessments and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

The significant estimations applied in these interim statements do not differ significantly from those applied to the annual financial statements.

NOTE 5 – RATES OF CHANGES IN THE CONSUMER PRICE INDEX AND FOREIGN CURRENCY EXCHANGE RATES

The changes that occurred in the consumer price index and in the exchange rates of the US dollar and the euro in the accounting period are as follows:

	Consumer Price Index	Rate of exchange of the US dollar	Rate of exchange of the euro
	%	%	%
For the six-month period ended on:			
June 30, 2008	**2.25**	**(12.8)**	**(6.6)**
June 30, 2007	0.97	0.57	2.68
For the three-month period ended on:			
June 30, 2008	**2.24**	**(5.66)**	**(5.9)**
June 30, 2007	1.21	2.26	3.23
For the year ended December 31, 2007	3.40	(8.97)	1.71

NOTE 6 – GROUP ENTITIES

A detailed description of the Group entities appears in Note 33 to the annual financial statements of the Group at December 31, 2007. Below are details of the material changes that occurred in connection with the Group entities since publication of the last annual report.

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

(1) Since commencing its operations, DBS has accumulated considerable losses. Its losses in 2007 amounted to approximately NIS 118 million and the loss during the six-month period ended June 30, 2008, amounted to approximately NIS 165 million. As a result of these losses, its capital deficit and its working capital deficit at June 30, 2008, amounted to approximately NIS 2,794 million and approximately NIS 543 million, respectively.

(2) The Company's investment in DBS (primarily through shareholders' loans) at the balance sheet date amounts to approximately NIS 1,562 million (without interest and linkage). The balance of DBS's current debt to the Company and its subsidiaries amounts to approximately NIS 133 million, of which approximately NIS 100 million is owed to the Company. The Company has come to an arrangement with DBS for the collection of a debt balance of approximately NIS 55.6 million in arrears. Under the arrangement, the debt will be paid in 60 equal monthly instalments plus interest at prime + 1.5%. At the balance sheet date, the debt balance in the arrangement is approximately NIS 36 million. The remainder of the debt to the Company, beyond the arrangement, is a current debt for which the agreed terms of payment are the regular credit terms in effect between the Company and its customers. At the date of approval of the financial statements, DBS is not in compliance with the arrangement and credit terms noted above. The Company and its subsidiaries are working to collect DBS's debts in arrears.

(3) During 2005, the banks completed the provision of the entire credit facility to which DBS was entitled under the financing agreements.

The terms of the loans and the credit facility that DBS received from the banks, the balance of which at June 30, 2008, is NIS 974 million, impose various restrictions on DBS that include, *inter alia*, restrictions on providing a lien on or sale of certain assets, a restriction on receipt of credit from other banks without prior approval, a restriction concerning repayment of shareholders' loans, and a requirement for compliance with financial criteria ("the Conditions").

NOTE 6 – GROUP ENTITIES (CONTD.)

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

(3) (contd.)

a. DBS applied to the banks requesting revision of the stipulations for 2008 so as to adapt them to its budget, and on March 5, 2008 the banks consented to amend the stipulations. DBS also requested a further revision of a particular operational stipulation, and on June 25, 2008, the banks consented to amend that stipulation.

b. At June 30, 2008, DBS is in compliance with the financial criteria set for it.

c. The management of DBS believes that the sources of financing available to it will be sufficient for the needs of its operations in the coming year, based on the projected cash flow approved by the board of directors of DBS. If additional resources are required to meet operational needs during the year, DBS will adapt its operations to preclude the need for additional resources beyond those available to it.

B. Pelephone Communications Ltd. ("Pelephone")

Further to Pelephone's right to purchase frequencies from the Ministry of Communications as described in Note 18G to the financial statements at December 31, 2007, Pelephone has applied to the Ministry of Communications requesting exercise of its right to allocation of the frequencies. In exercising its right, Pelephone will pay an additional sum of approximately NIS 178 million in frequency fees and license fees.

NOTE 7 – CONTINGENT LIABILITIES

A. Claims

During the normal course of business, legal claims are filed against the companies in the Group, including applications for certification as class action lawsuits.

In the opinion of the managements of the Group companies, based, *inter alia*, on legal opinions regarding the probability of success of the claims, including the applications for certification of the class action lawsuits, appropriate provisions in the amount of approximately NIS 330 million were included in the financial statements where such provisions were required to cover the exposure resulting from such claims.

In the opinion of the managements of the Group’s companies, the additional exposure (in addition to the above provisions) at June 30, 2008, due to claims filed against the companies in the Group on various matters and the probability of realisation of which is likely, amounts to approximately NIS 12.9 billion, of which approximately NIS 3.4 billion relates to claims filed by groups of employees or by individual employees which could have far-reaching implications. The above amounts are stated before the addition of interest.

Concerning applications for certification as class actions of lawsuits in respect to which the Group has exposure beyond the aforesaid (since the claims do not state a specific amount), see claims in Note 17A(4), (5), (7) and (20) to the financial statements at December 31, 2007, and significant changes as described below.

For a detailed description of these claims, see Note 17A to the Group’s annual financial statements at December 31, 2007. Details of the significant changes in the status of the material contingent liabilities of the Group since December 31, 2007 are provided below:

NOTE 7 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(1) Further to Note 17A(1) to the financial statements at December 31, 2007, concerning a claim and application for its certification as a class action, which alleges a cartel in public switching, a proceeding for certification the claim, the amount of which is estimated by the plaintiff at approximately NIS 1,750 million, is still in its preliminary stages. In April 2008 the plaintiff filed another application, for discovery of documents, as well as a motion to call witnesses. The plaintiffs' motions were dismissed.

(2) Further to Note 17A(2)(a) to the financial statements at December 31, 2007, concerning a claim filed by 2,343 retired employees who were transferred from the Ministry of Communications to the Company upon its establishment – on February 12, 2008 the plaintiffs filed a written summation of their allegations. The plaintiffs narrowed their claim to an incentive pay salary component and withdrew their claims relating to grossing up of tax and to clothing.

The claim from January 2007, which was filed by another 85 retired employees, was consolidated with the above claim.

(3) Further to Note 17A(3) to the financial statements at December 31, 2007, concerning a class action alleging unlawful collection of collection expenses – on July 20, 2008, in a court hearing , the parties were requested to respond to a proposal of the court whereby the decision on certification of the claim as a class action would be reversed and the group of plaintiffs would be widened as requested by the plaintiff. The parties were unable to agree on the proposal. In the matter of another class action mentioned in the same Note, in the amount of NIS 21 million in respect of unlawful debiting of collection fees – on July 2, 2008, the court ruled, following the request of the plaintiff's lawyer (after the death of the plaintiff) and the Company's consent, to strike out the claim and the application for its certification as a class action. It is noted that the causes of the two above claims are similar, and the first class action is still pending.

(4) Further to Note 17A(8) to the financial statements at December 31, 2007, concerning a claim and application for its certification as a class action, which alleges unlawful collection by the Company for surfing the internet at the promised speed – on April 7, 2008, the Company filed a motion for leave to appeal the decision of the District Court. The Supreme Court ruled that the motion for leave to appeal warrants a reply, and instructed the respondents to reply to it. The reply was filed on May 19, 2008.

(5) Further to Note 17A(17) to the financial statements at December 31, 2007, concerning a claim and application for its certification as a class action against the Company in the matter of collection of a regular monthly payment for a fixed telephone line through which high-speed internet infrastructure services are also provided – on June 27, 2008, a decision was given in which the application for certification of the class action and the action itself were struck out without an order to pay costs, with the consent of the parties.

(6) Further to Note 17A(19) to the financial statements at December 31, 2007, concerning a claim and application for its certification as a class action against the Company (the Company was later deleted from the statement of claim), Bezeq International, the Chairman of the Board of Bezeq International and the then CEO of Bezeq International – a hearing was held on April 14, 2008, in which the Court proposed the settlement described in the aforementioned Note 19A(17). Bezeq International rejected the settlement proposal and is awaiting the ruling of the Supreme Court on the merits of the appeal, i.e. whether the decision of the District Court to dismiss the application for certification as a class action should be reversed or not.

(7) Further to Note 17A(30) to the financial statements at December 31, 2007, concerning the class action filed against DBS and against the cable companies in connection with the broadcasting of commercials during the World Cup telecasts – on March 17, 2008, the applicants filed an agreed abandonment motion in the court, without an order to pay costs. On March 18, 2008, the court decided to allow the motion to abandon the claim.

NOTE 7 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(8) Further to Note 17A(31) to the financial statements at December 31, 2007, concerning class actions against DBS and against the Sports channel relating to the broadcasts of Channel 5+ - on July 9, 2008, the Cable and Satellite Broadcasting Council announced that it will not appear at the proceeding, while reserving the right to review its position should the need arise later in the proceedings.

(9) Further to Note 17A(32) to the financial statements at December 31, 2007, concerning claims filed against DBS in the matter of interrupted broadcasts – on April 13, 2008, DBS filed its response to the application for certification, in which it denied the plaintiffs' allegations outright.

B. Claims which cannot yet be assessed or for which the exposure cannot be calculated

For a detailed description of the claims which cannot yet be assessed or for which the exposure cannot be calculated, see Note 17B to the Group's annual financial statements at December 31, 2007. Details of significant changes since December 31, 2007, are provided below:

Claims for which the exposure cannot be calculated

(1) Further to Note 17B(1) to the financial statements at December 31, 2007, concerning a claim against the Company and against Makefet Fund which was filed by Company employees who retired under a retirement agreement from November 2007 – in March 2008 an identical claim was filed in the Tel Aviv District Labour Court by another 17 retired Company employees.

Claims which cannot yet be assessed

(2) Further to Note 17B(2) to the financial statements at December 31, 2007, concerning a claim against the Company, Makefet Fund and the State of Israel, which was filed by the Organization of Bezeq Retirees and six of its retirees, alleging violation of arrangements which were agreed when the employees transferred from the civil service to the Company – on June 5, 2008 the court decided to strike out the claim.

(3) During the second quarter of 2008, four claims were filed in the Tel Aviv District Court against Bezeq International, concerning Bezeq International's conduct relating to the use of international phone cards for calling destinations in the Philippines, Thailand and Nepal. The claims were filed together with application for their recognition as class actions. The plaintiffs estimate the loss incurred by all the members of the group at approximately NIS 200 million in the Philippine citizens' claim, approximately NIS 150 million in the Thai citizens' claim, approximately NIS 58 million in the Nepal citizens' claim, and approximately NIS 332 million in the additional group of Thai citizens.

(4) In April 2008, a claim was filed in the Tel Aviv District Court against Pelephone, together with an application for its certification as a class action, in a total amount of approximately NIS 60 million. The claim is for restitution of amounts allegedly over-collected from Pelephone's subscribers in respect of "Call Continue" service from a voice-mail box and debiting for 1-800 destinations.

(5) In May 2008, a financial claim was filed in the Tel Aviv District Court against Pelephone and another defendant. The total amount of the claim is not defined in the claim. The claim is for restitution of amounts by the other defendant, which the plaintiff alleges it collected, through Pelephone, from the members of its "customer club" for services provided to those customers.

(6) In May 2008, a claim was filed in the Tel Aviv District Court against Pelephone, Cellcom and Partner, together with an application for certification as a class action in a total amount of NIS 50 million. The claim is for the restitution of amounts which the plaintiffs allege were over-collected from the subscribers of the defendants for "Callback" service (calls made from abroad to Israel by means of a service which Pelephone calls "Saver Service").

NOTE 7 – CONTINGENT LIABILITIES (CONTD.)

B. Claims which cannot yet be assessed or for which the exposure cannot be calculated (contd.)

Claims which cannot yet be assessed (contd.)

(7) In June 2008, a claim was filed in the Tel Aviv District Court against Pelephone., together with an application for its certification as a class action in the amount of NIS 64 million. The claim is for restitution of amounts which the plaintiff alleges were collected by Pelephone unlawfully, in contravention of its license, as a commission for payment made by means of a voucher (a commission collected from a customer who does not pay the monthly charge by direct debit, but by individual payment each month).

(8) In July 2008, a claim was filed in the Tel Aviv District Court against Pelephone., together with an application for its certification as a class action, in the amount of approximately NIS 240 million. The claim is for restitution of amounts which the plaintiff alleges were over-collected from the defendant's subscribers in respect of "Continue Call" from the 144 information service, for the collection of arrearage interest from a subscriber who is late in making payment, and for direct debits and payments in respect of voucher payment at a service center.

(9) In July 2008, Bezeq International received a claim that was filed in the Tel Aviv District Court together with an application for its certification as a class action, concerning charging customers at a dollar exchange rate higher than the representative rate. The amount of the claim is not stated, but is estimated by the plaintiff in the tens of millions of shekels.
Bezeq International has filed a motion to order the plaintiff to deposit a guarantee to secure its expenses if the claim is dismissed. The plaintiff has not yet filed its response to the motion.

On July 13, 2008, Bezeq International received another claim in the same matter, together with an application for its certification as a class action, filed in the Tel Aviv District Court by another of its business customers. The application for certification is for the business customers of Bezeq International from whom payment was collected for Bezeq International's services at a dollar exchange rate higher than the representative rate, from September 2007 to the date of filing the claim. The plaintiff estimates the amount of the claim at approximately NIS 93 million. Bezeq International intends to file a motion to order the plaintiff to deposit a guarantee to secure Bezeq International's expenses if the claim is dismissed.

C. Other contingencies

For a detailed description of other contingencies, see Note 17C to the Group’s annual financial statements at December 31, 2007. Details of material changes since December 31, 2007 are provided below:

(1) Further to Note 17C(1) to the financial statements at December 31, 2007, in the matter of the Antitrust Commissioner's determination that the Company abused its status in the market when it disconnected its network from the HOT network – on March 16, 2008, the Company filed an appeal against the Commissioner's determination.

(2) Further to Note 17C(2)(b) to the financial statements at December 31, 2007, in the matter of a shareholder's letter pursuant to Section 194 of the Companies Law, on the matter of approval of transfer of funds from the Company to DBS despite the decisions of the Ministers of Communications – on April 6, 2008, the shareholder filed an application for leave to file a derivative action against the Company and a statement of claim against directors who were party to the decision, which led to the Company incurring losses of NIS 10 million (the amount called in by the Ministry of Communications from the Company's guarantee after the Minister of Communications denied the Company's appeal on March 25, 2008). The Company's response was filed on August 7, 2008.

NOTE 7 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies

(3) Further to Note 17C(6) to the financial statements at December 31, 2007, in connection with a claim filed by the cable companies ("HOT") against DBS – on July 9, 2008, the parties filed an application for approval of a settlement agreement, part of which is a request to strike out the claim without an order to pay costs. On the same date, the court validated the settlement decision between the parties.

In addition and further to the same Note, in the matter of a claim filed against Pelephone concerning the solicitation of information about the plaintiff's business – in May 2008, the claim was dismissed due to the plaintiff's failure to appear before the court.

(4) Further to Note 17C(7) to the financial statements at December 31, 2007, concerning the operation of facilities that emit electromagnetic radiation – after termination of the strike at the Ministry for Protection of the Environment, the proceedings for issue of operating permits for communications and broadcasting installations by the Supervisor of Radiation were completed. In addition, on April 17, 2008, the Company submitted its reservations concerning the proposed draft of National Outline Plan for Communications – NOP/36A Small Broadcasting Installations, and NOP/36B Large Broadcasting Installations. In brief, the reservations are that the plans as proposed, and in particular as they relate to changing the definitions of large and small broadcasting installations, create practical difficulties which could prevent the Company from granting the public some of the varied services it provides and is obligated by law to provide.

On July 29, 2008, the Company received notice that in June 2008, National Outline Plan 56 came into force, which regulates the manner of erection and registration of communications installations in the Administrated Territories. The plan includes transition directives for installations erected before 1984 and for existing installations. The Company is studying the subject, and at the date of publication of this report is unable to assess its expected implications.

(5) Further to Note 17C(9) to the financial statements at December 31, 2007, concerning an application for certification of a class action against Pelephone in the amount of NIS 12 billion – the action was struck out without an order to pay costs.

(6) Further to Note 17C(10) to the financial statements at December 31, 2007 – on February 28, 2008 the DBS shareholder, holding an insignificant number of shares, applied to the Tel Aviv District Court for the appointment of an arbitrator. The Companies filed a response to the application in which it explained that there is no cause for the appointment of an arbitrator. On May 4, 2008, the Court ruled that in view of the difficulty in understanding the essence of the claim that the shareholder wishes to put to the arbitrator, she must file such a draft claim, which she did and in which the claimed amount is NIS 160 million. On July 13, 2008, the Court ruled to allow the application for appointment of an arbitrator. An introductory meeting with the arbitrator is scheduled for September 9, 2008.

(7) In February 2008, the Ministry of Industry, Trade and Employment (in this sub-section – "the Ministry"), instituted an investigation of DBS relating to the terms of employment of a certain group of DBS employees, and DBS was required to submit various documents to the Ministry, which it did. The investigation is still in its initial stages, and its full extent is not yet known.
Furthermore, in December 2007, DBS received a letter from 19 of its employees (18 of whom are no longer employed by DBS), regarding various periods between 2001 and 2007 in which they allege that during the period of their employment at DBS they were not paid all the monies due to them. On April 21, 2008, DBS sent its reply to those employees, rejecting all their allegations. At this stage, the extent of the Ministry's investigation is unknown, and no action has been filed by the employees.

NOTE 8 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES

A. On June 1, 2008, the general meeting of the shareholders of the Company approved the terms of employment of the Chairman of the Board of the Company. Below are the main points of the engagement of the Chairman of the Board:

(1) The Chairman is employed under a personal employment agreement as acting Chairman of the Board of Directors of the Company, in a full-time position, effective from September 4, 2007, the date on which the Chairman actually started working in the Company.

(2) The salary of the Chairman is NIS 175,000 per month, linked to the CPI. In addition, Chairman in entitled to contributions to senior employees insurance, study fund and loss of earning capacity insurance. The Company will provide the Chairman with a company car, and will bear all the car maintenance expenses.

(3) The Chairman will be granted 9,000,000 options, as described in Section 9B below.

(4) A decision on the award of an annual bonus will be made at the discretion of the Board of Directors and subject to the approval of the Audit Committee and the general meeting. The amount of the annual bonus, if awarded, will be between six and eighteen monthly salaries.

(5) Immediately after approval of the agreement by the general meeting, the Company will pay the Chairman a special "signature bonus" of NIS 1.2 million.

(6) The Company will insure the Chairman with directors and officers insurance, and will indemnify him from time to time as is customary with regard to other directors in the Company.

(7) The engagement between the Company and the Chairman is for an unlimited period, where each party is entitled to bring it to an end at any time and for any reason by giving 12 months' notice (the Company) or 6 months' notice (the Chairman).

B. On July 31, 2008, the Board of Directors of the Company resolved to approve extension of the Company's engagement in the management agreement with a corporation related to Ap.Sb.Ar Holdings Ltd., the controlling shareholder in the Company, for a period of three years subsequent to the end of the term of the current agreement, on the same terms as the original agreement. Extension of the engagement is subject to the approval of the general meeting.

C. For the matter of stock options for senior officers who are key personnel in the Group, see Note 9 below.

NOTE 9 – SHARE-BASED PAYMENTS

A. On November 20, 2007, the Board of Directors of the Company resolved to adopt a new stock options plan for managers and senior employees in the Company and/or in associates, which would allocate up to 65,000,000 non-negotiable options exercisable for up to 65,000,000 shares of the Company and representing approximately 2.5% of the issued capital of the Company, and at full dilution – 2.37% of the share capital.

On December 25, 2007, the Company published an outline for the allocation of up to 65,000,000 options in accordance with the Securities (Details of an outline offer of securities to employees) regulations, 5760-2000, which described, *inter alia*, the terms of the plan, as well as a private placement report in accordance with the Securities (Private placement of securities in a listed company) Regulations 5760-2000.

The options plan and the allocation of all the options in accordance with it, were approved by the general meeting of the Company on January 31, 2008, in accordance with the Company's Articles of Association (since in certain cases, there is also a requirement in law for the further approval of the general meeting).

NOTE 9 – SHARE-BASED PAYMENTS (CONTD.)

A. (contd.)

Exercise of the options under the plan is contingent upon receipt of the appropriate approvals in accordance with the provisions of the Communications (Telecommunications and Broadcasts) (Determination of an essential service provided by Bezeq, The Israel Telecommunications Corp. Ltd.) Order, 5757-1997 ("the Telecommunications Order"), and it is possible that such exercise will necessitate amendment of the Telecommunications Order or a different solution. It is noted that on March 30, 2008, a letter was received from the Ministry of Communications, dismissing the possibility of amendment of the Telecommunications Order. Nevertheless, the Company believes a solution will be found that enables allocation of the Company's shares while complying with the Telecommunications Order.
The options will vest in three equal annual portions. The vesting dates of each portion will fall at the end of each of the first, second and third years from the grant date, respectively, and the expense for each portion will be spread according to its vesting period. In addition, the plan sets terms which, if met, bring forward the vesting dates.

Exercise of the options for shares will be by using a cashless exercise mechanism, unless the Board of Directors decides otherwise.

The exercise price set for the grant of up to 41,350,000 options is NIS 5.50 (adjusted for distribution of a dividend in cash or in kind). On June 26, 2008, the Board of Directors of the Company resolved that the exercise price for future grants of options, as will be approved by the Board of Directors from time to time, will be the same as the average closing price of the Company's share on the stock exchange in the 30 days' trading prior to the date of the Board's decision to grant options to those offerees.

B. Of the options, 54,700,000 were actually allocated at the date of the financial statements, as follows:

(1) 45,700,000 options whose theoretical economic value is approximately NIS 131 million (of which 13,500,000 were allocated to the CEO of the Company and to senior officers who are key persons in the Group, the theoretical economic value of which is approximately NIS 35 million), based, *inter alia*, on the share price on the grant date, a risk-free annual interest rate between 5.09% and 5.68%, a weighted average of expected life of between 4.5 and 5.5 years, the exercise price noted above, an annual standard deviation between 22.7% and 24.3%. The limitation described above by virtue of the Telecommunications Order was taken into account in calculating the theoretical economic value of the options, on the assumption that the limitation is resolvable. The grant date was set as the later of the date of the general meeting and the date of the notice to the employees.

(2) On April 17, 2008, the Board of Directors of the Company resolved to allocate 9,000,000 options to the Chairman of the Board in accordance with the plan described in Section A above, subject to a number of changes relating to the terms of his options. The allocation to the Chairman was approved by the general meeting of the shareholders of the Company on June 1, 2008.

The options will vest in 12 equal quarterly portions. The vesting dates of each portion will fall at the end of each quarter from the grant date, and the expense will be spread for each portion in accordance with its vesting period. In addition, the plan sets terms which, if met, will bring the vesting date forward.

The exercise price of the each option is NIS 6.4405 per share. The price was set according to the share price on the date on which the Chairman took up his post – September 4, 2007 (which was NIS 6.649 per share) and after adjustment for distribution of a net dividend in the amount of NIS 0.26 per share, for which the X-day was April 14, 2008. The closing price of the Company's share on June 1, 2008, the date of approval by the Audit Committee, was NIS 6.494 per share.

The theoretical economic value of the options granted to the Chairman as described above, according to a weighted Black and Scholes model, is approximately NIS 16 million, based, *inter alia,* on the share price on the grant date, a risk-free annual interest rate of 5.1%, a weighted average expected life of 4 years, the exercise price noted above, and an annual standard deviation of 23.11%, as well as resolution of the limitation described in Section A above pursuant to the Telecommunications Order.

NOTE 9 – SHARE-BASED PAYMENTS (CONTD.)

C. On June 26, 2008, the Board of Directors of the Company resolved to grant an additional 2,600,000 options to senior employees of the Group, in accordance with the outline dated December 25, 2007, and mentioned in Section A above. The grant date was set for July 17, 2008, as the later of the date of the general meeting and the date of the notice to the employees.

The theoretical economic value of the options granted, according to a weighted Black and Scholes model, is approximately NIS 5 million, based, *inter alia,* on the share price on the grant date, which was NIS 6.55, a risk-free annual interest rate of 5.3%– 5.5%, a weighted average expected life of 4.5 – 5.5 years, an exercise price of NIS 6.35 determine as aforesaid, an annual standard deviation of between 23.07% and 24.07%. The limitation described in Section A above pursuant to the Telecommunications Order was taken into account in calculating the theoretical economic value of the options, assuming that the limitation is resolvable.

D. On July 3, 2008, the board of directors of DBS resolved to approve in principle an allocation of 4,250,000 options of the Company to the CEO of DBS, exercisable for Company shares at an exercise price of NIS 5.5 per option (as will be adjusted according to dividend distributions starting from October 25, 2007). This was after approval of the grant by the Board of Directors of the Company. The options will vest in three equal annual portions, and those that vest will be exercisable through the end of five years from the vesting date of the third portion. The board of directors of DBS also resolved that after the allocation is approved by the Antitrust Commissioner, it will be brought to the organs of DBS for approval. The theoretical economic value of these options, which was calculated shortly before the date of approval by DBS's board of directors, is approximately NIS 11.4 million.
On the same date, the board of directors of DBS approved an annual bonus plan for the CEO of DBS for the years 2009-2010, which is contingent upon the approval of the Antitrust Commissioner and approval of the allocation by DBS's organs as aforesaid. The plan is based on attaining an aggregate percentage of certain goals as defined in the plan. On July 29, 2008, the Antitrust Commissioner notified DBS that it has no objection to the allocation, and the board of directors of DBS approved the allocation on August 11, 2008.

E. The terms of the options are as shown below:

Grant date / eligible employees	No. of instruments in thousands	Vesting terms	Contractual life of options
A. Grant of options from the State to employees on October 11, 2005	122,698	Immediate (subject to lock-up, commencing at the end of 2 years, to 3 years – one third each year)	4 years
B. Grant of options to employees on February 22, 2007 (1)	78,151	Immediate (subject to lock-up for two years)	5 years
C. Grant to the Chairman of the Board	9,000	12 quarterly portions	4 years
D. Approval and/or grant of options to managers, senior employees and officers up to the date of approval of the financial statements	48,300	Three equal annual portions	8 years
Total stock options granted	258,149		

(1) The expenses in respect of this grant were recorded in 2006 as a promise was made to the employees in 2006, along with the conditions of the grant.

Remark: The options referred to in A and B are settled by way of physical delivery of shares. The options referred to in C and D are settled in a cashless exercise mechanism.

NOTE 9 – SHARE-BASED PAYMENTS (CONTD.)

E. (contd.)

Changes in the number of options:

	Number of options		
	For the six-month period ended June 30		For the year ended December 31
	2008	2007	2007
	(in thousands)	(in thousands)	(in thousands)
Balance in circulation at January 1	**200,849**	200,849	200,849
Options granted during the period	**54,700**	-	-
Options forfeited during the period	**(1,100)**	-	-
Options exercised during the period	**(18,830)**	-	-
Balance in circulation at the end of the period	**235,619**	200,849	200,849
Exercisable at the end of the period, subject to lock-up terms	**159,950**	200,849	200,849
Exercisable at the end of the period not subject to lock-up	**22,069**	--	--

Subsequent to the balance sheet date, approximately 736,000 options granted by the State to employees on October 11, 2005, were exercised.

The weighted average exercise price in the six-month period ended June 30, 2008 and in 2007, was NIS 3.09 per share and NIS 2.852 per share, respectively.

The average share price in the six-month period ended June 30, 2008 and in 2007, is NIS 6.66 per share and NIS 6.82 per share, respectively.

The range of the exercise price of the balance of the issued options at June 30, 2008, is between NIS 2.22 and NIS 6.44, and the weighted average of the remaining contractual life is 3.309 years.

The fair value of the services received in consideration of the options for shares granted, is based on the fair value of the options granted, which was measured according to the Black and Scholes model on the basis of the following parameters:

	For the six-month period ended June 30		For the year ended December 31
	2008	2007	2007
Weighted average of the fair value on the grant date	**NIS 2.69**	-	-
Share price	**NIS 6.49 - 7.049**	-	-
Exercise price	**NIS 5.5 - 6.44**	-	-
Expected volatility (weighted average)	**22.7% - 24.3%**	-	-
Life of the option (expected weighted average)	**4 - 5.5 years**	-	-
Risk-free interest rate (based on government bonds)	**5.09% - 5.68%**	-	-

Salary expense

	For the six-month period ended		For the year ended
	June 30, 2008	June 30, 2007	December 31, 2007
	NIS millions	NIS millions	NIS millions
Stock options granted in the reporting period (1)	35	-	-

(1) In calculating the salary expense, a discount of 5% was taken into account in respect of forfeiture, for each year.

NOTE 10 – REVENUES

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Fixed-line domestic communications					
Landline telephony	**1,772**	1,921	**857**	936	3,798
Internet – infrastructure	**391**	336	**193**	172	711
Transmission, data communication and others	**470**	447	**241**	217	935
	2,633	2,704	**1,291**	1,325	5,444
Cellular telephones					
Cellular services and terminal equipment	**1,702**	1,630	**860**	817	3,669
Sale of terminal equipment	**522**	514	**264**	260	711
	2,224	2,144	**1,124**	1,077	4,380
International communications, internet services and network end point	**606**	625	**312**	319	1,226
Multi-channel television	**710**	659	**352**	327	1,331
Others	**13**	9	**7**	5	19
	6,186	6,141	**3,086**	3,053	12,400

NOTE 11 – OPERATING AND GENERAL EXPENSES

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cellular telephone expenses	**865**	891	**423**	439	1,828
General expenses	**524**	565*	**248**	308*	1,187
Materials and spare parts	**427**	430	**210**	210	924
Consumption of satellite services content	**232**	202	**117**	98	426
Services and maintenance by sub-contractors	**170**	192	**86**	90	381
Building maintenance	**156**	166	**78**	84	332
International communication expenses	**133**	172*	**65**	73*	338
Motor vehicle maintenance expenses	**94**	93	**48**	47	183
Royalties to the Government of Israel	**58**	96	**26**	48	194
Collection fees	**24**	26	**12**	13	48
	2,683	2,833	**1,313**	1,410	5,841

* See Note 3C.

NOTE 12 – CONDENSED DATA FROM THE INTERIM SEPARATE FINANCIAL STATEMENTS OF THE COMPANY

A. Income statement

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues (see B below)	**2,762**	2,835	**1,354**	1,393	5,713
Costs and expenses					
Depreciation and amortisation	**429**	473	**211**	236	941
Salary	**616**	636	**300**	326	1,293
General and operating expenses	**934**	1,067	**449**	534	2,121
Other operating expenses (income), net	**(13)**	47	**(34)**	54	79
	1,966	2,223	**926**	1,150	4,434
Operating income for the period	**796**	612	**428**	243	1,279

B. Revenue segmentation

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2008	2007*	2008	2007*	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Telephony	**1,809**	1,967	**876**	959	3,905
Internet	**391**	338	**193**	174	712
Transmission and data communication	**396**	367	**204**	184	754
Other services	**166**	163	**81**	76	342
	2,762	2,835	**1,354**	1,393	5,713

* See Note 3C.

NOTE 13 –SEGMENT REPORTING

The Company and the investee companies operate in various segments of the communications sector. Data on activities by segment are stated by the segments of operation of these companies.

	For the six-month period ended June 30, 2008 (unaudited)						
	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues							
Revenues from external sources	**2,587**	**2,224**	**606**	**756**	**13**	**-**	**6,186**
Inter-segment revenues	**175**	**137**	**34**	**5**	**24**	**(375)**	**-**
Total revenues	**2,762**	**2,361**	**640**	**761**	**37**	**(375)**	**6,186**
Segment results	**796**	**481**	**117**	**69**	**1**	**-**	**1,464**

	For the six-month period ended June 30, 2007 (unaudited)						
	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues							
Revenues from external sources	2,674	2,144	625	689	9	-	6,141
Inter-segment revenues	161	155	19	19	21	(375)	-
Total revenues	2,835	2,299	644	708	30	(375)	6,141
Segment results	612	453	104	56	2	-	1,227

NOTE 13 –SEGMENT REPORTING (CONTD.)

	For the three-month period ended June 30, 2008 (unaudited)						
	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues							
Revenues from external sources	**1,264**	**1,124**	**312**	**379**	**7**	**-**	**3,086**
Inter-segment revenues	**90**	**64**	**14**	**1**	**11**	**(180)**	**-**
Total revenues	**1,354**	**1,188**	**326**	**380**	**18**	**(180)**	**3,086**
Segment results	**428**	**266**	**63**	**43**	**-***	**-**	**800**

	For the three-month period ended June 30, 2007 (unaudited)						
	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues							
Revenue from external sources	1,312	1,077	319	340	5	-	3,053
Inter-segment revenue	81	75	2	14	10	(182)	-
Total revenues	1,393	1,152	321	354	15	(182)	3,053
Segment results	243	240	53	31	4	-	571

* Less than NIS 500,000.

Notes to the Financial Statements as at June 30, 2008

NOTE 13 –SEGMENT REPORTING (Contd.)

	For the year ended December 31, 2007 (audited)						
	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues							
Revenues from external sources	5,373	4,380	1,226	1,402	19	-	12,400
Inter-segment revenues	340	304	78	12	46	(780)	-
Total revenues	5,713	4,684	1,304	1,414	65	(780)	12,400
Segment results	1,279	805	204	48	-*	-	2,336

* Less than NIS 500,000.

NOTE 14 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD. D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD.

1. Pelephone Communications Ltd.

A. Balance sheet

	June 30, 2008	June 30, 2007	December 31, 2007
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Current assets	**1,983**	1,681*	1,976
Non-current assets	**2,585**	2,447*	2,363
	4,568	4,128	4,339
Current liabilities	**1,195**	1,053	1,106
Long-term liabilities	**1,140**	1,251	1,154
Total liabilities	**2,335**	2,304	2,260
Shareholders' equity	**2,233**	1,824	2,079
	4,568	4,128	4,339

* See Note 3C

B. Income statement

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues from services and sales	**2,361**	2,299	**1,188**	1,152	4,684
Cost of services and sales	**1,626**	1,603	**796**	795	3,347
Gross profit	**735**	696	**392**	357	1,337
Sales and marketing expenses	**191**	197	**94**	94	430
General and administrative expenses	**63**	46	**32**	23	102
	254	243	**126**	117	532
Operating income	**481**	453	**266**	240	805
Financing expenses	**72**	44	**46**	24	114
Financing income	**(64)**	(44)	**(29)**	(16)	(109)
Financing expenses, net	**8**	-	**17**	8	5
Earnings before income tax	**473**	453	**249**	232	800
Income tax	**130**	126	**69**	59	215
Net earnings for the period	**343**	327	**180**	173	585

NOTE 14 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD. (CONTD.)

2. D.B.S. Satellite Services (1998) Ltd.

A. Balance sheet

	June 30, 2008	June 30, 2007	December 31, 2007
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Current assets	**172**	172*	157*
Non-current assets	**978**	867*	943*
	1,150	1,039	1,100
Current liabilities	**715**	1,973	1,483
Long-term liabilities	**3,229**	2,040	2,246
Total liabilities	**3,944**	4,013	3,729
Equity deficit	**(2,794)**	(2,974)	(2,629)
	1,150	1,039	1,100

* See Note 3C.

B. Income statement

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues	**761**	708	**380**	354	1,415
Cost of sales	**564**	535	**278**	265	1,117
Gross profit	**197**	173	**102**	89	298
Sales and marketing expenses	**71**	67	**31**	33	138
General and administrative expenses	**57**	50	**28**	25	104
	128	117	**59**	58	242
Operating income	**69**	56	**43**	31	56
Financing expenses	**264**	183	**154**	97	394
Financing income	**(30)**	(20)	**(12)**	(6)	(226)
Financing expenses, net	**234**	163	**142**	91	168
Loss before income tax	**(165)**	(107)	**(99)**	(60)	(112)
Income tax	**-**	6	**-**	5	6
Net loss for the period	**(165)**	(113)	**(99)**	(65)	(118)

NOTE 14 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD. (CONTD.)

3. Bezeq International Ltd.*

A. Balance sheet

	June 30, 2008 (Unaudited) NIS millions	June 30, 2007 (Unaudited) NIS millions	December 31, 2007 (Audited) NIS millions
Current assets	**487**	429	431
Non-current assets	**475**	427	456
	962	856	887
Current liabilities	**297**	338	312
Long-term liabilities	**22**	46	26
Total liabilities	**319**	384	338
Shareholders’ equity	**643**	472	549
	962	856	887

B. Income statement

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues	**640**	644	**326**	321	1,304
Cost of sales	**382**	427	**192**	211	859
Gross profit	**258**	217	**134**	110	445
Sales and marketing expenses	**89**	68	**45**	33	147
General and administrative expenses	**52**	46	**26**	25	94
Other income, net	**-**	(1)	**-**	(1)	-
	141	113	**71**	57	241
Operating income	**117**	104	**63**	53	204
Financing expenses	**8**	7	**4**	3	13
Financing income	**(11)**	(8)	**(5)**	(5)	(14)
Financing income	**(3)**	(1)	**(1)**	(2)	(1)
Equity in earnings of an associate accounted for by the equity method	**2**	2	**1**	1	6
Earnings before income tax	**122**	107	**65**	56	211
Income tax	**(34)**	31	**18**	17	58
Net earnings for the period	**88**	76	**47**	39	153

* The above financial statements are presented solely in accordance with International Financial Reporting Standards (IFRSs).

NOTE 15 – MATERIAL EVENTS DURING THE REPORTING PERIOD AND EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

A. On March 10, 2008, the Board of Directors of the Company resolved to recommend to the general meeting of the shareholders of the Company to distribute a cash dividend to the shareholders in the amount of NIS 679 million (approximately NIS 0.26 per share). On April 3, 2008 the general meting approved payment of the dividend and it was paid on April 28, 2008.

B. On March 26, 2008, the Company signed an agreement for the sale of its satellite communications operations (Inmarsat and Bezeq Sat) and related assets, including the satellite communications site in Emek Ha'Ela. Under the agreement, the operation will be sold in consideration of USD 15 million plus VAT, subject to price adjustments resulting from various stipulations and from changes that will apply, if they apply, in the operation during the period until the date of closing the transaction. Closing the transaction is subject to various approvals in addition to the regulatory approvals of the Ministry of Defence, the Ministry of Communications and the Antitrust Commissioner. The Antitrust Commissioner's approval was given on June 4, 2008. If the transaction is closed at the maximum price noted above, the Company expects to record a capital gain of approximately NIS 50 million (before tax).

C. In May 2008, the amendment to the new collective labour agreement was completed, concerning bringing forward completion of the implementation of the organizational structure and concerning bringing forward the retirement dates and changing the mix of those scheduled to retire under the new collective agreement by the end of 2008.

D. On July 31, 2008, the Board of Directors of the Company resolved to recommend to the general meeting of the shareholders of the Company to increase the registered capital of the Company by 251,000,000 shares of NIS 1 par value each.

E. On July 31, 2008, the Board of Directors of the Company resolved to recommend to the general meeting of the shareholders of the Company the distribution of a cash dividend to the shareholders in a total amount of NIS 835 million (which is approximately NIS 0.32 per share).

NOTE 16 – DETAILS OF ADDITIONAL MOVEMENTS IN THE SHAREHOLDERS' EQUITY

	Share capital	Premium on shares	Translation fund	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of assets available for sale	Capital reserve in respect of options for employees	Deficit	Total	Minority rights	Total shareholders' equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
	Relates to holders of the Company's equity									
Six-month period ended June 30, 2008										
Balance at January 1, 2008 (audited)	**6,132**			**390**	**4**	**287**	**(2,268)**	**4,545**	**(373)**	**4,172**
Total revenues and expenses recognized in the period (unaudited)	**-**	**-**	**(11)**	**-**	**(4)**	**-**	**835**	**820**	**(37)**	**783**
Dividends to Company shareholders (unaudited)	**-**	**-**	**-**	**-**	**-**	**-**	**(679)**	**(679)**	**-**	**(679)**
Share-based payments (unaudited)	**-**	**-**	**-**	**-**	**-**	**35**	**-**	**35**	**-**	**35**
Minority injection in a subsidiary (unaudited)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**4**	**4**
Balance at June 30, 2008 (unaudited)	**6,132**	**-**	**(11)**	**390**	**-**	**322**	**(2,112)**	**4,721**	**(406)**	**4,315**
Six-month period ended June 30, 2007										
Balance at January 1, 2007 (audited)	6,309	1,623	-	384	1	287	(2,849)	5,755	(564)	5,191
Total revenues and expenses recognized in the period (unaudited)	-	-	-	-	3	-	760	763	(35)	728
Dividends to shareholders – distribution that does not pass the earnings test (unaudited)	(177)	(1,623)	-	-	-	-	-	(1,800)	-	(1,800)
Payments to a former senior officer (unaudited)	-	-	-	6	-	-	-	6	-	6
Balance at June 30, 2007 (unaudited)	6,132	-	-	390	4	287	(2,089)	4,724	(599)	4,125

NOTE 16 – DETAILS OF ADDITIONAL MOVEMENTS IN THE SHAREHOLDERS' EQUITY (CONTD.)

	Share capital	Premium on shares	Translation fund	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of assets available for sale	Capital reserve in respect of options for employees	Deficit	Total	Minority rights	Total shareholders' equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
	Relates to holders of the Company's equity									
Three-month period ended June 30, 2008										
Balance at April 1, 2008 (unaudited)	**6,132**	**-**	**-**	**390**	**-**	**300**	**(1,870)**	**4,952**	**(386)**	**4,566**
Total revenues and expenses recognized in the period (unaudited)	**-**	**-**	**(11)**	**-**	**-**	**-**	**437**	**426**	**(24)**	**402**
Dividends to company shareholders (unaudited	**-**	**-**	**-**	**-**	**-**	**-**	**(679)**	**(679)**	**-**	**(679)**
Share-based payments (unaudited)	**-**	**-**	**-**	**-**	**-**	**22**	**-**	**22**	**-**	**22**
Minority injection in a subsidiary (unaudited)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**4**	**4**
Balance at June 30, 2008 (unaudited)	**6,132**	**-**	**(11)**	**390**	**-**	**322**	**(2,112)**	**4,721**	**(406)**	**4,315**
Three-month period ended June 30, 2007										
Balance at April 1, 2007 (audited)	6,132	-	-	384	1	287	(2,450)	4,354	(578)	3,776
Total revenues and expenses recognized in the period (unaudited)	-	-	-	-	3	-	361	364	(21)	343
Payments to a former senior officer (unaudited)	-	-	-	6	-	-	-	6	-	6
Balance at June 30 2007 (unaudited)	6,132	-	-	390	4	287	(2,089)	4,724	(599)	4,125

NOTE 16 – DETAILS OF ADDITIONAL MOVEMENTS IN THE SHAREHOLDERS' EQUITY (CONTD.)

	Share capital	Premium on shares	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of assets available for sale	Capital reserve in respect of options for employees	Deficit	Total	Minority rights	Total shareholders' equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Year ended December 31, 2007									
Balance at January 1, 2007 (audited)	6,309	1,623	384	1	287	(2,849)	5,755	(564)	5,191
Total revenues and expenses recognized (audited)	-	-	-	3	-	1,341	1,344	31	1,375
Dividends to Company shareholders (audited)	-	-	-	-	-	(760)	(760)	-	(760)
Dividend to Company shareholders – dividend that does not pass the profit test (audited)	(177)	(1,623)	-	-	-	-	(1,800)	-	(1,800)
Change in due date of a loan provided by the minority in a subsidiary (audited)	-	-	-	-	-	-	-	160	160
Payments to a former senior officer (audited)	-	-	6	-	-	-	6	-	6
Balance at December 31, 2007 (audited))	6,132	-	390	4	287	(2,268)	4,545	(373)	4,172