May 23, 2006

"Bezeq" The Israel Telecommunication Corp. Limited

Quarterly Report for the period ending 31.3.06

Update of Chapter A (Description of Company Operations) of the Periodic Report for 2005

Directors' Report on the State of the Company's Affairs for the period ended March 31, 2006

Condensed Interim Consolidated Financial Statements as at March 31, 2006

Update of Chapter A (Description of Company Operations) of the Periodic Report for 2005

Update of Chapter A (Description of Company Operations)[1] of the Periodic Report for the Year 2005 ("the Periodic Report") of "Bezeq", the Israel Telecommunication Corp. Ltd. ("the Company")

1 – Description of General Development of the Group's Operations

To Section 1.1 – Group Activity and Description of its Business Development

To Section 1.1.6 of the Periodic Report – Mergers and acquisitions

With regard to reports in the media on the subject and pursuant to the Company's clarifying immediate report from April 10, 2006, the Company is examining its continued holding in Walla! Communications Ltd. by means of its subsidiary Bezeq International Ltd. This examination has not yet matured to the point of any form of negotiations.

On April 30, 2006 an agreement was signed between the Company, Malam Systems Ltd. and the Goldnet Communications Services partnership, on the one hand, and the subsidiary Bezeq International Ltd. on the other, in the matter of the acquisition of all the operations of the Goldnet Communication Services partnership by Bezeq International Ltd. in consideration of the sum of NIS 6.8 million, which would be divided between the Company (NIS 5.1 million) and Malam Systems Ltd. (NIS 1.7 million). In this regard see also the update to Section 4.9 hereunder.

To Section 1.4 – Distribution of Dividends

Further to Section 1.4.3 of the Periodic Report in the matter of the resolution of the Company's Board of Directors from March 1, 2006 to recommend to the General Meeting of the Shareholders of the Company the distribution of a cash dividend to the shareholders of the Company, in a total amount of NIS 1,200,000,193, which constitute, as at the date of the distribution, NIS 0.4606446 per share and 46.06446% of the issued and paid up capital of the Company, the General Meeting of the Shareholders of the Company approved the distribution of the dividend on March 23, 2006. The dividend was distributed on April 16, 2006.

[1] The update is in accordance with Regulation 39A of the Securities Regulations (Periodic and immediate reports), 5730-1970, and includes material innovations or changes that took place in the corporation's business in any matter that must be described in the Periodic Report. The update pertains to the numbers of the sections in Chapter 1 (Description of Company Operations) in the Periodic Report of the Company for the year 2005.

2 – Fixed-Line Domestic Communications - "Bezeq", the Israeli Telecommunication Corp. Ltd. ("the Company")

To Section 2.1 – General Information regarding the Area of Operations

In the matter of Section 2.1.2 of the Periodic Report on the subject of updating the Company's tariffs – the next tariff update is expected to be on June 1, 2006, although as of the date of this report the Company has not yet received a draft of the relevant regulations.

In the matter of Section 2.1.9 of the Periodic Report on the subject of issuing special general licenses for the providing fixed-line domestic communication services – see Sections 2.6.1 and 2.6.4 below.

To Section 2.2 – Products and Services

The Ministry of Communications has informed the Company that its position is that the Company should have informed it about the provision of IP – Centrex services, which is a virtual private network service before starting to provide the service, and that therefore the Ministry is considering approval of the provision of the service by the Company and its terms. The Company explained to the Ministry that the service is included in its license. The Company replied to all the Ministry's questions and provided the information it requested.

In the matter of Section 2.2.3 of the Periodic Report – on March 7, 2006, the Ministry of Communications published a hearing for all the communication companies in connection with its intention that a united 144 call center would be operated for all the communication companies, with callers being able to obtain the telephone numbers of all the operators' subscribers in a single telephone call. Concurrently, a united website would operate for all the communication companies. In a letter of response submitted by the Company on March 26, 2006, the Company presented its position that the directory assistance service is auxiliary to the telephony services provided by the license holder; that entities that do not hold a general license should not be permitted into the sector and that the service should be retained in its present format as an auxiliary service to the services of the general license holder. The Company's position is that the demand for directory assistance services to be provided free of charge on the internet is unreasonable and disproportionate, places an unreasonable burden on the operators and compromises their rights of ownership. The directory assistance call center provided by the Company is already a "united call center" that provides information services about most telephony subscribers in Israel and, insofar as this depends on the Company – the call center will provide all the information about those telephony subscribers in Israel who request that the information about them be published for the public.

In the matter of Section 2.2.3 of the Periodic Report – internet access service – the number of the Company's ADSL subscribers as at March 31, 2006, is approximately 824,000 (compared with approximately 800,000 subscribers at the end of 2005).

To Section 2.6 - Competition

To Section 2.6.1 of the Periodic Report – Telephony

A. As at the date of publication of this report, according to reports in the media, HOT's telephony service numbers over 100,000 customers.

B. A license for a paid marketing trial for VoIP services has also been issued to a subsidiary of Pelephone Communications Ltd. On this matter, see Section 3.7 hereunder.

C. In the matter of Sections 2.6.1 and 2.6.4 of the Periodic Report on the subject of the issuing of special general licenses for the provision of fixed-line domestic communication services – to the best of the Company's knowledge, such licenses have been issued to GlobeCall Communications Limited Partnership and to Cellcom Fixed-Line Communication Services Limited Partnership. The subsidiary Bezeq International Ltd. has submitted an application for such a license (see update to Section 4.1.2 below).

To Section 2.6.3 of the Periodic Report – Transmission and Data Communication

On the subject of the Accountant General's tender for the provision of data communication services – on April 11, 2006 the Supreme Court decided to dismiss the appeal filed by the Company against the District Court's ruling and to order it to pay court costs. The Accountant General has not yet published the results of the tender.

To Section 2.6.4 of the Periodic Report – Competition from the Cellular Companies

In the matter of moderation of the downtrend in the number of voice minutes, *inter alia* as a result of the slowdown in the growth rate of the cellular companies, it is clarified that the downtrend in the number of fixed-line voice minutes is continuing. In the Company's opinion, this is due to the development of alternatives to these calls, mainly by means of internet-based calls.

In the matter of the appeal filed by the Company in 2001 in the Antitrust Court with regard to the Antitrust Commissioner's refusal to change the declaration of the Company's status as a monopoly in basic telephony service (fixed-line domestic telephony) – in the wake of the Company's petition that the Court expedite the hearing of the appeal, the Company, acting on the Court's suggestion, agreed to withdraw the appeal, and intends to file a new and revised petition to the Antitrust Commissioner. In the Company's opinion, the cellular telepohny market constitutes an alternative market to fixed-line telephony, and this fact is reinforced by new and up-to-date data that have accumulated during the period since the start of the proceeding before the Court.

To Section 2.6.5 of the Periodic Report – Additional Factors that could affect Competition

A. Numbering and number portability – during February/March 2006 there was a further exchange of letters on the matter of the operators', including the Company, inability to meet the timetables that were set. The Company reiterated that it is preparing for the implementation of number portability but for real and technical reasons, it cannot meet the timetable set for implementation of the plan, and it reserves its legal rights in this matter.

On April 23, 2006 a letter was received from the Deputy Director General for Engineering and Licensing at the Ministry of Communications, in which he suspends the use of certain ranges of the prefix 076, that was allocated for the Company's use, in the wake of information received by the Ministry indicating that the Company intends to use that allocation for the provision of a service which, ostensibly, has not yet been duly approved – the IP – Centrex service. In the matter of this service, see update to Section 2.2 above.

B. Other potential competing infrastructures – on the subject of the allocation of frequencies (WIMAX) – the Company made it clear that its position is that there is no reason and no need to allocate these frequencies, which are a limited State resource, to operators who hold special licenses and who are not obligated to provide universal service. The Company believes that mainly due to the vital need of these frequencies for providing services in outlying areas, the top priority of the policy on the subject of frequency allocation for wireless access systems must be universal service and the creation of conditions that will make it possible to provide it.

To Section 2.6.7 of the Periodic Report – positive and negative factors affecting the Company's competitive status

In the matter of a lack of tariff flexibility – the Ministry of Communications recently began to intervene in the marketing campaigns offered by the Company to the public. On April 5, 2006, the Ministry of Communications published a press release addressing the consumer public directly, whereby the legality of the Springtime Campaign that the Company launched a few days previously was being examined. In the Springtime Campaign, customers who buy a telephone and other equipment from the equipment suppliers participating in the campaign are entitled to 200 free call minutes per month for calls made from Bezeq to Bezeq, for a period of one year. The Ministry announced that it is possible that customers who purchase the telephones will not be able to realize the benefit. Previously, the Director General of the Ministry of Communications sent a letter to the Company stating that the campaign was launched without the Ministry's approval. In its reply, the Company noted its fundamental legal position, which was sent to the Ministry and had not yet elicited a response, whereby the Company does not need the Ministry's approval for marketing campaigns. However, without prejudice to this position on the part of the Company, the Company clarified that in any case the campaign in question does not fall under the category of an existing work procedure vis-à-vis the Ministry. After publication of the Ministry's press release, the Company demanded that the Ministry publish a denial or a correction. The Ministry failed to respond and continued to demand information, documents and data. The Company gave the Ministry documents and data, despite its position that the Ministry has no authority in this matter. In addition, the Company announced that it reserves the right to act in this matter. Subsequently, the Ministry of Communications announced its intention to foreclose on a guarantee in the sum of NIS 7 million out of the bank guarantee of $10 million that the Company deposited to guarantee fulfillment of the terms of its license.

The Company intends to exhaust all the legal recourses at its disposal in this regard and, initially, the Company is filing an appeal of the ruling to the Minister of Communications.

To Section 2.9 – Human Resources

In the matter of Section 2.9.1 – on May 10, 2006 the Company's Board of Directors approved the appointment of a Vice President for Regulation, as of June 1, 2006.

In the matter of Section 2.9.5 – negotiations between the Company's management and the employees' representatives regarding the change in the Company's organizational structure, retirement/dismissal of employees, and a new collective labor agreement, are continuing but have not yet matured to the point of an agreement. Regarding a collective labor dispute declared on April 27, 2006, see note 5 to the financial statements for the period ending March 31, 2006.

To Section 2.13 - Financing

To Section 2.13.6 of the Periodic Report – Credit Rating

1. Maalot rating – on April 4, 2006 the Company's existing rating (AA) for the debentures in circulation (private, public and Eurobonds), which had been on the Watch List since May 10, 2005, was ratified and validated, after renewed examination of the business risk, the financial risk and the Company's strategy, and following the sale of the Company's controlling interest to Ap.Sb.Ar. Holdings Ltd. (**"Ap.Sb.Ar."**).
2. Midroog rating – on April 11, 2006 the Company's rating was removed from the Watch List and left as Aa1. However, Midrug decided to lower the Company's rating horizon from stable to negative in order to reflect the possibility that the change in the Company's ownership will affect the Company's future business and financial profile.

To Section 2.15 – Environmental Protection

In the matter of Section 2.15.2 - the Non-Ionizing Radiation Law, 5766-2006 – on March 26, 2006 the Radiation Supervisor notified the Company and the cellular operators that for the purpose of readiness for the law coming into effect and with the goal of tightening and improving supervision, he intends to exercise his authority under the Pharmacists Regulations. He further notified that therefore, as of June 1, 2006, those applying for operating permits would be required to comply with the conditions for issuing a permit, including the condition relating to submission of a permit under the Planning and Construction Law. The Company is examining its continued preparations for the new law, taking notice of the said notification. See also the update to Section 3.18.1.3.2 below.

To Section 2.16 – Limitations and Regulation of Company Activity

To Section 2.16.2 of the Periodic Report – the Company's General License

On the subject of volume discounts – to the best of the Company's knowledge, the Ministries of Communications and Finance approved a basket of alternative payments which allow the Company to provide volume discounts at a rate of up to 10%. As of the date of the publication of this Report, the Company has not received the signed approval mentioned above.

On the subject of measuring the Company's market share – on March 15, 2006 the Company submitted a detailed position document to the Ministry of Communications clarifying that the demand for the loss of "market share" – is vague and constitutes fertile ground for disputes, delays and legal resolution; likewise, the Company's position is that the conditions are ripe for granting the Company the possibility of marketing joint packages with its subsidiaries. In any case, in the opinion of the Company, a date should be set for this matter – no later than the end of Q1 2007. The Company stressed that the restrictions should be removed and the Company permitted to market joint packages in areas in which the Company has lost 15% of market share. In the matter of the parameters for measuring market share (insofar as the demand is not rescinded), the Company believes that the worthy test is the minutes test and not the revenues test, and that the loss of the Company's market share should be measured in relation to a relevant starting point (November 2004) and that proof that the loss was in favor of certain competitors should not be required.

To Section 2.16.3 of the Periodic Report – Royalties

In April 2006 the Company paid the sum that was requested by the Ministry in respect of the Company's revenues from interconnect fees on calls from cellular subscribers to Company subscribers (approximately NIS 17 million). It should be noted that the Company is involved in advanced negotiations with the Ministry in order to solve various other disputes related to royalties. In connection with the reduction in the rate of royalties from 3.5% to 3% beginning January 1, 2006, the Ministry of Communications notified the Company that amendment of the Royalty Regulations, which will arrange for the decrease, will be implemented shortly.

To Section 2.16.7 of the Periodic Report – Antitrust Laws

To Subsection (C) on the subject of the Company's appeal against the failure to rescind the declaration of the Company as a monopoly in basic telephony – see updated to Section 2.6.4 above.

In connection with the antitrust authority's application in the matter of claims by certain telecommunication operators, see note 1(c)(8) to the financial statements of the Company for the period ended March 31, 2006.

In connection with the search conducted at the Company's offices on May 23, 2006 and the interrogation of a number of Company employees regarding the alleged abuse of the status of the monopoly and/or an unreasonable refusal to supply an asset or service under the monopoly, see note 1(C)(9) to the Company's financial statements for the period ended March 31, 2006.

To Section 2.16.10 of the Periodic Report – Class Action Suit Law

On March 12, 2006 a new class action law was published, whereby a class action can be filed on various grounds detailed in the addendum to the law and under an explicit provision of the law in the matter of class actions (individual provisions, *inter alia*, in the Antitrust Law, the Consumer Protection Law, and the Banking Law – have been cancelled). Under the law, its provisions will apply also to petitions and actions that were pending on the date of publication of the law. The law includes definitions and expansions of the parties who are permitted to file a motion for a suit to be recognized as a class action, and determines the terms for its filing. The law grants the court discretion in various matters such as compensation, relief, replacement of a plaintiff in a class action and a reservation regarding the approval of the action against a body that provides an essential service to the public. The law makes it very hard to abandon a claim or to reach a settlement, both of which, *inter alia*, require the court's approval. Under the law, a fund for financing class action suits is being established, whose function is to assist representative plaintiffs in financing petitions whose submittal is of public and social importance.

To Section 2.17 – Substantial Agreements

Management Agreement

On March 23, 2006 the General Meeting of the Shareholders of the Company approved the Company's contractual arrangement under an agreement with a company that would be under the ownership and control of the shareholders of Ap.Sb.Ar., in the framework of which the Company would receive regular management and consulting services, including by means of directors who serve and who will serve from time to time at the Company and/or at its subsidiaries, all in consideration of $1.2 million *per annum*. The term of the contractual arrangement is from October 11, 2005 (the date of closing the acquisition of 30% of the Company’s shares by Ap.Sb.Ar.) to December 31, 2008, unless one party gives the other three months' notice of its wish to terminate the agreement. A full description of the terms of the contractual arrangement was provided in the Company's Immediate Report (Amendment) dated March 13, 2006, concerning a transaction between the Company and a controlling shareholder.

To Section 2.18 – Legal Proceedings

For updates on the subject of legal proceedings, see Note 6 to the financial statements of the Company for the period ended March 31, 2006.

3 – Mobile Radio telephone – Pelephone Communications Ltd. (hereinafter: "Pelephone")

To Section 3.7 - Competition

In the matter of Section 3.7.2 of the Periodic Report – during the quarter, Pelephone obtained a license for a marketing trial using VoIP technology, in accordance with an application that it submitted. The license includes a condition which, in the main, stipulates that if, at the end of the hearing, the policy document of the Ministry of Communications is amended in a way which prevents Pelephone from providing VOB services, the license for the trial shall expire. The license for the trial allows Pelephone to provide domestic telephony services using VoIP technology in the scope of 8,500 extensions and lines.

To Section 3.18 – Restrictions and Supervision of Pelephone's Activities

In the matter of Section 3.18.1.3.2 – notification was recently received from the Radiation Supervisor whereby the implementation of some of the requirements of the law, among then making the issue of authorizations contingent on obtaining a building permit, will be brought forward to June 1, 2006. Pelephone informed the Supervisor of its opposition to the date being brought forward, and that the Supervisor should adhere to the effective date determined in the law, i.e. January 1, 2007.

In the matter of Section 3.18.2 (E) – in addition to changes in the Telecommunications Regulations (Interconnect fees), 5760-2000, from December 2004, whereby as of January 1, 2009 the payment for the call completion segment to another cellular network will be according to time units of one second (unlike the present billing method that permits billing according to segments of up to 12 seconds), Pelephone's license was amended in December 2004 so that as of January 1, 2009, the fee for the airtime segment will also be calculated (in addition to the call completion segment as aforesaid) according to time units of one second (rather than the present billing method, which is according to time units of 12 seconds).

In the matter of Section 3.18.2 (G) – a typographical error was made in the Periodic Report for the year 2005, and the following sentence should be deleted from the end of this section: "During the past few months, a hearing took place, both in writing and orally, in the matter of the interconnect fees for all the cellular operators and, as at the date of publication of these statements, Pelephone is awaiting the decision that shall be made by the Finance Ministry and the Ministry of Communications."

In the matter of Section 3.18.3.1:

A. The Ministry of Communications recently amended the licenses of the cellular operators in the matter of limiting users' access to the internet in order to obtain services that include adult content. The amendment stipulates, *inter alia*, that access to erotic services included in a cellular portal or by means of an application such as a search engine which is included in a cellular portal and which enables access to sites on the internet, will be blocked for all subscribers by default, and only an adult aged 18 and above will be able to request the removal of the block from his cellular operator, in accordance with a reliable identification procedure. The amendment to the licenses entered into effect on March 30, 2006. At this stage Pelephone does not expect material damage to its revenues as a result of the amendment.

B. The Ministry of Communications is holding a hearing with regard to its intention to require a subscriber whose call is routed to a voicemail box be given the option of disconnecting the call with no charge, by means of a preliminary voice message notifying the subscriber that his call is being transferred to a voicemail box, and that he will be charged only from that time. Pelephone intends to express its opposition in the response to the hearing.

To Section 3.19 – Legal Proceedings

For updates on the subject of legal proceedings, see Note 6 to the financial statements of the Company for the period that ended on March 31, 2006.

4 – International Communication and Internet Services – Bezeq International Ltd. ("Bezeq International")

To Section 4.1 – General

In the matter of Section 4.1.2 – Legislative and Regulatory Restrictions Applicable to Bezeq International – on May 16, 2006 Bezeq International submitted an application for a special general license for the provision of fixed-line domestic communications services to the Ministry of Communications. The issuing of a license, as stated, by virtue of which domestic VOB services will be provided (constituting an essential part of the product mix of internet service providers), will enable Bezeq International to continue to provide its customers with comprehensive_communications solutions (of the types that its competitors will offer, some of which have already received similar licenses) and to expand as an equal among equals.

To Section 4.9 – Intangible Assets

On April 30, 2006 Bezeq International signed an agreement with Malam Systems Ltd. ("Malam") and the Company, for the acquisition of all the operations of the Goldnet Communication Services ("Goldnet"), a registered partnership owned by Malam (25%) and the Company (75%), which provides solutions for the dissemination and transfer of information via secured electronic means between organizations, in consideration of the sum of NIS 6.8 million, which would be paid to Goldnet. In the framework of this acquisition all the agreements between Goldnet and its customers and its suppliers, and the franchise agreements and business cooperation agreements that it has entered into will be endorsed to Bezeq International and all the intellectual property rights, inventory and/or fixed assets of Goldnet will be transferred to the ownership of Bezeq International.

On fulfillment of all the suspending conditions stipulated in the acquisition agreement (*inter alia*, approval by the Antitrust Commissioner and the Ministry of Communications), and the payment of the consideration, Goldnet, which conducted its business under the trade name of "Bezeq Gold", shall cease to provide services and shall dismiss all its employees, the lion's share of whom will be hired by Bezeq International. Goldnet shall pay its dismissed employees all the monies to which they shall be entitled in respect of the termination of their employment. Likewise, for a period of 12 months from the date of completion of the acquisition deal, Goldnet will continue with its contractual arrangements with customers by the power of agreements that it will not be possible to endorse to the Company and shall transfer all the receipts in respect thereof to the Company.

To Section 4.10 – Human Resources

In the matter of Section 4.10.3 - Organizational Structure - on May 15, 2006, Bezeq International consolidated the Technologies Division and the Information Systems Division into a new division to be called Information Technologies, which shall be headed, as Vice President, the man who served as director of the Technologies Division up to that time. The background for the change is the need to adapt the organizational structure to Bezeq International's changing needs and technologies, which stem from the customers' needs.

To Section 4.14 – Investments

During Q1 2006, Bezeq International and others exercised option warrants of Walla (Series 3). In total, Bezeq International exercised 2,564,764 option warrants (Series 3) during Q1 2006, in consideration of a sum total of NIS 4,617 thousand, which was offset from the owners loan balance that Bezeq International extended to Walla. Following the exercise of the option warrants as stated, Bezeq International's holding in Walla grew from 42.85% on December 31, 2005 to 44.92% as at the date of the interim financial statements (fully diluted, as at March 31, 2006 – 33.66%). Following the exercise of the option warrants, goodwill in the sum of NIS 2,313 thousand was generated for the Company.

To Section 4.19 – Legal proceedings

In connection with the intention of the Ministry of Communications to impose a financial sanction on Bezeq International in respect of a breach of the terms of its license, due to the provision of access by telephone to erotic services, described in Section 4.19.4 of the Periodic Report, the Director General of the Ministry of Communications informed the Company, on March 29, 2006, of his decision to impose a financial sanction on the Company in the sum of around NIS 1,064 thousand; this is in respect of a single breach of provisions of Bezeq International's license and due to an ongoing breach of 115 days. After Bezeq International's request from the Ministry of Communications to delay the payment until the appeal that it intends to file has been clarified was rejected, the said sum was paid in April 2006 and was fully credited to the profit and loss report.

On May 9, 2006, Bezeq International filed an appeal to the Tel Aviv Magistrates Court against the said ruling of the Director General of the Ministry of Communications, on the basis of the opinion of Bezeq International's legal advisors whereby there is a good chance that the sum of the sanction will be either cancelled or reduced.

5 – Multi-channel Television – D.B.S. Satellite Services (1998) Ltd. ("D.B.S.")

To Section 5.1 – General Information on Area of Activity

To Section 5.1.3 – Developments in Markets in the Field of Operations

With regard to the government's decision on the free dissemination of certain channels by means of a land-based system of transmitters based on digital technology, supported by a digital satellite system: DBS is conducting negotiations with representatives of the Treasury with regard to the implementation of the said government's decision and was told that the Finance Ministry intends to publish a public hearing on the matter.

With regard to the government decision on the subject of obligating the multi-channel television companies to sell the public reduced channel packages, DBS is conducting negotiations with representatives of the Finance Ministry. As at the date of this report, provisions for the implementation of this government ruling are included in the Budget Law which, to the best of DBS's knowledge, has passed its first reading in the Knesset plenum.

To Section 5.6 - Competition

To Section 5.6.5 – Principal Methods for Coping with Competition

In the matter of VOD – DBS was recently informed by representatives of the Ministry of Communications that it will receive a license for conducting the technological trial within a short period, but as at the date of this report the license for the trial has not yet been received.

To Section 5.10 – Raw Materials and Suppliers

To Section 5.10.1 – Main Raw Materials

In the matter of Sub-Section B – space segments – as at the date of this report, DBS is paying the regular leasehold fees in respect of space segments in the Amos 1 satellite, and performs partial payment on account of the leasehold fee debt in respect of the previous period whose date of payment to Israel Aircraft Industries has passed (in view of the endorsement of the right to receive the leasehold fees from HLL to Israel Aircraft Industries). In view of DBS's delay in payments that were stipulated in the said agreement, Israel Aircraft Industries contacted DBS in March 2006 demanding that the entire debt be settled, and the parties are conducting negotiations on the matter. In addition, there is a dispute between DBS and HLL in the matter of the annual leasehold fees that HLL is entitled to receive in respect of the leasing of space segments in the Amos 2 satellite, which has not yet been arranged, with DBS paying only those sums that are not in dispute.

To Section 5.11 – Working Capital

In Q1 2006 an increase occurred in the working capital deficit of DBS, which totaled approximately NIS 510 million as at March 31, 2006.

To Section 5.12 - Financing

To Section 5.12.2 – Restrictions of the Corporation for the Receipt of Credit

As at March 31, 2006 DBS met the financial criteria, as per the financing agreement (after the banks agreed to amend the targets of these criteria with regard to Q1 2006). In the estimation of the management of DBS, in view of its forecasts with regard to its business results for the years ahead, it is also necessary to adjust the criteria with regard to the period up to the end of the repayment of the bank credit. In consequence, in April 2006 DBS turned to the banks in order to update the targets of the financial criteria for the period commencing in the year 2006 and until the end of repayment of the bank credit (in accordance with the targets that shall be agreed upon between DBS and the banks). The banks' answer to this request has not yet been received.

As at the date of this report, DBS is not fully meeting its undertakings under the financing agreement to take out insurance in connection with its activities and its assets in general, including with regard to its obligation to take out satellite failure insurance with regard to the satellites leased by DBS from the space segments for the purpose of its broadcasts. DBS is conducting negotiations with the banks to obtain concessions with regard to its insurance undertakings, which will enable it to meet these undertakings.

In addition, the delay in DBS's payments to Israel Aircraft Industries (as stated in the update to Section 5.10.1 above) constitutes a *prima facie* breach of the financing agreement; however, the banks have confirmed to DBS that they will not deem the demand by Israel Aircraft Industries for the repayment of the debt to be a breach of the financing agreement on the part of DBS, provided by August 1, 2006, the parties arrive at a written settlement with Israel Aircraft Industries with regard to the repayment of the said debt and that during the period up to August 1, 2006, Israel Aircraft Industries does not employ any means whatsoever to collect the said debt.

To Section 5.14 – Restrictions and Supervision of the Corporation

To Section 5.14.1 – The Activity's Subordinacy to Specific Laws

On the subject of original (local) productions - DBS has met its obligation for the year 2004 (including the relative share of completing past obligations), apart from immaterial deviations in the subdivision into the various genres, which the Council ordered DBS to amend during 2005. DBS notified the Council that it has met its original productions obligation for the year 2005 (including the relative share of completing past obligations), and the issue is under examination by the Council as at this date.

On the subject of royalties - To the best of DBS's knowledge, as at the date of this report an amendment to secondary legislation is under process, whereby the rate of royalties applicable to DBS beginning in the year 2006 and thereafter will be gradually reduced to a fixed percentage of 1%. DBS is unable to estimate whether the said amendment will actually be promulgated.

To Section 5.14.3 – The Principal Limitations by virtue of the Law and Broadcasting License

As at the date of this report, the Council has issued an additional broadcasting license to a designated "Israeli Heritage" channel, which is also expected to be aired via DBS's broadcasts. At present, no broadcasts of independent license holders are aired in the framework of DBS's broadcasts.

The decision with regard to the restrictions that apply to DBS as to the percentage of local channels under its ownership which aired in the framework of its broadcasts, was approved by the Council as part of the rules and entered into effect in March 2006.

In the matter of tiering – in March 2006 the cable companies informed the Director General of the Ministry of Communications that in view of DBS's alleged breaches, of the administrative orders, they are ceasing to receive the notifications that DBS sends to the cable companies in connection with the transition of cable companies subscribers to DBS. DBS contacted the Ministry of Communications and requested the enforcement of the Administrative orders by the cable companies and likewise demanded that the cable companies once again receive the notifications. As at this date DBS's notifications are not being received by the cable companies, which are continuing to bill their subscribers who asked to disconnect from their services and connect to DBS's services. The results of the hearing have not yet been published. In the estimation of DBS's management, should the Administration's provisions be cancelled, without the existence of a suitable alternative arrangement that will enable one supplier to make use of another supplier's infrastructures at the subscribers' homes, this will constitute a material barrier to the transition of subscribers between the various providers.

To Section 5.17 – Legal Proceedings

In the matter of Section 5.17.3 – with regard to the arbitration proceedings between DBS and Play TV Ltd., producer of the Playboy and Adult channels ("Play TV"), in connection with the arbiter's ruling and the request for clarification thereof, the parties have arrived at a settlement agreement whereby all the proceedings that were conducted between them that are the object of the arbiter's ruling, have ended. According to the settlement agreement DBS is entitled to receive a certain sum from Play TV.

Commercial agreements were also reached between the parties on other matters that were anchored within the bounds of the settlement agreement.

In the matter of Section 5.17.4 – in the matter of the Endemol lawsuit: the parties have arrived at an agreement in principle with regard to the termination of the dispute with a settlement, but this has not yet been formulated into a binding agreement whereby the lawsuit will be annulled, while DBS will pay Endemol approximately $180,000 (including in respect of the purchase of certain content from Endemol).

In addition, on March 15, 2006 a verdict was handed down against DBS and Mr. Shlomo Liran, its former CEO, following DBS's conviction at the Tel Aviv District Labor Court of the offense of disturbing a work supervisor on behalf of the Ministry of Labor and Social Welfare – an offense under Section 26(2) of the Hours of Work and Rest Law, 5711 – 1951 and Sections 36(A)(1) and 36(C) of the Organization of Supervision of Labor Law, 5714 – 1954, and with regard to Mr. Liran, also under Section 27(A) of the Hours of Work and Rest Law, 5711 – 1951 and Section 36(E) of the Organization of Supervision of Labor Law, 5714 – 1954. DBS's conviction was based on the failure to submit documents to a work supervisor, on demand, in contravention of the obligations stipulated by law. The District Court imposed an administrative fine in the sum of NIS 25,800 on DBS and an administrative fine in the sum of NIS 38,700 on Mr. Liran. DBS is considering the possibility of appealing the verdict.

May 23, 2006	
Date	"Bezeq", The Israel Telecommunication Corp. Ltd.

Name and title of signatories:

Menachem Inbar, Member of the Board (Chairman of the approval meeting)

Yacov Gelbard, President & CEO

Directors' Report on the State of the Company's Affairs for the period ended March 31, 2006

May 23, 2006

Directors' Report on the State of the Company's Affairs for the three months ended March 31, 2006

We respectfully present the Directors' Report on the state of affairs of "Bezeq" - The Israel Telecommunication Corp. Limited ("the Company") and the consolidated Group companies (the Company and the consolidated companies are hereinafter collectively referred to as "the Group") for the three-month period ended March 31, 2006 ("the Directors' Report").

The Directors' Report contains a review of its subject matter, in condensed form, and was prepared on the assumption that the reader can also refer to the Directors' Report for the year ended December 31, 2005.

The Group operates in four principal areas which are reported as business segments in the Company's consolidated reports, as follows:

1) **Fixed-line domestic communications**

2) **Cellular**

3) **International communications and internet services**

4) **Multi-channel television**

The Company has other areas of operation which are not material to the operations of the Group, and these are included in the financial statements as at March 31, 2006 of the Company as the "Others' business segment, which consists mainly of network end point services, customer center services and content services for the business segment.

1. Financial Position

A. The Group's assets as at March 31, 2006, amounted to approximately NIS 20.52 billion, compared with NIS 20.36 billion on March 31, 2005. Of these, approximately NIS 9.61 billion (approximately 47%) are fixed assets, compared with approximately NIS 10.50 billion (approximately 52%) on March 31, 2005.

In the fixed-line domestic communications segment there was a decrease in the net book value of the fixed assets resulting from the difference between depreciation expenses and the investment made in the reporting period. Conversely, cash balances and short-term investments increased compared with March 31, 2005.

In the cellular segment, cash balances, short-term investments and trade receivables increased. The increase was partially offset by a decrease in the inventory balance following the efficiency measures implemented by Pelephone, a decrease in the deferred tax balance due to utilization of past losses for tax purposes, and additionally a decrease in the net book value of the fixed assets.

In the international communications and internet services segment there was a decrease in total assets compared with March 31, 2005, due to a decrease in the cash balances and the net investment in fixed assets.

In the multi-channel television segment total assets decreased compared with March 31, 2005, which derived mainly from a decrease in the net investment in fixed assets. The decrease was offset by an increase in the broadcasting rights and the customer credit balance.

B. The shareholders' equity of the Group as at March 31, 2006 amounted to approximately NIS 7.08 billion, comprising approximately 35% of the total balance sheet, compared with approximately NIS 7.75 billion on March 31, 2005, which comprised approximately 38% of the total balance sheet. The decrease in shareholder' equity derived from the declaration of a dividend of NIS 1.2 billion during the reporting period. The decrease was moderated by the net earnings of the Group.

C. Total Group debt to financial institutions and debenture holders as at March 31, 2006 amounted to approximately NIS 8.73 billion, compared with approximately NIS 8.54 billion on March 31, 2005. The increase derived mainly from the increase in liabilities in the multi-channel television segment.

The Company's auditors drew attention to the financial condition of DBS, as mentioned in note 4, including DBS management's belief, based on its 2006 budget and on its business plan, that the prospects are good for arranging the financial resources it will need in the coming year.

D. Group balances in cash and short-term investments as at March 31, 2006 amounted to approximately NIS 4.73 billion compared with approximately NIS 3.13 billion on March 31, 2005. The source of the increase is the cash flow from current operations in the principal segments of the Group's business.

2. Results of Operations

A. Principal results

Net earnings for the first quarter of 2006 amounted to approximately NIS 226 million, compared with net earnings of approximately NIS 280 million in the corresponding period in 2005. The difference in the results derived mainly from changes in operating income of the Group companies, an increase in financing expenses and a decrease in the Company income (expenses) item. Earnings after financing expenses amounted to approximately NIS 329 million compared to NIS 311 million in the corresponding period.

Below are details of the changes in the results of the segments this year compared with the first quarter of 2005.

	For the three-month period ended March 31	
Segment	**2006 NIS millions**	**2005 NIS millions**
Fixed-line domestic communications	240	249
Cellular	139	121
International communications and internet services	33	21
Multi-channel television	(14)	(24)
Others	3	(1)

Earnings per share in the first quarter of 2006 amounted to NIS 0.087 per NIS 1 par value, compared with earnings of NIS 0.107 per share in the corresponding period in the prior year.

B. Revenues

Group revenues in the first quarter of 2006 amounted to approximately NIS 2.82 billion, compared with approximately NIS 2.77 billion in the corresponding period.

Revenues from fixed-line domestic communications decreased from approximately NIS 1.20 billion in the corresponding quarter to approximately NIS 1.17 billion in the first quarter of 2006 (a decrease of approximately 2.1%). Most of the decrease in the segment's revenues derived from tariff reductions in June 2005, a decrease in call traffic and in development work. The decrease in revenues was moderated by the ongoing growth in the number of customers who subscribe to high-speed internet service (ADSL). In their review letter, the auditors drew attention to the ongoing opening of the communications industry to competition and to tariff changes.

Revenues from the cellular telephone segment decreased from approximately NIS 1.11 billion in the corresponding quarter to approximately NIS 1.09 billion in the first quarter of 2006, resulting from a decrease in revenues from the sale of terminal equipment due smaller quantities of handsets sold. Conversely, revenues from Pelephone services and terminal equipment services increased due to an increase in the number of customers but was offset by a decrease in interconnect tariffs payable to other communications operators..

Revenues from the international communications and internet services segment increased from approximately NIS 199 million in the corresponding quarter to approximately NIS 245 million in the first quarter of 2006. The increase was due mainly to an increase in all areas and in global operation, except for a decrease in revenues from outgoing calls as traffic continues to decline and tariffs are eroded due to the expansion of competition since the corresponding quarter.

Revenues from the multi-channel television segment increased from approximately NIS 289 million in the corresponding quarter, to approximately NIS 332 million in the first quarter of 2006, as a result of the increase in the number of subscribers and in average revenue per customer.

C. General and Operating Expenses

The Group's general and operating expenses in the first quarter of 2006 amounted to approximately NIS 1.78 billion, compared with approximately NIS 1.76 billion in the corresponding period.

In the fixed-line domestic communications segment, general and operating expenses increased from approximately NIS 562 million in the corresponding quarter, to approximately NIS 577 million in the reporting period. Most of the increase is attributable to the increase in salary and vehicle maintenance expenses, and were moderated mainly by a decrease in general expenses and in expenses for materials and spare parts.

In the cellular segment, general and operating expenses decreased from approximately NIS 839 million in the corresponding quarter, to approximately NIS 779 in the reporting period, mainly due to lower costs of terminal equipment in parallel with a decrease in revenues from terminal equipment, as well as a one-time expense of NIS 30 million recorded in the corresponding quarter in respect of a transaction with the Accountant General in the amount of NIS 30 million.

In the international communications and internet services segment, general and operating expenses increased from approximately NIS 152 million in the corresponding quarter, to approximately NIS 190 million in the reporting period. The increase derived mainly from the increase in expenses for foreign managers deriving from a significant increase in traffic routed from one foreign operator to another foreign operator, with a corresponding increase in revenues from that service, and also from an increase in expenses attributed to internet customers and in advertising and marketing expenses.

The general and operating expenses of the multi-channel television segment increased from approximately NIS 235 million in the corresponding quarter, to approximately NIS 262 million in the reporting period, as a result of an increase in content expenses and lease fees for satellite segments.

D. Depreciation

The Group's depreciation expenses decreased from approximately NIS 578 in the corresponding quarter, to approximately NIS 572 million in the reporting period, resulting from a decrease in those expenses due to the cessation of depreciation of fixed assets and a smaller investment in new assets in the fixed-line domestic communications segment and in the international communications and internet services segment. Most of the decrease was offset by an increase in depreciation expenses in the cellular segment and in the multi-channel television segment..

E. Royalties to the Government of Israel

The Group's royalties expense in the first quarter of 2006 amounted to approximately NIS 63 million, compared with approximately NIS 66 million in the corresponding quarter,, resulting from a decrease in the royalties expense in the fixed-line domestic communications segment due to the deduction of the payment for interconnect fees.

F. Operating income

The Group's operating income in the first quarter of 2006 amounted to approximately NIS 401 million, compared with approximately NIS 366 million in the corresponding quarter, an increase of approximately NIS 35 million. The increase in operating income derives from the changes in the results of the segments described above in the revenue and expense items. These changes led to an increase in the profitability of the cellular segment and international and internet services segment, to improved operating results in the multi-channel television segment and to lower profitability in the fixed-line domestic communications segment.

G. Financing expenses

The Group's net financing expenses in the first quarter of 2006 amounted to approximately NIS 72 million, compared with approximately NIS 55 million in the corresponding quarter an increase of approximately NIS 17 million. The increase derived from an increase in the financing expenses of the multi-channel television segment and the fixed-line domestic communications segment.

Financing expenses were influenced by the overall increase in the Group's debt and by changes in exchange rates and the Consumer Price Index. The increase was partially offset by revenues from the capital market in respect of investments in marketable securities and revenues from deposits.

In the fixed-line domestic communications segment, financing expenses increased due to the rise in the euro exchange rate and in the percentage increase of the Index. The effect of the changes in the foreign currency and shekel rates on liabilities in this segment was partially offset by hedging transactions and investment in financial assets.

In the multi-channel television segment, financing expenses increased as a result of the increase in the Index and an increase in total loans.

H. Other income

Income in the first quarter of 2006 amounting to approximately NIS 9 million was recorded in the Group's Other income, net item, compared with an income of approximately NIS 88 million in the corresponding quarter.
The income in the corresponding quarter derived mainly from capital gains of approximately NIS 104 million, which was partially offset by an expense of approximately NIS 23 million in amortization of goodwill in respect of companies then consolidated for the first time in the financial statements (see Note 10 to the financial statements). Following publication of Accounting Standard 20 (Amended), effective from the current reporting period, the method of amortization of goodwill was terminated.

I. Group's equity in earnings (losses) of affiliates

The Group's equity in earnings of affiliates in the first quarter of 2006 amounted to approximately NIS 1 million, compared with approximately NIS 3 million in the corresponding quarter.

3. Liquidity and sources of financing

Consolidated cash flows generated by operating activities in the first quarter of 2006 amounted to approximately NIS 748 million, compared with approximately NIS 592 million in the corresponding quarter, an increase of approximately NIS 156 million. The source of the increase in cash flow is adjustments in revenues and expenses not involving cash flow, and was partially offset by a decrease in the earnings of the Group.

In the cellular segment, cash flows generated by operating activities increased compared with the corresponding quarter, due mainly to an increase in earnings and a decrease in the balance of trade receivables.

Cash flows generated by operating activities are the principal source of financing of the Group's investments, which during the reporting period amounted to NIS 349 million of which, *inter alia*, approximately NIS 306 million was in the development of communications infrastructures and approximately NIS 31 million was in short-term investments. In the corresponding period, net cash flows used for investments amounted to NIS 758 million.

During the reporting period, the Group repaid approximately NIS 313 million of debt, of which approximately NIS 164 million was on account of long-term loans and approximately NIS 149 million on account of debentures. In the reporting period the Group raised new debt in a total amount of approximately NIS 46 million by receipt of short-term bank credit. The net amount of debt repaid during the reporting period amounted to NIS 267 million, compared with the raising of new debt in the amount of NIS 259 million during the corresponding period.

The average monthly short-term credit during the first quarter of 2006 was approximately NIS 98 million. The average monthly long-term liabilities in the first quarter of 2006 was approximately NIS 8,726 million.

Working capital as at March 31, 2006, was positive and amounted to approximately NIS 1,247 million, similar to the working capital on March 31, 2005 which amounted to NIS 1,254 million. In the fixed-line domestic communications segment, improved working capital was offset by a decrease in the working capital of the other main companies in the Group.

4. Group involvement in the community and donations

The Group involves itself in community institutions and social organizations such as the education system in distressed areas and border areas, and additionally, employees volunteer is various community activities.

For example, about 500 Group employees hold "Exposure to Modern Communications" workshops for junior high school students, in a program launched in 2005 in cooperation with the Ministry of Education.

In another project, "Children and Parents Learn Computers and Internet", which has been in operation for about five years, Company employees tutor parents and children from disadvantaged groups on various aspects of computers and the internet. The cost of the project, in addition to the volunteer employees' time, is approximately NIS 250 thousand per year.

Pelephone does not have a binding policy on donations, and its management discusses each case on its merits. In the reporting period, Pelephone donated approximately NIS 15,000 to various causes.

Bezeq International is involved in ongoing activities for disadvantaged populations in Petach Tikva, the "adoption" of soldiers without families in Israel and the adoption of a fighting battalion, and also participates in environmental and educational projects. In the reporting period, Bezeq International expenses amounted to approximately NIS 120 thousand.

5. Details concerning market risk exposure and management thereof

A. Further to the description in the Directors' Report for 2005, as a result of hedging transactions against market risks relating to exposure to changes in exchange rates, the Group's financing expenses significantly decreased in the accounting period.

B. The report of positions in derivatives as at March 31, 2006, is not significantly different from the report as at December 31, 2005 (see note 6 to the financial statements).

C. The report on linkage bases as at March 31, 2006, is not significantly different from the report as at December 31, 2005.

Surplus monetary liabilities over monetary assets denominated in or linked to a foreign currency as at March 31, 2006, amounted to approximately NIS 2.5 billion in the Group. As a result of forward currency transactions, the net balance of foreign currency liabilities not hedged as aforesaid as at March 31, 2006, amounted to approximately NIS 155 million.

Surplus monetary liabilities over monetary assets linked to the CPI as at March 31, 2006 amounted to approximately NIS 4.2 billion in the Group. Due to this surplus, the Group incurred exceptional financing expenses resulting from the exceptional rise in the Consumer Price Index in the quarter.

In the main segments of the Group, the protection in place reduces exposure to the Index deriving from the computation of tax expenses on real earnings.

6. Miscellaneous

a. Peer review

The Company has agreed to transfer the material required for a sampling relating to a peer review, following the directive of the Securities Authority published on July 20, 2005. This consent is subject to the maintaining of the confidentiality of the data transferred, as well as guaranteeing prevention of conflict of interests of the reviewers.

b. Post balance sheet date events

On May 14, 2006, the Company received a partnership notice from the Eurofund 2000 venture capital fund, regarding a distribution from which the Company expects to receive an immediate payment of $5.7 million and to record a capital gain (before tax) of approximately NIS 25 million (see Note 11 to the financial statements).

We thank the managers and employees of the Group companies, and our shareholders.

______________________	______________________
Menachem Inbar	Yacov Gelbard
Member of the Board	President & CEO
(Chairman of the approval meeting)	

"BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2006

(UNAUDITED)

Condensed Interim Consolidated Financial Statements as at March 31, 2006 (unaudited)

Contents

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

Dear Sirs,

Re: Review of the Unaudited Condensed Interim Consolidated Financial Statements as at March 31, 2006

At your request, we have reviewed the condensed interim consolidated balance sheet of "Bezeq" - The Israel Telecommunications Corp. Limited (hereinafter "Company") as at March 31, 2006, as well as the condensed interim consolidated statements of operations, the condensed interim statements of changes in shareholders' equity and the condensed interim consolidated statements of cash flows for the three-month period then ended.

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

Reports of other auditors were furnished to us which relate to the review of the condensed interim financial statements of consolidated subsidiaries, whose assets as at March 31, 2006, constitute approximately 37% of the total assets included in the condensed interim consolidated balance sheet and whose revenues constitute approximately 61% of the total revenues included in the condensed interim consolidated statement of operations for the three-month period then ended. Furthermore, reports of other auditors were furnished to us which relate to investments in affiliated companies in which the Company's investments amount to approximately NIS 87 million as at March 31, 2006, and the Company's share in the losses in respect thereof amount to approximately NIS 1 million for the three-month period 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 interim consolidated financial statements.

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

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

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

2. A program for early retirement as described in Note 5.

3. Contingent claims made against the Company and against invested companies, as described in Note 6A.

4. The financial position of a subsidiary as described in Note 4, including the opinion of the Management of the consolidated company, based on the 2006 work plan and on the alternative business plan, that the prospects of arranging sources of finance required by the consolidated company in the forthcoming year are good.

Somekh Chaikin
Certified Public Accountants (Isr.)

May 23, 2006

Condensed Interim Consolidated Balance Sheets as at

Reported amounts

	March 31 2006 (Unaudited)	March 31 2005 (Unaudited)	December 31 2005 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets			
Cash and cash equivalents	**2,290,703**	1,549,873	2,158,773
Short-term investments	**2,439,802**	1,577,274	2,398,525
Trade receivables	**2,084,237**	2,099,986	2,113,512
Other receivables and debit balances	**385,855**	487,696	321,507
Inventory	**207,525**	304,441	220,404
	7,408,122	6,019,270	7,212,721
Materials and spare parts	**87,639**	137,309	88,881
Broadcasting rights, net	**173,597**	150,617	154,500
Investments and long-term receivables			
Investments, deposits and debit balances	**769,359**	887,189	766,840
Investments in investee companies	**86,509**	69,933	75,467
	855,868	957,122	842,307
Fixed assets			
Cost	**30,839,518**	34,632,903	30,627,629
Less– accumulated depreciation	**21,229,767**	24,128,266	20,684,981
	9,609,751	10,504,637	9,942,648
Other assets			
Goodwill	**1,699,546**	1,769,379	1,699,546
Deferred charges and other assets	**365,653**	387,007	380,483
Deferred taxes	**324,176**	438,686	344,786
	2,389,375	2,595,072	2,424,815
	20,524,352	20,364,027	20,665,872

	March 31 2006 (Unaudited)	March 31 2005 (Unaudited)	December 31 2005 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current liabilities			
Bank credit	**121,497**	103,561	75,191
Current maturities of:			
Long-term bank loans	**1,221,193**	918,637	1,262,583
Debentures	**436,807**	302,914	527,167
Trade payables	**1,157,644**	1,375,675	1,400,714
Employee severance benefits	**565,706**	634,337	567,878
Other current liabilities	**1,458,283**	1,429,857	1,387,955
Dividend proposed	**1,200,000**	-	-
	6,161,130	4,764,981	5,221,488
Long-term liabilities			
Long-term loans	**2,046,286**	2,813,357	2,151,960
Debentures	**4,902,063**	4,398,407	4,903,056
Employee severance benefits	**277,937**	612,947	297,427
Other long-term liabilities	**53,564**	30,038	34,081
Loans extended by the minority in a subsidiary:			
Loans	**1,118,506**	1,064,057	1,114,498
Less – minority share in deficit of a subsidiary	**(1,118,506)**	(1,064,057)	(1,114,498)
	7,279,850	7,854,749	7,386,524
Minority rights	**-**	(1,177)	-
Contingent liabilities (Note 6)			
Shareholders' equity	**7,083,372**	7,745,474	8,057,860
	20,524,352	20,364,027	20,665,872

Menachem Inbar Member of the Board (Chairman of the approval meeting)	**Yacov Gelbard** President & CEO	**Ron Eilon** Deputy CEO and CFO

Date of approval of the financial statements: May 23, 2006.

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

Condensed Interim Consolidated Statements of Operations

Reported amounts

	For the three-month period ended March 31		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues (Note 8)	**2,819,255**	2,773,123	11,098,686
Costs and expenses			
Operating and general expenses (Note 9)	**1,783,650**	1,763,851	7,193,468
Depreciation	**571,830**	577,507	2,330,711
Royalties to the Government of Israel	**63,194**	65,552	257,429
	2,418,674	2,406,910	9,781,608
Operating income	**400,581**	366,213	1,317,078
Financing expenses, net	**(71,973)**	(54,876)	(417,309)
Earnings after financing expenses	**328,608**	311,337	899,769
Other income, net (Note 10)	**9,382**	87,614	109,386
Earnings before income tax	**337,990**	398,951	1,009,155
Income tax	**(113,502)**	(132,870)	(429,594)
Earnings after income tax	**224,488**	266,081	579,561
Equity in earnings (losses) of affiliates	**1,050**	(3,321)	(12,645)
Minority share in losses (earnings) of subsidiaries	**(26)**	1,947	8,942
Earnings before the cumulative effect of a change in an accounting method	**225,512**	264,707	575,858
Cumulative effect of a changes in accounting method as at the beginning of the year	**-**	15,000	15,000
Net earnings	**225,512**	279,707	590,858
Primary and diluted earnings per share (in NIS)			
Earnings before the cumulative effect of a change in accounting method	**0.087**	0.102	0.222
Cumulative effect of a change in accounting method as at the beginning of the year	**-**	0.005	0.005
Net earnings per share	**0.087**	0.107	0.227

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

Condensed Interim Statements of Changes in Shareholders' Equity

Reported amounts

	Share capital	Capital reserve – share premium	Capital reserve in respect of transactions between the Company and a controlling shareholder	Dividend proposed after the balance sheet date	Retained earnings (deficit)	Total
Three months ended March 31, 2006						
Balance as at December 31, 2005 (audited)	**6,309,133**	**1,623,423**	**39,010**	**1,200,000**	**(1,113,706)**	**8,057,860**
Net earnings (unaudited)	**–**	**–**	**–**	**–**	**225,512**	**225,512**
Dividend (unaudited)	**–**	**–**	**–**	**(1,200,000)**	**–**	**(1,200,000)**
Balance as at March 31, 2006 (unaudited)	**6,309,133**	**1,623,423**	**39,010**	**–**	**(888,194)**	**7,083,372**
Three months ended March 31, 2005						
Balance as at December 31, 2004 (audited)	6,309,133	1,623,423	37,775	–	(504,564)	7,465,767
Net earnings (unaudited)	–	–	–	–	279,707	279,707
Balance as at March 31, 2005 (unaudited)	6,309,133	1,623,423	37,775	–	(224,857)	7,745,474
Year ended December 31, 2005						
Balance as at December 31, 2004 (audited)	6,309,133	1,623,423	37,775	–	(504,564)	7,465,767
Net earnings (audited)	–	–	–	–	590,858	590,858
Payment by the State in respect of Company privatization (audited)	–	–	1,235	–	–	1,235
Dividend proposed for payment (audited)	–	–	–	1,200,000	(1,200,000)	–
Balance as at December 31, 2005 (audited)	6,309,133	1,623,423	39,010	1,200,000	(1,113,706)	8,057,860

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

Condensed Interim Consolidated Statements of Cash Flows

Reported amounts

	For the three-month period ended March 31		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Cash flows from operating activities			
Net earnings	**225,512**	279,707	590,858
Adjustments to reconcile net earnings to cash flows from operating activities (see A below)	**522,420**	312,057	2,127,730
Net cash generated by operating activities	**747,932**	591,764	2,718,588
Cash flows used for investing activities			
Investment in fixed assets	**(306,135)**	(475,508)	(1,694,071)
Proceeds from disposal of fixed assets and sale of operation	**13,655**	12,568	147,810
Investment in long-term deposits and investments	**(3,491)**	-	(10,068)
Proceeds from long-term deposits and investments	**3,593**	6,318	91,431
Increase in short-term investments, net	**(30,753)**	(275,089)	(972,260)
Investment in investee companies	**(9,491)**	(2,628)	(18,836)
Investment in other assets	**(16,541)**	(23,760)	(91,893)
Net cash used for investing activities	**(349,163)**	(758,099)	(2,547,887)
Cash flows from financing activities			
Issue of other debentures (after deduction of issue expenses)	**-**	812,295	1,702,265
Repayment of other debentures	**(148,968)**	(91,603)	(267,332)
Receipt of long-term loans	**-**	114,500	474,521
Repayment of long-term loans	**(164,177)**	(591,550)	(1,365,578)
Receipt (repayment) of short-term bank credit, net	**46,306**	15,459	(12,911)
Net cash generated by (used for) financing activities	**(266,839)**	259,101	530,965
Increase in cash and cash equivalents	**131,930**	92,766	701,666
Balance of cash and cash equivalents at the beginning of the period	**2,158,773**	1,457,107	1,457,107
Balance of cash and cash equivalents at the end of the period	**2,290,703**	1,549,873	2,158,773

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

Condensed Interim Consolidated Statements of Cash Flows (Contd.)

Reported amounts

	For the three-month period ended March 31		For the year ended December 31
	2006	2005	2005
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
A – Adjustments to reconcile net earnings to net cash flows generated by operating activities			
Revenue and expenses not involving cash flows:			
Depreciation	**571,830**	577,507	2,330,711
Deferred taxes	**31,654**	40,859	144,035
Company's equity in losses (profits) of affiliated companies	**(1,050)**	3,321	12,645
Minority share in earnings (losses) of a subsidiary	**26**	(1,947)	(8,942)
Decrease in employee severance benefits, net	**(21,662)**	(25,286)	(407,265)
Loss from disposal of fixed assets	**(9,576)**	(1,730)	(5,715)
Provision for decrease in value of investments	**-**	-	5,868
Gain from sale of operation	**-**	(101,860)	(103,869)
Exchange rate differences, linkage and interest on long-term deposits and investments	**(1,729)**	21,839	22,170
Exchange rate differences and linkage on short-term investments, net	**(10,524)**	(14,376)	(60,396)
Exchange rate differences and linkage of long-term liabilities:			
Debentures	**66,166**	(84,391)	(69,730)
Long-term loans and other liabilities	**15,428**	25,489	129,032
Amortization of other assets and deferred expenses	**21,693**	47,936	196,015
Changes in asset and liability items:			
Increase in broadcasting rights	**(19,097)**	(10,121)	(14,004)
Decrease (increase) in trade receivables	**28,383**	(8,270)	(63,298)
Decrease (increase) in other receivables and debit balances	**(47,146)**	(29,244)	24,600
Decrease in inventory	**11,037**	5,740	75,943
Decrease (increase) in materials and spare parts	**(18,172)**	(35,935)	24,952
Decrease in trade payables	**(165,968)**	(142,772)	(112,461)
Increase in other current liabilities	**70,328**	62,635	20,733
Increase (decrease) in deferred revenues	**799**	(17,337)	(13,294)
	522,420	312,057	2,127,730
B – Non-cash transactions			
Acquisition of fixed assets, other assets, materials and spare parts on credit	**53,612**	122,859	124,719
Sale of fixed assets on credit	**28,977**	131,408	17,089

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

Notes to the Financial Statements as at March 31, 2006

NOTE 1 – GENERAL

A. These interim statements were prepared according to generally accepted accounting principles, applicable to the preparation of financial statements for interim periods pursuant to Accounting Standard 14 of the Israeli Accounting Standards Board (hereinafter – the IASB) and to the provisions of Section 4 of the Securities Regulations (Periodic and immediate reports), 5730-1970.

B. These statements should be read in conjunction with the annual financial statements of the Company and its subsidiaries as at December 31, 2005 and for the year then ended, and their accompanying notes (hereinafter – the Annual Reports).

C. The Company presents in the notes to the interim financial statements only those significant changes in its business and legal environment that occurred from the date of the latest annual financial statements until the date of these interim financial statements. The full and detailed description, including significant changes and developments which occurred in recent years, particularly in the fields of cellular telephone services, international communication services, domestic communication services, multi-channel television services, and the opening of those markets to competition, appear in Note 1 to the Company's annual financial statements as at December 31, 2005. The significant changes that occurred from the date of the annual financial statements to the date of these financial statements are as follows:

(1) Further to Note 1(C) to the financial statements as at December 31, 2005, concerning the gradual reduction in the rate of royalties from 3.5% to 3%. The Ministry of Communications notified the Company that the amendment to the Royalty Regulations will be implemented shortly.

(2) Further to Note 1(D) to the financial statements as at December 31, 2005, concerning an appeal filed by the Company in 2001 in the Antitrust Court to change the announcement of the Company's monopoly in the basic telephony service (fixed-line domestic telephony) – following the Company's request that the court expedite the hearing of the appeal, the Company agreed, at the proposal of the court, to withdraw the appeal, and it intends to file a new and revised application to the Antitrust Commissioner. In the opinion of the Company, the fixed-line telephony market is an alternative market for cellular telephony, and this fact is reinforced by new and up-to-date data which have accumulated during the period since the start of the proceeding before the court.

(3) Further to Note 1(E)(1)(a) to the financial statements as at December 31, 2005, concerning an update to the Company's tariffs, the next tariff update is expected to be on June 1, 2006, although as of the date of the publication of these statements the Company has not yet received the relevant draft Regulations.

(4) Further to Note 1E(1)(c) to the financial statements as at December 31, 2005, concerning regulations relating to proceedings and conditions for receipt of a special general license for providing fixed-line domestic communications services without a universal obligation – to the best of the Company's knowledge, during the first quarter of 2006 another two licenses were granted to two additional operators. The subsidiary Bezeq International Ltd. has filed an application for such a license.

(5) Further to Note 1(E)(1)(f) to the financial statements as at December 31, 2005, concerning the numbering and number portability plan, during February/March 2006 there was a further exchange of letters on the matter of the operators', including the Company, inability to meet the timetables that were set. The Company once again notified that it is preparing for the implementation of number portability but for real and technical reasons, it cannot meet the timetable set for implementation of the plan, and it reserves its legal rights in the matter.

(6) Further to Note 1(H) to the financial statements as at December 31, 2005, concerning resolutions adopted by the Board of Directors of the Company on March 1, 2006 to recommend to the General Meeting of the shareholders of the Company the distribution of a cash dividend to the shareholders in the amount of NIS 1,200,000,193, which as at the date of the distribution constitutes NIS 0.4606446 per share and 46.06446% of the Company's issued and paid up capital – the Special General Meeting

NOTE 1 – GENERAL (CONTD.)

C. (CONTD.)

(6) (contd.)

of the shareholders of the Company which convened on March 23, 2006, approved the distribution of the dividend. The dividend was distributed on April 16, 2006.

(7) The Ministry of Communications notified the Company on May 9, 2006 of its intention to call in a guarantee of NIS 7 million out of the bank guarantee of $10 million which the Company deposited for securing fulfillment of the terms of its license, due to its position that the Company launched a campaign in a way which deviates from the rules of the regulation applicable to campaigns. The position of the Company is that it does not require the approval of the Ministry for marketing campaigns. The Company intends to find every legal method available to it in this matter and at the initial stage, the Company is filing an appeal to the Minister of Communications regarding the decision.

(8) On May 11, 2006 the Company received a communication from the Antitrust Authority in the matter of complaints by certain communications operators about actions that were allegedly taken by the Company vis-à-vis these operators. According to the said operators, the said actions constitute abuse of the Company's monopolistic power. The Company has been asked to send data and replies to the questions that were "detailed" in the letter and is sending the requested information.

(9) On May 23, 2006 investigators from the Antitrust Authority appeared at the offices of the Company and presented an order from the Magistrates' Court permitting them to conduct a search at the offices of the Company and to seize any document or object required for an investigation. According to the order, the grounds for issuing the order was the alleged abuse of the status of the monopoly under Section 29A of the Antitrust Law, along with Section 47A (4A) of the Antitrust Law and/or an unreasonable refusal to supply an asset or service under the monopoly, as per Section 29 of the Antitrust Law. During the search, which has not yet been completed, various documents were collected by the investigators, including computerized material, and a number of employees were asked to accompany the investigators to the offices of the Antitrust Authority for interrogation. The Company is cooperating fully with the Authority's investigators.

NOTE 2 – REPORTING PRINCIPLES AND ACCOUNTING POLICY

A. GENERAL

The significant accounting policies applied in thee financial statements are consistent with those applied in the Annual reports, except as stated in this Note.

B. INITIAL APPLICATION OF ACCOUNTING STANDARDS

(1) Accounting Standard No. 20 (Amended) – Accounting treatment of goodwill and intangible assets in the acquisition of an investee company

Commencing January 1, 2006, the Company has applied Accounting Standard No. 20 (Amended) ("the Standard") of the IASB. The Standard prescribes the accounting treatment for goodwill and intangible assets upon acquisition of a subsidiary and of an investee company which is not a subsidiary, including a company under joint control.

The principle changes set out in the Standard compared with the principles applied in the past, are attribution of the surplus cost of the acquisition of investment in an investee company also to identifiable intangible assets of the acquired company; a distinction between intangible assets with a defined useful life and intangible assets of an indefinite useful life; immediate recognition as gain, on the date of acquisition, in the statement of income, of negative goodwill created in

NOTE 2 – REPORTING PRINCIPLES AND ACCOUNTING POLICY (CONTD.)

B. INITIAL APPLICATION OF ACCOUNTING STANDARDS (CONTD.)

(1) (contd.)

the acquisition after deduction of intangible assets and non-financial assets of the investee company; termination of the systematic deduction of positive goodwill and intangible assets with an indefinite useful life; distinction between goodwill of a subsidiary and of an investee company which is not a subsidiary for the matter of impairment. Comparative figures were not restated.

The amount of goodwill amortized in the corresponding period and in the year 2005 amounted to NIS 23,279 thousand and NIS 93,112 thousand, respectively. (see also note 10).

(2) Accounting Standard No. 21 – Earnings per share

Commencing January 1, 2006, the Company has applied Accounting Standard No. 21 (Amended) ("the Standard") of the IASB. Pursuant to the Standard, the Company computes the basic earnings per share with regard to profit or loss, as well as the basic earnings per share with regard to profit or loss from ongoing operations, attributed to the ordinary shareholders. The basic earnings per share is calculated by dividing the profit or loss attributed to the ordinary shareholders, by the weighted average of the number of ordinary shares in circulation during the period. For the purpose of calculating diluted earnings per share, the Company adjusted the profit or the loss attributed to the ordinary shareholders, and the weighted average of the number of ordinary shares in circulation, in respect of the effects of all the diluting potential ordinary shares. The Company's equity in the earnings of investee companies was computed according to its equity in the earnings per share of those companies, multiplied by the number of shares the Company holds. The initial application of the Standard did not affect the earnings per share of the Company.

(3) Accounting Standard No. 22 – Financial instruments: disclosure and statement

Commencing January 1, 2006, the Company has applied Accounting Standard No. 22 ("the Standard") of the IASB. The Standard sets out the rules for the stating financial instruments in the financial statements and details the proper disclosure required for them. In addition, the Standard determines the manner of classification of financial instruments as financial liability and as shareholders' equity, the classification of interest, dividends, related losses and gains, and the circumstances in which financial assets and financial liabilities should be set off. The Standard cancels Opinion 53 – Accounting treatment of convertible liabilities, and Opinion 48 – Accounting treatment of option warrants. The Standard was adopted "from now on". Comparison figures relating to prior periods were not restated. Following the initial adoption of the accounting standard, the Company offset deferred issuance expenses in the amount of NIS 9 million from the debentures and loan items.

(4) Accounting Standard No. 24 – Share-based payment

Commencing January 1, 2006, the Company has applied Accounting Standard No. 24 ("the Standard") of the IASB. Pursuant to the provisions of the Standard, the Company will recognise share-based payment transactions in its financial statements including transactions with employees or other parties that must be settled in equity instruments, in cash or by other assets. Share-based payment transactions in which goods or services are received will be reported at their fair value.

Regarding transactions which are cleared in capital instruments, the Standard applies to grants made after March 15, 2005 but which had not yet vested by January 1, 2006. In the same manner, the Standard applies to changes which occurred in the terms of the transactions cleared in capital instruments which were made after March 15, 2005, even if the grants in

NOTE 2 – REPORTING PRINCIPLES AND ACCOUNTING POLICY (CONTD.)

B. INITIAL APPLICATION OF ACCOUNTING STANDARDS (CONTD.)

(4) (contd.)

respect of which the changes were made were prior to that date. The initial application of the Standard did not affect the results of operations and the financial condition of the Company.

(5) Accounting Standard No. 25 – Income

Commencing January 1, 2006, the Company has applied Accounting Standard No. 25 ("the Standard") of the IASB. The Standard deals with recognition of income from three types of transactions: the sale of goods, the provision of services, and the made by others of the company's interest-yielding assets, royalties and dividends, and it prescribes the accounting treatment required (rules of recognition, measurement and disclosure) for those three types of transaction. The initial application of the Standard did not materially affect the results of operations and the financial condition of the Company.

As of January 1, 2006 the Company has applied the IASB published Clarification No. 8 – "Reporting income on a gross basis or a net basis" ("the Clarification"). The Clarification is based on the professional publication EITF 99-19 of the Emerging Issues Task Force in the U.S.A. According to the Clarification, an entity operating as an agency or as a broker without bearing the risks and yields deriving from the transaction, will state its income on a net basis. Conversely, an entity operating as a principal supplier and bearing the risks and yields deriving from the transaction will state its income on a gross basis. The Clarification provides a list of indicators to be considered in order to determine the basis on which income should be reported – gross or net. Since in the past the Company treated the matter of gross or net income in accordance with the provisions of EITF 99-19, the initial application of the new Clarification did not influence the Company in any way.

NOTE 3 – 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 period of account, are as follows:

	Consumer price index	Exchange rate of the US dollar	Exchange rate of the euro
	%	%	%
For the three-month period ended:			
March 31, 2006	**0.583**	**1.347**	**3.964**
March 31, 2005	(0.596)	1.230	3.879
For the year ended December 31, 2005	2.386	6.848	(7.334)

Notes to the Financial Statements as at March 31, 2006

NOTE 4 – INVESTMENTS IN INVESTEE COMPANIES

A. D.B.S. SATELLITE SERVICES (1998) LTD. ("DBS")

In January 1999, DBS received a license from the Ministry of Communications for satellite television broadcasts, and commenced the provision of services in July 2000. Since starting operations, DBS has accumulated considerable losses. The loss for 2005 amounted to approximately NIS 328 million and the loss for the three-month period ended March 31, 2006, amounted to approximately NIS 67 million. As a result of these losses, DBS's capital deficit and working capital deficit as at March 31, 2006 amount to approximately NIS 3,638 million and NIS 510 million respectively.

The Company's investment in DBS (mainly shareholders' loans) as at the balance sheet date is approximately NIS 1,562 million (before interest and linkage). The Company's equity in the accumulated losses of DBS since its investment (excluding deduction of goodwill) is approximately 1,639 million, of which approximately NIS 64 million was recorded in the reporting period (DBS's losses for the period, net of the increase in new loans given by minority shareholders). The balance of DBS's current debt to the Company and its consolidated companies amounts to approximately NIS 83 million.

The terms of the long-term loans which DBS received from banks, the balance of which as at March 31, 2006 is NIS 1,324 million (including current maturities), impose various restrictions on DBS, which include, *inter alia* – restrictions relating to encumbrance or sale of certain assets, restrictions on receipt of credit from other banks without prior approval, a restriction on repayment of shareholders loans, and a demand to comply with financial criteria ("the Conditions"). As at March 31, 2006, DBS is in compliance with the Conditions prescribed in the financing agreements (after a benefit which was granted in connection with the financial criteria in respect of the first quarter of 2006). In view of the projections of the Management of DBS regarding its business results for 2006, DBS is working with the banks to revise the financial directives in the financing agreement. DBS is also negotiating with the banks to settle a dispute relating to insurance obligations prescribed in the financing agreement.

In March 2006 Israel Aircraft Industries Ltd. ("IAI") contacted DBS and demanded full repayment of DBS's debt to IAI in the wake of DBS's failure to adhere to the payment arrangement that was determined between the parties. As at the date of approval of the financial statements, DBS is conducting talks with IAI in order to arrive at a solution that will be acceptable to both parties. A delay in payment to IAI constitutes a *prima facie* breach of the financing agreement, but the banks have confirmed to DBS that they will not deem IAI's demand for the repayment of the loan and the non-payment on the part of DBS a breach of the financing agreement, provided IAI does not take any steps whatsoever in order to collect the said debt by August 1, 2006 and that a written repayment solution is agreed between the parties by that date.

In March 2004, the Board of Directors of the Company approved an investment of NIS 440 million in DBS by the end of 2005 ("the Additional Injection"), of which, by October 11, 2005, the Company had transferred approximately NIS 284 million.

On December 31, 2004, and February 14, 2005, the Company and DBS were notified of decisions of the then Minister of Communications relating to the Additional Injection. Those decisions determined, *inter alia*, that –

(1) The total amount of the planned Additional Injection (NIS 440 million) was limited to a maximum of NIS 350 million.

(2) With regard to the NIS 195 million of the Additional Injection already transferred by the Company at that time to DBS, no additional action was taken.

(3) The balance of the sum, a maximum of NIS 155 million, would be transferred once every quarter in equal portions during 2005.

(4) The Company would not be permitted to provide a guarantee to the shareholders of DBS, to banks or to institutional financing entities, or to make any other similar commitment, for securing their part in the Additional Injection or in credit granted to DBS by them.

NOTE 4 – INVESTMENTS IN INVESTEE COMPANIES (CONTD.)

A. D.B.S. SATELLITE SERVICES (1998) LTD. ("DBS") (CONTD.)

In April and May 2005, the Company and DBS filed petitions in the High Court of Justice for grant of an order *nisi* against the Minister of Communications, declaring that the decisions described above are null and void. The petitions, which were heard on October 11, 2005, raised questions of principle which are far from simple, both factually and legally, and which were brought into sharp focus during the hearing. The Court has not yet given its decision.

On March 21, 2006, the Company received a letter from the Minister of Communications, stating that after examining the implications of further injections of funds into DBS for the promotion and consolidation of competition in fixed-line domestic communications, and since the business plan of DBS for 2006 calls for injections in 2006 amount to NIS 55 million, the Minister of Communications was considering placing a limit on injections of funds in 2006 in the following manner:

(1) The Company's share in the total injections into DBS would not exceed 40%.

(2) The share of the other DBS shareholders and of the banks or financing institutions would not exceed 60%.

(3) The Company or an entity acting on its behalf would not provide a guarantee to the shareholder, the banks or institutional financing entities, or any similar commitment, for securing their part in the injections or in credit granted by them to DBS.

(4) Towards the end of 2006, the subject of the injections, insofar as may be required in future years, would be re-examined.

The Company sent its response to the letter on April 2, 2006, in which it gave notice that it opposes the decision being considered by the Ministry of Communications, which it believes to be *ultra vires*, and requesting a hearing to explain its position and make its arguments orally before the Minister of Communications.

On January 31, 2006, the Board of Directors of DBS approved its budget for 2006, which requires that DBS obtains additional external financing for the year. As at the date of approval of the financial statements, DBS is working to obtain additional financial resources which will enable it to achieve the goals of the budget for the coming year. If those resources cannot be obtained, DBS will operate in accordance with an alternative business plan which does not necessitate additional resources beyond the existing ones. The Management of DBS believes, based on the 2006 budget and on the alternative business plan, that the prospects for arranging the financial resources required by DBS in the coming year are good.

B. GOLDNET COMMUNICATION SERVICES - A REGISTERED PARTNERSHIP ("GOLDNET")

On April 30, 2006 an agreement was signed between the Company, Malam Systems Ltd. and Goldnet Communication Services – a Registered Partnership **("GOLDNET")** of the first part, and the subsidiary Bezeq International of the other part, for the acquisition of all the operations of Goldnet by Bezeq International, in consideration of NIS 6.8 million, which will be divided between the Company (NIS 5.1 million) and Malam Systems (NIS 1.7 million).

Upon fulfillment of all the suspending conditions stipulated in the acquisition agreement (*inter alia* approval by the Antitrust Commissioner and the Ministry of Communications) and payment of the consideration, Goldnet will cease to provide services.

NOTE 5 – LIABILITIES DUE TO TERMINATION OF EMPLOYER-EMPLOYEE RELATIONS

EARLY RETIREMENT PLAN

Pursuant to the foregoing in Note 16D in the financial statements as at December 31, 2005, regarding negotiations that have commenced between Company Management and the employees' representatives in connection with a change in the organizational structure involving employee retirement and/or dismissal and a new collective labor agreement, the negotiations are continuing but have not yet matured to the point of an agreement.

On April 27, 2006, a "notification of a strike or lockout" was received at the offices of the Company in accordance with the Law for the Settlement of Labor Disputes, 5717-1957 ("the Notification"). The Notification pertains to a strike at the Company beginning on May 14, 2006, and thereafter, which was declared by the New General Federation of Labor and was approved, according to the aforementioned, by the representative professional union.

The matters in dispute, according to the aforementioned in the Notification, are:

"A. Severe implications expected to affect the employees as a result of the severe damage to the Company's financial robustness due to the failure to arrange the matter of granting discounts, reducing the Company's royalties, tariff flexibility and in light of the issuing of licenses to competitors on terms that seriously harm the Company.

B. Disregard for the employees' representative and it's requests and conduct that is not in good faith and is unacceptable in collective labor relations in general and in labor relations in the public service in particular."

Following serious disruptions and disconnections that were caused as a result of the employee sanctions, the Company applied to the labor court on May 18, 2006. During the discussion that took place in the labor court, it was decided that the employees would return to work and intensive negotiations would be conducted in order to reach an agreed upon solution through negotiations and not through sanctions and strikes.

NOTE 6 – CONTINGENT LIABILITIES

A. CLAIMS AND CONTINGENT LIABILITIES

The Company and the investee companies have contingent liabilities in respect of which the maximum possible exposure is considerable. A detailed description of these contingent liabilities appears in Note 19A to the annual financial statements of the Company as at December 31, 2005. No material changes in contingent liabilities have occurred up to the date of signing these financial statements, other than the following:

(1) Further to Note 19A(4)b. to the financial statements as at December 31, 2005, concerning a number of claims relating to recognition of various of salary components as pension components and of the notice of a party to the a collective dispute ("the Claim") which was filed by the New General Federation of Workers ("the Histadrut") in the name of all the employees of the Company, in which the Histadrut alleged that grossing up payments, the administrative on-call component and clothing allowances ("the Components") which were and are paid to Company employees, are regular pay, which form part of the determining salary of every employee, including for the calculation of payments upon retirement, redemption of holidays, grants, acclimatization payments, percentage increments and hourly pay value and that various payments and provisions should be made in respect thereof, including for pension purposes.
On April 4, 2006, the decision of the Jerusalem Regional Labor Court dismissed the Claim and all its component parts filed by the Histadrut in the name of all Company employees.

Notes to the Financial Statements as at March 31, 2006

NOTE 6 – CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS AND CONTINGENT LIABILITIES (CONTD.)

(1) (Contd.)

In its decision, the Court allowed in full the argument of the Company, that the conduct of the parties over so many years indicates unequivocally that the demands of the Histadrut directly contradict the agreements applicable in the relations of the parties, which are binding in the circumstances, and therefore those demands should be dismissed. The Court further determined that even if the Components are examined on their merits, the Claim would be dismissed since according to case law, all three Components fall within the definition of "extras" and not "pay", and therefore do not grant entitlement entitled to the reliefs claimed by the Histadrut.

The financial statements include a provision of NIS 50 million in respect of the administrative on-call component and in respect of another components claim. The Company has examined the significance and implications of the decision and concluded that the conditions have not yet been reached in order to allow for canceling or reducing the provision.

(2) Further to Note 19A(11) to the financial statements as at December 31, 2005, concerning a claim and application for recognition as a class action, in the matter of reimbursement of a commission which the plaintiff alleges was collected unlawfully, for calls in Israel from a public telephone operated by means of a BezeqCard, on April 16, 2006, the applicant filed an application to amend the application for recognition as a class action pursuant to the new Class Actions Law, 5766-2006. The Company opposed the application. The Court has not yet given its decision. In the opinion of the legal advisers who are handling the claim on behalf of the Company, in any case, and even if the plaintiff's application is allowed, following amendment of the Telecommunications Regulations, the basis for the claim and the application for recognition as a class action no longer exists.

(3) Further to Note 19A(14) to the financial statements as at December 31, 2005, concerning the dismissal of a class action filed against the Company in May 2003, alleging that the Company abuses its monopolistic power and collects enormous sums of money from internet users in that it refuses to install splitters on high-speed (ADSL) lines. On March 27, 2006, the plaintiff filed an appeal in the Supreme Court, in which he petitions for the decision of the District Court dismissing his claim to be cancelled. The Company believes, based on the opinion of its external legal advisers, that the chances that the appeal will be allowed are lower than the possibility of the appeal being dismissed.

(4) Further to Note 19A(20) to the financial statements as at December 31, 2005, concerning the dispute between the Company and the Ministry of Communications relating to the payment of royalties in respect of interconnect revenues from cellular subscribers to Company subscribers in the period between April 1999 and the end of 2000, on April 12, 2006, the Company paid the sum of approximately NIS 17 million requested by the Ministry. The Company is in advanced discussions with the Ministry in an attempt to resolve the other disputes related to royalties.

(5) On April 6, 2006, the Company received a claim together with an application for recognition as a class action, which was filed by a private (and inactive) company which is a shareholder of the Company. According to its allegations, the claim concerns the plaintiff being subscribed to the "Free From 7" track and being charged according to that track tariff, without it having ordered the service. According to the plaintiff, it has cause of claim in the circumstances of the matter, under the Consumer Protection Law, 5741-1981, the Contracts Law (General part), 5733-1973, and the Unjust Enrichment Law, 5739-1979. The amount of the personal claim is assessed by the plaintiff at NIS 239.18.

The plaintiff has applied for the claim to be recognized as a class action in the name of all the subscribers who were charged unlawfully in chargeable tracks and for certain services of the Company which are listed in the claim. The plaintiff estimates that the financial loss of the members of the group included in the class action could reach millions of shekels per year. The Company is studying the claim and in unable, at this stage, to assess its chances.

NOTE 6 – CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS AND CONTINGENT LIABILITIES (CONTD.)

(6) On May 15, 2006, the Company received a claim with an application for recognition as a class action, which was filed pursuant to Section 5 of the Class Actions Law, 5766-2006. The Statement of Claim alleges that the Company collected from the plaintiff arrearage interest on amounts of Value Added Tax which the plaintiff should have paid to the Company and which are not part of the services provided by the Company. The amount of the plaintiff's personal claim is NIS 0.33. The plaintiff does not make any assessment of the amount of the class action.
The Company is studying the claim and is unable, at this stage, to estimate its outcome.

(7) Further to Note 19A(34) to the financial statements as at December 31, 2005, concerning notice of the filing of an application to add Pelephone to an appeal proceeding filed by the owners of rights in land adjoining a cellular communication site operated by Pelephone together with others in Ramat Gan. Pelephone's objection to joining the proceeding as a whole was allowed. Pelephone believes, relying on its legal advisers at this stage of the proceeding, that it is at no risk of exposure.

(8) A number of proceedings were recently submitted to Pelephone, in which local committees were requested to add Pelephone as a party to various appeals filed in appeals committees against dismissal of claims of impairment of value under Section 197 of the Planning and Construction Law, in respect of the erection of communications installations. Pelephone is studying each application and making its decisions accordingly. Pelephone believes, relying on its legal advisers, that it is not at risk of material exposure at this stage of these proceedings.

(9) A number of legal proceedings are in progress against Pelephone (whether in administrative petitions, appeals or civil actions), which were filed against the licensing and/or erection of communications sites. Pelephone, the respondent in these proceedings, opposes the reliefs applied for. Pelephone believes, relying on its legal advisers, that it is not at risk of material exposure in these proceedings.

B. FORWARD TRANSACTIONS

Forward Currency Transactions – Hedging Transactions

Consolidated

	Currency purchased	Currency payable	Final repayment date	Amounts receivable	Amounts payable
				NIS millions	
Forward contracts at predetermined exchange rate					
(excluding premium/discount)	Dollar	NIS	September 2006	271	268
	Euro	NIS	August 2007	1,690	1,704
	CPI-linked NIS	NIS	December 2010	1,102	1,146

Futures Currency Transactions – Contracts not for Hedging Purposes

	Purchased currency	Currency payable	Last repayment date	Scope of commitment
				NIS millions
Forward contracts at predetermined exchange rate				
(excluding premium/discount)	Dollar	Shekel	August 2006	383
	Index	Shekel	December 2006	50

Notes to the Financial Statements as at March 31, 2006

NOTE 7 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES

A. Further to Note 27C to the financial statements as at December 31, 2005, on March 23, 2006, the General Meeting of the shareholders of the Company approved the Company entering into an agreement with a company which will be owned and controlled by the shareholders of Ap.Sab.Ar. and will provide the Company with regular management and consultation services, including by means of serving directors and directors who will serve from time to time in the Company and/or in its subsidiaries, for US $1.2 million per year. The term of the agreement is from October 11, 2005 the date of closing the purchase of 30% of the shares of the Company by Ap.Sab.Ar.) to December 31, 2008, unless one of the parties gives the other three months' notice of its wish to terminate it.

B. **BENEFITS FOR DIRECTORS**

On May 15, 2006, the Audit Committee and the Board of Directors approved the terms of employment of the Chairman of the Board who is expected to be elected as Director and Chairman. Below are the details of the terms of his employment:

1 Employment at an 80% position under a personal employment agreement at a monthly salary of NIS 150,000 and related benefits as customary (senior employees' insurance plan, supplementary study fund, Company car, driver, reimbursement of expenses, telephone, etc.).

2. In addition to his regular monthly salary, a once yearly payment (with no conditions of any kind) in the amount of one million two hundred thousand shekels (linked to the Index).

3. The commitment shall be for an undefined period, where each party has the right to bring the commitment to an end by giving three months' notice.

4. Insofar as the Company has an employee stock options plan, the Chairman shall be included in it in accordance with the criteria of that plan.

The terms of employment are subject to the approval of the general meeting of shareholders which will convene on June 21, 2006.

NOTE 8 – REVENUES FROM TELECOMMUNICATION SERVICES

	For the three-month period ended March 31		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from communication services –			
Traffic	**340,542**	368,237	1,436,615
Fixed fees	**649,800**	624,370	2,559,559
Total revenues from fixed-line communications	**990,342**	992,607	3,996,174
Cellular telephone	**926,805**	927,364	3,643,795
International communications and internet services	**232,117**	188,566	775,532
Multi-channel television	**314,963**	284,134	1,171,318
Installation and sale of equipment to subscribers	**294,630**	314,207	1,246,947
	2,758,857	2,706,878	10,833,766
Other revenues	**60,398**	66,245	264,920
	2,819,255	2,773,123	11,098,686

Notes to the Financial Statements as at March 31, 2006

NOTE 9 – OPERATING AND GENERAL EXPENSES

	For the three-month period ended March 31		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses –			
Operations	**455,351**	433,934	1,794,458
General and administrative	**172,076**	162,443	684,290
Total salaries and incidentals	**627,427**	596,377	2,478,748
General expenses	**291,333**	299,514	1,209,169
Materials and spare parts	**202,324**	256,546	1,016,735
Consumption of content from satellite services	**108,442**	100,198	419,309
Cellular telephone expenses	**256,759**	254,521	991,066
Building maintenance	**84,149**	86,807	366,630
Services and maintenance by sub-contractors	**114,301**	105,761	422,416
International communications expenses	**96,406**	64,027	277,210
Vehicle maintenance expenses	**45,402**	40,086	181,385
Collection fees	**12,328**	12,073	49,196
	1,838,871	1,815,910	7,411,864
Less salaries charged to investment in fixed assets	**55,221**	52,059	218,396
	1,783,650	1,763,851	7,193,468

NOTE 10 – OTHER INCOME, NET

	For the three-month period ended March 31		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Provision for employee severance benefits upon early retirement	**–**	(7,000)	83,000
Provision for impairment and other liabilities in respect of investments in other companies	**–**	–	(5,868)
Compensation in respect of a settlement agreement	**–**	14,483	14,483
Amortization of goodwill	**–**	(23,279)	(93,112)
Capital gain from sale of operation	**–**	101,860	103,869
Capital gains, net	**9,576**	1,730	5,715
Others	**(194)**	(180)	2,129
Disposal of assets and impairment of value of fixed assets	**–**	–	(830)
	9,382	87,614	109,386

Notes to the Financial Statements as at March 31, 2006

NOTE 11 – POST BALANCE SHEET DATE EVENTS

On May 14, 2006 the Company received notice from Eurofund 2000, a venture capital fund which invests mainly in communications, software, internet, semiconductor and homeland security start-ups ("the Fund"), of a distribution from which the Company, a partner in the Fund, is expected to receive immediately the sum of US $5.7 million.
The distribution follows the sale of approximately 18% of the Fund's holdings in an optical network equipment company, for approximately US $42 million (the Fund's investment in the company was US $2 million).

As a result of the distribution, the Company will record a capital gain (before tax) of approximately NIS 25 million.

NOTE 12 – CONDENSED INTERIM FINANCIAL STATEMENTS OF THE COMPANY

A. STATEMENTS OF OPERATIONS

	For the three-month period ended March 31		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues (Note 12B)	**1,170,709**	1,195,718	4,723,734
Costs and expenses			
Operating and general expenses (Note 12C)	**576,593**	562,004	2,346,451
Depreciation	**323,405**	349,395	1,390,435
Royalties to the Government of Israel	**31,020**	35,386	135,575
	931,018	946,785	3,872,461
Operating income	**239,691**	248,933	851,273
Financing expenses, net	**(18,202)**	(5,927)	(80,897)
Earnings after financing expenses	**221,489**	243,006	770,376
Other revenues, net	**11,097**	110,771	201,012
Earnings before income tax	**232,586**	353,777	971,388
Income tax	**(65,200)**	(103,046)	(332,118)
Earnings after income tax	**167,386**	250,731	639,270
Company's equity in earnings (losses) of investee companies	**58,126**	13,976	(63,412)
Earnings before the cumulative effect of a change in accounting method	**225,512**	264,707	575,858
Cumulative effect of a change in accounting method at the beginning of the year	**–**	15,000	15,000
Net earnings	**225,512**	279,707	590,858

Notes to the Financial Statements as at March 31, 2006

NOTE 12 – CONDENSED INTERIM FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

B. REVENUES FROM TELECOMMUNICATIONS SERVICES

	For the three-month period ended March 31		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Domestic fixed-line communications			
Traffic	**346,444**	380,460	1,460,076
Fixed fees	**606,620**	585,894	2,404,970
Total revenues from fixed-line communications	**953,064**	966,354	3,865,046
Cellular telephone	**92,863**	92,660	370,706
International communications	**29,259**	28,519	109,207
Installation and sale of equipment to subscribers and other	**53,219**	54,175	167,904
	1,128,405	1,141,708	4,512,863
Other revenues	**42,304**	54,010	210,871
	1,170,709	1,195,718	4,723,734

C. OPERATING AND GENERAL EXPENSES

	For the three-month period ended March 31		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses –			
Operations	**289,471**	277,467	1,140,482
General and administrative	**77,321**	68,640	288,804
Total salaries and incidentals	**366,792**	346,107	1,429,286
General expenses	**65,232**	73,760	298,767
Materials and spare parts	**18,225**	20,890	97,294
Building maintenance	**76,186**	78,226	320,700
Services and maintenance by sub-contractors	**48,509**	50,141	195,820
International communications expenses	**7,248**	5,075	30,033
Vehicle maintenance expenses	**33,460**	28,430	128,961
Collection fees	**9,308**	8,797	36,735
	624,960	611,426	2,537,596
Less salaries charged to investments in fixed assets	**48,367**	49,422	191,145
	576,593	562,004	2,346,451

Notes to the Financial Statements as at March 31, 2006

NOTE 13 – BUSINESS SEGMENTS

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

	For the three-month period ended March 31, 2006						
	Domestic fixed line communications	Cellular telephone	International communications and Internet services	Multi-channel television	Others	Adjustments	Consolidated
Revenues							
Revenues from external sources	**1,102,787**	**1,084,941**	**239,952**	**326,998**	**64,577**	**–**	**2,819,255**
Inter-segment revenues	**67,922**	**3,484**	**4,899**	**5,049**	**24,623**	**(105,977)**	**–**
Total revenues	**1,170,709**	**1,088,425**	**244,851**	**332,047**	**89,200**	**(105,977)**	**2,819,255**
Segment results*	**239,691**	**139,226**	**33,148**	**(13,835)**	**2,351**	**–**	**400,581**

	For the three-month period ended March 31, 2005						
	Domestic fixed line communications	Cellular telephone	International communications and Internet services	Multi-channel television	Others	Adjustments	Consolidated
Revenues							
Revenues from external sources	1,132,440	1,106,280	193,812	284,394	56,197	–	2,773,123
Inter-segment revenues	63,151	4,040	5,359	4,268	27,246	(104,064)	–
Total revenues	1,195,591	1,110,320	199,171	288,662	83,443	(104,064)	2,773,123
Segment results*	248,933	121,269	20,517	(24,453)	(53)	–	366,213

	For the year ended December 31, 2005						
	Domestic fixed line communications	Cellular telephone	International communications and Internet services	Multi-channel television	Others	Adjustments	Consolidated
Revenues							
Revenues from external sources	4,457,189	4,413,421	795,176	1,200,865	232,035	–	11,098,686
Inter-segment revenues	266,545	14,854	21,488	20,997	104,511	(428,395)	–
Total revenues	4,723,734	4,428,275	816,664	1,221,862	336,546	(428,395)	11,098,686
Segment results*	851,273	466,165	97,978	(99,535)	1,197	–	1,317,078

* Segment results do not include Other revenues (expenses), net, as stated in Note 10.

Notes to the Financial Statements as at March 31, 2006

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

1. PELEPHONE COMMUNICATIONS LTD.

A. Balance sheet

	For the three-month period ended March 31		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**1,846,501**	1,472,269	1,881,982
Long-term trade receivables	**334,505**	299,820	338,281
Investment in investee companies	**3,565**	3,521	3,565
Deferred income tax	**–**	73,901	19,799
Fixed assets, net	**2,926,413**	3,055,918	3,009,219
Other assets	**333,805**	335,939	337,787
	5,444,789	5,241,368	5,590,633
Current liabilities	**1,713,509**	1,320,297	1,558,012
Long-term liabilities	**1,567,542**	1,719,959	1,666,193
Shareholders' equity	**2,163,738**	2,201,112	2,366,428
	5,444,789	5,241,368	5,590,633

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

1. Pelephone Communications Ltd. (contd.)

B. Statement of Operations

	For the three-month period ended March 31		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from Pelephone services, sales and services	**1,088,424**	1,110,321	4,428,277
Cost of Pelephone services, sales and services	**826,813**	859,151	3,415,885
Gross profit	**261,611**	251,170	1,012,392
Sales and marketing expenses	**99,230**	104,980	432,808
General and administrative expenses	**23,154**	24,917	107,218
	122,384	129,897	540,026
Operating income	**139,227**	121,273	472,366
Financing expenses, net	**(3,382)**	(10,127)	(115,264)
Other revenues (expenses), net	**(1,407)**	42	1,136
Earnings before income tax	**134,438**	111,188	358,238
Income tax	**(37,128)**	(36,602)	(113,333)
Earnings after income tax	**97,310**	74,586	244,905
Company's equity in losses of an affiliate	**–**	(3,504)	(8,507)
Net earnings	**97,310**	71,082	236,398

Notes to the Financial Statements as at March 31, 2006

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

2. DBS SATELLITE SERVICES (1998) LTD.

A. Balance sheet

	For the three-month period ended March 31		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**156,759**	131,581	154,567
Broadcasting rights, net	**173,601**	150,621	154,500
Fixed assets, net	**1,024,583**	1,088,292	1,047,994
	1,354,943	1,370,494	1,357,061
Current liabilities	**666,479**	608,559	613,379
Long-term liabilities	**1,409,791**	1,291,075	1,419,257
Loans from shareholders	**2,916,558**	2,714,884	2,893,024
Capital deficit	**(3,637,885)**	(3,244,024)	(3,568,599)
	1,354,943	1,370,494	1, 357,061

B. Statement of Operations

	For the three-month period ended March 31		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from DBS services	**332,046**	288,662	1,221,863
DBS operating expenses	**288,694**	256,574*	1,099,364*
Gross profit	**43,352**	32,088	122,499
Sales and marketing expenses	**31,611**	33,264*	131,136*
General and administrative expenses	**22,610**	20,144	77,055
	54,221	53,408	208,191
Operating loss	**(10,869)**	(21,320)	(85,692)
Financing expenses, net	**(56,194)**	(39,419)	(241,335)
Other expenses, net	**(201)**	(80)	(830)
Net loss	**(67,264)**	(60,819)	(327,857)

* Reclassified

Notes to the Financial Statements as at March 31, 2006

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

3. BEZEQ INTERNATIONAL LTD.

A. Balance sheet

	For the three-month period ended March 31		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**229,579**	250,045*	366,078
Long-term investments and debit balances	**33,509**	26,251*	28,702
Fixed assets	**303,197**	345,015	305,826
Other assets	**22,223**	17,314	23,625
	588, 508	638,625	724,231
Current liabilities	**238,685**	227,377	401,126
Long-term liabilities	**16,643**	182,077	14,835
Shareholders' equity	**333,180**	229,171	308,270
	588,508	638,625	724,231

B. Statement of Operations

	For the three-month period ended March 31		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from international telecommunication services	**244,852**	199,171	816,664
Operating expenses	**160,976**	132,835*	530,806
Gross profit	**83,876**	66,336	285,858
Marketing, general and administrative expenses	**50,728**	45,819*	193,297
Operating income	**33,148**	20,517	92,561
Financing income (expenses), net	**813**	(1,589)	(3,361)
Earnings after financing, net	**33,961**	18,928	89,200
Other expense (income), net	**(206)**	340	1,377
Earnings before income tax	**33,755**	19,268	90,577
Tax benefit (income tax)	**(10,804)**	6,778	15,226
Earnings after income tax	**22,951**	26,046	105,803
Company's equity in earnings of an affiliated company	**1,624**	204	4,583
Net earnings	**24,575**	26,250	110,386

* Reclassified