November 14, 2007

"Bezeq" The Israel Telecommunication Corp. Limited

Quarterly Report for the period ending 30.9.07

Update of Chapter A (Description of Company Operations) of the Periodic Report for 2006

Directors' Report on the State of the Company's Affairs for the period ended September 30, 2007

Condensed Interim Consolidated Financial Statements as at September 30, 2007

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

Update of Chapter A (Description of Company Operations) of the Periodic Report for 2006

Update Of Chapter A (Description of Company Operations)[1] of The Periodic Report For 2006 ("The Periodic Report") of "Bezeq" – The Israel Telecommunications Corp. Ltd. (hereinafter: "The Company")

In this report, which contains an update of the chapter regarding the description of the Group's business from the periodic report for 2006, the Group has included forward-looking information, as defined in the Securities Law 5728-1968 (hereinafter: the "Securities Law") with respect to both itself and the market. Such information includes forecasts, targets, appraisals and assessments which apply to future events or matters the realization of which is not certain and is not under the Group's control. Forward-looking information in this report will usually be identified specifically, or by employing statements such as "the Company expects", "the Company assesses", "it is the Company's intention", and similar statements.

Forward-looking information is not a proven fact and is based only on the Group's subjective assessment, based, inter alia, on a general analysis of the information available at the time of drafting of this report, including public announcements, studies and surveys, and they contain no undertakings as to the correctness or completeness of the information contained therein, and the Group does not independently check the correctness thereof.

In addition, the realization and/or otherwise of the forward-looking information will be affected by factors that cannot be assessed in advance, and which are not within the control of the Group, including the risk factors that are characteristic of its operations as set out in this report, and developments in the general environment, and external factors and the regulation that affects the Group's operations, as set out in this report.

1. Description of General Development of Group Operations

Section 1.1 – Group Activity and Description of its Business Development

Section 1.1.5 – Mergers and acquisitions

With respect to the merger of the Company and DBS (sub-section A) – on May 15, 2007, the Company filed an appeal against the decision of the Antitrust Commissioner in which the Commissioner objected to the Company's merger with DBS. The Antitrust Commissioner has submitted her response to the appeal and the file has been set down for hearing of evidence in January 2008.

The Company's and DBS's petition to the High Court of Justice against the Minister of Communications regarding restrictions imposed upon the Company's investments in DBS was set aside. Contemporaneous with those proceedings, the Ministry of Communications gave notice, at the time, of its intention to forfeit NIS 10 million out of the Company's guarantee. In this regard, see also Note 8(c)(2) to the Financial Statements of the Company for the period ended September 30, 2007.

With respect to the agreement for the purchase of the operations of Tadiran Telecom – Communications Services in Israel (Limited Partnership) (the "**Partnership**") by the subsidiary BezeqCall Communications Ltd. (which has, in the meantime, merged into the subsidiary Bezeq International Ltd.) – in April 2007, the agreement was rescinded in light of the decision of the Antitrust Authority not to allow the transaction, and following notice by the Partnership of a decision to rescind the agreement.

Section 1.4 – Distribution of Dividends

On September 19, 2007, a special general meeting of the shareholders of the Company[2] approved the board of directors' recommendation of August 13, 2007 to pay a cash dividend to the shareholders in the sum total of NIS 760 million (constituting NIS 0.2917415 per share). The dividend was paid on October 15, 2007

1 The update is pursuant to Article 39A of the Securities Regulations (Periodic and Immediate Reports), 5730-1970, and includes material changes or innovations that have occurred in the corporation in any matter which must be described in the Periodic Report. The update relates to the periodic report of the Company for 2006 and relates to the section numbers used in Chapter A (Description of Company Operations) in that periodic report.

2 On this matter, see also the immediate report of the Company dated November 8, 2007, concerning ratification of the resolution of the general meeting on September 19, 2007.

2. Fixed-Line Domestic Communications –

"Bezeq" – The Israel Telecommunications Corp. Limited ("the Company")

Section 2.1 – General information on areas of operation

On June 1, 2007, the Communications (Telecommunications and Broadcasts) (Payments for Telecommunications Services) Regulations, 5767-2007 and the Communications (Telecommunications and Broadcasts) (Calculation and Linkage of Payments for Telecommunications Services) (Amendment) Regulations, 5767-2007 came into force. Under the above regulations, and based on the draft tariff update set out in the Communications (Telecommunications and Broadcasts) (Calculation and Linkage of Payments for Telecommunications Services) Regulations, 5763-2003, reduction of the Company's supervised tariffs as of June 1, 2007, is expected to be at an average rate of approximately 3.13%. This reduction is based on a reduction of approximately 0.1% in the consumer price index less the average rationalization coefficient at a rate of approximately 3.038%. Likewise, the Communications (Telecommunications and Broadcasts) (Payments for Interconnect) (Amendment) Regulations, 5767-2007 came into force on the same date, prescribing that the reduction of interconnect tariffs as of June 1, 2007 is at a rate of approximately 4.01%. The aforesaid tariff update is expected to have a substantial adverse effect on the Company's revenues from services the tariffs for which are under supervision as aforesaid.

On June 7, 2007, the Communications (Telecommunications and Broadcasts) (Payments for Telecommunications Services) (Amendment) Regulations, 5767-2007 were signed, under which as of October 1, 2007, the criterion for entitlement to reduced service fees shall be amended from a criterion of reduced service to entitlement granted to whomever receives a pension under the Assurance of Income Law, 5741-1980 – the National Insurance Office has provided the Company with details of this – and has a single subscriber telephone line registered in his name in an apartment that is used for residential purposes only. This change is not expected to have a substantial effect on the Company's revenues.

Section 2.1.3 – Changes in scope of operations in the field, and in profitability

	First nine months of 2007	First nine months of 2006	Q3 2007	Q2 2007	Q1 2007	Q4 2006	Q3 2006
Revenues (NIS millions)	4,260	4,360	1,425	1,393	1,442	1,439	1,465
Operating Profit (NIS millions)	939	951	327	243	369	(198)	363
Number of active subscriber lines as at the end of the period (thousands)	2,767	2,813	2,767	2,778	2,797	2,808	2,813
Average monthly income per line (NIS)*.	76.3	80.7	75.5	75.3	78.2	79.0	81.2
No. of outgoing use minutes (millions)	11,514	12,782	3,848	3,753	3,914	4,005	4,257
No. of incoming use minutes (millions)	3,250**	2,725	1,137	1,069	1,045	990	967
Number of ADSL subscribers as at the end of the period (thousands)	942	867	942	924	912	892	867
Average monthly revenue per ADSL subscriber (NIS).	58.2***	57	58.8***	58.5	57.3	57.0	56.6

* Not including revenues from transmission and data communication services, services to communications providers, contractor work and others, and revenue from incoming traffic.

** The increase in incoming minutes stems from a 90% increase in traffic minutes from domestic carriers in competition with Bezeq.

*** The increase in average monthly revenue per ADSL subscriber stems from value added services (not from an increase in prices).

Section 2.1.9 –Structure of competition in the areas of operation and changes thereto

Competition in this sector is also dependent upon the recommendations formulated by the Gronau Commission regarding the communications industry in Israel, and on the way in which those recommendations are adopted and applied. (See update to section 2.6 below)

Section 2.2 – Products and Services

The Company is in the throes of setting up a Data Center website, which shall enable the provision of a total solution for customers, in terms of back up and survivability services. The service planned is following a large increase in demand by customers for DRP sites (disaster recovery program – a program for continuing working in the event of disaster) and for true back-up of information at all organizational levels. This site is expected to provide the Company's customers with a variety of solutions, including: hosting of the organization's central site, taking into account needs of survivability, electricity, air conditioning, etc., backing up organizational information on a reliable and protected system so that when necessary, it will be possible to recover the information required, remote back-up of organizational information, full DRP to the organization's central site, storage of the organization's important information in a protected underground site. The Data Center service is planned to be launched during the month of December 2007.

Section 2.2.2 – Telephony

As part of the Company's marketing strategy, it is working intensively to develop and introduce new services in both the private and commercial sectors. During the second quarter of 2007, the Company launched a broad variety of services, the most prominent of which, in the field of telephony, is: the short message service (SMS) in the voice service field, music streamer (an electronic music player) in the field of terminal equipment. The Company plans to continue launching additional products in accordance with market trends and customer requirements.

With respect to the unified telephone call center, on October 15, 2007, the Company submitted an application to the Antitrust Authority requesting exemption from the approval for the restraint of trade arrangement between the Company and the cellular carriers and domestic fixed-line licensees regarding the operation of the 144 information service and the unified information service for the telephone numbers of the Company and other carriers, 1344, and the unified website that provides corresponding services. The application was submitted on grounds of caution and in light of a letter from the Antitrust Authority of September 9, 2007, which gave notice that the Antitrust Authority viewed the agreement the subject of the application to be an arrangement in restraint of trade.

Section 2.2.3 – Internet access services

For changes in the number of the Company's ADSL subscribers and average monthly income per ADSL subscriber, see the update to section 2.1.3 above.

On November 5, 2007, the Company received a letter from the Director General at the Ministry of Communications, concerning provision of broadband access service for ISPs without a telephone subscriber line ("naked ADSL"). According to the letter, the Ministry of Communications is considering splitting the broadband access service from the telephony service, i.e. to require the Company to offer access service to ISPs without its provision being conditional also on the purchase of a subscriber telephone line. The Company was requested to submit its remarks by November 29, 2007 to an amendment to the ADSL service file proposed by the Ministry of Communications, and is considering its response. See also the update to Section 2.16.2 below.

Section 2.2.5 D – IP-Centrex

The Company has submitted a service portfolio to the Ministry of Communications with respect to this service.

Section 2.3 – Split of revenues and profits of products and services

For updates of the split of the Company's revenues by product and service, see Note 12B to the financial statements of the Company for the period ended September 30, 2007.

Section 2.5 – Marketing, distribution and service

Section 2.5.1 – the Company operates 17 points of sale and service (BezeqStores) around the country.

Section 2.6 – Competition

With respect to the Commission for Formulation of Recommendations regarding Policy and Rules of Competition in the Field of Communications in Israel (the "**Gronau Commission**"), the Company's main position as expressed in a document submitted to the Commission on April 11, 2007 was: a regulatory horizon for the communications market in general and for the Company in particular as a condition of continued investment in upgrading the Company's infrastructure; providing tariff flexibility and absolute freedom in marketing service packages; cancelling structural separation and corporate separation and amending the Company's license so as to permit the Company to provide IPTV services. Note that the Company's positions are developing and changing with time. .

The Commission's recommendations, which are supposed to relate to matters that are of the greatest substance to the communications market and to the Company, might bring about changes in the rules of competition employed to date, and the Company estimates that it will be harmed by the committee's recommendations, but is unable too estimate the trends or the influences that these may have.

Section 2.6.1 – Telephony

With respect to the petition filed by the Company to the High Court of Justice regarding breach of the duty of structural separation by HOT – on April 1, 2007, the Company received a ruling of the Court, following the consent of the parties, that the Ministry of Communications would make a decision within 6 months regarding structural separation of HOT. After receipt of the Ministry's decision, the parties will submit an updated notice in that regard to the Court, following which, a decision will be made as to continued handling of the petition.

On May 2, 2007, the Company contacted the Ministry of Communications, requesting that it be informed as to the full exercise of the Ministry of Communications' instruction to HOT (based on the Ministry's notice to the High Court of Justice) to appoint separate chief executive officers to HOT Telecom and HOT Cable Communications Systems, without any the one being administratively subordinate to the other, and to make the entire administrative level of HOT Telecom subordinate to the chief executive officer to be appointed to that corporation, no later than May 1, 2007. On May 21, 2007, the Director General of the Ministry of Communications responded to the Company that HOT had informed the Ministry that it was intending to act in order to implement the provisions regarding appointment of separate chief executive officers. The Company repeated this request on June 5, 2007, and asked to know the timetable for implementing the provision.

On July 10, 2007, the Company wrote to the State Attorney's Office expressing an objection to amendment of the license of HOT which would permit it to market a parcel of services including HOT Telecom service and broadcasting services provided by HOT's broadcasting company, and asked that it be cancelled. The State Attorney's Office rejected the Company's claims in a letter dated July 12, 2007.

On October 8, 2007, a supplementary notice was received from the State to the effect that the Minister of Communications had decided, based on the recommendation of professional staff at the Ministry, and in accordance with a recommendation of the chairman of the Commission for Formulation of Recommendations regarding Policy and Rules of Competition in the Field of Communications, Prof. Gronau, not to alter the existing structural separation format for HOT Telecom at this stage. It was further noted that this issue would be examined once again after the submission of the Gronau Commission's recommendations as part of an examination of the entire issue of the question of structural separation in the field of communications. On November 8, 2007, the Company filed an application in the High Court of Justice for amendment of the petition so as to include the Company's reservations about the amendment to HOT's license as noted above.

With respect to the grant of special general licenses for the provision of domestic fixed line communications services to various communications providers, the providers which received such licenses have commenced providing the services in accordance with their licenses.

Sections 2.6.1 and 2.6.2

As seen from the reports of HOT – Cable Communications System Ltd., HOT's telephony and internet subscriptions continue to increase.

For the provision of VOB services by the subsidiary Bezeq International Ltd., see update to section 4.1.5 below.

Section 2.6.4 – Competition by cellular companies

With respect to the refusal of the Antitrust Commissioner to alter the monopoly declaration pertaining to the Company in the field of fixed-line telephony services, the Company is examining its continued handling of the matter.

Section 2.6.5 – VOD service provision policy

In July 2007 an amendment to the Communications Law was authorized enabling additional content providers, apart from HOT, to provide a service supplying content upon subscriber demand, over an broadband access network, using IP technology. The significance of this amendment is that subsidiaries of the Company (except for DBS) will not be entitled to provide this service. In this regard, see also the updates to sections 5.4 and 5.6.5 below.

Section 2.6.6A – Numbering and number portability

The Company is preparing for the operational implications of implementation of the number portability program. In the Company's assessment, the extent of harm to its revenues as a result of implementation of the program is expected to be substantial, but it cannot, at this stage, assess the actual extent.

Implementation of the number portability program in full requires compliance with all of the requirements on the part of all communications providers (domestic fixed-line carriers, cellular carriers and international carriers).Indications have been received to the effect that some of the carriers are still not in compliance with all of the technical threshold requirements for the commencement of implementation of the program, and therefore, there is a fear regarding implementation of the program at a total integration level on the date prescribed (December 1, 2007).

The chairman of the Forum of Carriers regarding Number Portability warned that in his assessment, the present timetable will not permit completion of the necessary examinations between the carriers to a sufficient extent and level of certainty, and recommended that an application be made to the Minister of Communications asking for a window of one additional month for examinations which would, in his view, enable the extent and severity of the problems to be significantly reduced, even if it would not solve them entirely. The chairman of the Forum added that the launch of portability under the present timetable imposes a risk which does not reasonably need to be taken. In response to the warning of the chairman of the Carriers Forum published, *inter alia*, in the media, the Director General of the Ministry of Communications sought to clarify unequivocally to the chairman of the Forum, on behalf of the Minister of Communications, that the date for number portability would be December 1, 2007 and that should any carrier not be in compliance with that date, the Ministry would employ the full severity of the law, and would employ all legal measures available to it.

The Company's representatives informed the representatives of the Ministry of Communications, as part of the Ministry's supervision regarding preparations to implement the portability program, that the Company would be ready to implement number portability on time (December 1, 2007). However, given the brief timetable for running tests, and the dependence upon suppliers and other carriers for its readiness to implement the plan on schedule, it is impossible to foresee how the program will be implemented when first operated. Problems that arise as a result of these constraints could also have adverse affects on the financial results of the Company.

This information includes forward-looking information based on the Company's assessments. The actual outcome might be substantially different from the above assessments, if there is a change in any one of the factors taken into account in these assessments.

On May 24, 2007, the Company received a notice from the Director General of the Ministry of Communications, stating that he is considering imposing a financial sanction on the Company under Chapter G1 of the Communications Law, 5742-1982, in respect of violation of the duty to provide number portability commencing 1.9.06, as follows:

1. For the period from September 1, 2006 to the date of the Director General's notice – a financial sanction of NIS 2,031,750.

2. For the period from May 25, 2007 to November 30, 2007 or until the date of remedy of the alleged violation (whichever is earlier) by the Company – NIS 6,450 for each additional day the violation continues.

3. For the period from December 1, 2007 (which is, according to the notice, the reasonable date required by the relevant licensees to remedy the alleged violation) until the date of remedy of the alleged violation – a financial sanction as described in sections 37B(b) and 37C(a) of the Communications Law after Amendment 36. [It is noted that according to the provisions of those sections, the rate of the relevant sanction is 7 times the penalty laid down in section 61(a)(4) of the Penal law (which is NIS 202,000), plus 0.25% of the annual income of the Company, plus a financial sanction of one fiftieth of such sanction for each day on which the violation continues.]

The subsidiaries Pelephone Communications Ltd. ("Pelephone") and Bezeq International Ltd. ("Bezeq International"), received similar notices. As noted in the Company's Periodic Report for 2006, the Company and Pelephone (together with other cellular companies) petitioned the High Court of Justice on this matter, contending, *inter alia*, that it was the Ministry of Communications which had not prepared a number portability plan as required by the provisions of the law. On July 5, 2007, the Company replied to the notice of the Director General of the Ministry of Communications, setting out its position that the Company's position was not in breach of the provisions of the Law or the license, that the matter is pending before the High Court of Justice, and that in any event, in these circumstances, it would be unreasonable to impose sanctions on the Company, including in light of the date prescribed by the Ministry of Communications as being reasonable in this regard for implementation of number portability (December 1, 2007). Pelephone and Bezeq International also responded to the notice of the Ministry of Communications.

With respect to the petition to the High Court of Justice – the court decided to accede to the application of some of the petitioners to dismiss the date of the hearing set down for October 2007, *inter alia*, in light of the fact that the hearing on the petition might be reduced in scope or might even become unnecessary. The date of the hearing was set down for December 20, 2007.

Section 2.6.6.B – Infrastructure of other potential competitors

On September 24, 2007, the Ministry of Communications published a hearing regarding the frequency allocation policy for broadband wireless access networks. Under the Ministry of Communications' document, the Minister of Communications intends to publish a policy for the allocation of frequencies for broadband wireless access networks (WiMAX), as set out in the draft policy attached to the document. The Company intends to submit a response within a few days. Note that the Company submitted a position in the past regarding the previous policy document published by the Ministry in this regard on January 31, 2006, to the effect that there are no grounds for allocating these frequencies, which are a limited State resource, to carriers with special licenses that are not under a duty to provide universal service.

Section 2.6.7 – The Company's preparations for coping with intensifying competition

With respect to sub-section (g) regarding agreements with business customers – on April 11, 2007, following the setting aside of the Company's petition to the High Court of Justice, the Ministry of Communications forfeited the sum of NIS 8 million out of the guarantee deposited by the Company under the provisions of its general license.

Section 2.6.8 – Negative factors affecting the Company's competitive status

Competition – the extent to which competition affects the Company depends, as aforesaid, on the recommendations of the Gronau Commission on communications in Israel, and on the manner in which such will be adopted and applied, and the Company is unable to assess what these might be.

With respect to the Company's lack of flexibility with regard to marketing campaigns – on April 26, 2007, an additional sum of NIS 7 million was forfeited out of the above guarantee. This forfeit followed a decision by the High Court of Justice dated April 10, 2007 not to award an interim injunction in a petition filed by the Company, which has not yet been heard, against the Minister of Communications and the Director General of the Ministry of Communications, against forfeiture of the guarantee and the setting aside of the Company's appeal against such, with respect to a campaign under which call minutes were given to subscribers of the Company who purchased terminal equipment (the "Spring Campaign").

Section 2.7 – Property, plant & equipment

Section 2.7.1 – Fixed-line domestic telecommunications infrastructure (and section 2.6.7(j) and 2.19.2 – Network

With respect to sub-section (a) (switches) – during 2008, the Company's Nortel switches are due to be upgraded to a new ISN09 switch. This upgrade is supposed to enable continued use of the Company's switching network, which is based on Nortel's switches, until the end of 2008, subject to the conditions of the agreement with Nortel. Should the Company be required to continue holding the switches beyond the above date, this will entail substantial additional expense.

Section 2.7.4 – Real estate

With respect to sub-section (c) – the total number of properties sold by the Company over the years (both before and after the settlement agreement) amounts to approximately 40 properties (in whole or in part) out of the leased properties which were privatized in the agreement for the transfer of assets, such that as at the date of this update to the periodic report, the group of leased properties numbers approximately 180 properties.

With respect to sub-section (d) – during the first half of 2007, the Company sold an additional 7 real estate properties, of a total area of approximately 10,900 sqm of land plus approximately 4.730 sqm built-up, at a total sum of approximately 7.68 million dollars. In the third quarter of 2007, the Company did not sell any real estate assets.

Likewise, during the first quarter of 2007, sale of the Hillel Station premises has been completed (as set out in the Company's immediate report dated November 15, 2006). The area of the premises is approximately 956 dunams, and the consideration received for sale of it is approximately $ 20.8 million.

Further to the reexamination done by management of the Company with respect to the realization of the Company's real estate assets, the board of directors approved the continued procedure of sale of real estate assets that are not active and/or that can be relatively easily vacated, without incurring significant expense, in accordance with the list presented to it. Likewise, the board of directors approved a detailed work procedure regarding sale of the Company's real estate assets, and procedures for the approval of such transactions. The board of directors has resolved to postpone improvements to the Company's assets at this stage.

The Company is working to realise its real estate assets.

Section 2.9 – Human resources

Section 2.9.1 – organizational structure, and employees according to organizational structure

A. Appointment of a new chairman and transfer of authority for subsidiaries to the board of directors.

On September 4, 2007, Shlomo Rodav was appointed to the position of chairman of the board of directors of the Company. On the same date, the board of directors of the Company resolved, pursuant to section 50(a) of the Companies Law, 5759-1999, and pursuant to sections 119 and 121.1 of the Companies Regulations, that the powers of the CEO with respect to corporations held directly or indirectly by the Company (including Pelephone Communications Ltd., Bezeq International Ltd., DBS Satellite Services (1998) Ltd., Walla! Communications Ltd., Bezeq On-Line, Bezeq Gold Holdings Ltd. and BezeqCall Ltd.) would be transferred to the board of directors, and that decisions regarding implementation of the aforesaid would be passed later on.

B. Negotiations – progress of implementation of new collective agreement.

Management of the Company is negotiating with employee representatives mainly with respect to the progress towards completing implementation of the new organizational structure, in accordance with the new special collective agreement of December 5, 2006 regarding the moving forward of retirement dates and an option for the Company to change the mix of retirees who are supposed to retire under that agreement by 2008 (by increasing the number of those taking early retirement over those retiring with severance pay) (see also section 2.17.4(f) of the periodic report for 2006).

C. Appointments which constitute a change in organizational structure

On June 28, 2007, a VP Economics and Budgets was appointed to the Company, whose areas of responsibility are economics, budgeting and control, and collection, which had previously been under the responsibility of the Deputy CEO and CFO. The VP Economics and Budgets reports to the Deputy CEO and the CFO, and to the Acting CEO of the Company.

In mid- August 2007, the new Company Secretary of the Company took office, reporting to the Chairman of the Board of Directors. This function was handled, since October 2005 and until entry of the Company Secretary into office, by the Company's General Counsel.

Section 2.9.2 – Personnel according to employment framework

During the first nine months of 2007, the number of employees in the Company fell from 8,096 as at December 31, 2006 to 7,658 as at October 1, 2007 (a net reduction of 438 employees) as a result of retirement of employees from the Company (concurrently with an intake of needed employees such as service representatives).

Note that of the 975 employees who are supposed to end their employment in the Company under the collective agreement of December 5, 2006 between 2006 and 2008 under early retirement plans or increased severance pay plans (see section 2.17.4(f) of the periodic report for 2006), to date the numbers of employees who have left the Company under the plans is as follows:

Period	Retirements in the period	Cumulative retirements
Up to March 31, 2007	399	399
Up to June 30, 2007	275	674
Up to September 30, 2007	52	726

Section 2.9.6 – Employee remuneration schemes

On September 25, 2007, the board of directors resolved to approve an outline on a policy for the compensation of senior employees and officers in the Bezeq Group, whereby the Company will act for compensation by way of an allocation of stock options for those senior employees in the Company and the subsidiaries upon whom it decides. Such compensation would constitute a mechanism for retaining managers and an appropriate incentive for them, taking into account the salary policy, the position of each manager, his status, his abilities and his contribution to the subsidiary in which he works and to the Group. Subject to any law, the Company will publish an immediate report and detailed description of the stock options plan, after its approval by the board of directors.

In October 2007, the audit committee and the board of directors approved the issue of options to the two directors elected from amongst the employees, under the employee option scheme that was approved and that will come into force in March 2007[3]. The issue requires the consent of the general meeting. In this regard, see also the Company's immediate report of October 29, 2007.

Section 2.9.7 – Company officers and senior executives

As at the date of publication of this report, there are 16 directors acting in the Company[4] and 14 members of senior management. Note that following the departure of the CEO of the Company on April 30, 2007, an Acting CEO has been acting in the Company (between April 30, 2007 and June 26, 2007, this position was held by Ika Abravanel, and as of that date, Avi Gabbay has held this position). Likewise, on September 4, 2007, the office of the chairman of the board of directors, Dov Weissglas, terminated and on the same date, Shlomo Rodav was elected by the general meeting as director, and by the board of directors, as chairman.

Commencing August 1, 2007, the Company's VP Regulations was appointed also as internal compliance officer for antitrust affairs.

During the third quarter of 2007, the Deputy CEO and CFO, VP Human Resources, VP Commercial Division and VP Private Division also gave notice of termination of their employment at the Company.

[3] An issue of 59,574 options for shares in the Company at an exercise price of NIS 2.9991 per share. The total value of the benefit is approximately NIS 237,006. All data as at October 21, 2007. See also the Company's immediate report of October 29, 2007.

[4] Including two external directors and two employee-directors.

New officers have been appointed in place of the above officers (apart from the Deputy CEO and CFO, who remains in office).

With respect to bonuses for officers – following the recommendations contained in the report of the external examiner, Dr. Yoram Danziger, dated April 26, 2007 (see update to section 2.20 below), on May 22, 2007, the board of directors of the Company approved bonuses for officers for 2006 in the total sum of NIS 1,059,566. In addition, the board of directors at the same meeting approved the award of bonuses to officers for 2005 in the total sum of NIS 210,000. In the opinion of the board of directors, award of these bonuses does not constitute an extraordinary transaction, as that term is defined in the Companies Law, 5759-1999.

In addition, on May 22, 2007, the board of directors, having received the consent of the Audit Committee in its meetings of May 15, 2007 and May 22, 2007, approved the award of bonuses to a number of officers. The Company reported these bonuses in an immediate report on May 22, 2007.

With respect to the bonuses unlawfully paid to the former CEO of the Company, Mr. Yacov Gelbard, for 2005 and 2006, his obligation to return those bonuses to Pelephone and to the Company still remains. The Company resolved that if the bonuses are not returned to the Company, it will institute all available legal measures to collect this debt.

Some of the officers will repay the Company the difference (if any) between the bonuses they received in the past and the bonuses approved for them as aforesaid. The total repayment is approximately NIS 590,000 (all of the sums set out above are in gross terms – before tax).

In this regard, see also the Company's immediate report dated May 22, 2007.

Section 2.10 – Raw Materials and Suppliers, Purchase of Equipment and Suppliers

Section 2.10.2 **–** At the date of this report, the Company has no supplier from which it purchases more than 5% of its total purchases in any area of operation.

Section 2.13 – Finance

Section 2.13.4 – Sums of credit received after December 31, 2006

During the period between May 27, 2007 and July 16, 2007, the Company raised approximately NIS 1,200 million via sale of 1,070 million par value debentures (Series 5) of the Company. The sale of the debentures was effected by the subsidiary Bezeq Gold (Holdings) Ltd. ("**Bezeq Gold**") and the aforesaid consideration was transferred to the Company as repayment of the loan granted by the Company to Bezeq Gold, for the purpose of purchasing the above debentures. This fundraising was effected at an average interest rate of 3.71% (the debentures are linked to the CPI). See update to section 2.13.7 below.

Section 2.13.6 – Credit rating

On May 1, 2007, Maalot announced that following discoveries and following the examination report submitted by the external examiner (see update to section 2.20 below) regarding subtraction of property plant and equipment at Pelephone, at this stage, no change is expected to be made to the rating of the Company's undertakings. In this regard, see also the update to section 3.15.6 below.

Section 2.13.7 – Estimate of raising funds in the coming year (2007) and sources of financing

On May 14, 2007, the board of directors of the Company approved the raising of debt of up to NIS 1,200 million during 2007, for the purpose of repayment of an existing debt of the Company. The Company completed this fundraising as set out in the update to section 2.13.4 above. Note that on August 8, 2007, the Company repaid the principal of the Eurobonds which it had issued in 2000, in the total sum of EUR 293 million.

Section 2.15 – Environmental protection

The new Non-Ionized Radiation Regulations which were approved on October 23, 2007 by the Interior and Environmental Protection Committee of the Knesset, and which are required to be approved by the Ministers, prescribe payment of commissions for the filing of an application for a permit for a radiation source. Following approval of the Regulations, the Company is expected to be required to pay commissions, in a not substantial sum, expected to be spread over a number of years.

Section 2.15.2 – The Non-Ionized Radiation Law, 5766-2006 (the "Radiation Law")

During the first half of 2007, the Company acted for issue by the Commissioner for Non-Ionized Radiation in the Ministry of the Environment (the "**Commissioner**") of operating permits, in accordance with the Non-Ionized Radiation Law which came into force at the beginning of 2007. Following this activity, the Company received operating permits for the communications installations that it operates, with a few exceptions in respect of which there is still a radiation permit in force under the Pharmacists Regulations. The Company is acting to receive operating permits under the Radiation Law for these few installations as well. Note that the Commissioner may require building permits as a condition of the continued force of the operating permits for the communications installations (including broadcast installations) granted by the Commissioner. Likewise, the Commissioner may require an affidavit regarding an exemption from a building permit for "wireless access installations" which are under a "class permit" granted to the Company by the Commissioner. See also updated to section 2.16.11 below.

Section 2.16 – Limitation and regulation of Company activities

Section 2.16.2 – The Company's general license

With respect to measurement of the Company's market share, and the review dates: On April 22, 2007, a letter was received from the Ministry of Communications stating that the Ministry had commenced the process, however, it was not able to effect a quantitative review at a sufficiently reliable level, because the Company had not yet provided amended data in the format that it requested. When the data is provided, the Ministry will continue its review. On July 15, 2007, the Company responded to another letter from the Ministry of Communications (dated June 13, 2007) alleging that it disputed the objections of the Ministry of Communications regarding the data provided by the Company to the Ministry, and that in any event, such objections ought not postpone the review. Later on, the Company provided the data requested in a format acceptable to both parties.

According to a government decision, the Minister of Communications was instructed to do all acts required so that no later than December 31, 2007, a general licensee for the provision of domestic fixed line telecommunications services will not be permitted to make provision of broadband access to the internet conditional upon the provision of basic telephone services. This resolution, if and to the extent that it is passed, could have a substantial effect on the Company and on its tariff structure, and these effects cannot be assessed at this stage. See also the update to Section 2.2.3 above.

Section 2.16.7 – Antitrust Laws

With respect to the Antitrust Commissioner's investigation of May 2006 regarding suspicion of abuse of monopolistic status following industrial action by employees of the Company during the course of a labor dispute, the Antitrust Authority announced that the investigation into the matter had ended. However, on May 27, 2007 the Company received notice from the Antitrust Authority (the "**Authority**") stating that the Antitrust Commissioner (the "**Commissioner**") is considering a determination, pursuant to her authority under Section 43(a)(5) of the Antitrust Law, 5748-1988 (the "**Law**"), that the Company abused its status, contrary to the provisions of Section 29A of the Law, in view of the findings of an investigation carried out in recent months by the investigations department of the Authority. The notice states that the Commissioner is considering determining that –

1. In the first half of 2006, and in particular in April and May 2006, the Company's employees imposed sanctions concerning delay in the performance of works or not performing works for the connection or expansion of an existing connection of domestic operators to the Company's network.

2. During the afternoon of May 17, 2006, an existing connection between HOT Telecom and the Company's network was disconnected and was not repaired, due to sanctions of Company employees, until the night of May 18, 2006.

3. The Company failed to act as required in order to prevent or minimize these events and the harm to domestic operators, competition and the public.

4. In this way, the Company abused its status, in contravention of Section 29A of the Law.

It is noted that under Section 43(e) of the Law, such a determination by the Commissioner, if and insofar as made, will serve as *prima facie* evidence of the contents of the determination in any legal proceedings.

On September 24, 2007 the Company provided its position, in which it claimed, *inter alia*, that the prohibitions on a monopolist against unreasonably refusing and abusing its status in the market do not apply to a monopolist acting as employer under a labor dispute with its employees.

For the request for an exemption from approval of an arrangement in restraint of trade regarding telephone number information services, see update to section 2.2.2 above.

On October 18, 2007, the Company provided the Antitrust Authority with data and documents at the Authority's request, with respect to the alleged transfer of information to a subsidiary.

Section 2.16.8 – The Telegraph Ordinance

With respect to the disputes with the Ministry of Communications regarding frequency levies and the Ministry's requirement that the Company pay such – following clarification proceedings with the Ministry with respect to such disputes, most of them have been resolved. The principal sum remaining in dispute is for fees in Judea, Samaria and Gaza, and amounts, as at September 30, 2007 to approximately NIS 46 million.

Section 2.16.9 – Proposed legislation regarding termination of contractual relations

On May 14, 2007, another hearing was held in the Economics Committee of the Knesset, but the statute has not yet received the full approval of the Committee.

Section 2.16.11 – Construction of communications installations – NOP 36

With respect to sub-section (a) – NOP 36A – with respect to "wireless access installations", there are a number of initiatives for cancelling the exemption from a building permit. If the Company is required to issue an affidavit regarding an exemption from a building permit as set out in the update to section 2.15.2 and/or if the exemption from building permit is cancelled, this might have substantial adverse implications which the Company is unable to assess at this stage. For the implications to Pelephone, see update to section 3.18.3.3 below.

With respect to sub-section (c) – NOP 36B – the draft of NOP 36B of September 1, 2007 includes not only the Company's broadcast installations but also microwave installations the safety range of which is greater than 10 m, which were originally included in NOP 36A, and the process of issue of the building permits under which are less complex. Likewise, this draft includes a cancellation of provisions which prescribed that the licensing procedures for broadcast installations the safety range of which is not more than 10 m, or the land area required for which is not greater than 300 sqm, be in accordance with NOP 36A and not NOP 36B. The Company is working with the Ministry of Communications and the Ministry of the Interior to cancel these amendments and to put this class of installations back within the application of NOP 36A.

In addition, that draft proposes that NOP 36B include a provision under which a building permit will not be given to all of the broadcast installations included in NOP 36B unless the party applying for the building permit submits a deed of indemnity for all of the compensation under section 197 of the Planning and Building Law, if a ruling is made against the Local Committee. The Company is working with the Ministry of Communications and the Ministry of the Interior to cancel this provision.

With respect to sub-section (d) – General – if the Company is required to take out a building permit for communications installations (including broadcast installations), this might have substantial adverse implications which the Company is unable at this stage to assess. The aforesaid information is forward-looking information, based on the Company's assessments. The actual outcome might be substantially different from the above assessments, if any of the factors taken into account in these assessments changes.

Section 2.16.12 – Bill to amend section 13 of the Communications Law

A bill authorized to amend the Communications Law was published on December 3, 2006. The amendment, *inter alia*, gives the Minister of Communications authority to give instructions to a licensee in the event of a fault or significant cessation fo the provision of communications services, not in circumstances of emergency.

Section 2.16.13 – Restrictions and supervision on the Company's activities regarding the Government Resolution relating to the proposed amendment of the Communications Law

To the best of the Company's knowledge, the Ministry of Finance is initiating an amendment to the Second Authority for Television and Radio Law, 5750-1990, the purpose of which is that the Second Authority for Television and Radio will set up and operate a terrestrial broadcasting set-up based on digital technology, backed up by a digital satellite system for distributing the television broadcasts of the television broadcast franchisees freely to the public at large in Israel, and nationally, so that such distribution will be effected no later than December 1, 2008.

Section 2.17 – Substantial agreements

Section 2.17.4(f) – new collective agreement of December 5, 2006 – for the negotiations between management of the Company and employee representatives regarding bringing forward the date for implementation of the change in the organizational structure and the dates of retirement of employees, see the update to section 2.9.1 above.

Section 2.17.5 – management agreement – on July 29, 2007, a management agreement was signed between the Company and a corporation owned and controlled by the shareholders of Ap.Sb.Ar. Holdings Ltd. The agreement is in force as of October 11, 2005, and the main points of it are set out in the periodic report for 2006.

Section 2.18 – Legal proceedings

For updates on the subject of legal proceedings, see Note 8 to the financial statements of the Company for the period ended September 30, 2007.

Section 2.20 – Event or matter outside the normal course of business

Sub-section (b) – appointment of external examiner

At the request of the Securities Authority, on April 26, 2007, the Company published the final report of the external examiner and on April 30, 2007, the Company published an immediate report setting out a series of resolutions passed by the board of directors following the examination report.

On July 1, 2007, pursuant to the requirements of the Securities Authority, the Company published an immediate report setting out details of the steps taken by the Company following the report of the external examiner. This report relates, *inter alia*, to adoption of new working procedures for the board of directors.

On September 4, 2007, members of the board of directors were elected by the annual general meeting of shareholders of the Company including a number of new members, and on the same date, the board of directors appointed a new chairman for the Company (see also update to section 2.9.1 above). It was also resolved to set up committees of the board of directors, as well as their nature and composition. In addition, the Company approved the appointment of new directors of the subsidiaries.

A. On June 7, 2007, a special general meeting of the shareholders of the Company was convened at the request of the Government Companies Authority, which discussed the examination report of the external examiner Dr. Yoram Danziger, and the implications thereof. During the course of this discussion, the Company provided a review of its operations following the findings set out in the report. The meeting took place in order to discuss the report, and no resolutions were passed at it. In this regard, see also the Company's immediate report of June 7, 2007.

B. Note that on May 1, 2007, an application was received at the offices of the Company pursuant to Article A of Chapter 3 of Part V of the Companies Law, 5759-1999 (derivative claim), sent by a plaintiff claiming to be a public shareholder in the Company. According to the applicant, in his final report the external examiner indicates a long list of failures and deficiencies relating directly to the procedures of the board of directors, the committees of the board and the members of the board of directors and the former CEO of the Company, and the significance of a large portion of the findings of the report is that those directors and other officers of the Company who were involved in passing the various resolutions in the Company prima facie breached their duty of care and/or trust. Therefore, the application requests that the Company take legal steps against the directors and other officers of the Company who were responsible for such. On July 19, 2007, the Company gave notice to the applicant of its decision to dismiss the application with respect to submission of the derivative claim, *inter alia* on the grounds that the claim in this matter was not to the Company's benefit and for the reason that the Company was, is and will continue to act to fix the defects disclosed by the report of the external examiner. In this regard, see also Note 8 to the financial statements of the Company for the period ended on September 30, 2007.

C. It should be further noted that on May 13, 2007, a claim was received at the offices of the Company together with an application to recognize it as a class action, submitted by a plaintiff who claimed to have purchased shares in the Company in 2006. The claim was filed against the Company, two former CEOs of the Company, directors acting at the time relevant to the claim or at present on the Company and against Ap. Sab. Ar. Holdings Ltd, which holds 30% of the shares of the Company. The claim relates to the allegation that the financial statements of the Company for 2004 and 2005 included substantial information that was false and misleading, including with respect to the annual profit, property plant & equipment and shareholders' equity, in light of the Company's notice in an immediate report dated March 26, 2007 regarding a retroactive subtraction of approximately NIS 320 million in property plant & equipment which was not in use by the subsidiary Pelephone Communications Ltd. According to the Plaintiff, he suffered damage as a result of publication of the misleading information, *inter alia* because he had purchased shares at a higher price than that which he would have purchased had the aforesaid information been available on the market on the date on which the plaintiff purchased the shares. The Group which the plaintiff seeks to have the claim apply to is a group of plaintiffs who purchased shares of the Company in the course of trade on the stock exchange during the period between March 5, 2005 (the first day following publication of the report for 2004) and March 26, 2007 (the date of publication of the aforesaid immediate report), and held shares after March 26, 2007. The sum of the personal claim is NIS 194 and the total sum of the claim for the group is NIS 56.5 million.

D. For re-approval of bonuses for 2005 and 2006, see update to section 2.9.7 above.

<u>Section 2.21 – Risk Factors</u>

A risk factor of large consequence – implementation of the number portability program – is added to the list of risk factors. In this regard, see update to section 2.6.6A above.

3. Cellular – Pelephone Communications Ltd. ("Pelephone")

Section 3.1 Information on the area of operation

Section 3.1.5.3 Technological changes

On October 25, 2007, the Board of Directors of the Company approved a resolution of the board of directors of Pelephone regarding the setting up of a network using HSPA / UMTS technology for a total sum of approximately one billion shekels. Following the resolution, the general meeting of Pelephone approved the set-up of the network. Ericsson was chosen as supplier of the system. The new network is expected to commence operations at the beginning of 2009. Investment in the network will be over a period of four years.

Section 3.7 – Competition

Section 3.7.2

As part of an examination by the Ministries of Finance and Communications of the question of operation of virtual operators in Israel (MVNO), the Ministry of Communications has hired the services of a consulting firm and has requested that the carriers provide it with information on the cellular sector, for use in this examination. The Ministry of Communications has asked the consulting firm to submit its conclusions by the end of June 2007. After receiving the conclusions, and prior to making a final decision on the matter, the Ministry is expected to hold a hearing for the carriers. Pelephone, with the assistance of a consulting firm hired for this purpose, is getting ready to present its position to the Ministry of Communications, and is preparing a response to the expected hearing.

During the month of June 2007, Pelephone, Cellcom and Partner entered into an agreement with a joint consultation company in accordance with the consent of the Antitrust Commissioner, for the purpose of obtaining advice regarding competition in the cellular market in Israel, and on the issue of MVNO, pending the Ministry's hearing. Recently, the Ministry of Communications accepted the report of the consultancy company hired by it to look into the issue of introduction of MVNO. According to the recommendations of the report, there is no need for the Ministry of Communications to intervene in the matter at this stage. The Ministry of Communications has not published a hearing regarding introduction of MVNO. Likewise, during discussions by the Government on the Arrangements Law, the statutory amendments proposed regarding the creation of tools for enforcing the right of a virtual carrier to use a cellular network were also made.

In discussions of the State budget for 2008, the government decided that the Ministry of Communications should grant an MVNO license commencing December 31, 2007 to those who wish for one. If an MVNO license is granted and that licensee negotiates with the carriers but no positive outcome is achieved after a period of 6-9 months and it can be proven that this is the result of anti-competitive conduct of the existing carriers, then the Minister of Communications will consider intervening on the question of the introduction of MVNO into the market by exercise of his authority.

Section 3.7.3

On May 24, 2007, Pelephone received notice from the Ministry of Communications stating that it was considering imposing a financial sanction on Pelephone for alleged breach of the obligation to provide number portability as of September 1, 2006, as follows:

A. For the period between September 1, 2006 and the date of the notice of the Director General of the Ministry, a financial sanction in the sum of NIS 2,031,750.

B. For the period between May 25, 2007 and November 30, 2007, or up to the date of remedy by Pelephone of the alleged breach (whichever is the earlier) – the sum of NIS 6,450 for each additional day during which the breach continues.

C. For the period between December 1, 2007 (which is, according to the provisions of the notice, the reasonable date necessary for the relevant licensees with respect to amendment of the alleged breach) and until the date of remedy of the alleged breach – the financial sanction set out in sections 37B(b) and 37C(a) of the Communications Law (note that under the provisions of those sections, the rate of the relevant sanction is seven times the fine set out in section 61(a)(4) of the Penal Law (which is NIS 202,000) plus 0.25% of the Pelephone's annual revenues, plus a financial sanction in the sum of one fiftieth of such sanction for each day on which the breach continues).

According to the provisions of the notices of the Ministry of Communications, Pelephone was given an opportunity to make its own claims to the CEO of the Ministry of Communications by June 24, 2007. As set out in the financial statements for December 31, 2006, Pelephone (together with the other cellular companies) petitioned the High Court of Justice, alleging, *inter alia*, that it was the Ministry of Communications that had not prepared the number portability program as required under the provisions of the Law. On July 5, 2007, Pelephone submitted its response to the aforesaid hearing. As at the date of drafting this update, the Ministry's response to the response submitted has not yet been received.

Pelephone is preparing for the operational and marketing implications of implementation of the number portability program, and it expects harm to its revenues as a result of implementation of the program. At this stage, it is not possible to assess the scope of the harm.

This information includes forward-looking information, based on Pelephone's assessments. The actual outcome might be substantially different from the above assessments, if there is a change in any of the factors taken into account in making these assessments.

On this matter, see also the update of Section 2.6.6(a).

Section 3.7.4

During the month of September 2007, the Ministry of Communications published a hearing regarding the policy of allocation of frequencies for the activation of WiMAX technology. Under the proposed policy, preference is to be given in this allocation to new carriers and to the smallest cellular carrier in the market (Mirs). Pelephone has not yet submitted its response to this hearing.

Section 3.15 – Financing

Section 3.15.6 – Credit rating

On May 1, 2007, Maalot, which rates all of the Company's debenture series, announced that following recent discoveries and following the examination report submitted by the external examiner (see update to section 2.20 above) regarding reduction of property plant and equipment at Pelephone, at this stage, no change is expected to be made to the rating of Pelephone's undertakings (see also update to section 2.13.6 above).

Section 3.17 – Environmental protection

During the course of 2007, Pelephone has been adjusting its broadcast sites on the basis of an annual plan to comply with the requirements of the Non-Ionized Radiation Law, 5766-2005. In this context, Pelephone is receiving new operations permits for broadcast sites, in force for five years. With respect to certain kinds of broadcast installations that have a very slight effect on the environment, such as internal transmissions, Pelephone has received new class permits, which are in force for five years. See the update to section 3.18.3.3 below.

Section 3.18 – Restriction and supervision of Pelephone's activities

The Minister for the Environment has submitted the Non-Ionized Radiation Regulations, 5767-2007 to the Interior and Environmental Protection Committee of the Knesset. The Regulations have been made and approved by the Committee, but have not yet come into force. Pursuant to the wording of the Regulations approved by the Committee, the Regulations are expected to adversely affect the construction and operation of broadcast centers in several ways, including the following: significant reduction of the possibility of using access facilities in areas of high population density; more stringent processes for obtaining radiation permits for existing and new broadcast installations, and for effecting changes to the operation thereof; imposition of payment of fees for the construction and operation of existing and new broadcast installations.

Recently, there have been delays and difficulties in handling renewals of construction and operation permits as required under the Non-Ionized Radiation Law, 5766-2006 and the method of implementation of such by the Commissioner for Radiation at the Ministry of the Environment. Should these delays and difficulties not be resolved within a reasonable period of time and permits not be given for installations, this will give rise to the need to terminate broadcast from several installations, so long as no other solution is found. Should the above conditions exist, this will have an adverse affect on the data in section 3.18.1.3.

This information includes forward-looking information, which is based on Pelephone's assessments. The actual outcome might be substantially different from the above assessments, if there is a change in any one of the factors which were taken into account in making these assessments.

Section 3.18.3.1 – Pelephone's license

In April 2007, the Ministry of Communications published its decision regarding amendment of the license on the matter of changing the mechanism used for identifying users of erotic services as being an adult. Under the amendment, removal of the obstruction of access to receipt of erotic services is to be by way of submission of a written application together with a photocopy of an identity card or by physically appearing before a service representative. The amendment, which was supposed to come into force on May 25, 2007, has been delayed in the meantime by virtue of a temporary injunction awarded by the Supreme Court, pending hearing of the application for injunction and petition before a panel of three judgments. This injunction was given under a private petition to the High Court of Justice against this amendment, which was filed during the month of May. The petition includes an application for an interim injunction to suspend entry of the amendment into force. Pelephone intends to join this petition.

On April 17, 2007, the Ministry of Communications published a hearing document to carriers regarding repeal of a clause in the MRT licenses permitting the marketing of plans with alternate billing segments to 12 second billing segments. According to the document, Pelephone will be allowed to market plans with 12 second billing segments only, and as of January 1, 2009, plans with 1 second billing segments only. During August 2007, the Ministry of Communications' decision i was received, pursuant to which as of September 4, 2007, the cellular companies are not permitted to market plans with billing segments of greater than 12 seconds. Likewise, the Ministry of Communications referred, in its decision, to the December 2004 amendment of the license and noted that charging by segments of one second as of January 1, 2009 as set out in the Regulations (see also section 3.18.2 of the periodic report) will apply retroactively to packages marketed prior to that date as well, contrary to Pelephone's position. In discussions in the Economic Committee of the Knesset held in August 2007, a sub-committee was appointed to the Economic Committee regarding the Promotion of Competition in the Cellular Market. The sub-committee chose to focus on the issue of transparency in the cellular companies' invoices. The committee proposed a number of changes to the existing structure of the invoice. In addition, at the beginning of October 2007, a ministerial committee of the Ministry of Communications was set up with the aim of promoting changes in the invoices of the cellular companies in order to increase transparency. The committee is expected to adopt the recommendations of the sub-committee to the Economic Committee, and is also expected to recommend additional changes. Pelephone has welcomed the process and is working to improve the invoices sent to its customers.

During September 2007, the Ministry of Communications published a hearing for carriers under which it proposed an amendment to the MRT licenses which will restrict the maximum liability period for subscribers to 18 to 24 months. This hearing is based on the recommendations of a consultancy firm which checked the issue of virtual carriers for the Ministry of Communications, and in the same framework, also checked the level of competition in the cellular market in Israel. According to the recommendations, the most common liability period in the Israeli market is 36 months, which is longer than usual in similar competitive markets in Europe. Pelephone's position is that in any event, a provision requiring the shortening of the period of liability should not be imposed retroactively, and companies should be allowed to offer a range of plans with differing commitment periods along with plans requiring no commitment,

Section 3.18.3.3 – Site licensing

Certain local authorities and planning committees are trying to attack the legality of the use made by Pelephone and other cellular companies of an exemption from a building permit granted to wireless access installations used by the cellular networks under the Planning and Building Law, 5725-1965. In a number of judgments, the courts of local affairs have recognized the legality of use of such exemptions. Recently, the Court of Local Affairs handed down a ruling which contradicted previous rulings in the same court, to the effect that the above exemption does not apply to access installations that operation on cellular networks. Additional proceedings in this matter, including appeal proceedings in the District Court, have not yet been ruled upon. Recently, a High Court petition was also filed in this regard, in an attempt to attack the legality of use of the above exemption which was dismissed due to threshold conditions. Pelephone is operating in accordance with the exemption proceedings, erects and operates such access installations as aforesaid in accordance with detailed radiation permits granted under the Non-Ionized Radiation Law, 5766-2005. For this issue, see also the update to section 3.18.1.3 above.

A number of local authorities recently contacted the Commissioner for Radiation at the Ministry of the Environment, expressing their objection to the erection of access facilities, relying on a section of the Non-Ionized Radiation Law which makes the grant of activation permits for access facilities conditional upon the consent of the relevant authority. Additional authorities are expected to join in expressing this objection. Due to these objections, the Ministry for the Environment is refusing to issue operations permits for access facilities which have been constructed lawfully in those authorities.

During the past month, discussions were held in the Interior and Environmental Protection Committee of the Knesset regarding regulations under the Non-Ionized Radiation Law. The regulations provide a series of rules for the construction of sites, such as safety distances, location of sites, etc. After termination of the hearings in the committee and approval of the regulations, the Minister of the Environment and the Minister of Communications must sign the regulations as final approval thereof. With respect to the access facilities, two further judgments were recently passed by the Court for Local Affairs which recognized the legality of erecting wireless access facilities used by cellular networks.

Section 3.19 – Legal proceedings

For updates on the subject of legal proceedings, see Note 8 to the financial statements of the Company for the period ended September 30, 2007.

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

Section 4.1 – General

Section 4.1.1 – Structure and changes to area of operations

In addition to the services set out in this chapter of the periodic report, Bezeq International has, since its full merger with BezeqCall Communications Ltd. ("**BezeqCall**") on February 11, 2007 (the "**date of full merger**"), been providing NEP (network end point) services ("**NEP Services**"), including data communications infrastructure services, passive infrastructure installation services and low voltage systems, sale of exchange systems including IP telephony communications systems, and provision of installation and maintenance services for these systems.

Section 4.1.2 – Legislative and statutory restrictions applicable to Bezeq International

Section 4.1.2.1 – On July 11, 2007, the Bill for an amendment to the Communications (Telecommunications and Broadcasting) Law, 5742-1982, which is parallel to the Limitation of Access to Adult Internet Sites Bill, 5766-2006, of Knesset Member Amnon Cohen, was approved by the Ministerial Committee and submitted to the Economic Committee of the Knesset. The Bills, which were discussed by the Economics Committee, propose restricting access to sites that contain pornographic content, gambling, or violence; *inter alia* by imposing an obligation on internet service providers, including Bezeq International, to activate mechanisms that oversee access to such sites. Due to the many questions raised in the Committee relating to the constitutionality of the amendment, as well as to the technical aspects involved in implementation of it, the Committee requested that the Ministry of Communications present it with data prior to its making any decision in this regard. At this stage, the basic format of the proposed law has not yet been prescribed, and it is not possible to assess the implications of this Law, if and when it is passed, on the commercial operations of Bezeq International.

Section 4.1.2.5 – Network End Point License

On December 31, 2006, the Ministry of Communications approved transfer of BezeqCall's NEP License to Bezeq International. As of the date of the full merger, Bezeq International has been providing NEP services under this license.

Section 4.2 – Products and Services

Section 4.2.5 – NEP Services

In the NEP Services sector Bezeq International provides: Sale, installation and maintenance of exchange systems, installation and maintenance of data communications infrastructure, installation and maintenance services for passive infrastructure and low voltage systems, placing an emphasis on integrative solutions that are tailored to business and institutional customers on their premises.

Section 4.4 – New products

As of the date of full merger, all of the products and services that BezeqCall sold and supplied at that date were received by Bezeq International. In this regard, see update to section 4.2 above – Products and Services.

Section 4.6 – Competition

Section 4.6.4 – NEP Services

The traditional field of telephone exchanges is characterized by a large number of competitors and by fierce competition, which has given rise to an erosion of prices for services. The most prominent competitors are: Tadiran, Eurocom, Telrad, GlobeCall, Gil International, Tel-Yad.

The data communications and IP telephony field is characterized by the entry of new players – IT companies – into the world of voice. These are companies such as: Binat, Teldor, Netcom, IBM. These companies are substantially different from the traditional NEP companies and are of a higher technological level. There is also a trend of communications companies conglomerating and of entry of new carriers, intending to provide customers with total communications solutions – telephony, transmission, data communications, internet, information security, etc.

Section 4.9 – Intangible Assets

Section 4.9.3 – Acquisition of Actcom – Active Communications Ltd.

On July 9, 2007, the Registrar of Companies approved the merger of Actcom and Bezeq International Ltd., under the provisions of section 323 of the Companies Law, 5759-1999; such that Bezeq International received Actcom (all of its assets, rights and liabilities) and Actcom was expunged from the Register.

Section 4.10 – Human Resources

On June 18, 2007, the appointment of the Deputy CEO as Acting CEO of Bezeq International was approved (in place of CEO of Bezeq International, who had been appointed Acting CEO of the Company). The position of Deputy CEO of Bezeq International was cancelled. On November 6, 2007, the appointment of the Acting CEO as CEO was approved.

Section 4.10.2 – Organizational Structure

Management of Bezeq International has resolved, with the consent of the board of directors, to alter the organizational structure of the company, in the following way:

A. Organization and Methods Department will be transferred to the management of the Finance Department;

B. Human Resources will be separated from the Finance Department into an independent department, under the management of a manager reporting to the CEO of Bezeq International;

C. Operations Department will be merged into the Service Department, under the management of the VP Services.

Section 4.11 - Suppliers

As of the date of full merger, all of the rights and obligations of BezeqCall under joint venture, marketing and sale agreements to which BezeqCall had been a party, were transferred to Bezeq International, giving it the right to market and supply installation, support and maintenance services for the equipment sold as part of the NEP services; the most significant of these are the agreements with: LG, Nortel, Cisco and Tadiran.

Section 4.13 – Credit Policy

Section 4.13.1 – Customer credit

As part of the provision of NEP services, Bezeq International effects sales to its customers by way of payments in many instalments. In this way, Bezeq International gives its customers credit, which they repay in instalments. In order to reduce the exposure which might stem from providing credit for lengthy periods to its customers, Bezeq International checks their financial resilience, sets ceilings for the maximum credit available to customers and registers a charge over the equipment sold, pending full repayment of the credit.

Section 4.14 - Investments

1. As at June 10, 2007, Bezeq International held 42.84% (33.66% under full dilution) of the share capital of Walla! Communications Ltd. During the second quarter of 2007, Bezeq International exercised the rest of the options available to it, in return for shareholders loans it provided to Walla! During the third quarter of 2007, the rest of the holders of the series 3 options of Walla! exercised their rights such that as at September 30, 2007, Bezeq International held 34.41% (33.66% under full dilution) of the share capital of Walla!.

2. B-Zone Partnership – on October 23, 2006, Bezeq International executed an agreement with 2+ (Two Plus) Wireless Solutions Ltd. (hereinafter: “**2+**”) to set up a general partnership under the name of B-Zone (hereinafter: the “**Partnership**”). Each of the parties’ share in the Partnership is 50%. The purpose of the Partnership is to work to set up, support and manage wireless browsing networks in public areas, enabling connection to high-speed internet browsing and collecting payment from the end user for permission to browse the internet (hereinafter: the “**area of operations**”). Under the agreement, each of the partners transferred its activities in the partners’ area of operations to the Partnership, as of the date

of commencement of the Partnership's operations. After the Partnership was set up, an agreement was signed between it and 2+ for the provision of outsourcing services to the Partnership by 2+, under which the Partnership would operate and its ongoing management would be effected by 2+. On July 1, 2007, the Partnership commenced its operations. Pursuant to the provisions of the foundation agreement of the Partnership, Bezeq International gave the Partnership a guarantee in favor of the receipt of a line of credit in the sum of US $ 50,000. In addition, on October 15, 2007, Bezeq International granted a loan to the Partnership in the amount of $35,000 for the purpose of developing the Partnership's operations. Under the Agreement, Bezeq International also undertook to pay 2+ the sum of US $ 45,000 in favor of setting up the Partnership's operations, of which Bezeq International paid 2+ US $ 30,000 on October 15, 2007.

3. On December 21, 2006, an agreement was signed between Bezeq International and Dasner Communications Ltd. for the establishment of a joint company, under which Bezcom Ltd. was set up during January 2007 (hereinafter: "**Bezcom**"). Bezcom was set up as part of the expansion of Bezeq International's global operations, together with the Dasner Group which specializes in marketing over the internet. The purpose of Bezcom is to act to provide communications services to end customers around the world, *inter alia* via a unique communications solution for the provision of telephony services. Bezcom commenced development operations in March 2007, and during August 2007 commenced its commercial launch. Pursuant to Bezcom's foundation agreement, the parties undertook to provide initial financing for Bezcom's operations in the sum of up to US $ 1.5 million per party, by way of provision of shareholders' loans. On September 3, 2007, the parties each provided a sum of NIS 210,000 to cover Bezcom's expenses as at such date.

Section 4.15 – Finance

During the month of January 2007, Bezeq International repaid on-call loans provided to BezeqCall by a number of banks, in the total sum of approximately NIS 20.3 million.

After the balance sheet date, Bezeq International began a process of early repayment of loans received from banking corporations, subject to the approval of its organs. During October 2007, approximately NIS 15 million of the loan balance of approximately NIS 35.8 million was repaid.

Section 4.16 – Taxation

During the month of February 2007, Bezeq International paid income tax down payments for the 2006 tax year, in the sum of approximately NIS 36.3 million.

Section 4.19 – Legal proceedings

1. With respect to section 4.19.4 of the Company's periodic report for 2006 regarding the petition to the Supreme Court sitting as the High Court of Justice, filed by Bezeq International on February 5, 2006, to cancel the decision of the Minister of Communications under which Bezeq International would only be granted a license to operate domestic fixed line telephony services using VOB technology after the Company's market share in the field of domestic fixed line telephony fell below 85%, the Supreme Court accepted Bezeq International's application and on July 8, 2007, awarded an interim injunction instructing 012 Telecom to focus its requests to contracts regarding fixed line domestic telephone on their own customers only, by direct mail, rather than by applying to the public; On September 5, 2007, the Supreme Court handed down a judgment dismissing the Petition and leaving the Minister of Communications' decision in force.

2. On June 6, 2007, HOT Telecom Limited Partnership ("**HOT**") filed a claim against Bezeq International in the District Court at Tel Aviv, under which it sought declaratory relief and an interim injunction under which Bezeq International would not do any act, directly or indirectly, to obtain confidential information belonging to it, and would not make any use of such information should it be obtained; that following an investigation that it had undertaken which showed, it claimed, that Bezeq International was operating unlawfully to obtain the details of customers who had joined as subscribers to its internet access infrastructure services.

   Bezeq International filed its response to the application for temporary injunction to the Court, in which it alleged that HOT's claims against Bezeq International and its managers regarding the existence of methodical and systematic operations at Bezeq International aimed at unlawfully obtaining information about HOT's customers are insubstantial and that in any event, there is no evidentiary infrastructure for such, and that if any of Bezeq's representatives has indeed acted as alleged by HOT, such person acted of their own accord, in absolute contravention of the instructions of Bezeq International.

On July 23, 2007, the Court acceded to HOT's application and awarded an injunction prohibiting Bezeq International and/or any of its employees and/or persons acting on its behalf and/or any representative of it from contacting the employees of HOT and/or its representatives directly or indirectly in order to obtain confidential information regarding the identity of its customers, by way of grant of benefits and/or making use of such information that may have reached it. In light of Bezeq International's clear policy, which existed even prior to the filing of this claim, and which prohibits unauthorized receipt and use of such information, it would appear that the injunction granted by the Court will not have any implications on Bezeq International's operations or its financial results. As at the date of this report, Bezeq International's response to the principal claim (regarding the declaratory relief) has not yet been submitted; however, at this stage, given the causes of action and the clear policy of Bezeq International regarding the receipt of information relating to customers of infrastructure suppliers, it would appear that the claim will not substantially affect the conduct of Bezeq International's business, or require it to use substantial resources to remove such.

3. On July 29, 2007, Bezeq International filed a claim against HOT in the District Court at Tel Aviv in the sum of NIS 23.2 million for damages caused to it by HOT since the latter decided, in contravention of the provisions of its license, not to allow Bezeq International to participate in the joint parcels offered by it (joint parcels for access services and for infrastructure services which offer a total price which is attractive to customers). The claim was filed following a decision by the Ministry of Communications, in October 2006 (passed following a complaint by Bezeq International in this regard) that HOT had breached the conditions of its license and therefore was required to integrate Bezeq International into the joint parcels, together with the other internet access service providers in competition with Bezeq International. In the statement of claim, Bezeq International claims loss of profits in the sum of NIS 23.2 million over a period of approximately two years (2005-2007) in which HOT blatantly refused to cooperate with it. According to Bezeq International, during this period it lost many customers who wished to enjoy its services but wanted to have HOT's infrastructure services. Due to HOT's conduct, Bezeq International was in fact obstructed from accessing a whole swathe of customers which it could not bring into its services or retain. As at the date of this report, HOT has not yet filed a statement of defense.

4. Further to the provisions of the update to section 2.6.6A above, on May 27, 2007, Bezeq International received a letter from the Director General of the Ministry of Communications, giving notice to Bezeq International that he intended to impose a financial sanction upon it in the sum of NIS 2,031,750 for failure to implement and operate the number portability plan, commencing on September 1, 2006.

   In response to the Ministry of Communications, Bezeq International claimed that as holder of a general license for the provision of international telecommunications services, it does not allocate numbers to its customers and therefore, in any event, is not part of number portability, which is effected by domestic carriers and cellular carriers. Bezeq International's part in this matter amounts only to creating the interfaces required with respect to incoming calls to cellular and/or domestic carriers, in accordance with the characterization of the form of number portability prescribed by the cellular and domestic carriers, and checks done with them. Bezeq International performed its duties under the law by preparing itself as required and it was ready, prior to the date set down for implementation of the portability program on September 1, 2006, to do all that was required to implement the program, in whatever manner the domestic carriers might decide to employ, and its acts did not prevent the effecting of portability from any number or customer whatsoever.

   Therefore, there are no grounds for the Ministry of Communications' claim in this regard, since not only is it in contradiction to the facts of the matter, but also causes harm to Bezeq International, which has invested immense resources in this regard and which acted without delay to implement what was required of it on time and in the manner prescribed by the relevant persons. In light of all of the above, it is clear that Bezeq International has implemented number portability faultlessly, and that it should be deemed to be a party prepared for number portability, in accordance with the provisions of the law and on the date set out in such provisions.

5. With respect to section 4.19.3 of the Company's periodic report for 2006 regarding the application for leave to appeal filed by Bezeq International with the District Court at Tel Aviv against the ruling of the Local Court in Tel Aviv under which Bezeq International's appeal against the decision of the Director General of the Ministry of Communications to impose a monetary sanction in the sum of approximately NIS 1 million for alleged breach of the conditions of its license regarding erotic services was partially upheld and under which the Ministry of Communications was required to refund Bezeq International the sum of NIS 387,000, on October 15, 2007, the District Court handed down a judgment dismissing the appeal and affirming the ruling of the Local Court regarding the rest of the sum of the monetary sanction paid by Bezeq International.

For further updates on the subject of legal proceedings, see Note 8 to the financial statements of the Company for the period ended September 30, 2007.

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

Section 5.1 – General information on areas of operation

As at June 30, 2007, DBS had 543,031 subscribers.

Section 5.1.3 – Market developments in the area of operations

In October 2007, the Bill for the Arrangements Law for 2008 was approved under first reading by the Knesset Plenum, which included, *inter alia*, provisions to amend the Second Authority for Radio and Television Law, 5750-1990, under which the Second Authority for Television and Radio must plan, set up and operate a digital distribution system, backed up by a satellite distribution system for the commercial television stations (Channel 2 and Channel 10) for two channels of the Broadcasting Authority (if the Broadcasting Authority should so desire) and of the Knesset Channel (Channel 99), should it so request, such that such channels will be distributed to the public freely throughout the country, by December 2008 (under the limitations set out in the Bill). Should the aforesaid Bill be legislated as a binding statute and such distribution as aforesaid be effected by the Second Authority, the broadcasts of such channels shall constitute a partial substitute for DBS's broadcasts.

Section 5.4 – New Products

High Definition TV (HDTV) – DBS is currently completing its preparations for marketing a decoder enabling the reception of high definition broadcasts. In DBS's assessment, the service is expected to be launched by the end of 2007.

The aforesaid is forward looking information and realization of it is dependent, *inter alia*, upon technical preparations and third parties, and therefore, this assessment may not come into being or may come into being in a substantially different manner.

Viewing Programs on the Internet – in August 2007. DBS launched a content website in cooperation with Walla! Communications Ltd. which presents content intended for viewing over the internet.

Section 5.6.5 – Competition

With respect to section 5.6.5F - VOD, in July 2007, the Knesset approved the Communications (Telecommunications and Broadcasts) (Amendment No. 37) Law, 5767-2007 in second and third readings. This law, *inter alia*, authorizes the Minister of Communications to provide satellite broadcast licensees to provide services upon demand (VOD) to its subscribers, in whole or in part, after consulting with the Council and taking into account the considerations set out in the Communications Law, if it finds that there is a difficulty in transmitting VOD broadcasts via satellite in the scope and format similar to those broadcast by the general licensee for cable broadcasts. However, commercial launch of VOD services by DBS requires a license from the Ministry of Communications, upgrade of telecommunications infrastructure by Bezeq, connection of the subscriber to the DSL network and receipt of the consent of Bezeq to provide the service on conditions that will enable DBS to provide it for its subscribers, conditions which to date have not yet been met.

In this regard, see also update to section 2.6.5 above.

Section 5.10 – Raw materials and suppliers

For the lawsuit between DBS and Hillel which is being heard by an arbitrator, see update to section 5.17 below.

Section 5.12 – Finance

Section 5.12.2 – Credit restrictions applicable to the corporation

In July 2007, the financing agreement was amended under which, *inter alia*, the targets of the financial conditions which DBG is required to comply with starting with the second quarter of 2007 and ending in 2013 (the date for full repayment of the bank credit) were amended. A mechanism was also prescribed as part of this amendment setting out the rate of receipts from the issue of Debentures (Series A) of the Company, including future increases of the series, if any, to be used to repay the bank credit. In this regard, see also Note 7A to the financial statements of the Company for the period ended on September 30, 2007.

As at September 30, 2007, DBS was in compliance with the financial conditions under the (amended) financing agreement, after receiving relief from the banks (received after the balance sheet date) with respect to the targets of a number of stipulations at September 30, 2007.

The banks extended the date for DBS to reach an arrangement with the Israel Aviation Industry regarding DBS' debt to it, so that such debt and the call for payment of it not be deemed to be a breach by it of the financing agreement, to December 31, 2008, and provided that as at such date, no proceedings are instituted against DBS by the IAI.

Private placement of debentures

In July 2007, DBS raised the sum of approximately NIS 620 million as part of a private issue to institutional investors of registered Debentures (Series A) listed on TACT Institutional at TASE (the "**Debentures**"). For the purpose of this issue, the Debentures were rated by Maalot the Israel Securities Rating Company Ltd. at BBB- / stable.

In October 2007, Maalot gave notice that the rating of the Debentures had been placed on the watch list due to disruptions of DBS's broadcasts (see below), due, according to Maalot, to higher than expected expenses having been incurred, to a deviation from DBS's business plan and to the filing of a number of lawsuits against it. Maalot noted that it will examine the effect of these events on the present rating, and will publish its conclusions at the end of its examination.

On October 21, 2007, DBS received a letter from the trustee for the debentures, stating that following disturbances in broadcasts and the publicity about them, including about falling subscriber numbers at DBS and about the compensation that DBS will grant its subscribers, he requests various documents and confirmations from DBS in order to ascertain whether those events and their long-term implications are liable to have an adverse effect on DBS's undertakings towards the debenture-holders. Following the trustee's letter, the Company and the trustee met to discuss the matter, at which time the Company was requested to submit additional information to that disclosed at the meeting. At the date of this report, the Company is considering the trustee's request.

For further details with respect to this issue, see Note 7A to the financial statements of the Company for the period ended on September 30, 2007.

Section 5.13 – Taxation

DBS is in the process of discussing tax deduction assessments for the years 2002-2004. DBS has made an appropriate provision on its books.

Section 5.17 – Legal proceedings

For the claim of DBS v. Pace (section 5.17.1 of the Periodic Report): On March 18, 2007, the registrar of the District Court set aside the defendant's application to cancel the permit of service. On April 10, 2007, the defendant appealed that decision to the District Court, and hearing of the appeal was set down for June 11, 2007. Pursuant to agreements reached by the parties, the appeal was struck out on May 28, 2007, without any order being made as to costs.

On July 15, 2007, a statement of defense was filed by Pace, simultaneously with a statement of counter-claim by it against DBS and Eurocom Digital Communications Ltd., in which an interested party is also an interested party in DBS ("**Eurocom Communications**"), jointly and severally, relating to a monetary claim in the sum of NIS 42,640,000. For this counter-claim, see also Note 8 to the financial statements of the Company for the period ended September 30, 2007.

With respect to the Al-Jazeera claim (section 5.17.2 of the Periodic Report): Following negotiations, the parties have reached an agreement with respect to continued broadcast of the channel, as part of DBS' transmissions. On May 9, 2007, Al-Jazeera signed a memorandum of understanding which anchored this agreement and set out that an application to strike out the claim would be filed within 7 days of execution of the memorandum of understanding. On May 17, 2007, an application was filed to strike out the claim, and on May 21, 2007, the Court upheld the application to strike.

With respect to the class action regarding the Sports Channel: On February 28, 2007, the court's ruling was published stating that the value of the benefit was $ 10,000,000, and costs at a rate of 6% of the sum of the benefit were ruled for counsel for the plaintiffs, and a total sum of NIS 2,514,000 plus VAT, plus remuneration to the plaintiffs in the sum of NIS 400,000 (including VAT). DBS and the cable companies agreed that the division between the parties would be 70-30, and accordingly, on April 26, 2007, DBS's portion (30% of the total sum) was transferred to counsel for the representative plaintiff.

On April 16, 2007, the representative plaintiffs filed an appeal to the Supreme Court against the sum ruled as remuneration to the plaintiffs, and an application to increase it. DBS plans to file a counter-appeal regarding appraisal of the value of the benefit (and accordingly, with respect to the fees of counsel for the plaintiffs), and with respect to the remuneration to the plaintiff. On May 16, 2007, DBS, together with the Cable Company, filed a counter-appeal regarding the appraisal of the value of the benefit (and accordingly, with respect to the fees of counsel for the plaintiffs) and with respect to the remuneration to the plaintiff.

Proceedings regarding deficit demand from the Customs Department: In December 2006, a deficit demand was sent to Eurocom Digital Communications Ltd. ("Eurocom Communications") from the Customs Department, for payment of purchase tax and VAT (including linkage differentials, interest and fines) in the sum total of approximately NIS 10 million, for decoders purchased by DBS from Eurocom Communications, and imported by it for DBS, smart cards belonging to DBS having arrived with such decoders. Eurocom Communications and DBS have mounted objection proceedings against the deficit demand, the dispute dealing with the proper classification of the smart cards for the purposes of purchase tax. DBS has provided the sureties required by the Customs Department for assurance of the taxes in dispute and DBS and Eurocom Communications have agreed that DBS will bear any payments required under the deficit demand, if any. In the opinion of DBS' and Eurocom Communications' legal advisers, there is a reasonable chance of no effective debt in respect of the sum of approximately NIS 5 million out of the deficit demand, which is in respect of VAT, and there is a reasonable chance of subtraction or cancellation of the linkage differentials, interest and fines included in the deficit demand. As at the date of this report, a decision has not yet been made with respect to the objection to the deficit demand.

Arbitration with Halal Communications: A dispute has arisen between the Company and Halal Communications Ltd. ("Halal") in which an interested party is also an interested party in DBS, regarding the sum of the monthly payment to Halal for the leasing of space segments on the Amos 2 satellite under the agreement between the parties dated May 16, 2000 (the "agreement"), due to the Company's claim that it is entitled to an annual discount on the rental that it owes under the agreement, due to the number of space segments that it leases on Amos 2, whilst Halal claims that it is not entitled to such discount, since two of the segments leased from Halal are segments transferred from Amos 1. The parties negotiated in an attempt to solve the dispute, under which the DBS made an ex gratia payment of the sum of $700,000 out of the sum in dispute. DBS deposited the sum in dispute with a trustee, at the rate of such at the time of commencement of the arbitration proceedings and from time to time deposits additional sums in dispute with the trustee. . In May 2007, an initial pre-arbitration session was held – in order to determine the procedures for hearing Halal's claim regarding the debt, amounting at present to $ 1,575,000, including the sum of $ 700,000 above (the alleged debt increasing by $ 75,000 each month). On June 14, 2007, Halal filed a statement of claim and on July 8, 2007, DBS filed a statement of defense. On August 28, 2007, Halal submitted affidavits of evidence in chief and DBS is entitled to submit affidavits of evidence in chief by November 1, 2007.

Re class action regarding decoder depreciation (section 5.17.3 of the periodic report) - pursuant to a procedural arrangement reached by the parties, DBS filed its response to the application for approval on February 13, 2007. No response has yet been filed to the response, and the Attorney-General's position has not yet been submitted. A hearing date has been set down for November 12, 2007.

New class action regarding Pizza Meter campaign – on July 11, 2007, an application to approve submission of a class action against DBS and Pizza Meter Ltd. (hereinafter: "Pizza Meter") was filed with the District Court at Tel Aviv with respect to a campaign by DBS under which subscribers who joined the campaign were entitled to 52 coupons for a family-sized pizza from Pizza Meter for one year (hereinafter: the "Application for Approval"). According to the applicant, in May 2007, there was a change in the policy for exercising these vouchers, mainly in that delivery services were no longer provided, and this made it impossible to exercise the vouchers, in contravention of the conditions promised to subscribers when they joined the campaign. The class action is estimated to be in the sum of approximately NIS 7 million. DBS has not yet filed its response to this Application for Approval. On September 2, 2007, Pizza Meter gave notice to DBS of termination of exercise of the campaign vouchers by it following the transfer of ownership and all of the rights in the "Pizza Meter" brand from Pizza Meter Holdings Ltd. to Pizza Meter Israel – Management (2005) Ltd. Following termination of the campaign by Pizza Meter and the company's notice as aforesaid, on September 20, 2007, the applicant filed an application to amend the application for approval regarding the new facts as stated above, noting that this amounted to a litigant's admission on the part of the respondents as to the blatant breach of their undertakings.

For additional updates on the subject of legal proceedings, see Note 8 to the financial statements of the Company for the period ended September 30, 2007.

Section 5.19 – Discussion of Risk Factors

5.19.3 – Special Risks to DBS

Secondary allocation of frequency range – the frequency range used by DBS to transmit its broadcasts from the broadcast satellites to the satellite dishes installed at subscribers' homes, and allocated in accordance with a license by the Ministry of Communications is defined as the frequency range allocated under secondary allocation, such that there is an Israeli entity which is permitted to make primary authorized use of the frequency range. If the owner of the primary allocation uses the frequency range on an ongoing and significant basis, disruptions may occur to the quality and/or availability of DBS's broadcasts to its subscribers which might cause harm to the financial results of DBS. As at the date of this report, to the best of DBS's knowledge, the owner of the primary allocation has not made use of these frequencies in such a way as to cause significant and/or ongoing disruptions to DBS's broadcasts. Disruptions to reception of broadcasts – since DBS's broadcasts are wireless transmissions from the broadcast satellites on which DBS leases space segments, to the satellite dishes in subscribers' homes, the broadcast of wireless signals in the same frequency range might cause disruptions to the quality and/or availability of the broadcasts provided by DBS to its subscribers and harm to its financial results. For the disruption that occurred during September and October 2007, and to the Government's resolution in this regard, see below.

New Section 5.20 – Extraordinary Event in DBS's Business

On September 5, 2007, non-continuous disruptions began to occur in DBS's broadcasts, which occurred on a variety of waves, power and scope which caused disruptions, at various strengths, to the quality and availability of DBS's broadcasts, mainly in the north of the country and along the coast. The disruptions to broadcasting also gave rise to extraordinary loads on DBS's customer service center, which caused difficulties in receiving service. In order to locate the source of the disruptions, DBS set up teams to locate and pinpoint the disruptions, with the cooperation of specialists in this area, and with the assistance of various governmental bodies as well. To the best of DBS's knowledge, and as informed to it by government bodies following the location operations, the source of the disruptions was external, was not within DBS's control and was not related to it. The disruptions ceased on October 9, 2007 and have not occurred since, as at the date of publication of this report. To the best of DBS's knowledge, the disruptions were caused due to broadcasting operations in the frequency range in which DBS's broadcasts are transmitted from the satellites that it uses to the dishes in subscribers' homes. Therefore, despite the fact that the disruptions have stopped as at the date of this report, there is no certainty that a disrupting transmission of this kind may not occur again in the future.

The frequency range in which DBS operates as aforesaid was permitted for its use under a license granted to DBS by the Ministry of Communications prior to its commencing commercial operations (see section 5.8.1.4 to the periodic report of Bezeq for 2006), in respect of which DBS paid and continues to pay appropriate fees. In this regard, in October 2007, the Government resolved as follows:

"A. Further to the operations done by the Ministry of Communications, the Ministry of Defense and the Foreign Ministry to cease the disruptions to reception of the broadcasts of YES, to appoint an inter-ministerial committee headed by the Director General of the Ministry of Communications, and with the participation of a representative of the Foreign Ministry, a representative of the Ministry of Defense, a representative of the Ministry of Finance and a representative of the Ministry of Justice, to examine all of the aspects and issues arising with respect to these disruptions, and in broader contexts as well.

B. To instruct the relevant government ministries to give the matter appropriate priority. The team to be appointed as set out in section A above shall place special emphasis on the issues arising in the field of mass communications in cases of emergency.

C. The team shall provide the Government with an interim report by mid November 2007."

On October 16, 2007, DBS gave notice that despite the fact that the disruptions to its broadcasts had been caused by external entities and not by its own act or omission, it would compensate all of its subscribers by opening up all of the channels marketed by it (with the exception of erotic channels and pay per view movie channels) to its subscribers for free, for a period of three months ending January

15, 2008, and subscribers who, under their contracts, pay a separate fee to purchase "premium" channels will be credited for such payment. This compensation, and the other expenses and damages caused to DBS with respect to these disruptions could cause harm to DBS's financial results.

November 14, 2007	
Date	Bezeq – The Israel Telecommunication Corp. Ltd.

Names and titles of signatories:

Shlomo Rodav, Chairman of the Board
Avi Gabbay, Acting CEO

Directors' Report on the State of the Company's Affairs for the period ended September 30, 2007

November 14, 2007

Chapter B of the Periodic Report

Directors Report on the State of the Company's Affairs for the nine month period ending September 30, 2007

We respectfully present the Directors' Report on the state of the affairs of "Bezeq" – The Israel Telecommunication Corp. Limited (hereinafter: the "Company") and the consolidated Group companies (the Company and the consolidated companies hereinafter collectively referred to as the "Group"), for the nine-month period ending September 30, 2007 (hereinafter: "the Directors' Report").

The Directors' Report contains a review, in condensed form, of the matters dealt with by the board of directors, and is drafted taking into account the fact that the reader of the Report is also equipped with a copy of the Directors' Report for the year ended December 31, 2006.

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

1) **Domestic fixed-line communications.**
2) **Cellular.**
3) **International communications, internet services and NEP.**
4) **Multi-channel television.**

The Company has an additional area of operations which is not substantial to the Group's operations, and which has been included in the financial statements for September 30, 2007 as a business sector, which mainly includes customer call center services and investment in a venture capital fund.

The financial statements are drafted in accordance with the International Financial Reporting Standards (IFRSs). The financial statements for the first nine months of 2006 have been redrafted in accordance with IFRSs. The effect of the transition to reporting in accordance with international standards on the Company's financial situation and on the results of its operations is set out in Note 14 to the financial statements. In order to properly reflect the financial situation of the Group under Israeli accepted accounting rules prior to the transition to IFRSs, the financial statements of the Group were adjusted by way of restatement as set out in Note 14L to the financial statements.

1. Financial Position

A. The Group's assets, as at September 30, 2007, amount to approximately NIS 15.55 billion, compared with approximately NIS 17.45 billion as at September 30, 2006. Of these, approximately NIS 6.08 billion (approximately 39%) are property, plant and equipment, compared with approximately NIS 6.64 billion (approximately 38%) as at September 30, 2006.

Most of the decrease stems from the fixed-line domestic communications segment. There was a decline in total assets in this segment, not including investment in subsidiary companies, compared with the previous year, in the sum of approximately NIS 2.42 billion, mainly due to the realization of commercially held financial assets and a decrease in cash balance which were mainly used for the distribution of dividends. In addition, there was a decrease in the depreciated cost of property, plant and equipment resulting from the difference between depreciation expenses and the investment made in the reporting period.

In the cellular segment, the segment's assets increased from approximately NIS 4.05 billion as at September 30, 2006 to the sum of approximately NIS 4.25 billion as at September 30, 2007. The increase stemmed mainly from an increase in cash balance. In addition, there was an increase in the base of long-term customers stemming from an increase in sales in payment installments and a decrease in credit card payments. On the other hand, there was a decrease in the tax asset stemming from realization of the asset recorded in the past for losses, and a drop in the depreciated cost of property plant and equipment.

In the international communications, internet and NEP services segment, there was an increase in total assets compared with September 30, 2006, mainly due to the merger of Bezeq International with BezeqCall in January 2007.

In the multi-channel television segment, there was an increase in total assets compared with September 30, 2006, which stemmed mainly from an increase in broadcasting rights which was offset by the decrease in balance of net investments in property, plant and equipment.

B. The shareholders' equity ascribed to the shareholders of the Company as at September 30, 2007 amounted to approximately NIS 4.22 billion, comprising approximately 27% of the total balance sheet, compared with approximately NIS 6.27 billion as at September 30, 2006, which comprised approximately 36% of the total balance sheet. The decrease in shareholders' equity stemmed from the distribution of a dividend in the sum of NIS 3.26 billion. The decrease was partially offset by the Group's net profit and share-based payments to Company employees.

C. The Group's total debt amounted to approximately NIS 7.23 billion as at September 30, 2007, compared with approximately NIS 8.18 billion as at September 30, 2006. The Group's debt to financial institutions and debenture holders as at September 30, 2007 amounted to approximately NIS 6.87 billion, compared with approximately NIS 7.62 billion as at September 30, 2006. The decrease stemmed mainly from payment of Eurobonds in the domestic fixed line communications segment in the sum of approximately NIS 1.7 billion and payment of liabilities in the multi-channel television segment and in the cellular segment, The decrease was partially offset by the sale of debentures to institutional investors in the domestic fixed-line communications segment in the sum of approximately NIS 1.2 million and issue of debentures in the multi-channel television segment in the sum of approximately NIS 614 million.

The Company's auditors drew attention to the financial position of DBS, as set out in Note 7A to the financial statements – that at the balance sheet date DBS is not in compliance with the financial criteria set for it in the financing agreement, and since the financial criteria are cumulative, DBS will be compelled to seek relief in connection with those conditions also at December 31, 2007. After the balance sheet date, DBS received relief in connection with the financial criteria at September 30, 2007, and therefore at the date of approval of the financial statements DBS is in compliance with the financial criteria. The management of DBS believes that the financial resources available to it will be sufficient for the subsidiary's operating needs in the coming year. If it transpires that additional resources are required for meeting the needs of operations in the coming year, the subsidiary will act in accordance with an alternative business plan that does not necessitate additional resources beyond those at its disposal.

D. The Group's cash and other current investment balances as at September 30, 2007 amounted to the sum of approximately NIS 2.08 billion compared with approximately NIS 3.52 billion as at September 30, 2006. The decrease stemmed mainly from the realization of commercially held securities in the domestic fixed-line communications segment, which were used in the payment of a dividend in the sum of NIS 3.26 billion, and for payment of liabilities. The decrease was partially offset due to an increase in cash balances in the cellular segment, sale and issue of debentures in the fixed-line domestic communications segment and the multi-channel television segment, and due to the cash flow from current operations in the principal segments of the Group's operations.

2. Results of Operations

A. Principal Results

Net earnings ascribed to shareholders of the Company for the first nine months of 2007 amounted to approximately NIS 1,015 million as opposed to net earnings of approximately NIS 916 million for the corresponding period. An increase in net earnings attributed to the shareholders stemmed mainly from an increase in operating profit.

The following are details of changes in the results of the various segments, compared with the corresponding period:

Segment	For the nine-month period ended September 30, 2007 NIS millions profit (loss)	For the nine-month period ended September 30, 2006 NIS millions profit (loss)
Fixed-line domestic communications	939	951
Cellular	672	535
International communications, internet services and NEP	159	109
Multi-channel television	51	(3)
Others	2	-
Total	**1,823**	**1,592**

Basic earnings per share for the first nine months of 2007 amounted to NIS 0.39 per NIS 1.00 par value (diluted earnings per share amounted to NIS 0.38 per NIS 1.00 par value) compared with basic and diluted earnings per share of NIS 0.35 per NIS 1.00 par value for the corresponding quarter.

B Revenue

The Group's revenues in the first nine months of 2007 amounted to approximately NIS 9.28 billion compared with approximately NIS 9.11 billion in the corresponding period.

Revenue from fixed-line domestic communications decreased from approximately NIS 4.36 billion in the first nine months of 2006 to approximately NIS 4.26 billion in the reporting period (a decrease of approximately 2%). The decrease in the segment's revenue stemmed mainly from a reduction of tariffs as of July 2006 and June 2007, and from a reduction in call traffic. The decrease in revenue was offset primarily by ongoing growth in the number of customers who subscribe to high-speed internet service (ADSL) and an increase in revenue from data communication services. The Company's auditors continue to draw attention to the continued opening up of the communications sector to competition and the effects of regulation.

Revenue in the cellular segment increased from the sum of approximately NIS 3.33 billion in the first nine months of 2006 to approximately NIS 3.50 billion in the reporting period. The increase stemmed from an increase in revenue from sale of terminal equipment, stemming mainly from an increase in the quantity of handsets sold and upgraded. In addition, there was an increase in revenue from cellular services, following an increase in content revenue and an increase in the number of subscribers, which was set off mainly by price erosion.

Revenue in the international communications, internet and NEP services segment increased from the sum of approximately NIS 957 million in the first nine months of 2006 to approximately NIS 970 million in the reporting period. The increase stemmed from an increase in internet revenue due to sale of capacity and from an increase in revenue from outgoing calls, alongside a decrease in operations relating to transfer of calls between communications carriers around the world.

Revenue from the multi-channel television segment increased from the sum of approximately NIS 1,009 million in the first nine months of 2006 to approximately NIS 1,068 million in the reporting period, as a result of an increase in the number of subscribers and an increase in average revenue per customer.

C. Depreciation and amortization

The Group's depreciation and amortization expenses decreased from the sum of approximately NIS 1,401 million in the first nine months of 2006 to the sum of approximately NIS 1,323 million in the reporting period, mainly as a result of a decrease in depreciation expenses due to the end of depreciation of property, plant & equipment and a decrease in investments in new property in the principal segments in which the Group operates.

D. Salaries

The Group's salary expenses increased from the sum of approximately NIS 1,715 million in the first nine months of 2006 to the sum of approximately NIS 1,757 million in the reporting period, due to an increase in salary expenses in the Group's main segments. Salary expenses in the domestic fixed line segment increased due to the increase in wages that offset the reduction in expenses stemming from retiring employees, and due to increases on account of employment terms and severance terms for executives.

E. General and Operating Expenses

The Group's general and operating expenses for the first nine months of 2007 amounted to approximately NIS 4.31 billion compared with approximately NIS 4.36 billion during the corresponding period.

Revenues in the domestic fixed-line communications segment decreased from the sum of approximately NIS 1,649 million in the first nine months of 2006 to approximately NIS 1,576 million in the reporting period. The decrease stemmed mainly from a decrease in expenses relating to interconnection to cellular operators, services and maintenance by sub-contractors, materials and spare parts, and maintenance of buildings which was set off by an increase in royalty expenses and general expenses, mainly due to an increase in interconnection to domestic fixed line communication operators.

In the cellular segment, general and operating expenses increased from the sum of approximately NIS 1,991 million in the first nine months of 2006 to the sum of approximately NIS 2,033 million in the reporting period, mainly as a result of an increase in costs of terminal equipment due to an increase in the quantity of handsets sold and an increase in access fees to telecom operators and content expenses as well as an increase in revenues from cellular services.

In the international communications, internet and NEP services segment, there was a decrease in general and operating expenses from the sum of NIS 603 million in the first nine months of 2006 to the sum of approximately NIS 564 million in the report period. The decrease stemmed mainly from a reduction in operations relating to call transfers between communications carriers around the world.

Revenues in the multi-channel television segment increased from the sum of approximately NIS 672 million in the first nine months of 2006 to approximately NIS 682 million in the reporting period, as a result of an increase in general expenses due to provisions for increases stemming from the disruption of broadcasting services in September and compensation for customers. The increase was offset by a decrease in content expenses and in royalty expenses.

F. Other operating expenses (income), net

The Group's other net operating expenses originated mainly in the domestic fixed-line communications segment. These expenses rose from the sum of approximately NIS 46 million in the first nine months of 2006 to approximately NIS 70 million in the reported period, due mainly to provisions made for a decrease in long-term loans and a decrease in capital gain.

G. Operating income

The Group's operating income during the first nine months of 2007 amounted to approximately NIS 1,823 million, compared with approximately NIS 1,592 million in the corresponding period, an increase of approximately NIS 231 million. The increase in operating income stems from changes in the results of the segments as described above under the revenue and expense items. These changes brought about an increase in operating income in all of the main segments in which the Group operates, except for the fixed-line domestic communications segment, in which operating income decreased.

H. Financing expenses, net

The Group's net financing expenses in the first nine months of 2007 amounted to approximately NIS 265 million compared with approximately NIS 281 million in the corresponding period, a reduction of approximately NIS 16 million.

The Group's debt to financial institutions and debenture-holders is linked, for the most part, to the Consumer Price Index, and financing expenses are influenced by changes in that index. In the reporting period, the rate of rise in the CPI increased compared with the corresponding period, and revaluation of the liabilities led to an increase in the Group's financing expenses (see also Section 4 below).

In the domestic fixed line communications segment there was an increase in net financing expenses compared to the corresponding period. This stemmed mainly from a decrease in revenues in the capital market due to realization of deposits and securities and a decrease in the resulting yields. In this segment there is an increase in expenses due to revaluation of CPI-linked liabilities and the foreign currency exchange rate, which was partially offset by hedging transactions. In addition, during the corresponding period there was a decrease in financing expenses stemming from cancellation of the provision for termination of past disputes with the Ministry of Communications.

There was a decrease in financing expenses in the cellular segment, mainly due to the reduction in debt and erosion of the dollar. The decrease was offset by the increase in expenses for revaluating CPI-linked liabilities as a result of a rise in the index.

In the multi-channel television segment net financing expenses in the first nine months of 2007 amounted to approximately NIS 89 million compared with NIS 267 million in the corresponding period. The rise in the CPI led to an increase in financing expenses due to revaluation of CPI-linked liabilities. On the other hand, the fair value of the shareholders' loans was recalculated due to postponement of expected payment dates. As a result, financing revenues in the multi-channel television segment increased by NIS 213 million and in the Group by NIS 96 million (see Note 7A to the financial statements). This increase in the income of the Group was attributed to the minority interest in the subsidiary, and accordingly, did not affect the profit attributed to the shareholders of the Company.

I. Income tax

The Group's tax expenses in the first nine months of 2007 amounted to approximately NIS 505 million, representing approximately 32.3% of pre-tax profit, compared with approximately NIS 455 million in the corresponding period, representing approximately 34.5% of pre-tax profit. Most of the decrease in the rate of the tax out of profits before income tax is derived from profits in the reporting quarter in the multi-channel television segment, which are not taxable due to setoff against past losses.

3. Liquidity and sources of financing

The consolidated cash flows from current operations for the first nine months of 2007 amounted to approximately NIS 2,443 million, compared with approximately NIS 2,688 million in the corresponding period, a decrease of approximately NIS 245 million. The decrease in cash flows from current operations is due mainly to revenues and expenses which do not involve cash flows, changes in asset and liability items, and an increase in the tax payments less an increase in tax expenses, which were partially offset by the increase in earnings.

Cash flows generated by operating activities are one of the sources of financing of the Group's investments, which during the reported period included, *inter alia*, approximately NIS 681 million in the development of communications infrastructure, compared with an investment in the sum of approximately NIS 699 million in the corresponding period. During the reported period, the Group realized investments in net financial assets in the sum of approximately NIS 68 million compared with a net realization in the sum of approximately NIS 135 million during the corresponding period.

During the reporting period, the Group repaid debts and paid interest in the total sum of approximately NIS 3,069 million, of which, approximately NIS 1,902 million in debentures, approximately NIS 754 million in loans, approximately NIS 56 million in short-term credit, and approximately NIS 357 million in interest payments. During the reporting period, the Group raised new debt in a total sum of approximately NIS 1,864 million by taking loans in the sum of approximately NIS 50 million and issue of debentures in the sum of approximately NIS 1,814 million, compared with payment of net debt and interest payments in the sum of approximately NIS 1,751 million in the corresponding period. In the reporting period, cash dividends in the sum of NIS 2.1 billion were paid, with the sum of NIS 1.2 billion in the corresponding period.

The monthly average short-term credit average from banks in the first nine months of 2007 amounted to approximately NIS 88 million. The monthly average of long-term liabilities to financial institutions and debenture holders in the first nine months of 2007 amounted to approximately NIS 7,305 million.

The working capital as at September 30, 2007 was negative, and amounted to approximately NIS 1,037 million, compared with negative operating capital as at September 30, 2006, which amounted to approximately NIS 676 million, an increase of approximately NIS 361 million in deficit. This increase stems from the domestic fixed line communications segment. In this segment there was a decrease in working capital amounting to approximately NIS 1,609 million mainly due to exercise of commercially held financial assets, a decrease in cash balance, and recording of liabilities for payment of the dividend. On the other hand, there was a decrease in current debenture maturities. Working capital was used mainly to pay the dividend and repay liabilities. The decrease in working capital in this segment was almost completely set off by improved working capital of the other segments in which the Group operates.

4. <u>Comparison of the results of the third quarter of 2007 with the results of the corresponding quarter.</u>

Segment	**For the three month period ended September 30, 2007 NIS millions profit (loss)**	**For the three month period ended September 30, 2006 NIS millions profit (loss)**
Fixed-line domestic communications	327	363
Cellular	219	170
International communications and internet services	54	39
Multi-channel television	(4)	(12)
Other	-	-
Total	**596**	**560**

Revenue during the third quarter of 2007 increased by approximately NIS 56 million compared with the corresponding quarter.

Total costs and expenses increased by approximately NIS 20 million compared with the corresponding quarter. This increase included an increase in other net operating expenses in the sum of approximately NIS 50 million.

Net financing expenses increased by approximately NIS 44 million compared with the corresponding quarter. Financing expenses in the quarter were affected mainly by an increase in the CPI, to which most of the Company's liabilities are linked, and a decrease in return on investments. See Section 6(D) below for the effect of hedging transactions. The increase in financing expenses was mainly offset by revenue of NIS 96 million recorded for the change in conditions of shareholders' loans in the multi-channel television segment. See section 2(H) above.

The behavior of the various income and expense items and the causes of the differences between the quarters are similar to the explanations set out in the nine month results. The changes described above in the profit and loss statements brought about a net profit ascribed to shareholders of the Company of approximately NIS 255 million in the third quarter, compared with a net profit attributed to the Company's shareholders, of approximately NIS 313 million in the corresponding quarter.

5. Group involvement in the community and donations

The Group is active in the community through its involvement in social institutions and organizations such as the education system in underprivileged areas and the confrontation line. In addition, employees of the Group volunteer for a variety of other communal activities.

During the report period, the Company donated approximately NIS 1,142,000. The main issues are described below.

In the project “Children and Parents Study Computer and Internet”, which has been ongoing for some six years, the Company's employees voluntarily mentor underprivileged parents and children on selected subjects in the field of computers and the internet.

In the project "Summer for the Community", which is in its fourth year, employees' children work in medical institutions and community centers during the summer. The project costs the Company NIS 930,000.

The Company’s employees and retirees have set up a charitable association called Halav. The association works together with local councils to locate families in distress, with the aim of providing them with basic food products.

Pelephone has no binding policy regarding donations and its management discusses each case on an individual basis. During the reporting period, Pelephone donated approximately NIS 30,000 to various associations.

Bezeq International is involved in ongoing operations on behalf of underprivileged communities in Petach Tikva, it adopted “lone” soldiers, adopted a fighting division and participated in projects for special needs children. During the reporting period, Bezeq International's expenses amounted to approximately NIS 400,000.

6. Details Concerning Exposure to and Management of Market Risks

A. Further to the statements made in the Directors’ Report for 2006, hedging transactions against the market risks involved in exposure to exchange rate fluctuations substantially reduced this exposure.

B. The report on positions on derivatives at September 30, 2007 differs from the report at December 31, 2006. The up-to-date report is shown below:

Positions in derivatives at September 30, 2007 (consolidated)
(amounts are in NIS thousands)

	Dollar / NIS							
	Nominal Value				**Fair Value - asset (liability)**			
	Up to one year		**More than one year**		**Up to one year**		**More than one year**	
	Long	**Short**	**Long**	**Short**	**Long**	**Short**	**Long**	**Short**
Forward transactions								
Hedging - not recognized for accounting	280,479		-	-	(4,105)		-	-

Euro / NIS								
	Nominal Value				Fair Value - asset (liability)			
	Up to one year		More than one year		Up to one year		More than one year	
	Long	Short	Long	Short	Long	Short	Long	Short
Forward transactions								
Hedging - not recognized for accounting	85,347	(170,694)	-	-	398	8,943	-	-

CPI / NIS								
	Nominal Value				Fair Value - asset (liability)			
	Up to one year		More than one year		Up to one year		More than one year	
	Long	Short	Long	Short	Long	Short	Long	Short
Forward transactions								
Hedging - not recognized for accounting	1,450,000	-	650,000	-	27,916	-	(2,073)	-

C. Analyses of sensitivity to fair value and the affect of the change in market prices on the fair value of the balance-sheet and off-balance-sheet surpluses in respect of which there are strong contracts as at September 30, 2007, are not significantly different from the report as at December 31, 2006, except for the analysis below:

Sensitivity to changes in the euro/shekel exchange rate

	Profit (loss) due to changes		Fair value	Profit (loss) due to changes	
	10%	5%		-5%	-10%
Cash	668	334	6,683	(334)	(668)
Other investments	2,712	1,356	27,122	(1,356)	(2,712)
Deposit investments	4,389	2,195	43,891	(2,195)	(4,389)
Hedging instruments not recognized for accounting: Euro/shekel forward transactions	(8,535)	(4,267)	9,341	4,267	8,535
Debentures	(3,135)	(1,568)	(31,350)	1,568	3,135
Suppliers	(287)	(144)	(2,871)	144	287
Total	(4,188)	(2,094)	52,816	2,094	4,188

Sensitivity to changes in real shekel interest

	Profit (loss) due to changes		Fair value	Profit (loss) due to changes	
	10%	5%		-5%	-10%
Non-tradable debentures	41,859	21,241	(2,349,037)	(21,552)	(43,758)
Bank loans	6,185	3,108	(1,162493)	(3,140)	(6,311)
Loans from others	5,772	2,938	(94,951)	(3,048)	(6,209)
Total	53,816	27,287	(3,606,481)	(27,740)	(56,278)

Analysis of sensitivity to fluctuations in index-linked securities

	Profit (loss) due to changes		Fair value	Profit (loss) due to changes	
	2%	1%		-1%	-2%
CPI-linked debentures	8,158	4,079	407,891	(4,079)	(8,158)
Debenture 4	(25,944)	(12,972)	(1,297,200)	12,972	25,944
Debenture 5	(33,181)	(16,591)	(1,659,061)	16,591	33,181
Total	(50,967)	(25,484)	(2,548,370)	25,484	50,967

The sensitivity analysis of the debentures was calculated at values of 1% and 2%, based on a review of the maximum change in prices of CPI linked debentures.

D. The report on linkage bases for September 30, 2007 is not significantly different from the report as at December 31, 2006, with the exception of a decrease in Euro-linked liabilities due to payment of debentures (Eurobonds) in the domestic fixed line segment in the sum of approximately NIS 1.7 billion.

The Group's surplus monetary liabilities over monetary assets denominated in or linked to foreign currency as at September 30, 2007 amounted to approximately NIS 50 million.
Surplus monetary liabilities over monetary assets linked to the CPI as at September 30, 2007 amounted to approximately NIS 6.7 billion in the Group. As a result of forward currency transactions as at September 30, 2007, the net balance of CPI-linked liabilities not hedged by such forward transactions amounted to approximately NIS 4.6 billion.

Hedging accounting is not implemented in the Group's forward transactions. These transactions are presented according to fair value as at the balance sheet date. This creates timing differences in recording of the hedging transaction results compared with the liabilities presented according to the known CPI on the balance sheet date or the currency exchange rate as at the balance sheet date. The high rise in CPI in the reported quarter created a significant difference in timing of this recording, which led to an increase in the Company's reported financing expenses.

The Group's main segments have hedging policies which reduce CPI exposures caused by tax expenses being calculated on real profit.

7. Disclosure regarding the internal auditor at the Company

A. The internal auditor's procedures were updated and approved by the audit committee of the board of directors on January 4, 2005.

B. During the course of 2006, the internal auditor's term of office at the Company terminated and an acting replacement was appointed. Later on, in August 2007, the acting internal auditor was appointed as internal auditor of the Company. The employment terms of the Company's internal auditor were discussed and approved by the audit committee of the Company's board of directors on August 30, 2007 and October 21, 2007 and subsequently approved by the Company's board of directors on October 25, 2007, as follows:

1. Total monthly salary of NIS 40,000 linked to the CPI from the date she was appointed as acting internal auditor (August 2006).
2. Annual target-based bonus determined in advance by the audit committee and approved by the board of directors and/or the compensation committee authorized by the board of directors, amounting to up to 35% of the annual salary without extras.

In the opinion of the board of directors, the internal auditor's compensation is not likely to affect her professional judgment.

C. During 2007, in the framework of the Company's streamlining measures, the unit was reduced by another five audit employees.

D. The audit plan approved for 2007 is for 10,000 work hours (compared with the work plan of 12,000 hours in 2006).

E. During the course of 2007, CEO discussions were held on fifteen audit reports (some dating to 2006). The Audit Committee discussed four audit reports.

F. As of May 15, 2007, the external director Eyal Yaniv has been acting as chairman of the audit committee.

8. Disclosure regarding process of approval of financial statements at the Company

The organ responsible for overseeing at the Company is the Board of Directors. The Board of Directors of the Company appointed a balance sheet committee, whose composition and functions are as follows:

A. Most of the members of the committee are to have accounting and finance qualifications, and at least one of them is to be an external director.

B. The balance sheet committee is to discuss the financial statements prior to discussion of them on the board of directors, and is to make recommendations to the board regarding approval of them. The committee is to invite the auditors to participate in these discussions. The balance sheet committee is to discuss and make recommendations to the board of directors with respect to the following matters: prescription of accounting policy and setting down procedures relating to financial reporting and recording.

C. The balance sheet committee is to follow-up changes in accounting rules and to discuss the effect of such on the Company, is to discuss matters that might arise during financial audits and is to discuss changes in internal reporting mechanisms.

D. The balance sheet committee is to follow up and supervise implementation of the prescribed accounting policy and implementation of the procedures prescribed for financial reporting and recording.

E. The balance sheet committee is to provide its opinion on the above issues and on other financial and accounting issues, when it discusses the financial statements and whenever a specific issue of a substantial size arises in any of these areas.

F. The balance sheet committee is to advise the board of directors on the scope of work done by the auditors, and on their fees.

G. The balance sheet committee is to be responsible for contact between the board of directors and the auditors, with respect to their work.

The financial statements were discussed by the balance sheet committee and presented to the board of directors for approval. The following officers took part in the discussions of the board of directors: Board members: Shlomo Rodav, David Blumberg, Eyal Yaniv, Menachem Inbar, Michael Grabiner, Stephen Grabiner, Yoav Rubinstein, Alon Shalev, Aryeh Saban, Key Kiarie, David Gilboa, Rami Nomkin and Yehuda Porat. Officers: Avi Gabbay – Acting CEO, Ran Oz – Deputy CEO and CFO, and Bosmat Chelouche – General Counsel. Representatives of the Company's accountants, Somekh Chaikin, also participated in the discussions.

9. Critical Accounting Estimates

The preparation of the financial statements according to international accounting principles obligates the management to make estimates and assessments that influence the reported values of assets and liabilities, income and expenses, and disclosure relating to contingent assets and liabilities. Management bases its estimates and assessments on past experience and on estimating values and opinions and additional factors which it believes are relevant, taking into account the circumstances. The actual results can differ from those assessments based on various assumptions and conditions. The main issues of uncertainty regarding critical estimates and considerations involved in implementing accounting policy are similar to those that were implemented in the annual statements (see Note 4 to the Financial Statements). We are of the opinion that these estimates and assessments are critical because any change in the estimates and presumptions has the potential of substantially affecting the financial statements.

10. Miscellaneous

Event subsequent to the date of the financial statements

A. Following a query by the Securities Authority, it was resolved to appoint an external examiner to examine the issues arising out of the immediate reports of the Company of March 20, 2007 regarding approval of the option scheme for employees and directors, the immediate report of the Company of March 26, 2007 regarding approval of grants to office bearers, and the immediate report of the Company of March 26, 2007 regarding restatement, pursuant to the provisions of the letters of the Securities Authority to the Company dated March 25, 2007 and March 28, 2007. The external examiner's findings and the subsequent resolutions of the board of directors, including approval of the notice of Mr. Yacov Gelbard regarding termination of office as CEO of the Company, and commencement of office of Mr. Avi Gabbay in the post of Acting CEO, are set out in Note 16 to the financial statements and in section 2.20 of the Periodic Report, and in the Company's immediate reports published since then.

B. On October 25, 2007, the board of directors re-adopted a code of ethics, which was presented at the meeting. The code of ethics defines principles and rules of conduct as guidelines for the Company's officer bearers, managers and employees. The code of ethics was formulated by the Company in 2005 and its new version includes amendments and updates. The board of directors authorized the Company's management to take steps to assimilate the code of ethics in the Company and determined that the code of ethics would be part of the Company's regulations.

C. On September 4, 2007, Shlomo Rodav was appointed Chairman of the Board of Directors of the Company. On the same day, the Board of Directors of the Company resolved, in accordance with Section 50(a) of the Companies Law, 5759-1999 and Articles 119 and 121.1 of the Company's Articles of Association, that the powers of the CEO in everything relating to investee corporations of the Company, whether the holding in them is direct or indirect (including Pelephone Communications Ltd., Bezeq International Ltd., D.B.S. Satellite Services (1998) Ltd, Walla! Communications Ltd., Bezeq Zahav Holdings Ltd. and BezeqCall Ltd.), would be transferred to the Board of Directors, and that decisions on the implementation of the above would be made at a later date.

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

Shlomo Rodav **Chairman of the Board**	**Avi Gabbay** **Acting CEO**

Chapter C – Financial Statements

“BEZEQ” THE ISRAEL TELECOMMUNICATION CORP. LIMITED

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

SEPTEMBER 30, 2007

(UNAUDITED)

Contents

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

At your request, we have reviewed the condensed consolidated interim balance sheet of "Bezeq" - The Israel Telecommunication Corp. Limited ("the Company") at September 30, 2007, as well as the condensed consolidated interim statement of income, the condensed consolidated interim statement of recognised income and expense and the condensed consolidated interim statement of cash flows for the nine and three-month periods then ended.

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

Reports of other auditors were furnished to us which relate to investments in associates in which the Company's investments amount to approximately NIS 33 million at September 30, 2007, and the Company's equity in their profits amount to approximately NIS 2.405 million and NIS 761,000 for the nine-month and three-month periods then ended, respectively.

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

In the course of our review, including reviewing the reports of other auditors as mentioned above, nothing came to our attention which would indicate the necessity of making material changes to the said interim financial statements in order for them to be in conformity with International Financial Reporting Standards (IFRSs) 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 and the effects of regulation on the Group's financial position and operating results, as described in Note 1.

2. Contingent claims made against the Group of which the exposure cannot yet be assessed or calculated, and other contingencies as described in Notes 8B and 8C.

3. The financial condition of a subsidiary, as described in Note 7A – At the balance sheet date, DBS is not in compliance with the financial criteria set for it in the financing agreement, and since those criteria are cumulative, DBS will be compelled to seek relief in connection with those conditions also at December 31, 2007. After the balance sheet date, the subsidiary received relief in connection with the financial criteria at September 30, 2007, and therefore, at the date of approval of these financial statements the subsidiary is in compliance with the financial criteria. The subsidiary's management believes that the financial resources available to it will be sufficient for the subsidiary's operating needs in the coming year. If it transpires that additional resources are required for operations in the coming year, the subsidiary will act in accordance with an alternative business plan that does not necessitate additional resources beyond those at its disposal.

Additionally, we draw attention to Note 14L to the Group's condensed consolidated interim financial statements regarding the adjustment by way of restatement of the financial statements at September 30, 2006, in order to retroactively reflect the depreciation of property, plant and equipment and the related tax effects thereon, in respect of the presentation of receipts from interconnect to the cellular networks and in respect of a reduction of lease payments of land from the Israel Lands Administration as described in the aforementioned note. These aforementioned corrections were implemented on the data presented in the Note of restatement to IFRSs in order to properly reflect, according to generally accepted accounting principles in Israel, the financial position of the Group prior to the effect of the transition to IFRSs.

Somekh Chaikin
Certified Public Accountants (Isr.)

November 14, 2007

Condensed Consolidated Interim Balance Sheets at

	September 30, 2007	September 30, 2006	December 31, 2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Assets			
Cash and cash equivalents	**1,104,769**	1,188,480	2,631,790
Investments and loans, including derivatives	**979,824**	2,335,178	960,561
Trade receivables	**2,335,772**	2,116,297	2,111,451
Other receivables	**192,297**	172,383	250,657
Inventory	**189,040**	193,532	204,669
Broadcasting rights	**223,976**	177,925	169,017
Current tax assets	**12,942**	12,132	11,105
Assets classified as held for sale	**22,562**	-	-
Total current assets	**5,061,182**	6,195,927	6,339,250
Trade and other receivables	**473,249**	363,417	417,144
Investments and loans, including derivatives	**273,751**	383,155	342,175
Property, plant and equipment	**6,075,139**	6,638,321	6,492,362
Intangible assets	**2,526,208**	2,563,121	2,554,242
Deferred and other expenses	**362,759**	381,450	373,749
Investments in associates accounted by the equity method	**33,176**	27,799	32,122
Deferred tax assets	**743,287**	899,712	993,616
Total non-current assets	**10,487,569**	11,256,975	11,205,410
Total assets	**15,548,751**	17,452,902	17,544,660

Condensed Consolidated Interim Balance Sheets at

	September 30, 2007	September 30, 2006	December 31, 2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Liabilities			
Loans and credit	**1,970,562**	3,734,392	3,637,347
Trade payables	**1,314,852**	1,340,335	1,393,568
Other payables, including derivatives	**785,239**	856,246	802,747
Current tax liabilities	**50,832**	72,487	121,704
Deferred income	**35,933**	37,496	57,879
Provisions	**357,927**	256,813	288,851
Employee benefits	**823,126**	573,986	906,203
Dividend payable	**760,000**	-	300,000
Total current liabilities	**6,098,471**	6,871,755	7,508,299
Debentures	**4,424,859**	3,224,662	3,169,441
Obligations to banks	**341,906**	544,837	480,830
Loans from others	**132,366**	118,045	169,182
Loans provided by the minority in a subsidiary	**362,275**	558,120	564,250
Employee benefits	**243,980**	346,059	373,036
Deferred income and others	**36,856**	22,313	37,020
Provisions	**53,442**	52,805	51,857
Total non-current liabilities	**5,595,684**	4,866,841	4,845,616
Total liabilities	**11,694,155**	11,738,596	12,353,915
Shareholders' equity			
Share capital	**6,132,636**	6,309,133	6,309,133
Share premium	**-**	1,623,423	1,623,423
Reserves	**684,698**	386,099	671,820
Deficit	**(2,594,341)**	(2,046,229)	(2,849,381)
Total equity attributable to shareholders of the Company	**4,222,993**	6,272,426	5,754,995
Minority interest in capital deficit of consolidated companies	**(368,397)**	(558,120)	(564,250)
Total shareholders' equity	**3,854,596**	5,714,306	5,190,745
Total shareholders' equity and liabilities	**15,548,751**	17,452,902	17,544,660

Shlomo Rodav	**Avi Gabbay**	**Ran Oz**
Chairman of the Board	Acting CEO	Deputy CEO and CFO

Date of approval of the financial statements: November 14, 2007.

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

Condensed Consolidated Interim Statements of Income

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenue (Note 10)	**9,280,444**	9,114,536	**3,139,090**	3,083,547	12,231,830
Costs and expenses					
Depreciation and amortisation	**1,322,676**	1,400,831	**445,344**	469,201	1,864,035
Salary	**1,757,025**	1,714,759	**597,354**	575,654	2,586,437
Operating and general expenses (Note 11)	**4,307,330**	4,360,539	**1,474,948**	1,503,019	5,966,616
Other operating expenses (income), net	**70,077**	45,988	**25,647**	(24,585)	249,540
	7,457,108	7,522,117	**2,543,293**	2,523,289	10,666,628
Operating profit	**1,823,336**	1,592,419	**595,797**	560,258	1,565,202
Financing costs					
Financing expenses	**689,718**	581,633	**368,802**	154,510	694,393
Financing income	**(424,586)**	(300,188)	**(234,850)**	(65,006)	(356,425)
Net financing expenses	**265,132**	281,445	**133,952**	89,504	337,968
Profit after net financing expenses	**1,558,204**	1,310,974	**461,845**	470,754	1,227,234
Equity in profits of investees accounted by the equity method	**2,405**	6,932	**761**	2,919	11,184
Profit before income tax	**1,560,609**	1,317,906	**462,606**	473,673	1,238,418
Income tax	**504,936**	455,004	**132,240**	177,377	488,393
Profit for the period	**1,055,673**	862,902	**330,366**	296,296	750,025
Attributable to:					
The shareholders of the Company	**1,015,040**	915,742	**255,198**	312,934	808,995
Minority interest in consolidated companies	**40,633**	(52,840)	**75,168**	(16,638)	(58,970)
Profit for the period	**1,055,673**	862,902	**330,366**	296,296	750,025
Earnings per share					
Basic earnings per share (in NIS)	**0.39**	0.35	**0.10**	0.12	0.31
Diluted earnings per share (in NIS)	**0.38**	0.35	**0.09**	0.12	0.31

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

Condensed Consolidated Interim Statements of Recognised Income and Expense

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Net change in fair value of financial assets classified as available for sale	**9,364**	(186)	**4,751**	(2,073)	(1,464)
Net change in fair value of financial assets classified as available for sale and transferred to profit and loss	**-**	(5,218)	**-**	-	(5,218)
Actuarial gains from a defined benefit plan (1)	**-**	-	**-**	-	3,427
Taxes in respect of income and expenses charged directly to equity	**(2,236)**	1,566	**(559)**	633	2,227
Income and expenses charged directly to equity	**7,128**	(3,838)	**4,192**	(1,440)	(1,028)
Profit for the period	**1,055,673**	862,902	**330,366**	296,296	750,025
Total recognised profits for the period	**1,062,801**	859,064	**334,558**	294,856	748,997
Attributed to:					
The shareholders' of the Company	**1,022,168**	911,904	**259,390**	311,494	807,967
Minority interest in consolidated companies	**40,633**	(52,840)	**75,168**	(16,638)	(58,970)
Total recognised income for the period	**1,062,801**	859,064	**334,558**	294,856	748,997

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

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

Condensed Consolidated Interim Statements of Cash Flows

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Cash flows from operating activities					
Profit for the period	**1,055,673**	862,902	**330,366**	296,296	750,025
Adjustments:					
Depreciation	**1,115,820**	1,205,721	**375,023**	397,975	1,591,054
Amortisation of intangible assets	**191,372**	176,375	**65,389**	64,544	247,557
Amortisation of deferred and other charges	**15,484**	18,735	**4,932**	6,682	25,424
Loss (gain) from decrease in holdings in associates	**1,372**	(614)	**1,026**	(30)	(595)
Financing costs, net	**416,786**	265,459	**228,870**	25,705	440,429
Equity in profits of investees accounted by the equity method	**(2,405)**	(6,932)	**(761)**	(2,919)	(11,184)
Net capital gain	**(7,154)**	(32,389)	**(1,693)**	(24,415)	(159,017)
Share-based payment transactions	**-**	-	**-**	-	286,506
Payments to a former senior officer	**5,750**	-	**-**	-	-
Income tax expenses	**504,936**	455,004	**132,240**	177,377	488,393
Change in inventory	**12,765**	38,167	**38,352**	36,536	23,014
Change in trade receivables	**(304,013)**	(3,819)	**(195,369)**	(31,064)	109,100
Change in other receivables	**(25,890)**	14,937	**(264)**	24,264	(107,854)
Change in trade payables	**17,607**	65,215	**225**	46,866	(56,778)
Change in suppliers	**(124,995)**	(138,204)	**4,182**	(10,908)	(79,046)
Change in provisions	**67,712**	(2,552)	**22,474**	2,856	27,327
Change in broadcasting rights	**(54,959)**	(23,425)	**(18,649)**	11,061	(14,517)
Change in employee benefits	**(212,133)**	(194,031)	**(20,376)**	(33,920)	168,758
Change in deferred and other income	**(8,501)**	(3,198)	**125**	(3,676)	11,509
	2,665,227	2,697,351	**966,092**	983,230	3,740,105
Interest received	**100,488**	174,582	**30,415**	47,275	220,078
Dividend received	**3,418**	26,010	**334**	-	26,010
Income tax paid	**(326,207)**	(210,188)	**(101,817)**	(66,902)	(277,573)
Net cash from operating activities	**2,442,926**	2,687,755	**895,024**	963,603	3,708,620
Cash flows from investing activities					
Investment in intangible assets	**(132,181)**	(130,693)	**(40,053)**	(48,690)	(209,733)
Proceeds from sale of property, plant and equipment	**133,278**	23,336	**16,883**	10,431	47,804
Proceeds from realisation of deferred expenses	**4,213**	272	**-**	-	-
Current investments, net	**18,667**	78,487	**11,292**	171,156	1,491,439
Purchase of property, plant and equipment	**(680,956)**	(698,667)	**(270,630)**	(187,412)	(953,226)
Investment in deferred expenses and others	**(23,934)**	(12,032)	**(21,319)**	(6,667)	-
Proceeds from realisation of investments and long-term loans	**48,967**	56,598	**15,587**	44,710	62,729
Purchase of investments and long-term loans	**-**	(18,184)	**-**	(5,856)	(19,723)*
Acquisition of a subsidiary	**(12,468)**	-	**-**	-	-
Net cash from (used in) investment activities	**(644,414)**	(700,883)	**(288,240)**	(22,328)	419,290

* Reclassified

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

Condensed Consolidated Interim Statements of Cash Flows (contd.)

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Cash flows for financing activities					
Receipt of loans	**50,000**	-	**-**	-	50,000
Issuance of debentures	**1,814,415**	-	**1,057,602**	-	-
Repayment of debentures	**(1,902,055)**	(262,081)	**(1,805,181)**	(83,025)	(280,350)
Repayment of loans	**(753,825)**	(1,145,132)	**(605,162)**	(757,869)	(1,268,656)
Short-term credit, net	**(55,640)**	65,500	**(32,871)**	9,922	43,146
Dividends paid	**(2,099,920)**	(1,200,000)	**-**	-	(1,600,000)
Distribution of a dividend to the minority interest in a subsidiary , less minority interest transfers, net	**(3,928)**	-	**(3,928)**	-	-
Interest paid	**(357,008)**	(409,509)	**(158,437)**	(173,161)	(601,752)
Net cash used in financing activities	**(3,307,961)**	(2,951,222)	**(1,547,977)**	(1,004,133)	(3,657,612)
Net increase (decrease) in cash and cash equivalents	**(1,509,449)**	(964,350)	**(941,193)**	(62,858)	470,298
Cash and cash equivalents at the beginning of the period	**2,631,790**	2,158,773	**2,063,408**	1,256,603	2,158,773
Effect of fluctuations in the rate of exchange on cash balances	**(17,572)**	(5,943)	**(17,446)**	(5,265)	2,719
Cash and cash equivalents at the end of the period	**1,104,769**	1,188,480	**1,104,769**	1,188,480	2,631,790

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

Appendix to Condensed Consolidated Interim Statements of Cash Flows

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Appendix of non-cash activities					
Purchase of property, plant and equipment, and intangible assets	**109,444**	149,958	**109,444**	149,958	141,518
Sale of property, plant and equipment on credit	**55,079**	43,749	**55,079**	43,749	161,800

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

NOTE 1 – REPORTING ENTITY

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

B. On October 11, 2005, control in the Company was transferred from the State to Ap.Sb.Ar. Holdings Ltd. and the Company ceased to be a government company. The Company was declared a monopoly in the main areas in which it operates. An appeal filed by the Company was pending in the Antitrust Court against the non-revocation of its monopoly status in the basic telephony field; however, at the suggestion of the court (in view of the time elapsed since it was filed), the Company consented to withdraw the appeal and is considering its continued handling of the matter. All the segments of operation of the Group are subject to competition. The activities of the Group are, in general, subject to government regulation and control. It is expected that the said regulation and control, as well as the intensifying competition, including implementation of the number portability program, together with all the changes in the communications market, will have an adverse effect on the business results of the Group, an effect that the Group is unable to estimate.

NOTE 2 – BASIS OF PRESENTATION

A. The interim consolidated financial statements were prepared in accordance with the International Financial Reporting Standards ("IFRSs"), as required for the preparation of interim financial statements in accordance with IAS 34 – Interim Financial Reporting, and in accordance with Section 4 of the Securities (Periodic and immediate reports) Regulations, 5730-1970.

B. These reports should be reviewed in the context of the annual financial statements of the Company and its subsidiaries at December 31, 2006 and the year then ended, and their accompanying notes ("the annual financial statements"). The Group states in the notes to the interim financial statements only the material changes that have occurred from the date of the most recent annual financial statements until the date of these interim financial statements.

NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICY

The significant accounting policies applied in these financial statements are consistent with those applied in the annual financial statements for the year ended December 31, 2006, except as described in this Note.

A. Non-current assets held for sale

Non-current assets expected to be realised by way of sale and not by way of ongoing use, are classified as assets held for sale. These assets are presented according to the lower of the carrying value and the fair value, net of selling costs. Losses from impairment at the time of initial classification of an asset held for sale, and subsequent profits or losses as a result of the re-measurement, are charged to profit and loss. Profits are recognised up to the cumulative amount of a loss from impairment recorded in the past.

B. Initial application of accounting standards

Commencing January 1, 2007, the Group applies a number of standards and clarifications of the international accounting standards that have come into effect, as follows:

(1) IFRIC 7 – "Applying the Restatement Approach under IAS 29 – Financial Reporting in Hyperinflationary Economies", that relates to the application of IAS 29 when an economy becomes hyperinflationary for the first time, and in particular the accounting treatment of deferred tax.

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

B. Initial application of accounting standards (contd.)

(2) IFRIC 8 – "Scope of IFRS 2 – Share-based Payment", that relates to the accounting treatment of share-based payment transactions in which some or all of the goods or services received cannot be specifically identified.

(3) IFRIC 9 – "Reassessment of Embedded Derivatives", that determines that reassessment with regard to the need to separate an embedded derivative from a host contract will arise only when changes occur in the contract.

(4) IFRIC 11 – "Group and Treasury Share Transactions" is an interpretation dealing with the application of "IFRS 2 – Share-based Payment", in share-based payment transactions related to the equity instruments of the Group.

(5) IFRIC 10 – "Interim Financial Reporting and Impairment", prohibits the cancellation of an impairment loss that was recognised in a prior interim period in respect of goodwill, investment in an equity instrument or a monetary asset stated on a cost basis.

The implementation of the new standards has no effect on the results of the Group's operations and its financial position.

C. New standards during the period, prior to their implementation

(1) IFRIC 12 – "Segment Reporting Arrangements". This interpretation deals with the accounting treatment of operators from the private sector that provide public infrastructure assets and services. IFRIC 12 distinguishes between two types of arrangements for service concessions. In one, the operator receives a financial asset, an unconditional contractual right to receive cash or another financial asset from the government in exchange for the construction or upgrading of a public asset. In the other, the operator receives an intangible asset and the right to collect payment in return for the use of the public asset it constructs or upgrades. The right to collect payment from users is not an unconditional right to receive cash, since the amounts depend on the scope of use the public will make of the service. The interpretation will apply to annual periods commencing January 1, 2008, or thereafter, where early adoption is permitted. The adoption of IFRIC 12 is not expected to affect the financial statements of the Group.

(2) In June 2007 the IFRIC published Interpretation 13 regarding customer loyalty programs. The Interpretation addresses the accounting treatment of companies that grant benefits in the framework of customer loyalty programmes (e.g. "points" or "frequent flyer" plans) upon the purchase of goods or services. IFRIC 13 determines how companies should account for their obligation to provide in the future, free or discounted goods or services (benefits) to customers who are expected to utilize the benefits. The Interpretation will apply to annual periods commencing July 1, 2008, or thereafter. The adoption of IFRIC 13 is not expected to significantly effect the financial statements of the Group.

(3) In July 2007 the IFRIC published Interpretation 14 regarding "IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction". The Interpretation addresses three issues: a) When are reductions in future funding requirements or returns considered "available" in the context of IAS 19 – "Employee Benefits". b) How does a minimum funding requirement affect the availability of future reductions in contributions. c) When does a minimum funding requirement create a liability. The Interpretation will apply to annual periods commencing January 1, 2008, or thereafter. The adoption of IFRIC 14 is not expected to significantly affect the financial statements of the Group.

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

C. New standards during the period, prior to their implementation (contd.)

(4) IFRS 8 – “Segment Reporting” (“the Standard”) determines how a company should report on segment operations in its annual financial statements, and addresses selected details pertaining to segments in interim reports. In addition, the Standard addresses the disclosure required regarding products and services, geographic regions and major customers. The Standard determines that the identification of segments will be based on the reporting to the management that is used to make operational decisions. The Standard will apply to annual periods commencing January 1, 2009, or thereafter. The Standard permits early adoption, and requires amendment of comparative numbers on its adoption. The adoption of IFRS 8 is not expected to significantly affect the financial statements of the Group.

(5) In March 2007 an amendment to IAS 23 – “Borrowing Costs” (“the Standard”) was published. The amendment removes the possibility of immediate recognition of all borrowing costs to profit and loss where the specific borrowing costs were generated from the purchase, establishing or production of a recognised asset. The amendment to the Standard requires that such costs be capitalised as part of the total cost of the asset. The remainder of the borrowing costs will be recorded to profit and loss when they arise. The Standard will apply to annual periods commencing January 1, 2009, or thereafter, and is not expected to have a significant effect on the financial statements of the Group.

(6) In September 2007, the IASB published a revised version of IAS 1 – Presentation of Financial Statements ("The Revised IAS 1"), which replaces the 2003 version of the standard. The changes include a requirement to collate the information in the financial statements on the basis of common criteria, and to present a comprehensive income statement. The Revised IAS 1 permits, in the preparation of financial statements, the presentation of income and expense items in one of the following reports:
Presentation of a single report on comprehensive income (a combined report of profit and loss and other comprehensive income), or presentation in two separate reports – a profit and loss report and a comprehensive income report. The changes also include changes in the headings of some of the reports so as to reflect the purpose more clearly (for example, the name "Balance sheet" will be changed to "Statement of Financial Position"). It should be noted that The Revised IAS 1 will require the presentation of the Statement of Changes to Shareholders' Equity as a principal report. The Revised IAS 1 will apply to annual periods commencing January 1, 2009 or thereafter. Early adoption is permitted. The adoption of the Revised IAS 1 is not expected to significantly affect the financial statements of the Group.

NOTE 4 – ESTIMATES

The preparation of interim financial statements requires Management to make judgments and use estimates, assessments and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.
The significant estimates applied in these interim statements do not differ significantly from those applied in the annual financial statements.

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

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

	Consumer Price Index	Rate of exchange of the US dollar	Rate of exchange of the euro
	%	%	%
For the nine-month period ended on:			
September 30, 2007	**2.29**	**(5.02)**	**2. 26**
September 30, 2006	0.78	(6.54)	0.16
For the three-month period ended on:			
September 30, 2007	**1.30**	**(5.55)**	**(0.41)**
September 30, 2006	(0.76)	(3.11)	(3.34)
For the year ended December 31, 2006	(0.10)	(8.21)	2.16

NOTE 6 – PROPERTY, PLANT AND EQUIPMENT

During the reporting period, the Group companies initiated examination of the useful lives of property, plant and equipment, in order to determine whether significant circumstances exist that justify changing their estimated useful lives.

The findings of the examination to date indicate that the Company's intention to replace switches in its landline network necessitates shortening the useful lives of these switches. As a result, depreciation expenses will increase in 2007 by approximately NIS 18 million, in 2008 by approximately NIS 18 million and in 2009 by approximately NIS 14 million, before tax.

NOTE 7 – GROUP ENTITIES

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

(1) Since commencing its operations, DBS has accumulated considerable losses. Its losses in 2006 amounted to approximately NIS 320 million and the loss in the nine-month period ended September 30, 2007, amounted to approximately NIS 43 million. As a result of these losses, its capital deficit and its working capital deficit at September 30, 2007 amounted to approximately NIS 2,555 million and NIS 1,040 million, respectively. The profit for the three-month period ended September 30, 2007, amounted to approximately NIS 70 million.

The Company's investment in DBS (primarily through shareholders' loans) at the balance sheet date amounts to approximately NIS 1,562 million (without interest and linkage). The balance of the current debt of DBS to the Company and its subsidiaries amounts to approximately NIS 126 million, of which approximately NIS 98 million is owed to the Company. The Company has come to an arrangement with DBS for the collection of a debt balance of approximately NIS 55.6 million which was in arrears. In accordance with the arrangement, the debt is being paid in 60 equal monthly instalments plus interest at prime + 1.5%. At the balance sheet date, the debt balance in the arrangement is approximately NIS 44 million. The remainder of the debt to the Company, over and above the aforementioned arrangement, is a current debt balance, for which the agreed terms of payment are the regular credit terms in effect between the Company and its customers. As of the date of approval of the financial statements, DBS is not in compliance with the arrangement and with the credit terms. Bezeq and its subsidiary are taking action to collect DBS debts in arrears.

During 2005, the banks made available the full credit line to which DBS was entitled under the financing agreements.

NOTE 7 – GROUP ENTITIES (CONTD.)

A. D.B.S. Satellite Services (1998) Ltd. (Contd.)

(1) (Contd.)

The terms of the loans and the credit line that DBS received form the banks, whose balance at September 30, 2007, is NIS 909 million, imposes various restrictions on DBS, which include, *inter alia*, restrictions concerning the lien or sale of certain assets, a restriction on receipt of credit from other banks without prior approval, a restriction on repayment of shareholder loans, and a requirement to meet certain financial criteria ("the Conditions").

On July 22, 2007, DBS and the banks signed the Eighth Addendum ("the Addendum") to the financing agreement. The following issues, among others, are addressed in the Addendum:

(a) The Conditions from the financing agreement were updated.

(b) Under the Addendum, NIS 100 million of the monies raised from DBS's issue of debentures in July 2007 (see below) were assigned to be used by DBS for repayment of part of the bank credit, for repayment of the loan taken by DBS from an institutional body in 2006 (including a bridge loan extended by that body to DBS in June 2007). In addition, the monies would be used for DBS's current operations.

At September 30, 2007, DBS is not in compliance with the financial criteria set for it. Subsequent to the balance sheet date, DBS was granted relief in connection with the criteria at September 30, 2007, and accordingly, at the date of approval of the financial statements, DBS is in compliance with the criteria set in the financing agreement.
Since DBS prepares its financial statements according to IFRSs, which require review of its compliance with the Conditions at the date of the financial statements, the loans are classified at September 30, 2007, as short-term liabilities.
The management of DBS foresees that since the financial stipulations are cumulative, it will be compelled to seek further relief in connection with those stipulations at December 31, 2007.
DBS's management estimates that the sources of financing available to it will provide it with the operational requirements of DBS for the coming year, and if additional resources are required to meet those needs in the coming year DBS will act in accordance with the alternative business plan which does not require additional resources beyond those at its disposal.

On July 31, 2007, DBS issued through a private placement to institutional investors Debentures (Series A) at an inclusive par value of approximately NIS 620 million, that will be registered in the TACT-institutional system (TACT – Tel Aviv Continuous Trading) of the Tel Aviv Stock Exchange. Prior to the issuance, the debentures were rated by Maalot – The Israel Securities Rating Company Ltd. ("the Rating Agency") at BBB-/stable. The proceeds from the issuance amount to approximately NIS 614 million net.

The debentures will be repaid in 8 annual principal and interest payments every 5th of July in each of the years 2010 to 2017. The principal payments in each of the years 2010 to 2013 will be at a rate of 8% of the par value of the debentures, and the principal payments in each of the years 2014 to 2017 will be at a rate of 17% of the par value of the debentures. The debentures are linked to the consumer price index commencing from the June 2007 index, and bear linked annual interest at 7.9% p.a. (subject to various possible adjustments according to the debenture terms), that will be paid in semi-annual payments in January and July of each of the years 2009 – 2017.

DBS did not undertake to list the debentures on the stock exchange, but in the event that they are listed, the annual interest to be paid on them commencing on the listing date will be reduced to 7.4%. Conversely, if the debentures are not listed until July 31, 2008, the linked annual interest paid thereon will be increased to 8.4% as long as they are not listed (and in the event of subsequent listing, the linked annual interest rate will be reduced to 7.4% commencing on the listing date). If the rating of the debentures is lowered by two rating levels while the debentures are not listed, the linked annual interest rate will be increased to 8% until the debentures return to their original rating or until they are listed on the stock exchange (in this case, the aforesaid interest rate decrease will also apply).

NOTE 7 – GROUP ENTITIES (CONTD.)

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

(1) (contd.)

In addition, should DBS fail to comply with the Conditions set in the financing agreement between it and the banks, and as a condition for the banks ceding that breach, DBS will undertake to pay to the banks, for the bank credit, additional interest to that of the banking interest margin, and if the debentures are not listed at that time, then as long as that margin supplement is paid to the banks and the debentures are not listed, DBS will pay the debenture-holders an annual interest supplement at the same rate.

The debentures are secured by an unlimited first ranking floating charge on all of DBS's assets (other than exceptions as dictated by the provisions of the Communications Law) and additionally. an unlimited first ranking fixed charge on DBS's rights and assets that were registered by it in favour of banks (other than exceptions as dictated by the provisions of the Communications Law). These securities are first ranking and *pari passu* to the floating charges and the fixed charge registered by DBS in favour of the banks in order to secure the bank credit.

In October 2007, the Rating Agency announced that the debentures had been placed on the watch list following disruptions in DBS's broadcasts as described in section 3 below, which it claimed had led to expenses being higher than forecast, to deviation from DBS's business plan, and to the filing of a number of legal claims against it. The Rating Agency notes that it will review the effects of the events on the present rating, and will publish its conclusions after doing so.

On October 21, 2007, DBS received an enquiry from the trustee of the debentures, in which, following the disruptions in various broadcasts and the publicity about them, including regarding falling DBS subscriber numbers and regarding the compensation granted by DSB to its subscribers, he has requested various documents and confirmations from DBS in order to clarify whether the aforementioned events and their long-term implications could harm DBS's undertakings towards the debenture holders.

During 2005-2006, DBS received loans from institutional bodies amounting to NIS 100 million.
In December 2006, DBS signed an agreement with another institutional body for receipt of a loan of NIS 50 million. DBS was granted an option for an additional loan in the same amount. DBS exercised the option in June 2007. Following the issue of debentures described above, the loan agreement was amended and the parties agreed that DBS would repay the principal of the loan, NIS 100 million, upon receipt of the proceeds of the issuance, since the institutional body had purchased debentures in the issuance. The loan was repaid during the reporting period in accordance with the foregoing.

Loans provided by shareholders to DBS were included in the financial statements of DBS at their fair value at the date of receipt. The fair value of the loans was determined according to the present value of the anticipated cash flows to be received as repayment of the loans, taking into account the dates on which the shareholders will first be able to demand repayment of the loans (according to the restrictions to which the shareholders agreed in agreements with the banks and the financial institutions), and at the interest rates that applied to loans at a similar risk level on the date of receipt of the loans. The interest rate taken into account as aforesaid, which is the effective interest rate for loans, is 12%.

As part of the DBS debenture rating process with the Rating Agency, it was agreed to defer the dates on which the shareholders could first demand repayment of the loans.
When a change occurs in the terms of the loans which results in a change of more than 10% in the discounted cash flows calculated at the original interest rate, the difference between the cash flows expected before the change, discounted at the rate of interest on the date of providing the loans, and their discounted value at the rate of interest on the date of the change, is charged to financing income. The difference between the present value of the new cash flows when discounted according to the interest rate on the date of the change in the old cash flows, discounted at the interest rate on the date of the change, will be charged to a capital reserve as part of the DBS shareholders' equity. Differences relating to loans provided by the minority shareholders in DBS are expected to influence the financing expenses in the consolidated report in the future, while increasing the loss that will be attributed to the minority in DBS.

NOTE 7 – GROUP ENTITIES (CONTD.)

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

(1) (contd.)

The interest rate on the date of the change was set in accordance with a professional opinion that DBS received from an external adviser, which stated that the interest rate for discounting the interest-free shareholder loans is 15.63%, and the interest rate for discounting the shareholder loans bearing 5.5% interest is 15.58%.
These rates were applied for charging the difference between the cash flows expected before the change, discounted at the interest rate on the date of provision of the loans – 12%, and their discounted value at the interest rate on the date of the change – 15.63% or 15.58%, as the case may be, to financing income in the amount of approximately NIS 213 million in the financial statements of DBS and approximately NIS 96 million in the consolidated financial statements.

The difference between the present value of the expected cash flows according to the new repayment dates and the present value of the cash flows that were expected according to the repayment dates prior to the change, discounted at the interest rate on the date of the change, 15.63% or 15.58%, which amounted to NIS 348 million, was charged to a capital reserve in the financial statements of DBS, of which approximately NIS 159 million was charged as the minority interest in the consolidated financial statements.

(2) On January 2, 2005, the Antitrust Commissioner gave his conditional approval for a merger of the Company and DBS (increasing the Company's holdings in DBS to more than 50%). The merger was not executed within a year from the date of the approval, and a new approval was required. On August 2, 2006, the Company and DBS submitted new merger notices to the Antitrust Commissioner, regarding the Company exercising options for shares in DBS, which would increase the Company's holdings in DBS from approximately 49.8% to approximately 58%. On December 31, 2006, the Antitrust Authority gave notice of the Commissioner's opposition to the merger, and on February 18, 2007, it gave its reasons for the opposition. On May 15, 2007, the Company filed an appeal against the decision. The Antitrust Commissioner submitted her response to the appeal and the file has been set for hearing of evidence in January 2008.

Further to Note 32(3) to the financial statements at December 31, 2006, regarding the petition of the Company and DBS to the High Court of Justice against the Minister of Communications in the matter of restrictions imposed on the Company's investments in DBS – the petition was dismissed in September 2007.

(3) On September 5, 2007, sporadic disturbances were observed in DBS's broadcasts, which occurred in waves of various strength and extent, which caused disruptions of varying severity in the quality and availability of those broadcasts, mainly in the north of the country and the coastal plain. The disturbances also resulted in exceptional loads on the DBS's customer service centres, which made it difficult to obtain service. In order to locate the source of the disturbances, DBS, in cooperation with experts and with various government bodies, dispatched crews to identify and pinpoint the disturbances. To the best of DBS's knowledge and as reported to it by government entities following the identification operations, the source of the disturbances was an external entity beyond DBS's control and unrelated to it. The disturbances ceased on October 9, 2007, and have not recurred up to the date of this report.

On October 5, 2007, in a gesture to its customers, DBS opened its DVD BOX for free viewing for two weeks. On October 16, 2007, DBS opened most of its content channels, including various Premium channels for three months, as compensation for the event, and subscribers who purchase separately those Premium channels in their contract with DBS, that were broadcast free of charge will be credited for that payment.

The compensation and other expenses and damages sustained by DBS in connection with the disturbances described above, are liable to have an adverse effect on the financial results of DBS.
These financial statements include an appropriate provision in respect of the expenses incurred by DBS regarding the compensation for the reporting period. Regarding a class action lawsuit filed against DBS in connection with the broadcast disturbances, see Note 8A(12).

NOTE 7 – GROUP ENTITIES (CONTD.)

B. Bezeq International Ltd.

Further to Note 32(4) to the Group's 2006 financial statements, concerning an agreement with Bezeqcall Communication Ltd. for the acquisition of all the operations of Tadiran – Telecom Communication Services in Israel ("Tadiran") in consideration of approximately NIS 93 million, the agreement was cancelled in light of the decision of the Antitrust Authority to withhold approval of the transaction and following Tadiran's announcement of its decision to cancel the agreement.

NOTE 8 – CONTINGENT LIABILITIES

A. Claims

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

In the opinion of the managements of the Group companies, which is based, *inter alia*, on legal opinions regarding the probability of success of the claims, including the applications for certification of the class action lawsuits, appropriate provisions in the amount of NIS 355 million, where such provisions were required, have been included in the financial statements to cover the exposure resulting from such claims.

In the opinion of the managements of the Company and the consolidated companies, the additional exposure (in addition to the above provisions) at September 30, 2007, due to claims filed against the companies in the Group on various matters and the probability of realisation of which is remote or likely, amounts to approximately NIS 29 billion, of which approximately NIS 3.4 billion relates to claims filed by employees.

Concerning applications for certification as class action lawsuits in respect to which the Group has exposure beyond the aforesaid (since the claims do not state a specific amount), see claims in Note 17A(4), (5), (7) and (19) to the financial statements at December 31, 2006.

For a detailed description of these claims, see Note 17A to the Group's annual financial statements at December 31, 2006. Details of the significant changes to the status of the material contingent liabilities of the Group since December 31, 2006, are provided below:

(1) Further to Note 17A(4) to the financial statements at December 31, 2006, on April 10, 2007, a decision was given, granted effect to the procedural arrangement in which the Company and Bezeq International will be struck off the claim (after undertaking to transfer any sum transferred to them by the Department of Customs and VAT, if transferred, in connection with the claim, as instructed by the court).

(2) Further to Note 17A(15) to the financial statements at December 31, 2006, concerning a claim filed by subscribers of the Company, Cellcom, Partner and HOT against those companies, with an application for its certification as a class action lawsuit, on September 10, 2007, a court decision validated a procedural arrangement whereby the claim against the cellular companies would be struck off and the hearing of the application for certification of the claim would be combined with another application for certification which was filed against the cellular companies.

(3) Further to Note 17A(2)(c) to the financial statements at December 31, 2006, concerning a claim in the matter of the inclusion of a number of components as part of the regular wage for pension, following a court decision dismissing the claim, an appeal on the matter is being heard.

NOTE 8 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(4) Further to Note 17A(18) to the financial statements at December 31, 2006, on June 11, 2007, a hearing was held at which the court proposed that Bezeq International publish an apology and make some kind of contribution to the community. On June 24, 2007, Bezeq International delivered a notice to the court, stating that there is no room for an apology or such an apology or contribution is misplaced, since there was no deceit and/or misleading advertising. Bezeq International also stated that in view of its respect for the court, it would make a donation, unrelated to the class action lawsuit. On August 23, 2007, the Supreme Court ruled that the parties should give notice of whether they see need for a hearing in the presence of the parties. On August 26, 2007, Bezeq International gave notice that it sees a need for an additional hearing, in order to present the facts relevant to the proceeding and to explain that in view of the gravity of the evidence, the claim should not be certified as a class action lawsuit.

(5) Further to Note 17A(27) to the financial statements at December 31, 2006, regarding application for certification of a class action against Pelephone concerning the deception to subscribers who reside in Eilat, who were charged VAT for cellular communication service, the claim was dismissed without an order to pay costs.

(6) Further to Note 17A(8) to the financial statements at December 31, 2006, regarding a claim and application for certification as a class action concerning the installation of splitters for high speed internet lines which was dismissed, and an appeal filed against that decision, in October 2007 a decision was given to strike out the petition by consent.

(7) In May 2007, the Company received a claim, together with an application for its certification as a class action that was filed with the District Court in Tel Aviv by a plaintiff claiming to have purchased shares of the Company in 2006. The claim was filed against the Company, two former CEOs of the Company, directors who served or are serving in the Company during the relevant period, as well as Ap.Sb.Ar. Holdings Ltd., which holds 30% of the Company's shares.

The claim alleges that the Company's financial statements for the years 2004 and 2005 contained false and misleading material information, including with regard to the annual profit, the property, plant and equipment and the shareholders' equity, in light of a retroactive deduction of approximately NIS 320 million in respect of property, plant and equipment that was not in use by the subsidiary Pelephone Communications Ltd.

The amount of the personal claim is NIS 194, and the total amount of the claim for the group is NIS 56.5 million.

(8) In April 2007, an application was filed with the District Court for certification of a class action against DBS and against Sports Channel Ltd. (the producer of Channel 5, Channel 5+, Channel 5 live and Channel 5 Gold) and its managers, in connection with the broadcasts of Channel 5 live ("the Certification Application"). According to the applicant, the broadcasts of Channel 5 live involve the transfer of content from Channel 5+ to Channel 5 live, which contravenes "the basic promise of DBS as ratified in earlier legal proceedings". The applicant, whose cause of claim against DBS is violation of a contractual undertaking, breach of the duty of good faith in a contractual engagement and unjust enrichment, estimates the amount of the action at approximately NIS 63 million.

(9) In June 2007, a financial action and application for certification as a class action was filed against Pelephone in the Tel Aviv District Court. The aggregate amount of the claim is approximately NIS 239 million, and it relates to a group of Russian customers and the bundles of services offered to them.

NOTE 8 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(9) (contd.)

The action alleges deceit when making the agreement with the customer, conduct of bad faith and continuous misleading in that the customer was offered a subscription to the service track without being warned that the charge is based on rounding up to 60 seconds, rather than on 12 second units (which, according to the plaintiffs, is required by the provisions of the license). In addition, it is alleged that Pelephone did not attach the price list to the track as required by its license, and did so to reinforce the purpose of the deceit.

(10) In August 2007, the Company received a claim together with an application for certification as a class action, which was filed against the Company in the Tel Aviv District Court by a plaintiff alleging to be a customer of the Company who signed a contract with the subsidiary DBS for receipt of high-speed internet infrastructure services (ADSL). The plaintiff is seeking reimbursement of all the fixed monthly payments he made for maintaining a landline for which he no longer has any use, since he contends that these payments were collected unlawfully since from the technological aspect, high-speed internet can be provided without the landline being used. According to the plaintiff, all the Company's customers and/or of DBS who subscribed to the Company's high-speed internet service during the past two years and who requested that the Company's landline be disconnected and/or who ceased to use it but continued making the fixed monthly payments for it, have the right of such a claim. The plaintiff is seeking certification of the claim as a class action in the name of the customers referred to above, and he estimates the amount of the class action at approximately NIS 108 million.

(11) In September 2007, a financial claim was filed against Pelephone in the Be'er Sheva District Court, with an application for its certification as a class action. The amount of the claim is approximately NIS 600 million, and it concerns restitution of amounts at which Pelephone customers were charged for calls transferred to the internal answering service of the handset called, and without an announcement as required by Pelephone's license, On October 28, 2007, an application was filed by the plaintiff's lawyer to strike the claim, in which it states that it is withdrawing the claim with the consent of Pelephone, without an order for costs.

(12) Subsequent to the balance sheet date, two applications were filed in the District Court against DBS, for certification of filed claims as class action lawsuits concerning disruptions in broadcasts, as described in Note 7A(3) above.
The plaintiffs in these claims allege that DBS subscribers were subjected to daily disruptions and long interruptions in television broadcasts, which were reflected, *inter alia*, in severe picture and voice distortion, and that DBS's service centre was not operating and neither service nor assistance were available.
The plaintiffs are seeking approval, on behalf of all DBS subscribers at that time, for restitution, compensation or credit of the full amount of the monthly subscription fees paid to DBS for September 2007. The plaintiffs assess the total amount of one claim at NIS 122 million, and of the other claim at approximately NIS 66 million.

(13) In July 2007, a statement of defence was filed on behalf of an entity sued by DBS, and together with that statement the entity also filed a statement of counter-claim for the sum of approximately NIS 43 million against DBS and another company. The statements of defence and counter-claim alleged that the liability for failures in decoders provided to DBS is not that of the entity but of DBS and/or the other company, since, *inter alia*, the decoders were not properly characterised by the defendants, were not properly inspected, and in at least some of the cases were not properly installed in DBS subscribers' homes. Due to these allegations, various losses were allegedly sustained by the counter-claimant, related to repair of the decoders even after the contractual warranty period, for the supply of spare parts, providing service and manpower, and various payments made to the other company. Alternatively, the counter-claimant is suing for its lost expenses and loss of profit, which is alleges are due to the acts of commission and omission of DBS and/or the other company.

NOTE 8 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(13) (contd.)

On November 1, 2007, DBS filed an application for amendment of the statement of defence and statement of counter-claim filed by the aforementioned entity, since they are not in compliance with civil procedures. Concurrently, DBS filed an application to postpone the date for filing a response and the statement of counter-claim on their behalf until a decision is made on the application for such an order. No decisions have yet been given on these applications.

B. Claims which cannot yet be assessed or in respect of which exposure cannot yet be calculated

For a detailed description of the claims which cannot yet be assessed or in respect of which the exposure cannot yet be calculated, see Note 17B to the Group's annual financial statements at December 31, 2006. Details of material changes since December 31, 2006 are provided below:

In September 2007, a claim was filed against the Company in the Tel Aviv District Court, with an application for certification as a class action, concerning the collection of VAT on arrearage interest and on charging collection expenses and commissions. The amount of the class action lawsuit is estimated at approximately NIS 114 million.

C. Other contingencies

For a detailed description of other contingencies, see Note 17C to the Group's annual financial statements at December 31, 2006. Details of material changes since December 31, 2006, are provided below:

(1) In May 2007, the Company received a letter pursuant to Section 194 of the Companies Law, which was sent by a claimant who said she is a holder of the Company's publicly owned shares. According to the request, following the findings of the external examiner appointed by the Company to examine the manner in which various decisions are made and as well as the management of the Company, that point to a multitude of shortcomings and failures related directly to the work of the Board of Directors, its committees, its members and the former CEO of the Company, the Company is requested to institute legal proceedings against the Board of Directors and the Company's other officers who were responsible for those shortcomings and failures. The Company's Board of Directors rejected the demand outright, and informed the claimant to that effect.

(2) Further to Note 17C(2) to the Group's annual financial statements for the year 2006, regarding commissions paid to DBS and the debts of DBS to the Company, the Company's Board of Directors rejected the demand and informed the claimant to that effect. In addition, the Company received another letter, dated September 20, 2007, from the same shareholder, made pursuant to Section 194 of the Companies Law, demanding that the Company institute legal proceedings against members of the Board of Directors of the Company who, according to the writer, approved injections of funds from the Company to DBS, contrary to the decisions of the Ministers of Communications, as a result of which the Company suffered losses of NIS 10 million (which is the amount that the Ministry of Communications notified at the time that it is considering foreclosing from the Company's guarantee). The Board of Directors of the Company discussed this letter and decided to reject it. It is noted that the petitions of the Company and DBS to the High Court of Justice against the Minister of Communications in the matter of the Company's injections of funds into DBS, were dismissed *in limine* in September 2007.

NOTE 8 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (contd.)

(3) Further to Note 17C(1) to the Group's annual financial statements for the year 2006, the Antitrust Authority announced that its investigation was complete. On May 27, 2007, the Antitrust Commissioner announced that the Authority was considering taking action under Section 43(A)(5) of the Antitrust Law, 5748-1988, to determine that the Company had abused its status, thereby violating the provisions of Section 29A of that law. This is in view of the findings of an investigation carried out by the Investigation Department of the Antitrust Authority.

The Commissioner announced that she is considering ruling that:

a. In the first half of 2006, and in particular in April and May 2006, the Company's employees instituted sanctions, in which they delayed or failed to carry out works involving the connection of domestic operators (Cellcom, Globecall, Golden Lines) to the Company's network.
b. During the afternoon of May 17, 2006, the existing connection between HOT Telecom and the Company's network was disconnected and was not repaired, due to sanctions of Company employees, until the night of May 18, 2006.
c. The Company failed to act as required in order to prevent or minimise these events and the ensuing damage to domestic operators, to competition and to the public.
d. In this way, the Company abused its status, in contravention of Section 29A of the Law.

It is noted that under Section 43(e) of the Antitrust Law, the Antitrust Commissioner's aforementioned ruling, if and insofar as made, shall serve as *prima facie* evidence of its contents in any legal proceeding.

In September 2007, the Company submitted its position with regard to the Commissioner's notice, in which it contends, *inter alia*, that the proscriptions against a monopoly to make unreasonable refusal and to abuse its status in the market, do not apply to a monopoly operating as an employer in a labour dispute with its employees.

It is noted that in May 2006, a claim and application for its certification as a class action was filed against the Company and the cable companies, concerning a fault in the telephone line in the HOT network on May 17, 2006. On this matter, see Note 17A12 to the financial statements of the Company at December 31, 2006. The Commissioner's determination as noted above, if and insofar as will be made, will mean re-examination of the assessment in that claim, this being based on the contents of the determination and the extent of its implications on the matter in dispute.

(4) Further to Note 17C(7) to the Group's annual financial statements for the year 2006, concerning number portability, on May 24, 2007 the Company received a notice from the Director General of the Ministry of Communications, stating that he is considering imposing on the Company a financial sanction due to the alleged violation of the duty to provide number portability commencing September 1, 2006, as follows:

a. For the period from September 1, 2006 to the date of the Director General's notice – a financial sanction in the amount of NIS 2,031,750.
b. For the period from May 25, 2007 to November 30, 2007 or until the date of remedy of the alleged violation (the earlier of the two) by the Company – NIS 6,450 for each additional day on which the violation continues.
c. For the period from December 1, 2007 (which, according to the notice, allows the relevant licensees reasonable time to remedy the alleged violation) to the date of remedy of the alleged violation – a financial sanction as specified in Sections 37B(b) and 37C(a) of the Communications Law after Amendment 36 (it is noted that according to the provisions of these Sections, the relevant sanction rate is seven times the penalty set in Section 61(a)(4) of the Penal Law (i.e. NIS 202,000), plus 0.25% of the annual income of the Company, plus a financial sanction of one fiftieth of such sanction for each day on which the violation continues.)

NOTE 8 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (contd.)

(4) (contd.)

The subsidiaries Pelephone and Bezeq International received similar notices. According to the notices from the Ministry of Communications, Pelephone and Bezeq International were given the opportunity to present their arguments to the Director General of the Ministry of Communications by September 24, 2007. In its response, the Company argued that its position does not constitute violation of the provisions of the Law or of its license, that the matter is pending before the High Court of Justice, and that in any case, in the circumstances, it would be unreasonable to impose sanctions on the Company, including in view of the date set by the Ministry of Communications as reasonable for the implementation of number portability (December 1, 2007). Pelephone and Bezeq International also responded to the notices of the Ministry of Communications. As noted in the financial statements at December 31, 2006, the Company and Pelephone (together with other cellular operators) petitioned the High Court of Justice on this matter, contending, *inter alia*, that it was the Ministry of Communications that had failed to prepare a number portability plan as required by the provisions of the law.

(5) Further to Note 17C(6) to the Group's annual financial statements for 2006, in the first half of 2007, the Company took steps to obtain operating permits from the Supervisor of Non-Ionizing Radiation at the Ministry of the Environment, pursuant to the Radiation Law that came into force at the beginning of 2007. Following these steps, the Company received operating permits for the communication facilities that it operates, with the exception of a small number which still have a valid radiation permit by virtue of the Pharmacists Regulations. The Company is taking steps to obtain operating permits under the Radiation Law for these few facilities.

D. Claims against an affiliated company

(1) In July 2007, a statement of claim was filed in the Jerusalem District Court against an affiliate of Bezeq International, the Israeli Police, the State of Israel, and 7 other defendants from the communications' field, for a total amount of more than NIS 65 million, for injuries allegedly sustained by the plaintiff, following publication of untruths and slander regarding the plaintiff's involvement in securities violations and conspiracy to commit murder. On October 22, 2007, the affiliate filed an application for deferral of the date for filing a statement of defence. In the opinion of the affiliated company and its legal advisors, since the claim is not supported by concrete evidence and since the affiliated company is not the principal party in the claim, the likelihood of success of the claim against the affiliated company is low, and therefore the affiliated company made no provision for this claim in its financial statements.

(2) On September 4, 2007, an application was filed in the Tel Aviv District Court for certification of a class action lawsuit against 70 respondents who include operators of e-trade sites, among them an affiliate of Bezeq International and suppliers who offered products for sale through those sites. According to the applicants, the respondents operate "fictitious bidders" who submit "fictitious bids" in auctions conducted on the sites, in order to prevent participants in the auctions from wining at prices the respondents consider to be too low, and in so doing, the applicants claim, they are acting in breach of contractor and deceit according to the Consumer Protection Law. The reliefs applied for by the applicants include orders prohibiting the respondents from interfering in auctions and financial reliefs which cannot be assessed.
On October 15, 2007 the court issued a temporary restraining order which includes prohibiting the deletion or changing of the sale data. In view of the preliminary stage of the proceeding, it is not possible to estimate the likelihood of the request being allowed.

NOTE 9 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES

A. Further to Note 29D to the Company's financial statements at December 31, 2006, concerning the cancellation of discount arrangements included in the agreement between the Company and the Ministry of Defence dated May 8, 2005 ("the 2005 agreement"), on April 22, 2007, the Company informed the Ministry of Communications and the Ministry of Defence of its decision to comply with this demand. It should be noted that the Company received a copy of the letter sent by the Ministry of Defence to the Ministry of Communications, that contained a request to freeze the instruction regarding cancellation of the discount arrangements set in the agreement between the parties, until the convening of a work meeting between the Ministry of Defence and the Ministry of Communication to discuss the matter. However, at the date of publication of this report, the Company has yet to receive a different instruction from the Ministry of Communications. It should be noted that in the Company's opinion, it was entitled to enter into the agreement in accordance with its general license. In addition, according to the Antitrust Authority's notice from August 2006, the agreement does not contravene the provisions of the Antitrust Law, and the Authority saw no justification, at that time, to insist on cancellation of the agreement. The Company notified the Ministry of Communications of the Antitrust Authority's position in August 2006.

It is further noted, that according to the agreement between the Company and the Ministry of Defence, whereby if one of the parties is unable to fulfil its undertakings as provided in the agreement due to a legal directive or a resolution of a competent authority, this shall not constitute a breach, and the parties will negotiate another agreement, the terms of which will reflect, to the extent possible, the wishes of the parties pursuant to the agreement. The Company requested an urgent negotiation meeting with the Ministry of Defence, but the request was not granted. On July 22, 2007 the Company informed the Ministry of Defence that commencing April 22, 2007, the Ministry of Defence would be charged based on rates set in a prior agreement with it, dated July 21, 2002 (hereinafter "the 2002 agreement"), and that this arrangement will apply unless otherwise agreed between the parties, or alternatively, unless an explicit directive is received from the Ministry of Communications, freezing or cancelling its previous directive to cancel the discount arrangement as provided in the agreement from May 8, 2005.. On August 5, 2007, the Ministry of Defence informed the Company that the settling of accounts between the Company and the Ministry of Defence according to the fees in the 2002 agreement, contradicts the provisions of the 2005 agreement, and that the Ministry of Defence pays its suppliers only according to agreements signed under the State Property Law. The Company is continuing to send invoices to the Ministry of Defence at the tariffs of the 2002 Agreement.

The Company is unable to assess the developments at this stage, and therefore the financial statements include income from the Ministry of Defence that is based on the rates provided in the 2005 agreement, which are estimated to be lower than the rates in the 2002 agreement and lower than the Company's regular rates (for the period from October 2005 to June 30, 2007).

B. Further to Note 26B to the financial statements at December 31, 2006, regarding stock options for the two employee-directors, on October 25, 2007, after approval by the Audit Committee, the Board of Directors of the Company discussed and resolved to approve an allocation of 59,574 stock options to the two aforementioned directors. The options constitute 0.00229% of the issued and paid up capital of the Company, and 0.00222% of the fully diluted issued and paid up capital of the Company. The value of the benefit for the two directors is estimated at approximately NIS 237,000. The allocation requires the approval of the general meeting of the Company.

C. Further to Note 29E to the financial statements at December 31, 2006, on July 29, 2007, an agreement was signed with a company owned and controlled by Ap.Sb.Ar., whereby the Company is granted regular management and consulting services in consideration of an annual fee of USD 1.2 million, during the period from October 11, 2005 to December 31, 2008.

NOTE 9 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

D. Further to Note 29H to the financial statements at December 31, 2006, on June 28, 2007, Ap.Sb.Ar., which owns 30% of the Company's shares, notified the Company that it has signed an agreement with the former CEO of the Company, Mr. Amnon Dick, whereby Ap.Sb.Ar. will pay him special compensation in the amount of NIS 5.750 million, as a gesture for his contribution to the Company. The compensation is recorded in the Company's books as a salary expense, and concurrently in a capital reserve from operations between a corporation and a controlling shareholder.

E. Further to Note 29G to the financial statements at December 31, 2006, in the matter of cancellation of the bonus for the former CEO, Mr. Yacov Gelbard, the Company resolved that if this bonus is not returned to the Company, it will institute legal proceedings for its recovery.

F. On October 25, 2007, after approval by the Audit Committee, the Board of Directors of the Company resolved to approve a retirement bonus of NIS 1.5 million for the former chairman of the Board, this being over and above the terms provided in the employment agreement with him. It is noted that payment of the bonus is contingent upon the approval of the general meeting of the shareholders of the Company. These financial statements include a provision for the bonus.

G. On November 14, 2007, the Board of Directors of the Company approved (after approval by the Board's Audit Committee) the continued engagement of the Company and the companies in the Group with an insurance company, in a policy insuring the liability of officers for a period of one year commencing October 11, 2007, at a limit of liability of up to $150 million per claim and in total for each year of insurance, plus cover of up to $30 million per claim and for all claims for the period of insurance in respect of litigation expenses in Israel only. The limit of liability for subsidiaries is up to $50 million (as part of the aforementioned limit of liability). The annual premium for the policy is $510,000. (It is noted that the scope of the insurance cover is the same as the officers insurance existing today in the Company, while the annual premium is significantly lower that the premium paid in the past, due to run-off insurance concurrent with this insurance.)

The engagement will be in the format of a "framework transaction", meaning three periods of 12 months each, on the same terms as the officers insurance existing in the Company today, except for reduction of the premium to $510,000 and the inclusion of the officers in the subsidiaries Pelephone and Bezeq International in the insurance, as well as senior employees who are not officers, for managerial actions taken by them. The renewal of the insurance also requires the approval of the general meting of the shareholders of the Company.

NOTE 10 – REVENUE

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Domestic fixed-line communications	**3,694,483**	3,829,078	**1,225,821**	1,293,215	5,086,022
Cellular telephone	**2,712,154**	2,612,522	**944,458**	904,490	3,493,541
Multi-channel television	**1,010,548**	944,772	**339,871**	318,407	1,284,337
Sale of equipment to subscribers, installations and miscellaneous	**945,932**	861,918	**314,406**	297,680	1,170,771
International communications and internet services	**747,385**	706,461	**258,206**	237,356	963,942
	9,110,502	8,954,751	**3,082,762**	3,051,148	11,998,613
Other income	**169,942**	159,785	**56,328**	32,399	233,217
	9,280,444	9,114,536	**3,139,090**	3,083,547	12,231,830

NOTE 11 – OPERATING AND GENERAL EXPENSES

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
General expenses	**840,953**	814,122	**289,849**	282,521	1,169,107
Cellular telephone expenses	**1,359,147**	1,389,798	**467,885**	472,883	1,854,347
Materials and spare parts	**646,796**	631,789	**217,441**	218,625	922,449
Consumption of satellite services content	**325,947**	333,900	**124,211**	117,743	441,268
Services and maintenance by sub-contractors	**286,206**	326,383	**93,946**	114,524	428,424
Building maintenance	**246,840**	258,995	**81,087**	88,791	347,849
International communication expenses	**275,232**	299,604	**89,781**	108,197	383,496
Motor vehicle maintenance expenses	**143,124**	142,888	**49,913**	51,370	190,079
Royalties to the State of Israel	**145,063**	125,741	**49,060**	36,319	179,589
Collection fees	**38,022**	37,319	**11,775**	12,046	50,008
	4,307,330	4,360,539	**1,474,948**	1,503,019	5,966,616

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

A. Income statement

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenue (See B below)	**4,259,884**	4,359,533	**1,424,721**	1,465,002	5,798,996
Costs and expenses					
Depreciation and amortisation	**708,582**	775,010	**236,064**	258,914	1,026,469
Salary	**963,531**	943,322	**327,763**	307,328	1,557,000*
General and operating expenses	**1,576,128**	1,649,320	**509,157**	558,104	2,233,167*
Other expenses (income), net	**72,328**	41,101	**24,889**	(22,316)	228,893
	3,320,569	3,408,753	**1,097,873**	1,102,030	5,045,529
Operating profit for the period	**939,315**	950,780	**326,848**	362,972	753,467

* Reclassified

B. Revenue segmentation

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Telephony	**2,909**	3,085	**967**	1,035	4,088
Internet	**515**	450	**179**	152	608
Transmission and data communication	**557**	532	**192**	181	711
Other services	**279**	293	**87**	97	392
Total	**4,260**	4,360	**1,425**	1,465	5,799

NOTE 13 –SEGMENT REPORTING

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

	For the nine-month period ended September 30, 2007 (unaudited)						
	Domestic fixed–line communications	**Cellular telephone**	**International communications, internet and NEP services**	**Multi-channel television**	**Others**	**Adjustments**	**Consolidated**
	NIS thousands	**NIS thousands**	**NIS thousands**	**NIS thousands**	**NIS thousands**	**NIS thousands**	**NIS thousands**
Revenue							
Revenue from external sources	**4,015,760**	**3,273,208**	**916,662**	**1,058,898**	**15,916**	**-**	**9,280,444**
Inter-segment revenue	**244,124**	**228,758**	**53,418**	**8,780**	**30,728**	**(565,808)**	**-**
Total revenue	**4,259,884**	**3,501,966**	**970,080**	**1,067,678**	**46,644**	**(565,808)**	**9,280,444**
Segment results	**939,315**	**671,799**	**158,814**	**51,541**	**1,867**	**-**	**1,823,336**

	For the nine-month period ended September 30, 2006 (unaudited)						
	Domestic fixed–line communications	**Cellular telephone**	**International communications, internet and NEP services**	**Multi-channel television**	**Others**	**Adjustments**	**Consolidated**
	NIS thousands	**NIS thousands**	**NIS thousands**	**NIS thousands**	**NIS thousands**	**NIS thousands**	**NIS thousands**
Revenue							
Revenue from external sources	4,146,223	3,074,213	895,129	984,175	14,796	-	9,114,536
Inter-segment revenue	213,310	255,803	61,926	25,221	27,325	(583,585)	-
Total revenue	4,359,533	3,330,016	957,055	1,009,396	42,121	(583,585)	9,114,536
Segment results	950,780	534,889	109,138	(2,663)	275	-	1,592,419

NOTE 13 –SEGMENT REPORTING (CONTD.)

	For the three-month period ended September 30, 2007 (unaudited)						
	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP services	Multi-channel television	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenue							
Revenue from external sources	**1,341,486**	**1,128,860**	**302,713**	**358,636**	**7,395**	**-**	**3,139,090**
Inter-segment revenue	**83,235**	**74,217**	**23,155**	**1,176**	**9,640**	**(191,423)**	**-**
Total revenue	**1,424,721**	**1,203,077**	**325,868**	**359,812**	**17,035**	**(191,423)**	**3,139,090**
Segment results	**326,848**	**218,760**	**54,394**	**(4,141)**	**(64)**	**-**	**595,797**

	For the three-month period ended September 30, 2006 (unaudited)						
	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP services	Multi-channel television	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenue							
Revenue from external sources	1,392,654	1,058,803	294,208	332,455	5,427	-	3,083,547
Inter-segment revenue	72,348	85,518	22,108	7,319	9,403	(196,696)	-
Total revenue	1,465,002	1,144,321	316,316	339,774	14,830	(196,696)	3,083,547
Segment results	362,972	170,258	39,332	(12,362)	58	-	560,258

Notes to the Financial Statements at September 30, 2007

NOTE 13 –SEGMENT REPORTING (Contd.)

	For the year ended December 31, 2006 (audited)						
	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP services	Multi-channel television	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenue							
Revenue from external sources	5,514,799*	4,140,771*	1,218,568*	1,338,826	18,866*	-	12,231,830
Inter-segment revenue	284,197*	337,216*	82,175*	23,563	36,889*	(764,040)	-
Total revenue	5,798,996	4,477,987	1,300,743*	1,362,389	55,755*	(764,040)	12,231,830
Segment results	746,320	691,682	118,922*	7,707	571*	-	1,565,202

* Reclassified.

NOTE 14 – TRANSITION TO INTERNATIONAL STANDARDS (IFRSs) – EXPLANATION

As noted in the financial statements for the year 2006, the Group first adopted IFRSs in 2006, with January 1, 2005 set as the transition date. In preparing its opening balance sheet in accordance with IFRSs and in the Group balance sheet at January 1, 2006, the Group adjusted amounts reported previously in financial statements prepared in accordance with its previous basis of accounting (Israeli GAAP).

Explanations of the material effects of the transition from Israeli GAAP to IFRSs on the Group's financial position and results of operations as of September 30, 2006 and for the nine-month and three-month periods then ended, are provided below. For the full explanations in respect to the transition from Israeli GAAP to IFRSs on the transition date and in respect to the reserves balance at January 1, 2006, see Note 33 to the Group's financial statements for the year 2006.

Material adjustments to the balance sheet line items

		Israeli GAAP	Effect of transition to IFRSs	IFRSs
		September 30, 2006		
		(Unaudited)	(Unaudited)	(Unaudited)
	Note	NIS thousands	NIS thousands	NIS thousands
Property, plant and equipment	a-f, k, l	8,813,942*	(2,175,621)	6,638,321
Intangible assets	d, f, g	2,083,224	479,897	2,563,121
Deferred tax assets	a-c, g, h, l	456,894*	442,818	899,712
Shareholders' equity	a-c, f-g, j, l	7,315,230*	(1,600,924)	5,714,306

Material adjustments to the income statement line items for the nine-month period ended September 30, 2006

		Israeli GAAP	Effect of transition to IFRSs	IFRSs
		For the nine-month period ended September 30, 2006		
		(Unaudited)	(Unaudited)	(Unaudited)
	Note	NIS thousands	NIS thousands	NIS thousands
Income	l	9,133,186*	(18,650)	9,114,536
Costs and expenses	a-c, f-g, j, l	7,798,386*	(276,269)	7,522,117
Net profit for the period (attributable to shareholders of the Company)	a-c, f-g, j, l	727,537*	188,205	915,742
Earnings per share				
Basic and diluted earnings per share (in NIS)		0.28*	0.07	0.35

* Restated – see section (l) below.

NOTE 14 – TRANSITION TO INTERNATIONAL STANDARDS (IFRSs) – EXPLANATION (CONTD.)

Material adjustments to the income statement line items for the three-month period ended September 30, 2006

	Note	Israeli GAAP	Effect of the transition to IFRSs	IFRSs
		For the three-month period ended September 30, 2006		
		NIS thousands	NIS thousands	NIS thousands
Revenue	l	3,087,963*	(4,416)	3,083,547
Costs and expenses	a-c, f-g, j, l	2,621,517*	(98,228)	2,523,289
Net profit for the period (attributable to shareholders of the Company)	a-c, f-g, j, l	256,132*	56,802	312,934
Earnings per share				
Basic and diluted earnings per share in NIS)		0.10*	0.02	0.12

* Restated – see section (l) below.

Notes to the material adjustments

a. In accordance with the relief under IFRS 1, as of the transaction date, the Group chose to state some of the property, plant and equipment items (the switching, transmission and power group) at their fair value and to determine this value as deemed cost. The deemed cost was based on an external expert opinion. As a result, the property, plant and equipment balance decreased by NIS 1,168 million at September 30, 2006, to a deemed cost of approximately NIS 1,210 million at that date, while the deferred tax balances deriving from the differences in the measurement of the property, plant and equipment for tax purposes, changed compared with the statement of the property, plant and equipment for accounting purposes, by approximately NIS 340 million at September 30, 2006. The reserves balance was reduced on that date by the net amounts. The depreciation expenses for the nine-month and three-month periods ended September 30, 2006, decreased by NIS 247 million and NIS 78 million, respectively.

b. On the date of transition to IFRSs, in accordance with the directives of IAS 16, the residual value of the property, plant and equipment not included in the calculation of depreciation according to accepted accounting principles in Israel was measured. The residual value was based on an opinion of an external expert. The effect was to increase the property, plant and equipment balances by approximately NIS 66 million and to reduce the depreciation expense for the nine-month and three-month periods ended on September 30, 2006 by approximately NIS 34 million and NIS 11 million, respectively. Another effect was to change the deferred tax balances derived from the differences in measurement of the property, plant and equipment for tax purposes as compared with the statement of property, plant and equipment in the financial statements. The reserve balances were reduced by the same net amounts at that date.

c. Under IAS 37, the Group is required to recognise liabilities in respect of bearing the costs of site decommissioning and clearing. Pursuant to IFRS 1, the Group selected a relief that allowed it to discount the costs of decommissioning and clearing sites at the transition date at historical discount rates.
As a result, the property, plant and equipment balance at September 30, 2006 increased by NIS 15 million, and the reserves balance decreased by approximately NIS 7 million (net of tax) at the same date.

NOTE 14 – TRANSITION TO INTERNATIONAL STANDARDS (IFRSs) – EXPLANATION (CONTD.)

Notes to the material adjustments (contd.)

d. Under IFRSs, computer software and capitalised software development costs that are not an integral part of the hardware related to them, are treated as intangible assets. Accordingly, with the transition to IFRSs, the carrying balances in the books at September 30, 2006, of approximately NIS 466 million, relating to computer software and discounted software development costs, were reclassified from the property, plant and equipment item to the intangible assets item.

e. Under accepted accounting principles in Israel, agreements granting the Group an indefeasible right of use of sea-bed cable capacity were treated as a finance lease and accordingly, a related asset was recognised in the balance sheet in the property, plant and equipment item. Under IFRSs and as provided in IFRIC 4, which determines whether an arrangement includes a lease, there are criteria for determining whether a right to use an asset is an arrangement having the form of a lease. If it is not a lease, the arrangement should be classified as an arrangement for receipt of services. The effect of application of the provisions of IFRSs and in the absence of the criteria required for those arrangements to be defined as a lease, the amounts paid to the suppliers for a future right of use of sea-bed cable capacity were classified as deferred and other long-term expenses.

The effect of the transition to IFRSs was to decrease property, plant and equipment by approximately NIS 185 million at September 30, 2006, against an increase in the following items:

(1) Other accounts receivable (prepaid expenses), of approximately NIS 19 million at September 30, 2006.
(2) Other long-term assets (long-term prepaid expenses in respect of a right of use of capacity), of approximately NIS 151 million.

f. Under accepted accounting principles in Israel, part of the customer acquisition costs of a subsidiary was partially capitalised to property, plant and equipment and depreciated over 6 years, and partially charged as a current expense to profit and loss. Under IFRSs, these costs were capitalised stated as intangible assets, and are depreciated over the term of the contractual engagement of the subscriber, which is usually one year.

The difference between the accumulated depreciation under Israeli GAAP and the accumulated depreciation under IFRSs for the three-month period ended September 30, 2006, amounts to approximately NIS 278 million (decrease of property, plant and equipment), and the effect on the depreciation expenses in the nine-month and three-month periods ended September 30, 2006 is a decrease in depreciation expenses of approximately NIS 28 million and NIS 9 million, respectively.

g. Under Israeli GAAP, the Group recognised as an asset the net direct costs paid to a third party in respect of sale to subscribers who signed a commitment to remain customers of the Group, as well as losses in respect of handset subsidies. These costs included the commissions paid to external dealers, as well as losses in respect of subsidising the terminal equipment for customers ("Subscriber Acquisition"). This Subscriber Acquisition was depreciated to profit and loss over the term of the customer commitment, which is up to 36 months.

Under IAS 38, the Group defers only the direct sales commissions paid to employees and to external dealers in respect of sales to those subscribers who signed a commitment to remain customers of the Group. These costs are depreciated to profit and loss over the term of the commitment of the subscribers, which is up to 36 payments. Losses in respect of handset subsidies are charged to profit and loss and are not deferred. As a result, the Subscriber Acquisition asset at September 30, 2006, was reduced by approximately NIS 90 million. The effect on profit and loss for the nine-month and three-month periods ended September 30, 2006 is a decrease of approximately NIS 22 million and NIS 18 million before tax, respectively,.

h. Under IFRSs, deferred tax assets are classified as non-current assets, even if the date of their realisation is expected to be in the short term. Under Israeli GAAP, deferred tax assets were classified as current or non-current assets, depending on the classification of the assets in respect of which they were generated.

NOTE 14 – TRANSITION TO INTERNATIONAL STANDARDS (IFRSs) – EXPLANATION (CONTD.)

Notes to the material adjustments (contd.)

Accordingly, with the transition to IFRSs, the balance of short-term deferred taxes at September 30, 2006, in the amount of approximately NIS 188 million, was reclassified from the accounts receivable and debit balances item under current assets, to the deferred tax item under non-current assets (in this Note, the deferred tax balance is stated after the reclassification).

i. Under IFRSs, bank loans to a subsidiary, of approximately NIS 1,245 million, were stated as short-term loans, while under Israeli GAAP these loans were classified as long-term loans. The classification was changed due to the transition to IFRSs, since the subsidiary failed to meet financial criteria set by the banks for these loans at balance sheet date.

j. Under Israeli GAAP, the minority interest item in the Company is measured at the amount of the loans provided by the minority interest in a subsidiary, at their carrying value in that company, and stated net of those loans.

Under IFRSs, the minority rights are stated in the consolidated balance sheet as a separate component of the shareholders' equity, in the amount of the loans, at fair value, provided by the minority in a subsidiary, plus the financing costs in respect of those loans, accumulated from the acquisition date to the balance sheet date. The minority interest share in the capital deficit of the subsidiary is stated as part of distribution of profits between the majority shareholders and the minority interest shareholders.

k. Other material classifications made in accordance with the provisions of IFRSs:
1. Leases of land from Israel Lands Administration classified as operating leases, of approximately NIS 222 million at September 30, 2006, were reclassified from the property, plant and equipment item to the deferred expenses item.
2. Materials and spare parts that were stated in a separate item between the current assets item and the property, plant and equipment item, were reclassified to property, plant and equipment in the amount of NIS 78 million at September 30, 2006.
3. Other income, net, was classified under other operating income, net.

l. Restatement

The financial statements at September 30, 2006, according to Israeli GAAP were adjusted by way of restatement in order to retroactively reflect the following changes:

(1) Recording of amortisation of lease payments in respect of land from Israel Lands Administration over the term of the lease, and not as amortised since the establishment of the Company (at a rate of 4%). The effect of this amendment is the addition of approximately NIS 109 million to property, plant and equipment, and of approximately NIS 82 million to the balance of shareholders' equity at September 30, 2006. The amendment does not have a material effect on the profit for the nine-month and three-month periods ended September 30, 2006.

(2) Statement of receipts from interconnect to the cellular networks, which were not stated commencing 2000 as part of the Company's income, and correspondingly as an operating expense in the same amount, following examination of the criteria under international standards and in order to state them as accepted in Israel and worldwide. The effect of this amendment for the nine-month and three-month periods ended September 30, 2006 is an increase in income and a corresponding increase in operating and general expenses of approximately NIS 607 million and NIS 207 million, respectively.

(3) Amendment of the accounting treatment of the depreciation of property, plant and equipment not used by Pelephone, and the resulting tax implications. The effect of this amendment is to depreciate property, plant and equipment by approximately NIS 252 million, and to reduce the balance of shareholders' equity by approximately NIS 181 million at September 30, 2006, as well as to reduce depreciation expenses by approximately NIS 31 million and NIS 11 million

NOTE 14 – TRANSITION TO INTERNATIONAL STANDARDS (IFRSs) – EXPLANATION (CONTD.)

Notes to the material adjustments (contd.)

I. Restatement (contd.)

and to increase net profit by approximately NIS 24 and NIS 9 million for the nine-month and three month periods ended September 30, 2006, respectively.

The table below shows the effect of restatement as aforesaid on the comparative numbers according to Israeli GAAP at September 30, 2006, before the effects of IFRSs.

(1) Effect on the consolidated balance sheet

	As previously reported	Effects of restatement	As reported in these financial statements prior to their adjustment to IFRSs
	(Unaudited)	(Unaudited)	(Unaudited)
	NIS thousand	NIS thousand	NIS thousand
Property, plant and equipment	8,957,533	(143,591)	8,813,942
Deferred tax assets	412,501	44,393	456,894
Shareholders' equity	7,414,428	(99,198)	7,315,230

(2) Effect on undesignated retained earnings (deficit)

	At September 30 2006
	(Unaudited)
	NIS thousand
As previously reported	(957,138)
Effect of restatement	(99,198)
	(1,056,336)

(3) Effect on net profit

	For the nine-month period ended September 30, 2006	For the three-month period ended September 30, 2006
	(Unaudited)	(Unaudited)
	NIS thousand	NIS thousand
Profit as reported in the past	700,568	244,990
<u>Effect of restatement</u>:		
Increase in revenue	606,655	206,559
Decrease in depreciation and amortisation expenses	35,099	13,683
Decrease in other operating expenses (income), net	1,241	1,241
Increase in operating and general expenses	(606,655)	(206,559)
Increase in income tax	(9,371)	(3,782)
Profit as reported in these financial statements in the note on adjustment to IFRSs	727,537	256,132

NOTE 15 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD.

1. Pelephone Communications Ltd.

A. Balance sheet

	September 30, 2007	September 30, 2006	December 31, 2005
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**1,909,312**	1,473,997	1,451,006
Non-current assets	**2,340,609**	2,577,435	2,520,473
	4,249,921	4,051,432	3,971,479
Current liabilities	**1,086,653**	1,224,177	1,089,973
Long-term liabilities	**1,185,758**	1,457,554	1,383,859
Total liabilities	**2,272,411**	2,681,731	2,473,832
Shareholders' equity	**1,977,510**	1,369,701	1,497,647
	4,249,921	4,051,432	3,971,479

B. Income statement

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenue from services and sales	**3,501,966**	3,330,016	**1,203,077**	1,144,321	4,477,987
Cost of services and sales	**2,450,621**	2,400,438	**847,559**	831,324	3,250,303
Gross profit	**1,051,345**	929,578	**355,518**	312,997	1,227,684
Sales and marketing expenses	**308,208**	304,605	**111,738**	107,496	417,178
General and administrative expenses	**71,337**	81,270	**25,019**	35,246	110,008
	379,545	385,875	**136,757**	142,742	527,186
Operating profit	**671,800**	543,703	**218,761**	170,255	700,498
Financing costs					
Financing expenses	**97,488**	116,322	**54,269**	29,709	114,775
Financing income	**(84,446)**	(72,459)	**(41,480)**	(20,930)	(97,088)
Net financing costs	**13,042**	43,863	**12,789**	8,779	17,687
Profit before income tax	**658,758**	499,840	**205,972**	161,476	682,811
Income tax	**177,156**	138,495	**51,565**	50,721	196,910
Net profit for the period	**481,602**	361,345	**154,407**	110,755	485,901

NOTE 15 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD. (CONTD.)

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

A. Balance sheet

	September 30, 2007	September 30, 2006	December 31, 2005
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**387,100**	355,358	338,662
Non-current assets	**681,020**	702,864	679,783*
	1,068,120	1,058,222	1,018,445
Current liabilities	**1,426,806**	2,002,498	1,889,416
Non-current liabilities	**2,196,838**	1,876,395	1,989,685*
Total liabilities	**3,623,644**	3,878,893	3,879,101
Capital deficit	**(2,555,524)**	(2,820,671)	(2,860,656)
	1,068,120	1,058,222	1,018,445

B. Income statement

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenue	**1,067,678**	1,009,396	**359,812**	339,774	1,355,735
Cost of income	**835,915**	856,864	**300,867**	293,521	1,139,308
Gross profit	**231,763**	152,532	**58,945**	46,253	216,427
Sales and marketing expenses	**104,331**	91,460	**36,767**	31,191	122,996
General and administrative expenses	**75,914**	70,062*	**26,329**	26,192*	92,398*
	180,245	161,522	**63,096**	57,383	215,394
Operating profit (loss)	**51,518**	(8,990)	**(4,151)**	(11,130)	1,033
Financing costs					
Financing expenses	**304,481**	276,963	**136,909**	90,459	345,669
Financing income	**(215,930)**	(9,480)	**(211,448)**[1]	(4,432)	(26,774)
Net financing costs (income)	**88,551**	267,483	**(74,539)**	86,027	318,925
Loss before income tax	**(37,033)**	(276,473)	**70,388**	(97,157)	(317,892)
Income tax	**6,251**	1,915*	**728**	247*	1,915*
Loss for the period	**(43,284)**	(278,388)	**69,660**	(97,404)	(319,807)

* Reclassified
(1) See Note 7A1.

NOTE 15 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD. (CONTD.)

3. Bezeq International Ltd.*

A. Balance sheet

	September 30, 2007	September 30, 2006	December 31, 2005
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**447,943**	311,731	332,526
Non-current assets	**435,616**	353,684	340,734
	883,559	665,415	673,260
Current liabilities	**350,595**	321,035	307,724
Long-term liabilities	**22,399**	14,894	15,613
Total liabilities	**372,994**	335,929	323,337
Shareholders' equity	**510,565**	329,486	349,923
	883,559	665,415	673,260

* The above financial statements are presented solely in accordance with International Financial Reporting Standards (IFRSs). In addition, commencing January 1, 2007, the financial statements include the operations of BezeqCall Communications Ltd.

NOTE 15 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD. (CONTD.)

3. Bezeq International Ltd.* (Contd.)

B. Income statement

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenue	**970,082**	755,414	**325,870**	259,033	1,021,573
Operating expenses	**(635,714)**	(490,097)	**(209,003)**	(170,753)	(662,244)
Gross profit	**334,368**	265,317	**116,867**	88,280	359,329
Sales and marketing expenses	**(104,317)**	(109,868)	**(36,350)**	(38,006)	(148,594)
General and administrative expenses	**(71,729)**	(50,822)	**(25,358)**	(16,811)	(71,806)
Other expenses (income), net	**494**	2,031	**(763)**	2,226	(7,064)
Operating profit	**158,816**	106,658	**54,396**	35,689	131,865
Financing costs					
Financing income	**(8,919)**	(21,137)	**(5,908)**	(2,431)	(19,752)
Financing expense	**9,663**	13,753	**5,717**	4,304	12,787
Net financing costs (income)	**744**	(7,384)	**(191)**	1,873	(6,965)
Equity in profits of an associate accounted by the equity method	**2,405**	6,902	**761**	2,889	11,051
Profit before income tax	**161,965**	106,176	**54,966**	40,451	135,951
Income tax	**(47,263)**	(31,088)	**(16,230)**	(11,769)	(40,391)
Profit for the period	**114,702**	75,088	**38,736**	28,682	95,560

* The above financial statements are presented solely in accordance with International Financial Reporting Standards (IFRSs). In addition, commencing January 1, 2007, the financial statements include the operations of BezeqCall Communications Ltd.

NOTE 16 – MATERIAL EVENTS DURING THE REPORTING PERIOD AND EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

A. On February 27, 2007, the Company's Board of Directors approved the allocation to the Company's executives of 56,836,888 options, exercisable for 56,836,888 ordinary shares of the Company, par value NIS 1 each, each representing 2.1818% of the Company's issued capital before issue of the shares.

Following an enquiry of the Securities Authority into this matter and the results of the Company's review of the plan approval process, the Company's Board of Directors resolved, on March 15, 2007, to cancel the plan and its published outline.

B. During May – July 2007, the subsidiary Bezeq Zahav (Holdings) Ltd. ("Bezeq Zahav") sold 1,069,900,000 debentures (Series 5) of the Company in private placements and on the Tel Aviv Stock Exchange, out of the debentures (Series 5) it purchased from the Company prior to publication of the Company's prospectus of May 24, 2004 ("the Prospectus"), and that had been listed for trading in accordance with the Prospectus, and out of the debentures (Series 5) it had purchased from the Company in a private placement in December 2004 (under legal lockout restrictions). The execution prices of the sales ranges between 111.8 and 112.5 (reflecting a yield to redemption of approximately 3.6% - 3.9%).

The proceeds from those sales, approximately NIS 1,199,961million, were transferred to the Company by Bezeq Zahav in (partial) repayment of the loan granted to Bezeq Zahav by the Company for purchasing the Debentures (Series 5), as provided in the loan agreements between the parties.

C. Following an enquiry of the Securities Authority, it was decided to appoint an external examiner to investigate the matter of compensation granted to officers in the Company since the transfer of control in the Company from the State to Ap.Sb.Ar. Holdings Ltd. (including approval of the stock option plan for employees and managers, and approval of bonuses for officers), and to investigate the matter of restatement in the Group's financial statements at December 31, 2004 and 2005. On April 26, 2007, the examiner submitted a report setting out the findings of his examination. The report specifies the shortcomings in the Company’s operations, and ways to prevent their recurrence in the future, in respect of all matters examined. The Company's Board of Directors discussed the findings of the reports and resolved, *inter alia*, to act towards implementation of the recommendations and to draw the necessary conclusions, as required by the report. The Board of Directors also approved a joint announcement to the Company and its then CEO, stating that the CEO will end his tenure as CEO of the Company, and as of June 26, 2007 Mr Avi Gabbay is the Company's Acting CEO. Decisions were made concerning, *inter alia*, the work procedures of the Board of Directors and the composition of its committees. Further to the aforementioned, after obtaining the approval of the Audit Committee, the Board of Directors of the Company discussed and approved the grant of bonuses to officers in respect of 2005 and 2006 and on June 28, 2007, adopted a new working procedure, that pertains to its meetings and to their management and to the management of Board committees, their powers and their work principles. On complaints submitted to the Company in respect of the aforementioned, see Notes 8A and 8C.

D. On September 4, 2007, the annual general meeting of the shareholders of the Company elected members of the Board, including a number of new members, and on the same date the Board of Directors appointed a new chairman for the Company. It was also resolved to establish Board committees, their nature and composition, as part of the implementation of the recommendations and conclusions drawn from the external examiner's report. In addition, the Company approved the appointment of new directors in the subsidiaries.

E. On August 13, 2007, the Board of Directors of the Company resolved to recommend to the general meeting of the shareholders of the Company, payment of a cash dividend to the shareholders of a total amount of NIS 760 million (representing NIS 0.29 per share). On 19 September, 2007, the general meeting approved payment of the dividend and it was paid in October 2007. The resolution of the general meeting is expected to be approved in an additional general meeting which will be convened for this matter.

NOTE 16 – MATERIAL EVENTS DURING THE REPORTING PERIOD AND EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE (CONTD.)

F. On October 25, 2007, the Board of Directors of the Company approved a resolution of the board of directors of Pelephone regarding the setting up of a network using HSPA / UMTS technology for a total sum of approximately one billion shekels. Following the resolution, the general meeting of Pelephone approved the set-up of the network. Ericsson was chosen as supplier of the system. The new network is expected to commence operations at the beginning of 2009. Investment in the network will be over a period of four years.

NOTE 17 – DETAILS OF ADDITIONAL MOVEMENTS IN SHAREHOLDERS' EQUITY

	Share capital	Premium on shares	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of financial assets available for sale	Capital reserve in respect of option warrants for employees	Balance of deficit	Total	Minority interest in capital deficit of consolidated companies	Total shareholders' equity
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
	Refers to shareholders of the Company								
Nine-month period ended September 30, 2007									
Balance at January 1, 2007 (audited)	**6,309,133**	**1,623,423**	**384,684**	**630**	**286,506**	**(2,849,381)**	**5,754,995**	**(564,250)**	**5,190,745**
Total profits recognised during the period (unaudited)	**-**	**-**	**-**	**7,128**	**-**	**1,015,040**	**1,022,168**	**40,633**	**1,062,801**
Change in the repayment date of a loan provided by a minority interest in a subsidiary (unaudited)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**159,148**	**159,148**
Dividends to shareholders of the Company which do not comply with the profits test* (unaudited)	**(176,497)**	**(1,623,423)**	**-**	**-**	**-**	**-**	**(1,799,920)**	**-**	**(1,799,920)**
Dividends to Company shareholders** (unaudited)	**-**	**-**	**-**	**-**	**-**	**(760,000)**	**(760,000)**	**-**	**(760,000)**
Distribution of a dividend to the minority interest in a subsidiary, less minority transfers, net (unaudited)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(3,928)**	**(3,928)**
Payments to a former senior officer (Note 9C) (unaudited)	**-**	**-**	**5,750**	**-**	**-**	**-**	**5,750**	**-**	**5,750**
Balance at September 30, 2007 (unaudited)	**6,132,636**	**-**	**390,434**	**7,758**	**286,506**	**(2,594,341)**	**4,222,993**	**(368,397)**	**3,854,596**
Nine-month period ended September 30, 2006									
Balance at January 1, 2006 (audited)	6,309,133	1,623,423	384,684	5,253	-	(1,761,971)	6,560,522	(505,280)	6,055,242
Total profits (losses) recognised for the period (unaudited)	-	-	-	(3,838)	-	915,742	911,904	(52,840)	859,064
Dividends to shareholders of the Company (unaudited)	-	-	-	-	-	(1,200,000)	(1,200,000)	-	(1,200,000)
Balance at September 30, 2006 (unaudited)	6,309,133	1,623,423	384,684	1,415	-	(2,046,229)	6,272,426	(558,120)	5,714,306

* On December 28, 2006, the general meeting of the shareholders of the Company approved the proposal of the Board of Directors regarding distribution of a cash dividend of approximately NIS 1.8 billion (representing NIS 0.69 per share) as a dividend which does not meet the income test. On February 4, 2007 a court approved the dividend and the distribution was subsequently made on February 26, 2007.

** See Note 16D.

NOTE 17 – DETAILS OF ADDITIONAL MOVEMENTS IN SHAREHOLDERS' EQUITY (CONTD.)

	Share capital	Premium on shares	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of financial assets available for sale	Capital reserve in respect of option warrants for employees	Balance of deficit	Total	Minority interest in capital deficit of consolidated companies	Total shareholders' equity
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
	Refers to shareholders of the Company								
Three-month period ended September 30, 2007									
Balance at July 1, 2007 (unaudited)	**6,132,636**	**-**	**390,434**	**3,566**	**286,506**	**(2,089,539)**	**4,723,603**	**(598,785)**	**4,124,818**
Total profits recognised during the period (unaudited)	**-**	**-**	**-**	**4,192**	**-**	**255,198**	**259,390**	**75,168**	**334,558**
Dividends to Company shareholders* (unaudited)	**-**	**-**	**-**	**-**	**-**	**(760,000)**	**(760,000)**	**-**	**(760,000)**
Change in the repayment date of a loan provided by a minority interest in a subsidiary (unaudited)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**159,148**	**159,148**
Distribution of a dividend to the minority interest in a subsidiary, less minority transfers, net (unaudited)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(3,928)**	**(3,928)**
Balance at September 30, 2007 (unaudited)	**6,132,636**	**-**	**390,434**	**7,758**	**286,506**	**(2,594,341)**	**4,222,993**	**(368,397)**	**3,854,596**
Three-month period ended September 30, 2006									
Balance as at July 1, 2006 (unaudited)	6,309,133	1,623,423	384,684	2,855	-	(2,359,163)	5,960,932	(541,482)	5,419,450
Total profits (losses) recognised for the period (unaudited)	-	-	-	(1,440)	-	312,934	311,494	(16,638)	294,856
Balance at September 30, 2006 (unaudited)	6,309,133	1,623,423	384,684	1,415	-	(2,046,229)	6,272,426	(558,120)	5,714,306

* See Note 16D

NOTE 17 – DETAILS OF ADDITIONAL MOVEMENTS IN SHAREHOLDERS' EQUITY (CONTD.)

	Share capital	Premium on shares	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of financial assets available for sale	Capital reserve in respect of option warrants for employees	Balance of deficit	Total	Minority interest in capital deficit of consolidated companies	Total shareholders' equity
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
	Refers to shareholders of the Company								
Year ended December 31, 2006									
Balance at January 1, 2006 (audited)	6,309,133	1,623,423	384,684	5,253	-	(1,761,971)	6,560,522	(505,280)	6,055,242
Profits (losses) recognised during the period (audited)	-	-	-	(4,623)	-	812,590	807,967	(58,970)	748,997
Dividends to shareholders of the Company (audited)	-	-	-	-	-	(1,900,000)	(1,900,000)	-	(1,900,000)
Share-based payments made by the Company (audited)	-	-	-	-	286,506	-	286,506	-	286,506
Balance at December 31, 2006 (audited)	6,309,133	1,623,423	384,684	630	286,506	(2,849,381)	5,754,995	(564,250)	5,190,745