"BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

FINANCIAL STATEMENTS

DECEMBER 31, 2001

Contents

Auditor's Report to the Shareholders of
“Bezeq” The Israel Telecommunication Corp. Limited

We have audited the accompanying balance sheets of “Bezeq” The Israel Telecommunication Corp. Limited (the Company) as at December 31, 2001 and 2000, and the consolidated balance sheets as at such dates and the related statements of income, shareholders’ equity and cash flows for each of the three years the last of which ended December 31, 2001. These financial statements are the responsibility of the Company’s Board of Directors and its Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of certain subsidiaries, including those consolidated by the proportionate method whose assets constitute approximately 17% and approximately 5% of the total consolidated assets as at December 31, 2001 and 2000 respectively, and whose revenues constitute approximately 28%, 9%, and 7% of the total consolidated revenues for the years ended December 31, 2001, 2000, and 1999 , respectively. The financial statements of those subsidiaries were audited by other auditors whose reports thereon were furnished to us. Our opinion, insofar as it relates to amounts emanating from the financial statements of such subsidiaries, is based solely on the said reports of the other auditors. Furthermore, the data included in the financial statements relating to the net asset value of the Company’s investments in affiliates and to its equity in their operating results is based on the financial statements of such affiliates, some of which were audited by other auditors.

We conducted our audits in accordance with generally accepted auditing standards, including standards prescribed by the Auditors’ Regulations (Manner of Auditor’s Performance), 1973. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors and by Management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and on the reports of the abovementioned other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the Company and the consolidated financial position of the Company and its subsidiaries as at December 31, 2001 and 2000 and the results of their operations, the changes in the shareholders’ equity and their cash flows for each of the three years the last of which ended December 31, 2001, in conformity with generally accepted accounting principles. Furthermore, in our opinion, the financial statements referred to above are prepared in accordance with the Securities Regulations (Preparation of Annual Financial Statements), 1993.

As explained in Note 2, the abovementioned financial statements are stated in values adjusted for the changes in the general purchasing power of the Israeli currency, in accordance with opinions of the Institute of Certified Public Accountants in Israel.

Without qualifying our opinion, we draw attention to the uncertainties relating to the following matters the maximum possible exposure of which is significant:

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

2. A program for a early retirement, as described in Note 16D (2).

3. Claims made against the Company and against investee companies, as described in Note 20A.

4. The financial condition of an affiliated company, and its non-compliance with the conditions set forth in the financing agreement between the affiliated company and banking corporations. As described in note 8F the activity of the affiliated company is dependent upon continued execution of the financing agreement, the increase of credit lines approved for the affiliated company by the banking corporations and additional loans to be received from the shareholders. The assessment of the affiliated company's management as to the likelihood of resolution of the required financing is included in the abovementioned note.

KPMG Somekh Chaikin
Certified Public Accountants (Isr.)

March 25, 2002

Balance Sheets

In terms of shekels of December 2001

	Note	Consolidated December 31, 2001 NIS thousands	Consolidated December 31, 2000 NIS thousands	Company December 31, 2001 NIS thousands	Company December 31, 2000 NIS thousands
Current assets					
Cash and cash equivalents	3	**1,303,000**	1,554,486	**1,270,366**	1,543,291
Short-term investments	4	**440,654**	191,024	**424,622**	170,749
Trade receivables	5	**1,687,212**	1,292,129*	**1,145,544**	738,615
Other receivables and debit balances	6	**322,008**	482,676	**252,739**	391,842
Inventory		**116,032**	136,320	**–**	–
		3,868,906	3,656,635	**3,093,271**	2,844,497
Materials and spare parts		**151,806**	187,794	**151,806**	187,794
Investments and long-term payables					
Investments, deposits and debit balances	7	**1,680,932**	293,575	**1,619,921**	247,450
Investments in investee companies	8	**461,067**	175,110	**1,600,135**	1,304,804
		2,141,999	468,685	**3,220,056**	1,552,254
Fixed assets	9				
Cost		**28,165,809**	29,451,255	**23,977,063**	25,654,709
Less - accumulated depreciation		**17,927,996**	17,680,460	**15,425,722**	15,693,822
		10,237,813	11,770,795	**8,551,341**	9,960,887
Other assets					
Deferred charges and other assets	10	**340,399**	383,418	**16,983**	15,500
Deferred taxes	11	**415,780**	642,273	**325,205**	641,971
		756,179	1,025,691	**342,188**	657,471
		17,156,703	17,109,600	**15,358,662**	15,202,903

		Consolidated		Company	
		December 31, 2001	December 31, 2000	December 31, 2001	December 31, 2000
	Note	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Current liabilities					
Short-term bank credit	12	**423,566**	745,503	**–**	–
Current maturities of:					
Long-term bank loans	13	**556,926**	382,909	**367,024**	321,970
Other debentures	14	**186,721**	227,755	**186,721**	227,755
Trade payables	15	**1,018,684**	961,641*	**570,527**	472,462
Employee severance benefits	16	**262,947**	349,639	**262,947**	349,639
Other current liabilities	17	**1,155,097**	975,084*	**953,879**	784,923*
		3,603,941	3,642,531	**2,341,098**	2,156,749
Long-term liabilities					
Long-term loans	13	**2,513,920**	2,864,596	**1,973,535**	2,438,620
Other debentures	14	**2,524,266**	2,182,406	**2,524,266**	2,182,406
Employee severance benefits	16	**1,275,911**	1,275,160*	**1,265,078**	1,270,826*
Deferred taxes	11	**–**	14,635	**–**	–
Deferred revenues	18	**58,034**	70,785	**74,054**	94,815
		6,372,131	6,407,582	**5,836,933**	5,986,667
Convertible debentures	19	**–**	69,052	**–**	69,052
Contingent liabilities	20				
Shareholders' equity	21	**7,180,631**	6,990,435	**7,180,631**	6,990,435
		17,156,703	17,109,600	**15,358,662**	15,202,903

Ido Dissentshik	Ilan Biran	Oren Lieder
Chairman of the Board	CEO	Chief Financial Officer

Date of approval of the financial statements: March 25, 2002

* Reclassified

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

Statements of Operation for the Year Ended December 31

In terms of shekels of December 2001

		Consolidated			Company		
	Note	2001 NIS thousands	2000 NIS thousands	1999 NIS thousands	2001 NIS thousands	2000 NIS thousands	1999 NIS thousands
Revenues from telecommunications services	22	**8,151,848**	8,520,659	9,283,746*	**5,894,652**	6,340,383	7,563,942
Costs and expenses							
Operating and general expenses	23	**4,467,546**	4,344,210	5,203,861*	**2,517,342**	2,571,924	3,982,755
Depreciation	9	**2,596,536**	2,738,343	2,759,267	**2,151,037**	2,277,958	2,325,632
Royalties to the Government of Israel		**270,388**	318,990	305,605	**189,315**	203,706	211,141
		7,334,470	7,401,543	8,268,733	**4,857,694**	5,053,588	6,519,528
Operating income		**817,378**	1,119,116	1,015,013	**1,036,958**	1,286,795	1,044,414
Financing expenses, net	24	**144,076**	348,069	365,147	**72,755**	298,487	369,829
Earnings after financing expenses		**673,302**	771,047	649,866	**964,203**	988,308	674,585
Other expenses, net	25	**(100,552)**	(1,290,592)	(566,329)	**(2,502)**	(1,250,233)	(489,574)
Earnings (loss) before income tax		**572,750**	(519,545)	83,537	**961,701**	(261,925)	185,011
Tax benefit (income tax)	11	**(230,592)**	155,484	(60,506)	**(346,757)**	140,748	(71,371)
Earnings (loss) after income tax		**342,158**	(364,061)	23,031	**614,944**	(121,177)	113,640
Equity in losses of investee companies	8	**(227,257)**	(197,910)	(21,854)	**(493,823)**	(435,832)	(105,340)
Minority share in losses of consolidated company		**6,220**	4,962	–	**–**	–	–
Earnings (loss) before cumulative effect of change in accounting method		**121,121**	(557,009)	1,177	**121,121**	(557,009)	8,300
Cumulative effect as at beginning of year of the change in accounting method		**–**	–	7,123	**–**	**–**	–
Net earnings (loss)		**121,121**	(557,009)	8,300	**121,121**	(557,009)	8,300
Primary and diluted earnings (loss) per NIS 1 par value of common shares (in NIS)	26	**0.050**	(0.229)	0.008	**0. 050**	(0.229)	0.008

* Reclassified

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

Statements of Changes in Shareholders' Equity

In terms of shekels of December 2001

	Share capital	Capital reserve for distribution of bonus shares	Capital reserve - share premium	Capital reserve in respect of transactions between the Company and a controlling shareholder	Retained earnings	Total
	NIS thousands					
Balance as at January 1, 1999	4,172,962	–	486,303	36,152	2,769,484	7,464,901
Changes in 1999 -						
Net earnings	–	–	–	–	8,300	8,300
Dividend for preceding year	–	–	–	–	(305,815)	(305,815)
Conversion of convertible debentures (1)	18,155	–	174,742	–	–	192,897
Balance as at December 31, 1999	4,191,117	–	661,045	36,152	2,471,969	7,360,283
Changes in 2000 -						
Erosion of dividend declared in a previous year and paid this year	–	–	–	–	(1,441)	(1,441)
Net loss	–	–	–	–	(557,009)	(557,009)
Tax benefit in respect of shares to employees	–	–	22,066	–	–	22,066
Conversion of convertible debentures(2)	14,861	–	151,675	–	–	166,536
Capitalization of undesignated earnings to a reserve fund for the distribution of bonus shares	–	1,621,029	–	–	(1,621,029)	–
Balance as at December 31, 2000	4,205,978	1,621,029	834,786	36,152	292,490	6,990,435
Changes in 2001						
Net earnings	–	–	–	–	**121,121**	**121,121**
Conversion of convertible debentures(3)	**6,017**	–	**63,058**	–	**-**	**69,075**
Distribution of bonus shares	**1,641,704**	**(1,621,029)**	–	–	**(20,675)**	**-**
Balance as at December 31, 2001	**5,853,699**	–	**897,844**	**36,152**	**392,936**	**7,180,631**

(1) 178,187,698 par value convertible debentures were converted into 17,607,480 ordinary shares with a par value of NIS 1 each.

(2) 147,652,429 par value convertible debentures were converted into 14,590,161 ordinary shares with a par value of NIS 1 each.

(3) 59,754,681 par value convertible debentures were converted into 5,904,612 ordinary shares with a par value of NIS 1 each.

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

Statements of Cash Flows for the Year Ended December 31

In terms of shekels of December 2001

	Consolidated			Company		
	2001	2000	1999	2001	2000	1999
	NIS thousands			NIS thousands		
Cash flows generated by operating activities						
Net earnings (loss)	**121,121**	(557,009)	8,300	**121,121**	(557,009)	8,300
Adjustments to reconcile net earnings (loss) to net cash flows generated by operating activities (see A below)	**3,094,994**	3,868,250	2,411,458	**2,704,707**	3,580,248	2,167,744
Net cash flow generated by operating activities	**3,216,115**	3,311,241	2,419,758	**2,825,828**	3,023,239	2,176,044
Cash flows generated by investing activities						
Acquisition of fixed assets	**(1,263,949)**	(1,749,962)	(1,437,557)	**(896,117)**	(1,119,800)	(933,559)
Proceeds from disposal of fixed assets	**81,997**	35,082	20,395	**62,747**	29,570	16,541
Proceeds from disposal of investment in affiliated company	**29,725**	173,532	–	**29,725**	173,532	–
Investment in long-term deposits and investments	**(1,102,540)**	(60,669)	(16,043)	**(1,081,292)**	(25,848)	(5,059)
Proceeds from long-term deposits and investments	**36,576**	60,865	114,295	**30,908**	23,877	84,367
Decrease (increase) in short-term investments, net	**(239,798)**	117,334	86,200	**(244,985)**	129,998	(138,045)
Decrease (increase) in materials and spare parts	**48,899**	58,776	(81,162)	**48,899**	58,776	(81,162)
Investment in investee companies	**(523,804)**	(329,297)	(61,355)	**(784,258)**	(271,574)	(44,542)
Investments in other assets	**(195,862)**	(266,708)	(305,653)	**(5,589)**	–	(132)
Net cash outflow used for investment activities	**(3,128,756)**	(1,961,047)	(1,680,880)	**(2,839,962)**	(1,001,469)	(1,101,591)
Cash flows generated by financing activities						
Repayment of debentures issued to the Government of Israel	**–**	(478,266)	(951,841)	**–**	(478,266)	(951,841)
Issue of other debentures (after deduction of issue expenses)	**510,553**	1,109,257	266,963	**510,553**	1,109,257	266,963
Repayment of other debentures	**(226,291)**	(229,443)	(209,486)	**(226,291)**	(229,443)	(209,486)
Receipt of long-term loans	**734,117**	814,254	730,968	**433,540**	598,169	567,202
Repayment of long-term loans	**(1,035,287)**	(1,848,530)	(1,122,137)	**(976,593)**	(1,663,954)	(1,070,654)
Receipt (repayment) of short-term bank credit	**(321,937)**	470,677	274,826	**–**	–	–
Dividend paid	**–**	(307,256)	–	**–**	(307,256)	–
Net cash outflow used for financing activities	**(338,845)**	(469,307)	(1,010,707)	**(258,791)**	(971,493)	(1,397,816)
Increase (decrease) in cash and cash equivalents	**(251,486)**	880,887	(271,829)	**(272,925)**	1,050,277	(323,363)
Cash and cash equivalents at beginning of year	**1,554,486**	673,599	945,428	**1,543,291**	493,014	816,377
Cash and cash equivalents at end of year	**1,303,000**	1,554,486	673,599	**1,270,366**	1,543,291	493,014

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

Statements of Cash Flows for the Year Ended December 31 (contd.)

In terms of shekels of December 2001

	Consolidated			Company		
	2001	2000	1999	2001	2000	1999
	NIS thousands			NIS thousands		
A - Adjustments to reconcile net earnings (loss) to net cash flows generated by operating activities						
Revenues and expenses not involving cash flows:						
Depreciation	**2,596,536**	2,738,343	2,759,267	**2,151,037**	2,277,958	2,325,632
Provision for decrease in value of fixed assets	**102,026**	11,168	107,879	–	–	107,879
Deferred taxes	**(116,925)**	(312,537)	81,240	**(2,072)**	(290,987)	73,911
Company's equity in losses of investee companies, net	**227,257**	197,910	21,854	**493,823**	435,832	105,340
Minority share in net losses of a consolidated company	**(6,220)**	(4,962)	–	–	–	–
Provision for decrease in value of an affiliated company	–	–	(15,129)	–	–	(15,129)
Increase (decrease) in employee severance benefits, net	**(85,941)**	1,199,014*	(295,159)*	**(92,440)**	1,187,256*	(297,144)*
Loss (gain) on disposal of fixed assets	**(8,705)**	(1,360)	(16,622)	**2,502**	(2,694)	(17,700)
Loss (gain) on disposal of investment in an affiliated company	**3,480**	(140,692)	–	–	(140,692)	–
Erosion (appreciation) of and interest on long-term deposits and investments	**(198,288)**	15,642	17,172	**(198,288)**	15,642	17,172
Appreciation of short-term investments, net	**(9,832)**	(2,973)	(321)	**(8,888)**	(2,140)	(321)
Appreciation (erosion) of long-term liabilities:						
Debenture issued to the Government of Israel	–	674	(2,442)	–	674	(2,442)
Other debentures	**16,564**	27,319	829	**16,564**	27,319	829
Long-term loans	**128,402**	(74,828)	(36,733)	**130,883**	(72,867)	(35,478)
Convertible debentures	–	–	142	–	–	142
Amortization of deferred expenses and other adjustments	**245,534**	152,581	68,467	**4,253**	1,101	7,702
Changes in asset and liability items:						
Decrease (increase) in trade receivables	**(403,371)**	253,279*	55,573	**(415,911)**	283,740	87,697
Decrease (increase) in other receivables and debit balances	**318,723**	(83,750)	(107,083)	**287,214**	(89,417)	(25,622)
Decrease (increase) in inventory	**22,222**	(14,921)	(83,098)	–	–	–
Increase (decrease) in trade payables	**79,942**	(187,917)*	94,192	**171,508**	(108,594)	68,434
Increase (decrease) in other current liabilities	**196,341**	105,366*	(232,140)*	**185,284**	75,241*	(221,197)*
Decrease in deferred revenues	**(12,751)**	(9,106)	(6,430)	**(20,762)**	(17,124)	(11,961)
	3,094,994	3,868,250	2,411,458	**2,704,707**	3,580,248	2,167,744
B – Non-cash transactions						
Acquisition of fixed assets, other assets, materials and spare parts on credit	**163,771**	305,275	328,730	**109,700**	184,246	267,038
Sale of fixed assets on credit	**–**	8,983	23,376	**–**	8,983	23,376
Transfer of fixed assets in return for an investment in a consolidated company	–	–	–	**12,006**	–	–
Proposed dividend	**–**	**–**	305,815	**–**	**–**	305,815

* Reclassified

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

NOTE 1 - GENERAL

A. "Bezeq" - The Israel Telecommunication Corp. Limited (hereinafter - the Company) is controlled by the State of Israel and as such, is subject to the provisions of the Government Companies Law, 5735-1975. The Company operates under a general license awarded under the Telecommunications Law (telecommunications and broadcasting), 5742-1982, which authorizes it to engage in the telecommunication business and provide telecommunication services. The Company's license, which was granted on March 1, 1994 (and which replaced an earlier license and was subsequently amended on various dates), sets out the terms under which the Company shall operate, and provides, inter alia, that the Company shall continue to provide telephone and related services, infrastructure services, and shall operate through subsidiaries which will engage in providing services in areas which were opened to competition. Under the license, the management of the subsidiaries is to be separate from the management of the Company. It was also determined that the provision of new services by the Company is contingent upon receipt of a license from the Ministry of Communications. Limits were also imposed on the extent of the Company's financial exposure with regard to projects undertaken outside Israel.

On March 18, 2002 the Company received a draft amendment to its general license. The Company is studying the proposed amendment and is required to submit its remarks during a hearing which will be scheduled. Preliminary reading of the text of the proposed amendment reveals that it includes the imposition of new provisions and directives on the Company (some of which are reflected in the Telecommunications Law and/or the Telecommunications Order and/or in other laws, and some of which are new provisions/directives), as well as expansion of existing provisions and restrictions on various issues.

B. The Company's operations are supervised by the Government and most of the tariffs for its services are determined in accordance with Section 15 of the Telecommunications Law, 5742-1982, and are updated according to regulations.

The Company's tariffs are updated according to the recommendations of the committee for arrangement of the Company's tariffs, which were adopted by the Minister of Communications and Minister of Finance with certain amendments. Those recommendations set the efficiency factor of the Company's tariffs ("the efficiency factor"), which averaged 6% in 1999 and 7% in 2000. Starting from 2001, this factor is 3.5% per year.

In accordance with the above recommendations, the Company's tariffs were lowered on April 1, 1999, May 1, 2000 and March 1, 2001. The March 2001 reduction included lowering of the Company's call tariffs by an average 1.4%, an increase of approximately 33% in interconnect tariffs to cellular communication operators, while other service tariffs were lowered by approximately 2.79%. The update scheduled for March 1, 2002 was postponed, due to the discussions in progress about its percentage and how it should be implemented. The update is now expected to take effect in May 2002.

In March 2002 a new committee was appointed to examine the structure and update mechanism of the Company's tariffs. This committee is supposed to recommend a new tariff arrangement for the Company, one which will be suited to the changing environment of the communications sector. The committee was requested to present its recommendations by the end of October 2002.

C. The Company and its subsidiary, Bezeq International Ltd. were required to pay royalties, from April 1, 1997 to December 31, 2000, to the Government of Israel at the rate of 5% of their revenues. Until December 31, 2000, Pelephone Communications Ltd. was required to pay royalties at the rate of 8% of its revenues. Since January 2001, the basis of revenues for the matter of payment of royalties has been broadened, with a gradual reduction in the percentage of royalties until a uniform rate is attained for all communications operators. The rate for 2001 is 4% for fixed-line domestic telecommunication services, 4.5% for international telecommunication services, and 5% for cellular services. The above rate for fixed-line domestic telecommunication services will remain in effect until 2003, and in 2004 will fall to 3.5%. The percentage of royalties for DBS Satellite Services (1998) Ltd. in 2001 was 1.5%, and will be 4% in 2002 and 3.5% from 2003 onwards.

NOTE 1 - GENERAL (CONTD.)

D. In June 1995, the Director General of the Anti-Trust Authority declared the Company a monopoly in the following areas: basic telephone service, telecommunications infrastructure services, two-way unrestricted international telephone services, including international telephone service for incoming calls and relay transfer and transmission services for public broadcasting. In December 2000 the Anti-Trust Commissioner declared the Company a monopoly in the field of telecommunications infrastructure for providing high-speed Internet access services. The Company submitted a petition to the Anti-Trust Tribunal, seeking revocation of the declaration.

The Company's request for revocation of the announcement with regard to basic telephone services, which includes, according to the Company, both fixed-line telephony and mobile telephony, was rejected by the Anti-Trust Commission. The Company filed a protest in the Anti-Trust Tribunal against the dismissal, and the Commissioner filed an application for dismissal in limine of the protest. As proposed by the Tribunal, the application for dismissal in limine was retracted and the discussion in the Tribunal will be held.

In April 2001 the Anti-Trust Commissioner rescinded the notice naming Bezeq International Ltd. a monopoly in the provision of international telephone services.

E. Below are the significant changes which have occurred in recent years with regard to the exclusivity which the Company enjoyed in providing communications services in Israel.

(1) Cellular services

Cellular services are currently provided by four companies (the Operators), of which one - Pelephone Communications Ltd. - is 50% owned by the Company.

Pursuant to notification from the Company to the Operators, as of March 1, 2000, the billing arrangement which was in effect between them was canceled and a new arrangement commenced, whereby the Company transfers to the Operators only the amounts which it actually collected in respect of airtime less a collection fee, in contrast to the then existing arrangement in which the transfer of moneys was made on the basis of customer charges without deduction of a collection fee. The Operators expressed their objection to the change in the arrangement, and one of them also filed a legal claim in the District Court, in which it requested that the Company be instructed to continue to act in accordance with the arrangement which had existed until then. The court denied the claim and confirmed the validity of the new arrangement instituted by the Company. The Operator appealed to the High Court. In its October 30, 2001 session, the High Court decided to summons the Attorney General as respondent to the appeal, in order to hear his position. Concurrently, the Company and the Operators negotiated in an attempt to arrive at an agreed arrangement. During the negotiations, the Company reached an agreement with Pelephone Communications Ltd. (a proportionally consolidated company), defining the relations between the companies with regard to billing from March 1, 2000 to December 31, 2002, and with MIRS Communications Ltd. In November 2001 the Ministry of Communications determined that the Company must pay the Operators (Cellcom and Partner) for airtime according to the volume of actual traffic minutes, irrespective of collection, for the period from October 2, 2000 to January 1, 2003. Pursuant to the decision, the Company will deduct from the payments a certain percentage reflecting "risk sharing" as agreed upon among the parties, and in the absence of such agreement – as the Minister will decide. Pursuant to the Minister's directive, the Company transferred to the Operators an immediate interim payment relating to traffic in the period from October 2000, less 2.5%. The financial statements of the Company include an expense of NIS 78 million deriving from the aforesaid.

As a result of the change in the billing arrangements, as described above, as of March 1, 2000, the Company's revenues and expenses from mobile wireless telephone do not include airtime. The airtime which was included in the revenues and expenses from mobile wireless telephone in 2000 amounted to approximately NIS 294 million (1999 – approximately NIS 1,521 million).

NOTE 1 - GENERAL (CONTD.)

(2) International communication services

At the beginning of July 1997, two new companies started providing international communication services, as a result of which, international call tariffs were significantly lowered, including those of the consolidated company Bezeq International Ltd. In the current reporting year, those operators filed an application to the Anti-Trust Commissioner for approval of their merger.

At the beginning of July 1997, regulations were promulgated for the purpose of regulating the duty of all the international operators to pay the Company a fee for "interconnect services". In addition, the general license awarded to the international operators obligates them to pay a fee to the Company for "access services", applicable only until December 31, 2001, after their reduction on January 1 2001 by about 30%.

In July 2001 the Ministry of Communications published a Request for Position in connection with a policy for regulating international telecommunication services. On December 26, 2001 the Ministry of Communications distributed a document setting out the policy for regulation of international telecommunication services, permitting the grant of a general license for providing such services to an applicant who meets the conditions set out in the document, effective from January 1, 2003. Concurrently, holders of special licenses for providing Internet access services will be allowed to purchase transmission services directly from a licensee for the provision of undersea cable services, in addition to the option of purchasing them from the international operators.

(3) Domestic communication services

In February 1999, Section 50 of the Telecommunications Law, 5742-1982 was repealed. The section granted the Company exclusivity in providing nationwide telecommunication services in a national network of telephones under the general license. The repeal took effect on June 1, 1999, but activities of new operators in domestic fixed-line communications will be permitted only from the date on which they are awarded a general license by the Ministry of Communications.

In July 2001 the Telecommunications Law was amended. The amendment regulates, *inter alia*, the opening of the domestic communications market and cable broadcasting to competition by means of granting licenses for providing communications services. The amendment includes numerous topics which influence the Company and the Group companies. The law enables the cable companies to switch from franchises to licenses that the cable companies or companies affiliated withthe cable companies, will be able to receive a general license for providing telecommunication services. If the license applicant currently owns a franchise, the grant of the license will be contingent upon transfer of the activity involving the provision of the broadcasting services to a company with such an affiliation, and if the license applicant is a company with such an affiliation, the franchisee will transfer to that company the rights in the cable network used for broadcasting.

In September 2001 the Telecommunications order (Determining an essential service provided by Bezeq, The Israel Telecommunication Corp. Ltd.), 5757-1997, was amended following the privatization decisions of August 27, 2000 and June 17, 2001 and following a hearing proceeding arranged for the Company. The Order refers, *inter alia*, to the inclusion of additional services which the Company provides under the definition of "Essential Services", and an extension of the limitations on control and holding in the Company.

Following the privatization decisions referred to above, the Company's license was amended in September 2001, *inter alia*, with regard to acquisitions and/or the installation of hardware in the telecommunications installations of the Company in accordance with directives which will be given to the Company pursuant to Section 13 of the Telecommunications Law and with regard to the establishment of a special committee of the Board of Directors of the Company to discuss security issues (on the same subject, the General Meeting of the Company approved, in August 2001, amendment of the Articles of Association of the Company).

NOTE 1 - GENERAL (CONTD.)

In March 2002 the Ministry of Communications commenced granting domestic operator licenses to the cable companies. The license is valid, at this stage, only for providing broadband Internet access services. The application of the cable companies to merge has not yet been approved by the regulatory authorities.

In addition, a cellular company filed a petition in the High Court of Justice against the Company and against the Minister of Communications, for cancellation of the directive it received to disconnect direct connections which bypass the Company's network, which it provides for business customers. On February 11, 2002 the High Court of Justice issued an interim order for preservation of the existing situation. Following the order, directives were issued on February 27, 2002 by the Ministry of Communications to all the cellular companies, forbidding them to make any additional direct connections. Based on the opinion of the legal advisor who is handling the claim on its behalf, the Company is unable to estimate the chances of the defense in this case.

As a result of the various changes in the communications market as described above, a significant deterioration has occurred in the business results of the Group. This is expected to continue with the opening of fixed-line domestic communication services to full competition, and cannot be estimated at this stage.

F. On August 27, 2000, the Ministerial Committee for Privatization decided to sell the State's holdings in the Company by way of a private sale which would be accompanied by a raising of capital for the Company. The sale will include shares comprising at least 50.01% of the Company's share capital. The Government Companies Authority was authorized to take the actions necessary for implementing the decision, including those actions set out in the decision.

The Ministerial Committee for Privatization later adopted a number of resolutions intended to advance the implementation of the above decision, and the Company's license, its Articles of Association and the Telecommunications Order were amended as aforesaid. On November 13, 2001, the Government of Israel published a notice stating that it was considering the sale of the State's holdings, comprising 50.01% of the share capital of the Company, by way of a private sale. Following the notice, several entities expressed their interest in participating in the sale process. These approaches are still being studied. On January 13, 2002 a framework agreement was signed between the State and the Company, concerning the raising of up to NIS 890 million in capital for the Company in accordance with the decision of the Ministerial Committee for Privatization, while concurrently, the Company will allot shares to the State in the same amount as those sold by the State (see Note 21B).

NOTE 2 - SIGNIFICANT ACCOUNTING PRINCIPLES AND REPORTING POLICIES

A. Definitions

In these financial statements -

(1) Subsidiaries – Companies whose financial statements are fully consolidated, directly or indirectly, with the financial statements of the Company.

(2) Proportionately consolidated companies – Companies whose financial statements are proportionally consolidated, directly or indirectly, with the financial statements of the Company.

(3) Affiliated companies – Companies, other than subsidiaries or proportionately consolidated companies and including a partnership, the Company's investment in which is stated, directly or indirectly on the equity basis.

(4) Investee companies – Subsidiaries, proportionately consolidated companies or affiliates.

(5) Related parties – As defined in Opinion No. 29 of the Institute of Certified Public Accountants in Israel (hereinafter - "ICPAI").

NOTE 2 - SIGNIFICANT ACCOUNTING PRINCIPLES AND REPORTING POLICIES (CONTD.)

A. DEFINITIONS (CONTD.)

(6) Interested parties – As defined in the Securities Law, Section 1 Paragraph (1)

(7) Controlling interest – As defined in the Securities Regulations (Presentation of transactions between a company and its controlling interest in the financial statements), 5756-1996.

(8) CPI - the Consumer Price Index published by the Central Bureau for Statistics.

B. FINANCIAL STATEMENTS IN ADJUSTED VALUES

(1) The financial statements have been prepared on the basis of historical cost adjusted for the effect of the changes in the general purchasing power of the Israeli currency (data on the Company in nominal values appear in Note 31).

(2) The adjusted value of non-monetary assets does not necessarily reflect their market or economic value, but rather, their cost adjusted for the effect of the changes in the general purchasing power of the shekel.

(3) The terms "cost" as used in the adjusted reports means "adjusted cost".

(4) All the comparative figures (including those of monetary items), have also been adjusted to the CPI of the end of the current reporting period.

C. USE OF ESTIMATES

Preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and disclosure relating to contingent assets and liabilities, as well as amounts of revenues and expenses for the report period. Actual results may differ from these estimates.

D. The items of the statements of operations have been reclassified and are presented in the order arising from the nature of the Company's business as a communications company.

E. Principles of adjustment

(1) Balance sheet

Non-monetary items (mainly fixed assets, materials and spare parts, investments stated at cost) have been adjusted on the basis of the changes in the CPI from the index in respect of the month in which the item was acquired or arose, to the index in respect of the balance sheet month.
Monetary assets are stated in the adjusted balance sheet at their nominal value at that date.
The net asset value of the investments in investee companies is determined on the basis of the adjusted financial statements of such investees.

(2) Statement of operations

Statement of operation items were adjusted on the basis of changes in the CPI as follows:

(a) Income and expenses deriving from non-monetary items (such as depreciation, amortization, changes in materials and spare parts, prepaid expenses, deferred income, etc.) or from provisions included in the balance sheet (such as for vacation pay, employee vacation expense allowance, etc.), were adjusted on the basis of the same specific indices as were applied to the related balance sheet items.

(b) Other statement of operation items (such as sales, purchases, current production costs, etc.), other than the components of the financing item, were adjusted on the basis of the CPI from the date of receipt of payment or making payment, until the index in respect of balance sheet month.

NOTE 2 - SIGNIFICANT ACCOUNTING PRINCIPLES AND REPORTING POLICIES (CONTD.)

E. PRINCIPLES OF ADJUSTMENT (CONTD.)

(2) Statement of operations (Contd.)

(c) The Company's equity in operating results of investee companies was included on the basis of the adjusted financial statements of those companies.

(d) The financing item reflects interest income and expenses in real terms, erosion of monetary items during the year, earnings and losses from the disposal and revaluation of marketable securities, and earnings and losses from derivatives.

(e) Income tax:
Current income tax expense is comprised of advance payments made during the year plus amounts payable (or less amounts refundable) at balance sheet date. The advance payments were adjusted on the basis of the CPI at the time of making each payment, while the amounts payable (or refundable) were not adjusted. Therefore, the current income tax expense includes also the expenses deriving from erosion in the value of the advance tax payments, from the date of payment until the balance sheet date.
See Notes 2O and 11D relating to deferred taxes.

(3) Statement of changes in shareholders' equity

A dividend that was announced and actually paid in the report year was adjusted on the basis of the CPI at date of payment. A dividend that was announced/proposed in the report year but had not been distributed as at balance sheet date, was stated unadjusted.

(4) Adjustments on the basis of the foreign currency exchange rates and foreign companies

The net asset value of an affiliate that operates autonomously in a foreign country is determined on the basis of the financial statements of the affiliate, adjusted to the changes in the purchasing power of the currency in which they were prepared and translated into NIS according to the representative exchange rate as at balance sheet date.

F. CONSOLIDATION OF THE FINANCIAL STATEMENTS

(1) The consolidated financial statements include the financial statements of those companies over which the Company has control. Jointly-controlled companies are consolidated by the proportionate consolidation method.

(2) A list of subsidiaries, affiliates, other companies and rates of holding is included in a schedule of the financial statements.

(3) For the purpose of the consolidation, the amounts appearing in the financial statements of the subsidiaries were taken after adjustments required by the application of the uniform accounting policies used by the Group.

(4) Inter-company balances and transactions between subsidiaries were eliminated upon consolidation.

(5) The excess of the net asset value upon acquisition over the cost of the investment (hereinafter - "negative goodwill") is attributed to fixed assets in accordance with Opinion No. 57 of the ICPAI and is amortized accordingly.

NOTE 2 - SIGNIFICANT ACCOUNTING PRINCIPLES AND REPORTING POLICIES (CONTD.)

G. INVESTMENTS IN INVESTEE COMPANIES

(1) Investments in affiliates are accounted for by the equity method. In determining the equity of the investments in these companies, the amounts as they are included in the financial statements of the companies are taken into account. Surplus cost of investment over the equity on the date of acquisition was attributed to goodwill and amortized in equal annual installments over 10 years.

(2) On the financial statements of an affiliate which are adjusted according to changes in the foreign currency exchange rate - see Note 2E(4).

H. DECREASE IN VALUE OF INVESTMENTS IN INVESTEE AND NON-NNVESTEE COMPANIES

The Company periodically checks whether a change of a non-temporary nature has occurred in its investments. The review is carried out upon the existence of signs indicating that the value of permanent investments has been impaired, including falling stock-exchange prices, ongoing losses in the investee, the sector in which the investee operates, the goodwill value included in the investment and other parameters. The deductions for adjusting the value of these investments, which management estimates is based on examination of all the relevant aspects and giving them their proper weight, and which are not of a temporary nature, are attributed to the statement of operations.

I. MARKETABLE SECURITIES

Current investments in marketable securities are carried at market value on the stock exchange as at the balance sheet date. The changes in the value of the securities are charged to the statement of operations.

J. PROVISION FOR DOUBTFUL DEBTS

In the opinion of management, the provisions for doubtful debts in the financial statements properly reflect the loss inherent in debts, the collection of which is considered doubtful. In determining the propriety of the provisions, management considered, among other things, the risk assessment as derives from the information in its possession concerning the financial situation of the debtors, the scope of their operations, and the period of arrears in clearing their debt. Doubtful debts which management believes cannot be collected are written off in the Company's books following a management decision. The financial statements also contain a general provision for doubtful debts.

K. INVENTORY

Inventory of equipment and user equipment is presented at the lower of cost or value to the business.

As part of its current operations, a proportionately consolidated company upgrades user equipment for its customers. As a result, inventory includes user equipment returned from customer, as well as spare parts which are used by the company for the repair of user equipment in the framework of the insurance it provides for its customers.

L. MATERIALS AND SPARE PARTS

Materials and spare parts are valued at the lower of cost (which is determined by the moving average method) or market. Materials are intended primarily for use as components of fixed assets.

M. FIXED ASSETS

(1) Fixed assets are stated at cost.

(2) The cost of an asset under self-construction includes materials, sub-contractors, wages and financing expenses in the construction period, but not exceeding their value to the business.

NOTE 2 - SIGNIFICANT ACCOUNTING PRINCIPLES AND REPORTING POLICIES (CONTD.)

M. FIXED ASSETS (CONTD.)

(3) Improvements and enhancements are added to the cost of assets, while maintenance and repairs are charged to the statement of operations as incurred.

(4) In the event of a decrease in the value of assets to the business, a provisions is recorded accordingly for decrease in value.

(5) Real financing expense for loans and credit used for financing the construction or purchase of fixed assets is attributed, starting on January 1, 2000, to the cost of those assets, in accordance with Accounting Standard No. 3 – Capitalization of Credit Costs. See Note 9A.

(6) Depreciation is calculated by the straight-line method, based on the estimated useful lives of the assets.

Annual depreciation rates:

		Principal depreciation %	
	% depreciation	**Until 2000**	**As of 2000**
Buildings	4	4	4
Digital switching equipment	10	8.3	10
Transmission and power equipment	10-20	20	20
Network equipment	5-25	4.33	5
Subscriber equipment and public telephones	20	20	20
Motor vehicles	15	15	15
Office equipment	10-20	20	10
Computers	33	20	33
Cellular telephone infrastructure equipment	10-20	20	20

Improvements to leased premises are depreciated throughout the term of the lease (including the Company's option to extend the lease period), which does not exceed the economic life of the asset.

N. DEFERRED EXPENSES AND OTHER ASSETS

(1) Cost of issue of debentures and raising loans
These costs (treated as a non-monetary item) are amortized over the term of the debentures pro rata to the balance of the debentures in circulation.

(2) Cost of acquiring a subscriber
Since 1999, Pelephone Communications Ltd. has been capitalizing its net direct costs paid to a third party in respect of the sale of subscribers who signed an undertaking to remain customers of Pelephone (where violation of the undertaking leads to payment of a penalty by the customer and depreciation of the asset). These costs appear in the balance sheet under Other assets, and are amortized throughout the period of the subscribers' undertaking, which is 36 months. The costs of acquiring a subscriber at Bezeq International Ltd. is amortized in a straight line over the term of their use, which is 5 and 10 years.

(3) Rights of representation of a communications corporation
The rights of representation of a communications corporation are amortized for the period of financial benefit over 10 years.

(4) Rights in channels
Rights in channels are amortized over the period of use, which is 5 and 10 years.

NOTE 2 - SIGNIFICANT ACCOUNTING PRINCIPLES AND REPORTING POLICIES (CONTD.)

O. DEFERRED TAXES

The companies in the Group allocate taxes for temporary differences. Temporary differences are differences between the value of assets and liabilities for tax purposes and their book value in the balance sheet. Such allocation of taxes is made for differences relating to assets whose consumption or depreciation is deductible for tax purposes. Deferred tax balances (asset or liability) are calculated according to the liability approach using the tax rates which will be in effect at the time of utilization of the deferred taxes, or upon realization of tax benefits, as they are known at the date of approval of the financial statements.

The main factors for which deferred taxes were not calculated are these:

(1) The amounts of the adjustment for changes in the purchasing power of the shekel which relate mainly to buildings and private cars, in accordance with the principles stated by the ICPAI.

(2) Investments in investee companies, since the Company intends to hold these investments and not to realize them.

(3) A tax receivable benefit in respect of timing differences where the likelihood of realizing the benefit is questionable.

P. INCOME RECOGNITION

Income is attributed to the statement of operations upon being generated, on the accrual basis.

Q. CAPITALIZATION OF CREDIT COSTS

The Company capitalizes credit costs in accordance with Standard No. 3 – Capitalization of Credit Costs, published in July 1999 by the Institute for Accounting Standardization.

This standard requires the capitalization of specific credit costs and credit costs which are not specific to qualified assets. Non-specific credit costs are capitalized to the investment or part thereof which was not financed by specific credit, at a rate which is the weighted average of the cost in respect of those credit resources whose cost was not specifically capitalized.

The provisions of this standard have been applied since January 1, 2000, and accordingly, credit costs attributed to assets under construction are capitalized until the date on which all activities preparing it for its intended use have been completed. See Note 9A.

R. DERIVATIVE FINANCIAL INSTRUMENTS

(1) Forward currency contracts intended to hedge foreign currency exposure of assets and liabilities are included in the statement of operations, concurrently with accounting reference to the hedged item.

(2) Derivative financial instruments not designated for hedging are presented in the balance sheet at their fair value. Changes in the fair value are attributed to the statement of operations in the period in which they occurred.

S. FOREIGN CURRENCY AND LINKAGE

Assets (excluding securities) and liabilities denominated in or linked to a foreign currency are stated at the representative exchange rates published by the Bank of Israel on the balance sheet date.
Assets (excluding securities) and liabilities linked to the CPI are stated on the basis of the contractual linkage terms of each balance.

NOTE 2 - SIGNIFICANT ACCOUNTING PRINCIPLES AND REPORTING POLICIES (CONTD.)

S. FOREIGN CURRENCY AND LINKAGE (CONTD.)

Details of the CPI and the U.S. dollar exchange rates:

	December 31 2001	December 31 2000	% of change 2001	% of change 2000	% of change 1999
CPI – index	**101.6**	100.2	**1.397**	0.00	1.34
US dollar exchange rate $1 – in NIS	**4.416**	4.041	**9.279**	(2.69)	(0.17)
Euro exchange rate	**3.907**	3.763	**3.827**	(9.87)	-

T. EARNINGS PER SHARE

Earnings per share are calculated in accordance with Opinion No. 55 of the ICPAI. Fully-diluted earnings per share are not presented as the effect of dilution is not significant.

U. DEBENTURES CONVERTIBLE TO SHARES

Debentures convertible to shares are classified by the likelihood of conversion, as laid down in Opinion No. 53 of the ICPAI. Debentures which are not expected to be converted are included as liabilities at their liability value. Debentures which are expected to be converted are included between the long-term liabilities item and the shareholders' equity item, at liability value or capital value, whichever is the higher.

V. RESTATEMENT

The Company adjusted its financial statements for the year ended December 31, 1999 by way of restatement, in order to reflect retroactively the accounting treatment in the capitalization of the cost of subscriber acquisition at Pelephone Communications Ltd. – a proportionately consolidated company. Until 1999, in the original reports, Pelephone had attributed customer acquisition costs to profit and loss. Starting with the financial statements for the year ended December 31, 1999, these costs in respect of the years up to 1999 also appear in the balance sheet under other assets and are amortized over 36 months. Amended reports for the year ended December 31, 1999 were published on August 15, 2000.

W. DISCLOSURE OF THE EFFECT OF ACCOUNTING STANDARDS IN THE PERIOD PRIOR TO THEIR APPLICATION

During the reporting period, the Israeli Institute for Accounting Standardization published the following new standards:

1. Accounting Standard No. 8 – Discontinued operations. The standard lays down rules for the separate presentation of information relating to a material business operation which is discontinued by a corporation and information relating to ongoing operations, and determines the minimum disclosure of information concerning a discontinued operation.
   Accounting Standard No. 8 will apply to financial statements starting from January 1, 2002.
   The Company does not expect the effects of this standard to be significant.

2. Accounting Standard No. 12 – Termination of adjustment of financial statements. This standard eliminates adjustment for inflation in financial statements, starting from January 1, 2003.
   Until December 31, 2002, the Company will continue to prepare its adjusted financial statements in accordance with Opinion No. 36 of the ICPAI. The adjusted amounts appearing in the financial statements as at December 31, 2002 will be the starting point for nominal financial reporting starting on January 1, 2003. This standard could have a significant detrimental effect on the reported results of the Company. The extent of that effect will depend on the rate of inflation and the financial structure of the Company.

NOTE 2 - SIGNIFICANT ACCOUNTING PRINCIPLES AND REPORTING POLICIES (CONTD.)

W. DISCLOSURE OF THE EFFECT OF ACCOUNTING STANDARDS IN THE PERIOD PRIOR TO THEIR APPLICATION (CONTD.)

3. Accounting Standard No. 13 – Effects of changes in foreign currency exchange rates. The standard deals with the translation of foreign currency transactions and the translation of the financial statements of overseas operations for integration in the financial statements of the reporting corporation, and supersedes the provisions of Clarifications 8 and 9 to Opinion No. 36, which will become null and void when Accounting Standard No. 12 – Termination of adjustment of financial statements, takes effect. Standard No. 13 will apply to financial statements for periods starting after December 31, 2002.

X. INITIAL APPLICATION OF ACCOUNTING STANDARD

The Company has elected to apply Accounting Standard No. 11 – Sectoral reporting, before it becomes compulsory. The standard requires the inclusion of information about business and geographical sectors, and sets out detailed guidelines for identifying such sectors.

This accounting standard will apply to financial statements for the period starting on January 1, 2002 or thereafter.

NOTE 3 - CASH AND CASH EQUIVALENTS

	Consolidated		Company	
	December 31 2001	December 31 2000	December 31 2001	December 31 2000
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Israeli currency	**1,261,397**	822,399	**1,251,301**	813,797
Foreign currency	**41,603**	732,087	**19,065**	729,494
	1,303,000	1,554,486	**1,270,366**	1,543,291

Cash equivalents include bank deposits with an original maturity not exceeding three months.

NOTE 4 - SHORT-TERM INVESTMENTS

	Consolidated		Company	
	December 31 2001	December 31 2000	December 31 2001	December 31 2000
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Marketable securities:				
Government debentures				
Linked to the CPI	**127,354**	56,290	**124,000**	54,105
Linked to the U.S. dollar exchange rate	**16,771**	12,150	**15,105**	10,634
Unlinked	**50,912**	40,381	**46,075**	29,872
Debentures convertible to shares	**15,796**	5,237	**15,614**	4,922
Other debentures	**56,288**	25,374	**56,288**	24,636
Mutual fund participation certificates	**169,914**	25,571	**167,540**	22,242
	437,035	165,003	**424,622**	146,411
Short-term bank deposits				
Linked to the CPI	**3,448**	24,596	**–**	24,338
Unlinked	**171**	1,425	**–**	–
	440,654	191,024	**424,622**	170,749

NOTE 5 - TRADE RECEIVABLES

	Consolidated		Company	
	December 31, 2001	December 31, 2000	December 31, 2001	December 31, 2000
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
In respect of domestic services:				
On open account	**1,543,069**	1,171,310	**1,014,221**	624,293
Income receivable	**315,748**	282,275	**251,353**	221,799
Credit cards and checks payable	**170,446**	128,582	**90,031**	91,091
Investee companies	**1,199**	997	**1,199**	8,137
In respect of international services	**37,999**	66,354*	**8,091**	16,908
	2,068,461	1,649,518	**1,364,895**	962,228
Less provision for doubtful debts	**381,249**	357,389	**219,351**	223,613
	1,687,212	1,292,129	**1,145,544**	738,615

* Reclassified

2001 – Including debts in respect of airtime – See Note 1E(1).

NOTE 6 - OTHER RECEIVABLES AND DEBIT BALANCES

	Consolidated		Company	
	December 31, 2001	December 31, 2000	December 31, 2001	December 31, 2000
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Deferred tax asset (see Note 11D)	**181,084**	188,785	**146,905**	164,551
Income tax refundable	**5,010**	226,530	**–**	189,981
Prepaid expenses	**34,987**	20,449	**19,742**	5,345
Forward exchange contracts	**81,210**	15,812	**78,262**	15,812
Other receivables and debit balances	**19,717**	31,100	**7,830**	16,153
	322,008	482,676	**252,739**	391,842

NOTE 7 - INVESTMENTS, DEPOSITS AND DEBIT BALANCES

	Consolidated		Company	
	December 31 2001	December 31 2000	December 31 2001	December 31 2000
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Investment in companies that are not investee companies:				
Investment in convertible debentures (1)	**1,106,871**	–-	**1,106,871**	–
Investments in shares	**58,396**	4,454	**58,396**	4,454
Bank deposit for granting loans to employees (2)	**223,434**	223,644	**223,434**	223,644
Investment in venture capital funds	**21,918**	19,352	**21,918**	19,352
Income tax refundable	**201,422**	–	**201,422**	–
Forward exchange contracts	**7,880**	–	**7,880**	–
Long term trade receivables(3)	**61,011**	46,125	–	–
	1,680,932	293,575	**1,619,921**	247,450

(1) See Note 8D(2).

(2) The deposit is unlinked and the average weighted monthly interest rate is approximately 0.19%. The Company is responsible for the loans to the employees. Withdrawal of the deposit is contingent upon repayment of the loans.

(3) Long-term receivables is calculated less deferred interest income which comprises the difference between the amount of the original debt and its present value on the date of recognition of the income. Present value is calculated at an effective interest rate of 8.5-11% per annum. (2000 – 12%).

NOTE 8 - INVESTMENTS IN AFFILIATED COMPANIES

A. COMPOSITION:

	Consolidated		Company	
	December 31 2001	December 31 2000	December 31 2001	December 31 2000
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Affiliated companies				
Investment in shares -				
Cost	**111,908**	117,893	**65,411**	63,270
Post-acquisition losses	**(394,510)**	(212,293)	**(371,917)**	(196,772)
Amortization of surplus equity over cost attributed to goodwill	**(25,638)**	(3,213)	**(1,111)**	(571)
	(308,240)	(97,613)	**(307,617)**	(134,073)
Other investments -				
Long-term loans (1)	**769,307**	272,723	**765,097**	269,748
	461,067	175,110	**457,480**	135,675
Consolidated companies				
Shares -				
Cost			**382,618**	359,320
Loans			**159,228**	-
Post-acquisition losses			**(215,217)**	(143,500)
			326,629	215,820
Proportionally consolidated company				
Shares -				
Cost			**343,755**	257,232
Post-acquisition earnings			**434,808**	658,614
Amortization of surplus equity over cost attributed to fixed assets			**37,463**	37,463
			816,026	953,309
			1,600,135	1,304,804

(1) Including a loan of NIS 732 million to D.B.S. Satellite Services (1998) Ltd. ("DBS"). At a general meeting of the shareholders of DBS on December 24, 2000, it was resolved that the various loans extended to DBS by the shareholders would bear linkage differentials plus interest at 7% p.a. from the date they were made to the date of their repayment, or their partial repayment, as the case may be, or at other interest rates and linkage differentials, as the general meeting of shareholders decides. These terms will apply also to future loans to DBS by the shareholders, as long as no other resolution is adopted by the general meeting. The same resolution determines that it will take effect on January 24, 2001 unless by that date a certain shareholder gives notice of its objection. If that shareholder does give notice of its objection, the resolution will take effect on the date on which that shareholder withdraws from the venture. As at the date of signing of these financial statements, the shareholder gave notice as aforesaid and accordingly, the resolution has not taken effect and no interest was attributed to the loan. The loans appearing in the financial statements are linked to the CPI.

The date of repayment of the loans has not yet been set, and is subject to limitations set out in a memorandum of terms which was signed between DBS and the banks – see section F below.

The market and book values of an affiliated company listed on the stock exchange as at December 31, 2001, are approximately NIS 8.9 million.

NOTE 8 - INVESTMENTS IN AFFILIATED COMPANIES (CONTD.)

A. COMPOSITION (CONTD.)

	Consolidated		Company	
	December 31 2001	December 31 2000	December 31 2001	December 31 2000
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Balance of surplus equity over cost not yet amortized, attributed to goodwill	**14,976**	37,401	**4,294**	4,834

A list of the companies in the Group appears in a schedule attached to the financial statements.

B. INVESTMENT ACTIVITY IN 2001 WAS AS FOLLOWS (NOT INCLUDING LONG-TERM LOANS):

	Consolidated	Company
	NIS thousands	NIS thousands
Balance as at the beginning of the year	**(97,613)**	**1,035,056**
Activity during the year:		
Investment in shares	**27,220**	**141,687**
Realization of investment	**(29,725)**	**(29,725)**
Equity in losses	**(204,642)**	**(471,208)**
Other changes	**(3,480)**	**–**
Balance as at the end of the year	**(308,240)**	**675,810**

C. SUMMARY OF COMPANY EQUITY IN ASSETS, LIABILITIES, INCOME AND EXPENSES OF A PROPORTIONALLY CONSOLIDATED COMPANY AS INCLUDED IN THE CONSOLIDATED STATEMENTS

	December 31 2001	December 31 2000
	NIS thousands	NIS thousands
Current assets	**521,127**	567,273
Other assets	**1,687,321**	1,812,097
Current liabilities	**918,258**	1,054,697
Long-term liabilities	**515,383**	407,316

	For the year ended December 31		
	2001	2000	1999
	NIS thousands	NIS thousands	NIS thousands
Revenues	**1,778,608**	1,684,233	1,176,202
Costs and expenses	**1,825,297**	1,782,904	1,351,896

NOTE 8 - INVESTMENTS IN AFFILIATED COMPANIES (CONTD.)

D. PELEPHONE COMMUNICATIONS LTD. ("PELEPHONE")

(1) In 1994 the Company was allotted shares which gave it 50% of the ownership and control of Pelephone, in exchange for the Company's rights to provide cellular services. In accordance with Government decisions of January 9, 1994 and August 10, 1994, the "market value" of the assets transferred, to be agreed upon between Motorola Israel Ltd. (50%-owner of Pelephone) and the Company, must be examined and will require the approval of the Government Companies Authority.

The Government Companies Authority appointed independent consultants to verify the aforementioned "market value". In the opinion of the consultants, the Company's share in Pelephone should be 60%.

The Company's Board of Directors considered the report's findings and concluded, on the basis of explanations and clarification obtained from the Company's management and the Company's legal advisors, that the transactions by which 50% of the ownership and control of Pelephone was allotted to the Company, was effected in a professional, economically-sound manner in accordance with the Government decisions referred to above. This position of the Board of Directors was conveyed to the Government Companies Authority. As of the date of publication of these financial statements, the Government Companies Authority has not yet conveyed its position to the Company.

The Government Companies Authority and the Company decided to review the validity and the legal and commercial implications of a letter of undertaking in connection with the agreement made between the Company and Motorola Israel Ltd., which the Company submitted to Motorola Israel Ltd. on October 10, 1994.

On November 5, 1997, a meeting to discuss the "market value" took place at the office of the Minister of Finance with the participation of representatives of his ministry and of the Ministries of Communications and Justice and of the Government Companies Authority. At the conclusion of the meeting the Minister of Finance decided that the Government would make no claim against the Company in the matter of this transaction and that the Legal Counsel of the Ministry of Finance, in coordination with the Ministry of Communications, would prepare a legal opinion concerning the possibility of the State exercising the Company's rights vis-a-vis Motorola, if such exist, whether directly or through the Company, and that the Ministry of Justice would relate to that legal opinion. As at balance sheet date, such opinions have not yet been prepared.

Neither the Company's management nor its legal advisors can predict the outcome of the investigations described above or their likely impact on the Company.

(2) In September 2000 a notice was received from Motorola Israel Ltd. ("Motorola"), informing the Company of negotiations between Motorola and a third party for the sale of its holdings in Pelephone. Under the Pelephone shareholders' agreement, if one party to the agreement wishes to sell its shares in Pelephone, it must offer them to the other party, and the other party is entitled, inter alia, to propose an alternative offeree to buy the shares. At its meeting on November 22, 2000, the Board of Directors of the Company selected Shamrock Holdings of California Inc. as the alternative offeree to purchase the shares of the Pelephone shareholder and sign an option agreement with the Company. The share purchase transaction was subsequently made by a corporation registered in the USA (hereinafter – "the Corporation") indirectly owned by Shamrock.

On February 27, 2001, after approval of the Ministry of Communications and the Anti-Trust Commissioner, the transaction was closed. The main points of the transaction are these:

NOTE 8 - INVESTMENTS IN AFFILIATED COMANIES (CONTD.)

D. PELEPHONE COMMUNICATIONS LTD. (CONTD.)

a. Motorola's shares in Pelephone were transferred to the Corporation in consideration of approximately $591 million. The consideration was partially financed by a loan of $240 million extended by the Company, for which it received debentures linked to the US dollar exchange rate, bearing interest and convertible, for up to four years, for 80% of the shares of the Corporation. These debentures are presented in the balance sheet under the Investments, deposits and long-term debit balances item. Accumulated interest and exchange rate differentials up to December 31, 2001 amount to approximately NIS 98 million.

b. The Company was given a call option to purchase the remaining 20% of the share capital of the Corporation together with conversion of the debentures to shares as aforesaid ("the Options"). In the event of conversion of the debentures to shares, the Company must exercise the option.

c. The Company can exercise the Options within six months of the date of purchase of the shares ("the Short Option"), or starting from the end of 24 months from the date of purchase of the shares until the elapse of four years from the date of the purchase ("the Long Option"). As at the report date, the Company had not exercised the Short Option and it expired.

d. The exercise price of the Long Option is the higher of return of the nominal investment or a valuation of the market value of 20% of the Corporation's shares.

During the year, the Company invested in Pelephone the sum of US $20 million as a premium on shares that were issued in the past. Shamrock Holdings of California, Inc. invested the same amount. In February 2002 each of the shareholders invested an additional US $30 million.

E. EMITEL TELECOMMUNICATION CORP. LTD. – A COMPANY REGISTERED IN HUNGARY ("EMITEL")

In December 2000, Aphrodite B.V. ("Aphrodite"), which is indirectly held by the Company (66.7%), signed an agreement for the sale of all its holdings in Emitel. Closing of the transaction was made contingent upon receipt of approvals from the Hungarian Minister of Communications and from the Hungarian Anti-Trust Authority. All the requisite approvals were obtained by June 30, 2001, enabling the transaction to be closed. In consideration of the sale, Aphrodite received approximately US $49 million and recorded a capital gain of approximately $32 million.

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

The Company holds 30% of the shares of D.B.S. Satellite Services (1998) Ltd. In January 1999, DBS received a license from the Ministry of Communications for satellite television broadcasts, in exchange for payment of NIS 30 million and a guarantee in the amount of NIS 30 million. DBS foresees considerable losses and negative cash flow from operations in the first years of its activities. Its losses in 2001 amounted to approximately NIS 840 million, and the negative cash flow from ordinary operations amounted to NIS – 596 million. These losses have led to an increase in its working capital deficit to approximately NIS 1,345 million (including NIS 883 million in short-term bank credit).

The Company's investment in DBS as at the balance sheet date was approximately NIS 732 million. The Company's share in the accumulated loses of DBS was approximately NIS 443 million, of which some NIS 252 million was recorded in the account year.

On May 23, 2001 a financing agreement was signed between DBS and three banks, determining, *inter alia*, preconditions for withdrawing funds from the credit lines, including an undertaking by DBS to meet the cumulative milestones and other stipulations set out in the agreement ("the Conditions"). As at the date of approval of these financial statements, not all the suspending conditions had been met. DBS and the banks are continuing to discuss the actions required for regulating these Conditions, as well as an increase in the credit lines approved for DBS.

NOTE 8 - INVESTMENTS IN AFFILIATED COMPANIES (CONTD.)

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

According to a decision of the Ministerial Committee for Privatization on January 21, 2001, the maximum cumulative exposure of the Company in connection with this investment shall at no time exceed the rate of the Company's actual holding in DBS, multiplied by $400 million (approximately NIS 1.8 billion). The Committee also approved an increase of the Company's holding in DBS to 50% of DBS's share capital, the approval being contingent upon amendment of the Telecommunications Regulations (or the Telecommunications Law) in the matter of limitations on a holding of the means of control in DBS by anyone who is a controlling interest in a broadcasting franchise. The Regulations were amended accordingly on May 14, 2001.

The sources of finance for DBS's activities are shareholders' loans and bank credit. On March 17, 2002 the Ministerial Committee for Privatization approved the Company's request to increase its exposure in DBS to the rate of its actual holdings multiplied by $480 million.

The activity of the affiliated company depends on continued implementation of the financing agreement, an increase in its approved bank credit lines, and the receipt of additional shareholders' loans. According to the assessment of the affiliated company's management, the agreements among the shareholders and the existing credit lines should be sufficient to provide most of the financial resources required by the affiliated Company in 2002, and there is a good chance that the further discussions between the affiliated company, the shareholders and the banks will lead to an arrangement for the balance of the finances required.

The Company has signed a perpetual guarantee for the banks, for payment of DBS's debts. The guarantee is up to a maximum sum equal to 30% of the value of DBS as derives from disposal of the pledged shares of the other shareholders. If the Company joins the sale as part of disposal of these pledged shares, the amount of the guarantee will not exceed the proceeds which the Company will receive from disposal of its shares in DBS. The deed of guarantee includes numerous restrictions on the Company in disposing of its shares, and sets out violations which, if perpetrated, will enable the banks to realize the guarantee.

In November 2001 an agreement was signed among the shareholders of DBS (except for Gilat DBS Ltd., which holds 15% of the shares of DBS), whereby the holdings of the Company in DBS will grow, initially to 44.9%. Some of the investments of the shareholders are supposed to become loans bearing interest at 5.5% per annum, and on March 31, 2002, the real investments of the shareholders in DBS are supposed to be recalculated together with a further adjustment in the percentages of holdings in DBS. Those of the DBS shareholders who signed the agreement, undertook that if the agreement was not signed by all the shareholders, they would act to implement the provisions of the agreement by means of adopting appropriate decisions in the competent organs of DBS. Furthermore, the Board of Directors of DBS approved the implementation of the provisions of the aforesaid agreement and allotted shares to the shareholders of the company as set forth in the agreement. As a result of the expected increase in the percentage of the Company's holdings in DBS, a surplus cost is expected to be generated, which will be depreciated over the period of expected financial benefit. The allotment has not yet been made, in view of the demand of the banks for certain amendments to the deed of guarantee which was forwarded to the Company, along with a demand from other DBS shareholders to amend the liens given to the banks.

The Anti-Trust Authority notified the Company on May 6, 2001 that in view of the domestic operator's license that a company in the Eurocom Group received, the Company and the Eurocom Group should be viewed as competitors. As a result, the cross-holding of the Company in DBS is liable to reduce the competition between them and as such, it constitutes, on its face, a binding agreement. The parties were requested to act as quickly as possible to approve the joint venture between them in one of the ways provided in the Anti-Trust Law. The Anti-Trust Commissioner gave notice that without derogating from the aforesaid, he was willing to try to find an agreed solution within 60 days. In response, the Company notified the Anti-Trust Commissioner that the fact of the partnership between it and Eurocom in the satellite venture does not constitute a binding agreement, since all its activities in this field were undertaken in accordance with lawful approvals, and that without derogating therefrom, it does not object to discussion and clarification of the matter with the Commissioner.

NOTE 8 - INVESTMENTS IN AFFILIATED COMPANIES (CONTD.)

F. D.B.S. SATELLITE SERVICES (1998) LTD. (CONTD.)

A first meeting at the Anti-Trust Authority was held soon after the Company's response was sent. In November 2001, the company from the Eurocom Group which received the domestic operator's license as aforesaid, gave notice that it was cutting back its operations and considering its further steps in this field. To the best of the Company's knowledge, the company has now ceased its activities in this field.

G. WALLA! COMMUNICATIONS LTD.

Bezeq International Ltd. invested in Walla, an Israeli company whose shares are listed on the Tel Aviv Stock Exchange and which provides Internet services and operates Internet portals. During 2000, Bezeq International acquired approximately 38.5% of he rights in Walla in consideration of approximately NIS 49,312 thousand.

On December 31, 2000, the affiliate Walla entered into a merger agreement with IOL Israel Online (2000) Ltd. ("IOL"). All the approvals required by law for the merger were obtained by June 24, 2001. Following the merger, the percentage of Bezeq International's holding in Walla decreased from 38.5% to 24.8% (as a result of an issue of shares to a third party), generating a loss for the Company from disposal of the investment. This loss, of approximately NIS 3,480 thousand, is included under the other expenses item in the financial statements for the year ended December 31, 2001.

As a result of the value ratios determined between IOL and Walla prior to the merger and the amortization of goodwill made at Walla after the merger with IOL, Bezeq International reduced its investment by recording additional amortization in accordance with the value ratios and other components pertinent to the investment. The depreciation, of approximately NIS 7,675 thousand, and Bezeq International's part in depreciation of the investment made by Walla following the merger, in the amount of approximately NIS 6,229 thousand, were included in the financial statements under the Company's equity in the losses of an affiliate.

On March 14, 2002 Walla issued a prospectus for a rights issue. Bezeq International invested approximately NIS 10,726 thousand in exercise of the rights and approximately NIS 3,157 thousand in the acquisition of additional rights from the public and their exercise. After exercise of the rights and the acquisition from the public, Bezeq International's holding in Walla increased from 24.8% to 36.68%.

H. ADANET FOR BUSINESS GROUP LTD. ("ADANET")

During the report period, the Company invested approximately NIS 40 million in Adanet, of which about NIS 19 million in exchange for 50% of Adanet's capital and NIS 21million as a shareholders' loan. Upon fulfillment of certain conditions, the Company, Clal Information Technologies Ltd. and the managers of Adanet have a put option and a call option for the other 50% of Adanet's shares, subject to any approvals required by law.

Adanet is a private company which erects and services networks and computer equipment.

NOTE 9 - FIXED ASSETS

A. COMPOSITION AND ACTIVITY

Consolidated

	Land & buildings	Switching, transmission and power equipment(1)	Network equipment	Subscriber equipment and public telephones	Motor Vehicles	Office equipment and computers	Total
				NIS thousands			
Cost –							
Balance as at January 1, 2001	2,119,595	14,406,691*	10,865,668 *	834,960*	328,012	896,329*	29,451,255
Additions	26,751	651,537	183,653	110,406	22,837	240,094	1,235,278
Disposals (2)	9,031	2,096,909	14,457	300,741	67,555	32,031	2,520,724
Balance as at December 31, 2001	2,137,315	12,961,319	11,034,864	644,625	283,294	1,104,392	28,165,809
Accumulated depreciation							
Balance as at January 1, 2001	1,095,231	8,311,545*	7,176,132*	528,312*	172,187	397,053*	17,680,460
Depreciation allocation	92,994	1,493,636	630,757	148,421	42,659	188,069	2,596,536
Cancellation in respect of disposals (2)	1,683	2,058,424	14,457	295,278	55,103	26,081	2,451,026
Provision for decrease of value (3)	-	102,026	-	-	-	-	102,026
Balance as at December 31, 2001	1,186,542	7,848,783	7,792,432	381,455	159,743	559,041	17,927,996
Net book value –							
As at December 31, 2001	950,773	5,112,536	3,242,432	263,170	123,551	545,351	10,237,813
As at December 31, 2000	1,024,364	6,095,146	3,689,536	306,648	155,825	499,276	11,770,795

* Reclassified

NOTE 9 - FIXED ASSETS (CONTD.)

A. COMPOSITION AND ACTIVITY (CONTD.)

Company

	Land & buildings	Switching, transmission and power equipment(1)	Network equipment	Subscriber equipment and public telephones	Motor Vehicles	Office equipment and computers	Total
	NIS thousands						
Cost –							
Balance as at January 1, 2001	2,059,322	11,156,774*	10,865,668*	800,318*	280,622	492,005*	25,654,709
Additions	11,849	373,103	183,653	96,401	10,303	122,447	797,756
Disposals (2)	8,690	2,085,006	14,457	276,666	59,674	30,909	2,475,402
Balance as at December 31, 2001	2,062,481	9,444,871	11,034,864	620,053	231,251	583,543	23,977,063
Accumulated depreciation							
Balance as at January 1, 2001	1,075,241	6,541,841*	7,176,132*	515,509*	153,913	231,186*	15,693,822
Depreciation allocation	86,585	1,148,477	630,757	132,051	35,138	118,029	2,151,037
Cancellation in respect of disposals (2)	1,622	2,051,598	14,457	276,666	49,650	25,144	2,419,137
Balance as at December 31, 2001	1,160,204	5,638,720	7,792,432	370,894	139,401	324,071	15,425,722
Net book value –							
As at December 31, 2001	902,277	3,806,151	3,242,432	249,159	91,850	259,472	8,551,341
As at December 31, 2000	984,081	4,614,933	3,689,536	284,809	126,709	260,819	9,960,887

* Reclassified

(1) Including NIS 2,377 thousand advance payments to suppliers on account of telephone exchange equipment ordered in respect of the year 2000.

(2) Fixed assets are written off the books at the end of the year in which they became fully depreciated, except for land, buildings and vehicles, which are written off the books when sold. In 2001, fully depreciated fixed assets of a cost of approximately NIS 2,296 million (2000 - NIS 1,294 million) were written off the books.

(3) A proportionally consolidated company made a provision for a decrease in value in respect of assets which it will not use in providing its services (see Note 9C).

(4) The cost includes the amount of NIS 10,000 in the Company and NIS 15,300 consolidated, which constitutes real financing expenses in respect of loans and credit during the establishment period, calculated at a real interest rate of approximately 4% per annum (preceding year – 7.4%).

NOTE 9 - FIXED ASSETS (CONTD.)

B. Most of the real estate assets used by the Company were transferred to it by the State under an agreement dated January 31,1984. Some of these assets are leased for 49 years with an option for an extension for another 49 years, and some are rented for renewable periods of two years each.

As at the time of the preparation of the financial statements, the Company's rights in a considerable part of its real estate assets are not registered at the Lands Registry Office.

The Accountant General of the Ministry of Finance notified the Company in January 1998 that the State intends to terminate the lease of those assets rented for the renewable two-year periods, and that the Ministry of Finance will examine the use actually made by the Company of each specific asset and will take appropriate action with respect to the matter of making available alternative land and the payment of the relocation expenses. The Company's management opposed implementation of the plan. In May 1999, representatives of the Company and the Israel Lands Administration held a meeting in the presence of representatives of the Government Companies Authority in the office of the Attorney General. In summing up the meeting, the Attorney General said that the Company could not carry out a public offering of its shares before clarification of the factual basis and the questions in dispute, so that the discussions could be held on the best way for settling the dispute. Further to the decision of the Ministerial Committee for Privatization of August 27, 2000 concerning the privatization of the Company, the Attorney General confirmed, in February 2001, the description of the land dispute which was described in an immediate report issued by the Company. The description includes the positions of the parties in their own words, to which was attached a list of the properties which are the subject of the dispute. The main points of the Company's position are, *inter alia*, that it is entitled to receive rights of ownership or "quasi-ownership" in those assets which are rented for renewable two-year periods. With regard to the leased part of the assets, the Company also believes that it is entitled to ownership rights or rights of lease for the maximum period that the State could offer. The State does not agree to these claims of the Company, and asserts, *inter alia*, that it is authorized, with notice to the Company, to terminate the renewable rental, and in any case not to renew it. In the opinion of the State, the Company's refusal to accede to the demands of the State has harmed and continues to harm the State's ability to make financially sound and efficient use of the land, and as an example the State mentions the value of two assets which, according to its preliminary estimates, are worth (together) approximately $440 million. On the leased assets, the State's position is that the Company's rights therein are rights of lease as stipulated in the agreements signed by the parties on this matter. It is noted that the parties negotiated in the past in an attempt to settle the various disputes on this matter, but were unsuccessful in reaching a settlement. At present, the intention is to bring the dispute to court for settlement.

C. A proportionally consolidated company depreciated assets in the account year which it will not use in providing its services. The net book value of the assets in the books of the proportionally consolidated company, was approximately NIS 204 million. The depreciation of the assets was included under the Other expenses item.

D. As at the balance sheet date, commitments exist for the purchase of fixed assets (mainly switching equipment) in the amount of approximately NIS 383 million (consolidated) and approximately NIS 260 million for the Company. A proportionally consolidated company has commitments to purchase inventory of subscriber equipment amounting to approximately NIS 131 million.

NOTE 10 - DEFERRED AND OTHER EXPENSES

Consolidated

	Cost	Accumulated depreciation	Balance for depreciation December 31 2001	Balance for depreciation December 31 2000
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Capitalized subscriber acquisition costs	757,534	450,274	**307,260**	356,305
Rights in channels	5,242	1,515	**3,727**	4,400
Representation rights in a communications corporation	3,600	1,710	**1,890**	2,250
	766,376	453,499	**312,877**	362,955
Expenses for issue of debentures and raising loans			**16,983**	15,500
Minority rights in proportionally consolidated company			**10,539**	4,963
			340,399	383,418

Company

	Balance for depreciation December 31 2001	Balance for depreciation December 31 2000
	NIS thousands	NIS thousands
Deferred expenses		
Expenses for issue of debentures and raising loans	**16,983**	15,500

NOTE 11 - TAXES ON INCOME

A. GENERAL

The Income Tax Law (Adjustments for inflation), 5745-1985, effective since the 1985 tax year, introduced a method of measuring operating results for tax purposes on a real basis. The various adjustments required by this law are intended to bring about taxation on the basis of real income. However, adjustment of the nominal profit in accordance with the tax laws is not always identical with the inflation adjustments prescribed for financial reporting purposes by opinions of the ICPAI. As a result, differences arise between the inflation-adjusted profit in the financial statements and adjusted taxable income.

The asset component demanded by the Company as an expense for tax purposes, is allocated directly to shareholders' equity.

Regarding deferred taxes in respect of these differences - see Notes 2O above and 11D below.

NOTE 11 - TAXES ON INCOME (CONTD.)

B. INCOME TAX (TAX BENEFIT) INCLUDED IN THE STATEMENT OF OPERATIONS

Consolidated

	For the year ended December 31		
	2001	2000	1999
	NIS thousands	NIS thousands	NIS thousands
Current taxes	**(339,838)**	(178,299)	9,732
Deferred taxes	**121,392**	327,374	(72,362)
Taxes for prior years, net	**(12,146)**	6,409	2,124
	(230,592)	155,484	(60,506)

Company

	For the year ended December 31		
	2001	2000	1999
	NIS thousands	NIS thousands	NIS thousands
Current taxes	**(336,710)**	(171,637)	(1,100)
Deferred taxes	**2,072**	305,824	(71,128)
Taxes for prior years, net	**(12,119)**	6,561	857
	(346,757)	140,748	(71,371)

C. RECONCILIATION BETWEEN THE THEORETICAL TAX COMPUTED IN RESPECT OF THE PRE-TAX INFLATION-ADJUSTED EARNINGS AND THE ACTUAL TAX EXPENSES IN THE BOOKS

Consolidated

	For the year ended December 31		
	2001	2000	1999
	NIS thousands	NIS thousands	NIS thousands
Tax computed at the regular tax rate (*)	**(206,190)**	187,036	(30,073)
Increase (savings) in tax liability due to:			
Inflationary erosion of advance tax payments	**(379)**	68	(1,191)
Exempt income and capital gains	**25,823**	48,689	14,674
Non-deductible expenses	**(13,461)**	(13,191)	(12,298)
Losses in respect of which a deferred tax asset was not created	**(16,872)**	(59,941)	(31,420)
Timing differentials for which no tax benefit was created	**(5,789)**	(11,843)	1,123
Taxes for prior years, net	**(12,146)**	6,409	2,124
Other	**(1,578)**	(1,743)	(3,445)
	(230,592)	155,484	(60,506)
(*) Regular tax rate	**36**	36	36

NOTE 11 - TAXES ON INCOME (CONTD.)

C. RECONCILIATION BETWEEN THE THEORETICAL TAX COMPUTED IN REAPECT OF THE PRE-TAX INFLATION-ADJUSTED EARNINGS AND THE ACTUAL TAX EXPENSES IN THE BOOKS (CONTD.)

Company

	For the year ended December 31		
	2001	2000	1999
	NIS thousands	NIS thousands	NIS thousands
Tax computed at the regular tax rate (*)	**(346,212)**	94,293	(66,604)
Increase (decrease) in tax liability due to:			
Inflationary erosion of advance tax payments	**(379)**	66	(704)
Exempt income and capital gains	**24,996**	48,669	8,337
Non-deductible expenses	**(10,934)**	(9,724)	(9,492)
Taxes for prior years, net	**(12,119)**	6,561	857
Other	**(2,109)**	883	(3,765)
	(346,757)	140,748	(71,371)
(*) Regular tax rate	**36**	36	36

NOTE 11 - TAXES ON INCOME (CONTD.)

D. DEFERRED TAXES

	Consolidated		Company	
	December 31 2001	December 31 2000	December 31 2001	December 31 2000
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Activity -				
Balance at beginning of year	**816,423**	458,072	**806,522**	469,721
Charged to statement of operations for the year	**121,392**	327,374	**2,072**	305,824
Charged to income tax refunds for prior years	**(336,484)**	45,814	**(336,484)**	45,814
Charged to statement of operations for prior years	**(4,467)**	(14,837)	**–**	(14,837)
Balance as at end of year	**596,864**	816,423	**472,110**	806,522
Composition of deferred taxes -				
Difference between the adjusted value of fixed assets and their value for income tax purposes	**(543,562)**	(206,868)	**(471,816)**	(170,803)
Adjustment of materials and spare parts	**(348)**	(182)	**(204)**	(73)
Deferred tax due to losses	**264,642**	142,894	**–**	–
Differences in the recognition of expenses relating to employee rights, doubtful debts and other	**876,132**	880,579	**944,130**	977,398
Total	**596,864**	816,423	**472,110**	806,522
Classified as follows:				
As part of current assets	**181,084**	188,785	**146,905**	164,551
As part of other assets	**415,780**	642,273	**325,205**	641,971
As part of long-term liabilities	**–**	(14,635)	**–**	–
Total	**596,864**	816,423	**472,110**	806,522

The deferred taxes are computed at the tax rate expected to be in effect at the time (36%). Realization of the tax benefit is contingent upon the existence of adequate taxable income in the future. The tax benefit is included in the financial statements since, according to the Company's business plans, its realization is anticipated. The tax benefit in respect of a loss accumulated at Pelephone was recorded according to the assessment of Pelephone's management that it is virtually certain that these losses will be realized in the foreseeable future.

Losses for tax purposes of subsidiaries which are carried forward to the coming years amounted to approximately NIS 1,007,117 thousand (2000 - NIS 672,272 thousand). The balance of the loss and deduction carry-forwards for which no deferred tax benefit was included because of the uncertainty of their realization, is approximately NIS 296,389 thousand (2000 - NIS 248,444 thousand).

NOTE 11 - TAXES ON INCOME (CONTD.)

E. FINAL TAX ASSESSMENTS

(1) In June 2001 an agreement was signed between the Company and the income tax authorities for final assessments for the years 1994 – 1998 inclusive. Under the agreement, the Company's claim to increase the depreciation rate of switching and subscriber equipment was recognized, and several other issues were also agreed upon, principally postponement of the dates of recognition of certain expenses. As a result of the above, the Company recorded tax expenses in its financial statements in respect of preceding years, amounting to approximately NIS 12 million, as well as financing income of approximately NIS 79 million (tax exempt) deriving from the rebate payable to the Company.

(2) On January 1, 2002, a subsidiary, Bezeq International Ltd., received a tax assessment (outside the agreement) in respect of the years 1996 – 1999. The assessment requires Bezeq International to pay additional taxes of NIS 106 million, most of which derives from adjustment of expenses. Bezeq International objected to the assessment. In the discussions being held between the subsidiary and the income tax authorities in connection with the assessment, the latter proposed a settlement agreement in the amount of NIS 15 million. Bezeq International's counter-proposal is for NIS 2 million. Since the subsidiary believes that it has valid arguments against the authorities' assessments which could lower the claimed tax payments considerably, it allocated a provision for taxes in respect of preceding years in the amount it proposed. The management of the subsidiary and its advisors are unable to estimate, at this stage, the outcome of the proceeding.

(3) A proportionally consolidated company has received final assessments up to and including 1994, and a final assessment was determined up to 1997 (by prescription). BezeqCall Communications Ltd. has received final assessments up to and including 1998.

F. VALUE ADDED TAX

(1) The Company files a consolidated tax return with its subsidiaries for value added tax purposes.

(2) The Company is in dispute with the value added tax authorities with regard to the Company's right to reimbursement of value added tax it paid which was not collected from customers in that it was a bad debt, and its right to that reimbursement plus interest and linkage differentials from the date on which the debt was generated. A protest filed by the Company was dismissed by the VAT authorities, and the Company intends to submit the matter for a decision in the appropriate proceedings.

NOTE 12 - BANK CREDIT

		Consolidated	
	Interest rate	December 31, 2001	December 31, 2000
	%	NIS thousands	NIS thousands
Unlinked loans	4 - 8.2	**388,056**	726,229
Dollar-linked loans	2.25 - 2.3	**35,510**	19,274
		423,566	745,503

NOTE 13 - LONG-TERM LOANS

A. COMPOSITION

	Consolidated		Company	
	December 31 2001	December 31 2000	December 31 2001	December 31 2000
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Banks	**2,986,034**	3,153,204	**2,273,021**	2,675,716
Pension fund	**84,877**	99,997	**84,877**	99,997
Others	**16,540**	7,820	**–**	–
Supplier credit	**1,407**	2,289	**–**	–
	3,088,858	3,263,310	**2,357,898**	2,775,713
Less -				
Current maturities from banks	**556,926**	382,909	**367,024**	321,970
Other current maturities	**18,012**	15,805	**17,339**	15,123
	2,513,920	2,864,596	**1,973,535**	2,438,620

B. LINKAGE TERMS AND INTEREST

	Interest rate	Consolidated		Company	
		December 31 2001	December 31 2000	December 31 2001	December 31 2000
	%	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Loans in foreign currency					
US dollar (*)	LIBOR +	**1,803,936**	2,039,721	**1,803,936**	2,039,721
Euro	0.42 – 0.65	**1,366**	–	**1,366**	–
		1,805,302	2,039,721	**1,805,302**	2,039,721
Loans linked to the CPI	3.6 – 6.2	**812,139**	1,085,349	**467,719**	635,995
	6.1	**84,877**	99,997	**84,877**	99,997
		897,016	1,185,346	**552,596**	735,992
Unlinked loans	6.85 – 9.45	**386,540**	38,242	**–**	–
		3,088,858	3,263,309	**2,357,898**	2,775,713

(*) These loans bear interest at the rate of LIBOR plus a margin. The rate shown in the above table is a weighted average rate as at the balance sheet date.

NOTE 13 - LONG-TERM LOANS (Contd.)

C. Repayment schedule

December 31	Consolidated NIS thousands	Company NIS thousands
2003	616,140	454,474
2004	543,563	412,817
2005	672,455	563,486
2006	640,816	542,758
2007 and thereafter	40,946	-
	2,513,920	1,973,535

D. Security

(1) Long-term loan agreements of the Company, aggregating NIS 1,986,493 thousand, include certain conditions upon the occurrence of which the lender may demand early repayment of the loans, including:

– The intervention of an authority in the administration of the Company's affairs.

– In respect of loans aggregating NIS 1,235,773 thousand, a decrease in the State's voting rights in the Company to 26% or less, of which in respect of a balance of approximately NIS 563,040 thousand upon the occurrence of an event which also allows other loans of the Company to be made available for early repayment.

– In respect of the remaining loan balance of NIS 750,720 thousand upon the occurrence of an event which allows early repayment of other loans of the Company and of material subsidiaries to be demanded, or failure to comply with the following financial ratios relating to the Group:

a. Net financial debt to Earnings Before Interest Taxes Depreciation and Amortization (EBITDA) of not more than 3 : 1.

b. Tangible shareholders' equity at least 35% of total tangible assets.

As at the balance sheet date, the Company is in compliance with these financial ratios.

– A change made without the lenders' consent in the character of the Company's business, which would have a materially adverse effect on its business, assets or financial condition.

Regarding the possibility of existence of the above conditions, including a decrease in the voting rights of the State and the possibility of the complete opening of the communications market to competition – see Note 1.

The Company created a negative pledge in favor of the lenders.

(2) A proportionally consolidated company created a negative pledge and undertook to meet certain financial conditions in respect of bank loans it received, the proportionally consolidated balance of which, as at the balance sheet date, is NIS 650,342 thousand. As at the balance sheet date, that company is complying with those financial conditions.

(3) A subsidiary created a negative pledge in respect of bank loans, the balance of which as at the balance sheet date is approximately NIS 72 million.

NOTE 13 - LONG-TERM LOANS (CONTD.)

E. LOAN-PROCUREMENT EXPENSES

Deferred expenses for raising loans as at December 31, 2001 and December 31, 2000 amounted to NIS 10,480 thousand and NIS 14,520 thousand respectively. The expenses are presented after deduction of accumulated depreciation amounting to NIS 3,816 thousand and NIS 9,663 thousand respectively.

NOTE 14 - OTHER DEBENTURES

A. COMPOSITION AND TERMS

		Consolidated and Company	
	Interest Rates	December 31 2001	December 31 2000
	%	NIS thousands	NIS thousands
CPI-linked debentures issued to the Public:			
Debentures Series 1 (1)	4.5	**199,589**	266,107
Debentures issued to the public:			
Linked to the euro (2)	6.5	**1,166,104**	1,137,680
Debentures issued:			
Unlinked (3)	6.8 – 8.5	**500,110**	–
Debentures issued to financial institutions and others:			
CPI-linked	3.9 – 6.35	**845,184**	1,006,374
		2,710,987	2,410,161
Less - current maturities		**186,721**	227,755
		2,524,266	2,182,406

(1) The outstanding balance of the debentures is NIS 59,850,864 par value (2000 - NIS 79,801,157 par value).

(2) The outstanding balance of the debentures is 300,000,000 euros par value.

(3) The outstanding balance of the debentures is NIS 500,656 par value.

B. REPAYMENT SCHEDULE

	NIS thousands
2003	197,114
2004	589,068
2005	204,764
2006	154,512
2007 and thereafter	1,378,808
	2,524,266

NOTE 14 - OTHER DEBENTURES (CONTD.)

C. SECURITY

The debentures are not secured, except for a nominal lien. However, the Company has undertaken that as long as the debentures are outstanding, it will refrain from encumbering its property with other liens.

Some of the lenders, the balance of whose loans as at December 31, 2001 amounts to approximately NIS 788,606 thousand, are entitled to demand the immediate repayment of the debentures if the State's holdings in the share capital of the Company falls below 26% (see Note 1).

In addition, for a balance of NIS 1,172,250 thousand of debentures which were issued to the public and are linked to the euro, upon the occurrence of an event enabling demand for immediate repayment of other loans of the Company and of material subsidiaries.

The Company has created a negative pledge in favor of the holders of the euro-linked debentures issued to the public.

D. ISSUE EXPENSES

Deferred expenses with respect to the issue of the debentures amounted to NIS 29,929 thousand (2000 – NIS 29,677 thousand), and are stated net of amortization of NIS 21,038 thousand (2000 - NIS 19,034 thousand).

NOTE 15 - TRADE PAYABLES

	Consolidated		Company	
	December 31 2001	**December 31 2000**	**December 31 2001**	**December 31 2000**
	NIS thousands	**NIS thousands**	**NIS thousands**	**NIS thousands**
Suppliers of goods and services(*)	**1,018,011**	*960,959	**570,527**	472,462
Current maturities of long-term supplier credit	**673**	682	**–**	–
	1,018,684	961,641	**570,527**	472,462
Including foreign currency balances(*)	**286,724**	329,079	**25,339**	16,027
Including subsidiaries	**–**	–	**8,374**	2,022
Including a proportionally consolidated company	**35,293**	16,267	**70,586**	32,534

* Reclassified

NOTE 16 - LIABILITY FOR EMPLOYEE SEVERANCE BENEFITS

A. COMPOSITION

	Consolidated		Company	
	December 31 2001	December 31 2000	December 31 2001	December 31 2000
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Provision for early retirement, net (see D below)	**1,450,166**	1,566,140	**1,450,166**	1,566,140
Compensation for unutilized sick leave (see E below)	**62,582**	48,396	**62,582**	48,396
	1,512,748	1,614,536	**1,512,748**	1,614,536
Provision for severance pay	**62,422**	32,352	**28,170**	15,088
Less - reserve in compensation fund	**(36,312)**	(22,089)	**(12,893)**	(9,159)
	26,110	10,263*	**15,277**	5,929*
	1,538,858	1,624,799	**1,528,025**	1,620,465
Stated as follows:				
Among current liabilities	**262,947**	349,639	**262,947**	349,639
Among long-term liabilities	**1,275,911**	1,275,160*	**1,265,078**	1,270,826*
	1,538,858	1,624,799	**1,528,025**	1,620,465

* Reclassified

B. ELIGIBILITY OF EMPLOYEES UPON REACHING RETIREMENT AGE

(1) The liability of the Company and its investee companies for severance benefits to employees is fully covered by current payments to pension funds and insurance companies and the above liabilities. The accumulated amounts are not under the management or control of the companies and, therefore, are not reflected in the balance sheet.

(2) The pension rights of the Company's employees with respect to the period of their employment in government service, up to January 31, 1985, are covered by a pension fund ("Keren Makefet") which assumed the Government's liability in accordance with an agreement between the Government, the Company, the New General Federation of Labor (Histadrut) and the Fund.

C. EMPLOYEE RIGHTS BEFORE RETIREMENT AGE

The Company's liability to pay severance pay to employees leaving their employment under conditions entitling them to such benefits is covered, in respect of the period from February 1, 1985, by current deposits in pension funds and with insurance companies, as stated in section B above. Severance pay in respect of the period of government service up to January 31,1985, is paid by the Company, and the amounts accumulated with Keren Makefet with respect to this period are held in the Fund for use in connection with the employees' rights.

Employees who transferred to the Company from government service and who leave the Company before reaching retirement age, are entitled, under certain conditions, if they so choose, to receive early retirement benefits in lieu of severance pay. The cost of the early retirement benefits, except for cases of sickness or disability up to retirement age, are to be borne by the Company. The costs of retirement of such employees is included in the provision for early retirement plans, as described below.

NOTE 16 - LIABILITY FOR EMPLOYEE SEVERANCE BENEFITS (CONTD.)

D. EARLY RETIREMENT PLANS

(1) Under a special collective agreement for retirement, signed on November 23, 1997 between the Company and the workers' representatives, approximately 2,050 employees retired from the Company up to December 31, 1999.

(2) As part of the plan for organizational change in the Company, which was approved by the Board of Directors in March 2000, about 530 employees retired from the Company between December 31, 1999 and December 31, 2001.

(3) In the wake of privatization of the Company and the opening of the telecommunications market to competition, additional workforce changes are required at the Company; accordingly, the Company reached agreement with the workers' representatives in September 2000, to extend the early retirement collective agreement from 1997. The new arrangement states that from April 1, 2001 to December 31, 2006 (with an option to extend the final retirement date for certain employees to December 31, 2008), another 1,770 employees will take early retirement. Furthermore, pursuant to the agreement, the Company's management will be able to dismiss employees under a compensation arrangement over and above the number stated in the agreement. The retirement of workers under this plan will start in 2002.

The financial statements for 2000 include an expense of approximately NIS 1,390 million in respect of the expected cost of implementation of this plan. The Company's management estimates that the likelihood of additional employees retiring in the compensation track is slight, and accordingly, no provision was made therefor in the financial statements.

E. COMPENSATION FOR UNUTILIZED SICK LEAVE

The financial statements include a provision for compensation in respect of unutilized sick leave for all employees, in accordance with the conditions fixed in the employment agreement.

NOTE 17 - OTHER CURRENT LIABILITIES

	Consolidated		Company	
	December 31 2001	December 31 2000	December 31 2001	December 31 2000
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
The Government of Israel in respect of royalties, interest and other fees	**196,913**	197,080	**148,834**	148,369
Wages and salaries [1][2]	**242,218**	196,257*	**197,890**	152,688*
Provision for vacation pay	**95,525**	92,798	**91,726**	84,634
Income tax payable	**95,798**	–	**91,255**	–
Governmental agencies	**101,994**	73,749	**86,396**	59,440
Accrued interest	**103,319**	105,042	**97,761**	101,726
Forward exchange contracts	**13,322**	34,835	**13,322**	34,835
Other accrued expenses	**148,260**	118,554	**84,928**	65,026
Current maturities in respect of prepaid income	**46,368**	45,389	**30,387**	26,825
Provision for claims in respect of salary and pension components	**111,380**	111,380	**111,380**	111,380
	1,155,097	975,084	**953,879**	784,923
[1] Including current maturities of a long-term loan from a pension fund	**17,339**	15,123	**17,339**	15,123

[2] Including a provision for payment of a bonus to employees at 10% of net earnings. The directives of the Government Companies Authority authorize the Company to pay a bonus at that rate if in the preceding year the Company made a profit. Subject to discussion and approval of the Board of Directors for sum to be paid, the Company intends to discuss with and request the approval of the Government Companies Authority for payment of the provision included in the financial statements. Payment of the bonus is contingent upon a resolution of the Board of Directors and the approval of the Government Companies Authority.

* Reclassified

NOTE 18 - DEFERRED REVENUES

Deferred revenues consists mainly of receipts in respect of making infrastructures available for the use of external entities, and from compensation in respect of a purchase agreement with a proportionally consolidated company.

NOTE 19 - CONVERTIBLE DEBENTURES

Registered debentures were issued pursuant to a prospectus from February 1998. The issued par value of the debentures is NIS 313,500,000. The debentures are convertible into ordinary shares of a par value of NIS 1 so that each NIS 10.12 par value of debentures can be converted into one ordinary share of NIS 1 par value. The debentures bear real annual interest of 3.25% and guarantee an annual nominal yield of at least 12% in their first year of issue. In addition, under the same prospectus, options were issued which can be exercised for a convertible debenture, where the par value of the debentures converted from the options is NIS 74,992,200. During the report period, 59,754,681 par value of debentures were converted and in exchange, 5,904,612 ordinary shares of a par value of NIS 1 were issued. A balance of 560,735 par value of debentures was repaid on February 28, 2001.

NOTE 20 - CONTINGENT LIABILITIES

A. CLAIMS

Below are details of the contingent liabilities situation of the Company and investee companies as at December 31, 2001, in which the maximum possible exposure is considerable.

(1) In August 1996 a claim and an application by way of motion for approval of the claim as a class action were filed against the Company in the District Court. The plaintiff alleges that the Company is misleading the public in that the prices of direct-dial international calls are calculated and collected on the basis of meter pulses rather than call time units as promised in its advertisements. The claimed damage relates to overcharging deriving from rounding-up of fractions of meter pulses to a whole meter pulse. The value of the claim as a class action is approximately NIS 125 million, and it refers to the seven years preceding the filing of the action. In February 1997 the court approved the action as a declaratory class action with regard to the deception only, and held that the extent of the damage of the members of the group should not be fixed, whether as a whole or as individuals. If the class action is allowed and a declaration made that the advertising was misleading, a subscriber who believes that he sustained damages as a result of the deception will be able to file a personal claim against the Company, in which he will attempt to prove his losses. The plaintiff filed an appeal against the part of the court's decision that rejects the application to recognize the action as a monetary class action. The Company filed an cross-appeal of the decision to recognize the action a declaratory class action. In March 1998 the application of the plaintiff to conjoin Bezeq International Ltd. as an additional defendant in the class action was allowed. Bezeq International filed an appeal against this decision in May 1998 in the Supreme Court. On the same occasion, Bezeq International Ltd. requested to be conjoined as an additional appellant in the Company's appeal. On July 2, 2001 the Supreme Court allowed the appeals of the Company and of Bezeq International. On July 17, 2001 the plaintiff filed an application for an additional hearing of the case. On September 12, 2001 the Israeli Consumer Council filed an application to be added as a party to the application for an additional hearing and as a party to that additional hearing, if held. In the Company's opinion, relying on the legal advisor who is handling the claim on its behalf, it is not possible to estimate whether the plaintiff's application for an additional hearing will be allowed, and if so, what the outcome of the proceeding will be. No provision is included in the financial statements in respect of this claim.

(2) In June 1997 a group of approximately 130 employees filed a claim, through the Histadrut, in the Regional Labor Court, for declaratory relief in respect of the pension rights of those employees of the group who were transferred from the Ministry of Communications, serving as managers and employed under personal contracts. According to the plaintiffs, they are entitled to pension terms identical to those of all Company employees to whom a collective agreement applies. In September 1997 the Attorney General gave notice of his appearance in the proceeding. In May 1998 the Company filed an actuarial opinion in the Regional Labor Court, stating that the cost of the plaintiffs' demand would be approximately NIS 146 million. In November 1999 a decision was given rejecting almost all the causes of the action. This decision has been appealed. The arguments stage in the case has been completed and now awaits the decision of the National Court on the appeal. Negotiations are in progress between the Company and the workers' representatives, with the aim of reaching an arrangement which will end the dispute. A provision is made in the financial statements based on a arrangement proposed by the Company's management.

(3) In July 1997 a claim and an application by way of motion were filed against the Company and the subsidiary - Bezeq International Ltd. - to recognize an action as a class action under Section 46A of the Anti Trust Law. The plaintiff alleges that the tariffs for international telecommunication services in the period from May 10, 1996 to July 8, 1997 were exorbitant and unreasonable, while exploiting its status as a monopoly, against a background of lowering prices as the international calls market was opening up to competition. The amount of the action is estimated by the plaintiff at about NIS 913 million. The plaintiff declared before the court his willingness to reword his claim so that it would stand against the Company only up to the date on which Bezeq International would give notice that it has taken upon itself responsibility for international calls. On October 19, 1998 the Attorney General conveyed his position to the court, stating that the action should not be recognized as a class action.

NOTE 20 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS (CONTD.)

On January 27, 1999 the Anti-Trust Commissioner applied to the court, requesting a hearing in which he would present evidence refuting the allegations of the Company and Bezeq International. On March 18, 1999 the Anti-Trust Commissioner applied to the court requesting to clarify that he does not dispute that the tariffs of Bezeq International and the Company, at the times relevant to the action, were binding prices rather than maximum prices as alleged by the plaintiff, and that Bezeq International and the Company could not have lawfully lowered the international call prices themselves without the approval of the competent authorities. On August 8, 1999, after submission of the summations of the parties, the District Court approved the claim as a class action. On September 30, 1999 the Company and Bezeq International filed for leave to appeal this decision. The Supreme Court allowed the appeal of the Company and Bezeq International, and the decision of the District Court approving the action was voided. The class action filed by the plaintiff was stricken, while reserving the right of the plaintiff to file it anew and preserving all the allegations of the litigants. In September 2001 a claim was filed against Bezeq International Ltd. and the State of Israel, with an application for recognition as a class action. In February 2002 Bezeq International filed its response in the court, rejecting the allegations of the plaintiff and alleging that the conditions for approval as a class action had not been met.

In the opinion of Bezeq International Ltd., relying on the legal advisors who are handling the claim on its behalf, it is not possible, at this stage, to estimate the chances of the claim. No provision is made in the financial statements in respect of this claim.

(4) In September 1997 a claim was filed against the Company and the State in the Regional Labor Court. The claim was filed on behalf of 128 senior employees who are employed under personal contracts. The nature of the claim is the plaintiffs' allegation that starting from October 1, 1996, they are entitled to a wage increment of 33%, corresponding to the increment which was given at that time to Members of the Knesset and to senior civil servants whose salaries are linked to those of Members of the Knesset. The total amount of the claim in respect of salary differences is approximately NIS 11 million. Withholding differences are also claimed in respect of these amounts. The Company alleged that it pays the salaries of the plaintiffs according to the directives of the Government Companies Authority. In the Company's opinion, relying on the legal advisor who is handling the claim on its behalf, it is not possible, at this stage, to estimate the prospects for this claim. No provision is made in the financial statements in respect of this claim.

The State joined as a party to the proceeding and filed a final opinion of the Attorney General, which supports the position of the Companies Authority that no obligation exists to pay senior employees the wage increment. In the hearing held on January 27, 1998, the State's representative announced that the Attorney General had made his decision, which was that the Companies Authority has no obligation to issue an instruction to raise the senior employees' salaries by 33%, and that the Companies Authority had exercised its discretion reasonably on this question in deciding not to accede to the claim.

(5) In November 1997 a claim was filed in the District Court, together with an application by way of motion to recognize a claim as a class action, against the Company, Bezeq International Ltd., the Chairman of the Board of Bezeq International and the then CEO of Bezeq International. The claim alleges, *inter alia*, that the Anti-Trust Commissioner determined that Bezeq International had unfairly exploited its status in the international calls market and had implemented a deliberate policy of misleading the public on the subject of overseas call tariffs when it refrained from clarifying to the public that only those who register as Bezeq International subscribers would enjoy the reduced tariffs. The amount of the class action is estimated by the plaintiffs at approximately NIS 50 million. In December 1997, the Company was stricken from the claim. On June 19, 2001 the District Court decided to reject the application for approval as a class action. On September 20, 2001 the decision of the District Court was appealed in the Supreme Court. On October 28, 2001 Bezeq International filed an application to strike the appeal *in limine*. On January 7, 2002 the court rejected the application and ruled that the appeal would be heard on its merits.

NOTE 20 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS (CONTD.)

The legal advisors of Bezeq International are unable, at this stage, to estimate the chances of the appeal, and therefore no provision is made in the financial statements in respect of this claim.

(6) In December 1998 the Anti-Trust Commissioner published notice that the Investigations Department of the Anti-Trust Commission had completed an investigation it had carried out over the past year, of *prima facie* suspicion of binding agreements between Koor Industries, Telrad, Tadiran, the Company and BezeqCall Communications, in the supply of large switchboards and in network end points.

Below are the main points of the Commissioner's notice:

The investigation focused on two main issues: the public switching market, which includes the supply of digital exchange equipment and concomitant services by Tadiran and Telrad to the Company; and the network end points exchange market.

According to the Commissioner, the Authority investigators recommend that indictments be obtained against some of those who were investigated concerning some of the suspicions which were investigated. The Legal Department at the Anti-Trust Commission will now examine the investigation material and the recommendations of the investigators, in order to determine whether offenses against the Anti-Trust Law were indeed perpetrated, and whether there is sufficient evidentiary basis for trial. This examination is expected to last several months.

The Commissioner added that the findings of the investigation paint a harsh picture of the manner in which the Company purchased exchanges from Koor, and of the manner in which the network end points market was operated until recently.

In the area of public switching, the Authority's investigation raises suspicions of collaboration between Telrad and Tadiran opposite the Company. Among other things, there is *prima facie* suspicion that Telrad and Tadiran coordinated various aspects of the competition between them in relation to the Company, in some cases with the knowledge of the Company and in other cases without its knowledge. The Authority also investigated suspicion of coordination between Telrad and Tadiran relating to telecommunications tenders in 1998 and relating to framework agreements with the Company in 1994 and 1996.

The second area of suspicion which was investigated in connection with large exchanges, concerns suspicion of binding agreements between the Company and Koor, Telrad and Tadiran, which includes a commitment by the Company not to purchase exchanges from a third vendor; division of purchases between Telrad and Tadiran according to a predetermined key, i.e. the ostensible pre-arrangement of the competition between the companies in relation to the Company; an undertaking by the Company not to purchase from the two companies equipment in tenders. It is suspected that these undertakings, or some of them, in the relevant circumstances, constitute violation of the provisions of the Anti-Trust Law. From the findings of the investigation, it appears, ostensibly, that in fact the Company purchased exchanges from one vendor (Koor Industries) - at prices which were seemingly much higher than those the Company would have paid had it not bound itself and had the entire market not been blocked by the aforementioned arrangement in relation to other equipment vendors.

The investigation of the Authority also revealed, ostensibly, that in some of these engagements the Company acted in clear contravention of the legal advice it received. In the opinion of the Authority investigators, this element of willful blindness constitutes not only proof that the relevant parties knew they were involved in an offense, but also defines aggravated circumstances for this offense.

NOTE 20 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS (CONTD.)

The findings of the Authority's investigation in this area appear to indicate a series of binding agreements and attempted offenses in the field of network end points, between Bezeq Call Communications, Telrad and Tadiran. Among other things, suspicions are raised of cartels or attempts at such arrangements - in providing maintenance service for private exchanges, in the prices of buying the service, in customer transfer arrangements and in price discrimination arrangements; in the field of providing maintenance services for private exchanges and network end point infrastructures, the type, composition and price of the service which will be offered to customers for the exchanges in their possession; in ongoing coordination between those entities or some of them; in tenders which were held by final customers for the purchase of network end point exchanges. It is suspected that these companies or some of them, in various instances, coordinated the prices of the proposals they would submit in the tenders of final customers. In addition, *prima facie* evidence was found of arrangement for dividing the market between the companies, as well as agreements concerning non-marketing of the product of an additional third vendor in the field of network end point exchanges.

In November 2000 a shareholder approached the Company with a demand that the Company take legal action against the suppliers, stating that in his opinion the Company had suffered a loss of about NIS 400 million due to the binding agreement. In his demand, the shareholder reserves the right to file a derivative action pursuant to Section 194 of the Companies Law. The Company replied that it is monitoring developments in the matter and has requested the investigative material from the Anti-Trust Authority, and that it would formulate its stance in accordance with the decision of the Authority and its findings, if any. In November 2001 a similar application was received from another shareholder, to which the Company replied that it was still awaiting the decision of the Anti-Trust Authority.

On March 3, 2002 the Company received a summons to a hearing from the Anti-Trust Authority. The summons (which relates to the investigation of the public switching case only, and not to the case of the network terminal point exchange market, which is still under examination by the legal department of the Authority) states that the Authority is considering committing the Company for trial for offenses against the Anti-Trust law, 5748-1988 ("the Anti-Trust Law"), and has not yet decided whether or not to file an indictment in this matter. It was decided to allow the Company to voice its allegations in a hearing proceeding, and to read the relevant investigation material in respect of which no immunity was granted. According to the summons, the findings of the investigation raise suspicions that that the Company was a party to the cartel arrangements concerning the purchase of equipment and receipt of various services in the field of public switching and the dividing up of the market and the non-entry of a new competitor in the framework agreements for the years 1994-1997 and the years 1997-2000.

The Anti-Trust Law forbids contracting as a party to a binding agreement which was not duly approved or which was not granted exemption or a temporary permit. Commission of such an act is a criminal offense and is also a tortious act and a possible basis for class action proceedings against a party to the arrangement.

The Company, relying on its legal advisors, is unable at this stage to estimate the significance of the decision of the Anti-Trust Authority or what the final decisions of the Authority will be after the Company's hearing and their implications for the Company, including the ability of its shareholders or its customers or any other third party to sue it, or its own ability to sue others.

(7) In March 1999 a claim was filed against the Company by a group of employees who were employed as temporary workers at the Ministry of Communications and were transferred to the Company when it commenced operations. The plaintiffs are requesting that the Labor Court determine that they are entitled to all the benefits which were granted to permanent transferred employees, graduates of Bezeq College and Ministry of Communications pensioners. The Company filed an application for dismissal of the claim *in limine* due to its prescription. In the hearing of the Company's application to dismiss, the parties reached agreement regarding partial dismissal and a narrowing of the claim in respect of some of its components, following which, exposure decreased in respect of the claim.

NOTE 20 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS (CONTD.)

The questions raised in this claim are liable to have a lateral effect on the Company. However, in view of the above agreements, exposure has been significantly reduced. The Company, relying on its legal advisors, is unable, at this stage, to estimate the outcome and the possible implications for the Company. Accordingly, no provision is made in the financial statements in respect of this claim.

(8) On February 15, 2000 a claim was filed against the Company in the District Court in Jerusalem in the amount of NIS 21 million. The plaintiff alleges in his claim that the Company violated its undertakings and representations to him to purchase large quantities of equipment from him. The plaintiff further alleges that the procedure which was used for selecting the equipment which would be purchased by the Company was unlawfully managed, with infringement of the tenders laws and the rules of good administration, with negligence and while exploiting the status of the Company as a monopoly or monopsony. At this stage of the proceedings, the Company is unable, relying on the legal advisor which is handling the claim on its behalf, to estimate the chances of the claim. Accordingly, no provision is made in the financial statements in respect of this claim.

(9) On February 23, 2000, two former employees of the Company filed a financial claim in the District Court in Jerusalem against the State of Israel and against the Company. An application was attached to the claim, requesting approval as a class action in the names of additional employees and pensioners of the Company. The amount of the personal claim of the two representative plaintiffs is approximately NIS 6,500. The amount of the claim of all the plaintiffs for whom representation is requested, is not stated in the claim. The groups for whom approval of representation is applied for in the action comprise a total of 8,272 employees.

In their statement of claim, the plaintiffs allege, *inter alia*, that the defendants violated various undertakings toward them which were included in the prospectus of the Company published in 1991, including undertakings to allot Company shares, pay dividends and make preferential loans available to the plaintiffs. The plaintiffs allege that the allotment of shares to employees in accordance with the Company's prospectus which was published in 1998 constitutes only partial and inadequate fulfillment of those undertakings. (For example, they allege that the number of shares allotted was insufficient, that inadequate sums were paid in dividends, that no preferential loans were given, etc.) The plaintiffs further allege that the 1998 prospectus contained misleading details and representations, and material documents which ought to have been attached were not attached.

On May 8, 2001 the District Court dismissed the claim, in part for prescription and in part due to absence of cause. The plaintiffs appealed this decision in the Supreme Court.

At this stage of the proceedings the Company is unable, relying n its legal advisors, to estimate the chances of the proceeding, and therefore no provision is made in the financial statements in respect of this claim.

(10) In October 1999, a class action was filed against Pelephone Communications Ltd. in the District Court, by virtue of the Consumer Protection Law, 5741-1981 and the Anti-Trust Law, 5748-1988. The basis for the claim is an allegation of exploitation of the Company's status as a monopoly and exploitation of distress and misleading consumers. If the action is recognized as a class action, the amount claimed is approximately NIS 12.3 billion.

Pelephone filed an application for dismissal *in limine*, out of the belief that the claim is unfounded. The management of Pelephone Communications Ltd. estimates, based on the opinion of its legal advisors and on an outside opinion, that the claim is unlikely to succeed. Accordingly, no provision is made in the financial statements in respect of this claim.

NOTE 20 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS (CONTD.)

(11) In July 2000 a class action and application for its approval as a class action were filed against the Company. According to the plaintiffs, the Company collected money unlawfully from its subscribers for certain services which it provides. The claim is for approximately NIS 915 million. ON February 18, 2002 the District Court decided to dismiss the application for approval as a class action.

(12) In April 2000, a company which provides cable television broadcasts filed a claim against the Company in which it petitions for a permanent mandamus for enforcement of the agreement to upgrade its cable network and alternatively, to enable it to carry out the works itself or through a contractor, alleging that as a result of the Company's sanctions, the upgrade works were interrupted, which constitutes breach of contract. On July 25, 2001 a decision was given to strike the claim, following a consensual application filed on behalf of both parties.

(13) On August 10, 2000 the Company received a letter from the a representative of the Anti-Trust Commissioner, stating that according to information which had reached the Anti-Trust Authority, there was *prima facie* evidence that the Company was taking actions, in connection with its preparations for providing ADSL services, which are liable to constitute violations of provisions in the Restraint of Trade Law, 5748-1988 ("the Law"). The alleged actions relate to agreements between the Company and its dealers (agents) for ADSL services. Accordingly, the Company was required to give its preliminary response to the allegations, and to submit to the Commissioner various items of information and documents. From the Company's initial investigation it transpires that the above-mentioned suspected violation of the Law, taking into consideration that it relates to a trial and to agreements with dealers who are actually agents, is exaggerated and unjustified.

The Company submitted its comments on the allegations, as well as information and documents as requested, and later received, on November 16, 2000, a letter from the representative of the Anti-Trust Commissioner, stating that in their opinion, even after consideration of the Company's response, the suspicion of violation of the Law still exists, and that the Company is required to cancel all the agreements with the dealers and notify them accordingly. The Company is firm in its position that the suspicion is unjustified. Nevertheless, the Company is examining ways to handle the matter, *inter alia,* in view of the final approval of the ADSL service file. It is noted that following that final approval, the agreements with the dealers were changed to bring them into line with the service file.

(14) In August 2000, a class action together with an application for approval as a class action, was filed against the Company in the amount of approximately NIS 61 million, including VAT. The plaintiff alleges that the Company unlawfully collected payment differentials from its subscribers, for the fixed fee for use of the telephone line. The requested reliefs are two – declaratory, whereby the Court is requested to declare that the Company collected the payment differentials unlawfully, and "operative – financial", for reimbursement of said amounts. The Company rejects the plaintiff's allegations and alleges that its method of charging meets the criteria of the law, reasonableness and justice. On November 20, 2001 the Company filed an application for dismissal *in limine* of the application for approval, since there is no legal authority for filing the class action. On December 17, 2001 it was determined that the hearing of the case would be continued for the time being, until the decision of the Supreme Court (in another case, to which the Company is to a party) on the question of whether the regulation which was relied upon in filing the claim, constitutes a source of legal authority for filing class actions. In the Company's opinion, relying on its legal advisors, the chances of the claim's success cannot be estimated at this stage. No provision was made in the financial statements in respect of this claim.

NOTE 20 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS (CONTD.)

(15) In September 2000, a declaratory claim was filed against the Company in the Jerusalem Labor Court, by 2,423 pensioners of the Company, former employees who were transferred from the Ministry of Communications to the Company upon its establishment. The plaintiffs are requesting from the Labor Court declaratory relief which will determine that the payments they received for grossing up of tax, clothing allowance and incentive pay are normal pay for work which should be seen as part of their regular wage for calculating their pension and the payments made to them upon retirement. The plaintiffs are also seeking declaratory relief which will determine that their last determining salary for the pension should be calculated according to the last salary which was paid to each of them for the last month of work, and not according to the average rank which each of them held. The Company has filed a preliminary application for dismissal of the claim *in limine*, a response to that application has been filed, and no defense has yet been filed. In the opinion of the Company, relying on the opinion of its legal advisor, the chances of the claim cannot be estimated at this stage. No provision was made in the financial statements in respect of this claim.

(16) In September 2000, a class action and an application for approval as a class action were filed against the Company in the amount which is estimated at approximately NIS 104 million. According to the plaintiff, the Company unlawfully collected from its subscribers "collection expenses" for Company bills which were not promptly paid, before it had started any collection actions in connection with the plaintiff. The reliefs requested by the plaintiff are mainly two – declaratory, in which the Court is requested to declare that the collection of "collection expenses" by the Company in the instances described in the claim was unlawful, and that the Company may not continue to collect such expenses in the future, and "operative – financial", for reimbursement of said amounts. In January 2001 the Company filed its response to the application for approval of the class action, in which it alleges that the claim does not meet the criteria of the law and states that it rejects the plaintiff's interpretation of the collection regulations, claiming to have acted lawfully. The plaintiff filed his reply to the Company's response. On May 30, 2001 the Court approved the arrangement reached by the parties as to continuation of the hearing, and the parties filed their summations.

On October 18, 2001 another class action was filed on the same matter, in respect of unlawful charging of collection fees on Company bills which were not promptly paid, before it had started any collection actions. The plaintiff alleges that this action constitutes exploitation of the distress of the consumer, in contravention of the Consumer Protection Law, as well as unjust enrichment. The plaintiff estimates amount of this class action at about NIS 20 million. On December 16, 2001 the Court approved a continuance until after a decision on the application for approval of the claim as a class action, due to the similarity in the cases of action in the two cases.

In the opinion of the Company, relying on its legal advisors, the chances of the claims cannot be estimated at this stage. No provision was included in the financial statements in respect of these claims.

(17) In September 2000 a class action and application for approval as a class action was filed against the Company in an amount estimated at more than NIS 761 million. According to the plaintiffs, the Company unlawfully collected from its subscribers a fixed payment for the lease of telephones which the Company made available to them, so they allege, since the telephones were supplied to subscribers without a specific lease agreement being made, without disclosure and proper publication of the fact that the telephones were given in a "lease" agreement unlimited in time, and also concerns the amount of the "lease fee" demanded and the duration of collection of the "lease fee" even after the date on which the Company's subscribers had paid the "lease fees" in an amount equal to the full revalued value of the telephones supplied. The plaintiffs further allege that the Company collected "lease fees" unlawfully in that it did not give its subscribers the choice of whether to "lease" or purchase the telephones and in that it did not inform them of the option to cease payment of the fixed lease fee in exchange for a lump-sum payment which of itself, according to the plaintiffs, is unlawful. The relief requested by the plaintiffs is mainly financial, for reimbursement of the aforesaid amounts.

NOTE 20 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS (contd.)

In addition, on November 21, 2000 the Company received a class action with an application for approval as a class action. The amount of this claim is estimated at about NIS 243 million. It is noted that the action makes allegations which are similar or identical to those in the above action from September 2000.

The plaintiffs filed an application for consolidation of the hearings for the two claims, which was approved on April 25, 2001.On June 10, 2001 the plaintiffs filed an amended statement of claim and amended application for approval as a class action. Additional allegations are made in the amended statement of claims, *inter alia* concerning unlawful charging of "maintenance fees". The amount of the two claims together is now estimated at more than one billion shekels. The Company filed an application for dismissal *in limine* of the amended application for approval as a class action. No decision has yet been made.

The Company, relying on its legal advisors, is unable, at this stage, to estimate the chances of the claim. No provision was made in the financial statements in respect of this claim.

(18) On May 10, 2001 a claim was served to an affiliate in which the plaintiff alleges that the affiliate is misleading consumers in its advertisements in connection with the possibility for the consumer to purchase certain channels only, and with regard to the number of channels offered. It is also alleged that the affiliate requires its subscribers to consume a maximum channel package even if they do not choose that package. The plaintiff filed the claim as the representative of the subscribers of the affiliate, and together with the claim also filed an application for recognition of the claim as a class action under the Consumer Protection Law. The personal losses of the plaintiff, as alleged by the plaintiff, are negligible, and the sum stated as accumulated loss for all members of the class is approximately NIS 177 million. The legal advisers of the affiliate believe that the affiliate has a good defense against the action as a class action.

(19) In September 2000 a class action and application for approval as a class action were filed against the Company, Bezeq International Ltd. and the other international communications operators. The amount of the claim, according to the action, cannot be calculated accurately, and is estimated to be in excess of the competence of the Magistrate's Court, which is currently one million shekels.

According to the plaintiffs, starting on October 20, 1998, the Company unlawfully collected 17% VAT for part of collect calls originating outside Israel and received by its subscribers in Israel, in contravention of the VAT law and its regulations and in violation of a legislated duty in a way which breaches existing agreements, acting in bad faith in the fulfillment of such contracts and with negligent conduct. The plaintiffs further allege against the international operators concerning the collection of VAT in respect of calls which were made abroad to Israel using phone cards. The plaintiffs estimate the total loss incurred by the group due to the unlawful collection of VAT for all calls made from abroad to Israel in the relevant period (since October 20, 1998) at millions of shekels per year.

The reliefs requested by the plaintiffs are mainly two – declaratory, in which each of the defendants violated its obligations under the contractual agreement between it and the members of the group with which it contracted, and financial, for restitution of said amounts, compensation for the loss incurred by the members of the group in the aforesaid amounts. On June 21, 2001 the Attorney General gave notice that he would appear in this proceeding. On January 6, 2002 the Court decided to conjoin the Director General of the VAT authorities as an additional defendant in the action and the application for its approval as a class action, and denied the application of Bezeq International Ltd. for dismissal *in limine*. At the hearing on February 28, 2002, the plaintiffs' legal representative clarified that the plaintiffs are not demanding independent relief from the communications companies, but rather, reimbursement of the VAT which the Director General of the VAT authorities will repay then if the claim is successful. The plaintiffs attorney also proposed that the communications companies be considered formal defendants.

NOTE 20 - CONTINGENT LIABILITIES (contd.)

A. CLAIMS (contd.)

A date was set for filing summations on the matter of approval of the claim as a class action, while excusing the communications companies from filing them. The legal advisors of the Company and of the subsidiary are unable, at this stage, to estimate the chances of the claim. No provision was made in the financial statements in respect of this claim.

(20) In December 2000 a claim was filed in the District Court against Pelephone Communications Ltd. ("Pelephone") by the State of Israel, for royalties allegedly payable for the period from January 1994 to February 1996. The amounts claimed is approximately NIS 264 million, consisting of principal, linkage differentials and interest.

In the opinion of the management of Pelephone, based on the opinions of its outside legal advisors, Pelephone has a genuine defense against the claim, the amount of which is also deemed to be highly exaggerated.

On March 11, 2001 Pelephone filed a defense and a counter-claim relating to the State's claim for payment of royalties for the period from January 1, 1994 until February 7, 1996. In the counter-claim, Pelephone claims reimbursement of NIS 66 million (including interest and linkage differentials) in respect of an advance payment it made to the State as a goodwill gesture for reaching a settlement in 1996, a payment which was contingent upon the State not suing Pelephone for royalties. Before the case came to court, the parties agreed to transfer the matter for clarification in a mediation proceeding.

It should be noted that the claim includes sums in respect of the period January – October 1994, for which the Company also received a demand to pay royalties, even though in the Company's opinion the royalties for that period were already paid by the Company as part of a compromise arrangement with the State in November 1995.

(21) In February 2001 a class action and application for its approval as a class action were filed against the Company, as well as an application for a temporary injunction. The amount of the claim is not stated, but according to the action, the accumulated loss for the entire group in whose name the plaintiff has filed suit, is estimated at "millions of shekels".

According to the plaintiff, the "Light Net" track, which is one of the tracks in the alternative basket of payments introduced on May 1, 2000, is actually a "default" from the aspect of the customer, since it is an offer which contains nothing but acquisition of the customer.

The plaintiff alleges that since from May 1, 2000, when the new tariffs took effect, until the end of June, the Company charged the calls to the network of subscribers who did not select one of the tracks, according to the Light Net track as if it were the "regular" tariff for connecting to the network, then from July 1, 2000 also the Company should have continued to apply the Light Net tariff to all subscribers who did not choose another track. The plaintiff alleges that the charge in the months May – June 2000 constitutes deception, as does the representation of the Company, on the basis of which the subscriber's situation changed for the worse, and therefore, according to the plaintiff, the Company is precluded from shrugging off that representation. In this, according to the plaintiff, the Company violated the provisions of Section 2(a) of the Consumer Protection Law, 5741-1981. On October 24, 2001 the District Court denied the plaintiff's application for recognition of the claim as a class action pursuant to the Consumer Protection Law. The plaintiff appealed the decision in the Supreme Court. The Company, relying on its legal advisors, is unable to estimate the chances of the plaintiff's appeal in this case, and the chances of the defense if the Supreme Court should rule that the action should have been recognized as a class action. No provision is made in the financial statements in respect of this clam.

NOTE 20 - CONTINGENT LIABILITIES (contd.)

A. CLAIMS (contd.)

(22) In March 2001 a petition was filed in the Supreme Court against the Minister of Communications, the Company and three cellular operators, in which the petitioner requests, *inter alia*, that the court direct the Minister of Communications and the Company to provide a blocking service for every Company subscriber against outgoing calls to cellular phone area codes, as a positive default. The court forwarded the petition to the defendants for their response. the Company gave notice that it does not oppose providing such a service, but emphasized that it would require the approval of the Ministry of Communications. Pelephone Communications Ltd. objected to the provision of the blocking service. The Company filed an application to expedite the hearing of the petition, and it was heard on October 15, 2001. In view of the notice of the Ministry of Communications that it is considering alternatives to blocking and will re-examine its policy, the hearing was postponed to a later date, as yet unspecified.

(23) In September 2001, an application was filed for approval of a class action against the Company. The plaintiffs allege that in view of the amendments to the Telecommunications Regulations, the maximum payment that can be collected from Bezeq's subscribers for Pelephone subscribers was lower than the amount actually collected. The applicants estimate the amount of the claim at about NIS 42 million. The Company filed a response to the application for approval, and applied to conjoin Pelephone Communications Ltd. as a party to the proceeding. Based on the opinion of its legal advisors, the Company is unable, at this early stage of the proceeding, to estimate the chances of the claim. No provision was made in the financial statements in respect of this claim.

(24) In July 2001 a claim was filed in the District Court against Pelephone Communications Ltd. ("Pelephone"). The plaintiffs allege that the pre-paid service constitutes infringement of their patent. Among the reliefs claimed are that Pelephone be directed to refrain from infringing the patent, ordered to submit a report on the number of cards, the revenues and profits, etc., received in respect of the sale of the cards, and ordered to pay NIS 100,000 in damages. At this stage, Pelephone is unable to estimate the outcome and the implications of the claim.

(25) In August 2001 an application for approval of a class action was filed against Pelephone in the Tel Aviv District Court. The applicant, through his attorney, alleges that Pelephone collected from its customers surplus amounts in respect of for reciprocal connection fees, in contravention of the regulations applicable thereto and/or of its license. The amount of the claim, had it been recognized as class action, would have exceeded NIS 32.6 million. The parties arrived at a compromise agreement, and on March 17, 2002 the District Court gave partial approval for the claim as a class action and simultaneously validated the settlement agreement as a decision. The settlement agreement stipulates it will take effect only after the elapse of the period permitted by law for opposition (45 days). The financial statements include a provision which Pelephone believes to be appropriate.

(26) In September 2001 a claim was filed in the Ramallah District Court by the General Public Palestinian Communications Co. Ltd., against Pelephone Communications Ltd. ("Pelephone") and another company. According to the claim, the plaintiff, which is a company registered with the Registrar of Companies in the West Bank, is involved in the setting up, operation, supply, sale and management of services and stations for telephone communication, both landline and mobile, in the West Bank and the Gaza Strip, except for settlement areas and IDF installations. The plaintiff alleges in its statement of claim that despite having been awarded exclusivity for providing cellular services in the West Bank and the Gaza Strip, Pelephone provides, among other things, cellular services to the inhabitants of the West Bank and the Gaza Strip without restriction and without a license, thereby breaking the law. The plaintiff alleges, inter alia, that due to these activities of Pelephone, the plaintiff has sustained and is sustaining extensive damages and heavy losses, and petitions for payment of NIS 676 million from Pelephone, while reserving the right to claim additional amounts from July 1, 2001 up to the date on which Pelephone ceases to provide these services. The plaintiff also petitions for an injunction against the provision of the cellular services by Pelephone. Pelephone and its legal advisors are studying the claim and are unable, at this stage, to estimate its chances and implications.

NOTE 20 - CONTINGENT LIABILITIES (contd.)

A. CLAIMS (contd.)

(27) In October 2001 the Company received a letter of demand in the name of the Moshav Porath Committee in the Sharon region, which contains allegations in connection with direct and indirect damages which were and are being sustained, according to the moshav members, as a result of the erection of the Hillel station near the moshav, and the station's broadcasts. The Company replied to the letter, refuting the allegations and the demand. In the Company's opinion, relying on its legal advisors, the chances of the Company's defense cannot be estimated if a claim is actually filed against it in this matter. No provision is made in respect of this matter in the financial statements.

(28) A number of individual claims of current and former employees are pending against the Company, mainly concerning the inclusion of wage components, which could have a lateral effect. The Company's management believes, relying on the opinion of the legal advisors who are handling the claims on its behalf, that the amount of money involved cannot be estimated, nor the chances and implications for the Company. No provision is made in respect of these claims in the financial statements.

(29) In 1995 the Company, together with others through a joint company, submitted bids in tenders of the Government of India for the erection of a basic communications system in India. Letters of intent and draft franchise agreements for development of the basic telephone system in the four regions for which the joint company won the tender, were submitted to the joint company. However, the joint company did not sign the letters and drafts because, *inter alia*, those documents do not correspond to the terms of the tender. At the time of the tender, the joint company gave the Indian Ministry of Communications bank guarantees, in which the Company's part was 273 million rupees (about NIS 24 million). The Indian Ministry of Communications demanded foreclosure of the guarantees at the end of June 1996. On September 19, 1997 the court gave a permanent injunction, preventing the Indian Ministry of Communications from foreclosing on the guarantees. At the end of October 1997 the Indian Ministry of Communications appealed that decision. The Company's management and legal advisors are unable to estimate the chances of the appeal in those proceedings. No provision was made in the financial statements in respect of this matter.

(30) In January 2002 the Company received a claim for payment of monetary compensation of about NIS 53 million and for writs of mandamus, which was filed in the Tel Aviv District Court by an international communications operator against the Company and a subsidiary, Bezeq International Ltd. The claim makes allegations concerning the customer allocation process to the international communications operators. According to the plaintiff, it is entitled to compensation from the Company and from Bezeq International in respect of postponement of implementation of the customer allocation process, and in respect of diverting those being allocated to Bezeq International by unlawfully including them in the main file and removing them from the customer allocation process, and in respect of losses it suffered due to the method of the voice announcement of the possibility of dialing from card-operated public telephones. Alternatively, the plaintiff alleges that it is entitled to reimbursement of access fees which it paid to the Company under a reciprocal connection agreement which was allegedly forced upon it unlawfully. The plaintiff also requests that the court give orders directing investigations and accounts be made in relation to certain actions in the allocation process and for changing the order of the voice announcement in public telephones so as to ensure, in its opinion, equality among the international operators. The Company, Bezeq International and their legal advisors are studying the claim, and are unable, at this stage, to estimate its chances and implications. No provision was made in the financial statements in respect of this claim.

NOTE 20 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS (contd.)

(31) In October 2000 , Bezeq International Ltd., a subsidiary, received a report from the Ministry of Communications expressing doubt as to the credibility of one of the main files which was forwarded to the Ministry of Communications in the customer allocation process. Bezeq International submitted its objection to the report to the Ministry of Communications. Following the report, one of the competing operators approached the Ministry of Communications, demanding that it direct that the dial code "00" be blocked to all telephone lines which were in the aforementioned file. On April 23, 2001, an agreement was signed between the subsidiary and the competing international operators, with the approval of the Ministry of Communications, whereby the allocation process will be redone for the group of customers called "new customers" in the main file, and the subsidiary would pay monetary compensation in respect of the period which had elapsed from the date of allocation of the main file to the date of the renewed allocation for that group, where the compensation formula is two thirds of the contribution generated to the subsidiary in respect of the traffic of those customers in that period. On May 21, 2001 the competing operators sent a letter to the Ministry of Communications giving notice of cancellation of the agreement. On June 7, 2001 the Ministry of Communications gave notice of transfer of the file to the operators for performance of the agreement. Despite this, the competing operators reneged on the maters which had been agreed and accordingly, the subsidiary notified them, on July 15, 2001, that if within seven days they do not give their explicit consent to performance of the agreement, the subsidiary will deem the agreement to have been breached. On July 16 and 18, 2001, the competing operators notified the Ministry of Communications that they do not intend to rescind their decision, and the subsidiary gave notice, on July 29, 2001, that it considers the agreement to have been breached. On October 28, 2001 the Minister of Communications notified the Company and the international operators that a supplementary referendum would be held for all the subscribers included in the "main file", except for those allocated to an international operator in an allocation form, and he requested their response to this proceeding by November 6, 2001. On that date, the subsidiary submitted to the Ministry of Communications its objections to carrying out the supplementary referendum. Following the objections of the Company, the subsidiary and the competing operators, the Ministry of Communications proposed another format for the supplementary referendum on December 11, 2001, and after receiving yet more objections from the Company, and subsidiary and the competing international operators, on February 14, 2002 the Ministry proposed a final text with details of the supplementary referendum, which will start on February 21, 2002 and end during July 2002. On March 12, 2002 the subsidiary petitioned the Supreme Court, sitting as the High Court of Justice, requesting that it direct the Ministry of Communications to refrain from passing the subsidiary's customer file to the competing international operators before the removal of the particulars of those customers who requested allocation to the subsidiary in the form, and that a supplementary referendum be carried out also for the customers of the competing operators who have no allocation form. The subsidiary also requested an interlocutory injunction concerning transfer of the customer file to the competing companies. On March 14, 2002 the Supreme Court decided to give an interlocutory injunction for non-transfer of the customer file to the competing companies until the petition was heard. The management of the subsidiary and its legal advisors are unable, at this stage, to estimate the outcome of the above proceeding.

(32) In January 2002 the Company received a letter of demand from a supplier, in which it was alleged that an order issued by the Company to the supplier for a total sum of about NIS 30 million, is valid. According to the Company, the order was made contingent upon suspending conditions which were not fulfilled, and therefore the order is not valid. In the opinion of the Company, relying on the legal advisor who is handling the demand on its behalf, the chances of the Company's defense cannot be estimated if a claim is filed against it in this matter. No provisions was made in the financial statements in respect of this matter.

NOTE 20 - CONTINGENT LIABILITIES (contd.)

A. CLAIMS (contd.)

(33) In February 2002 a claim and application for recognition as a class action were filed against the Company in the District Court, concerning reimbursement of a commission which the plaintiff alleges was collected unlawfully, for calls in Israel from a public telephone operated by means of a BezeqCard. The amount of the class action is estimated by the plaintiff at about NIS 14 million as at the date of filing the claim. A pre-trial hearing is scheduled for May 13, 2002. No response and/or defense has yet been filed. In the opinion of the Company, relying on the legal advisor who is handling the claim on its behalf, the chances of the claim cannot be estimated at this stage. No provisions was made in the financial statements in respect of this claim.

(34) On February 24, 2002 the Company received a "Notice of a party to a collective dispute" ("the Notice"), which was filed in the Regional Labor Court in Jerusalem on February 21, 2002 by the New General Federation of Workers ("the Applicant") in the name of Company employees. The Applicant alleges that payments for grossing up of tax, the on call duty benefits component and clothing allowances which were and are paid to Company employees are normal wages constituting part of the employee's regular pay, and that various payments and provisions should be paid in respect thereof, including for pension purposes. The Notice states that the requested reliefs are for all Company employees, including those whom were transferred from government service to the Company who are currently Company employees and also for former employees. In the Company's opinion, relying on its legal advisors, the claim is material and regarding at least part of it there are considerable risks. Nevertheless, it is not possible to assess those risks at this stage. A provision deemed suitable by the Company's management was included in the financial statements.

(35) On January 3, 2002 the Company received a class action together with an application for its recognition as a class action which were filed in the Tel Aviv District Court against the Company and against two cellular companies.
The amount of the class action against the two cellular companies is estimated at about NIS 94 million. No mention is made in the claim to the amount claimed (if any) from the Company, although the plaintiff alleges that the Company must repay customers the costs of disconnected calls which were collected through it to the coffers of the defendants. The plaintiff, who claims to be a subscriber of the Company and of the two cellular companies, alleges that the defendants collect payments in respect of calls in the cellular network which were disconnected due to a malfunction in the network rather than on the initiative of the caller or the call recipient. The plaintiff alleges that such collection for a product which was not supplied is unlawful, constitutes a violation of the provisions of the Consumer Protection Law and the Contracts Law, and even constitutes unjust enrichment.

In the Company's opinion, relying on the legal advisor who is handling the claim on its behalf, at this early stage the chances of the application for recognition cannot be estimated, and if allowed, the chances of the claim itself. No provisions was included in the financial statements in respect of this claim.

(36) In the matter of the notice of the Accountant General at the Ministry of Finance on the subject of the end of the period of two-year renewable rental of assets, see Note 9B.

(37) For the income tax and value added tax assessments, see note 11E.

(38) For possible demand for early repayment of bank loans, see Notes 13D1 and 14C.

(39) Miscellaneous claims - Various claims are pending against the Company in the normal course of business. It is the opinion of the Company's management that the risk inherent in each of these claims will not cause the Company material financial losses beyond the amounts included in the financial statements.

The amounts of the claims referred to above are adjusted (without interest) in terms of shekels of December 31, 2001.

NOTE 20 - CONTINGENT LIABILITIES (contd.)

B. FORWARD EXCHANGE CONTRACTS

Consolidated and Company

	Currency receivable	Currency payable	Repayment date	Amounts receivable	Amounts payable
				NIS millions	
Forward exchange contracts					
Commitment to purchase (including accrued interest)	Dollars	NIS	May 2002	1,009	959
	Euro	NIS	December 2003	666	658
Contracts at predetermined interest rates (excluding premium/discount)					
Commitment to sell:	Dollars	NIS	April 2002	79	77
Commitment to purchase:	Euro	NIS	December 2002	557	546
	Linked NIS	NIS	June 2003	595	601

A subsidiary has entered into forward exchange contracts not for a specific hedging purpose, which amount, as at December 31, 2001, to $28 million.

C. CONTRACTS

Lease Contract Commitments

For the year ended December 31	Consolidated NIS thousands	Company NIS thousands
2002	114,028	70,480
2003	116,911	63,696
2004	103,133	53,533
2005	92,559	46,679
2006	91,169	46,472
2007 and thereafter	411,466	342,133
	929,266	622,993

A subsidiary has contracted for providing maintenance services in the network terminal point field in the amount of approximately NIS 43 million.

D. SECURITIES AND LIENS

For securities, liens and stipulations in connection with loan covenants given by the Company and investee companies, see Notes 13D and Note 14C.

E. GUARANTEES

1. The Company has guaranteed third parties in the amount of approximately NIS 531,000.
2. A proportionally consolidated company has given a guarantee to third parties amounting to approximately NIS 214 million, of which about NIS 88 million is in connection with the third generation frequencies tender for cellular telephones.
3. Subsidiaries have guaranteed third parties for approximately NIS 76 million.

NOTE 20 - CONTINGENT LIABILITIES (CONTD.)

E. GUARANTEES (CONTD.)

4. After the balance sheet date, a subsidiary, Bezeq International Ltd., gave a bank guarantee for $2 million for fulfillment of the terms of its license, as demanded by the Ministry of Communications.

5. Affiliated companies guaranteed third parties for approximately NIS 55 million.
   Regarding guarantees to related parties, see Note 28C.

NOTE 21 - SHARE CAPITAL

A. The share capital consists of ordinary shares of a par value of NIS 1 each. The registered capital is 2,565,000,000 shares. The issued and paid up capital is 2,411,657,538 shares (2000 – 2,411,657,538 shares – after an issue of bonus shares). All the shares are listed on the Tel Aviv Stock Exchange.

   The General Meeting which convened on November 23, 2000 resolved to approve the recommendation of the Board of Directors of the Company to increase the registered capital of the Company by NIS 1.6 billion of ordinary shares and to distribute bonus shares in the amount of 1.6 billion shares, so that in respect of each share of a par value of NIS 1, two bonus shares of a par value of NIS 1 each will be distributed. In January 2001 the Ministerial Committee for privatization approved the increase of the registered capital for the purpose of allotment of the bonus shares. The increase and the allotment were implemented during February 2001.

B. On January 13, 2002 a framework agreement was signed between the State and the Company, whereby capital would be raised by way of a sale of the Company's shares by the State in a private placement, in accordance with Sections 15A and 15C(b) of the Securities Law. Concurrently, the Company will allot to the State an identical number of shares. The maximum quantity of shares is 148,333,334. The consideration in respect of the allotted shares will be the State's receipts less a distributors' commission and 1% to cover expenses. The Company is designating the proceeds for financing the costs involved in the retirement of Company employees.

   The price at which the State will sell the shares will be not less than NIS 6 net per share (i.e. after deduction of commissions), The registered share capital which has not been allotted in the issuance by February 28, 2003 or by another date on which the State holds 51.02% of the Company's share capital (at full dilution), whichever is the earlier, will be cancelled.

NOTE 22 - REVENUES FROM TELECOMMUNICATION SERVICES

Consolidated

	For the year ended December 31		
	2001	2000	1999*
	NIS thousands	NIS thousands	NIS thousands
Revenues from communications services -			
Domestic fixed-line communications	**2,400,232**	2,561,297	2,789,258
Fixed fees	**2,073,959**	2,016,679	1,844,673
Cellular telephone (1)	**2,071,833**	2,175,778	2,877,581
International communications and Internet services	**784,421**	858,299	916,624
Installation and sale of equipment to subscribers	**425,538**	503,262	485,923
Other	**119,163**	142,368	143,435
	7,875,146	8,257,683	9,057,494
Other revenues	**276,702**	262,976	226,252
	8,151,848	8,520,659	9,283,746

* Reclassified.

Company

	For the year ended December 31		
	2001	2000	1999
	NIS thousands	NIS thousands	NIS thousands
Revenues from communications services -			
Domestic fixed-line communications	**2,427,600**	2,582,509	2,804,317
Fixed fees	**1,962,541**	1,908,893	1,692,643
International communications and Internet services	**327,573**	393,942	450,633
Cellular telephone (1)	**668,216**	854,366	2,011,519
Installation and sale of equipment to subscribers	**139,786**	214,261	238,694
Other	**126,030**	146,152	145,761
	5,651,746	6,100,123	7,343,567
Other revenues	**242,906**	240,260	220,375
	5,894,652	6,340,383	7,563,942

(1) See Note 1E(1).

NOTE 23 - OPERATING AND GENERAL EXPENSES

Consolidated

	For the year ended December 31		
	2001	2000	1999*
	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses	**1,917,845**	1,699,806	1,694,683
General expenses	**733,106**	689,907	740,306
Materials and spare parts	**508,468**	423,994	289,794
Cellular telephone expenses (1)	**436,696**	516,913	1,384,163
Building maintenance	**381,644**	394,138	402,284
Services and maintenance by sub-contractors	**323,403**	403,715	477,337
International communications expenses	**199,890**	254,603	268,330
Vehicle maintenance expenses	**83,298**	73,622	66,380
Collection fees	**36,643**	39,557	42,707
	4,620,993	4,496,255	5,365,984
Less - salaries charged to investment in fixed assets	**153,447**	152,045	162,123
	4,467,546	4,344,210	5,203,861

Company

	For the year ended December 31		
	2001	2000	1999
	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses	**1,517,758**	1,331,160	1,412,647
General expenses	**284,463**	236,942	259,727
Materials and spare parts	**63,005**	48,898*	76,546*
Cellular telephone expenses (1)	**86,429**	307,106	1,518,275
Building maintenance	**334,060**	348,738	359,140
Services and maintenance by sub-contractors	**269,762**	336,190*	396,700*
International communications expenses	**9,693**	12,316	19,015
Vehicle maintenance expenses	**69,307**	63,291	60,780
Collection fees	**36,312**	39,328	42,048
	2,670,789	2,723,969	4,144,878
Less - salaries charged to investment in fixed assets	**153,447**	152,045	162,123
	2,517,342	2,571,924	3,982,755

* Reclassified

(1) See Note 1E(1)

NOTE 24 - FINANCING EXPENSES, NET

Consolidated

	For the year ended December 31		
	2001	2000	1999
	NIS thousands	NIS thousands	NIS thousands
Financing expenses in respect of a debenture issued to the State of Israel	**–**	4,950	56,850
Expenses in respect of long-term liabilities *			
Debentures	**186,232**	120,440	83,833
Loans	**302,708**	174,846	215,986
	488,940	300,236	356,669
Income in respect of deposits and investments	**(186,110)**	(66,930)	(74,643)
Expenses (income) in respect of forward exchange contracts	**(116,415)**	103,664	112,749
Short-term bank credit	**33,651**	36,273	15,183
Interest income from income tax	**(78,533)**	(6,749)	(3,398)
Other expenses (income), net	**2,543**	(18,425)	(41,413)
	144,076	348,069	365,147
(*) Includes appreciation (net of erosion) in respect of liabilities in foreign currency	**158,221**	(50,711)	(33,745)

Company

	For the year ended December 31		
	2001	2000	1999
	NIS thousands	NIS thousands	NIS thousands
Financing expenses in respect of a debenture issued to the State of Israel	**–**	4,950	56,850
Expenses in respect of long-term liabilities *			
Debentures	**186,232**	120,440	83,833
Loans	**266,128**	155,707	196,547
	452,360	281,097	337,230
Income in respect of deposits and investments	**(184,597)**	(66,930)	(74,643)
Expenses (income) in respect of forward exchange contracts	**(110,520)**	103,664	112,749
Interest income from income tax	**(78,533)**	(6,749)	(3,398)
Other expenses (income), net	**(5,955)**	(12,595)	(2,109)
	72,755	298,487	369,829
(*) Includes appreciation (net of erosion) of liabilities in foreign currency	**158,221**	(47,668)	(35,827)

NOTE 25 - OTHER EXPENSES, NET

Consolidated

	For the year ended December 31		
	2001	2000	1999
	NIS thousands	NIS thousands	NIS thousands
Provision for employee severance benefits upon early retirement (Note 16D)	**–**	(1,466,849)	(403,954)
Compensation (provision) in respect of billing system	**–**	100,528	(128,559)
Provision for claims for salary and pension components	**–**	(50,705)	–
Provision update for unutilized sick leave	**–**	–	9,905
Provision and decrease in value of fixed assets	**(102,026)**	(11,168)	–
Direct expenses for the customer allocation process	**(1,478)**	(28,080)	(76,626)
Capital gains, net	**8,705**	1,360	16,622
Capital gain from sale of an affiliated company (1)	**–**	140,692	-
Cancellation of provision for a guarantee for an affiliated company	**–**	23,634	15,129
Loss in respect of decrease in holding in an affiliated company	**(3,480)**	–	–
Others	**(2,273)**	(4)	1,154
	(100,552)	(1,290,592)	(566,329)

Company

	For the year ended December 31		
	2001	2000	1999
	NIS thousands	NIS thousands	NIS thousands
Provision for employee severance benefits upon early retirement (Note 16D)	**–**	(1,466,849)	(403,954)
Compensation (provision) for billing system	**–**	100,528	(128,559)
Provision for claims for salary and pension components	**–**	(50,705)	–
Provision update for unutilized sick leave	**–**	–	9,905
Capital gains (losses), net	**(2,502)**	2,694	17,700
Capital gain from sale of an affiliated company (1)	**–**	140,692	–
Cancellation of provision for a guarantee for an affiliated company	**–**	23,634	15,129
Others	**–**	(227)	205
	(2,502)	(1,250,233)	(489,574)

(1) In 2000, the Company signed an agreement for the sale and transfer of the Company's holdings in an affiliated company. By December 31, 2000, the Company had received the full consideration for the sale of its holdings.

NOTE 26 - EARNINGS PER SHARE (CONSOLIDATED AND COMPANY)

	For the year ended December 31		
	2001	2000	1999
	NIS thousands	NIS thousands	NIS thousands
Primary and diluted earnings (loss)	**121,302**	(551,999)	20,610
Weighted number of shares in primary earnings and diluted earnings	**2,411,658**	2,411,658	2,411,658

NOTE 27 - BUSINESS SEGMENTS

The Company and the investee companies operate in various segments of the communications sector. The data concerning operations by segment are presented according to the operations segments of those companies.

Consolidated

	For the year ended December 31, 2001					
	Fixed-line domestic communications	Cellular telephone	International communications	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues						
Revenues from external sources	**5,556,959**	**1,778,608**	**657,686**	**158,595**	**–**	**8,151,848**
Inter-segment revenues	**337,693**	**6,051**	**11,146**	**21,660**	**(376,550)**	**–**
Total revenues	**5,894,652**	**1,784,659**	**668,832**	**180,255**	**(376,550)**	**8,151,848**
Segment results	**1,036,958**	**(181,314)**	**(40,131)**	**1,248**	**617**	**817,378**
Financing expenses						**144,076**
Earnings after financing expenses						**673,302**
Other expenses, net						**(100,552)**
Earnings before income tax						**572,750**
Income tax						**(230,592)**
Earnings after income tax						**342,158**
Equity in losses of affiliated companies	**28,459**			**(255,716)**		**(227,257)**
Minority equity in losses of a consolidated company	**6,220**					**6,220**
Net earnings						**121,121**
Identified assets	**11,144,316**	**2,082,631**	**580,965**	**123,319**	**(57,183)**	**13,874,048**
Investment by equity method	**126,796**			**334,271**		**461,067**
General assets						**2,821,588**
Total consolidated assets						**17,156,703**
Segment liabilities	**1,457,284**	**742,812**	**292,059**	**53,474**	**(56,476)**	**2,489,153**
General liabilities						**7,486,919**
Total consolidated liabilities						**9,976,072**
Capital investments	**797,756**	**485,618**	**118,278**	**8,231**		
Depreciation and amortization	**2,151,037**	**707,206**	**75,834**	**5,100**		

NOTE 27 - BUSINESS SEGMENTS (CONTD.)

Consolidated

	For the year ended December 31, 2000					
	Fixed-line domestic communications	Cellular telephone	International communications	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues						
Revenues from external sources	5,995,268	1,691,328	676,658	157,405	–	8,520,659
Inter-segment revenues	345,115	53,996	4,497	31,272	(434,880)	–
Total revenues	6,340,383	1,745,324	681,155	188,677	(434,880)	8,520,659
Segment results	1,286,795	(29,319)	(150,984)	12,459	165	1,119,116
Financing expenses						348,069
Earnings after financing expenses						771,047
Other expenses, net						(1,290,592)
Loss before income tax						(519,545)
Tax benefit						155,484
Loss after income tax						(364,061)
Equity in losses of affiliated companies	(12,266)			(185,644)		(197,910)
Minority equity in losses of a consolidated company						4,962
Net loss						(557,009)
Identified assets	12,472,474	2,326,407	543,973*	90,423	(56,219)	15,377,058
Investment by equity method	101,883			73,227		175,110
General assets						1,557,432
Total consolidated assets						17,109,600
Segment liabilities	2,486,467	937,760	408,151*	50,085	(54,353)	3,828,110
General liabilities						6,222,003
Total consolidated liabilities						10,050,113
Capital investments	1,024,945	827,854	131,687	8,272		
Depreciation and amortization	2,277,958	537,436	75,456	4,508		

* Reclassified

NOTE 27 - BUSINESS SEGMENTS (CONTD.)

Consolidated

	For the year ended December 31, 1999					
	Fixed-line domestic communications	Cellular telephone	International communications	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues						
Revenues from external sources	7,228,434	1,176,202	719,930	159,180	–	9,283,746*
Inter-segment revenues	335,509	332,591	9,550	27,870	(705,520)	–
Total revenues	7,563,943	1,508,793	729,480	187,050	(705,520)	9,283,746
Segment results	1,044,412	64,465	(60,615)	14,855	(48,104)	1,015,013
Financing expenses						(365,147)
Earnings after financing expenses						649,866
Other expenses, net						(566,329)
Earnings before income tax						83,537
Income tax						(60,506)
Earnings after income tax						23,031
Equity in losses of affiliated companies	5,458			(27,312)		(21,854)
Earnings before cumulative effect of the change in accounting method						1,177
Cumulative effect, net, of change in accounting method as at beginning of year		7,123				7,123
Net earnings						8,300
Identified assets	13,009,625	1,922,987	740,450	95,423	(61,229)	15,707,256
Investment by equity method	49,313			27,249		76,562
General assets						1,268,307
Total consolidated assets						17,052,125
Segment liabilities	1,453,707	527,760	390,525	53,608	(90,795)	2,334,805
General liabilities						7,120,044
Total consolidated liabilities						9,454,849
Capital investments	1,079,165	782,731	106,832	7,393		
Depreciation and amortization	2,325,632	442,206	48,853	3,766		

* Reclassified

NOTE 28 - TRANSACTIONS WITH INTERESTED AND RELATED PARTIES

A. The Company is a government company which transacts a large volume of business in the regular course of its operations with government ministries and agencies and government companies. The business transacted is, primarily, the provision of telecommunications services and the execution of development work, as well as the receipt of various types of services. It is not practicable to determine the identity of the interested parties involved in such transactions, nor to make a distinction in the recording thereof. The Securities Authority, pursuant to its authority under the Securities Regulations (Preparation of annual financial statements), 5753-1993, exempted the Company from detailing its transactions with interested parties, other than extraordinary transactions. (The exemption in respect of 2001 is dated January 2, 2002.)

B. The Company provides services to the Israeli Defense and Security Forces in accordance with terms agreed upon in prior years and which provided, *inter alia*, that the Ministry of Defense will fund the Company's infrastructure investments in consideration of discounts which the Company will grant in respect of current services.

Due to controversies which arose between the Company and the Ministry of Defense in connection with the terms of the services which the Company provides to the Israeli Defense Forces, a professional committee was established to examine the differences of opinion. In May 1996, the committee submitted recommendations for the resolution of the differences of opinion, of which the main recommendations are these:

(1) The balance of the accounting between the Company and the Ministry of Defense for the first half of 1996 amounts to approximately NIS 355 million as excess investments by the Ministry of Defense.

(2) For the purpose of completing the accounting mentioned in (1) above, the Company will grant a discount at the rate of 14% on its total services provided to the Israeli Defense Forces, for a period of ten years commencing on July 1, 1996.

(3) All prior obligations and controversies between the parties, as they appear in the claims and demands submitted by both parties, are canceled.

(4) Commencing July 1, 1996, the relationship between the Company and the Ministry of Defense shall be similar to that between the Company and its other customers. Investments in communications infrastructure shall be made and financed by the Company, and the Ministry of Defense will be charged based on the Company's tariffs, subject to that stated in (2) above.

Since the recommendations were not adopted by the Ministers of Defense and Communications, the arrangements which were hitherto in effect between the Company and the Israeli Defense Forces, and which were the subject of the committee's discussions, continue to govern.

The Company and the Ministry of Defense are negotiating a revised arrangement of their commercial relations.

C. GUARANTEES

The Company has given guarantees to banks in connection with credit granted to subsidiary companies of up to NIS 70 million. As at balance sheet date, the balance of the guaranteed loans, as stated, amounted to approximately NIS 2.6 million.

In connection with guarantees given by the Company in respect of its investments in India, see Note 20A (29).

In connection with an additional guarantee in respect of the Company's investments in D.B.S. Satellite Services (1998) Ltd., see Note 8F.

NOTE 28 - TRANSACTIONS WITH INTERESTED AND RELATED PARTIES (CONTD.)

D. TRANSACTIONS WITH INVESTEE COMPANIES (COMPANY BOOKS)

	For the year ended December 31		
	2001	2000	1999
	NIS thousands	NIS thousands	NIS thousands
Revenues -			
Interconnect and access fees	**274,741**	301,907	425,247
Services, royalties and commissions	**318,264**	203,805	70,720
Rent and usage fees for buildings and equipment	**40,813**	9,920	909
Interest	**6,531**	–	–
Expenses -			
Purchase of services	**34,245**	144,879	681,994
Interest	**–**	–	14,836
Total earnings (losses) from fixed asset transactions	**–**	(450)	977
Total transaction turnover	**–**	576	1,612

Transactions with a proportionally consolidated company were presented in full (100%).

For balances with subsidiaries and a proportionally consolidated company, see relevant notes.

E. BENEFITS FOR DIRECTORS AND THE CEO

	For the year ended December 31		
	2001	2000	1999
	NIS thousands	NIS thousands	NIS thousands
Total cost of compensation of the CEO and the Chairman of the Board	**1,443**	1,189	1,533
Number of employees	**2**	2	3
Compensation of members of the Board of Directors who are not Company employees*	**1,344**	1,401	1,261
Number of directors receiving compensation	**19**	17	13

* Compensation for directors in a proportionally consolidated company is presented at the proportional share of the Company (50%).

The Company holds an insurance policy for the directors and officers of the Company. The maximum insurance is $150 million per event and per period (of 12 months), and up to an additional $30 million for legal expenses in Israel. In addition, the Company will indemnify directors and officers in an amount not exceeding $50 million per director and officer for a financial obligation imposed upon them in any matter connected with the Company's prospectus from February 27, 1998 and which is not covered by the insurance policy.

NOTE 29 - FINANCIAL INSTRUMENTS

A. FINANCIAL DERIVATIVES

The Group has an excess of liabilities over assets in or linked to foreign currency, in the amount of approximately NIS 2,063 million, of which the excess of current liabilities over current assets was approximately NIS 406 million. The excess of current liabilities is partially covered by forward exchange contracts, as described in Note 20B. The Group has revenues in foreign currency from international communications.

As at December 31, 2001, the excess of CPI-linked monetary liabilities over CPI-linked monetary assets amounted to approximately NIS 1,728 million, of which the excess of current liabilities over current assets was approximately NIS 435 million. As stated in Note 1B, most of the Company's tariffs are subject to government regulation and are revised from time to time in accordance with the increase in the CPI, net of an efficiency factor.

The Company has limited commitments in financial derivatives, which are intended solely for purposes of hedging.

Regarding the Company's commitments to execute forward exchange contracts, at December 31,2001 - see Note 20B.

B. CREDIT RISKS

Most of the cash and cash equivalents, at December 31, 2001, as well as bank deposits, are deposited in large Israeli banks. Short-term investments represent, primarily, investments in government debentures and bank deposits, while a small part is invested in debentures of companies trading on the stock exchange in Israel. Accordingly, Management does not expect significant losses deriving from credit risks.

The Group's revenues derive from a large number of customers. Management reviews customer balances on a current basis, and the financial statements include provisions which, in Management's opinion, are adequate for doubtful debts. The exposure to credit risk in connection with customers is limited considering the large number of customers of the Company.

C. FAIR VALUE OF FINANCIAL INSTRUMENTS

The book value of the cash and cash equivalents, short-term investments, customers, trade receivables, other current assets, most of the long-term liabilities, the payables and accrued expenses, are equal or are close to their fair values. The fair value of loans from banks is also close to their book value, since they bear interest at roughly the market rate.

Regarding several items, there is a difference between the amount recorded on the books and their estimated fair value, as detailed below.

	December 31, 2001	
	Book value NIS thousands	**Fair value NIS thousands**
Debentures:		
Issued to the public	**1,365,693**	**1,405,887**
Issued to others	**1,345,294**	**1,323,256**
CPI-linked loans	**812,139**	**767,195**
Unlinked loans	**386,540**	**324,367**
Foreign currency loans	**1,803,936**	**2,032,667**

The fair value of debentures issued to the public is based on their market price. The fair value of the other liabilities presented above is based on the present value of the cash flows related thereto.

NOTE 30 - LINKAGE TERMS OF MONETARY BALANCES AS AT DECEMBER 31, 2001

Consolidated

	In or linked to foreign currency					
	Dollar-linked	Euro-linked	Other	CPI-linked	Unlinked	Total
	NIS thousands			NIS thousands		
Assets						
Cash and cash equivalents	40,583	1,020	–	102	1,261,295	1,303,000
Short-term investments	16,983	–	–	151,510	272,161*	440,654
Trade receivables	30,321	–	–	5,291	1,651,600	1,687,212
Other receivables and debit balances	57,890	22,541	–	5,386	18,641	104,458
Long-term deposits and debit balances	1,106,871	7,880	–	215,453	270,414	1,600,618
	1,252,648	31,441	–	377,742	3,474,111	5,135,942
Liabilities						
Short-term bank credit	35,510	–	–	–	388,056	423,566
Current maturities of long-term liabilities	198,720	–	–	414,927	130,000	743,647
Trade payables	279,933	421	6,370	–	731,960	1,018,684
Other current liabilities	17,630	35,838	–	182,107	873,154	1,108,729
Long-term loans	1,605,216	1,366	–	650,598	256,740	2,513,920
Other long-term debentures	–	1,166,104	–	858,052	500,110	2,524,266
Employee severance benefits	–	–	–	–	1,538,858	1,538,858
	2,137,009	1,203,729	6,370	2,105,684	4,418,878	9,871,670

Company

	In or linked to foreign currency					
	Dollar-linked	Euro-linked	Other	CPI-linked	Unlinked	Total
	NIS thousands			NIS thousands		
Assets						
Cash and cash equivalents	18,045	1,020	–	–	1,251,301	1,270,366
Short-term investments	15,317	–	–	148,155	261,150*	424,622
Trade receivables	5,413	–	–	-	1,140,131	1,145,544
Other receivables and debit balances	54,942	22,541	–	1,450	5,680	84,613
Long-term deposits and debit balances	1,106,871	7,880	–	201,422	223,434	1,539,607
	1,200,588	31,441	–	351,027	2,881,696	4,464,752
Liabilities						
Current maturities of long-term liabilities	198,720	–	–	355,025	–	553,745
Trade payables	18,548	421	6,370	–	545,188	570,527
Other current liabilities	17,631	35,838	–	137,544	732,479	923,492
Long-term loans	1,605,216	1,366	–	366,953	-	1,973,535
Other long-term debentures	–	1,166,104	–	858,052	500,110	2,524,266
Employee severance benefits	–	–	–	–	1,528,025	1,528,025
	1,840,115	1,203,729	6,370	1,717,574	3,305,802	8,073,590

* Including mutual fund participation certificates of approximately NIS 170,000 consolidated, and NIS 167,000 for the Company.

For details of forward exchange contracts for covering exposure to foreign currency, see Note 20B.

NOTE 30 - LINKAGE TERMS OF MONETARY BALANCES AS AT DECEMBER 31, 2000 (CONTD.)

Consolidated

	In or linked to foreign currency				
	Dollar-linked*	Euro-linked*	CPI-linked	Unlinked	Total
	NIS thousands		NIS thousands		
Assets					
Cash and cash equivalents	122,905	609,182	–	822,399	1,554,486
Short-term investments	12,359	–	90,752	87,913	191,024
Trade receivables	46,174	–	4,597	1,241,358	1,292,129*
Other receivables and debit balances	–	18,892	225,963	28,587	273,442
Long-term deposits and debit balances	–	–	9,998	259,771	269,769
	181,438	628,074	331,310	2,440,028	3,580,850
Liabilities					
Short-term bank credit	19,274	–	–	726,229	745,503
Current maturities of long-term liabilities	153,673	–	456,991	–	610,664
Trade payables	329,079	–	–	632,562	961,641*
Other current liabilities	42,309	30,298	79,077	778,011*	929,695*
Long-term loans	1,886,048	–	940,305	38,243	2,864,596
Other long-term debentures	–	1,137,680	1,044,726	–	2,182,406
Employee severance benefits	–	–	–	1,624,799*	1,624,799*
	2,430,383	1,167,978	2,521,099	3,799,844	9,919,304

Company

	In or linked to foreign currency				
	Dollar-linked*	Euro-linked*	CPI-linked	Unlinked	Total
	NIS thousands		NIS thousands		
Assets					
Cash and cash equivalents	120,312	609,182	–	813,797	1,543,291
Short-term investments	10,843	–	88,567	71,339	170,749
Trade receivables	1,798	–	–	736,817	738,615
Other receivables and debit balances	–	18,892	189,414	13,640	221,946
Long-term deposits and debit balances	–	–	–	223,644	223,644
	132,953	628,074	277,981	1,859,237	2,898,245
Liabilities					
Current maturities of long-term liabilities	153,673	–	396,052	–	549,725
Trade payables	16,027	–	–	456,435	472,462
Other current liabilities	42,309	30,298	79,077	606,414*	758,098*
Long-term loans	1,886,048	–	552,572	–	2,438,620
Other long-term debentures	–	1,137,680	1,044,726	–	2,182,406
Employee severance benefits	–	–	–	1,620,465*	1,620,465*
	2,098,057	1,167,978	2,072,427	2,683,314	8,021,776

* Reclassified

For details of forward exchange contracts for covering exposure to foreign currency, see Note 20B.

NOTE 31 - CONDENSED FINANCIAL STATEMENTS OF THE COMPANY IN NOMINAL VALUES

A. BALANCE SHEETS

	December 31 2001	December 31 2000
	NIS thousands	NIS thousands
Assets		
Current assets	**3,093,366**	2,804,982
Materials and spare parts	**151,239**	184,983
Long-term deposits and debit balances	**1,619,378**	244,027
Investment in investee companies	**1,481,849**	1,143,339
Fixed assets	**6,374,488**	7,097,316
Other assets	**950,966**	1,492,624**
	13,671,286	12,967,271
Liabilities		
Current	**2,341,098**	2,126,776*
Long-term	**5,833,124**	5,898,875*
	8,174,222	8,025,651
Convertible debentures	**–**	68,092
Shareholders' equity	**5,497,064**	4,873,528**
	13,671,286	12,967,271

* Reclassified
** Restated

NOTE 31 - CONDENSED FINANCIAL STATEMENTS OF THE COMPANY IN NOMINAL VALUES (CONTD.)

B. Statements of Operations

	For the year ended December 31		
	2001	**2000**	**1999**
	NIS thousands	**NIS thousands**	**NIS thousands**
Revenues from telecommunications services	**5,875,892**	6,237,202	7,369,982
Costs and expenses			
Operating and general expenses	**2,503,376**	2,531,190	3,883,844
Depreciation	**1,466,867**	1,482,947	1,422,078
Royalties to the Government of Israel	**188,853**	204,058	205,769
	4,159,096	4,218,195	5,511,691
Operating income	**1,716,796**	2,019,007	1,858,291
Financing expenses, net	**(117,455)**	(289,522)	(416,655)
Earnings after financing expenses	**1,599,341**	1,729,485	1,441,636
Other expenses, net	**(18,193)**	(1,227,500)	(464,378)
Earnings before income tax	**1,581,148**	501,985	977,258
Income tax	**(577,431)**	*(77,418)	*(303,260)
Earnings after income tax	**1,003,717**	424,567	673,998
Equity in losses of investee companies	**(447,964)**	(364,188)	(48,562)
Net earnings	**555,753**	60,379	625,436

* Restated

NOTE 31 - CONDENSED FINANCIAL STATEMENTS OF THE COMPANY IN NOMINAL VALUES (CONTD.)

C. STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

	Share capital	Capital reserves	Retained earnings (loss)	Total
	NIS thousands			
Balance as at January 1, 1999	765,784	3,030,698	320,181*	4,116,663
Net earnings	–	–	625,436*	625,436
Dividend in respect of preceding year	–	–	(301,565)	(301,565)
Conversion of convertible debentures	17,607	169,820	–	187,427
Balance as at December 31, 1999	783,391	3,200,518	644,052	4,627,961
Net earnings	–	-	60,379*	60,379
Tax benefit for shares to employees	–	21,841	–	21,841
Capitalization of undesignated earnings to a reserve fund for the distribution of bonus shares	–	1,600,000	(1,600,000)	–
Conversion of convertible debentures	14,590	148,757	–	163,347
Balance as at December 31, 2000	797,981	4,971,116	(895,569)	4,873,528
Net earnings	**–**	**–**	**555,753**	**555,753**
Conversion of convertible debentures	**5,905**	**61,878**	**–**	**67,783**
Distribution of bonus shares	**1,607,772**	**(1,600,000)**	**(7,772)**	**–**
Balance as at December 31, 2001	**2,411,658**	**3,432,994**	**(347,588)**	**5,497,064**

* Restated

NOTE 31 - CONDENSED FINANCIAL STATEMENTS OF THE COMPANY IN NOMINAL VALUES (CONTD.)

D. RESTATEMENT

The Company adjusted its nominal financial statements by way of restatement, in order to reflect therein, retroactively, amendment of the accounting treatment in generating deferred tax in respect of fixed assets.

(1) Effect on the balance sheet as at December 31, 2000:

	As previously reported	Effects of restatement	As reported in these financial statements
	NIS thousands	NIS thousands	NIS thousands
Other assets	864,730	627,894	1,492,624
Shareholders' equity	4,245,634	627,894	4,873,528

(2) Effect on net earnings:

	For the year ended December 31	
	2000	1999
	NIS thousands	NIS thousands
Net earnings as previously reported	351,559	973,151
Effect of restatement:		
Increase in income tax	(291,180)	(347,715)
	60,379	625,436

NOTE 32 - CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD. AND ITS SUBSIDIARY

1. BEZEQ INTERNATIONAL LTD.

A. BALANCE SHEETS

	December 31 2001 NIS thousands	December 31 2000 NIS thousands
Current assets	**163,734**	170,549*
Investments	**8,557**	38,706
Fixed assets	**405,713**	364,763
Other assets	**15,540**	18,457
	593,544	592,475
Current liabilities	**324,059**	406,450*
Long-term liabilities	**193,346**	33,203
Quasi-capital receipt	**160,712**	160,712
Shareholders' deficit	**(84,573)**	(7,890)
	593,544	592,475

B. STATEMENTS OF OPERATIONS

	For the year ended December 31		
	2001 NIS thousands	2000 NIS thousands	1999 NIS thousands
Revenues from international communications services	**668,832**	681,174	729,583*
Operating expenses	**494,288**	564,958	603,125
Gross profit	**174,544**	116,216	126,458
Marketing expenses	**121,850**	167,724	112,996
General and administration expenses	**92,825**	99,481	74,080*
	214,675	267,205	187,076
Operating loss	**(40,131)**	(150,989)	(60,618)
Financing income (expenses), net	**(10,849)**	(3,223)	36,585
Loss after financing	**(50,980)**	(154,212)	(24,033)
Other income (expenses), net	**3,984**	(40,277)	(78,633)
Loss before income tax	**(46,996)**	(194,489)	(102,666)
Tax benefit (income tax)	**(3,018)**	(1,643)	9,130
Loss after income tax	**(50,014)**	(196,132)	(93,536)
Company's equity in losses of investee company	**(26,669)**	(10,606)	–
Net loss	**(76,683)**	(206,738)	(93,536)

* Reclassified

NOTE 32 - CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD. AND ITS SUBSIDIARY (CONTD.)

2. PELEPHONE COMMUNICATIONS LTD.

A. BALANCE SHEET

	Consolidated December 31 2001 NIS thousands	Consolidated December 31 2000 NIS thousands
Current assets	**1,098,689**	1,145,886
Long-term trade receivables	**93,960**	72,259
Investment in investee company	**–**	1,460
Deferred taxes	**180,210**	–
Fixed assets	**2,522,947**	2,903,319
Other assets, net	**594,674**	688,998
	4,490,480	4,811,922
Current liabilities	**1,842,310**	2,113,047
Provision for losses of investee company	**3,725**	–
Long-term liabilities	**1,009,687**	804,724
Shareholders' equity	**1,634,758**	1,894,151
	4,490,480	4,811,922

B. STATEMENTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31

	Consolidated		Company
	2001 NIS thousands	2000 NIS thousands	1999 NIS thousands
Revenues from cellular services, sales and services	**3,569,317**	3,490,648	3,017,057
Cost of cellular services, sales and services	**3,177,273**	2,916,869	2,424,124
Gross profit	**392,044**	573,779	592,933
Sales and marketing expenses	**507,889**	454,704	289,249
General and administration expenses	**221,509**	202,946	186,266
	729,398	657,650	475,515
Operating income (loss)	**(337,354)**	(83,871)	117,418
Financing expenses, net	**(123,192)**	(99,382)	(66,672)
Other income (expenses), net	**(203,710)**	1,739	528
Earnings (loss) before income tax	**(664,256)**	(181,514)	51,274
Tax benefit (income tax)	**228,035**	52,166	(25,526)
Earnings (loss) after income tax	**(436,221)**	(129,348)	25,748
Minority equity in losses of a subsidiary	**12,440**	9,928	–
Company equity in losses of investee companies	**(7,658)**	(11,077)	(4,034)
Earnings (loss) before cumulative effect of change in accounting method	**(431,439)**	(130,497)	21,714
Cumulative effect, net, of change in accounting method as at beginning of year	**–**	–	14,245
Net earnings (loss)	**(431,439)**	(130,497)	35,959

	Percent of control and ownership as at	
	December 31, 2001	December 31, 2000
	%	%
Subsidiaries		
Bezeq International Ltd.	**100**	100
BezeqCall Communications Ltd. (formerly Bezeq Bit 1995 Ltd.) (1)	**100**	100
BezeqCall Ltd. (1)	**100**	100
Bezeq Globe Ltd. (2)	**100**	100
Bezeq On Line Ltd. (3)	**100**	100
Proportionally Consolidated Companies		
Pelephone Communications Ltd.	**50**	50
GoNext Ltd. (4)	**26**	26
Affiliated Companies		
Stage One Venture Capital Fund (Israel) L.P. (an Israeli Limited Partnership) (hereinafter – the Fund) (5)	**100**	–
Stage One Capital Investments L.P. (an Israeli Limited Partnership) (hereinafter – SOCI) (5)	**27**	–
The International Company for Underwater Cables Ltd. (6)	**50**	50
Goldnet Communications Services – registered partnership (7)	**49**	49
Aphrodite B.V. Amsterdam (8)	**67**	67
Emitel Telecommunication Corp. Ltd. (Hungary) (8)	**–**	33
D.B.S. Satellite Services (1998) Ltd. (9)	**30**	30
Infogate Online Ltd. (10)	**29**	29
Safe Com-Car Communication (hereinafter - Safe-Car)(11)	**–**	–
Eden Telecom Ltd. (11)	**23**	–
Walla! Communications Ltd.(12)	**25**	38.5
Adanet for Business Group Ltd.(13)	**50**	23
Companies that are not investees		
Comfynet Ltd.	**17**	–
Xpert Integrated Systems Ltd. (14)	**16**	–
Personeta Inc.	**4**	–
Exent Ltd.	**6**	11
Atrica Inc.	**1**	–
Venture Capital Funds		
Eurofund 2000 L.P	**14**	14
B.R.M. Capital Fund L.P	**3**	4

(1) Commencing July 1, 1997, the operations of both companies were merged and BezeqCall Ltd. ceased operations.

(2) The company ceased to operate on July 1, 1998. In 2000 the company decided on voluntary liquidation. The liquidation was approved by the Ministerial Committee for Privatization, and a liquidator was appointed.

(3) The company was founded in December 2000 and started operations in 2001.

(4) On March 16, 2000, Pelephone Communications Ltd. signed an agreement for the establishment of GoNext Ltd. ("GoNext"). The activities of Gonext focus primarily on setting up a mobile Internet portal. Pelephone holds 51% of the shares of GoNext. The consolidated financial statements include consolidation of the financial statements of GoNext, in which control is held by Pelephone.

(5) The fund is a venture capital fund managed by SOCI. The Company undertook to invest the sum of $20 million in the fund, of which approximately $3 million was invested during the year.

(6) The Company maintained a underwater cable which it laid. The Company's share of the cost and maintenance of the equipment is charged to fixed assets and maintenance expenses. In February 1997, use of the cable ceased. In January 1999 the Board of Directors resolved upon voluntary liquidation as of March 31, 1999.

(7) Under the agreement between the partners, in 2000 the Company increased its investment in the partnership to 49%. In addition, under the agreement, the Company has an option to increase its share in the partnership by another 5%. Furthermore, the Company has an option to increase its share in the partnership up to an additional 20%, while the other partners have an option to obligate the Company to increase its share as aforesaid. The option is valid until March 31, 2003.

(8) See Note 8E.

(9) See Note 8F.

(10) The Company is developing and supplying data communication services under the ASP concept, in which computers are linked in a broadband network to a central server from which various services are received.

(11) In October 2000 an agreement was signed between Pelephone Communications Ltd. and the other shareholders in Safe-Car Communication Ltd. ("Safe-Car"), and Eden Telecom Ltd. ("Eden") and its shareholders, whereby the operations of Safe-Car were merged with the operations of Eden by a transfer of net assets from Safe-Car to Eden. After the merger, Pelephone holds 22.95% of Eden. The main business of Eden is the locating of vehicles, similar to the business of Safe-Car.

Until October 2000, Pelephone held 51% of Safe-Car. The financial statements of Safe-Car were not consolidated since Pelephone did not own a controlling or joint controlling interest, pursuant to the establishment agreement of the company, which stipulates that significant resolutions require a 75% majority.

(12) See Note 8G.

(13) See Note 8H.

(14) In the report period, the Company invested approximately NIS 40 million in Xpert Integrated Systems Ltd. ("Xpert"), in consideration of 16.26% of the capital of that company, as well as options which will enable it to increase its holdings to 20.33% (15.98% at full dilution). Xpert is an Israeli company involved mainly in the construction and integration of IP networks.