"BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

AS AT JUNE 30, 1999

(UNAUDITED)

Contents

Interim Consolidated Balance Sheets

In terms of shekels of June 1999

	June 30, 1999 (Unaudited)	June 30, 1998 (Unaudited)	December 31, 1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current Assets			
Cash and cash equivalents	858,470	706,871	916,577
Short-term investments	362,046	382,182	379,323
Trade receivables	1,462,173	1,587,670*	1,526,507
Other receivables and debit balances	378,559	495,273	431,837
Inventory	105,119	44,094*	56,074*
	3,166,367	3,216,090	3,310,318
Materials and spare parts	220,397	247,811*	230,890*
Investments and long-term receivables			
Bank deposits and other investments	290,476	276,745*	311,222
Investments in investee companies	57,063	31,554	35,930
	347,539	308,299	347,152
Fixed assets			
Cost	28,906,819	28,649,666	28,182,316
Less - accumulated depreciation	15,754,465	14,603,567	14,502,063
	13,152,354	14,046,099	13,680,253
Other assets			
Deferred charges and other assets	87,510	25,806	22,398
Deferred taxes	382,208	365,074	305,052
	469,718	390,880	327,450
	17,356,375	18,209,179	17,896,063

* Reclassified

	June 30, 1999 (Unaudited)	June 30, 1998 (Unaudited)	December 31, 1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current liabilities			
Short-term bank credit	108,186	2,138	-
Current maturities of:			
Debenture issued to the Government of Israel	923,352	922,458	925,453
Long-term bank loans	1,053,541	1,094,704	1,072,172
Other debentures	212,112	198,884	203,038
Trade payables	968,828	1,050,991	980,660
Employee severance benefits	266,998	750,122	626,961
Other current liabilities	946,493	1,026,496	1,048,056
	4,479,510	5,045,793	4,856,340
Long-term liabilities			
Debenture issued to the Government of Israel	-	922,459	462,726
Long-term loans	3,426,909	3,567,262	3,558,891
Other debentures	1,309,094	1,189,579	1,193,361
Convertible debentures	264,448	337,174	412,402
Employee severance benefits	370,778	352,795	91,549
Deferred revenues	81,377	83,019	83,687
	5,452,606	6,452,288	5,802,616
Contingent liabilities (Note 7)			
Shareholders' equity	7,424,259	6,711,098	7,237,107
	17,356,375	18,209,179	17,896,063

Israel Tapoohi	Ami Erel	Iris Stark	Oren Lieder
Chairman of the Board	CEO	Member of the Board	Chief Financial Officer

Date of approval of the financial statements: August 29, 1999

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

Interim Consolidated Statements of Operations

In terms of shekels of June 1999

	For the six months ended June 30		For the three months ended June 30		For the year ended December 31
	1999 (Unaudited)	1998 (Unaudited)	1999 (Unaudited)	1998 (Unaudited)	1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues from telecommunications services (Note 9)	4,428,079	4,572,072*	2,126,513	2,276,128*	9,280,759
Costs and expenses					
Operating and general expenses (Note 10)	2,404,107	2,452,003*	1,216,230	1,178,250*	4,826,763
Depreciation	1,331,648	1,233,677	665,991	621,475	2,466,863
Royalties to the Government of Israel	152,356	174,367	73,773	86,147	348,695
	3,888,111	3,860,047	1,955,994	1,885,872	7,642,321
Operating income	539,968	712,025	170,519	390,256	1,638,438
Financing expenses					
Debenture issued to the Government of Israel	35,972	51,904	11,365	18,030	99,981
Banks and others, net	150,423	166,125	47,651	77,370	348,151
	186,395	218,029	59,016	95,400	448,132
Earnings after financing expenses	353,573	493,996	111,503	294,856	1,190,306
Other income (expenses), net (Note 6)	(273,371)	82,698	-	59,818	37,434
Earnings before income tax	80,202	576,694	111,503	354,674	1,227,740
Income tax	(36,047)	(216,245)	(38,196)	(131,747)	(482,952)
	44,155	360,449	73,307	222,927	744,788
Equity in earnings (losses) of associated companies	(2,295)	1,979	(1,905)	69	6,359
Net earnings	41,860	362,428	71,402	222,996	751,147
Earnings per share per NIS 1 par value of ordinary shares (in NIS)	0.06	0.48	0.09	0.29	1.00

* Reclassified

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

Interim Statement of Changes in Shareholders' Equity

In terms of shekels of June 1999

	Share capital	Receipt from issue of option warrants	Capital reserve share premium	Capital reserve for transactions between the Company and a controlling shareholder	Unrestricted retained earnings	Total
	NIS thousands					
Six months ended June 30, 1999						
Balance as at December 31, 1998 (audited)	4,045,623	-	471,463	35,048	2,684,973	7,237,107
Net earnings (unaudited)	-	-	-	-	41,860	41,860
Exercise of convertible debentures (unaudited) (1)	13,775	-	131,517	-	-	145,292
Balance as at June 30, 1999 (unaudited)	4,059,398	-	602,980	35,048	2,726,833	7,424,259
Three months ended June 30, 1999						
Balance as at April 1, 1999 (unaudited)	4,047,426	-	488,416	35,048	2,655,431	7,226,321
Net earnings (unaudited)	-	-	-	-	71,402	71,402
Exercise of convertible debentures (unaudited) (2)	11,972	-	114,564	-	-	126,536
Balance as at June 30, 1999 (unaudited)	4,059,398	-	602,980	35,048	2,726,833	7,424,259
Six months ended June 30, 1998						
Balance as at December 31, 1997 (audited)	4,009,819	-	197,358	5,461	1,933,826	6,146,464
Net earnings (unaudited)	-	-	-	-	362,428	362,428
Public issue (unaudited)	-	79,229	-	-	-	79,229
Issue to employees (unaudited)	4,559	-	35,202	-	-	39,761
Offer to employees (unaudited)	-	-	-	3,423	-	3,423
Compensation to the Company's employees from the State (unaudited)	-	-	-	10,640	-	10,640
Exercise of options (unaudited)	11,425	(28,932)	86,229	-	-	68,722
Exercise of convertible debentures (unaudited)	42	-	389	-	-	431
Balance as at June 30, 1998 (unaudited)	4,025,845	50,297	319,178	19,524	2,296,254	6,711,098
Three months ended June 30, 1998						
Balance as at April 1, 1998 (unaudited)	4,018,298	69,410	261,979	8,884	2,073,258	6,431,829
Net earnings (unaudited)	-	-	-	-	222,996	222,996
Compensation to the Company's employees from the State (unaudited)	-	-	-	10,640	-	10,640
Exercise of options (unaudited)	7,505	(19,113)	56,810	-	-	45,202
Exercise of convertible debentures (unaudited)	42	-	389	-	-	431

Balance as at June 30, 1998 (unaudited)	4,025,845	50,297	319,178	19,524	2,296,254	6,711,098

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

In terms of shekels of June 1999

	Share capital	Receipt from issue of option warrants	Capital reserve share premium	Capital reserve for transactions between the Company and a controlling shareholder	Unrestricted retained earnings	Total
	NIS thousands					
Year ended December 31, 1998						
Balance as at December 31, 1997 (audited)	4,009,819	-	197,358	5,461	1,933,826	6,146,464
Net earnings (audited)	-	-	-	-	751,147	751,147
Public issue (audited)	-	79,229	-	-	-	79,229
Issue to employees (audited)	4,559	-	35,202	-	-	39,761
Offer to employees (audited)	-	-	-	3,423	-	3,423
Compensation to the Company's employees from the State (audited)	-	-	-	26,164	-	26,164
Exercise of options (audited)	31,011	(79,229)	236,665	-	-	188,447
Exercise of convertible debentures (audited)	234	-	2,238	-	-	2,472
Balance as at December 31, 1998 (audited)	4,045,623	-	471,463	35,048	2,684,973	7,237,107

(1) 138,945,113 par value convertible debentures were converted into 13,729,359 ordinary shares of NIS 1 par value.

(2) 121,210,704 par value convertible debentures were converted into 11,976,947 ordinary shares of NIS 1 par value.

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

Interim Consolidated Statements of Cash Flows

In terms of shekels of June 1999

	For the six months ended June 30,		For the three months ended June 30,		For the year ended December 31,
	1999 (Unaudited)	**1998 (Unaudited)**	**1999 (Unaudited)**	**1998 (Unaudited)**	**1998 (Audited)**
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Cash flows generated by operating activities					
Net earnings	41,860	362,428	71,402	222,996	751,147
Adjustments to reconcile net earnings to net cash flow generated by operating activities (see A below)	1,046,355	1,005,509	671,553	368,262	2,213,641
Net cash inflow generated by operating activities	1,088,215	1,367,937	742,955	591,258	2,964,788
Cash flows generated by investing activities					
Acquisition of fixed assets	(740,613)	(886,193)	(412,249)	(426,527)	(1,831,258)
Proceeds from disposal of fixed assets	5,718	43,271	1,628	34,809	63,921
Investment in long-term deposits	(14,045)	(36,998)*	(2,836)	(3,669)*	(86,470)
Proceeds from long-term deposits and investments	56,919	4,956*	34,645	206*	11,136
Decrease (increase) in short-term investments, net	19,357	(10,039)	118,165	(3,350)	(8,083)
Materials and spare parts, net	(31,387)	4,683*	(28,546)	28,276*	86,270*
Investment in investee companies	(23,428)	-	(12,319)	-	4
Investment in other assets	(91,835)	-	(63,289)	-	-
Net cash outflow generated by investing activities	(819,314)	(880,320)	(364,801)	(370,255)	(1,764,480)
Cash flows generated by financing activities					
Repayment of debenture issued to the Government of Israel	(463,725)	(460,322)	(231,290)	(228,818)	(912,857)
Issue of other debentures (net of issue expenses)	257,805	-	159,365	-	67,939
Repayment of other debentures	(132,829)	(170,512)	(15,981)	(13,242)	(236,734)
Receipt of long-term loans	460,775	351,548	155,469	254,535	713,026
Repayment of long-term loans	(557,220)	(642,532)	(273,692)	(313,459)	(1,248,697)
Receipt (repayment) of short-term bank credit, net	108,186	(16,369)	(28,095)	(269,896)	(18,506)
Proceeds from issue of shares to employees (net of issue expenses)	-	26,055	-	-	26,055
Proceeds from issue of share options (net of issue expenses)	-	79,229	-	-	79,229
Proceeds from convertible debentures and options thereon (net of issue expenses)	-	325,916	-	2,300	400,848
Proceeds from exercise of options	-	68,722	-	45,202	188,447
Net cash outflow generated by financing activities	(327,008)	(438,265)	(234,224)	(523,378)	(941,250)
Increase (decrease) in cash and cash equivalents	(58,107)	49,352	143,930	(302,375)	259,058
Cash and cash equivalents at beginning of period	916,577	657,519	714,540	1,009,246	657,519
Cash and cash equivalents at end of period	858,470	706,871	858,470	706,871	916,577

* Reclassified

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

Interim Consolidated Statements of Cash Flows (contd.)

In terms of shekels of June 1999

	For the six months ended June 30		For the three months ended June 30		For the year ended December 31
	1999 (Unaudited)	1998 (Unaudited)	1999 (Unaudited)	1998 (Unaudited)	1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
A - Adjustments to reconcile net earnings to net cash flow generated by operating activities					
Revenues and expenses not involving cash flows:					
Depreciation	1,331,648	1,233,677	665,991	621,475	2,466,863
Deferred taxes	(42,036)	100,642	12,816	87,359	161,303
Company's equity in losses (earnings) of investee companies, net	2,295	(1,979)	1,905	(69)	(6,359)
Provision for decrease in value	-	-	-	-	14,377
Increase (decrease) in employee severance benefits, net	(80,734)	(348,418)	(75,057)	(289,378)	(732,824)
Imputed salaries expense	-	27,769	-	10,640	43,295
Loss (gain) on disposal of fixed assets	(1,071)	(2,998)	(445)	(4,801)	(4,607)
Erosion (appreciation) of investment in long-term deposits	18,928	(21,500)*	(5,902)	(1,340)*	(69,982)
Erosion (appreciation) of short-term investments, net	(2,080)	4,280	(374)	6,736	5,183
Appreciation (erosion) of long-term liabilities:					
Debenture issued to the Government of Israel	(1,102)	(17,344)	(5,100)	(13,864)	(21,547)
Other debentures	(2,461)	(10,274)	(7,450)	(8,191)	(5,860)
Convertible debentures	(637)	(2,195)	(1,850)	(2,195)	(793)
Long-term loans	(52,635)	31,932	(5,647)	(16,358)	242,597
Amortization	25,825	3,490	22,317	2,341	8,196
Changes in asset and liability items:					
Decrease (increase) in trade receivables	65,345	(111,692)*	106,096	(93,080)*	(50,760)
Decrease (increase) in other receivables and debit balances	(23,909)	(4,561)*	7,325	50,381*	115,763
Decrease (increase) in inventory	(72,986)	(12,665)*	(3,370)	(3,411)*	(24,643)*
Increase (decrease) in trade payables	(13,678)	96,493	64,842	(7,207)*	8,954
Increase (decrease) in other current liabilities	(102,047)	40,109*	(103,416)	29,173*	63,075
Increase (decrease) in deferred revenues	(2,310)	743	(1,128)	51	1,410
	1,046,355	1,005,509	671,553	368,262	2,213,641
B - Non-cash transactions					
Acquisition of fixed assets, materials and spare parts on credit	1,962	40,937*	(39,411)	43,485*	(39,532)*

* Reclassified

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

Notes to the Interim Consolidated Financial Statements as at June 30, 1999 (unaudited)

NOTE 1 - GENERAL

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

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

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

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

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

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

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

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

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

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

   Commencing April 1, 1999, the Company's tariffs were adjusted in accordance with regulations approved by the Finance Committee of the Knesset. The main adjustments are as follows:

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

NOTE 1 - GENERAL (CONTD.)

B. (contd.)

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

In accordance with the regulations, beginning January 1, 2000 the efficiency factor will be 7%. The regulations do not specify the mechanism of examination and adjustment of the

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

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

Close to the date of publication of the financial statements, the Company received two Government resolutions dated August 22, 1999 concerning the acceleration and increased competition in the domestic telecommunications field during 1999 and in the personal mobile communications (PCS) field during the year 2000.

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

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

On May 18, 1999, Bezeq International applied to the Ministry of Communications demanding cancellation of the decision until a hearing could be held, and also petitioned the High Court of Justice for an order nisi and interim injunction. The Court granted a temporary injunction whereby the customer registration process will not be consummated prior to hearing of the petition before a panel of three justices. On June 28, 1999 the High Court of Justice discussed the petition and issued an order nisi and an interim order, and determined that additional affidavits could be submitted within 10 days. The Company also submitted a petition to the High Court of Justice against the amendment made to its license on the same subject, and in this petition an order nisi was granted as requested by the Company, instructing the Minister of Communications to submit its reasons within 30 days as to why the order should not be made absolute. An additional petition on the same subject was filed by Cellcom Communications Ltd. At a further session of the High Court of Justice on July 18, 1999, which discussed the petitions filed by the Company and Bezeq International, it was decided to grant the parties an extension of 30 days, to enable the parties to arrive at an agreed solution. The justices recommended to all the parties involved that they exploit the extension until the upcoming discussion to attempt to

NOTE 1 - GENERAL (CONTD.)

B. (contd.)

formulate a settlement arrangement among themselves which would resolve their disputes. Since that session, the parties have negotiated to formulate such a settlement arrangement on the matter of allocation, the main points of which are replacement of the "random allocation" model by a "speed-dial blocking" model, meaning that after a customer referendum is carried out, the dial code "00" will be blocked to each subscriber not selecting an operator, and that subscriber will be able to call overseas only by means of a three-digit dial code. Even though the negotiations are proceeding, it is not possible to determine, at this stage, that the matter will be settled amicably without the intervention of the courts. A session which was scheduled for August 23, 1999 was postponed and no new date has yet been set.

Implementation of the random allocation as stipulated in the amendment to the general license of Bezeq International is liable to have a material adverse effect on Bezeq International and its operations.

The Company believes, based on the opinion of Bezeq International, that pursuant to changes in the business environment in which the Company has operated since the onset of competition, changes are likely to occur during 1999 in the field of international telecommunications, among them, tariffs, market share and traffic ratios. Consequently, a material decrease in the Company's financial results is likely to ensue.

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

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

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

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

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

5. The Company was notified, as part of the issue process, that following a meeting attended by the former Minister of Communications and representatives of the Defense establishment, on March 16, 1999 the Government Companies Authority distributed to the relevant entities in various ministries a draft proposal of a resolution for the privatization of the State's holdings in the Company by way of a private sale. After receipt of the Ministries' comments, a proposal will

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

opinion in accordance with provisions of the Government Companies Law. The Company is unable to assess, inter alia in view of the delay in the public issue processes, if, when and how all or part of the State's shares in the Company will be sold.

NOTE 2 - ACCOUNTING POLICIES

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

b. As of January 1, 1999, Pelephone Communications Ltd. has been capitalizing its costs in respect of long-term subscriber acquisition. These costs appear in the balance sheet under Other assets and are amortized in the Statement of Operations over the minimum subscriber commitment period, which is between 18 and 36 months.

NOTE 3 - ADJUSTED FINANCIAL STATEMENTS

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

	Consumer Price Index	US dollar exchange rate
	%	%
For the six months ended:		
June 30, 1999	(0.37)	(2.02)
June 30, 1998	2.22	3.70
For the three months ended:		
June 30, 1999	1.06	1.04
June 30, 1998	2.15	1.95
For the year ended December 31, 1998	8.62	17.65

NOTE 4 - FIXED ASSETS

A. Depreciation policies

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

Pursuant to the resolution, the depreciation rates of a number of fixed assets recorded in the Company's books were changed as of January 1, 1999. Among these, the depreciation rate of the switching exchanges was changed to 10% per annum (from 8.33%), and the depreciation rate the Company's network to 4% per annum (from 5%). As a result of implementation of the recommendations, the Company's depreciation expense increased by approximately NIS 100 million during the six months ended June 30, 1999.

NOTE 4 - FIXED ASSETS (CONTD.)

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

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

B. Real estate assets

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

On May 13, 1999, discussions were held between representatives of the Company and the Israel Lands Administration, in the presence of the Government Companies Authority, at the Attorney

could not be launched before clarification of the factual basis and the issues in dispute, so that the dispute could be settled in the appropriate manner. The Attorney General also instructed relevant government entities to prepare a detailed working paper defining which assets are the subjects of the dispute, their value, and the use being made of them today, and recommended that the parties negotiate in an attempt to settle the dispute or to narrow it as much as possible. Representatives of the Company and the Israel Lands Administration have recently commenced negotiations.

C. Billing and collection software

A software supplier developing a billing and collection system for the Company gave notice of its unwillingness to continue the project in its present format, in light of the considerable losses it will allegedly incur. The supplier proposed two other alternatives. The Company notified the supplier that it does not accept the above alternatives and that it insists that the supplier meet all of its undertakings as per the agreement. In response, the supplier notified the Company that the Company's demands exceed those stipulated in the original agreement and it therefore does not intend to meet the Company's demands. The Company notified the supplier that if the breaches of the agreement are not remedied, it will present the bank guarantees given by the supplier, in the amount of $19.8 million. On August 8, 1999, a decision of the court granting a temporary injunction as requested by the supplier was presented to the Company. According to the court decision, a hearing regarding the temporary injunction order request will take place in September 1999 in the presence of both parties, but no final date has been set. In the decision, a temporary injunction is granted, forbidding the Company to present the bank guarantees given by the supplier. Concurrently, the supplier filed a claim against the Company concerning granting of a permanent injunction against presentation of the guarantees. The Company rejects outright the allegations of the supplier, and contends, inter alia, that the supplier committed a series of breaches of the agreement, including expected breaches. On August 29, 1999, the Company sent the supplier notice of cancellation of the agreement owing to its breach by the supplier, and a demand for reimbursement of all the moneys paid plus damages. The Company intends to exercise its rights under the agreement and under any law, including presentation of the bank guarantees which it holds.

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

NOTE 4 - FIXED ASSETS (CONTD.)

As at the balance sheet date, the Company's investment in the billing and collection project amounts to approximately NIS 114 million, of which about NIS 100 million has been paid to the supplier and those working jointly on the project.

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

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

guarantees was forfeited. The Company paid the balance of its part in the said guarantees, in the amount of approximately US $4 million.

NOTE 6 - LIABILITY FOR EMPLOYEE SEVERANCE BENEFITS

Plan for organizational change

Following adoption of the recommendations of the committee for arrangement of the Company's tariffs by the Ministers of Finance and Communications (see Note 1B), on March 4, 1999 the Board of Directors directed the Company's Management to present to the Board, within 90 days, a proposed pla

Management believes that implementation of an effective program in this context will require further changes in the organizational structure of the Company, one of which will be a further reduction in the Company's workforce by means of a new retirement plan. The Company is currently working on preparing a plan based on a material change in its organizational and operational concept, in a format similar to the change already made in several similar companies in the telecommunications arena upon their transition to functioning in a competitive environment. Preparation of the plan is a complex process which is likely to continue for another several months, and as at the balance sheet date the Company does not yet have a substantiated estimate of its possible cost. Against this backdrop, and owing to the necessity to prepare a preliminary estimate of the extent of the Company's preparation costs, Company Management has formulated a plan based on a number of changes which it believes can be implemented as part of its existing organizational and functional framework. The plan indicates a need for the retirement of approximately 530 employees, for which the Company has recorded a provision in its financial statements of approximately NIS 273 million, representing the estimated cost of this retirement plan.

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

NOTE 7 - CONTINGENT LIABILITIES

A. Claims and Contingent Liabilities

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

1. Further to the dispute between the Company, Keren Makefet and the workers' representatives concerning the amount of the vacation expense component in the base salary for pension, on April 27, 1999, the Board of Directors approved an arrangement to revise the vacation expense component used in the calculation of the pension salary of transferred employees retiring in accordance with the Makefet Bylaws. The arrangement is contingent upon signature of a collective agreement which will remove the collective labor dispute, inter alia, in this matter, and the settlement agreement with Company pensioners who have filed suit against it in this matter, as well as Company pensioners who are not party to the suit, by turning the suit, by consent, into a class action. The said arrangement was approved in May 1999 by the Government Companies Authority. In July 1999, such an agreement was signed with the pensioners filing suit, and on August 8th the Labor Court approved the initiation of proceedings to recognize the suit as a class action. (See Note 20A(6) to the financial statements as at December 31, 1998.)

2. Further to the matter of billing the Company for municipal taxes (as mentioned in Note 20A(19) to the financial statements as at December 31, 1998), at the end of March 1999, the Company received an amended 1998 municipal tax bill for the Company installation known as the "Hillel Station", amounting to approximately NIS 28.2 million (the previous bill amounted to approximately NIS 40.5 million), and the council sent the Company a demand for payment of this

   ex-parte temporary injunction preventing the instigation of debt collection proceedings, and the Company petitioned the court for declarative relief regarding the illegality of the municipal tax charge. Concurrently, the Municipal Council sent a 1999 municipal tax bill notice in the amount of NIS 23.4 million. On August 1, 1999 the Company received notice of a charge for the years 1997-
   the opinion of its legal advisers handling the demand on its behalf, there is a good chance that the demand for the years 1997-1999 will be cancelled in its entirety, in that it is a retroactive demand. Alternatively, even if it is determined that a retroactive demand can be issued in such circumstances, there is a good chance of a considerable reduction of the demand. In respect of current demands for the years 1998-1999, there is a very good chance of a considerable and material reduction of this charge as well. The financial statements include a provision which the Company and its advisers believe appropriate.

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

   On August 16, 1999, the Company received a copy of the notice from the Head of the Radiation Division at the Ministry of the Environment to the Broadcasting Authority, wherein the permit to operate the station was renewed subject to certain conditions detailed in the notice.

NOTE 7 - CONTINGENT LIABILITIES (CONTD.)

A. Claims and Contingent Liabilities (contd.)

4. Further to that mentioned in Note 20A(8) to the financial statements as at December 31, 1998 in the matter of the allegation of the claimant that the tariffs for the services of Bezeq International in effect during the period from May 10, 1996 to July 8, 1997 were overpriced and unreasonable and exploitative of its status as a monopoly, on August 8, 1999, the District Court handed down its decision approving the claim as a class action. The amount of the action was estimated by the claimant at approximately NIS 874 million. The Company is studying the decision and considering its actions. The chances of the success of the legal proceedings cannot be estimated at this time. No provision has been made in the financial statements in respect of this claim.
5. In July 1999 the Supreme Court rejected an appeal regarding dismissal of the request to recognize a claim as a class action, as mentioned in Note 20A(3) of the annual financial statements.
6. Regarding the dispute between the Company and the Accountant General of the Ministry of Finance and the Israel Lands Administration, see Note 4B.
7. Regarding the dispute between the Company and the supplier of the billing and collection system, see Note 4C.
8. Regarding the claim of the Ministry of Communications in India for forfeiture of guarantees, see Note 5.

B. Effect of computer adaptation to the Year 2000

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

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

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

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

NOTE 7 - CONTINGENT LIABILITIES (CONTD.)

B. Effect of computer adaptation to the Year 2000 (contd.)

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

The direct cost of the adaptation to the Year 2000 for the entire Group is estimated at this stage at approximately NIS 164 million, of which approximately NIS 53 million was expended as at June 30, 1999. Additionally, there are indirect costs relating primarily to the additional staff hired by the Company for the adaptation work. In addition to these costs, an acceleration of investments in the engineering systems, initially estimated at approximately NIS 95 million, were required and have been expended as at June 30, 1999.

C. Forward exchange contracts

The Company has entered into forward exchange contracts as a hedge against exposure resulting from changes in the exchange rate of the US dollar in relation to changes in the CPI. As at June 30, 1999, the Company contracted to purchase approximately US $374 million (approximately NIS 1,524 million) for which it will pay approximately NIS 1,486 million linked to the CPI. The contracts mature on various dates, the last of which is September 2001. The Company also contracted to purchase approximately US $350 million (NIS 1,427 million) for which it will pay approximately NIS 1,449 million, at predetermined rates.

NOTE 8 - SHARE CAPITAL

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

The above mentioned increase in capital requires the approval of the Ministerial Committee for Privatization in accordance with Section 11 of the Government Companies Law, 5735-1975. Following

assets (see Note 4B), the resolution was not submitted for the approval of the Ministerial Committee for Privatization.

NOTE 9 - REVENUES FROM TELECOMMUNICATIONS SERVICES

	For the six months ended June 30		For the three months ended June 30		For the year ended December 31
	1999 (Unaudited)	1998* (Unaudited)	1999 (Unaudited)	1998* (Unaudited)	1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues from telephone services -					
Domestic calls	1,419,671	1,580,642	610,383	792,223	3,202,765
Cellular telephone	1,304,703	1,295,041	645,144	645,758	2,623,819
Fixed fees	838,464	765,864	446,755	387,098	1,547,133
International communications	425,906	518,650	207,864	242,228	1,065,509
Installation and sale of equipment to subscribers	257,999	244,447	114,557	123,128	497,130
Other	53,367	61,775	25,601	36,961	75,102
	4,300,110	4,466,419	2,050,304	2,227,396	9,011,458
Other revenues	127,969	105,653	76,209	48,732	269,301
	4,428,079	4,572,072	2,126,513	2,276,128	9,280,759

* Reclassified

NOTE 10 - OPERATING AND GENERAL EXPENSES

	For the six months ended June 30		For the three months ended June 30		For the year ended December 31
	1999 (Unaudited)	1998* (Unaudited)	1999 (Unaudited)	1998* (Unaudited)	1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses	833,770	1,000,550	416,654	485,072	1,847,257
Cellular telephone expenses	595,013	532,852	305,631	254,638	1,072,609
General expenses	307,808	206,748	187,389	104,551	443,428
Services and maintenance by sub-contractors	223,986	189,120	109,586	97,938	422,248
Building maintenance	201,088	188,385	102,609	90,052	373,152
Materials and spare parts	154,668	139,883	41,024	72,264	283,697
International communications expenses	125,528	225,167	63,793	87,403	448,526
Vehicle maintenance expenses	28,288	32,334	14,413	15,994	61,919
Collection fees	21,150	21,835	10,550	10,920	42,347
	2,491,299	2,536,874	1,251,649	1,218,832	4,995,183
Less - salaries charged to investments in fixed assets	87,192	84,871	35,419	40,582	168,420
	2,404,107	2,452,003	1,216,230	1,178,250	4,826,763

* Reclassified

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

1. BEZEQ INTERNATIONAL LTD.

A. Balance sheet

	June 30 1999 (Unaudited)	June 30 1998 (Unaudited)	December 31 1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	545,997	816,259*	591,983
Investments	7,978	-	22,550
Fixed assets	285,561	293,675	291,602
Other assets	2,706	3,055	2,879
	842,242	1,112,989	909,014
Current liabilities	371,972	547,772*	431,367
Long-term liabilities	19,799	33,093	22,084
Quasi-capital receipt	155,803	155,803	155,803
Shareholders' equity	294,668	376,321	299,760
	842,242	1,112,989	909,014

B. Statements of Operations

	For the six months ended June 30 1999 (Unaudited)	1998 (Unaudited)	For the three months ended June 30 1999 (Unaudited)	1998 (Unaudited)	For the year ended December 31 1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues from international communications services	346,359	471,161*	162,998	218,669*	924,215
Operating expenses	267,120**	413,520*	118,412**	186,580*	781,544
Gross profit	79,239	57,641	44,586	32,089	142,671
Marketing expenses	52,186	27,931*	29,585	13,580*	58,893
General and administration expenses	23,952	20,679*	12,464	11,623*	53,251
Operating income	3,101	9,031	2,537	6,886	30,527
Other (expenses) revenues	-	(2,627)	-	522	(7,407)
Financing income, net	13,529	18,635	3,794	7,229	36,443
Earnings before income tax	16,630	25,039	6,331	14,637	59,563
Income tax	5,139	11,555	1,986	7,761	26,210
Net earnings	11,491	13,484	4,345	6,876	33,353

* Reclassified

** After deduction of approximately NIS 40 million in respect of cancellation of provisions to the credit of

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

2. PELEPHONE COMMUNICATIONS LTD.

A. Balance sheets

	June 30 1999 (Unaudited)	June 30 1998 (Unaudited)	December 31 1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	871,548	712,302	685,255
Long-term receivables	23,824	-	17,711
Fixed assets	2,602,825	2,196,111	2,388,390
Other assets	139,867	2,196	-
	3,638,064	2,910,609	3,091,356
Current liabilities	842,951	695,742	577,618
Long-term liabilities	841,786	369,950	585,659
Shareholders' equity	1,953,327	1,844,917	1,928,079
	3,638,064	2,910,609	3,091,356

B. Statements of Operations

	For the six months ended June 30 1999 (Unaudited)	1998 (Unaudited)	For the three months ended June 30 1999 (Unaudited)	1998 (Unaudited)	For the year ended December 31 1998 (Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Income from cellular services, sales and services	1,418,832	1,460,606	668,621	742,058	2,960,631
Cost of cellular services, sales and services	1,141,692	981,957	529,373	508,975	2,137,067
Gross profit	277,140	478,649	139,248	233,083	823,564
Sales and marketing expenses	127,499	124,810	72,431	60,376	226,586
General and administration expenses	83,853	80,645	5,113	40,959	158,857
	211,352	205,455	117,544	101,335	385,443
Income from ordinary operations	65,788	273,194	21,704	131,748	438,121
Financing expenses, net	21,420	12,510	14,235	6,822	29,044
Capital losses (gains)	(244)	154	(345)	8	5,070
Earnings before income tax	44,612	260,530	7,814	124,918	404,007
Income tax	19,372	95,985	4,094	46,008	156,299
Net earnings	25,240	164,545	3,720	78,910	247,708