November 14, 2007

Chapter B of the Periodic Report

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

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

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

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

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

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

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

1. Financial Position

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

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

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

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

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

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

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

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

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

2. <u>Results of Operations</u>

A. <u>Principal Results</u>

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

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

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

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

B Revenue

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

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

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

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

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

C. Depreciation and amortization

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

D. Salaries

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

E. General and Operating Expenses

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

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

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

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

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

F. Other operating expenses (income), net

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

G. Operating income

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

H. Financing expenses, net

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

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

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

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

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

I. Income tax

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

3. Liquidity and sources of financing

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

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

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

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

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

4. Comparison of the results of the third quarter of 2007 with the results of the corresponding quarter.

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

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

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

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

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

5. Group involvement in the community and donations

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

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

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

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

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

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

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

6. Details Concerning Exposure to and Management of Market Risks

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

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

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

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

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

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

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

Sensitivity to changes in the euro/shekel exchange rate

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

Sensitivity to changes in real shekel interest

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

Analysis of sensitivity to fluctuations in index-linked securities

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

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

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

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

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

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

7. Disclosure regarding the internal auditor at the Company

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

9. Critical Accounting Estimates

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

10. Miscellaneous

Event subsequent to the date of the financial statements

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

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

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

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

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