"BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2002

Contents

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

Dear Sirs,

Re:Review of the Unaudited Interim Consolidated Financial Statements for the Three Month Period Ended March 31, 2002

At your request we have reviewed the interim consolidated balance sheet of "Bezeq" - The Israel Telecommunication Corp. Limited and its subsidiaries as at March 31, 2002, as well as the interim consolidated statement of operations, the interim statement of changes in shareholders' equity and the interim consolidated statement of cash flows for the three month period then ended.

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

Reports of other auditors were furnished to us which relate to the review of the interim financial statements of subsidiaries, whose assets as at March 31, 2002, constitute approximately 17.43% of the total assets included in the interim consolidated balance sheet and whose revenues constitute approximately 29.95% of the total revenues included in the interim consolidated statement of operations for the three months then ended. Furthermore, the data contained in the interim consolidated financial statements, which relate to the net asset value of the Company's investments in affiliated companies and its equity in their results, is based on interim financial statements which were reviewed by other auditors.

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

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

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

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

2. A program of early retirement, as described in Note 6.
3. Claims made against the Company and against investee companies, as described in Note 7A.
4. The financial position of an affiliated company, non-compliance with conditions set forth in the financing agreement between the affiliated company and banking corporations, the need for hadditional financing which is significantly higher than the financing needs defined in the financing agreement, and agreements reached with the banking corporations which are in effect until June 30, 2002. As described in Note 4A 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 aforementioned note.

KPMG Somekh Chaikin
Certified Public Accountants (Isr.)

May 28, 2002

Interim Consolidated Balance Sheet

In terms of shekels of March 2002

	March 31 2002 (Unaudited)	March 31 2001 (Unaudited)	December 31 2001 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets			
Cash and cash equivalents	**1,522,965**	1,156,198	1,333,780
Short-term investments	**451,867**	227,396	451,063
Trade receivables	**1,647,300**	1,365,508*	1,727,067
Other receivables and debit balances	**300,808**	455,947*	296,696*
Inventory	**153,278**	176,879	118,773
	4,076,218	3,381,928	3,927,379
Materials and spare parts	**151,991**	206,301	155,392
Investments and long-term receivables			
Investments, deposits and debit balances	**1,701,668**	1,377,033	1,720,639
Investments in investee companies	**400,611**	327,507	471,958
	2,102,279	1,704,540	2,192,597
Fixed assets			
Cost	**29,049,336**	30,371,524	28,831,143
Less - accumulated depreciation	**18,871,471**	18,738,080	18,351,492
	10,177,865	11,633,444	10,479,651
Other assets			
Deferred charges and other assets	**345,410**	399,753	348,440
Deferred taxes	**446,703**	650,474*	458,520*
	792,113	1,050,227	806,960
	17,300,466	17,976,440	17,561,979

	March 31 2002 (Unaudited)	March 31 2001 (Unaudited)	December 31 2000 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current liabilities			
Bank credit	**234,183**	886,290	433,571
Current maturities of:			
Long-term bank loans	**565,034**	1,083,122	570,082
Other debentures	**190,026**	239,011	191,132
Trade payables	**920,417**	853,977*	1,042,747
Employee severance benefits	**232,745**	351,322	269,158
Other current liabilities	**1,098,711**	1,024,486*	1,182,383
	3,241,116	4,438,208	3,689,073
Long-term liabilities			
Long-term loans	**2,669,892**	2,244,408	2,573,304
Other debentures	**2,574,298**	2,613,803	2,583,894
Employee severance benefits	**1,301,261**	1,309,483*	1,306,051
Deferred revenues	**55,341**	70,292	59,405
	6,600,792	6,237,986	6,522,654
Contingent liabilities			
Shareholders' equity	**7,458,558**	7,300,246	7,350,252
	17,300,466	17,976,440	17,561,979

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

* Reclassified

Date of approval of the financial statements: May 28, 2002

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

Interim Consolidated Statement of Operations

In terms of shekels of March 2002

	For the three month period ended March 31		For the year ended December 31
	2002 (Unaudited)	2001 (Unaudited)	2001 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from telecommunications services (Note 8)	**1,985,287**	2,117,726	8,344,411
Costs and expenses			
Operating and general expenses (Note 9)	**1,098,321**	1,090,583	4,573,079
Depreciation (see also Note 5)	**556,906**	672,048	2,657,871
Royalties to the Government of Israel	**64,041**	82,892	276,775
	1,719,268	1,845,523	7,507,725
Operating income	**266,019**	272,203	836,686
Financing expenses, net	**43,185**	54,048	147,482
Earnings after financing expenses	**222,834**	218,155	689,204
Other revenues (expenses), net	**1,685**	16,685	(102,927)
Earnings before income tax	**224,519**	234,840	586,277
Income tax	**(66,771)**	(101,838)	(236,039)
Earnings after income tax	**157,748**	133,002	350,238
Equity in losses of affiliates	**(50,854)**	(61,029)	(232,625)
Minority share in losses of a consolidated company	**1,412**	2,001	6,367
Net earnings	**108,306**	73,974	123,980
Primary and diluted earnings per NIS 1 par value of common shares (in NIS)	**0.045**	0.030	0.051

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

Interim Statement of Changes in Shareholders' Equity

In terms of shekels of March 2002

	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					
Three months ended March 31, 2002						
Balance as at December 31, 2001 (audited)	**5,991,976**	**–**	**919,053**	**37,006**	**402,217**	**7,350,252**
Net earnings (unaudited)	**–**	**–**	**–**	**–**	**108,306**	**108,306**
Balance as at March 31, 2002 (unaudited)	**5,991,976**	**–**	**919,053**	**37,006**	**510,523**	**7,458,558**
Three months ended March 31, 2001						
Balance as at December 31, 2000 (audited)	4,305,332	1,659,321	854,505	37,006	299,400	7,155,564
Net earnings (unaudited)	–	–	–	–	73,974	73,974
Conversion of convertible debentures (unaudited) (1)	6,160	–	64,548	–	–	70,708
Distribution of bonus shares	1,680,484	(1,659,321)	–	–	(21,163)	–
Balance as at March 31, 2001 (unaudited)	5,991,976	–	919,053	37,006	352,211	7,300,246
Year ended December 31, 2001						
Balance as at December 31, 2000 (audited)	4,305,332	1,659,321	854,505	37,006	299,400	7,155,564
Net earnings (audited)	–	–	–	–	123,980	123,980
Conversion of convertible debentures (audited) (1)	6,160	–	64,548	–	-	70,708
Distribution of bonus shares	1,680,484	(1,659,321)	–	–	(21,163)	–
Balance as at December 31, 2001 (audited)	5,991,976	–	919,053	37,006	402,217	7,350,252

(1) 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.

Interim Consolidated Statement of Cash Flows

In terms of shekels of March 2002

	For the three month period ended March 31		For the year ended December 31
	2002 (Unaudited)	2001 (Unaudited)	2001 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Cash flows generated by operating activities			
Net earnings	**108,306**	73,974	123,980
Adjustments to reconcile net earnings to net cash flows generated by operating activities (see A below)	**539,842**	787,135	3,168,108
Net cash inflow generated by operating activities	**648,148**	861,109	3,292,088
Cash flows used for investing activities			
Acquisition of fixed assets	**(293,578)**	(407,670)	(1,293,806)
Proceeds from disposal of fixed assets	**4,087**	12,089	83,934
Proceeds from disposal of investment in affiliated company	**-**	-	30,427
Receipt on account of a dividend from affiliated company	**106,766**	-	-
Investment in long-term deposits and investments	**(14,030)**	(1,054,407)	(1,128,584)
Proceeds from long-term deposits and investments	**32,806**	4,062	37,440
Decrease (increase) in short-term investments, net	**1,490**	(28,632)	(245,463)
Decrease (increase) in materials and spare parts	**5,101**	(9,411)	50,054
Investment in investee companies	**(86,273)**	(209,290)	(536,177)
Investments in other assets	**(54,164)**	(56,652)	(200,489)
Net cash outflow used for investment activities	**(297,795)**	(1,749,911)	(3,202,664)
Cash flows generated by financing activities			
Issue of other debentures (after deduction of issue expenses)	**104,810**	522,613	522,613
Repayment of other debentures	**(120,585)**	(115,988)	(231,636)
Receipt of long-term loans	**161,790**	2,024	751,458
Repayment of long-term loans	**(107,795)**	(78,032)	(1,059,743)
Receipt (repayment) of short-term bank credit , net	**(199,388)**	123,177	(329,542)
Net cash inflow (outflow) generated by financing activities	**(161,168)**	453,794	(346,850)
Increase (decrease) in cash and cash equivalents	**189,185**	(435,008)	(257,426)
Cash and cash equivalents at the beginning of the period	**1,333,780**	1,591,206	1,591,206
Cash and cash equivalents at the end of the period	**1,522,965**	1,156,198	1,333,780

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

Interim Consolidated Statement of Cash Flows (contd.)

In terms of shekels of March 2002

	For the three month period ended March 31		For the year ended December 31
	2002 (Unaudited)	2001 (Unaudited)	2001 (Audited)
	NIS thousands	NIS thousands	NIS thousands
A - Adjustments to reconcile net earnings to net cash flows generated by operating activities			
Revenues and expenses not involving cash flows:			
Depreciation (see also Note 5)	**556,906**	672,048	2,657,871
Provision for impairment of fixed assets	**–**	–	104,436
Deferred taxes	**24,645**	15,175	(119,687)
Company's equity in losses of investee companies, net	**50,854**	61,029	232,625
Minority share in losses of a consolidated company	**(1,412)**	(2,001)	(6,367)
Increase (decrease) in employee severance benefits, net	**(41,203)**	3,694*	(87,971)
Gain on disposal of fixed assets	**(1,441)**	(18,875)	(8,911)
Gain on disposal of investment in an affiliate	**–**	–	3,562
Appreciation of and interest on long-term deposits and investments	**(59,539)**	(80,119)	(202,972)
Appreciation of short-term investments, net	**(2,294)**	(3,227)	(10,064)
Appreciation (erosion) of long-term liabilities:			
Other debentures	**5,073**	(20,905)	16,955
Long-term loans	**40,592**	85,634	131,435
Amortization of deferred expenses and other adjustments	**58,605**	51,398	251,339
Changes in asset and liability items:			
Decrease (increase) in trade receivables	**80,898**	77,067*	(412,899)
Decrease in other receivables and debit balances	**40,603**	40,807	326,252
Decrease (increase) in inventory	**(34,495)**	(36,066)	22,747
Increase (decrease) in trade payables	**(89,631)**	(95,189)*	81,830
Increase (decrease) in other current liabilities	**(84,255)**	38,828*	200,979
Decrease in deferred revenues	**(4,064)**	(2,163)	(13,052)
	539,842	787,135	3,168,108
B – Non-cash transactions			
Acquisition of fixed assets, other assets, materials and spare parts on credit	**61,253**	189,555	167,640
Sale of fixed assets on credit	**1,131**	25,523	–

* Reclassified

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

NOTE 1 - GENERAL

A. The interim statements were prepared in accordance with generally accepted accounting principles, applicable to the preparation of financial statements for 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, 2001 and for the year then ended.

B. In the notes to the interim financial statements, the Company presents only the significant changes in its business and legal environment which occurred from the date of the latest annual financial statements until the date of these interim financial statements. The extensive and detailed description, including significant changes and developments which occurred in recent years, particularly in the field of cellular telephone services, international telecommunication services, domestic telecommunication services, the opening of these markets to competition and decisions of the Ministerial Committee for Privatization to reduce the State's holdings in the Company, appear in Note 1 to the Company's annual financial statements as at December 31, 2001. The significant changes which occurred from the date of those annual financial statements to the date of these financial statements, are as follows:

1. Effective January 1, 2002, payment of the access fees to the Company by the international telecommunications operators was cancelled, pursuant to the licenses of the operators, which stated that payment of the access fees would be cancelled at the end of 2001.

   As a result of the cancellation of payment of the access fees as aforesaid, commencing January 1, 2002 the Company's revenues from international telecommunications do not include access fees. The access fees included in the Group's income from international communications in the three-month period ended March 31, 2001, were approximately NIS 28 million, and in the year ended December 31, 2001 approximately NIS 119 million (in the Company's revenues – approximately NIS 43 million and NIS 178 million respectively).

2. On March 18, 2002 the Company received a draft amendment to its general license. Preliminary study of the text of the amendment reveals that it incorporates the imposition of new provisions and restrictions on the Company (some of which are reflected in the Telecommunications Law and/or the Telecommunications Order and/or in other legislation, and some of which are new), as well as a broadening of existing provisions and restrictions on various matters. The Company submitted a preliminary document to the Ministry of Communications, containing significant comments on the draft amendment of the license. The Company expressed its opinion that in the current situation, where on the one hand the Company has not completed its many comments on the draft license, and on the other hand the two committees which were set up to formulate recommendations concerning the rules and policies for opening fixed-line communications in Israel to competition and to examine and revise the Company's tariffs, have started their work, there is no point in advancing the hearing proceeding which was scheduled for the Company in the matter of the license, on the basis of the amendment which was submitted to the Company, nor any point in completing the amendment, as long as the two committees had not completed their work.

3. On May 14, 2002 the Company's tariffs were changed. As part of the change, the tariffs for various services were revised, among them the call tariffs, installation fees and other services. The change in the call tariffs included an adjustment of peak and off-peak times, and uniformity of the tariff for local calls and domestic long distance calls at all hours of the day. As a result of these changes, the Company's revenues from the services which are under regulation (amounting to approximately NIS 4.3 billion per year), will be reduced by approximately 0.4%.

NOTE 2 - ACCOUNTING POLICY

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

NOTE 3 - FINANCIAL STATEMENTS IN ADJUSTED VALUES

The financial statements were prepared on the basis of historical cost adjusted for the effect of the changes in the general purchasing power of the Israeli currency. Below are the changes which occurred in the Consumer Price index ("CPI") and in the exchange rates of the US dollar:

	Consumer price index	Exchange rate of the US dollar	Exchange rate of the euro
	%	%	%
In the three month period ended:			
March 31, 2002	**2.362**	**5.706**	**4.382**
March 31, 2001	(0.499)	3.737	(1.935)
In the year ended December 31, 2001	1.397	9.279	3.827

NOTE 4 - INVESTMENTS IN INVESTEE COMPANIES

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

1. Further to Note 8(F) to the financial statements as at December 31, 2001, at the beginning of May 2002 the Company was allotted additional shares in DBS, increasing the Company's holding in DBS to 45%. As a result of the increase in the percentage of its holding in DBS, a surplus cost will be generated to the Company, which will be amortized over the period of expected financial benefit.

2. DBS expects to post considerable losses and a negative cash flow during its first years of operation. The loss in 2001 amounted to approximately NIS 859 million, and the loss in the three-month period ended March 31, 2002 amounted to approximately NIS 167 million. The negative cash flow from operating activities in 2001 amounted to approximately NIS 586 million, and in the three-month period ended March 31, 2002 about NIS 212,000. As a result of these losses, the deficit in working capital as at March 31, 2002 amounted to approximately NIS 1,475 million (including short-term bank credit of approximately NIS 933 million).

3. On May 23, 2001, a financing agreement was signed between DBS and the banks ("the Financing Agreement"), stipulating, *inter alia*, preconditions for withdrawing funds from credit lines, including undertakings by DBS to meet certain suspending conditions and to comply with cumulative milestones and the financial stipulations made ("the Conditions"). As at the date of approval of these financial statements, some of the Conditions had not been met.

4. In addition, a financial review carried out by the banks revealed that in order to finance the operations of DBS, additional financing would be required which considerably exceeds the financing needs defined in the Financing Agreement. As a result of the review, discussions are being held between DBS, its shareholders and the banks, to examine the options for obtaining the additional financing that will be required by DBS and the terms which will have to be fulfilled if DBS is to meet its undertakings.

5. On May 2, 2002, DBS and the banks signed an addendum to the Financing Agreement. On the same occasion, DBS also signed a bond in favor of the banks. The Company is a perpetual guarantor towards the banks, for payment of the debts of DBS. The guarantee is up to a maximum, equal to the percentage of the Company's holding in DBS multiplied by the value of DBS as derived from disposal of the pledged shares of the other shareholders. If the Company joins the sale for disposal of the pledged shares of the other shareholders, the amount of the guarantee will not exceed the amount received by the Company from the sale of its shares in DBS. The letter of guarantee includes numerous limitations on the Company in the disposal of its shares in DBS, and lists events of default which, should they occur, will allow the banks to foreclose on the guarantee.

NOTE 4 - INVESTMENTS IN INVESTEE COMPANIES (CONTD.)

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

The agreements reached with the banks determine that DBS will act to find a solution, with the consent of its shareholders and to the satisfaction of the banks, for obtaining the additional financing required for its operations, and to present a business plan showing that it will be able to meet its undertakings towards the banks. If no such solution is found by June 30, 2002, the banks will be entitled to take the necessary steps, at their absolute discretion, for collecting all the amounts payable to them, and to act in accordance with their rights in the event of default under the Financing Agreement.

The banks undertook to continue, until June 30, 2002, to inject additional funds in accordance with the Financing Agreement as if there had been no default, provided that concurrently, the shareholders of DBS invest additional equity, including shareholders' loans, in a total amount which is not less than a sum equal to 150% of the amount injected by the banks. This undertaking of the banks is subject, *inter alia*, to no additional defaults occurring, as defined in the Financing Agreement, and to the banks not reaching the conclusion, at their exclusive discretion, that a fitting solution for obtaining the additional financing cannot reasonably be expected to be found.

6. The sources of financing for the operations of DBS are shareholders' loans and bank lines of credit. Loans from the Company to DBS are subject, *inter alia*, to the approval of the Ministerial Committee for Privatization ("the Committee"). As at the date of publication of the financial statements, the Committee had given its approval for the Company to increase its exposure up to the total of the percentage of its holding in DBS multiplied by 480 million dollars.

7. The activities of DBS are contingent upon implementation of the Financing Agreement, increasing the credit lines approved by the banks and the receipt of additional loans from the shareholders.

   The management of DBS believes that the agreements among the shareholders and the existing credit lines should provide most of the financial sources the company requires in the coming year, and that there is a good chance that further discussion between DBS, its shareholders and the banks will lead to an arrangement for the balance of the financing required.

B. Walla! Communications Ltd. ("Walla")

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.

On March 14, 2002 Walla issued a prospectus for a rights issue. Bezeq International invested approximately NIS 10,752,000 in exercise of the rights and a further NIS 3,165,000 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 24.83% to 36.68%. Under the investment agreement between Bezeq International and Walla, Bezeq International is obligated to invest an additional $3 million, through itself or through a strategic investor. Bezeq International, through the Company, applied for the approval of the Government of Israel to make such investment in Walla.

C. Pelephone Communications Ltd. ("Pelephone")

During the first quarter of 2002, the Company and Shamrock Holdings of California, Inc. invested approximately NIS 142 million each in Pelephone, as an investment against a premium on shares of Pelephone issued in the past.

NOTE 5 - FIXED ASSETS

Pursuant to the Company's policy of examining the useful life of the assets from time to time, in October 2001 a committee was appointed to examine the need to revise the useful life of the assets and recommend its conclusions to management. The examination covered only the fixed assets of the Company, and was based on the balance of its fixed assets as at December 31, 2001. On May 28, 2002, the Board of Directors of the Company resolved to adopt the management recommendations, which were based on the report of the committee.

According to the recommendations of the committee, which were based, *inter alia*, on technological changes, changes in the investment plan of the Company (including providing broadband Internet service via ADSL technology on the existing copper infrastructure), and on what is customary among the world's communications companies, the balance of the useful life of certain investments in the Company's copper cable network was extended, effective from January 1, 2002, while conversely, the useful life of certain switching systems was shortened.

These changes reduced the depreciation expense of the Company in the three-month period ended March 31, 2002 by approximately NIS 60 million, and increased the Company's net earnings in the same period by approximately NIS 38 million. In addition, earnings per share in the period increased by approximately NIS 0.016 per NIS 1 par value.

Had the new depreciation rates been applied in 2001, depreciation in that year would have been approximately NIS 220 million less than it was (and for the three-month period ended March 31, 2001 – approximately NIS 55 million less), while the balance of the fixed assets would have increased by the same amounts. Net earnings would have increased in 2001 by approximately NIS 141 million (and in the three-month period ended March 31, 2001 by approximately NIS 35 million), and earnings per share would have increased by NIS 0.058 (and in the three-month period ended March 31, 2001 by approximately NIS 0.014) per NIS 1 par value.

NOTE 6 - LIABILITY FOR EMPLOYEE SEVERANCE BENEFITS

1. Early retirement plan

In September 2000, the Company reached an agreement with workers' representatives for extension of the 1997 collective agreement for early retirement. Under the agreement, from April 1, 2001 until December 31, 2006 (with an option to extend the final retirement date for certain employees to December 31, 2008), 1,770 additional employees would take early retirement.

The agreement also stated that the Company would be able to terminate the employment of employees in a compensation track, in excess of the aforementioned quota. In the opinion of the Company's management, there is little chance that additional employees will opt for the compensation track, and accordingly, no provisions was made in the financial statements.

Approximately 81 employees took early retirement in the period up to March 31, 2002.

2. The pension fund through which the early retirement plan is implemented ("the Fund") was directed by the Capital Market Division of the Ministry of Finance, to fulfill an undertaking it made in connection with changing the retirement tracks of approximately 600 Company retirees, provided that the Company paid the Fund NIS 50 million. The Company notified the Fund that it wishes to continue the agreement, which enabled transfer from one retirement track to another at no additional cost to the Company, after the Fund undertook that no extra cost would be imposed on the Company. As a result of the aforesaid, the Fund no longer allowed for Company retirees to switch retirement tracks, and even stopped implementation of the agreement, in whole or in part, in relation to retirement benefits paid in respect of April 2002.

NOTE 6 - LIABILITY FOR EMPLOYEE SEVERANCE BENEFITS (CONTD.)

2. (Contd.)

In the opinion of Company management, relying on its legal advisors, it is unlikely that the Company will be charged any costs in connection with implementation of the agreement, and therefore it will insist on its implementation with no further payment to the Fund. Accordingly, no provision was made in the financials statements in respect of the above.

NOTE 7 - CONTINGENT LIABILITIES

A. CLAIMS

The Company and the investee companies have contingent liabilities in respect of which the maximum possible exposure is considerable. A detailed description of these contingent liabilities appears in Note 20A to the Company's annual financial statements for the year ended December 31, 2001. No significant changes occurred in contingent liabilities up to the date of signing these financial statements, except for the following:

1. Further to Note 20A(7) to the financial statements as at December 31, 2001 in the matter of a claim of a group of employees who were employed as temporary employees at the Ministry of Communications and were transferred to the Company when it commenced operations, the plaintiffs have withdrawn their consent to narrow the claim. The Labor Court may now decide whether it will approve the withdrawal of consent.

2. Further to Note 20A(11) to the financial statements as at December 31, 2001 in the matter of a class action in which the plaintiffs allege that the Company unlawfully collected money from its customers for certain services which it provides, on March 24, 2002 an application was filed to appeal the decision of the District Court to dismiss the application for approval of the claim as a class action. The decision concerning the application has not yet been given.

3. Further to Note 20A(18) to the financial statements as at December 31, 2001 in the matter of a claim and an application to approve the claim as a class action which were submitted to an affiliate, in which it is alleged that the affiliate is misleading consumers in its advertisements in connection with the possibility for the consumer to purchase only certain channels, as well as with regard to the number of channels offered, on March 18, 2002 the parties signed a compromise agreement under which an application will be filed in court to strike the claim and the application for approval of the claim as a class action. In exchange, the affiliate will compensate the plaintiff in an amount that is not material.

4. Further to Note 20A(22) to the financial statements as at December 31, 2001 in the matter of a providing blocking service for all land-line subscribers of the Company against outgoing calls to cellular phone area codes as an automatic default, on April 26, 2002 a complementary notice was filed by the State, based on a report prepared by a team of experts who investigated the subject. The main points of the notice are that the consumer can attain his aim of "expense control" by other means and without need for blocking, and in addition, the Company is liable to turn the blocking into a means for harming other operators and the competition, and therefore, for overall balance, the Minister of Communications decided not to permit the blocking. A response was filed by the petitioners. The Company has not yet filed its response.

5. Further to Note 20A(25) to the financial statements as at December 31, 2001 in the matter of a class action against Pelephone Communications Ltd. ("Pelephone") concerning the plaintiff's allegation that Pelephone collected surplus amounts from its subscribers for reciprocal connection fees, in contravention of the applicable regulations and/or its license, the parties reached a compromise arrangement which took effect on May 2, 2002, in which the District Court partially approved the claim as a class action while validating the compromise agreement as a judgment. The amount of the settlement deriving from the agreement is approximately NIS 6.6 million. The financial statements include a provision which the management of Pelephone believes to be appropriate.

NOTE 7 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS (CONTD.)

6. Further to Note 20A(26) to the financial statements as at December 31, 2001 in the matter of a claim filed in the Ramallah District Court by the General Public Palestinian Communications Co. Ltd. against Pelephone and another company, as at the date of signing these financial statements, the processes of service of this claim were terminated by the Attorney General and it is no longer counted among the claims pending against Pelephone.

7. On May 21, 2002 a statement of claim together with an application for its recognition as a class action were received at the Company's offices. The claim and application were filed in the Tel Aviv District Court against all the cellular companies in Israel, among them Pelephone (a proportionally consolidated company) and against the Company as a formal defendant.

   The plaintiffs. who contend that they are subscribers of the Company and of one of the defendant cellular companies, allege in their claim that the defendant cellular companies collected and collect, unlawfully, payments for what are ostensibly cellular calls but which in fact are fixed-line calls in every respect. The reference is to calls initiated by Company subscribers to commercial entities which provide entertainment and information services. These entities have formed an association with the cellular companies. Even though these calls do not “consume airtime”, the cellular companies collected payment for them, in contravention of their licenses and of the law.

   The amount of the class action against the cellular companies is estimated at approximately NIS 600 million. It is noted that the Company recently approached the Ministry of Communications on this matter, requesting its intervention. The Company is studying the claim, and is unable, at this stage, to estimate its chances and implications. No provision was made in the financial statements in respect of this claim.

B. Forward Exchange Contracts

1. Hedging (Forward)

	Currency purchased	Currency payable	Repayment date	Amounts receivable	Amounts payable
				NIS millions	
Contracts at predetermined interest rates -					
	Dollars	CPI Linked NIS	March 2004	814	778
	Euro	CPI Linked NIS	February 2005	818	798
Contracts at predetermined exchange rate - (excluding premium/discount)					
	Dollars	NIS	April 2002	47	43
	Euro	NIS	February 2003	459	443
	CPI Linked NIS	NIS	June 2003	522	520

NOTE 7 - CONTINGENT LIABILITIES (CONTD.)

B. Forward Exchange Contracts (Contd.)

2. Contracts not for hedging purposes

	Currency purchased	Currency payable	Repayment date	Fair Value	Total contract
				NIS millions	
Forward exchange contracts -					
	Dollars	NIS	June-Sept. 2002	7	84
	NIS	Dollars	December 2002	4	700
	NIS	Dollars	December 2002	(14)	700

NOTE 8 - REVENUES FROM TELECOMMUNICATIONS SERVICES

	For the three month period ended March 31		For the year ended December 31
	2002 (Unaudited)	2001 (Unaudited)	2001 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from communications services -			
Domestic fixed-line communications	**564,879**	636,304	2,456,930
Cellular telephone	**521,875**	514,402	2,120,774
Fixed fees	**509,110**	535,802	2,122,950
International communications and Internet services (1)	**164,097**	199,794	802,951
Installation and sale of equipment to subscribers	**120,286**	116,362	435,590
Other	**31,806**	37,626	121,978
	1,912,053	2,040,290	8,061,173
Other revenues	**73,234**	77,436	283,238
	1,985,287	2,117,726	8,344,411

(1) See Note 1B(1).

NOTE 9 - OPERATING AND GENERAL EXPENSES

	For the three month period ended March 31		For the year ended December 31
	2002 (Unaudited)	2001 (Unaudited)	2001 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses	**494,173**	484,471	1,963,148
Cellular telephone expenses	**109,066**	74,987	447,012
General expenses	**179,587**	178,418	750,423
International communications expenses	**32,875**	60,257	204,612
Materials and spare parts	**127,294**	116,408	520,479
Building maintenance	**90,857**	103,739	390,659
Services and maintenance by sub-contractors	**70,835**	79,535	331,042
Vehicle maintenance expenses	**24,132**	20,225	85,266
Collection fees	**8,106**	9,607	37,509
	1,136,925	1,127,647	4,730,150
Less - salaries charged to investment in fixed assets	**38,604**	37,064	157,071
	1,098,321	1,090,583	4,573,079

NOTE 10 - CONDENSED INTERIM FINANCIAL STATEMENTS OF THE COMPANY

A. STATEMENT OF OPERATIONS

	For the three month period ended March 31		For the year ended December 31
	2002 (Unaudited)	2001 (Unaudited)	2001 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from telecommunications services (Note 10B)	**1,381,621**	1,548,075	6,033,896
Costs and expenses			
Operating and general expenses (Note 10C)	**604,756**	616,478	2,576,807
Depreciation (see also Note 5)	**462,144**	557,543	2,201,849
Royalties to the Government of Israel	**46,200**	53,616	193,787
	1,113,100	1,227,637	4,972,443
Operating income	**268,521**	320,438	1,061,453
Financing expenses, net	**(43,751)**	(30,170)	(74,476)
Earnings after financing expenses	**224,770**	290,268	986,977
Other revenues (expenses), net	**1,416**	19,033	(2,561)
Earnings before income tax	**226,186**	309,301	984,416
Income tax	**(75,324)**	(117,348)	(354,948)
Earnings after income tax	**150,862**	191,953	629,468
Equity in losses of investee companies	**(42,556)**	(117,979)	(505,488)
Net earnings	**108,306**	73,974	123,980

NOTE 10 - CONDENSED INTERIM FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

B. Revenues from Telecommunications Services

	For the three month period ended March 31		For the year ended December 31
	2002 (Unaudited)	2001 (Unaudited)	2001 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from communications services -			
Domestic fixed-line communications	**569,867**	641,890	2,484,945
Cellular telephone	**157,826**	166,078	684,001
Fixed fees	**485,961**	508,966	2,008,900
International communications (1)	**38,489**	82,979	335,311
Installation and sale of equipment to subscribers	**38,187**	38,843	143,088
Other	**33,789**	37,765	129,007
	1,324,119	1,476,521	5,785,252
Other revenues	**57,502**	71,554	248,644
	1,381,621	1,548,075	6,033,896

C. Operating and General Expenses

	For the three month period ended March 31		For the year ended December 31
	2002 (Unaudited)	2001 (Unaudited)	2001 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses	**385,153**	384,803	1,553,611
Cellular telephone expenses	**8,991**	–	88,471
General expenses	**73,514**	59,910	291,183
International communications expenses	**1,363**	2,668	9,922
Materials and spare parts	**12,264**	20,144*	64,493
Building maintenance	**78,568**	90,752	341,951
Services and maintenance by sub-contractors	**55,198**	68,325*	276,134
Vehicle maintenance expenses	**20,237**	17,362	70,944
Collection fees	**8,072**	9,578	37,169
	643,360	653,542	2,733,878
Less - salaries charged to investment in fixed assets	**38,604**	37,064	157,071
	604,756	616,478	2,576,807

* Reclassified.
(1) See Note 1B(1).

NOTE 11 - CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD.

1. BEZEQ INTERNATIONAL LTD.

A. BALANCE SHEET

	March 31 2002	March 31 2001	December 31 2001
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**175,949**	222,170*	167,605
Investments	**20,947**	35,633	8,759
Fixed assets	**408,361**	378,271	415,303
Other assets	**13,848**	17,216	15,907
	619,105	653,290	607,574
Current liabilities	**320,555**	405,673*	331,719
Long-term liabilities	**196,177**	120,997	197,916
Quasi-capital receipt	**–**	164,511	164,511
Shareholders' equity (deficit)	**102,373**	(37,891)	(86,572)
	619,105	653,290	607,574

* Reclassified.

NOTE 11 - CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD. (CONTD.)

1. BEZEQ INTERNATIONAL LTD. (CONTD.)

B. STATEMENT OF OPERATIONS

	For the three month period ended March 31		For the year ended December 31
	2002 (Unaudited)	2001 (Unaudited)	2001 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from international communications services	**163,174**	168,053	684,642
Operating expenses	**92,523**	132,557*	505,972
Gross profit	**70,651**	35,496	178,670
Marketing expenses	**34,318**	32,309	124,730
General and administrative expenses	**15,919**	24,270*	95,019
	50,237	56,579	219,749
Operating income (loss)	**20,414**	(21,083)	(41,079)
Financing income (expenses), net	**5,826**	(3,176)	(11,105)
Earnings (loss) after financing, net	**26,240**	(24,259)	(52,184)
Other income (expenses), net	**197**	(1,565)	4,077
Earnings (loss) before income tax	**26,437**	(25,824)	(48,107)
Income tax	**(274)**	–	(3,090)
Earnings (loss) after income tax	**26,163**	(25,824)	(51,197)
Company's equity in losses of an affiliate	**(1,729)**	(3,989)	(27,299)
Net earnings (loss)	**24,434**	(29,813)	(78,496)

* Reclassified

NOTE 11 - CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD. (CONTD.)

2. PELEPHONE COMMUNICATIONS LTD.

A. BALANCE SHEET

	March 31 2002	March 31 2001	December 31 2001
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**1,146,291**	1,199,975*	1,058,805*
Long-term trade receivables	**115,119**	91,230	96,180
Investment in affiliate	**–**	397	–
Deferred income taxes	**268,589**	43,221*	250,304*
Fixed assets, net	**2,552,337**	2,930,023	2,582,545
Other assets	**604,132**	721,674	608,721
	4,686,468	4,986,520	4,596,555
Current liabilities			
Provision for losses of investee company	**1,460,733**	2,346,708	1,885,829
Long-term liabilities	**3,817**	–	3,813
Shareholders' equity	**1,300,954**	763,885*	1,033,538
	1,920,964	1,875,927	1,673,375
	4,686,468	4,986,520	4,596,555

* Reclassified.

NOTE 11 - CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD. (CONTD.)

2. PELEPHONE COMMUNICATIONS LTD. (CONTD.)

B. STATEMENTS OF OPERATIONS

	For the three month period ended March 31		For the year ended December 31
	2002 (Unaudited)	2001 (Unaudited)	2001 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from cellular services, sales and services	**926,829**	907,022	3,653,631
Cost of cellular services, sales and services	**795,346**	775,234	3,252,326
Gross profit	**131,483**	131,788	401,305
Sales and marketing expenses	**126,332**	128,863	519,886
General and administrative expenses	**53,689**	53,228	226,742
	180,021	182,091	746,628
Operating loss	**(48,538)**	(50,303)	(345,323)
Financing expenses, net	**(8,212)**	(41,169)	(126,102)
Other income (expenses), net	**159**	562	(208,522)
Loss before income tax	**(56,591)**	(90,910)	(679,947)
Tax benefit	**18,297**	26,015	233,422
Loss after income tax	**(38,294)**	(64,895)	(446,525)
Minority equity in losses of a consolidated company	**2,824**	4,000	12,734
Company equity in losses of an affiliate	**(101)**	(2,095)	(7,839)
Net loss	**(35,571)**	(62,990)	(441,630)