"BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2001

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 and Nine Month Periods Ended September 30, 2001

At your request we have reviewed the interim consolidated balance sheet of "Bezeq" - The Israel Telecommunication Corp. Limited and its consolidated companies as at September 30, 2001, as well as the interim consolidated statements of operations, the interim statements of changes in shareholders' equity and the interim consolidated statements of cash flows for the nine month and three month periods then ended.

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

Reports of other auditors were furnished to us which relate to the review of the interim financial statements of subsidiaries, whose assets as at September 30, 2001, constitute approximately 17.6% of the total assets included in the interim consolidated balance sheet and whose revenues constitute approximately 27.2% and approximately 27.8% of the total revenues included in the interim consolidated statements of operations for the nine months and three months, respectively, 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 is 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 5.

3. Claims made against the Company and against investee companies, as described in Note 6A.

4. The financial state of an affiliated company, the signing of a financing agreement between the affiliated company and banking corporations, the non-fulfillment of conditions prescribed in the agreement as well as the continuation of the implementation of the finance agreement and receiving additional loans from shareholders as a condition for the operation of the affiliated company as explained in Note 4C.

Yours truly,

KPMG Somekh Chaikin
Certified Public Accountants (Isr.)

November 27, 2001

Interim Consolidated Balance Sheet

In terms of shekels of September 2001

	September 30 2001 (Unaudited)	September 30 2000 (Unaudited)	December 31 2000 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets			
Cash and cash equivalents	1,108,344	1,546,905	1,563,666
Short-term investments	277,541	200,581	192,152
Trade receivables	1,394,660	1,376,119	1,400,350
Other receivables and debit balances	561,139	563,863	485,527
Inventory	133,503	122,896	137,124
	3,475,187	3,810,364	3,778,819
Materials and spare parts	198,664	188,084	188,903
Investments and long-term receivables			
Bank deposits and other investments	1,662,114	291,979	295,309
Investee companies	403,312	193,993	176,144
	2,065,426	485,972	471,453
Fixed assets			
Cost	30,301,119	30,544,937	29,625,179
Less - accumulated depreciation	19,609,838	18,405,494	17,784,872
	10,691,281	12,139,443	11,840,307
Other assets			
Deferred charges and other assets	366,501	360,551	385,683
Deferred taxes	297,591	616,991	646,066
	664,092	977,542	1,031,749
	17,094,650	17,601,405	17,311,231

	September 30 2001 (Unaudited)	September 30 2000 (Unaudited)	December 31 2000 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current liabilities			
Bank credit	513,179	700,730	749,905
Current maturities of:			
Long-term bank loans	453,040	846,506	385,170
Other debentures	187,274	225,570	229,100
Trade payables	837,239	1,006,293	1,067,910
Employee severance benefits	290,356	399,333	351,704
Other current liabilities	940,613	886,837	986,806
	3,221,701	4,065,269	3,770,595
Long-term liabilities			
Long-term loans	2,668,688	2,939,618	2,881,513
Other debentures	2,572,226	2,162,982	2,195,294
Employee severance benefits	1,299,516	1,275,729	1,276,726
Deferred taxes	4,063	27,427	14,722
Deferred revenues	62,338	73,826	71,203
	6,606,831	6,479,582	6,439,458
Convertible debentures	-	74,200	69,459
Contingent liabilities			
Shareholders' equity	7,266,118	6,982,354	7,031,719
	17,094,650	17,601,405	17,311,231

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

Date of approval of the financial statements: November 27, 2001

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

Interim Consolidated Statement of Operations

In terms of shekels of September 2001

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2001 (Unaudited)	2000 (Unaudited)	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues from telecommunications services (Note 8)	6,156,507	6,458,046	2,039,242	2,127,671*	8,570,978
Costs and expenses					
Operating and general expenses (Note 9)	3,354,837	3,262,677	1,114,285	1,005,112*	4,369,864
Depreciation	1,948,414	2,062,067	641,835	681,527	2,754,514
Royalties to the Government of Israel	201,012	246,418	61,043	86,240	320,874
	5,504,263	5,571,162	1,817,163	1,772,879	7,445,252
Operating income	652,244	886,884	222,079	354,792	1,125,726
Financing expenses	(99,323)	(293,881)	(47,379)	(125,033)	(350,128)
Earnings after financing expenses	552,921	593,003	174,700	229,759	775,598
Other expenses, net	(902)	(1,331,425)	(24,319)	(1,420,268)	(1,298,213)
Earnings (loss) before income tax	552,019	(738,422)	150,381	(1,190,509)	(522,615)
Tax benefit (income tax)	(250,222)	251,682	(79,389)	447,545	156,402
	301,797	(486,740)	70,992	(742,964)	(366,213)
Equity in losses of affiliated companies	(141,767)	(120,317)	(65,094)	(69,576)	(199,078)
Minority share in losses of consolidated company	4,886	2,144	1,460	1,743	4,994
Net earnings (loss)	164,916	(604,913)	7,358	(810,797)	(560,297)
Basic and diluted earnings (loss) per NIS 1 par value of common shares (in NIS)	0.133	(0.249)**	0.003	(0.333)**	(0.231)

*Reclassified

**Restated due to issue of bonus shares

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

Interim Statement of Changes in Shareholders' Equity

In terms of shekels of September 2001

	Share capital	Capital reserve for distribution of bonus shares	Capital reserve share premium	Capital reserve in respect of transactions between the Company and a controlling shareholder	Retained earnings	Total
	NIS thousands					
Nine months ended September 30, 2001						
Balance as at December 31, 2000 (audited)	4,230,817	1,630,602	839,716	36,365	294,219	7,031,719
Net earnings (unaudited)	-	-	-	-	164,916	164,916
Conversion of convertible debentures (unaudited) (1)	6,053	-	63,430	-	-	69,483
Distribution of bonus shares (unaudited) (5)	1,651,399	(1,630,602)	-	-	(20,797)	-
Balance as at September 30, 2001 (unaudited)	5,888,269	-	903,146	36,365	438,338	7,266,118
Three months ended September 30, 2001						
Balance as at July 1, 2001 (unaudited)	5,888,269	-	903,146	36,365	430,980	7,258,760
Net profit (unaudited)	-	-	-	-	7,358	7,358
Balance as at September 30, 2001 (unaudited)	5,888,269	-	903,146	36,365	438,338	7,266,118
Nine months ended September 30, 2000						
Balance as at December 31, 1999 (audited)	4,215,867	-	664,948	36,365	2,486,568	7,403,748
Erosion of dividend proposed in a previous year and paid this year (unaudited)	-	-	-	-	(1,450)	(1,450)
Net loss (unaudited)	-	-	-	-	(604,913)	(604,913)
Tax benefit in respect of shares to employees (unaudited)	-	-	22,196	-	-	22,196
Conversion of convertible debentures (unaudited) (2)	14,532	-	148,241	-	-	162,773
Balance as at September 30, 2000 (unaudited)	4,230,399	-	835,385	36,365	1,880,205	6,982,354

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

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

In terms of shekels of September 2001

	Share capital	Capital reserve for distribution of bonus shares	Capital reserve share premium	Capital reserve in respect of transactions between the Company and a controlling shareholder	Retained earnings	Total
	NIS thousands					
Three months ended September 30, 2000						
Balance as at July 1, 2000 (unaudited)	4,229,487	-	825,929	36,365	2,691,002	7,782,783
Net loss (unaudited)	-	-	-	-	(810,797)	(810,797)
Conversion of convertible debentures (unaudited) (3)	912	-	9,456	-	-	10,368
Balance as at September 30, 2000 (unaudited)	4,230,399	-	835,385	36,365	1,880,205	6,982,354
Year ended December 31, 2000						
Balance as at December 31, 1999 (audited)	4,215,867	-	664,948	36,365	2,486,568	7,403,748
Net loss (audited)	-	-	-	-	(560,297)	(560,297)
Erosion of dividend proposed in a previous year and paid this year (audited)	-	-	-	-	(1,450)	(1,450)
Tax benefit in respect of shares to employees (audited)	-	-	22,196	-	-	22,196
Conversion of convertible debentures (audited) (4)	14,950	-	152,572	-	-	167,522
Capitalization of undesignated earnings to a reserve fund for the distribution of bonus shares (audited) (5)	-	1,630,602	-	-	(1,630,602)	-
Balance as at December 31, 2000 (audited)	4,230,817	1,630,602	839,716	36,365	294,219	7,031,719

(1) 59,754,681 par value convertible debentures were converted into 5,904,612 ordinary shares with a par value of NIS 1 each.
(2) 143,514,228 par value convertible debentures were converted into 14,181,248 ordinary shares with a par value of NIS 1 each.
(3) 8,643,500 par value convertible debentures were converted into 854,101 ordinary shares with a par value of NIS 1 each.
(4) 147,652,429 par value convertible debentures were converted into 14,590,161 ordinary shares with a par value of NIS 1 each.
(5) See Note 7

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

Interim Consolidated Statement of Cash Flows

In terms of shekels of September 2001

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2001 (Unaudited)	2000 (Unaudited)	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Cash flows generated by operating activities					
Net earnings (loss)	164,916	(604,913)	7,358	(810,797)	(560,297)
Adjustments to reconcile net earnings to net cash flows generated by operating activities (see A below)	2,213,480	3,069,697	843,000	1,691,763	3,891,091
Net cash inflow generated by operating activities	2,378,396	2,464,784	850,358	880,966	3,330,794
Cash flows used for investing activities					
Acquisition of fixed assets	(1,033,856)	(1,325,692)	(312,112)	(487,632)	(1,760,296)
Proceeds from disposal of fixed assets	50,200	14,323	8,266	1,744	35,289
Proceeds from disposal of investment in affiliated company	-	-	-	-	174,557
Collection of loan from affiliated company	29,901	-	29,901	-	-
Investment in investee companies	(380,119)	(235,152)	(121,234)	(6,564)	(331,241)
Investment in long-term deposits and investments	(1,096,642)	(45,324)	(51,609)	(17,790)	(61,028)
Proceeds from long-term deposits and investments	14,521	44,117	3,942	8,522	61,225
Decrease (increase) in short-term investments, net	(78,922)	108,321	(6,056)	(46,337)	118,026
Decrease (increase) in materials and spare parts, net	(21,367)	45,973	(50,028)	33,334	59,123
Investment in other assets	(161,011)	(202,808)	(53,547)	(73,777)	(268,283)
Net cash outflow used for investment activities	(2,677,295)	(1,596,242)	(552,477)	(588,500)	(1,972,628)
Cash flows generated by financing activities					
Repayment of debentures issued to the Government of Israel	-	(481,089)	-	-	(481,089)
Issue of other debentures (after deduction of issue expenses)	513,568	1,115,808	-	1,115,808	1,115,808
Repayment of other debentures	(206,662)	(214,114)	(71,643)	(66,332)	(230,798)
Receipt of long-term loans	686,425	715,956	530,359	45,379	819,063
Repayment of long-term loans	(913,028)	(1,250,984)	(715,186)	(599,510)	(1,859,446)
Receipt (repayment) of short-term bank credit, net	(236,726)	424,282	(180,707)	212,895	473,458
Dividend paid	-	(309,072)	-	-	(309,072)
Net cash inflow (outflow) generated by financing activities	(156,423)	787	(437,177)	708,240	(472,076)
Increase (decrease) in cash and cash equivalents	(455,322)	869,329	(139,296)	1,000,706	886,090
Cash and cash equivalents at beginning of period	1,563,666	677,576	1,247,640	546,199	677,576
Cash and cash equivalents at end of period	1,108,344	1,546,905	1,108,344	1,546,905	1,563,666

The notes to the financial statements are integral part thereof.

Interim Consolidated Statement of Cash Flows (Contd.)

In terms of shekels of September 2001

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2001 (Unaudited)	2000 (Unaudited)	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands		NIS thousands		NIS thousands
A - Adjustments to reconcile net earnings (loss) to net cash flows generated by operating activities					
Revenues and expenses not involving cash flows:					
Depreciation	1,948,414	2,062,067	641,835	681,527	2,754,514
Provision for decrease in value of fixed assets	21,350	-	21,350	-	11,234
Deferred taxes	21,848	(295,041)	31,251	(449,777)	(314,382)
Company's equity in losses of investee companies, net	141,767	120,317	65,094	69,576	199,078
Minority share in losses of a consolidated company	(4,886)	(2,144)	(1,460)	(1,743)	(4,994)
Increase (decrease) in employee severance benefits, net	(38,558)	1,236,786	(35,055)	1,379,262	1,190,153
Loss (gain) on disposal of fixed assets	(27,578)	(1,754)	3,407	(88)	(1,367)
Loss (gain) on disposal of investment in affiliated company	3,501	-	-	-	(141,523)
Erosion (appreciation) of and interest on long-term deposits and forward contracts	(143,053)	23,687	(125,329)	361	15,735
Erosion (appreciation) of short-term investments, net	(6,467)	(1,714)	(2,509)	442	(2,991)
Appreciation (erosion) of long-term liabilities:					
Debenture issued to the Government of Israel	-	679	-	-	679
Other debentures	28,200	(25,046)	124,582	(21,708)	27,480
Long-term loans	87,136	(73,376)	53,174	(5,391)	(75,270)
Amortization of deferred charges and other adjustments	185,973	108,036	77,556	42,340	153,482
Changes in asset and liability items:					
Decrease (increase) in trade receivables	12,103	178,154	(39,505)	(45,923)	154,185
Decrease (increase) in other receivables and debit balances	48,578	(125,558)	(92,536)	(53,775)	(84,245)
Decrease (increase) in inventory	5,994	(2,054)	26,811	(640)	(15,009)
Increase (decrease) in trade payables	(33,986)	(157,655)	115,919	14,868	(88,436)
Increase (decrease) in other current liabilities	(27,991)	30,851	(17,677)	84,508	121,929
Decrease in deferred revenues	(8,865)	(6,538)	(3,908)	(2,076)	(9,161)
	2,213,480	3,069,697	843,000	1,691,763	3,891,091
B - Non-cash transactions					
Acquisition of fixed assets, materials and spare parts on credit	99,275	315,020	99,275	315,020	307,078
Sale of fixed assets on credit	14,707	23,514	14,707	23,514	9,036
Acquisition of other assets on credit	871	-	871	-	-

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

Notes to the Interim Consolidated Financial Statements as at September 30, 2001 (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, 2000 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 previous annual financial statements and 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 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, appear in Note 1 to the Company's annual financial statements as at December 31, 2000. The significant changes which occurred from the date of the annual financial statements to the date of these financial statements are described below:

1. Access fees from the international telecommunications operators were reduced as of January 1, 2001 by approximately 30%, in accordance with the licenses of the operators which determined that the access fees would be reduced every year by that percentage.

2. The annual updated tariffs took effect on March 1, 2001, including a reduction of the Company's call tariffs by an average of 1.4%, an increase in the tariffs for links to the cellular operators by an average of approximately 33%, and the tariffs for other services were reduced by approximately 2.79%.

3. Pursuant to notification from the Company to the cellular communication service operators, (hereinafter - the Operators), starting on March 1, 2000, the billing arrangement which was in effect between them was canceled and a new arrangement commenced, whereby the Company transfers to the operators only the amounts which it actually collected in respect of airtime less a collection fee, in contrast to the existing arrangement in which the transfer of moneys was made on the basis of customer charges without deduction of a collection fee. The Operators expressed their objection to the change in the existing arrangement, and one of them also filed a legal claim in which it requested that the Company be instructed to continue to act in accordance with the arrangement which had existed until then. The court denied the claim and confirmed the validity of the new arrangement instituted by the Company. The Operator appealed to the High Court. Sitting on October 30, 2001, the High Court decided to summons the Attorney General as respondent to the appeal, in order to hear his position. Concurrently, the Company and the Operators negotiated in an attempt to arrive at an agreed arrangement. During the negotiations, the Company reached an agreement with Pelephone Communications Ltd. (a proportionally consolidated company), defining the relations between the companies with regard to billing from March 1, 2000 to December 31, 2002, and with MIRS Communications Ltd. upon the start of its operations as a cellular service operator. The Company included in its financial statements a provision of approximately NIS 78 million to cover its obligations deriving from the agreement.

   As a result of the change in the billing arrangements, as described above, starting on March 1, 2000, the Company's revenues and expenses from mobile wireless telephone do not include airtime. The airtime which is included in the revenues and expenses from mobile wireless telephone in the corresponding reported period last year, amount to approximately NIS 297 million.

   Further to Note 1E(1) in the financial statements of December 31, 2000, in connection with the petition of Pelephone Communications Ltd. to the High Court concerning regulations promulgated by the Ministry of Communications relating to incoming call tariffs to the cellular network, on October 24, 2001 the High Court dismissed the petition filed by Pelephone in view of the settlement arrangement arrived at between it and the Ministers of Communications and Finance, whereby the amounts prescribed in Regulation 3C(a) of the Telecommunications Regulations (Payments for reciprocal connection), 5760-2000, would be amended.

NOTE 1 - GENERAL (CONTD.)

The Company notified the Court that in its opinion, the aforementioned settlement arrangement is incomplete, since it does not include full reference to the arrangement which is intended to apply to relations between the Company and the cellular companies regarding the collection activities carried out by the Company for the cellular companies and regarding loss bearing in respect of charges which are not paid by the subscribers themselves.

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

   The request of the Company to consider rescinding the notice naming it a monopoly in basic telephone services, which includes, according to the Company, both fixed and mobile telephony, was rejected by the Anti-Trust Commissioner. The Company filed an appeal in the Anti-Trust Tribunal against the rejection, and the Commissioner filed an application for a complete dismissal of the appeal.

5. In July 2001, regulations effective from January 2001 were published, which changed the arrangements which existed until that date for payment of royalties to the State by communications companies. Under the new regulations, the basis of revenues from which the royalties are calculated was broadened, along with a gradual reduction of the rate of royalties paid, until arriving at a uniform rate for all communications operators. The rates in effect for 2001 are 4% for fixed-line domestic telecommunication services, 4.5% for international telecommunication services, and 5% for cellular services. The rate of royalties for domestic telecommunication services will remain in effect through 2003, and in 2004 will be lowered to 3.5%. The rates of royalties for international and cellular services will be gradually lowered to 3.5% by 2004.

6. Further to Note 1E(3) in the financial statements of December 31, 2000, in July 2001 the Communications Law (Telecommunications and broadcasts), 5742-1982 ("the Communications Law") was amended. The amendment regulates, inter alia, the opening of the domestic communications market and the field of cable broadcasts to competition, by way of granting licenses for providing communication services. The amendment includes a large number of topics that will affect the Company and other companies in the Group. The Law enables the cable companies to switch from a regime of franchises to one of licenses, so that they or companies with an interest in the cable companies will be able to receive a general license to provide telecommunication services. If an applicant for a license currently holds a franchise, the granting of the license will be contingent upon transfer of the activities involved in providing broadcasting services to such a company with an interest, and if the license applicant is such a company with an interest, the franchisee will transfer to that company the rights in the cable network used for the broadcasts. Upon granting the licenses in accordance with the Law and the start of operations of the new licensees, full competition will commence in fixed-line domestic telecommunications, which is expected to have an materially adverse effect on the business results of the Company which cannot be estimated at this stage.

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

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

Notes to the Interim Consolidated Financial Statements as at September 30, 2001 (Unaudited)

NOTE 1 - GENERAL (CONTD.)

8. In August 2001, the Ministry of Communications published a Request For Position in connection with the policy for regulating international telecommunication services. The document discusses the possibility of approving a merger between the competitors of the subsidiary Bezeq International Ltd., granting licenses to additional international communications operators, and a structural separation of Internet activities of an international communications operator. The Company and its subsidiary, Bezeq International Ltd., have submitted their remarks, which include reservations as to the main points of the document.

9. Further to Note 1F in the financial statements of December 31, 2000, at its meeting on August 27, 2000, the Ministerial Committee for Privatization decided to sell the State's holdings in the Company by way of a private sale which would be accompanied by raising capital for the Company. The sale will include shares comprising at least 50.01% of the Company's share capital. The Ministerial Committee for Privatization later adopted a number of resolutions intended to advance the implementation of the above decision, and the Company's license, its Articles of Association and the Telecommunications Order were amended as aforesaid. On November 13, 2001, the Government of Israel published a notice stating that it was considering the sale of the State's holdings, comprising 50.01% of the share capital of the Company, by way of a private sale. According to the notice, anyone wishing to purchase the State's holdings may apply to the Government of Israel through the Companies Authority. Adoption of a procedure for the sale of the State's holdings will be effected through the Companies Authority. Those wishing to participate in the sale proceedings are required to submit their applications, in accordance with the procedure, by February 13, 2002.

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. In the report period, the Israeli Institution for Standardization in Accounting published the following new regulations:
Accounting Standard No. 7 – Events after the balance sheet date. The new standard determines the requirements to report on events after the balance sheet date, when a corporation must make adjustments in its financial statements for events after the balance sheet date, and the disclosure required of a corporation concerning the date on which the financial statements are approved for publication.
Accounting Standard No. 8 – Terminated operations. The standard sets out rules for the separate statement of information relating to a material business operation which is terminated by a corporation, from information relating to ongoing operations, and also determines the minimum disclosure of information concerning terminated operations.
Accounting Standard No. 11 – Sectoral reporting. The standard requires the inclusion of information in respect of business sectors and geographical sectors, and also gives detailed guidelines for the identification of business and geographical sectors.
Accounting Standard No. 13 – Effects of changes in foreign currency exchange rates. The standard deals with the translation of foreign currency transactions and the translation of financial statements of overseas operations, for the purpose of their integration in the financial statements of the reporting corporation, and supersedes the provisions of Clarifications 8 and 9 to Opinion 36, which are voided with the institution of Accounting Standard No. 12 – Termination of adjustment of financial statements (see Section C. below). This Standard will influence the financial statements for the period starting after December 31, 2002.

   Accounting Standard No. 7 will apply to financial statements for periods ending on December 31, 2001 or thereafter.
   Accounting Standards Nos. 8 and 11 will apply to financial statements for periods starting on January 1, 2002 or thereafter.

   In the opinion of the Company, the effects of the new standards will not be material.

NOTE 2 - ACCOUNTING POLICIES (CONTD.)

C. In October 2001, the Israeli Institute for Accounting Standardization published Accounting Standard No. 12 – Termination of adjustment of financial statements. Pursuant to this Standard, adjustment for inflation in financial statements will terminate starting on January 1, 2003.

Until December 31, 2002, the Company will continue to prepare adjusted statements in accordance with Opinion 36 of the Association of Certified Public Accountants in Israel. The adjusted amounts included in the statements as at December 31, 2002 will serve as the starting point for nominal financial reporting starting on January 1, 2003. The Standard is liable to have a materially adverse effect on the results reported by the Company. The extent of that effect depends on the rate of inflation and on the capital structure of the Company.

The Government Companies Authority has been in correspondence with and submitted documents to various entities, among them the Attorney General, requesting them to ascertain, inter alia, the legal status of the Israeli Institute for Accounting Standardization, its authority, its management methods and the correctness of the standard.

In addition, a lawsuit was filed in the Tel Aviv District Court by another government company, suing, inter alia, the Israeli Institute for Accounting Standardization, the Securities Authority and the Government Companies Authority, in which it requests that the Court determine, inter alia, that the aforementioned standard is invalid and void.

The Attorney General, in its response to the District Court, gave notice in the name of some of the respondents, inter alia, that he will not express any opinion as to the body of the standard and does not intend to intervene in standards.

D. A proposed law for amendment of the Income Tax law (Adjustments for inflation), 5745-1985 ("the Law") recently passed its second and third readings. The amendment would authorize the Minister of Finance, during the tax year or up to February 28 of the subsequent year, to determine that if the rise in the Index does not or did not exceed 3%, the provisions of the Law shall not apply, in whole or in part, or that the rate of the rise in the Index that year shall be deemed to be 0% and to determine the adjustments required for such a determination. The Law has not yet been published in the Official Gazette.

It is not possible to know whether the Minister of Finance will indeed exercise his above authority and if he does so, it is not possible to estimate which provisions of the Law will not apply or whether the rate of the rise in inflation that year will be deemed to be 0%. In view of this uncertainty, the Company is unable to estimate the effects on its tax expenses if the Minister exercises his authority as aforesaid.

NOTE 3 - FINANCIAL STATEMENTS IN ADJUSTED VALUES

The financial statements have been prepared on the agreed basis of historical cost adjusted for the effect of the changes in the general purchasing power of the Israeli currency. Comparative data in the financial statements have been adjusted to the shekel of September 2001. To follow are the changes which occurred in the consumer price index and the rates of exchange of the US dollar:

	Consumer price index	Exchange rate of the US dollar	Exchange rate of the euro
	%	%	%
In the nine-month period ended			
September 30, 2001	1.99	7.77	2.74
September 30, 2000	(0.47)	(3.10)	(14.89)
In the three-month period ended			
September 30, 2001	0.88	4.56	9.57
September 30, 2000	(0.84)	(1.47)	(9.24)
In the year ended December 31, 2000	0.00	(2.69)	(9.87)

NOTE 4 - INVESTMENTS IN INVESTEE COMPANIES

A. PELEPHONE COMMUNICATIONS LTD. ("PELEPHONE")

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

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

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

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

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

   d. The exercise price of the Short Option is return of the nominal investment plus US $8 million, and of the Long Option is the higher of return of the nominal investment or a valuation of the market value of 20% of the Corporation's shares.

2. During the quarter, the Company transferred to Pelephone the sum of US $20 million as a premium on shares that were issued in the past. Shamrock Holdings of California, Inc. transferred the same amount during October 2001.

B. EMITEL TELECOMMUNICATION CORP. LTD. – A COMPANY REGISTERED IN HUNGARY

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

NOTE 4 - INVESTMENTS IN INVESTEE COMPANIES (CONTD.)

C. D.B.S. SATELLITE SERVICES (1998) LTD.

The Company holds 30% of the shares of D.B.S. Satellite Services (1998) Ltd. (hereinafter - DBS). In January 1999, DBS received a license from the Ministry of Communications for satellite television broadcasts, in exchange for payment of NIS 30 million and a guarantee in the amount of NIS 30 million. DBS foresees considerable losses and negative cash flow from operations in the first years of its activities. Its losses in 2000 amounted to approximately NIS 555 million, and for the nine months ended September 30, 2001 amounted to approximately NIS 603 million. These losses have led to an increase in its working capital deficit to approximately NIS 1,176 million (including NIS 768 million in short-term bank credit). The sources of finance for DBS's operations are shareholders' loans and bank credit lines.

The Company's investment in DBS as at the balance sheet date was approximately NIS 639 million. The Company's share in the accumulated loses of DBS was approximately NIS 373 million, of which NIS 181 million was recorded in the nine months ended September 30, 2001, and approximately NIS 62 million in the three-month period then ended.

Pursuant to a decision of the Ministerial Committee for Privatization on January 21, 2001, the maximum cumulative exposure of the Company in connection with this investment shall at no time exceed the rate of the Company's actual holding in DBS, multiplied by $400 million (approximately NIS 1.7 billion). The Committee also approved an increase of the Company's holding in DBS of up to 50% of DBS's share capital, the approval being contingent upon amendment of the Telecommunications Regulations (or the Telecommunications Law) in the matter of limitations on a holding of means of control in DBS by anyone who is a controlling interest in a broadcasting franchisee. The Regulations were amended on May 14, 2001.

On June 24, 2001, the Ministerial Committee for Privatization approved an infusion of up to 40 million dollars by the Company in DBS, without changing the actual holdings ratio. The Company undertook to endeavor that not later than 120 days from the date of the Committee's decision, the ratio of exposure to the rate of the Company's holdings would comply with the decision of January 21. 2001. The Company further undertook to convey to the Ministerial Committee, within 120 days of the date of the decision, the position of the Board of Directors and the Management of the Company on the financial viability of the DBS venture for the Company, and its implications for its strategic plan and privatization. The position of the Board of Directors and the Management of the Company was forwarded to the Government Companies Authority on October 22, 2001, together with the Company's notice of its activities for reaching a settlement among the shareholders of DBS that would bring about the required ratio between its exposure in its investments and the percentage of its holdings in DBS.

On May 23, 2001 a financing agreement between DBS and three banks was signed, determining, inter alia, preconditions for withdrawing funds from the credit lines, including an undertaking by DBS to meet the cumulative milestones stipulated in the agreement. The agreement also determines that if by June 30, 2001, all the suspending conditions in the agreement are not met, the agreement will be canceled. The last date for full compliance with the suspending conditions was postponed to July 31, 2001. As at the date of approval of these financial statements, not all the suspending conditions had been met. DBS and the banks are continuing to discuss the actions required for regulating these conditions. As at the date of approval of these financial statements, the banks are continuing to make credit available to DBS in accordance with the financing agreement. The sources of finance for DBS's operations are shareholders' loans and bank credit. As at the date of approval of these financial statements, some of the shareholders had stopped making any further loans to DBS. Loans from the Company and increased exposure in DBS are subject, inter alia, to the approval of the Ministerial Committee for Privatization. The operations of DBS are continent upon further implementation of the financing agreement and the receipt of additional loans from the shareholders.

4 - INVESTMENTS IN INVESTEE COMPANIES (CONTD.)

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

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

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

D. WALLA! COMMUNICATIONS LTD.

Upon receipt of all the requisite approvals, the merger of Walla! Communications Ltd. ("Walla") and IOL Israel On Line (2000) Ltd.)("IOL") was completed. Following the merger, the percentage of the holdings of Bezeq International Ltd. in Walla decreased from 38.5% to 24.8% (as a result of an issue of shares to a third party), and Bezeq International Ltd. generated a loss from disposal of an investment. This loss, of approximately NIS 3.5 million, is included in the Other expenses item in the financial statements. Based on the IOL – Walla value ratio determined immediately prior to the merger and the amortization of goodwill at Walla following the merger with IOL, Bezeq International Ltd. set its investment in Walla while further amortizing in accordance with the value ratio and the additional elements connected with the investment. The amortization that resulted was approximately NIS 7.7 million, and Bezeq International Ltd.’s portion in the amortization of the investment made at Walla following the merger, which was approximately NIS 6.2 million, was included in the financial statements under Losses of affiliated companies.

E. XPERT INTEGRATED SYSTEMS LTD.

In the report period, the Company invested approximately NIS 40 million in Xpert Integrated Systems Ltd. ("Xpert"), in consideration of 15.6% (at full dilution) of the capital of that company, and also received options enabling it to increase its holdings to 21.5%. Xpert is an Israeli company involved primarily in the building and integration of IP networks.

NOTE 5 - EMPLOYEE SEVERANCE BENEFITS

EARLY RETIREMENT PLAN

A. As part of the plan for organizational change in the Company, which was approved by the Board of Directors in March 2000, 491 employees retired from the Company between December 31, 1999 and September 30, 2001.

B. In the wake of privatization of the Company and the opening of the telecommunications market to competition, additional workforce changes are required at the Company; accordingly, the Company reached agreement with the workers' representatives in September 2000, to extend the early retirement collective agreement from 1997. The new arrangement states that from April 1, 2001 to December 31, 2006 (with an option to extend the final retirement date for certain employees to December 31, 2008), another 1,770 employees will take early retirement. Furthermore, pursuant to the agreement, the Company's management will be able to dismiss employees under a compensation arrangement over and above the number stated in the agreement. The retirement of workers under this plan has not yet started.

The financial statements for the year 2000 include an expense of approximately NIS 1,393 million in respect of the expected cost of implementation of this plan. The Company's management estimates that the possibility of additional employees retiring under a compensation arrangement is slight, and accordingly, no provision was made thereof in the financial statements.

NOTE 6 - CONTINGENT LIABILITIES

A. CLAIMS AND CONTINGENT LIABILITIES

The Company and 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 21A to the annual financial statements of the Company as at December 31, 2000. No material changes occurred in the contingent liabilities up to the date of signing these financial statements, except for the following:

1. Further to Note 21A(4) to the financial statements of December 31, 2000 concerning a class action in which the plaintiff alleges that the tariffs for international telecommunications services in the years 1996 and 1997 were exorbitant and unreasonable, the Supreme Court allowed the appeal of the Company and Bezeq International Ltd. and the decision of the District Court in the matter of approval of the action as a class action was overruled. The class action was stricken, while reserving the right of the plaintiff to file it anew and while retaining all the allegations of the litigants. In September 2001, a claim and an application for recognition of the claim as a class action was filed against Bezeq International Ltd. and against the State of Israel,. A statement of defense has not yet been filed. The legal advisers of Bezeq International Ltd. are unable, at this stage, to estimate the chances of the claim.

2. Further to Note 21A(21) to the financial statements of December 31, 2000, the (first) action was amended, as was the application for approval of the action as a class action, so that the amount of the action is now estimated at more than NIS 1 billion (rather than approximately NIS 750 million as in the original application). In addition, the application for unifying the hearing of the two claims referred to in the Note was approved, and the plaintiffs filed an amended action and application for approval of the action as a class action.

3. Further to Note 21A(12) to the financial statements of December 31, 2000, concerning a financial claim and class action of Company workers and pensioners, on May 8, 2001 the District Court dismissed the claim partly due to limitation and partly due to absence of cause. The plaintiffs have appealed this decision to the Supreme Court.

NOTE 6 - CONTINGENT LIABILITIES (CONTD.)

A. Claims and contingent liabilities (contd.)

4. Further to Note 21A(26) to the financial statements of December 31, 2000, concerning a petition in the High Court of Justice for the provision of a blocking service for every Company subscriber against outgoing calls to cellular phone area codes, as a positive default, the Company gave notice that it does not oppose providing such a service, but emphasized that it would require the approval of the Ministry of Communications. The Ministry of Communications stated that it sees no reason for approving a block to cellular phones or for the promulgation of regulations in the matter. The Company filed an application to expedite the hearing of the petition, and a hearing of the petition was held on October 15, 2001. In view of the notice of the Ministry of Communications that it is considering alternatives to blocking and will re-examine its policy, the hearing was postponed for three months.

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

6. Further to note 21A(6) to the financial statements of December 31, 2000 concerning a class action in connection with actions of Bezeq International Ltd. upon the start of competition, the District Court decided, on June 19, 2001, to reject the application for approval as a class action. On September 20, 2001, an appeal was filed in the Supreme Court against the above decision of the District Court. On October 25, 2001, Bezeq International Ltd. applied for the dismissal of the appeal in limine.

7. Further to Note 21A(2) to the financial statements of December 31, 2000 concerning the prices of direct dial international calls, the Supreme Court ruled, on July 2, 2001, to allow the appeal of the Company and Bezeq International Ltd.. On July 17, 2001 the plaintiff filed an application for an additional hearing of the case. On September 12, 2001 the Israeli Consumer Council filed an application to be added as a party to the application for an additional hearing and as a party to that additional hearing, if held. The Company's legal advisers are unable to estimate whether the plaintiff's application for an additional hearing will be allowed, and if so, what might be the results of the proceeding.

8. Further to Note 11E(2) to the financial statements of December 31, 2000 concerning assessments issued to the Company for the years 1994-1998 an agreement was signed in June 2001 between the Company and the Income Tax Authorities for final assessments for those years. Under the agreement, the Company's claim to increase the depreciation rate of exchanges was recognized, and several other issues were also agreed upon, principally postponement of the dates of recognition of certain expenses. As a result of the above, the Company recorded tax expenses in its financial statements in respect of preceding years, amounting to approximately NIS 12 million, as well as financing income of approximately NIS 79 million (tax exempt) deriving from the rebate payable to the Company.

9. Further to Note 21A(16) to the financial statements of December 31, 2000, on July 25, 2001 a decision was given which strikes the claim, following a consensual application that was filed on behalf of both parties.

Notes to the Interim Consolidated Financial Statements as at September 30, 2001 (Unaudited)

NOTE 6 - CONTINGENT LIABILITIES (CONTD.)

A. Claims and contingent liabilities (contd.)

10. Further to Note 21A(22) to the financial statements of December 31, 2000 concerning a class action filed against the Company in respect of unlawful collection of VAT for some collect calls received by subscribers in Israel from abroad, the plaintiffs have filed an application to add the Director of Customs and VAT as a defendant. Furthermore, the Attorney General gave notice that he will be present during the proceeding.

11. Further to Note 21A(24) to the financial statements of December 31, 2000 concerning a class action in which the plaintiff alleges that the "LightNet" track is in fact a "default option" from the point of view of the customer since it is an offer purely to debit the customer, on October 24, 2001 the District Court rejected the application for recognition as a class action under the Consumer Protection Law, 5741-1981. The plaintiff gave notice that he will apply to appeal that decision in the Supreme Court. The legal advisers of the Company are unable to estimate the chances of the application for leave to appeal, whether it will be filed, and the chances of the defense in the case if the Supreme Court decides that the claim should be recognized as a class action.

12. Further to Note 21A(20) to the financial statements of December 31, 2000, on October 18, 2001 an additional class action was filed, identical to the above claim, in respect of an unlawful charge of collection fees of the Company's bills. The plaintiff estimates the amount of the class action at approximately NIS 20 million. Bezeq has not yet filed its response.

13. In September 2001, an application was filed for approval of a class action against the Company. The plaintiffs allege that in view of the amendments to the Telecommunications Regulations, the maximum payment that could have been collected from a Bezeq subscriber calling a Pelephone subscriber was lower than the amount actually collected. The applicants estimate the amount of the claim at approximately NIS 42 million. The Company filed a response to the application, and applied to add Pelephone Communications Ltd. as a party to the proceeding. In the opinion of the Company's legal advisers, in view of the early stages of the proceeding, they cannot assess the interpretation that will be adopted by the Court, nor is it possible to estimate whether the Court will reject or allow the arguments of the Company.

14. Further to Note 11E(3) to the financial statements of December 31, 2000, concerning an assessment made according to best judgment which was issued to BezeqCall Ltd. (an inactive company), an amended assessment was issued to BezeqCall Ltd. in September 2001, in which the position of BezeqCall Ltd. was allowed, and its original report became a final assessment (the demand of the Income Tax Authority was rescinded).

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

16. In August 2001 an application was filed in the Tel Aviv District Court for approval of a class action against Pelephone Communications Ltd. ("Pelephone"). The applicant, through his lawyer, alleges that Pelephone collected from its customers excess amounts for reciprocal connection fees, in contravention of the regulations applicable thereto and/or of its license. The amount of the claim, if approved as class action, may exceed NIS 32.6 million. Pelephone and its legal advisers are studying the claim material and are unable to estimate, at this stage, its chances and its implications.

NOTE 6 - CONTINGENT LIABILITIES (CONTD.)

A. Claims and contingent liabilities (contd.)

17. Further to Note 21A(14) to the financial statements of December 31, 2000, concerning a class action against Pelephone Communications Ltd. for charging Value Added Tax within the Free Trade Zone in Eilat, in view of a consensual application which was filed by the parties, a decision was given whereby the application for approval as a class action and the action itself will be stricken with no order to pay costs.

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

B. FORWARD EXCHANGE CONTRACTS

The Company has entered into forward exchange contracts as a hedge against exposure resulting from changes in the exchange rates of foreign currencies versus changes in the Consumer Price Index (CPI). As at September 30, 2001, the Company contracted to purchase approximately US $297 million (approximately NIS 1,294 million) for which it will pay approximately NIS 1,254 million linked to the CPI, and approximately 117 million Euro (approximately NIS 467 million), for which it will pay approximately NIS 452 million linked to the CPI. The contracts mature on various dates, the last of which is in April 2003. The Company also contracted to purchase approximately US $64 million (approximately NIS 279 million), for which it will pay approximately NIS 271 million at predetermined interest rates, and approximately 205 million Euro (approximately NIS 818 million), for which it will pay approximately NIS 790 million at predetermined interest rates, and approximately NIS 502 million linked to the CPI, for which it will pay approximately NIS 508 million.

C. GUARANTEES

Pelephone Communications Ltd. gave a guarantee to the Ministry of Communications in connection with a tender for third generation frequencies of cellular telephones. The amount of the guarantee is approximately NIS 100 million.

Notes to the Interim Consolidated Financial Statements as at September 30, 2001 (Unaudited)

NOTE 7 - SHARE CAPITAL

A. The General Meeting which convened on November 23, 2000 resolved to approve the recommendation of the Board of Directors of the Company to increase the registered capital of the Company by 1.6 billion ordinary shares and to distribute bonus shares in the amount of 1.6 billion shares, so that in respect of each share of a par value of NIS 1, two bonus shares of a par value of NIS 1 each will be distributed. For this purpose, it was resolved to capitalize undesignated earnings to a reserve fund which will be earmarked for the distribution of bonus shares, and to authorize the Board of Directors to issue those bonus shares. In January 2001, approval was received from the Ministerial Committee for Privatization for the increase of the registered capital for allotment of the bonus shares. The increase in the registered capital and the allotment of the bonus shares as aforesaid, were implemented in February 2001.

B. The General Meeting which convened on April 30, 2001 resolved to approve an increase in the registered capital of the Company by 130 million ordinary shares, which will be designated for raising capital as defined in the privatization resolution from August 27, 2001. The terms for the cancellation of capital which is not allotted, were also resolved. On June 11, 2001, the Ministerial Committee for Privatization approved the resolution of the General Meeting.

NOTE 8 - REVENUES FROM TELECOMMUNICATION SERVICES

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2001 (Unaudited)	2000 (Unaudited)	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues from telephone services -					
Domestic fixed-line communications	1,821,847	1,954,175	609,169	661,044	2,576,422
Cellular telephone (1)	1,563,935	1,677,105	524,944	507,671	2,188,627
Fixed fees	1,562,964	1,516,858	517,831	511,274	2,028,588
International communications and Internet services					
	588,271	629,842	200,172	216,127*	863,368
Installation and sale of equipment to subscribers					
Other	323,175	384,955	101,983	128,609	506,235
	97,925	108,105	32,677	34,984	143,208
Other revenues	5,958,117	6,271,040	1,986,776	2,059,709	8,306,448
	198,390	187,006	52,466	67,962	264,530
	6,156,507	6,458,046	2,039,242	2,127,671	8,570,978

* Reclassified

(1) See Note 1B(3)

Notes to the Interim Consolidated Financial Statements as at September 30, 2001 (Unaudited)

NOTE 9 - OPERATING AND GENERAL EXPENSES

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2001 (Unaudited)	2000 (Unaudited)	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Salaries and related expenses	1,444,136	1,268,987	480,995	393,587	1,709,844
General expenses	529,788	504,707	189,892	195,164*	693,981
Materials and spare parts	368,727	333,700*	122,849	110,778*	426,498
Cellular telephone expenses (1)	341,192	421,785	109,582	68,551	519,965
Building maintenance	293,598	283,360	96,226	96,425	396,465
Services and maintenance by sub-contractors	235,861	289,869*	71,872	101,362*	406,099
International communications expenses	158,760	191,877	49,179	47,387	256,117
Vehicle maintenance expenses	60,835	54,500	20,729	18,864	74,057
Collection fees	27,997	30,052	8,849	9,872	39,781
	3,460,894	3,378,837	1,150,173	1,041,990	4,522,807
Less – salaries charged to investment in fixed assets	106,057	116,160	35,888	36,878	152,943
	3,354,837	3,262,677	1,114,285	1,005,112	4,369,864

* Reclassified

(1) See Note 1B(3)

NOTE 10 - CONDENSED INTERIM FINANCIAL STATEMENTS OF THE COMPANY

A. STATEMENTS OF OPERATIONS

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2001 (Unaudited)	2000 (Unaudited)	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues from telecommunication services (Note 10B)	4,475,382	4,834,951	1,468,301	1,550,246	6,377,826
Costs and expenses					
Operating and general expenses (Note 10C)	1,908,295	1,990,434	618,428	549,125	2,587,113
Depreciation	1,612,811	1,718,814	532,279	567,592	2,291,410
Royalties to the Government of Israel	144,665	157,458	47,977	54,328	204,909
	3,665,771	3,866,706	1,198,684	1,171,045	5,083,432
Operating income	809,611	968,245	269,617	379,201	1,294,394
Financing expenses, net	(47,815)	(258,864)	(30,261)	(110,244)	(300,248)
Earnings after financing expenses	761,796	709,381	239,356	268,957	944,146
Other expenses, net	(4,891)	(1,301,611)	(24,273)	(1,417,485)	(1,257,616)
Earnings (losses) before taxes on income	756,905	(592,230)	215,083	(1,148,528)	(263,470)
Tax benefit (income tax)	(269,045)	241,527	(79,807)	443,729	141,579
	487,860	(350,703)	135,276	(704,799)	(121,891)
Company's equity in losses of affiliated companies	(322,944)	(254,210)	(127,918)	(105,998)	(438,406)
Net earnings (loss)	164,916	(604,913)	7,358	(810,797)	(560,297)

Notes to the Interim Consolidated Financial Statements as at September 30, 2001 (Unaudited)

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

B. REVENUES FROM TELECOMMUNICATIONS SERVICES

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2001 (Unaudited)	2000 (Unaudited)	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues from telephone services -					
Domestic fixed-line communications	1,839,814	1,965,690	616,028	663,382	2,597,760
Cellular telephone (1)	515,750	701,293	165,634	139,773	859,411
Fixed fees	1,480,249	1,425,518	486,350	484,884	1,920,166
International communications	246,359	292,578	81,962	105,639	396,268
Installation and sale of equipment to subscribers	110,901	158,959	39,042	54,101	215,526
Other	98,053	108,998	32,865	35,128	147,016
	4,291,126	4,653,036	1,421,881	1,482,907	6,136,147
Other revenues	184,256	181,915	46,420	67,339	241,679
	4,475,382	4,834,951	1,468,301	1,550,246	6,377,826

C. OPERATING AND GENERAL EXPENSES

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2001 (Unaudited)	2000 (Unaudited)	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Salaries and related expenses	1,145,638	1,005,289	386,494	301,198	1,339,021
General expenses	191,789	178,648	66,940	66,534	238,341
Materials and spare parts	50,746	38,725*	14,646	15,266*	39,805
Cellular telephone expenses (1)	85,713	297,230	14,791	-	308,920
Building maintenance	255,267	250,267	81,388	85,440	350,797
Services and maintenance by sub-contractors	199,751	251,032*	61,757	88,747*	347,558
International communications expenses	7,226	9,019	2,165	2,764	12,389
Vehicle maintenance expenses	50,402	46,646	17,291	16,318	63,665
Collection fees	27,820	29,738	8,844	9,736	39,560
	2,014,352	2,106,594	654,316	586,003	2,740,056
Less – salaries charged to investments in fixed assets	106,057	116,160	35,888	36,878	152,943
	1,908,295	1,990,434	618,428	549,125	2,587,113

* Reclassified
(1) See Note 1B(3).

Notes to the Interim Consolidated Financial Statements as at September 30, 2001 (Unaudited)

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

1. BEZEQ INTERNATIONAL LTD.

A. Balance sheet

	September 30 2001	September 30 2000	December 31 2000
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	210,801	288,711	272,147
Investments	11,339	41,722	38,935
Fixed assets	374,478	374,343	366,919
Other assets	18,316	20,217	18,566
	614,934	724,993	696,567
Current liabilities	340,107	444,319	509,443
Long-term liabilities	193,813	32,224	33,398
Quasi-capital receipt	161,662	161,662	161,662
Shareholders' equity (deficit)	(80,648)	86,788	(7,936)
	614,934	724,993	696,567

Notes to the Interim Consolidated Financial Statements as at September 30, 2001 (Unaudited)

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 nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2001 (Unaudited)	2000 (Unaudited)	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues from international telecommunications services	501,256	517,891	172,932	171,214	685,199
Operating expenses	375,196	423,468	120,552	125,742	576,264
Gross profit	126,060	94,423	52,380	45,472	108,935
Marketing expenses	91,338	106,309	32,575	42,365	168,715
General and administrative expenses	77,043	67,071	26,078	24,896	92,101
	168,381	173,380	58,653	67,261	260,816
Operating loss	(42,321)	(78,957)	(6,273)	(21,789)	(151,881)
Financing income (expenses), net	(10,452)	124	(4,231)	(3,458)	(3,243)
Loss after financing expenses, net	(52,773)	(78,833)	(10,504)	(25,247)	(155,124)
Other income (expenses), net	4,156	(27,992)	(203)	(1,722)	(40,515)
Loss before taxes on income	(48,617)	(106,825)	(10,707)	(26,969)	(195,639)
Income tax	-	-	-	-	(1,653)
Loss after taxes on income	(48,617)	(106,825)	(10,707)	(26,969)	(197,292)
Company's equity in losses of affiliated company	(24,095)	(6,412)	(3,376)	(3,133)	(10,669)
Net loss	(72,712)	(113,237)	(14,083)	(30,102)	(207,961)

NOTE 12 - CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD. (CONTD.)

2. PELEPHONE COMMUNICATIONS LTD.

A. Balance sheet

	September 30 2001	September 30 2000	December 31 2000
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	1,072,412	1,160,555	1,152,645
Long-term trade receivables	90,005	57,153	72,685
Investments in affiliated company	-	-	1,469
Reserve in compensation fund, net	-	3,170	-
Fixed assets	2,793,297	2,880,409	2,920,442
Other assets	643,079	650,042	693,061
	4,598,793	4,751,329	4,840,302
Current liabilities	1,706,952	2,075,846	2,125,488
Provision for losses of investee company	192	12,003	-
Long-term liabilities	1,141,242	694,236	803,720
Minority rights	12,111	9,228	5,750
Shareholders' equity	1,738,296	1,960,016	1,905,344
	4,598,793	4,751,329	4,840,302

Notes to the Interim Consolidated Financial Statements as at September 30, 2001 (Unaudited)

NOTE 12 - CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD. (CONTD.)

2. PELEPHONE COMMUNICATIONS LTD. (CONTD.)

B. Statement of Operations

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2001 (Unaudited)	2000 (Unaudited)	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues from Pelephone services, sales and services	2,665,081	2,643,976	880,609	921,236	3,511,236
Cost of Pelephone services, sales and services	2,350,592	2,184,096	794,802	752,144	2,934,072
Gross profit	314,489	459,880	85,807	169,092	577,164
Sales and marketing expenses	360,299	331,955	116,794	124,058	457,386
General and administrative expenses	164,494	151,592	51,382	50,126	204,142
	524,793	483,547	168,176	174,184	661,528
Operating loss	(210,304)	(23,667)	(82,369)	(5,092)	(84,364)
Financing expenses, net	(80,118)	(75,831)	(24,408)	(24,627)	(99,968)
Other income (expenses), net	1,956	(1,692)	341	(2,097)	1,749
Loss before taxes on income	(288,466)	(101,190)	(106,436)	(31,816)	(182,583)
Tax benefit	28,445	28,253	1,440	8,107	52,473
Loss after taxes on income	(260,021)	(72,937)	(104,996)	(23,709)	(130,110)
Minority share in losses of a consolidated company	9,772	4,288	2,918	3,487	9,987
Company's equity in losses of an investee company	(3,918)	(7,948)	(498)	(2,718)	(11,142)
Net loss	(254,167)	(76,597)	(102,576)	(22,940)	(131,265)