"BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

FINANCIAL STATEMENTS

MARCH 31, 2007

Contents

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

At your request, we have reviewed the condensed interim consolidated balance sheet of "Bezeq" - The Israel Telecommunication Corp. Limited (hereinafter "Company") as at March 31, 2007, as well as the condensed interim consolidated statement of income, the statement of recognised income and expense and the condensed 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 condensed interim financial statements of subsidiaries, whose assets as at March 31, 2007, constitute approximately 7% of the total assets included in the condensed interim consolidated balance sheet and whose revenues constitute approximately 11% of the total revenues included in the condensed interim consolidated statement of income for the three-month period then ended. Furthermore, reports of other auditors were furnished to us which relate to investments in associates in which the Company's investments amount to approximately NIS 32 million as at March 31, 2007, and the Company's share in the losses in respect thereof amount to approximately NIS 473 thousand for the three-month period then ended.

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 to the said interim financial statements in order for them to be in conformity with International Financial Reporting Standards (IFRSs) and in accordance with the provisions of Section 4 of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

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 condensed interim consolidated financial statements.

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

1. The continuing opening of the communications sector to competition and the effects of regulation on the Group's financial position and operating results, as described in Note 1.

2. Contingent claims made against the Group of which the exposure cannot yet be assessed or calculated, and other contingencies as described in Notes 8B and 8C.
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3. The financial position of a subsidiary. As mentioned in Note 7A, the continuation of the activity of the subsidiary is contingent on arranging sources of finance required by the subsidiary in the forthcoming year. In the opinion of the management of the subsidiary, based, among others, on the 2007 budget and on the alternative business plan, the prospects of arranging sources of finance required by the subsidiary in the forthcoming year are good.

Additionally, we draw attention to Note 14L to the Group financial statements regarding the adjustment by way of restatement of the financial statements as at March 31, 2006, in order to retroactively reflect the depreciation of property, plant and equipment and the related tax effects thereon, in respect of the presentation of receipts from interconnect to the cellular networks and in respect of a reduction of lease payments of land from the Israel Lands Administration as described in the aforementioned note. These aforementioned corrections were implemented on the data presented in the Note of restatement to IFRSs in order to properly reflect the financial position of the Group in the transition to IFRSs in accordance with generally accepted accounting principles in Israel.

Somekh Chaikin
Certified Public Accountants (Isr.)

May 28, 2007

Condensed Consolidated Interim Balance Sheets as at

	March 31, 2007 (Unaudited) NIS thousands	March 31, 2006 (Unaudited) NIS thousands	December 31, 2006 (Audited) NIS thousands
Assets			
Cash and cash equivalents	**1,032,988**	2,290,704	2,631,790
Trade receivables	**2,106,158**	2,074,193	2,111,451
Other receivables	**295,568**	174,513	250,657
Inventory	**252,356**	219,225	204,669
Broadcasting rights	**200,486**	173,601	169,017
Investments and loans, including derivatives	**850,686**	2,461,631	960,561
Current tax assets	**11,944**	13,254	11,105
Total current assets	**4,750,186**	7,407,121	6,339,250
Trade and other receivables	**442,939**	373,016	417,144
Investments and loans, including derivatives	**325,687**	497,964	342,175
Property, plant and equipment	**6,334,974**	7,046,082	6,492,362
Intangible assets	**2,563,374**	2,595,231	2,554,242
Deferred and other expenses	**366,260**	386,177	373,749
Investments in associates accounted by the equity method	**32,089**	22,418	32,122
Deferred tax assets	**870,712**	1,019,882	993,616
Total non-current assets	**10,936,035**	11,940,770	11,205,410
Total assets	**15,686,221**	19,347,891	17,544,660

	March 31, 2007	March 31, 2006	December 31, 2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Liabilities			
Loans and borrowing	**3,706,678**	3,065,140	3,637,347
Trade payables	**1,467,210**	1,311,106	1,393,568
Other payables, including derivatives	**883,095**	920,664	802,747
Current tax liabilities	**68,096**	15,467	121,704
Deferred income	**35,705**	34,960	57,879
Provisions	**302,487**	280,539	288,851
Employee benefits	**833,945**	715,606	906,203
Proposed dividend	**-**	1,200,000	300,000
Total current liabilities	**7,297,216**	7,543,482	7,508,299
Debentures	**2,939,578**	4,899,855	3,169,441
Obligations to banks	**434,904**	650,857	480,830
Loans from others	**171,675**	110,609	169,182
Loans provided by the minority in a subsidiary	**577,933**	521,320	564,250
Employee benefits	**359,888**	375,447	373,036
Deferred income and others	**74,870**	24,328	37,020
Provisions	**53,570**	53,020	51,857
Total non-current liabilities	**4,612,418**	6,635,436	4,845,616
Total liabilities	**11,909,634**	14,178,918	12,353,915
Shareholders' Equity			
Share capital	**6,132,636**	6,309,133	6,309,133
Share premium	**-**	1,623,423	1,623,423
Reserves	**672,515**	405,606	671,820
Deficit	**(2,450,631)**	(2,647,869)	(2,849,381)
Total equity attributable to shareholders of the Company	**4,354,520**	5,690,293	5,754,995
Minority equity in capital deficit of a consolidated company	**(577,933)**	(521,320)	(564,250)
Total shareholders' equity	**3,776,587**	5,168,973	5,190,745
Total shareholders' equity and liabilities	**15,686,221**	19,347,891	17,544,660

Dov Weissglas	**Ika Abravanel**	**Ran Oz**
Chairman of the Board	Acting CEO	Deputy CEO and CFO

Date of approval of the financial statements: May 28, 2007.

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

Condensed Consolidated Interim Statements of Income

	For the three month period ended March 31		For the year ended December 31
	2007	2006	2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenue	**3,088,679**	3,012,099	12,231,830
Costs and expenses			
Depreciation and amortisation	**441,199**	460,080	1,864,035
Salary	**575,397**	567,214	2,586,437
Operating and general expenses	**1,422,770**	1,456,434	5,966,616
Other operating expenses (income), net	**(7,676)**	12,010	249,540
	2,431,690	2,495,738	10,666,628
Operating income	**656,989**	516,361	1,565,202
Financing costs			
Financing expenses	**162,387**	246,086	694,393
Financing income	**(104,519)**	(164,104)	(356,425)
Net financing expenses	**57,868**	81,982	337,968
Profit after financing expenses	**599,121**	434,379	1,227,234
Equity in profits of investees accounted by the equity method	**473**	1,591	11,184
Profits before income tax	**599,594**	435,970	1,238,418
Income tax	**214,527**	137,908	488,393
Profit for the period	**385,067**	298,062	750,025
Attributable to:			
The shareholders' of the Company	**398,750**	314,102	808,995
Minority in a consolidated company	**(13,683)**	(16,040)	(58,970)
Profit for the period	**385,067**	298,062	750,025
Earnings per share			
Basic and diluted earnings per share (in NIS)	**0.15**	0.12	0.31

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

Condensed Consolidated Interim Statements of Recognised Income and Expense

	For the three month period ended March 31		For the year ended December 31
	2007	2006	2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Net change in fair value of financial assets classified as available for sale	**972**	2,874	(1,464)
Net change in fair value of financial assets classified as available for sale transferred to profit and loss	**-**	21,851	(5,218)
Actuarial gains from a defined benefit plan (1)	**-**	-	3,427
Taxes in respect of income and expenses attributable directly to equity	**(277)**	(9,056)	2,227
Income and expenses recognised directly to equity	**695**	15,669	(1,028)
Profit for the period	**385,067**	298,062	750,025
Total recognised income and expense for the period	**385,762**	313,731	748,997
Attributable to:			
The shareholders' of the Company	**399,445**	329,771	807,967
Minority in a consolidated company	**(13,683)**	(16,040)	(58,970)
Total recognised income and expense for the period	**385,762**	313,731	748,997

(1) The Group does not recalculate its actuarial provisions in each reporting period, unless there are changes in the benefit plan or fundamental changes in market terms during the interim period. As a result, there are no actuarial earnings or losses in the reporting period.

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

Condensed Consolidated Interim Statements of Cash Flows

	For the three month period ended March 31		For the year ended December 31
	2007	2006	2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Cash flows from operating activities			
Net earnings for the period	**385,067**	298,062	750,025
Adjustments:			
Depreciation	**376,109**	413,912	1,591,054
Amortisation of intangible assets	**59,762**	40,145	247,557
Amortisation of deferred and other charges	**5,328**	6,023	25,424
Loss (Gain) from decrease in holdings in associates	**318**	(523)	(595)
Net financing costs	**11,857**	61,191	440,429
Equity in earnings of associates accounted by the equity method	**(473)**	(1,591)	(11,184)
Net capital gain principally due to disposal of property	**(16,843)**	(10,565)	(159,017)
Share-based payment transactions	**-**	-	286,506
Income tax expenses	**214,527**	137,908	488,393
Change in inventory	**(47,663)**	10,215	23,014
Change in trade receivables	**(12,959)**	38,249	109,100
Change in other receivables	**(52,256)**	(32,579)	(107,854)
Change in trade payables	**55,475**	50,633	(56,778)
Change in suppliers	**32,653**	(159,510)	(79,046)
Change in provisions	**15,349**	21,389	27,327
Change in broadcasting rights	**(31,469)**	(19,101)	(14,517)
Change in employee benefits	**(84,906)**	(23,023)	168,758
Change in deferred and other income	**37,850**	(1,183)	11,509
	947,726	829,652	3,740,105
Interest received	**43,068**	94,129	220,078
Dividend received	**-**	-	26,010
Income tax paid	**(137,888)**	(68,058)	(277,573)
Net cash from operating activities	**852,906**	855,723	3,708,620
Cash flows from investing activities			
Investment in intangible assets	**(49,499)**	(23,840)	(209,733)
Proceeds from sale of property, plant and equipment	**19,311**	13,383	47,804
Proceeds from realisation of deferred expenses	**4,213**	272	-
Current investments, net	**115,816**	(47,426)	1,491,439
Purchase of property, plant and equipment	**(177,493)**	(307,170)	(953,226)
Investment in deferred expenses and others	**(825)**	(2,041)	-
Proceeds from sale of investments and long-term loans	**7,870**	4,264	62,729
Purchase of investments and long-term loans	**-**	(9,507)	(19,723)*
Purchase of a subsidiary	**(12,468)**	-	-
Net cash from (used for) investment activity	**(93,075)**	(372,065)	419,290

* Reclassified

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

Condensed Consolidated Interim Statements of Cash Flows (Contd.)

	For the three month period ended March 31		For the year ended December 31
	2007	2006	2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Cash flows from financing activities			
Receipt of loans	**-**	-	50,000
Repayment of debentures	**(81,633)**	(148,968)	(280,350)
Repayment of loans	**(69,017)**	(161,081)	(1,268,656)
Short-term credit, net	**(32,023)**	46,316	43,146
Dividends paid	**(2,099,920)**	-	(1,600,000)
Interest paid	**(75,373)**	(89,335)	(601,752)
Net cash used for financing activities	**(2,357,966)**	(353,068)	(3,657,612)
Net increase (decrease) in cash and cash equivalents	**(1,598,135)**	130,590	470,298
Cash and cash equivalents at January 1	**2,631,790**	2,158,773	2,158,773
Effect of fluctuations in the rate of exchange on cash balances	**(667)**	1,341	2,719
Cash and cash equivalents at the end of the period	**1,032,988**	2,290,704	2,631,790

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

Appendix to Condensed Consolidated Interim Statements of Cash Flows

	For the three month period ended March 31		For the year ended December 31
	2007	2006	2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Appendix of activities not affecting cash flows			
Purchase of property, plant and equipment, and intangible assets	186,430	140,355	141,518
Sale of property, plant and equipment on credit	161,575	9,563	161,800

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

NOTE 1 – REPORTING ENTITY

A. Bezeq – The Israel Telecommunication Corp. Ltd. ("the Company") is a company domiciled in Israel whose shares are traded on the Tel Aviv Stock Exchange. The official address of the Company is 132 Menachem Begin Road, Tel Aviv. The consolidated financial statements of the Company comprise those of the Company and its subsidiaries (together referred to as the "Group"), and the Group's interests in affiliated companies. The Group is a principal provider of communications services in Israel (see Note – Segment Reporting).

B. On October 11, 2005, control in the Company was transferred from the State to Ap.Sb.Ar. Holdings Ltd. and the Company ceased to be a government company. The Company was declared a monopoly in the main areas in which it operates. An appeal filed by the Company was pending in the Antitrust Court against the non-revocation of its monopoly status in basic telephony; however, at the suggestion of the court (in view of the time elapsed since it was filed), the Company consented to withdraw the appeal and is considering a revised application for submission to the Antitrust Commissioner. All the segments of operation of the Group are subject to competition. The activities of the Group are, in general, subject to government regulation and control. It is expected that the regulation and control, as well as the intensifying competition, together with all the changes in the communications market, will have an adverse effect on the business results of the Group, an effect that the Group is unable to estimate.

NOTE 2 – BASIS OF PRESENTATION

A. The interim consolidated financial statements were prepared in accordance with the International Financial Reporting Standards ("IFRS"), as required for the preparation of interim financial statements in accordance with standard IAS 34 – Interim Financial Reporting, and in accordance with Section 4 of the Securities (Periodic and immediate reports) Regulations, 5730-1970.

B. These reports should be reviewed in the context of the annual financial statements of the Company and its subsidiaries as at December 31, 2006 and the year then ended, and their accompanying notes ("the annual financial statements"). The Group states in the notes to the financial statements only the material changes that have occurred from the date of the most recent financial statements until the date of these interim financial statements.

NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICIES

The significant accounting policies applied in these financial statements are consistent with those applied in the annual financial statements for the year ended December 31, 2006.

A. Initial application of accounting standards

Commencing January 1, 2007, the Group applies several standards and interpretations of the international accounting standards that have come into effect, as follows:

(1) IFRIC 7 – "Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies", that relates to the application of IAS 29 when an economy becomes hyperinflationary for the first time, and in particular the accounting treatment related to deferred tax.

(2) IFRIC 8 – "Scope of IFRS 2 Share-based Payment", that relates to the accounting treatment of share-based payment transactions in which some or all of the goods or services received cannot be specifically identified. IFRIC 8 was adopted by way of retroactive application.

(3) IFRIC 9 – "Reassessment of Embedded Derivatives", that determines that reassessment with regard to the need to separate an embedded derivative from a host contract will arise only when changes occur in the contract.

NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICIES (CONTD).

A. Initial application of accounting standards (contd.)

(4) IFRIC 11 – "Group and Treasury Share Transactions" is an interpretation dealing with the application of "IFRS 2: Share-based Payment", in share-based payment transactions related to the equity instruments of the Group.

(5) IFRIC 10 – "Interim Financial Reporting and Impairment", that prohibits the cancellation of an impairment loss that was recognised in a prior interim period in respect of goodwill, investment in an equity instrument or a monetary asset stated on a cost basis. IFRIC 10 applies to the financial statements of the Group for the year 2007.

The application of the new standards has no effect on the Group's results of operations and its financial position.

B. New standards during the period not yet adopted

IFRIC 12 – "Segment Reporting Arrangements". This interpretation relates to the accounting treatment of operators from the private sector that provides public infrastructure assets and services. IFRIC 12 creates a distinction between two types of arrangements for service concessions. In one, the operator receives a monetary asset, an unconditional contractual right to receive cash or other monetary assets from the government in exchange for the construction or upgrading of a public asset. In the other, the operator receives an intangible asset and the right to collect payment in return for the use of the public asset it is constructing or upgrading. The right to collect payment from users is not an unconditional right to receive cash, since the amounts depend on the scope of use the public will make of the service. The interpretation will apply to annual periods commencing on January 1, 2008 or thereafter, and early adoption is permitted. The adoption of IFRIC 12 is not expected to affect the financial statements of the Group.

NOTE 4 – ESTIMATES

The preparation of interim financial statements requires Management to make judgments and use estimates, assessments and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

The significant estimations applied in these interim statements do not differ significantly from those applied to the annual financial statements.

NOTE 5 – RATES OF CHANGES IN THE CONSUMER PRICE INDEX AND FOREIGN CURRENCY EXCHANGE RATES

The changes that occurred in the consumer price index and in the exchange rates of the US dollar and the euro in the accounting period are as follows:

	Consumer Price Index	Rate of exchange of the US dollar	Rate of exchange of the euro
	%	%	%
For the three month period ended on:			
March 31, 2007	**(0.23)**	**(1.66)**	**(0.54)**
March 31, 2006	0.58	1.35	3.95
For the year ended December 31, 2006	(0.10)	(8.21)	2.16

NOTE 6 – PROPERTY, PLANT AND EQUIPMENT

During the reporting period, the Group companies commenced examination of the useful lives of their property, plant and equipment in order to determine whether there are significant circumstances justifying a change in their estimated useful lives.

The findings of the examination to date indicate that due to the Company's intention to replace switches in its fixed-line network, it is necessary to shorten the useful lives of these switches. As a result of the aforementioned, depreciation expenses will increase in 2007 by approximately NIS 18 million, in 2008 by approximately NIS 18 million and in 2009 by approximately NIS 14 million, net before tax.

The examination also revealed that there are assets whose useful lives might exceed the present estimate, but at this stage a new estimate cannot be assessed. The companies will continue to examine whether these are significant circumstances which support this assessment, also taking into account a clarification of the Securities Authority that its decision regarding extension of the amortisation period of property, plant and equipment should also be implemented by corporations which report according to IFRS, so long as the Authority does not publish another directive.

NOTE 7 – GROUP ENTITIES

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

Since commencing operations, DBS has accumulated considerable losses. Its losses in 2006 amounted to approximately NIS 320 million and the loss in the three-month period ended March 31, 2007, amounted to approximately NIS 48 million. As a result of these losses, its capital deficit and its working capital deficit as at March 31, 2007, amounted to approximately NIS 2,909 million and NIS 1,552 million, respectively.

The Company's investment in DBS (primarily through shareholders' loans) at the balance sheet date amount to approximately NIS 1,562 million (without interest and linkage). The balance of the current debt of DBS to the Company and its subsidiaries amounts to approximately NIS 134 million, of which approximately NIS 111 million is owed to the Company. The Company has come to an arrangement with DBS for the collection of a debt balance of approximately NIS 50 million in arrears. Under the arrangement, the debt will be paid in 60 equal monthly instalments plus interest at prime + 1.5%. The remainder of the debt to the Company is a current debt balance, for which the terms of payment are the normal credit terms in effect between the Company and its customers.

During 2005, the banks completed the provision of the entire credit facility to which DBS was entitled under the financing agreements.

The terms of the loans and the credit facility that DBS received from the banks, the balance of which as at March 31, 2007 is NIS 1,376 million, impose various restrictions on DBS that include, *inter alia*, restrictions on the encumbrance or sale of certain assets, a restriction on receipt of credit from other banks without prior approval, a restriction concerning repayment of shareholders' loans, and a requirement for compliance with financial criteria ("the Conditions").

At the date of approval of the financial statements, DBS is in compliance with the Conditions laid down in the financing agreements (following a relief granted in connection with the financial criteria in respect of the first quarter of 2007), however the management of DBS does not expect that it will be in compliance with the Conditions in 2007 and thereafter. In view of this forecast, the bank loans are stated as part of current liabilities. DBS approached the banks for amendment and adjustment of the maturity dates for full repayment of the bank credit. As at the date of approval of the financial statements, these terms have not yet been agreed. The management of the subsidiary believes, based on past experience and talks with the banks, that the financial criteria are likely to be changed.

During 2005-2006, DBS was granted loans in the total amount of NIS 150 million by institutional entities. As at the date of approval of the financial statements, DBS holds an option for the receipt of an additional loan in the amount of NIS 50 million from one of the institutions. DBS is attempting to increase the option to NIS 100 million.

NOTE 7 – GROUP ENTITIES (CONTD.)

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

On January 2, 2005, the Antitrust Commissioner gave his conditional approval for a merger of the Company and DBS (increasing the holdings of the Company in DBS to more than 50%). The merger was not realised with the elapse of a year from the date of the approval, and a new consent was required. On August 2, 2006, the Company and DBS submitted new merger notices to the Antitrust Commissioner, in the matter of exercise of options for shares in DBS by the Company, which would increase the Company's holdings in DBS from approximately 49.8% to approximately 58%. On December 31, 2006, the Antitrust Authority gave notice of the Commissioner's opposition to the merger, and on February 18, 2007 it gave its reasons for the opposition. On May 15, 2007, the Company filed an appeal against the decision.

As at the date of approval of the financial statements, DBS exceeds the credit terms set in agreements with certain suppliers. DBS is acting to reduce the balances owed to these suppliers.

On December 24, 2006, the board of directors of DBS approved the budget for 2007. According to this aforementioned budget, DBS will require additional external financing in 2007. As at the date of approval of the financial statements, DBS is working to obtain additional sources of finance that will enable it to achieve the budget targets for the forthcoming year. If such sources cannot be found, DBS will operate in accordance with an alternative business plan that does not require additional funding beyond that available to it. The Management of DBS estimates, based on the 2007 budget and on the alternative business plan, that the chances of arranging the sources of financing required by DBS in the forthcoming year are good.

B. Bezeqcall International Ltd.

In pursuance to Note 32(4) to the Group's financial statements for the year 2006, regarding an agreement with Bezeqcall Communication Ltd. for the acquisition of all operations of Tadiran – Telecom Communication Services in Israel ("Tadiran") for a consideration of approximately NIS 93 million, the said agreement has been cancelled in light of the Antitrust Authority's decision to withhold approval of the transaction and following Tadiran announcement of its decision to cancel the agreement.

NOTE 8 – CONTINGENT LIABILITIES

A. Claims

During the normal course of business, legal claims have been filed against the companies in the Group, including applications for certification as class action lawsuits.

In the opinion of the managements of the Group's companies, based, *inter alia*, on legal opinions regarding the probability of success of the claims, including the applications for certification of the class action lawsuits, appropriate provisions, where such provisions were required, have been included in the financial statements to cover the exposure resulting from such claims.

In the opinion of the managements of the Group's companies, the additional exposure as at March 31, 2007, due to claims filed against the companies in the Group on various matters and the probability of realisation of which is remote or likely, amounts to approximately NIS 30 billion, of which approximately NIS 3.4 billion relates to claims filed by employees.

Concerning applications for certification as class action lawsuits in respect to which the Group has exposure beyond the aforesaid (since the claims do not state a specific amount), see claims in Note 17A(4), (5), (7) and (19) to the financial statements as at December 31, 2006 .

For a detailed description of these claims, see Note 17A to the Group's annual financial statements as at December 31, 2006. Details of the material changes to the status of the significant contingent liabilities of the Group at December 31, 2006 are provided below:

NOTE 8 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(1) Further to Note 17A4 to the financial statements as at December 31, 2006, on April 10, 2007, a ruling granted effect to the procedural arrangement, in which the Company and Bezeq International will be struck out from the claim (after undertaking to transfer any sum transferred to them from the Tax and VAT Department, if transferred, in connection with the claim, as instructed by the court.

(2) Further to Note 17A27 to the financial statements as at December 31, 2006, regarding application for certification of a class action against Pelephone concerning the allegation of the misleading of the defendant's subscribers who reside in Eilat, who were charged VAT for cellular communication service, the plaintiffs announced their intention to withdraw the claim. The parties are in the process of filing to the court an application requesting striking-off of the claim.

B. Claims in respect of which exposure cannot yet be assessed or calculated

For a detailed description of the claims in respect of which the exposure cannot yet be assessed or calculated, see Note 17B to the Group's annual financial statements as at December 31, 2006. Details of material changes since December 31, 2006 are provided below:

(1) In May 2007, a claim arrived at the Company's offices, together with a request to recognise it as a class action, that was filed by a plaintiff claiming to have purchased shares of the Company in 2006. The claim was filed against the Company, two former CEOs of the Company, directors who served in the Company during the relevant period, as well as Ap.Sb.Ar. Holdings Ltd., that holds 30% of the Company's shares.

The claim involves the assertion that the Company's financial statements for the years 2004 and 2005 contained false and misleading material information with respect to the annual profit, to property, plant and equipment and to shareholders' equity, considering a retroactive depreciation amounting to approximately NIS 320 million in respect of property, plant and equipment that was not in use by the subsidiary Pelephone Communications Ltd.

The amount of the personal action is NIS 194, and the total amount of the claim for the Group is NIS 56.5 million.

The Company is currently studying the claim and request, and at this stage is unable to asses their probability of success.

(2) In April 2007, an application was filed in the District Court for certification of a class action against DBS and against Sports Channel Ltd. (the producer of Channel 5, Channel 5+, Channel 5 live and Channel 5 gold)and its managers, in connection with the broadcasts of Channel 5 live ("the Certification Application"). According to the applicant, the broadcasts of Channel 5 live involve the transfer of content from Channel 5+ to Channel 5 live, which contravenes the basic promise of DBS as ratified in earlier legal proceedings. The applicant, whose cause of claim against DBS is violation of a contractual undertaking, breach of the duty of good faith in a contractual engagement and unjust enrichment, estimates the amount of the action at approximately NIS 63 million.

At this early stage, when DBS has not yet formulated its position and the relevant data for drafting the response have not yet been collated, the likelihood of the Application Certification being allowed and the prospects of the action if it is allowed, cannot be assessed.

C. Other contingencies

For a detailed description of other contingencies, see Note 17C to the Group's annual financial statements as at December 31, 2006. Details of material changes since December 31, 2006 are provided below:

NOTE 8 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (contd.)

(1) In May 2007, a letter arrived at the Company's offices, pursuant to Section 194 of the Companies Law, that was sent by a plaintiff who claims to be a holder of the Company's publicly owned shares.

According to the letter, following the findings of the external examiner appointed by the Company to examine the manner in which various decisions are made and as well as management of the Company, that point to a multitude of shortcomings and failures related directly to the work of the Board of Directors, its committees, its members and the former CEO of the Company, the Company is requested to take legal action against the Board of Directors and the Company's other officers who were responsible therefor.

The Company is assessing the allegations made in the letter, and will respond in accordance with the Companies Law.

(2) Further to Note 17C2 to the Group's annual 2006 financial statements regarding a letter concerning commissions paid to DBS and the debts of DBS to the Company, the Company intends to recommend to the Board of Directors that it reject the aforementioned letter (after having obtained the consent of the writer to an extension for preparing its reply).

(3) Further to Note 17C1 to the Group's annual 2006 financial statements, the Antitrust Commissioner announced on May 27, 2007, that it is considering exercising its authority under Section 43(A)(5) of the Antitrust Law, 5748-1988, to determine that the Company abused its status, contrary to the provisions of Section 29A of that Law, in view of the findings of an investigation carried out recently by the investigations department of the Antitrust Authority.

The Commissioner is considering determining that –

a. In the first half of 2006, and in particular in April and May 2006, the Company's employees imposed sanctions concerning delaying the performance of works or not performing works for the connection of domestic operators (Cellcom, Globecall and Golden Lines) to the Company's network.

b. During the afternoon of May 17, 2006, an existing connection between HOT Telecom and the Company's network was disconnected and was not repaired, due to sanctions of Company employees, until the night of May 18, 2006.

c. The Company failed to act as required in order to prevent or minimise these events and the harm to domestic operators, competition and the public.

d. In this way, the Company abused its status, in contravention of Section 29A of the Law.

Under Section 43(e) of the Antitrust Law, the Commissioner's determination, if and insofar as made, shall serve as *prima facie* evidence in any legal proceeding.

The Company was given until June 17, 2007 to state its position to the Commissioner. The Company is studying the notice and intends to exercise its right to a hearing.

It is noted that in May 2006, a claim was filed against the Company and against the cable company, with an application for certification as a class action, concerning a fault in the telephone line in the HOT network on May 17, 2006. On this matter, see Note17A(12) to the financial statements of the Company at December 31, 2006.

(4) Further to Note 17C7 to the Group's annual 2006 financial statements concerning number portability, on May 24, 2007, the Company received a notice from the Director General of the Ministry of Communications, stating that he is considering imposing a financial sanction on the Company in respect of alleged violation of the duty to provide number portability commencing September 1, 2006, as follows:

NOTE 8 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (contd.)

1. For the period from September 1, 2006 to the date of the Director General's notice – a financial sanction of NIS 2,031,750.

2. For the period from May 25, 2007 to November 30, 2007 or until the date of remedy of the alleged violation (whichever is earlier) by the Company – NIS 6,450 for each additional day the violation continues.

3. For the period from December 1, 2007 (which allows, according to the notice, the reasonable time required by the relevant licensees to remedy the alleged violation) until the date of remedy of the alleged violation – a financial sanction as described in sections 37B(b) and 37C(a) of the Communications Law after Amendment 36. (It is noted that according to the provisions of those sections, the rate of the relevant sanction is 7 times the penalty laid down in section 61(a)(4) of the Penal Law (which is NIS 202,000), plus 0.25% of the annual income of the Company, plus a financial sanction of one fiftieth of such sanction for each day on which the violation continues.)

The subsidiaries Pelephone Communications Ltd. and Bezeq International Ltd. received similar notices. In the Ministry's notice, Pelephone and Bezeq International were given an opportunity to state their positions to the Director General of the Ministry of Communications by June 24, 2007. As noted in the financial statements as at December 31, 2006, the Company and Pelephone (together with other cellular companies) petitioned the High Court of Justice on this matter, contending, *inter alia*, that it was the Ministry of Communications which had not prepared a number portability plan as required by the provisions of the law. The Company, Pelephone and Bezeq International are studying the implications of the notices, and each of them will respond accordingly.

NOTE 9 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES

A. Transactions with interested parties and related parties

	For the three month period ended March 31		For the year ended December 31
	2007	2006	2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Sales of products and services			
Telephony services –			
The State of Israel	**82,285**	82,968	368,487
Others	**-**	706	3,267
Expenses –			
State of Israel –			
Royalties	**48,364**	63,194	180,941
Frequencies	**2,854**	4,777	29,342
Others (mainly purchase of satellite segments)	**31,493**	35,188	124,256
Balances with related parties – Loans and long-term debts of interested parties			
Loans and debts – index-linked, with no maturity date and bearing no interest	**868**	875	872

NOTE 9 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

B. Further to Note 29D to the Company's financial statements as at December 31, 2006, concerning the cancellation of discount arrangements included in the agreement between the Company and the Ministry of Defence dated May 8, 2005, the Company informed the Ministry of Communications and the Ministry of Defence on April 22, 2007, of its decision to comply with this demand. It should be noted that the Company received a copy of the letter sent by the Ministry of Defence to the Ministry of Communications, which contained a request that the instruction regarding cancellation of the discount arrangements determined in the agreement between the parties be frozen, until the convening of a work meeting between the Ministry of Defence and the Ministry of Communications that will discuss the subject. As of the date of publication of this report, the Company has yet to receive a different instruction from the Ministry of Communications. It should be noted that in the Company's opinion, it was entitled to enter into the agreement in accordance with its general license. In addition, according the Antitrust Authority's notice dated August 2006, the agreement does not contravene the provisions of the Antitrust Law, and the Authority saw no justification, at that time, to insist on cancellation of the agreement. The Company notified the Ministry of Communications of the Antitrust Authority's position, already, in August 2006. It is further noted, that according to the agreement between the Company and the Ministry of Defence, according to which, should one of the parties be unable to fulfil its undertakings provided for in the agreement due to a legal directive or resolution of a competent authority, the same shall not constitute breach, and the parties shall negotiate another agreement, the terms of which shall reflect, to the extent possible, the wishes of the parties in accordance with the agreement. The Company has requested urgent meetings and negotiations with the Ministry of Defence, but the request has not yet been granted.

The Company is unable to assess the developments at this stage, and therefore the financial statements include income from the Ministry of Defence, based on the rates in the agreement dated May 8, 2005, that are estimated to be lower than the rates in the old (2002) agreement and lower than the Company's regular rates.

NOTE 10 – REVENUE

	For the three month period ended March 31		For the year ended December 31
	2007	2006	2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Fixed-line domestic communications	**1,258,168**	1,273,608	5,086,022
Cellular telephone	**881,659**	844,210	3,493,541
Multi-channel television	**349,917**	309,913	1,284,337
Sale of equipment to subscribers, installations and miscellaneous	**313,603**	295,754	1,170,771
International communications and internet services	**235,125**	228,798	963,942
	3,038,472	2,952,283	11,998,613
Other revenues	**50,207**	59,816	233,217
	3,088,679	3,012,099	12,231,830

NOTE 11 – OPERATING AND GENERAL EXPENSES

	For the three month period ended March 31		For the year ended December 31
	2007	2006	2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
General expenses	**256,706**	278,412	1,169,107
Cellular telephone expenses	**452,108**	459,942	1,854,347
Materials and spare parts	**219,949**	197,292	922,449
Consumption satellite services content	**104,046**	108,442	441,268
Services and maintenance by sub-contractors	**101,909**	111,194	428,424
Building maintenance	**81,903**	84,257	347,849
International communication expenses	**98,567**	96,406	383,496
Motor vehicle maintenance expenses	**45,831**	44,968	190,079
Royalties to the Government of Israel	**48,364**	63,194	179,589
Collection fees	**13,387**	12,327	50,008
	1,422,770	1,456,434	5,966,616

NOTE 12 – CONDENSED DATA FROM THE INTERIM SEPARATE FINANCIAL STATEMENTS OF THE COMPANY

Income statement

	For the three month period ended March 31		For the year ended December 31
	2007	2006	2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenue	**1,442,342**	1,454,516	5,798,996
Costs and expenses			
Depreciation and amortisation	**237,415**	257,676	1,026,469
Salary	**309,779**	310,887	1,557,000*
General and operating expenses	**532,905**	566,298	2,233,167*
Other expenses (income), net	**(6,939)**	11,903	228,893
	1,073,160	1,146,764	5,045,529
Operating income for the period	**369,182**	307,752	753,467

* Reclassified

NOTE 13 –SEGMENT REPORTING

The Company and the investee companies operate in various segments of the communications sector. Data on activities by segment are stated by the segments of operation of these companies.

For the three-month period ended March 31, 2007 (unaudited)

	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP services	Multi-channel television	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenue							
Revenues from external sources	**1,362,116**	**1,067,806**	**305,769**	**349,917**	**3,071**	**-**	**3,088,679**
Inter-segment revenues	**80,226**	**79,627**	**16,873**	**3,669**	**11,413**	**(191,808)**	**-**
Total revenue	**1,442,342**	**1,147,433**	**322,642**	**353,586**	**14,484**	**(191,808)**	**3,088,679**
Segment results	**369,182**	**213,119**	**50,825**	**24,001**	**(138)**	**-**	**656,989**

For the three-month period ended March 31, 2006 (unaudited)

	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP services	Multi-channel television	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenue							
Revenues from external sources	1,386,562	1,002,346	296,593	321,949	4,649	-	3,012,099
Inter-segment revenues	67,954	86,078	20,473	5,049	9,017	(188,571)	-
Total revenue	1,454,516	1,088,424	317,066	326,998	13,666	(188,571)	3,012,099
Segment results	307,752	174,764	35,578	(1,645)	(88)	-	516,361

NOTE 13 –SEGMENT REPORTING (Contd.)

	For the year ended December 31, 2006 (audited)						
	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP services	Multi-channel television	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenue							
Revenues from external sources	5,514,799*	4,140,771*	1,016,300	1,338,826	221,134	-	12,231,830
Inter-segment revenues	284,197*	337,216*	21,519	23,563	97,545	(764,040)	-
Total revenue	5,798,996	4,477,987	1,037,819	1,362,389	318,679	(764,040)	12,231,830
Segment results	746,320	691,682	131,416	7,707	(11,923)	-	1,565,202

* Reclassified.

NOTE 14 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION

As noted in the financial statements for the year 2006, the Group first adopted IFRS in 2006, with January 1, 2005 set as the transition date. In preparing its opening balance sheet in accordance with IFRS and in the Group balance sheet as at January 1, 2006, the Group has adjusted amounts reported previously in financial statements prepared in accordance with its previous basis of accounting (Israeli GAAP).

Explanations of the significant effects of the transition from Israeli GAAP to IFRS on the Group's financial position and on its results of operation as of March 31, 2006 and for the three-month period then ended, are provided below. For the full explanations in respect to the transition from Israeli GAAP to IFRS on the transition date and in respect to the reserve balance as at January 1, 2006, see Note 33 to the Group's financial statements for the year 2006.

Significant adjustments to the balance sheet line items

	Note	Israeli GAAP	Effect of the transition to IFRS March 31, 2006	IFRS
		NIS thousands	NIS thousands	NIS thousands
Property, plant and equipment	a-f, k, l	9,439,069*	(2,392,987)	7,046,082
Intangible assets	d, g	1,699,546	895,685	2,595,231
Deferred tax assets	a-c, g, h, l	578,560*	441,322	1,019,882
Equity capital	a - l	6,965,018*	(1,796,045)	5,168,973

Significant adjustments to the income statement line items

	Note	Israeli GAAP	Effect of the transition to IFRS March 31, 2006	IFRS
		NIS thousands	NIS thousands	NIS thousands
Revenue		3,020,255*	8,156	3,012,099
Costs and expenses	a - l	2,610,674*	(114,936)	2,495,738
Net earnings for the year (attributable to shareholders of the Company)	a - l	232,244*	81,858	314,102
Earnings per share				
Basic and diluted earnings per share (in NIS)		0.09*	0.03	0.12

* Restated – see section (l) below.

NOTE 14 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

Notes to the material adjustments

a. As of the transaction date, the Group chose to state some of the property, plant and equipment items (the switching, transmission and power group) at their fair value and to determine this value as deemed cost, in accordance with the relief under IFRS 1. The deemed cost was based on an external expert opinion. As a result, the property, plant and equipment balance decreased by NIS 1,329 million at March 31, 2006, to a fair value of approximately NIS 1,803 at that date, while the deferred tax balances deriving from the differences in the measurement of the property, plant and equipment for tax purposes changed compared with the presentation of property, plant and equipment for accounting purposes, by approximately NIS 380 million as at March 31, 2006. The reserve balances were reduced on that date by the net amounts. The depreciation expenses for the three-month period ended on March 31, 2006 decreased by NIS 86 million.

b. On the date of transition to IFRS, in accordance with the directives of IAS 16, the residual value of the property, plant and equipment not included in the calculation of depreciation according to accepted accounting principles in Israel was measured. The revaluation was based on an opinion of an external appraiser. The effect was to increase the property, plant and equipment balances by approximately NIS 43 million and to reduce the depreciation expense for the three month period ended on December 31, 2006 by approximately NIS 12 million. Another effect was to change the deferred tax balances derived from the differences in the measurement of the property, plant and equipment for tax purposes as compared with the presentation of property, plant and equipment fin the financial statements. The reserve balances were reduced by the same net amounts as at the above dates.

c. Under IAS 37, the Group is required to recognise liabilities to bear the costs of site decommissioning and clearing. Under IFRS 1, the Group selected a relief that allowed it to capitalise the expected costs of decommissioning and clearing sites at the transition date at historical capitalization rates.
As a result, the property, plant and equipment balances as at March 31, 2006 increased by NIS 17 million, and the reserve balance decreased by approximately and NIS 12 million (net of tax) as at the same date.

d. Under IFRS, computer software and capitalised software development costs that do not constitute an integral part of the hardware attributed to them, are treated as intangible assets. Accordingly, with the transition to IFRS, the carrying balances at March 31, 2006, of approximately NIS 495 million, relating to computer software and to capitalised software development costs, were reclassified from the property, plant and equipment item to the intangible assets item.

e. Under accepted accounting principles in Israel, agreements granting the Group an indefeasible right of use of sea-bed cable capacity were treated as a finance lease and a related asset was recognised in the balance sheet in the property, plant and equipment item. Under IFRS and as provided for in IFRIC 4, that determines whether an arrangement includes a lease, there are criteria for determining whether a right to use an asset is an arrangement having the form of a lease. If it is not a lease, the arrangement should be classified as an arrangement for receipt of services. The effect of application of the provisions of IFRS and in the absence of the criteria required for the said arrangements to be defined as a lease, the amounts paid to the suppliers for a future right of use of sea-bed cable capacity were classified as deferred and other long-term expenses.

The effect of the transition to IFRS was to decrease property, plant and equipment by approximately NIS 169 million at March 31, 2006, against an increase in the following items:

(1) Other accounts receivable (prepaid expenses), of approximately NIS 19 million as at March 31, 2006.

(2) Other long-term assets (long-term prepaid expenses in respect of a right of use of capacity), of approximately NIS 150 million.

NOTE 14 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

f. Under accepted accounting principles in Israel, customer acquisition costs in a subsidiary were partially capitalised to property, plant and equipment and depreciated over 6 years, and a part of the same was charged as a current expense to profit and loss. Under IFRS, these costs were capitalised and are depreciated over the terms of the contractual engagement of the subscriber, that are usually one year.

The difference between the accumulated depreciation under accepted accounting principles in Israel and the accumulated depreciation under IFRS for the three-month period ended on March 31, 2006 amounts to approximately NIS 295 million (decrease in property, plant and equipment), and the effect on the depreciation expenses for the three-month period ended on March 31, 2006 is a decrease of approximately NIS 9 million.

g. Under accepted accounting principles in Israel, the Group recognised as an asset the net direct costs paid to a third party in respect of sale to subscribers who signed a commitment to remain customers of the Group. These costs included the commissions paid to external dealers, as well as the losses in respect of subsidising the terminal equipment for customers ("Subscriber Acquisition"). This Subscriber Acquisition was depreciated to profit and loss over the term of the customer commitment, that is up to 36 months.

Under IAS 38, the Group defers only the incremental direct sales commissions to employees and to external dealers in respect of sales to those subscribers who signed a commitment to remain customers of the Group. These costs are depreciated to profit and loss over the term of the commitment of the subscribers, which is up to 36 installments. The losses in respect of subsidising the telephones is attributed to profit and loss and are not deferred. As a result, the Subscriber Acquisition asset as at March 31, 2006 was reduced by approximately NIS 84 million. The effect on profit and loss for the three month period is an increase of approximately NIS 6 million before tax.

h. Under IFRS, deferred tax assets are classified as non-current assets, even if the expected date of their realisation is expected to be in the short term. Under accepted accounting principles in Israel, deferred tax assets were classified as current or non-current assets, depending on the classification of the assets in respect of which they were generated.

Accordingly, with the transition to IFRS, the balance of short-term deferred taxes was reclassified, as at March 31, 2006, in the amount of approximately NIS 200 million, from the accounts receivable and debit balances item under current assets, to the deferred tax item under non-current assets (in this Note, the deferred taxes are stated after the above reclassification).

i. Under IFRS, bank loans to a subsidiary, of approximately NIS 1,284 million, were stated as short-term loans, while under accepted accounting principles in Israel these loans were classified as long-term loans. The classification was changed since the subsidiary failed to meet financial criteria set by the banks for these loans on the balance sheet date.

j. Under accepted accounting principles in Israel, the minority item in the Company is measured at the amount of the loans provided by the minority for DBS, a subsidiary, at their carrying value in the investee company, and stated net of those loans.

Under IFRS, the minority rights are stated in the consolidated balance sheet as a separate component of the shareholders' equity, in the amount of the loans provided by the minority for a subsidiary at their fair value, plus the costs of financing in respect of those loans, accumulated from the acquisition date to the balance sheet date. The minority equity in the capital deficit of the subsidiary is stated under distribution of profits between the majority shareholders and the minority shareholders.

NOTE 14 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

k. Other classifications made in accordance with the provisions of IFRS:

1. Leases of land from Israel Lands Administration classified as operating leases, of approximately NIS 119 million at March 31, 2006, were reclassified from the property, plant and equipment item to the deferred expenses item.
2. Materials and spare parts that were stated in a separate item between the current assets item and the property, plant and equipment item in the amount of NIS 76 million as at March 31, 2006.
3. Other income, net, was classified under other operating income, net.

l. Restatement

The financial statements as at March 31, 2006, were adjusted by way of restatement in order to retroactively reflect the following changes:

(1) Recording of amortisation of lease payments in respect of land from the Israel Lands Administration over the term of the lease and not as amortised since the establishment of the Company (4%). The effect of this amendment is the addition of approximately NIS 105 million to property, plant and equipment, and of approximately NIS 80 million to the balance of shareholders' equity as at March 31, 2006. The amendment does not have a significant effect on the profit for the year.

(2) Presentation of receipts from interconnect to the cellular networks, that were not stated commencing 2000 as part of the Company's income, and correspondingly as an operating expense in the same amount, following examination of the criteria under international standards and in order to present them as accepted in Israel and worldwide. The effect of this amendment is an increase to income and a corresponding increase to operating and general expenses of approximately NIS 201million.

(3) Amendment of the accounting treatment of the depreciation of property, plant and equipment not used by Pelephone, and the resulting tax implications. The effect of this amendment is to depreciate property, plant and equipment by approximately NIS 275 million, and to reduce the balance of shareholders' equity by approximately NIS 200 million March 31, 2006, as well as to reduce depreciation expenses by approximately NIS 10 million and to increase net profit by approximately NIS 10 million for the three month period ended on March 31, 2006.

NOTE 14 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

I. Restatement (Contd.)

The table below shows the effect of restatement as aforesaid on the comparison numbers according to accepted accounting principles in Israel at March 31, 2006, before the effects of IFRS.

(1) Effect on the consolidated balance sheet

	As previously reported	Effects of restatement	As reported in these financial statements prior to their adjustment to IFRS
	NIS thousand	NIS thousand	NIS thousand
Property, plant and equipment	9,609,751	(170,682)	9,439,069
Deferred tax assets	526,232	52,328	578,560
Shareholders' equity	7,083,372	(118,354)	6,965,018

(2) Effect on undesignated retained earnings (deficit)

	As at March 31 2006
	NIS thousand
As previously reported	(1,032,194)
Effect of restatement	(118,354)
	(1,150,548)

(3) Effect on net earnings

	For the three-month period ended March 31, 2006
	NIS thousand
Net earnings as reported in the past	225,512
<u>Effect of restatement</u>	
Increase in revenue	201,000
Decrease in depreciation expenses and amortisation	9,159
Increase in operating and general expenses	(201,000)
Increase in income tax	(2,427)
Net earnings as reported in these financial statements in the note on adjustment to IFRS	232,244

NOTE 15 –CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD.

1. Pelephone Communications Ltd.

A. Balance sheet

	March 31, 2007	March 31, 2006	December 31, 2005
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**1,660,043**	1,799,432	1,451,006
Non-current assets	**2,445,770**	2,780,635	2,520,473
	4,105,813	4,580,067	3,971,479
Current liabilities	**1,171,077**	1,725,654	1,089,973
Long-term liabilities	**1,283,439**	1,591,588	1,383,859
Total liabilities	**2,454,516**	3,317,242	2,473,832
Shareholders' equity	**1,651,297**	1,262,825	1,497,647
	4,105,813	4,580,067	3,971,479

B. Income statement

	For the three month period ended March 31		For the year ended December 31
	2007	2006	2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from services and sales	**1,147,433**	1,088,424	4,477,987
Cost of services and sales	**808,221**	792,801	3,250,303
Gross profit	**339,212**	295,623	1,227,684
Sales and marketing expenses	**102,425**	97,706	417,178
General and administrative expenses	**23,668**	23,154	110,008
	126,093	120,860	527,186
Operating income	**213,119**	174,763	700,498
Financing expenses (income), net	**(7,879)**	2,852	17,687
Earnings before income tax	**220,998**	171,911	682,811
Income tax	**66,914**	45,641	196,910
Net earnings for the period	**154,084**	126,270	485,901

NOTE 15 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD. (CONTD.)

2. D.B.S. Satellite Services (1998) Ltd.

A. Balance sheet

	March 31, 2007	March 31, 2006	December 31, 2005
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**375,965**	355,095	338,662
Non-current assets	**672,244**	744,117	677,732
	1,048,209	1,099,212	1,016,394
Current liabilities	**1,927,752**	1,975,643	1,889,416
Non-current liabilities	**2,029,224**	1,750,050	1,987,634
Total liabilities	**3,956,976**	3,725,693	3,877,050
Capital deficit	**(2,908,767)**	(2,626,481)	(2,860,656)
	1,048,209	1,099,212	1,016,394

B. Income statement

	For the three month period ended March 31		For the year ended December 31
	2007	2006	2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenue	**353,586**	332,046	1,355,735
Cost of income	**269,736**	282,525	1,139,308
Gross profit	**83,850**	49,521	216,427
Sales and marketing expenses	**34,716**	32,490	122,996
General and administrative expenses	**25,133**	22,700	94,313
Operating earnings (loss)	**24,001**	(5,669)	(882)
Financing expenses, net	**72,112**	78,529	318,925
Net loss for the period	**(48,111)**	(84,198)	(319,807)

NOTE 15 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD. (CONTD.)

3. Bezeq International Ltd.*

A. Balance sheet

	March 31, 2007	March 31, 2006	December 31, 2005
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**410,549**	233,098	332,526
Non-current assets	**422,384**	354,502	340,734
	832,933	587,600	673,260
Current liabilities	**350,364**	240,277	307,724
Long-term liabilities	**50,202**	14,798	15,613
Total liabilities	**400,566**	255,075	323,337
Shareholders' equity	**432,367**	332,525	349,923
	832,933	587,600	673,260

B. Income statement

	For the three month period ended March 31		For the year ended December 31
	2007	2006	2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenue	**322,642**	241,533	1,021,573
Operating expenses	**215,465**	157,579	662,244
Gross profit	**107,177**	83,954	359,329
Sales and marketing expenses	**35,378**	34,566	148,594
General and administrative expenses	**21,711**	16,162	71,806
Other income (expenses), net	**(737)**	206	7,064
Operating income	**50,825**	33,020	131,865
Financing costs, net	**(637)**	(9,404)	(6,965)
Equity in earnings of an associate accounted for by the equity method	**474**	1,624	11,051
Earnings before income tax	**50,662**	25,240	135,951
Income tax	**14,158**	7,596	40,391
Net earnings for the period	**36,504**	17,644	95,560

* The above financial statements are presented solely in accordance with International Financial Reporting Standards (IFRS). In addition, commencing January 1, 2007, the financial statements include the operations of BezeqCall Communications Ltd.

NOTE 16 – MATERIAL EVENTS DURING THE REPORTING PERIOD AND EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

A. On February 27, 2007, the Company's Board of Directors approved the allocation to the Company's executives of 56,836,888 options that are exercisable into 56,836,888 ordinary shares of the Company, par value NIS 1 each, each representing 2.1818% of the Company's issued capital before issue of the shares.

Following an enquiry of the Securities Authority in this matter and the results of the Company's review of the plan approval process, the Company's Board of Directors resolved on March 15, 2007, to have this options plan and the related publicised profile in respect thereof, cancelled. The Board of Directors intends to work towards the formulate a compensation plan for executives to replace the one cancelled.

B. In May 2007, the subsidiary Bezeq Zahav (Holdings) Ltd. ("Bezeq Zahav") sold 100,000,000 par value of Debentures (Series 5) of the Company on the Tel Aviv stock exchange, out of the Debentures (Series 5) it purchased from the Company prior to the publication of the Company's prospectus on May 24, 2004 ("the Prospectus"), and which were listed for trading in accordance with the Prospectus. The execution rate of the sale is 111.9 (reflecting a yield to redemption of approximately 3.67%).

The proceeds from the sale, NIS 111,900,000, will be transferred to the Company by Bezeq Zahav in (partial) repayment of the loan granted to Bezeq Zahav by the Company for purchasing the Debentures (Series 5), as provided in the loan agreement between the parties.

C. Following an enquiry of the Securities Authority, it was decided to appoint an external examiner to investigate the matter of compensation granted to officers in the Company since the transfer of control in the Company from the State to Ap.Sb.Ar. Holdings Ltd. (including approval of the stock option plan for employees and managers, and approval of grants for officers), and to investigate the matter of restatement in the Group's financial statements as at December 31, 2004 and 2005. On April 26, 2007, the examiner submitted a report detailing the findings of his examination. The report specifies the shortcomings in the Company’s work and methods to prevent their recurrence in the future, in respect of all matters examined. The Company's Board of Directors discussed the findings of the reports and resolved, *inter alia*, to work towards implementation of the recommendations and to learn the lessons, as required by the report. The Board of Directors also approved a joint announcement from the Company and its CEO, stating that the CEO will end his tenure as CEO of the Company. Decisions were made concerning, *inter alia*, the work procedures of the Board of Directors and composition of its committees. On the matter of contingent liabilities submitted to the Company in respect of the aforementioned, see Notes 8B and 8C.

Subsequently, the Board of Directors of the Company discussed and re-approved the grant of bonuses to officers (excluding the outgoing CEO) in respect of the years 2005 and 2006.

NOTE 17 – DETAILS OF ADDITIONAL MOVEMENTS IN THE SHAREHOLDERS' EQUITY

	Share capital	Premium on shares	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of financial assets available for sale	Capital reserve in respect of option warrants for employees	Balance of deficit	Total	Minority rights in capital deficit of a subsidiary	Total equity
	NIS thousands								
	Refers to shareholders of the Company								
Three-month period ended March 31, 2007									
Balance as at January 1, 2007 (audited)	**6,309,133**	**1,623,423**	**384,684**	**630**	**286,506**	**(2,849,381)**	**5,754,995**	**(564,250)**	**5,190,745**
Total earnings (losses) recognised in the period (unaudited)	-	-	-	695	-	398,750	399,445	(13,683)	385,762
Dividends to shareholders of the Company which does not comply with the earnings test (unaudited)	(176,497)	(1,623,423)	-	-	-	-	(1,799,920)	-	(1,799,920)
Balance as at March 31, 2007 (unaudited)	**6,132,636**	**-**	**384,684**	**1,325**	**286,506**	**(2,450,631)**	**4,354,520**	**(577,933)**	**3,776,587**
Three-month period ended March 31, 2006									
Balance as at January 1, 2006 (audited)	6,309,133	1,623,423	384,684	5,253	-	(1,761,971)	6,560,522	(505,280)	6,055,242
Total earnings (losses) recognised for the period (unaudited)	-	-	-	15,669	-	314,102	329,771	(16,040)	313,731
Dividends to shareholders of the Company (unaudited)	-	-	-	-	-	(1,200,000)	(1,200,000)	-	(1,200,000)
Balance as at March 31, 2006 (unaudited)	6,309,133	1,623,423	384,684	20,922	-	(2,647,869)	5,690,293	(521,320)	5,168,973

* On December 28, 2006, the general assembly of the shareholders of the Company approved the proposal of the Board of Directors regarding allocation of a cash dividend of approximately NIS 1.8 billion (at NIS 0.69 per share) as a dividend which does not meet the income test. On February 4, 2007 a court approved the dividend and as such the allocation was carried out on February 26, 2007.

NOTE 17 – DETAILS OF ADDITIONAL MOVEMENTS IN THE SHAREHOLDERS' EQUITY (CONTD.)

	Share capital	Premium on shares	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of financial assets available for sale	Capital reserve in respect of option warrants for employees	Balance of deficit	Total	Minority rights	Total equity
	NIS Thousands								
	Refers to shareholders of the Company								
The year ended December 31, 2006									
Balance as at January 1, 2006 (audited)	6,309,133	1,623,423	384,684	5,253	-	(1,761,971)	6,560,522	(505,280)	6,055,242
Total earnings (losses) recognised for the period (audited)	-	-	-	(4,623)	-	812,590	807,967	(58,970)	748,997
Dividends to shareholders of the Company (audited)	-	-	-	-	-	(1,900,000)	(1,900,000)	-	(1,900,000)
Share-based payments made by the Company (audited)	-	-	-	-	286,506	-	286,506	-	286,506
Balance as at December 31, 2006	6,309,133	1,623,423	384,684	630	286,506	(2,849,381)	5,754,995	(564,250)	5,190,745