November 24, 2008

"Bezeq" The Israel Telecommunication Corp. Limited

Quarterly Report for the period ending 30.9.08

Update of Chapter A (Description of Company Operations) of the Periodic Report for 2007

Directors' Report on the State of the Company's Affairs for the period ended September 30, 2008

Condensed Interim Consolidated Financial Statements as at September 30, 2008

Update of Chapter A (Description of Company Operations) of the Periodic Report for 2007

UPDATE OF CHAPTER A (DESCRIPTION OF COMPANY OPERATIONS)[1]
OF THE PERIODIC REPORT FOR 2007 ("THE PERIODIC REPORT")
OF "BEZEQ" – THE ISRAEL TELECOMMUNICATIONS CORP. LTD. (HEREINAFTER: "the Company")

In this report, which contains an update of the chapter regarding the description of the Company's business in the 2007 periodic report, the Company has included forward-looking information, as defined in the Securities Law 5728-1968 (hereinafter: the "Securities Law") with respect to both itself and the market. Such information includes forecasts, goals, appraisals and assessments which apply to future events or matters the occurrence of which are not certain and are not within the Corporation's control. Forward-looking information in this report will usually be identified specifically, or by employing statements such as "the Company expects", "the Company estimates", "it is the Company's intention", and similar statements.

Forward-looking information is not a proven fact and is based only on the Corporation's subjective assessment, which relies on its assumptions based, *inter alia*, on a general analysis of the information available at the time of drafting of this report, including public announcements, research and surveys, which contain no undertakings as to the correctness or completeness of the information contained therein, and whose correctness has not been independently corrected by the Corporation. The Corporation's assessments vary from time to time in accordance with the circumstances.

In addition, the occurrence or non-occurrence of the forward-looking information will be affected by factors that cannot be assessed in advance, and which are not within the Corporation's control Corporation, including the risk factors that characterize its operations as set out in this report, and additionally, developments in the general environment, and external factors and the regulation that affects the Corporation's operations, as set out in this report.

1. Description of General Development of Group Operations

Section 1.1 – Group Activity and Description of its Business Development

A. The Worldwide Economic Crisis

During the current quarter, subsequent to the worldwide economic crisis, global markets have entered a slowdown and credit choke. It is assumed that this situation will continue to be felt throughout 2009 and possibly worse, with a shift from growth to recession. A significant slowdown and decline of business operations and key economic parameters are also expected in the local market. The Corporation assumes that this crisis may have a negative impact on its operations, but cannot at this stage estimate the scope of such impact on the Group's operation

This information includes forward looking information based on internal estimates of the Company. The actual results may be materially different from the foregoing estimates if changes take place in any of the factors taken into account for this assessment.

B. Gronau Committee Report

On March 12, 2008, the Gronau Committee, appointed by the Minister of Communications to formulate detailed recommendations regarding policy and rules of competition in the field of communications in Israel (the "Gronau Committee"), published its Report. Following are the principal summary recommendations:

Fixed-Line Sector

1. To act to develop the wholesale market in the fixed-line sector, centered around the local loop unbundling (hereinafter - "LLU") obligation. In this context, the owners of the universal infrastructure are required to sell services wholesale and lease access segments to competitors. For reasons of technological applicability, at this stage the local loop unbundling obligation will only apply to the Company.

[1] The update is pursuant to Article 39A of the Securities Regulations (Periodic and Immediate Reports), 5730-1970, and includes material changes or innovations that have occurred in the corporation in any matter which must be described in the Periodic Report. The update relates to the Company's periodic report for 2007 and relates to the section numbers in Chapter A (Description of Company Operations) in such periodic report.

2. Within 15 months of the date of adoption of the recommendation by the Minister of Communications, the regulating body will publish maximum tariffs for the leasing of access segments and other services sold on the wholesale market (bitstream access services, resale, etc.) and the conditions for provision of such services. Such tariffs and conditions are to be determined subsequent to hearing the positions of the entities operating in the segment.

3. To grant a permit to the Company's subsidiaries to supply non-degradable service packages[2], including Bezeq Fixed-Line telephony and broadband services and IPTV, after implementation of the arrangement set out in section 1 above. On that date, the subsidiaries of the Company shall also be entitled to receive special licenses for the supply of domestic carrier services that are not VOB.

4. So long as the Bezeq Group's market share is greater than 60%, supervision of the Company's tariffs shall continue in the format of fixing binding tariffs (fix); various restrictions (as set out in the recommendations) shall be set with respect to approval of alternative tariff bundles for the Company; with respect to supervised tariffs - up until the middle of 2009, cost-based tariffs will be prescribed for call completion on the fixed-line network; with respect to non-supervised tariffs, "loyalty discounts" will be prohibited so long as the Company is a monopoly: PRI lines - if there is no significant change in market share, the prices of these will come under supervision.

5. The structural separation in the Company is to remain so long as there are only two companies with nationally deployed fixed line infrastructure. Likewise, if the Minister of Communications finds, within a reasonable time of implementation of the local loop unbundling arrangement (no longer than two years), that the Company's actions are preventing expansion of competition in the domestic communications market, the recommendation is that he will exercise his powers under section 4(d2)(3) of the Communications Law regarding structural separation between operation of the infrastructure and operation of services at the Company.

<u>Cellular Sector</u>

It is necessary to accelerate the regulation processes required for the entry of virtual carriers, to accelerate the WiMAX tender in order to strengthen competition in the mobile sector and additionally, during 2009, to check the cost of call completion on mobile networks and to amend the tariff accordingly.

<u>International Call Sector</u>

International call tariffs via mobile telephones to be prescribed by the international calling company, and that company will make payments to the cellular company at the tariff determined in the Interconnect Regulations for call completion on mobile networks. Furthermore, new players controlled by the cellular companies shall be permitted entry into the international call sector.

<u>Multi-Channel Television</u>

1. Setting up of a "narrow basic channel package", including 5-10 channels (open channels and channels of special social or cultural value), with the possibility that the regulating body might determine the price of the package.

2. Enforcement of structural separation between Hot Broadcasts and Hot Telecom in the framework of their licenses, in accordance with the existing format in place in the Company.

<u>General</u>

<u>Consumer Issues</u> - The OECD recommendations are a guiding framework for handling consumer issues. It shall be prohibited to change fixed tariffs in a contract with customers during the contract term, the term of contracts shall be limited to 18-24 months and the prevention of transfer due to the tying of purchase of a handset to purchase of services will be removed.

<u>Royalties</u> - adoption of the position taken by the Carol Committee regarding the gradual reduction of the rate of royalties payable by licensees, up to cancellation of such royalties in the future. If there is a reduction of taxes during 2008-2012, the royalties will be cancelled. It is proper that cancellation of the royalties accompany a parallel reduction in tariffs.

On August 13, 2008, the Minister of Communications announced his decision to adopt the Committee’s recommendations, subject to changes and points of emphasis, which will become the

[2] For which there is no obligation for any service included in such packages to be purchased individually under similar terms as provided in the service package.

Ministry's guiding policy for the upcoming years. The Minister's decision clarifies the regulatory situation to a certain extent. Hereunder, please find the principal changes and points of emphasis:

Structure Changes in the Fixed Line Sector

According to the decision of the Minister of Communications, the Ministry of Communications will commence work on preparing the regulatory and pricing infrastructure required to establish a wholesale market, including arrangements for separation into segments (LLU). Nonetheless, in order to provide an incentive for the Company to implement the wholesale market arrangements as quickly as possible, the Company will be allowed to present the Ministry with a commercial agreement for the provision of wholesale services with any communications operator that is not a subsidiary of the Company.

The Minister agrees with the Committee regarding the importance of the fixed telephone infrastructure. Therefore, as long as the Minister thinks that it is appropriate to create incentives for the Company, which will advance rapid, universal deployment of the next generation network (NGN), he will work to do so.

Tariff Flexibility for Bezeq – Alternative Service Packages

In order to streamline the process for approving alternate payment packages and provide a higher level of certainty for the Company, the Minister decided to change the mechanism for approving alternate payment packages, such that the Company will not need to wait until the explicit approval of two Ministers is received but rather it will be able to offer a package 45 days subsequent to the detailed request being filed at the Ministry of Communications unless the Minister of Communications or the Minister of Finance informs it of their objection to the request. It should be noted that the Minister adopted the Committee's recommendation that as long as the Bezeq Group's market share is greater than 60%, regulation of the Company tariffs will continue in accordance with the current format of setting obligatory ("fix") tariffs. Regarding alternative payment packages, the maximum permitted discount rate will increase as the Group's market share for fixed telephony decreases (it will remain 15% as long as the market share is greater than 85%; 25% as long as the market share is between 75% and 85%; and 40% when the market share is between 60% and 75%).

Competition in the Mobile Field

The Minister instructed the CEO of the Ministry of Communications to work towards advancing a licensing policy for virtual operators (MVNO).

Multi-Channel Television Sector – Basic Package of Channels

The Minister decided to conduct a more comprehensive examination of all aspects of the broadcast field. Therefore, he announced that in the near future, it is his intention to appoint a committee to provide recommendations regarding policy and terms of competition in the multi-channel and commercial television sector. It is noted that the Minister of Communications appointed an inter-ministerial committee to regulate the commercial television sector and subsequently, on October 12, 2008 the committee announced a hearing to be replied by December 1, 2008.

Structural Separation in the HOT Group

According to the decision of the Minister of Communications, the Ministry of Communications will work in order to ensure that the companies in the Hot Group comply with the rules of structural separation established in their licenses, with the exception of the possibility available to the companies, of marketing packages of services that include services offered by the companies, on a regular basis as is currently permitted by their licenses, contrary to the committee's decision, which was that the terms of separation in the form applied to the Company, should be enforced.

The guidelines for structural separation must make it possible to implement the recommendations regarding the wholesale markets in general and its prices in particular.

International Call Sector – Entrance of Players Controlled by Mobile Companies to the International Call Sector

The Minister is of the opinion that the recommendations of the Committee regarding setting fees for outgoing international calls using a mobile network in the framework of the interconnect regulations should be advanced.

The Company is examining the decisions of the Minister and is unable to assess, at this stage, what their precise impact will be on its business results and those of its subsidiaries.

See also updates to sections 3.7, 4.1.2 and 5.1.3.5 below.

Section 1.1.4 - Holdings of the Company

The following are details of the current rate of holdings of the Company, fully diluted, assuming the exercise of all of the options actually allocated to employees of the Company as of September 30, 2008 and November 23, 2008 (as set out in the Periodic Report for 2007 and in the update to section 1.3.2 below, including the allocation to the Chairman of the Board of Directors, made on June 1, 2008), and subsequent to the exercise of Ap. Sab. Ar.'s option to purchase approximately 10.66% of the State's shares in the Company (see update to section 1.3 hereunder):.

Shareholders	Holdings		
	As of 30.9.08	As of 23.11.08	Fully diluted
Ap.Sb.Ar	40.66%	40.66%	38.65%
State of Israel	4.95%	4.70%	0.96%
Zeevi Group	17.75%	17.75%	16.87%
Public	36.64%	36.89%	43.52%

Section 1.1.5A – Mergers and Acquisitions – DBS

The hearing of an appeal filed by the Company in the Antitrust Court, against the decision of the Antitrust Commissioner to object to the Company's merger with DBS, is at the closing stage.

Section 1.1.6 - Realizations

With respect to the satellite communication operations - on March 26, 2008, an agreement regarding the sale of the Company's satellite communications operations ("Inmarsat" and "Bezeq Sat") and assets relating to such operations, including the satellite communications site at the Ella Valley, was executed between the Company and RRsat Global Communications Network Ltd., a company registered in Israel whose shares are traded on NASDAQ in the USA for consideration in the NIS amount equivalent to US $ 15 million plus VAT, subject to price adjustments. Conclusion of the transaction was subject, *inter alia*, to the regulatory consent of the Ministry of Defense, the Ministry of Communications and the Antitrust Commissioner and on November 4, 2008 the transaction was completed subsequent to the fulfillment of all the conditions required for its conclusion, including receipt of the regulatory consent. With respect to this transaction, the Company will record in its financial statements for the period ending December 31, 2008, capital gains of NIS 50 million (gross before tax).

Section 1.3 – Investments in the Corporation's Equity and Transactions in its Shares

Section 1.3.1 – Exercise of Ap. Sab. Ar option

On September 25, 2008, Ap.Sab.Ar acquired 277,697,862 ordinary shares of the Company from the State, by way of fully exercising the option granted to Ap.Sab.Ar by virtue of the purchase agreement for the controlling interest in the Company between Ap.Sab.Ar and the State of Israel signed on October 11, 2005. The consideration for the option exercise is NIS 1.08 billion. Per Ap.Sab.Ar's request, the holder of the acquired shares is registered in the name of the trust company (Romema Trust Ltd.).

As a result of the exercise of options as aforesaid, Ap.Sab.Ar's holding in the Company has increased to 40.66% (38.64% fully diluted) and the State's holding declined as a result to 4.95% (0.96% fully diluted) and from that date on, the State ceased to be an interested party in the Company

Section 1.3.2 - Employee Share Option Plans

Under the share option plan for senior managers and employees of the Group of November 2007 for the allocation of up to 65,000,000 options, since the date of publication of the 2007 periodic report and as at September 30, 2008, the date of the publication of this report, 21,450,000 additional options have been allotted (including the allotment of 9,000,000 options to the Chairman of the Board of Directors of the Company and 4,250,000 options to the CEO of DBS) such that as of the date of this update, a net total (less options that have been forfeited) of 57,650,000 options have been allotted through the plan (57,750,000 options as at September 30, 2008).

Section 1.4 – Payment of Dividends

On April 28, 2008, a cash dividend for a total amount of NIS 679 million was distributed to the Company shareholders, representing, as at the date of the distribution NIS 0.260648 per share, this having been approved by the General Meeting of shareholders of the Company on April 3, 2008.

On October 29, 2008, a cash dividend was distributed to the Company's shareholders in a total amount of NIS 835 million, representing, as at the date of the distribution NIS 0.3205318 per share, subsequent to the approval by the General Meeting of shareholders of the Company on September 28, 2008.

Section 1.5 - Financial Information regarding the Group's Areas of Operations

Section 1.5.3 - Principal Results and Operational Data

A. Bezeq Fixed-Line (operations of the Company as domestic carrier)

	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q 2 2007	Q1 2007
Revenues (NIS millions)	1,388	1,354	1,408	1,453	1,425	1,393	1,442
Operating Profit (NIS millions)	422	428	368	340	327	243	369
Depreciation and amortization (NIS millions)	214	211	218	232	236	236	237
EBITDA (NIS millions)	636	639	586	572	563	479	606
Payments for investments in property, plant and equipment and intangible assets (NIS millions) [1]	156	132	158	141	149	101	113
Proceeds received from sale of property, plant and equipment (NIS millions) [1]	12	25	60	23	16	96	18
Number of active subscriber lines at the end of the period (thousands)	2,645	2,681	2,712	2,761	2,767	2,778	2,798
Average monthly revenue per line (NIS) [2]	84.3	81.8	83.9	86.1	85.9	85.4	88.5
Number of outgoing call minutes used (millions) [3]	3,425	3,346	3,511	3,653	3,760	3,654	3,802
Number of incoming call minutes used (millions) [4]	1,708	1,655	1,673	1,661	1,651	1,553	1,545
Number of ADSL subscribers at the end of the period (thousands)	994	982	970	963	942	924	912
Average monthly revenue per ADSL subscriber (NIS) [5]	67.3	66.5	68.3	68.6	63.5	62.1	61.4

1 Data for Q1 2008 were updated retroactively, in order to reflect the timing of payments of investments in property, plant and equipment and receipts from sale of property, plant and equipment.

2 Not including revenues from transmission and data communications services, internet services, services to communications providers, and other contractor work. In this item, insignificant adjustments were made to prior quarters in order to present nominal, non-standardized figures.

3 Outgoing calls were updated retroactively to exclude the number of direct dial internet calls and the calls of Bezeq's operational lines.

4 Incoming calls were updated retroactively to include the number of international calls.

5 The average monthly revenue for ADSL subscribers was updated retroactively to include revenue from equipment.

B. <u>Pelephone</u>

Pelephone	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q2 2007	Q1 2007
Revenues (NIS millions)	1,214	1,188	1,173	1,182	1,203	1,152	1,147
Operating Profit (NIS millions)	293	266	215	133	219	240	213
Depreciation and amortization (NIS millions)	129	130	129	126	121	115	117
EBITDA (NIS millions)	422	396	344	259	340	355	330
Net profit (NIS millions)	211	180	163	104	154	173	154
Cash flows from current operations (NIS millions)	386	351	264	252	392	246	359
Payments for investments in property, plant and equipment and intangible assets (NIS millions)	350	182	103	120	81	117	63
Proceeds received from sale of property, plant and equipment (NIS millions)	-	1	1	3	-	-	2
Number of subscribers at end of period (thousands)	2,698	2,636	2,595	2,622	2,560	2,513	2,478
Average minutes of use per subscriber (MOU) per month	359	358	355	358	363	350	344
Average monthly revenue per subscriber (NIS) (ARPU)	129	128	126	130	135	129	132
Number of 3G subscribers at end of period (thousands)	1,068	977	867	749	607	471	358
Revenues from value added services and content, as a percentage of total cellular service revenues	16.2%	15.5%	15.0%	13.6%	12.8%	12.5%	12.0%

C. Bezeq International

	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q2 2007	Q1 2007
Revenues (NIS millions)	329	326	314	334	326	321	323
Operating Profit (NIS millions)	59	63	54	46	54	53	51
Depreciation and amortization (NIS millions)	20	20	20	21	21	22	23
EBITDA (NIS millions)	79	83	74	67	75	75	74
Net profit (NIS millions)	44	47	41	38	39	39	37
Cash flow from current operations (NIS millions)	42	51	8	30	34	32	(1)
Payments for investments in property, plant and equipment and intangible assets (NIS millions)*	33	31	28	36	29	18	8
Proceeds received from sale of property, plant and equipment (NIS millions)	-	-	-	2	2	-	-

* This item also includes long-term investments in assets.

D. DBS

	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q2 2007	Q1 2007
Revenues (NIS millions)	375	380	381	347	360	354	354
Operating Profit (NIS millions)	52	43	26	4	(4)	31	25
Depreciation and amortization (NIS millions)	59	60	65	70	66	69	68
EBITDA (NIS millions)	111	103	91	74	62	100	93
Net profit (loss) (NIS millions)	(82)	(99)	(66)	(75)	70	(65)	(48)
Cash flows from current operations (NIS millions)	97	32	84	76	53	25	93
Payments for investments in property, plant and equipment and intangible assets* (NIS millions)	56	40	79	81	84	45	45
Number of subscribers (end of period, in thousands)	556	551	549	549	545	543	542
Average monthly revenue per subscriber (NIS).	226	230	231	212	220	218	218

* This item also includes investments in the cost of acquisition of subscribers

2. Fixed-Line Domestic Communications – “Bezeq” – The Israel Telecommunications Corp. Limited (“the Company”)

Section 2.1 – General information on areas of operation

Section 2.1.2 – Limitations set by legislation and standards and special restrictions

Recently, on June 1, 2008, the Company’s tariffs change. The interconnect charges to the Company were reduced, effective June 11, 2008.

Section 2.1.3 - Changes in volume of activity and profitability in the area

For changes in the volume of activity and profitability in this area, see update to section 1.5.3(a) above.

Section 2.1.5 – Technological changes that are necessary to significantly impact on the area of activity

Subsection A – Regarding the adaptation of company infrastructure to high broadband, see the updates to sections 2.6.7 and 2.7.2, below, regarding NGN.

Section 2.1.9 – Technological changes Competitive environment and changes therein

With respect to the competitive factors in this sector and the Company's flexibility see update of section 2.6.1 and section 2.16.2 with respect to the decline in the Company's market share in the mobile phone (private sector) sector to below 85% and possible benefits to the Company due to it.

Section 2.2 – Products and Services

Section 2.2.2 - Telephony

On April 7, 2008, a draft amendment to the license and service file of the toll free service (1-800) was received from the Ministry of Communications. The significance of the amendment is, inter alia, that the Company's 1-800 subscribers will pay the cellular companies a higher tariff for calls made to them from the cellular network. On May 6, 2008, the Company sent its comments on the aforementioned amendment.

In respect of the Company’s request to the Antitrust Commission for an exemption from a cartel arrangement to an arrangement with the cellular operators and fixed domestic licensees for information services –on August 13, 2008, the Commissioner decided to grant a conditional exemption as a response to the Company’s request.

Section 2.2.3 – Internet Access Services

For changes in the number of ADSL subscribers, and the average monthly revenue per ADSL subscriber, see the update to the table in section 1.5.3(a) above.

With respect to broadband access services via internet service providers without purchasing a basic telephone service (ADSL only) - the Company commenced provision of this service on May 15, 2008.

Section 2.2.5B - Satellite Services and Broadcasting

See update to section 1.1.6 above with respect to the agreement for sale of the Company's satellite communications operations.

Section 2.3 - Breakdown of Revenues and Profitability of Products and Services

For updates of data regarding the breakdown of the Company's revenues based on products and services, see Note 11B in the financial statements of the Company for the period ended on September 30, 2008.

Section 2.6 – Competition

For an update regarding publication of the recommendations of the Gronau Committee, see the update to section 1.1 above.

Partner Ltd. recently announced its intention of expanding its operations in the internet (ISP), fixed-line telephony (VOB) and content at the customer's home. If Partner does expand its operations, as aforesaid, this will increase the competition in these sectors.

Section 2.6.1

With respect to the Company’s petition to the High Court of Justice with respect to the application to enforce the requirement of structural separation on HOT, on July 15, 2008, the Court decided that the petition will be corrected according to the Company’s request, that a hearing will be set and the respondents will submit their responses prior to the hearing.

Regarding the policy for providing VOB services – on August 12, 2008, the Company applied to the Ministry and requested, for the sake of good order, to make an addition to the Services Addendum to the Company’s license for broadband telephone service, if it reaches a market share of 85%. It is noted that according to the Ministry of Communications’ announcement on August 25, 2008, the

Company's market share has declined, in terms of normative revenues, as at June 2008, in the fixed-line telephony sector (private sector) to below 85%. In addition, according to the announcement of the Ministry of Communications on November 11, 2008, as at August 2008 the Company's market share is 83.8% in the residential sector and 89.2% in the business sector.

Section 2.6.6A - Numbering and Number Portability

As of the end of September 2008, approximately 165,000 thousand lines have switched from the Company to competing companies (of which 47,000 in the third quarter) and approximately 16,000 lines switched to the Company from the competitors (of which 8,000 in the third quarter).

On April 9, 2008, the Ministry of Communications gave notice to the Company and to other communications providers that it was considering amending the numbering plan and prescribing that with respect to the entitlement to number portability a "subscriber" would be deemed to include an NEP licensee to whom telephone numbers have been allocated and who pays for use thereof, and the end user will not be entitled to port such a number. On May 7, 2008, the Company submitted its comments to this amendment, claiming that it would amount to confiscation of the end user's right to decide whether to port the number or not. Despite this, on September 1, 2008 the numbering plan, as stated in the Ministry's announcement above, was amended. Nonetheless, the Ministry noted in an accompanying document that it intends to examine regulating the relationship between the end user and the NEP license holders, in whose name the telephone numbers are registered, so that the number portability regulation will also be applicable to the end users

On May 4, 2008, the Company received an Administrative Directive from the Ministry of Communications to the effect that a customer which has been allotted an abbreviated business dialing number (asterisk plus four digits) may port such a number.

Section 2.6.6.b – Other Potential Competitive Infrastructures

Regarding the hearing on the subject of the policy for allocating frequencies for wireless broadband access networks (WiMAX) – on July 30, 2008, the Ministry of Communications announced an additional hearing in which changes were made to the previous hearing. In this context, the Ministry announced that it is examining the possibility of amending the Communications Regulations (Telecommunications and Broadcast) (Frequencies for Wireless Access Devices) 5762-2002 which lists the devices that are exempt from permits pursuant to Chapter 5 of the Planning and Construction Law, so that it includes the *2.5* GHz and 3.7 GHz frequency ranges. On September 1, 2008 the Company filed its responses for the hearing and reiterated its claim that the Company should be allocated national deployment frequencies at 30 MHz bandwidth and in the 2.5 GHz frequency range and at least in the 3.5 GHz frequency range, and that no maximum limit should be set for the band width allocated to the Company. Furthermore, with respect to the matter of unbundling over the wireless network, should the method be introduced, the Company explained that it is not clear if this can be done at all and in any case, the responsibility should be applicable to all the operators. At the same time as an overall policy is being drawn up, negotiations are underway between the Company and the Ministry of Communication with respect to the allocation of alternative frequencies for the Company in return for vacating frequencies that the Company currently uses to provide services to the radio systems subscribers, as required by the Ministry of Communications (see update to section 2.16.8 below).

Section 2.6.7 – the Company's preparations for managing increased competition

Sub-section (i) regarding examination of the deployment of uniform infrastructure for the transmission of communications services – further to the decision of the Board of Directors of the Company to beginbegin detailed planning of an NGN (Next Generation Network) ("the **project**"), on June 26, 2008, the Board of the Directors of the Company decided to to promote the project. In 2008, detailed plans will be made for the project, two areas will be set up as operational pilots and soft switches will be purchased. The project will be conducted in a modular fashion and the Company will examine regularly and at each stage, the feasibility of continuing the project, and the requirement to update the project's outline. The content, pace of implementation and amounts to be invested in the project will be determined annually, as part of the Company's annual budget. In addition to the purchase approved on June 26, 2008, the Board of Directors approved, on July 31, 2008, the purchase of management systems and other equipment required for deployment of the new system. In this respect, see also the update to section 2.7.2, below, and note 3(e) to the financial statements for the period ending September 30, 2008.

Section 2.7 – Fixed assets and Installations

Section 2.7.2 – Domestic, fixed-line communications infrastructure

NGN Network – The Company believes that the requirements of future communications services in the State of Israel, as in the entire world, will require increasing larger broad bands and an advanced IP platform. In order to provide a response to these needs, the Company intends to gradually establish, commencing in late 2008, an NGN network based on the core of the IP network and bringing fiber optic infrastructure to street switching cabinets (the topology of the network is referred to as "fiber to the curb" – FTTC). With this network, it is possible to supply broadband technology up to 50 Mbit/s in the download channel and innovative added-value services. In addition, the NGN network will allow the Company to make the network more efficient. The project for establishing the new network will be implemented gradually with the pace of the deployment being tested annually. In this respect, see also the update of section 2.6.7, above, and note 3(e) to the financial statements for the period ending September 30, 2008.

The information in this section includes forward-looking information based on the Company's assessments. The actual results are likely to be significantly different from these estimations, when attention is paid to the changes that will occur in technology and in the communications market.

Section 2.7.4 – Land

Subsection d – In Q1 2008, the Company did not sell any real estate assets. During Q2 2008, the Company sold three real estate assets with a total area of approximately 40,500 sq. meters of land and approximately 7,800 sq. meters of building for a total of NIS 22 million. In Q3 2008, the Company did not sell any real estate assets.

Section 2.9 – Human Resources

Section 2.9.1 - Organizational structure and position of employees based on organizational structure

A. With respect to the organizational structure - the CFO and the VP Strategy and Business Development report only to the CEO.

B. In May 2008, execution of the amendment to the new collective agreement regarding advancing the completion of implementation of the organizational structure, and regarding advancing dates of retirement and changes in the mix of retirees under the new collective agreement before the end of 2008, was completed.

C. On October 2, 2008 the Company's board of directors resolved to approve the resignation of 135 employees during the course of 2009, at a cost of NIS 100 million, in accordance with the terms of the collective agreement of December 2006.

Section 2.9.2 – Personnel according to employment framework

During the first nine months of 2008, the number of employees of the Company fell from 7,614 employees at December 31, 2007, to 7,417 as at September 30, 2008 (a net reduction of 197 employees) as a result of retirements from the Company (in parallel with the recruitment of employees required, such as sales representatives)

It is noted that, as at September 30, 2008 all the 975 employees who are supposed to terminate their employment at the Company between 2006-2008 under early retirement tracks or increased severance pay tracks, under the collective agreement of December 5, 2006 (see section 2.17.4(f) of the Periodic Report for 2007), had retired.

Section 2.9.6 – Employee remuneration schemes

Section 2.9.6.3 - for the allotment of options to senior managers and employees of the Group, including to the Chairman of the Board of Directors, see update to section 1.3.2 above.

Section 2.9.7 – Company officers and senior executives

On April 17, 2008, the Board of Directors of the Company, after receiving the approvals of the Remunerations Committee and the Audit Committee of the Board of Directors, approved the conditions of employment of the Chairman of the Board of Directors as set out in the immediate report of the Company published on April 18, 2008. The conditions of employment of the Chairman of the Board of Directors were approved by the general meeting of shareholders of the Company on June 1, 2008 and on September 28, 2008.

Section 2.13 – Finance

Section 2.13.4 - Credit received after December 31, 2007

Commencing June 2008, the Company on occasion takes short-term, on-call loans, generally for insignificant amounts. As of the date of this update, the company does not have any such loans.

Section 2.13.6 – Credit Rating

On May 21, 2008, the Midroog Rating Company ("Midroog") gave notice that it had returned the Company's rating (which is Aa1) from negative to stable in light of the improvement in the Company's financial results, and the continued presentation of a strong financial profile, compensation for erosion in the fixed line communications segment via operations in the other segments and very low rates of financing despite the distribution of all of the net profit as dividend, after transfer of the controlling stake in the Company.

On August 12, 2008, Standard & Poor's ("S&P") gave notice that it is changing the Company's rating outlook (which is BBB+) from "negative" to "stable," on the basis of its re-examination of its operating performance and the leverage within the company. In its announcement, S&P noted that the company's rating relies, *inter alia*, on the Company's leadership as the national communications operator, its operational efficiency, the range of services it offers in the communications market and its adequate financial profile. It is noted that on October 7, 2008, S&P confirmed the validity of this rating and this, inter alia, following examination of the anticipated impact of the exercise of the purchase option (10.66%) executed by Ap.Sb.Ar. (see update of Section 1.3.1). On August 25, 2008, S&P Maalot announced that it was raising the Company's debt rating from AA to AA+ with a stable forecast. In its announcement it noted that the raised rating is based primarily on the Group's improved performance and operational effectiveness, the stability of the Company's managerial structure and the changes to the structure of the business risks as a result of the change in the mix of the Group's revenues. It is noted that on October 13, 2008, Standard & Poor's Maalot confirmed the validity of this rating and this, *inter alia*, following examination of the anticipated impact of the exercise of the purchase option (10.66%) executed by Ap.Sb.Ar. (see update of Section 1.3.1).

Section 2.13.7 – Assessment of funds raising in the coming year (2008) and sources of financing

In the Company's assessment, the Company is likely, from time to time, to raise loans from banks and/or other credit providers to bridge gaps in cash flow as may arise, if at all, from time to time.

Section 2.15 – Environmental Protection

Following termination of the strike at the Ministry of the Environment, the process of obtaining operating permits was completed for most of the communications and broadcasting facilities.

Section 2.16 – Limitation and Regulation of Company Activities

Section 2.16.1 – Supervision of the Company's tariffs

Sub-section (a) (regarding the update of the Company's tariffs) – on March 20, 2008, a letter was received from the Ministry of Communications under which the next update (on June 1, 2008) would be based on the existing tariff outline prescribed by the Gronau Committee in 2003, in accordance with the formula set out in the Communications Regulations regarding calculation and linkage of payments for telecommunications services (the "Calculations Regulations"). According to the letter, after and to the effect that the Gronau Committee's recommendations are adopted regarding policy and rules of competition in the communications market, the path will be laid for the work of a commission to prescribe new tariff arrangements for the coming years. On June 1, 2008, the Company's tariffs were reduced in accordance with a formula fixed in the Calculation Regulations, at the average rate of approximately 2%, except for the fixed fee for a telephone line that was updated in accordance with the increase in the Cost-of-Living index (3.4%). The interconnect tariffs currently paid to domestic carriers by licensees were reduced by an average of approximately 2%, effective June 11, 2008. With respect to the update of the Company's tariffs, see also the update regarding publication of the recommendations of the Gronau Committee in section 1.1 above.

Section 2.16.2 – The Company's general license

On July 3, 2008, the Company received a draft amendment of the Company's license and the licenses of it subsidiary companies Pelephone, Bezeq International and D.B.S. regarding the marketing of joint packages of services. On July 27, 2008, the Company submitted its position to the Ministry of Communications, stating that the amendment of the licenses represents an intensification of regulation in comparison to the policy document of the Minister of Communications dated March 31, 2004, which is supposed to reflect relief for the Company, and it would be desirable to allow a model for marketing of joint packages of services that represents relief for the Company now that its market share has decreased to 85% or less, together with ministerial supervision using more moderate measures than those proposed in the draft amendment to the license. Regarding the positions of the subsidiary companies on this matter, see the updates to sections 3.18.3.1, 4.1.2 and 5.6.5, below.

According to the Ministry of Communications announcement on August 25, 2008, the Company's market share declined, in terms of normative revenues, as at June 2008, in the fixed-line telephony sector (private sector) to below 85%. In addition, according to the announcement of the Ministry of Communications on November 11, 2008, as of August 2008 the said market share is 83.8% in the residential sector and 89.2% in the business sector.

Regarding the main points of the general license – subsection c regarding tariffs – on April 14, 2008, the Company's license was amended so as to permit it to require a subscriber to pay using a direct debit or a credit card, except for a private subscriber who does not have a bank account. It should be noted that the Economics Committee of the Knesset discussed a proposal to amend the Consumer Protection Law, by which a communications business would not be permitted to make a transaction conditional on payment using a direct debit or credit card. If the law is amended according to this proposal, the Company will be unable, despite the amendment to its license, to require a private subscriber to pay using a direct debit or credit card.

Main points of the general license – subsection 11 (miscellaneous issues) – on May 17, 2008, the Ministry published a hearing regarding its policies and amendment of the operators' licenses regarding fair disclosure on telephone bills. In this context, it is examining imposing new requirements on the operators regarding details and computation of bills. It should be noted that approximately three years ago, the licenses were amended so that a standard was adopted for telephone bills. The Company submitted its position on the matter on July 20, 2008, stating, *inter alia*, that there is no justification, neither from the consumers' perspective nor from an ethical perspective, to make changes in the Company's telephone bills. This would also be harmful to some of the Company's customers while being of no benefit to others. In its position, the Company claimed that since the demands being considered would require very extensive development and resources to implement and because of the technical issues involved, it would be worthwhile, before a decision is made, to discuss the matter with the Company.

On October 28, 2008, the Ministry of Communications approved Company's cessation of the services relating to the satellite communications operations and its overall license, and the fourth addendum to the Telecommunications Order (Telecommunications and Broadcasts) (Determination of Essential Service Provided By Bezeq The Israel Telecommunication Corp., Limited), 5757-1997 was amended accordingly (see update to section 1.1.6 above)

Section 2.16.5 - Immunities

On May 19, 2008, the Company received a letter, dated May 18, 2008, from the Ministry of Communications, addressed to communications licensees, stating that the Ministry of Communications is of the opinion that following the adoption of the Civil Wrongs Ordinance Amendment (No. 10) Law, 5765-2005, under which the restrictions on the State's liability in tort were reduced, there might be grounds to consider reducing the existing immunity arrangement granted to general licensees and special general licensees. The licensees were requested to submit their positions to the Ministry of Communications by June 18, 2008. On July 31, 2008, the Company submitted its position to the Ministry of Communications stating that the said Amendment 10 does not change any of the arrangements regarding liability for torts to an extent that justifies reducing the existing immunity arrangement and assigning responsibility to the communications companies. Additionally, expansion of responsibility means placing a heavy burden on communications companies, including the Company, because of the potential extent of the indirect damages and the dimensions of the possible suits.

Section 2.16.7 - Antitrust laws

Subsection h. with respect to the Antitrust Commissioner's ruling that the Company had abused its market status in handling an interconnection fault between the Company's network and that of HOT, against the backdrop of labor disruptions by the Company's employees - on March 16, 2008, the Company filed an appeal against the Commissioner's ruling. In this regard, see also Note 6C(1) to the financial statements of the Company for the period ended September 30, 2008.

Section 2.16.8 – Telegraph Regulations

Regarding the Company's use of radio frequencies – on October 25, 2007, the Ministry of Communications notified the Company that it is considering ordering it to cease using neighborhood radio and rural radio systems and the frequencies allocated to it for the purposes for which they are being used, amongst others, in order to provide its services in areas where an infrastructure of telephone lines does not exist. On December 25, 2007, the Company submitted its response in which it clarified that the Ministry must allocate alternative frequencies and that the Ministry's requirement would create difficulties for the Company and requires extensive deployment and operations that would entail significant expenses. Furthermore, the Company noted that it would be required, within a period of two years, to transfer subscribers from the existing systems to new systems and demanded that the State bear the cost of the migration from the systems that the Company would be required to evacuate. Since then the Company has been negotiating with the Ministry of Communications with respect to the allocation of alternative frequencies for those frequencies that the Company is required to vacate.

Section 2.16.9 - Proposed Legislation to Amend the Consumer Protection Law and the Communication Law

During April 2008, an amendment of the Consumer Protection Law regarding fixed transactions was approved by the Knesset (the "Amendment"). Under the Amendment, dealers will be required to inform consumers of the date of termination of a fixed transaction prior to termination of such, and of the conditions that will apply after the date of termination. In addition, dealers will be required to obtain the positive consent of the consumer to continue with the contract beyond the fixed period. If positive consent is not obtained, the consumer will be disconnected from the service to which the fixed transaction applied, apart from basic telephone services as defined in the Communications Law (voice services). This Amendment will come into force as of 2009. The Company's hearing regarding the amendment to the Company's license and those of other licensees in this regard, proposed by the Ministry of Communications, is also continuing. In this context, the Ministry of Communications announced on October 29, 2008 that with regard to the hearing with respect to setting a uniform tariff for the commitment period, the Ministry decided to amend only the licenses of general licensees for providing cellular services in a way that will obligate a uniform tariff as aforesaid. This amendment becomes valid as of December 31, 2008. Furthermore, the Knesset approve an amendment to the Consumer Protection Law regarding disconnection from ongoing services (effective October 2008) allowing a private subscriber to disconnect from ongoing service by using mail, electronic mail or telephone. In addition, the Knesset approved the amendment to the Consumer Protection Law (effective September 2008) which imposes, in certain circumstances, fines if a technician is late and an amendment to the Communications Laws regarding junk mail (effective November 2008), according to which requires, among other provisions, as a general rule, a subscriber's explicit permission to receive advertising by way of electronic mail, facsimile, automatic dialing systems and SMS.

The Company is implementing the arrangements which took effect and is preparing to implement the other amendments.

Section 2.16.11 – Erection of communications installations – NOP 36

On April 17, 2008, the Company submitted its objections to the proposed wording of the National Communications Outline plan NOP/36A regarding small broadcast installations, and the National Communications Outline Plan NOP/36B regarding large broadcast installations. In summary, the objections are that the plans, as currently worded, particularly with respect to the changes in definitions of small and large broadcast installations, give rise to practical difficulties which might prevent the Company from providing the public with some of the varied services that it provides, and that it is required by law to provide.

Establishing communications facilities in the territories

On July 29, 2008, the Company received notification that in June 2008 National Master Plan 56, which regulates construction and licensing of communications facilities in the territories, took effect. The plan includes transition instructions for facilities that were constructed prior to 1984 and for existing facilities. The Company is examining the subject and, as of the date this report, it is not able to evaluate the expected ramifications.

Section 2.17 – Significant Agreements

With respect to section 2.17.4(f) – the new collective agreement of December 5, 2006 – regarding the amendment to the agreement, see update to section 2.9.1 above.

Section 2.17.5 – Management Agreement

On September 28,, 2008, the general meeting of the shareholders of the Company approved (subsequent to approval by the Audit Committee and the Board of Directors) the extension of the relationship and management contract with AP. SB. AR. Cayman L.P., a company related to Ap.Sb.Ar., for a period of three additional years commencing January 1, 2009, through December 31, 2011, according to the conditions of the original agreement..

Section 2.18 – Legal proceedings

For updates on the subject of legal proceedings, see Note 6 to the financial statements of the Company for the period ended September 30, 2008.

Section 2.19 – Goals and Business Strategy

Section 2.19.2 - Summary of Strategy and Directions for the Future

Regarding the Company's network – see sections 2.6.7 and 2.7.2, above, on the subject of NGN.

Section 2.21 – Risk Factors

During the current quarter, subsequent to the worldwide economic crisis, global markets have entered a slowdown and credit choke. It is assumed that this situation will continue to be felt throughout 2009 and possibly worse, with a shift from growth to recession. A significant slowdown and decline of business operations and key economic parameters are also expected in the local market. The Company assumes that this crisis may have a negative impact on its operations, inter alia, as a result of the harm to the Company's revenues and difficulties in selling its real estate properties.

This information includes forward looking information based on internal estimates of the Company. The actual results may be materially different from the foregoing estimates if changes take place in any of the factors taken into account for this assessment.

3. Cellular – Pelephone Communications Ltd. ("Pelephone")

Section 3.2.1 – Services

At the end of March 2008, the Ministry of Communications published a document of a public hearing regarding the policy of regulating the provision of telephone trading services via a public telecommunications network. Telephone trading services including voice and visual information services, entertainment services, dating services, etc., provided to subscribers via terminal equipment connected to a network. It is important to note that the field of telephone trading services is a significant source of income in the content world of Pelephone and the other cellular carriers. Following the proposed regulation, the Regulator is seeking to dramatically change the conduct of the telephone trading services sector, in a way that it is also likely to harm Pelephone's revenues in this area. The Ministry of Communications has asked all relevant persons operating in the field of telephone trading for responses to the aforesaid hearing. Pelephone submitted its position in this regard, in which it, among others, requested that the Ministry of Communications hold frontal discussions on the subject of the hearing prior to making any decisions. During August 2008, the Ministry of Communication called for frontal discussions on the issue in hand opposite all the cellular providers and part of the content providers. During the aforesaid discussion, Pelephone presented its opinion on this matter to the Ministry's representatives. The Ministry has not yet set down its final policy on this matter.

Section 3.6 – Marketing, distribution and service

In September 2008, Pelephone signed an agreement with Super Pharm, who up until now has marketed Partner phones, to market its phones as of January 2009. Subsequently, Pelephone's distribution will be significantly expanded.

Section 3.7 – Competition

For an update regarding publication of the recommendations of the Gronau Committee, see the update to section 1.1 above.

On August 13, 2008, Minister of Communications published a document regarding adoption of the recommendations of the Gronau Committee. Following are the main points that relate to Pelephone:

1. The Minister instructed the CEO of the Ministry of Communications to work to promote the licensing of virtual operators (MVNO) while making it possible for the relevant parties to express their opinion on the subject to the Ministry of Communications. In the event that within a period of six months from the date that a virtual operator applies to a mobile operator, the parties do not reach an agreement regarding the provision of virtual services, the Minister will examine the reasons for this and, subsequent to a hearing with the relevant parties, consider issuing instructions on the matter in accordance with his authority.

2. It is the intention of the Minister to promote a change in the tariff structure for outgoing international calls using the mobile network, in the context of interconnect regulations so that the international carrier will determine the tariffs for these calls and, in the context of its accounting with the mobile operators, the international operator will transfer only interconnect charges to the mobile operator. A hearing with the relevant parties is to be held regarding the implementation of his policy.

   According to the Minister's position, international licenses should not be issued to existing mobile operators, at this stage.

Regarding Section 3.7.2

Recently the Minister of Communications expressed his position according to which he intends to promote the issuance of MVNO licenses in the near future. The Minister stated that the Ministry would examine a variety of possibilities for granting MVNO licenses, ranging from a reseller model to full operation. Furthermore, in September 2008, as part of the Government's discussions with respect to the Budget Law and Settlements Law for 2009, a decision was made that the Minister of Communications shall complete all the procedures required for granting MVNO licenses by April 1, 2009. Similarly, according to media releases, the Ministry of Communications intends announcing a hearing by the end of 2008 for the cellular operators with respect to the granting of MVNO licenses.

During the Government's discussions on the Budget Law for 2009, further decisions were taken with respect to the communication sector and the cellular sector in particular, inter alia, following the Gronau Committee recommendations.

1. The cellular roaming tariffs will be examined by a government inter-ministerial team. The team will submit its recommendations regarding the options for lowering the roaming tariffs by the end of 2008. Similarly, the Ministry of Communications, together with other relevant government ministries, will act to apply the European regulations on roaming tariffs by February 28, 2009.

2. An inter-ministerial team from the Ministry of Communications and the Finance Ministry will examine the option of reducing the interlinking tariffs. The team will submit its recommendations by March 31, 2009 (to the best of Pelephone's knowledge, the format for the team has not yet been formulated).

3. The Ministry of Communications will examine the option of the allocation of frequencies for the establishment of an additional communication network by a new operator which will enter the communications market. This examination will be completed until the end of 2008.

Section 3.7.4

At the end of July 2008, the Ministry of communications published its policies regarding the allocation of frequencies, inter alia, regarding the 2.5 GHz frequency range. This frequency range is intended to serve the WiMAX technology in fixed-line telephony as well as 4G technology in the cellular sector. According to the proposed policies, the aforesaid frequencies will be allocated in two separate tenders: The first will take place by the end of 2008 and in its context; frequencies will be allocated to new operators as first priority and to Mirs as second priority (to establish a network with WiMAX technology). The second tender will take place as of mid 2011, after vacating another band of frequencies in the above frequency ranges, and other cellular operators may also participate in this tender. Pelephone submitted its response to the aforesaid policy document and in this context, expressed its objection to Mirs's priority in the first tender and demanded government undertaking to vacate additional frequencies prior to the second tender in order to ensure the natural development path of fourth generation cellular technology.

Section 3.10 – Intangible Assets

Regarding Section 3.10.2 – Right to use frequencies

During 2008, Pelephone requested the Ministry of Communications to execute the allocation of frequencies in the 2100 MHZ range. In order to execute this right, Pelephone is required to pay approximately NIS 181 million in respect of retroactive licensing and frequency fees from the day it won the tender for the frequencies through the day that it executed its right for allocation of the frequencies. During September 2008, Pelephone paid the said amount for the completion of the allocation of frequencies by the Ministry of Communication.

Section 3.15.6 – Credit Rating

On October 28, 2008, Maalot announced the affirmation of the rating of Pelephone's debentures (AA minus).

Section 3.17 – Environment

Regarding Section 3.17.1

On July 17, 2008, a petition was filed on behalf of The Forum for Sane Cellular Consumption and the Israel Union for Environmental Defense with the High Court of Justice requesting an order nisi against the Minister for Environmental Protection, the Minister of Communications and others because of an alleged failure to reach an agreement on the wording of regulations by virtue of sections 25(a)(2) and 25(a)(5) of the Non-ionizing Radiation Law, 5766-2006, despite the obligation stated in the law to issue the said regulations by January 1, 2007. Furthermore, a declaration was requested that until these regulations are issued no construction permits or operating permit would be issued for sources of radiation intended for cellular communications. Simultaneously, a request was also filed for an interim order not to issue construction permits or operating permits for sources of radiation intended for cellular communications until a ruling is made on the petition.

Section 3.18 – Restriction and Control of Pelephone's Actions

Section 3.18.1.4 – the Consumer Protection law

During the month of April 2008, an amendment of the Consumer Protection Law regarding fixed transactions was approved by the Knesset. In this regard, see section 2.16.9 above. Pelephone is examining significance of implementing this regulation and is preparing to implement it.

Section 3.18.3 – Pelephone’s license

Regarding subsection 3.18.3.1(e), during June 2008, the Ministry of Communications published a hearing regarding proper disclosure on telephone bills. During this hearing, a variety of changes in the structure of the invoice were proposed. The hearing was based on the recommendations of the Subcommittee of the Knesset Economics Committee and recommendations of the professional committee of the Ministry of Communications regarding the structure of the invoice, which completed its work recently. Pelephone submitted its position to the Ministry of Communications. Implementation of the recommendations as proposed will require Pelephone to make appropriate operational arrangements.

Regarding subsection 3.18.3.1(f) – during the month of March 2008, the Ministry of Communications made a decision to implement the amendment of the MRT licenses under which the maximum obligation term for customers who are not business customers would be reduced to 18 months, and the carriers would be required to offer customers a reasonable no-obligation alternative. This resolution was passed following a hearing into this matter. Implementation of the amendment commenced on April 22, 2008.

Section 3.18.3.1(g) – during the first quarter of 2008, Pelephone submitted its response to a hearing regarding fixed-term transactions, with respect to the policy format presented. However, on April 14, a request was received from the Ministry of Communications for responses to a further hearing in this regard, under which the Ministry of Communications proposed a new ruling to the effect that a fixed tariff would apply during the obligation period, i.e., as different from the previous hearing: the current amendment proposes that during the obligation period, it will not be possible to amend tariffs. Pelephone submitted its response to the Ministry.

On October 30, 2008 the Ministry of Communications published its final amendment for the cellular licenses which states that as of December 31, 2008 in communication contracts with new subscriptions for plans which include a commitment period, the operators will be obligated to set the service prices in advance and may not update them until the end of the commitment period. Without derogating from the aforesaid, the operators may lower the preset prices during the commitment period. Pelephone is preparing to implement the license amendment.

In September 2008, the Ministry of Communications published an amendment to the cellular operator's licenses regarding the following matters

1) Termination of service to a dormant subscriber – pursuant to this amendment, the operator is entitled to terminate service to a subscriber who does not make use of the cellular service for a period of 12 months. The termination of the service will be made possible after the operator gives notice to the subscriber regarding its intention to terminate the service, in the format as set forth in the said license amendment. A subscriber requesting that the service not be terminated despite being a "dormant subscriber" will not be disconnected by the operator, unless no use is made of the cellular service for a period of 36 months.

2) Blocking end equipment in the event of loss / theft – according to this amendment, the cellular operators are obligated to maintain a joint store of end devices which were reported lost or stolen and ensure that these devices are blocked from any use immediately upon receipt of the loss / theft report.

Following are additional changes that are being considered by the Ministry of Communications:

1) Further to the hearing held on the subject during July 2008, the Ministry of Communications published a legal opinion stating that it is prohibited to make the purchase of a Third Generation (3G) instrument conditional on the purchase of 3G services. According to this opinion, customers must be offered an economically effective alternative for purchasing a 3G instrument without a package of 3G services.

2) According to the policy document of the Ministry of Communications from 2004, the Company will be permitted to market joint packages of services with its subsidiary companies when its market share for fixed telephony services drops to 85% as the Company's market share approaches 85% (in the mean time, the Company's market share in the private sector has dropped to below 85%, see update to section 2.6.1 above). The Ministry of Communications recently announced the hearing including the proposed amendments to Pelephone's license. According to the proposed amendment, the Company and Pelephone will be permitted to market combined packages (for fixed and mobile telephony) but only subsequent to approval being received from the Minister of Communications for marketing the package, on the condition that the package will be completely broken up, meaning that each component of the package will also be offered to customers, at the same price, outside of the package, and on the condition that can be proved that similar packages are available in the market. Pelephone submitted its response to the hearing, in which it expressed its objection to the proposed change.

<u>Section 3.18.3.3 – License for Building Sites</u>

On May 1, 2008, the Attorney General expressed his position regarding wireless access devices and stated that he accepts the opinion that the exemption, according to its wording and purpose, also applies to wireless communications devices for cellular communications and that the exemption represents the balance that the legislator created between the various interests. Despite this, and because of changes and developments in the law and the factual reality, the Attorney General asked that an inter-ministerial committee re-examine the significance and ramifications of continued application of the exemption for cellular devices, the purpose of developing an updated position regarding a worthy justification for the exemption for cellular telephone devices, by the end of 2008.

On May 22, 2008, Tel Aviv District Court, sitting as a Court of Appeals, handed down a ruling regarding the issue of wireless access devices. The main points of its determination were as follows:

a. The exemption from a building permit does not apply to access devices operating in a cellular network that were constructed on the roofs of buildings.

b. Wireless access devices, as defined by law, are fixed devices.

c. The antenna is not included the definition of an exception to the requirement for a building permit for an "internal change in an apartment."

Pelephone disagrees with the District Court's ruling and on June 10, 2008, it filed a request for permission to appeal to the Supreme Court.

On July 21, 2008, the Union of Local Authorities in Israel and others filed a petition with the High Court requesting an order nisi instructing the Attorney General to appear and explain, *inter alia,* why the enforcement guidelines he issued to municipal prosecutors stating that charges are not be filed and administrative demolition orders are not to be issued for the construction and operation of the cellular access devices without a permit should not be cancelled. Furthermore, the High Court was asked to determine, *inter alia*, that the position of the Attorney General (in a document dated May 1, 2008) suffers from an extreme lack of reasonableness. Furthermore, a request was made for an interim order to the Attorney General instructing him to defer or suspend the validity of the enforcement guidelines or, alternately, to forbid the construction of cellular access devices without a building permit, until the court meets and rules on the petition.

It is hereby clarified that Pelephone continues to construct wireless access devices. If Pelephone's position is rejected by the courts, in whole or in part, it will have an adverse impact on the possibility of deploying sites, the pace of deployment, etc. In the event that it is necessary to cease the operation of access devices, there will also be damage to service in the areas where these devices operate.

Section 3.21 – Legal proceedings

For updates on the subject of legal proceedings, see Note 6 to the financial statements of the Company for the period ended September 30, 2008.

Section 3.24.1 – Macro-economic risk factors

During the current quarter, subsequent to the worldwide economic crisis, global markets have entered a slowdown and credit choke. This situation is expected to continue to be felt throughout 2009 and possibly beyond, and there may be a shift from growth to recession. In the local market the slow down is also expected to be significant, as is a decline of the central economic parameters. This decline is liable to have negative impact on the results of the Pelephone's operations in 2009.

Impacts which could derive from the changes in the economic climate are, among others:

1. Decline in recruiting new subscribers, churn / silencing of existing subscribers.
2. Decrease in revenues resulting from the decline in use, price erosion and reduction in the number of users of additional services.
3. Changes to the exchange rate which will impact the profitability of the sale of end equipment and financing costs.
4. Inflationary changes.

This information includes forward looking information based on internal estimates of the Pelephone. The actual results may be materially different from the foregoing estimates if changes take place in any of the factors taken into account for this assessment.

4. International Communications, Internet Services and NEP – Bezeq International Ltd. ("Bezeq International")

Section 4.1.2 – Statutory and Standards Limitations on Bezeq International

On March 12, 2008, a report was published by the Committee to Formulate Detailed Recommendations on Policy and Rules of Competition in the field of Communications in Israel headed by Prof. Reuven Gronau. Inter alia, the report includes recommendations regarding the areas of operations of Bezeq International, which, if adopted by the Ministry of Communications in setting its policy, will affect the management of Bezeq International's business. Additionally, the Committee recommended: that a permit be given to the subsidiaries of the Company to supply unbundled service packages, including the Company's telephony and broadband services, after implementation of the local loop unbundling arrangement (see update to section 1.1 above); that on such date, the subsidiaries shall be granted special domestic carrier licenses for the provision of domestic carrier services that are not VOB; and that the entry of new players controlled by the mobile telephony companies shall be permitted into the international call sector, after the method of prescription of tariffs for international calls via mobile handsets is changed so that the international call tariff is set by the international calling company, which will pay the cellular carrier in accordance with the tariff set out in the Interconnect Regulations for call completion.

For an update regarding publication of the recommendations of the Gronau Committee, see also update to section 1.1 above.

On August 13, 2008, the Minister of Communications published his decision regarding setting policy and competition guidelines in the field of communications in Israel, on the basis of the conclusions of the Gronau Commission, which were published in March 2008. In the estimation of Bezeq International, the decisions of the Minister will not have an impact on its business operations in the near future and, in any case, it is currently unable to assess their possible long-term impact since the implementation of changes in its field of activity require, according to the Minister's decision, completion of an extended process of preparing regulatory infrastructure, whose nature is uncertain at this time, as well as the creation of new market arrangements, for which it is unclear when and if they will exist.

On July 3, 2008, Bezeq International received a letter from the Director-General of the Ministry of Communications on the subject of the amendment to its general license regarding the sale of packages of services that include both its services and the services of the Company, to which drafts of the amendment to the licenses of Bezeq International and the Company were appended. In the response written to the said letter and during the hearing on this matter that was held in the Ministry of Communications on July 30, 2008, Bezeq International notified the Ministry of Communications of its objections to the proposed wording of the amendment to its general license because, on one hand, the amendment will not alleviate the limitations that currently apply to it and the Company as regards the sale of joint packages of service and, on the other hand, the proposed amendment could change its current situation for the worse and discriminate against it in comparison to its competitors.

Section 4.6 – Competition

During September 2008, Partner Communications Ltd. ("Partner") announced its intention to begin providing internet access services and IP based content and telephony services. Thus, Partner will join, as a competitor, the markets in which Bezeq International operates. Bezeq International's management expects that this act of Partner is expected to impact the operations of Bezeq International and its business results, and however, at the present time Bezeq International is unable to estimate the extent of this impact on its results. Bezeq International is preparing and adjusting its work plans to its assessments in this regard.

Section 4.9 – Intangible Assets

On March 23, 2008, Bezeq International signed an agreement with Gil A.R. Telecom Systems ("**Gil A.R.**") under which Bezeq International acquired all of the operations of Gil A.R. relating to the sale, leasing and service of communications products and switches manufactured by Avaya Office.

Section 4.14 - Investments

As at September 30, 2008, Bezeq International held 34.25% (32.42% under full dilution) of the share capital of Walla! Communications Ltd.

Section 4.19 – Legal proceedings

With respect to section 4.19.2 of the Periodic Report of the Company for 2007, regarding the claim filed against Bezeq International and against two other international carriers on grounds of breach of patent for a pre-paid telephone system by persons claiming to be the inventors and owners of such patent, the Court accepted the parties request to defer the dates set in the proceedings in order to enable them to conclude the out of the court compromise negotiations conducted between them.

For further updates on the subject of legal proceedings, see Note 6 to the financial statements of the Company for the period ended September 30, 2008.

Section 4.21 – Risk Factors

During the current quarter, subsequent to the worldwide economic crisis, global markets have entered a slowdown and credit choke. The impact of this situation is expected to continue to be felt throughout 2009 and possibly beyond, and there may be a shift from growth to recession. In the local market the slow down is also expected to be significant, as is the decline of business operations and of the central economic parameters. Bezeq International's management expects that these events may impact the operations of Bezeq International and its business results, and at the present time Bezeq International is unable to estimate the extent of this impact on its results However, Bezeq International is preparing and adjusting its work schedules in this regard.

This information includes forward looking information based on internal estimates of the Company. The actual results may be materially different from the foregoing estimates if changes take place in any of the factors taken into account for this assessment.

5. Multi-channel Television – D.B.S. Satellite Services (1998) Ltd. (“DBS”)

Section 5.1.3 – Developments in markets in the area of operations

Section 5.1.3.3 – the private bill regarding the inclusion of two designated channels and the education television channel in the DTT system was approved in a preliminary reading by the Knesset Plenum. A number of private bills dealing with the addition of other channels to the cluster of channels intended for broadcast via the DTT system were also submitted to the Knesset and to the best of DBS’s knowledge they are currently in the initial processes of enactment. To the best of DBS's knowledge, the Second Authority for Television has chosen the winner of the tender that it published for the supply of broadcasting equipment which will serve for the establishment of the distribution system. In DBS's estimate, the distribution system will begin operation only in the second quarter of 2009.

Section 5.1.3.5 – in March 2008, the Minister of Communications published the recommendations of the Gronau Committee. The recommendations deal with the areas of telephony, internet and multi-channel broadcasts. Among other recommendations, the Committee recommended requiring multi-channel broadcasting companies to offer their subscribers a narrow channel package containing 5-10 channels, having the characteristics set out in the recommendations. The Committee also recommended not to remove the structural separation applying to the Company at this stage, due to its status in the field of fixed-line telephony, and recommended that subsidiaries of the Company, including DBS, not be allowed to supply “service packages” including the Company’s services (including IPTV services) until its other recommendations regarding infrastructure and the Company’s services are implemented. DBS expressed its opposition to and reservations regarding the recommendations to the Minister of Communications.

For an update regarding publication of the recommendations of the Gronau Committee and the decisions of the Minister, see also the update to section 1.1 above.

In August 2008, the Government decided, inter alia, that the Communications Law will be amended as such that as of March 1, 2011 DBS and the cable companies will be obligated to allow any subscriber to connect to a basic package including Channel 1, Channel 33, Channel 2, Channel 10 and the Knesset Channel (in this section - "the Basic Package") against payment for the connection to the broadcasting center, which will be calculated on the basis of subscriber connection costs plus reasonable profit; to allow any subscriber to purchase any other broadcast whereby the tariff for the acquisition of several broadcasts shall not be set in a manner that will be conditional as aforesaid; to set a price that will be paid by the owners of the channels in the basic package to the cable companies and to DBS for transferring their broadcasts and this on the basis of usage cost plus reasonable profit; DBS and the cable companies will be entitled to broadcast commercials as of April 1, 2010 when the Commission will establish rules with respect to maximum broadcast time for the various types of channels for a period of three years, which will enable the gradual broadcast of commercials; an order will be legislated with respect to the broadcast of joint channels in the format set forth in section 6(20)1 of the Law, which will expire. In addition, the Government decided to instruct the Commission to examine cancellation of the restrictions applicable to the special license holders for cable broadcasts that do not exist for DBS and the cable companies and the establishment of an inter-ministerial committee headed by a representative of the Ministry of Communications to examine the method of arrangements in the commercial television broadcast sector.

In September 2008 the inter-ministerial committee was established, headed by the CEO of the Ministry of Communications and in October 2008, the committee announced a hearing which included a series of questions regarding the probability of granting additional licenses, including method of distribution to the public and their terms and conditions. DBS has not yet submitted its responses with regard to this hearing.

On October 29, 2008, the Government published the Settlements in the State Economy (Legislative Amendments for Achieving Budget Goals and Economic Policies for Fiscal Year 2009) Bill 5768-2008, which anchored the aforesaid principles of the Government decision in legislature. In DBS's estimation, it is possible that the dissolution of the Knesset for the purpose of elections to be held on February 14, will defer the legislature until the first session of the Knesset following the elections.

In June 2008, the Council published a hearing regarding a new policy relating to broadcast of sports on multi-channel television, effective January 2009. According to the hearing, the Council’s intention is to expand the protection of content broadcast on the basic sports channel (Channel 5) and the channel known as Channel 5+ and to impose limitations on the broadcast of live sporting events on the pay sports channels. Furthermore, according to the hearing, the imposition of an obligation to broadcast certain sporting events using the PPV method for a defined payment is being considered. In July 2008, DBS submitted its response, in which it objected to implementation of the policy discussed at the hearing. In October 2008, the Commission announced that it intended to reduce a number of aspects of the restrictions presented in the above hearing, and accordingly requested DBS's opinion with regard to two options for regulating the sport broadcast market, which in principle is the imposition of restrictions on the pay-for sports channels produced by the Sport Channel Ltd., and extension of the obligations applicable to Channels 5 and 5+ which are included in the basic package and in the sports package, respectively. DBS clarified its opinion in this matter, according to which he objects to any expansion of the regulation on the matter of the sports channels or the imposition of additional restrictions.

In September 2008, the Commission announced a hearing with respect to granting of special license to broadcast a movie and series channel on DBS and the cable companies. According to the hearing, the Commission is considering that the actual granting of the aforesaid license and its terms and conditions, whatever they may be, will limit the ownership of such organization to a number of special licenses and obligating the holders of more than one special license to invest in original productions. DBS objected to the actual hearing with regard to granting new licenses before the issue of transfer fees which will be paid by the special license holders is settled. Furthermore, DBS submitted its responses to the hearing, according to which the granting of special licenses to broadcast movie and series channels should not be permitted or the restriction regarding the maximum number of licenses granted to a single organization should be changed. DBS also requested to equate the obligation to pay license holders royalties as aforesaid, to its obligations and to obligate an organization holding more than one license with a higher obligation to produce original productions than that imposed on DBS.

Section 5.6 – Competition

Entry of a cellular company to the multi-channel television sector:

To the best of DBS's knowledge, Partner Ltd, a cellular operator in Israel, is planning to soon launch a new venture which will include, inter alia, entering the ISP service sector, the VoIP service sector and the content and broadcasts (particularly VOD) sector. Apparently, the provision of these services will initially be via the PC and later via the television screen with end equipment that will also allow reception of channels distributed by means of DTT.

To the best of DBS's knowledge, Celcom Israel Ltd, which is also a cellular operator in Israel, is going to be a partner in a joint venture which will launch a television venture and will offer customers VOD services over the television screen and broadcasts transferred over the internet. This service will be enabled with end equipment which, apparently, will also allow viewing of channels which are distributed by means of DTT.

In September 2008, DBS demanded from the Ministry of Communications to stop all activities of the aforesaid cellular companies taken prior to the matter being examined by the Ministry and until after equality policies with respect to all multi-channel television broadcasts are set. Subsequent to this request, the Ministry announced that it will request clarifications from the cellular companies with respect to their activities in the multi-channel television sector and requested that their response in this matter be given by October 23, 2008.

In October 2008, DBS demanded that the Cable and Satellite Commission proceed and caution the said cellular companies (and any other player wishing to operate in the multi-channel broadcast market) that some extent of supervision will be applicable to them and that the same restrictions and obligations that apply to the multi-channel platforms will also be applicable on them. The Minister of Communication and the Commission Chairman have not yet responded to these demands

Section 5.6.5 – Principal methods for coping with competition

Section 5.6.5(g) – “package of services” – as of April 2008, DBS has ceased marketing a package of services to its subscribers containing broadcasts and high-speed internet connection infrastructure, and has commenced selling the Company’s promotions of high-speed internet connection infrastructure such that subscriber contracts regarding such infrastructure are performed with the Company only. DBS has the option of contracting with a subscriber directly and transferring compensation from the subscriber to the Company.

On July 3, 2008, DBS received a letter from the Ministry of Communications stating that the Ministry is considering an amendment to the Company’s license as a supplementary amendment to the amendment of the DBS license that would make it possible to offer a package of services according to the following principles:

The package of services will be unbundled so that it will be possible to purchase each of the services offered in the package of services separately for the same price it is offered in the package, a package of services may not be offered if is not also offered by the cable companies, marketing of the package of services must be approved by prior request by DBS to the Ministry of Communications. These instructions relate to any service offered by DBS together with services from the Company.

In its response to the letter dated July 27, 2008, DBS objected to the proposed amendment to its license. In its response, DBS also claimed that offering the possibility of offering an unbundled package of services does not provide a true response to the package of services offered by its competitor and that the amendments must apply to marketing of the Company’s telephony services only and not to other services, such as internet infrastructure services. Furthermore, DBS claims that it is necessary to change the supervisory mechanism for offering and services so that is not obliged to receive prior permission from the Ministry of Communications but rather required only to notify it and that offering packages of services should not be limited to offering services of the Company similar to those offered by the cable companies.

Section 5.7.1 – Rental for buildings

In November 2008 DBS signed an agreement to extend the rental contract for its main offices, according to which the original rental period will be extended to October 31, 2014, with DBS having an option to extend the contract by a further five years, and this with a price increase of 5%. Furthermore, the rented space was enlarged and is 8.335 sq. m with additional parking spaces. DBS also extended its rental contract for the additional 1,994 sq.m rented from another party, until July 2010. DBS came to an understanding with regard to increasing the rented space in Nesher to 1,612 sq. m and extending the rental period until May 2011. Furthermore, DBS has rented, as of September 2008 until October 1, 2009, 1,100 sq. m space in Beer Sheva for the purpose of operating a service center. DBS has an option to extend the rental period of the service center for periods and at terms to be decided by the parties.

Section 5.8.1 - Licenses

In October 2008, the Ministry of Communication extended the validity of DBS's special license for providing uplink/downlink services to other communication licensees until October 2013.

Section 5.10.4 – Employee Compensation Plans

For further information regarding the allocation of Company options to the CEO of DBS see Note 8 to the Company's financial statements for the period ended September 30, 2008. Furthermore, in September 2008, the annual grant plan for the CEO of DBS became effective for 2009 – 2010, based on the rate for meeting of certain goals as defined in the plan, subsequent to receiving the consent of the Antitrust Commissioner and the approval of DBS institutes.

Section 5.13 – Finance

Section 5.13.6 –at September 30, 2008, DBS is in compliance with the financial stipulations under the financing agreement.

Section 5.13.8 – since debentures (series A) that were issued by DBS were not registered for trading until July 31, 2008, they will begin bearing annual interest at the rate of 8.4% from that date.

Furthermore, in August 2008,Maalot announced its validation of the BBB- / stable outlook rating for the debentures.

Section 5.15.1 – Subordination of Activity to Specific Laws

During April 2008, the Knesset approved an amendment to the Consumer Protection Law regarding group transactions. On this matter see the update to section 2.16.9, above.

In October 2008, the Ministry of Communications informed DBS that due to the fact that Bank Leumi Ltd (in this section: "Bank Leumi") is part of the consortium of banks in whose favor some of the DBS shareholders attached the DBS share capital held by them on the one hand and on the other hand Bank Leumi's holding in on the other hand as part of the share capital of Keshet Broadcasting Ltd., the concession holder in accordance with the Second Authority for Television and Radio, 5750-1990. As of October 31, 2008 on which the transfer provisions set forth in the Regulations for the granting of a license expired with respect to a parallel holding as aforesaid at a rate exceeding 25% of the concession holder's equity, and one of the qualifying restrictions set forth in the Regulations for granting licenses, in the opinion of the Ministry of Communication, will be applicable with regard to

DBS. The permission to surpass expiry of the transfer provision as aforesaid, was given to DBS by Bank Leumi and by the Ministry of Communication, due to the formulated of a memorandum of agreement between them, according to which the Ministry of Communication will not take any action against DBS for its forgoing position, subject to the splitting of the attachment deeds of the attached DBS shares, so that only the appropriate portion of DBS shares attached to all the banks will be attached in favor of Bank Leumi and subject to compliance with other obligations on the part of Bank Leumi, during the defined period.

Section 5.16.2 – Space segment lease agreements

Second space agreement – on April 28, 2008, the Amos 3 satellite, to be operated by HLL and intended as a downstream satellite for Amos 1 and Amos 2, was successfully launched. In July 2008, its positioning in space was completed. Commencing June 30, 2008, DBS ceased using the satellite Amos 1 and it now uses the satellites Amos 2 and Amos 3 for its satellite segments.

On July 15, 2008, DBS and HLL signed an amendment to the second space agreement stating, *inter alia*, that DBS will lease 13 space segments from HLL, instead of 14 and DBS will cease leasing the 13th segment until another agreement is made between the parties, according to the mechanism stated in the agreement. Furthermore, a mechanism for back-up was set up using satellite Amos 3 in the event that space segments are not available on satellite Amos 2.

Section 5.16.4 – Agreement for Telephony Service Center

As of January 1, 2009, DBS intends to independently operate the service center which to date was operated by Bezeq On-line Ltd., in Beersheva.

Section 5.17 – Joint Venture agreements

Section 5.17.1 – as set out in the update to section 5.6.5(g), this joint venture has ended.

Section 5.18 – Legal Proceedings

Regarding the claim against Pace and the counterclaim (section 5.18.1): on July 3, 2008, the registrar rejected the respondent’s request to erase the suit, while determining that the nominal amount in the statement of claim is the maximum amount that DBS may receive if it wins the suit, including the amount of value added tax for which it was required to pay a fee. Similarly, the request of DBS to grant an order correcting the statement of defense and the statement of countersuit submitted by the respondent was rejected. A pretrial hearing was set for December 16, 2008.

The class action claim regarding the sports channel (section 5.18.6): on May 29, 2008, DBS, in cooperation with the cable company, submitted a summary of its claims regarding the primary appeal and also a summary of its claims regarding the counter-appeal. On June 23, 2008, appellants submitted summaries of their responses to the primary appeal and a summary of their response to the counter-appeal. On July 9, 2008, D.B.S., in cooperation with the cable company, filed summaries of their response to the counter-appeal. A court date for the hearing the appeal and counter-appeal has been set for June 17, 2009.

Re the deficit demand from the Customs Department (Section 5.18.7): In April 2008, the Taxation Authority stated that there is nothing preventing the VAT in the cash invoice from being paid by DBS, which shall be entitled to deduct the input tax contained therein. Therefore, DBS paid the value added tax. In July 2008, the parties signed a compromise agreement that brings to an end the dispute over the demand for deficit taxes, subject to the payment of approximately NIS 1.5 million by DBS.

For further updates on the subject of legal proceedings, see Note 6 to the financial statements of the Company for the period ended September 30, 2008.

Section 5.21.1.2 – Macro Risks

During the current quarter, subsequent to the worldwide economic crisis, global markets have entered a slowdown and credit choke. The impact of this situation is expected to continue to be felt throughout 2009 and possibly beyond, and there may be a shift from growth to recession. In the local market the slow down is also expected to be significant, as is the decline of business operations and of the central economic parameters. The anticipated economic slowdown is expected, *inter alia*, to lead to a decrease in the number of DBS subscribers, decrease in DBS revenues and to harm the results of its operations. Furthermore, if the economic slowdown leads to harming the operations or termination of the operations of significant suppliers, it is possible that this will have a negative impact on DBS's operations.

This information includes forward looking information based on internal estimates of the Company. The actual results may be materially different from the foregoing estimates if changes take place in any of the factors taken into account for this assessment.

Section 5.21.3 – Special risks to DBS

Section 5.21.3.5 - as set out in the update to section 5.16.2 above, commencing July 2008, DBS ceased using the Amos 1 satellite and it now uses the Amos 2 and Amos 3 satellites.

Section 5.21.3.6 as stated above, commencing July 2008 HLL is the only owner of rights with whom DBS has a contract for leasing space segments.

November 24, 2008	
Date	Bezeq – The Israel Telecommunication Corp. Ltd.

Names and titles of signatories:

Shlomo Rodav – Chairman of the Board

Avi Gabbay, CEO

Directors' Report on the State of the Company's Affairs for the period ended Sept 30, 2008

Chapter B of the Periodic Report

Directors' Report on the State of the Company's Affairs For the nine-month period ended September 30, 2008

We respectfully present the Directors' Report on the state of affairs of Bezeq - The Israel Telecommunication Corp. Limited (hereinafter: "the Company") and the consolidated Group companies (the Company and the consolidated companies together are hereinafter collectively referred to as “the Group”), for the nine month period ended September 30, 2008 (hereinafter: "the Directors' Report").

The Directors’ Report includes a condensed review of the Company’s affairs and it assumes that the Directors’ Report for December 31, 2007 is also available to the reader.

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

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

The Company has an additional area of operations which is not material to the Group's operations, and which has been included in the financial statements of September 30, 2008 as another business segment, which mainly includes customer call center services and investment in a venture capital fund.

Net earnings in the first nine months of 2008 amounted to NIS 1.229 billion, compared to net earnings of NIS 1.056 billion in the corresponding period last year. Net earnings attributable to the shareholders of the Company amounted to NIS 1.329 billion, compared to NIS 1.015 billion in the corresponding period last year. The increase in net earnings is due to an increase in earnings in all segments, with the exception of the multi-channel television segment, where there was an increase in the loss. See below for further details.

1. Financial position

A. The financial statements are drafted in accordance with International Financial Reporting Standards (IFRSs).

B. The Group's assets on September 30, 2008 amounted to approximately NIS 14.74 billion, compared to approximately NIS 15.55 billion on September 30, 2007. Of these, approximately NIS 5.96 billion (40%) are property, plant and equipment, compared to approximately NIS 6.08 billion (39%) on September 30, 2007.

The decrease in the Group's assets is due to the domestic fixed-line communications segment. There was a decline in total assets in this segment, not including investment in subsidiaries, compared to the corresponding period , in the amount of NIS 1.12 billion, mainly due to the sale of financial assets held for trading, which were used for financing and investment activities. In addition, there was a decrease in the net book value of property, plant and equipment resulting from the difference between the depreciation expense and investment made during the reporting period and a decrease in the deferred taxes balance. The decrease in the assets was offset by an increase in cash and cash equivalents and in trade receivables.

In the cellular segment, assets increased from approximately NIS 4.25 billion on September 30, 2007 to approximately NIS 4.54 billion on September 30, 2008. The increase was mainly due to an increase in frequency rights and the trade receivables balance, mainly due to the termination of discounting of credit card payments. In addition, there was an increase in depreciated cost of property, plant and equipment resulting from the difference between the depreciation expense and investment made during the reporting period. On the other hand, there was a decrease in the cash balance and a reduction in the tax asset due to the sale of the asset recorded in the past for losses.

In the international communications, internet and NEP services segment, there was an increase in total assets compared to September 30, 2007, mainly due to the increase in the trade receivables balance and advance long-term expenses for user rights of capacities. The increase was offset by a reduction in the cash balances used for early payment of loans.

In the multi-channel television segment, there was an increase in total assets compared to September 30, 2007, which was mainly due to an increase in broadcasting rights and an increase in the net investment balance in property, plant and equipment.

C. The equity attributable to the shareholders of the Company on September 30, 2008, amounted to approximately NIS 4.4 billion, representing 29.9% of the total balance sheet, compared to approximately NIS 4.22 billion on September 30, 2007, representing 27% of the total balance sheet. The increase in equity is mainly due to the Group's net profit, which was mainly offset by distribution of a dividend amounting to approximately NIS 1.514 billion.

D. Group debt to financial institutions and debenture holders on September 30, 2008, amounted to approximately NIS 6.22 billion, compared to approximately NIS 6.87 billion on September 30, 2007. The decrease is mainly due to repayment of debentures in the amount of approximately NIS 601 million in the domestic fixed line communication segment. Total repayment of debentures and loans in the Group amounted to approximately NIS 922 million. The decrease was mainly offset by revaluation of the CPI-linked loans and debentures due to a sharp rise in the CPI.

The Company's auditors have highlighted the financial position of DBS in the financial statements. As mentioned in Note 5, as of September 30, 2008 DBS meets the financial criteria set for it, following the amended stipulations in respect of 2008 placed upon it by the banks on March 5, 2008 and June 25, 2008 as adapted to the subsidiary's 2008 annual budget and to certain prescribed operational data. The continuation of the operations of DBS is also conditional on compliance with conditions set for 2008 and/or further relief to be received during the year. The management of DBS believes that the financial resources available to it will be sufficient for its operational requirements in the coming year based on the forecasted cash flow approved by the board of directors of DBS.

E. The Group's cash and other current investment balances on September 30, 2008, amounted to approximately NIS 1.259 billion compared to approximately NIS 2.085 billion on September 30, 2007. The decrease is mainly due to a decrease in current investment balances in the domestic fixed-line communications segment, which was partially offset by the increase in cash balances, due to positive cash flows from current operations in this segment and in the principal segments of the Group's operations.

2. Results of operations

A. Principal results

	Nine months ended September 30				Three months ended September 30			
	2008	2007			2008	2007		
	NIS millions	NIS millions	Increase (Decrease)	%	NIS millions	NIS millions	Increase (Decrease)	%
Revenues from sales	9,345	9,280	65	0. 7%	3,159	3,139	20	0. 6%
Costs and expenses	7,059	7,457	(398)	(5.3%)	2,337	2,543	(206)	(8.1%)
Operating income	2,286	1,823	463	25.4%	822	596	226	37.9%
Financing expenses, net	469	265	204	77%	186	134	52	38.8%
Profit after financing expenses, net	**1,817**	**1,558**	**259**	**16.6%**	**636**	**462**	**174**	**37.7%**
Company's share in profits of investees accounted by the equity method	4	2	2	100%	2	1	1	100%
Profit before taxes	**1,821**	**1,560**	**261**	**16.7%**	**638**	**463**	**175**	**37.8**%
Income tax	592	504	88	17.5%	207	133	74	**55.6%**
Profit for the period	**1,229**	**1,056**	**173**	**16.4%**	**431**	**330**	**101**	**30.6%**
Attributable to:								
The shareholders of the Company	1,329	1,015	314	30.9%	462	255	207	81.2%
Non-controlling interests	(100)	41	(141)		(31)	75	(106)	
Profit for the period	**1,229**	**1,056**	**173**	**16.4%**	**431**	**330**	**101**	**30.6%**
Earnings per share								
Basic earnings per share (in NIS)	0.51	0.39	0.12	30.8%	0.18	0.10	0.08	80%
Diluted earnings per share (in NIS)	0.50	0.38	0.12	31.6%	0.17	0.09	0.08	88.9%

Group revenue in the first nine months of 2008 amounted to approximately NIS 9.35 billion compared to approximately NIS 9.28 billion in the corresponding period, an increase of approximately 0.7%.

Group revenue in the third quarter of 2008 amounted to approximately NIS 3.16 billion compared to approximately NIS 3.14 billion in the corresponding period, an increase of approximately 0.64%.

The increase is mainly due to the cellular and multi-channel television segment, which was partially offset by a decrease in the domestic fixed-line communications segment.

The Group's depreciation and amortization expenses in the first nine months of 2008 amounted to approximately NIS 1.274 billion, compared to approximately NIS 1.323 billion in the corresponding period, a decrease of approximately 3.7%.

The Group's depreciation and amortization expenses in the third quarter of 2008 amounted to approximately NIS 423 million, compared to approximately NIS 445 million in the corresponding period , a decrease of approximately 4.9%. The decrease was mainly due to the domestic fixed-line communications segment and the multichannel television segment, which was partially offset by an increase in expenses in the cellular segment.

The Group's salary expenses in the first nine months of 2008 amounted to approximately NIS 1.774 billion, compared to approximately NIS 1.757 billion in the corresponding period, an increase of approximately 1%. The increase is due to an increase in salary expenses in all segments, with the exception of the domestic fixed-line communication segment, where there was a decrease in salary expenses.

The Group's salary expenses in the third quarter of 2008 amounted to approximately NIS 573 million, compared to approximately NIS 597 million in the corresponding period, a decrease of approximately 4%. The decrease is due to a decrease in salary expenses in the domestic fixed-line communication segment, which was partially offset by an increase in salary expenses in the other Group segments.

The Group's operating and general expenses in the first nine months of 2008 amounted to approximately NIS 4.03 billion, compared to approximately NIS 4.31 billion in the corresponding period in the prior year, a decrease of approximately 6.5%.

The Group's operating and general expenses in the third quarter of 2008 amounted to approximately NIS 1.34 billion, compared to approximately NIS 1.48 billion in the corresponding period in the prior year, a decrease of approximately 9.5%. The decrease is due to a decrease in expenses in all the segments.

Profit for the period attributable to the shareholders of the Company in the first nine months of 2008 amounted to NIS 1.329 million, and in the third quarter NIS 462 million. Profit was affected by the early application of international standards, whereby 58% of the losses of DBS were included in the part of the Company's shareholders – for further details, see Note 3(A)(4) to the financial statements.

B. Operating segments

Below are details of operations according to segments stated by the operating segments of the Group:

Revenue by segment of operations	1-9/2008		1-9/2007		7-9/2007		7-9/2007	
	NIS millions	% of total revenues	NIS millions	% of total revenues	NIS millions	% of total revenues	NIS millions	% of total revenues
Domestic fixed-line communication	4,150	44.4%	4,260	45.9%	1,388	43.9%	1,425	45.4%
Cellular	3,575	38.2%	3,502	37.7%	1,214	38.4%	1,203	38.3%
International communications, internet and NEP services	969	10.4%	970	10.5%	329	10.4%	326	10.4%
Multi-channel television	1,136	12.2%	1,067	11.5%	375	11.9%	360	11.5%
Others and adjustments	(485)	(5.2%)	(519)	(5.6%)	(147)	(4.6%)	(175)	(5.6%)
Total	9,345	100%	9,280	100%	3,159	100%	3,139	100%

Operating income by segment of operations	1-9/2008		1-9/2007		7-9/2007		7-9/2007	
	NIS millions	% of total revenues	NIS millions	% of total revenues	NIS millions	% of total revenues	NIS millions	% of total revenues
Domestic fixed-line communications	1,218	29.3%	939	22.0%	422	30.4%	327	23.0%
Cellular	774	21.6%	672	19.2%	293	24.1%	219	18.2%
International communications, internet and NEP services	176	18.2%	159	16.4%	59	17.9%	54	16.6%
Multi-channel television	122	10.7%	51	4.8%	52	13.9%	(4)	(1.1%)
Other and setoffs	(4)		2		(4)		-	
Operating income	2,286		1,823		822		596	

<u>Domestic fixed-line communications</u>

Revenues:

Revenues in the first nine months of 2008 amounted to approximately NIS 4.15 billion compared to approximately NIS 4.26 billion in the corresponding period in the prior year, a decrease of approximately 2.6%.

Revenues from the segment in the quarter amounted to approximately NIS 1.39 billion compared to NIS 1.43 billion in the corresponding period last year, a decrease of approximately 2.8%.

The decrease in the segment's revenue is due to a decrease in interconnect fees to the cellular networks (as well as a decrease in expense). An additional decrease is due to a decrease in the number of lines (mainly due to number portability), a reduction in call traffic and a decrease in tariffs in June 2007 and June 2008. The decrease in revenues was offset mainly by ongoing growth in revenues from high-speed internet service (ADSL) due to an increase the number of subscribers and sales of household networks as well as due to an increase in income from data communication services. The Company's auditors continue to draw attention to the growing competition, changes in the communications market and the impact of regulation on the financial situation of the Group and the results of its operations

Costs and expenses:

Depreciation expenses in the first nine months of 2008 amounted to approximately NIS 643 million compared to approximately NIS 709 million in the corresponding period in the prior year, a decrease of approximately 9.3%.

Depreciation expenses in the quarter amounted to approximately NIS 214 million compared to approximately NIS 236 million in the corresponding quarter, a decrease of approximately 9.3%.

The decrease is due to full depreciation of property, plant and equipment and a decrease in investments in new property.

Salary expenses in the first nine months of 2008 amounted to approximately NIS 905 million compared to approximately NIS 964 million in the corresponding period , a decrease of approximately 6.1%.

Salary expenses in the quarter amounted to approximately NIS 289 million compared to approximately NIS 328 million in the corresponding quarter, a decrease of approximately 11.9%.

The decrease in salary expenses is due mainly to retirement of employees, partially offset by share-based payments.

Operating and general expenses in the first nine months of 2008 amounted to approximately NIS 1.398 billion compared to approximately NIS 1.576 billion in the corresponding period , a decrease of approximately 11.3%.

General and operating expenses in the quarter amounted to approximately NIS 464 million compared to approximately NIS 509 million in the corresponding quarter, a decrease of approximately 8.8%.

The decrease in general and operating expenses is mainly due to a reduction in interconnect fees to cellular operators alongside a decrease in income, update of the provision for royalties, cancellation of the provision for international suppliers and implementation of efficiency measures that resulted in a decrease in operating expenses.

Other operating revenues in the first nine months of 2008 amounted to approximately NIS 14 million, compared to expenses of approximately NIS 72 million in the corresponding period.

Other net operating revenues in the quarter amounted to approximately NIS 1 million compared to expenses of approximately NIS 25 million in the corresponding period. . This is mainly due to provisions recorded for lawsuits in the corresponding period compared to capital gain and a decrease in provisions in the reporting period.

Operating income:

The segment's operating income in the first nine months of 2008 amounted to approximately NIS 1.218 billion compared to approximately NIS 939 million in the corresponding period, an increase of approximately 29.7%.

Operating income from the segment in the quarter amounted to approximately NIS 422 million compared to approximately NIS 327 million in the corresponding quarter, an increase of approximately 29%.

The improvement in operating income is due to the changes described in the expenses and revenues section above.

Cellular

Revenues:

Revenues from the segment in the first nine months of 2008 amounted to approximately NIS 3.58 billion compared to approximately NIS 3.5 billion in the corresponding period, an increase of approximately 2.3%.

Revenues from the segment in the quarter amounted to approximately NIS 1.21 billion compared to approximately NIS 1.2 billion in the corresponding quarter, an increase of approximately 0.8%.

The increase is mainly due to an increase in the number of subscribers, in particular 3G subscribers, which led to an increase in revenue from user fees and from content services. This was partially offset by a decrease in average revenue per user, mainly due to erosion of fees for outgoing calls and a decrease in interconnecting fees.

Costs and expenses:

Depreciation and amortization expenses in the first nine months of 2008 amounted to approximately NIS 388 million compared to approximately NIS 353 million in the corresponding period, an increase of approximately 9.9%.

Depreciation expenses in the quarter amounted to approximately NIS 129 million compared to approximately NIS 121 million in the corresponding quarter, an increase of approximately 6.6%.

Salary expenses in the first nine months of 2008 amounted to approximately NIS 486 million compared to approximately NIS 444 million in the corresponding period, an increase of approximately 9.5%.

Salary expenses in the quarter amounted to approximately NIS 157 million compared to approximately NIS 150 million in the corresponding quarter, an increase of approximately 4.6%.

The increase in salary expenses is mainly due to recognition of expenses for share-based payments and salary updates.

Operating and general expenses in the first nine months of 2008 amounted to approximately NIS 1.927 billion compared to approximately NIS 2.033 billion in the corresponding period, a decrease of approximately 5.2%.

General and operating expenses in the quarter amounted to approximately NIS 635 million compared to approximately NIS 713 million in the corresponding quarter, a decrease of approximately 11%.

The decrease is mainly due to a decrease in the amount of devices sold and upgraded and a decrease in costs of terminal equipment following a decrease in the dollar exchange rate.

Operating income:

Operating income in the segment in the first nine months of 2008 amounted to approximately NIS 774 million compared to approximately NIS 672 million in the corresponding period, an increase of approximately 15.2%.

Operating income in the segment in the quarter amounted to approximately NIS 293 million compared to approximately NIS 219 million in the corresponding quarter, an increase of approximately 33.8%.

The improvement in operating income is due to the changes described in the expenses and revenues sections above.

<u>International communications, internet services and NEP</u>

Revenues:

Group revenue in the first nine months of 2008 amounted to approximately NIS 696 million compared to approximately NIS 970 million in the corresponding period, a decrease of approximately 0.1%.

Revenues from the segment in the quarter amounted to approximately NIS 329 million compared to approximately NIS 326 million in the corresponding quarter, an increase of approximately 0.9%.

In this sector, there was a decrease in operations relating to call transfers between communication operators around the world. Conversely, there was an increase in the Company's revenues from outgoing international calls due to an increase in the volume of outgoing minutes, an increase in revenues from internet due to an increase in the number of broadband subscribers, and an increase in integration activities and communication solutions for corporate customers.

Costs and expenses:

Depreciation expenses in the first nine months of 2008 amounted to approximately NIS 60 million compared to approximately NIS 66 million in the corresponding period in the prior year, a decrease of approximately 9.1%.

Depreciation expenses in the quarter amounted to approximately NIS 20 million compared to approximately NIS 21 million in the corresponding quarter, a decrease of approximately 4.7%.

Salary expenses in the first nine months of 2008 amounted to approximately NIS 197 million compared to approximately NIS 182 million in the corresponding period, an increase of approximately 8.2%.

Salary expenses in the quarter amounted to approximately NIS 67 million compared to approximately NIS 61 million in the corresponding quarter, an increase of 9.8%.

The increase in salary expenses is mainly due to an increase in the number of employees in response to higher operational requirements and share-based payments.

Operating and general expenses in the first nine months of 2008 amounted to approximately NIS 535 million compared to approximately NIS 564 million in the corresponding period, a decrease of approximately 5.1%.

General and operating expenses in the quarter amounted to approximately NIS 183 million compared to approximately NIS 190 million in the corresponding quarter, a decrease of approximately 3.4%.

The decrease is mainly due to a reduction in operations relating to call transfers between communication operators around the world alongside a decrease in revenues.

Operating income:

Operating income in the segment in the first nine months of 2008 amounted to approximately NIS 176 million compared to approximately NIS 159 million in the corresponding period, an increase of approximately 10.7%.

Operating income from the segment in the quarter amounted to approximately NIS 59 million compared to approximately NIS 54 million in the corresponding quarter, an increase of approximately 9.3%.

The improvement in operating income is due to the changes described in the expenses and revenues sections above.

Multichannel television

Revenues:

Revenues in the segment in the first nine months of 2008 amounted to approximately NIS 1.136 million compared to approximately NIS 1.067 million in the corresponding period, an increase of approximately 6.4%.

Revenues from the segment in the quarter amounted to approximately NIS 375 million compared to approximately NIS 360 million in the corresponding quarter, an increase of approximately 4.2%.

The increase in revenues is mainly due to an increase in the average revenue per user (ARPU).

Costs and expenses:

Depreciation expenses in the first nine months of 2008 amounted to approximately NIS 184 million compared to approximately NIS 201 million in the corresponding period, a decrease of approximately 8.5%.

Depreciation expenses in the quarter amounted to approximately NIS 59 million compared to approximately NIS 69 million in the corresponding quarter, a decrease of approximately 14.5%.

Salary expenses in the first nine months of 2008 amounted to approximately NIS 142 million compared to approximately NIS 133 million in the corresponding period ,an increase of approximately 7%.

The increase in salary expenses is mainly due to an increase in the number of employees in response to the increase in operational requirements.

Salary expenses in the quarter amounted to approximately NIS 45 million compared to approximately NIS 46 million in the corresponding quarter, a decrease of approximately 2.2%.

Operating and general expenses in the first nine months of 2008 amounted to approximately NIS 688 million compared to approximately NIS 682 million in the corresponding period, an increase of approximately 0.8%. The increase is mainly due to an increase in content consumption expenses due to broadcasts of original productions, an increase in services and maintenance by subcontractors and an increase in car maintenance expenses, partially offset by a decrease in general expenses.

General and operating expenses in the quarter amounted to approximately NIS 218 million compared to approximately NIS 249 million in the corresponding quarter, a decrease of approximately 12.4%. The decrease is mainly due to a decrease in general expenses.

Operating income:

Operating income in the segment in the first nine months of 2008 amounted to approximately NIS 122 million compared to approximately NIS 52 million in the corresponding period, an increase of approximately 134.6%. The improvement in operating income is due mainly to the increase in revenues as noted above.

Operating income from the segment in the quarter amounted to approximately NIS 52 million compared to a loss of approximately NIS 4 million in the corresponding quarter. The increase in operating income in the quarter is mainly due to a decrease in operating expenses.

C. Financing expenses, net

The Group’s net financing expenses in the first nine months of 2008 amounted to approximately NIS 469 million compared to approximately NIS 265 million in the corresponding period last year, an increase of approximately 77%.

The Group's debt to financial institutions and debenture holders is primarily linked to the CPI and the financing expenses are affected by fluctuations in the index. During the reporting period there was a rise in the index to which the debt balance is linked, compared to the corresponding period , and revaluation of liabilities led to an increase in the Group's financing expenses.

Net financing expenses in the domestic fixed-line communication segment in the first nine months of 2008 amounted to approximately NIS 77 million compared to approximately NIS 164 million in the corresponding period last year, a decrease of approximately 53%. The decrease in net financing expenses compared to the corresponding period is mainly due to an increase in revenues from shareholders’ loans to DBS and a decrease in interest expenses, which were partially offset by an increase in linkage differences expenses and a decrease in interest revenues from deposits.

In the cellular segment, net financing expenses remain unchanged, mainly due to the increase in revaluation of CPI-linked liabilities expenses as a result of a rise in the CPI and an increase in forward transactions and embedded derivatives expenses following a decrease in the exchange rate. This was partially offset by capitalized credit costs for qualified assets and a decrease in net debt.

In the multi-channel television segment, net financing expenses in the first nine months of 2008 amounted to approximately NIS 369 million compared to approximately NIS 89 million in the corresponding period, an increase of approximately 314.6%. The change is mainly due to financing revenues of approximately NIS 213 million recognized in the third quarter in the prior year due to a change in the capitalization rate of shareholders' loans. In addition, the rise in the CPI led to an increase in financing expenses due to the revaluation of CPI-linked liabilities and an increase in the Company’s financial debt.

D. Income tax

The Group's tax expenses in the reporting period amounted to approximately NIS 592 million, representing approximately 32.5% of profit before taxes, compared to approximately NIS 504 million in the corresponding period, representing approximately 32.3% of profit before taxes. Most of the decrease in the tax expenses from profit before income taxes is due to a reduction in the tax rate and the cancellation of the Income Tax (Taxation under Conditions of Inflation) Law. The decrease was offset by the increase in the losses of DBS that are not tax deductible.

3. Liquidity and sources of financing

Consolidated cash flows generated by operating activities in the first nine months of 2008 amounted to approximately NIS 2.65 billion, compared to approximately NIS 2.38 billion in the corresponding period, an increase of approximately NIS 271 million. The increase in cash flows generated by operating activities is mainly due to an increase in operating income in all segments of the Group, and to a change in the balance of trade receivables, which was partially offset by a rise in payments in respect of early retirement, a change in the balance of accounts payable and a decrease in interest received.

Cash flows generated by operating activities are one of the sources of financing of the Group's investments, which during the reporting period included approximately NIS 962 million invested in development of communications infrastructures, compared to investments amounting to approximately NIS 681 million in the corresponding period.

In the reporting period, the Group repaid net debts and paid interest of approximately NIS 1.044 billion, of which approximately NIS 697 million was on account of debentures, NIS 112 million of loans, NIS 266 million of interest payments and NIS 5 million of short-term credit. On the other hand, the Company's net proceeds from the realization of derivative financial instruments was approximately NIS 36 million, compared to payment of net debt and interest payments in the amount of approximately NIS 3.001 billion in the corresponding period.

In the reporting period, cash dividends amounting to approximately NIS 679 million were paid, compared to approximately NIS 2.1 billion paid in the corresponding period.

The monthly average short-term credit average from banks in the first nine months of 2008 amounted to approximately NIS 97 million. The monthly average of long-term liabilities to financial institutions and debenture holders in the first nine months of 2008 amounted to approximately NIS 6.347 billion.

The working capital deficit at September 30, 2008 amounted to approximately NIS 727 million, compared to NIS 1.307 billion in the corresponding period. The improvement is mainly due to the multi-channel television segment, where there was a decrease in deficit of approximately NIS 738 million, mainly from classification of bank loans as long-term loans, in view of compliance with the terms of the financing agreement with the banks and an improvement in the international communication and NEP segment in the amount of approximately NIS 123 million.

The improvement was partially offset by an increase in deficit in working capital in the domestic fixed-line communication segment.

The Board of Directors examined the projected cash flow of the Company, including credit sources and the possibility of a capital raising, and determined that the deficit in working capital does not indicate a problem in the Company's liquidity.

The aforementioned information includes forward-looking information based on the Company's assessments. The actual results may differ significantly from those assessments if a change occurs in one of the factors taken into account in making the assessments.

4. Group involvement in the community and donations

The Group is active in the community through contributions to recognized non-profit organizations that channel funds to education, welfare and other causes, as well as through development of direct volunteering of employees in the community. In the reporting period, Bezeq works with "Matan - Your Way to Give", a non-profit organization that assists companies in implementing their philanthropic vision. In addition, the Company has become a member of "Maale- Business for Social Responsibility", a non-profit membership organization that advocates corporate values. Additionally, Group employees volunteer in additional and diverse community involvement activities. During the reporting period, Group was involved in the community and donated approximately NIS 2.252 million.

5. Exposure to and management of market risks

A. Further to the description in the 2007 Directors' Report, hedging transactions against market risks concerning exposure to fluctuations in the exchange rate and the CPI partially reduced this exposure.

B. The sensitivity analyses for the fair value and the effect of the change in the market prices on the fair value of on- or off-balance sheet contractual agreements on September 30, 2008, are not substantially different from the December 31, 2007 statements. However, the total fair value of net liabilities that are sensitive to fluctuations in the dollar-shekel exchange rate on December 31, 2007 should amount to approximately NIS 1.148 billion. The sensitivity to changes in the dollar interest rate should amount to approximately NIS 622 million, due to the adjusted measuring of communications to space sections, which should amount to approximately NIS 611 million instead of approximately NIS 343 million.

C. The linkage base report on September 30, 2008 is not substantially different from the December 31, 2007 statement.

The excess monetary liabilities over monetary assets in or linked to foreign currency on September 30, 2008 amounted to approximately NIS 88 million in the Group. Forward currency transactions on September 30, 2008 amounted to approximately NIS 232 million. The transactions were also intended to hedge against off-balance sheet liabilities in or linked to foreign currency.

The excess liabilities on financial assets linked to the CPI on September 30, 2008 amounted to approximately NIS 5.818 billion in the Group. As a result of hedging transactions, on September 30, 2008 the net CPI-linked liabilities, which are not hedged by forward transactions, amounted to approximately NIS 4.619 billion.

6. Critical accounting estimates

Preparation of the financial statements according to IFRS requires the management to make estimates and assessments that influence the reported values of assets and liabilities, income and expenses, and disclosure relating to contingent assets and liabilities. Management bases its estimates and assessments on past experience and on additional factors, fair value assessments and opinions which it believes are relevant, taking circumstances into account. The actual results can differ from those assessments based on various assumptions and conditions. Information on the principal matters of uncertainty in critical assessments and judgments in the application of the accounting policies is provided in the annual financial statements. We believe that these assessments and estimates are critical because every change in them and in the assumptions has the potential to materially affect the financial statements.

7. Disclosure regarding the process for approval of the Company's financial statements

The Company organ given the responsibility for oversight is the Board of Directors. The Board of Directors appointed a balance sheet committee whose duties and composition are described in the 2007 Directors’ Report.

The financial statements were discussed at the balance sheet committee and submitted to the Board of Directors for approval. The following officers attended the board discussion: Board members – Shlomo Rodav, Eyal Yaniv, Menachem Inbar, Michael Grabiner, Ran Gottfried, Yoav Rubinstein, Elon Shalev, Kihara Kiarie, David Gilboa, Rami Nomkin, Yitzhak Idelman, Yehuda Porat, Arieh Saban and Adam Chesnoff. In addition, the following officers attended: Avi Gabbay – CEO, Alan Gelman – Deputy CEO and CFO. Representatives of the Company's auditors, Somekh Chaikin, also participated in the discussion.

8. Sundry and events subsequent to the date of the financial statements

A. On June 1, 2008, the general shareholders meeting approved, this subsequent to the approval by the board of directors on April 17, 2008, the employment conditions for the chairman of the Board of Directors as described in Note 7 to the financial statements. The directors examined each component in the compensation package and the package as a whole, and in their opinion the general compensation package is appropriate and reasonable under the circumstances and is compatible with the nature of the position and the challenges facing the chairman and the expectations of the board. The compensation package was also compared to other large companies in Israel and was found to be within the high range of the benchmarks.

B. On September 28, 2008, the general meeting of the Company’s shareholders (after approval of the Board of Directors and its Audit Committee) approved the extension of the Company’s management agreement with a corporation connected to Ap.Sb.Ar. Holdings Ltd., the Company’s controlling shareholder, for an additional three years subsequent to the expiry of the current agreement, under the same terms as the original agreement.

C. In the current quarter, following the global economic crisis, markets worldwide are slowing down and credit is being tightened. The expectation is that the effects of this process will continue to be felt throughout 2009 and a transition from growth to recession seems likely. The Israeli market will also suffer a significant slow-down and business activity and central economic parameters will worsen. The Company estimates that the crisis could have an adverse effect on its operations, but at this stage it is unable to assess the impact of the crisis on the activities of the Group.

The aforementioned information includes forward-looking information based on the Company's assessments. The actual results may differ significantly from those assessments if a change occurs in one of the factors taken into account in making the assessments.

D. At September 30, 2008, the Group's net dollar-linked contractual liabilities (including off-balance sheet) amounted to approximately NIS 909 million. The Group's net CPI-linked liabilities (including off-balance sheet) amounted to approximately NIS 5.517 billion. The dollar exchange rate rose by 16.7% between September 30, 2008, and the date of approval of the financial statements as well as the CPI which rose by 0.1% in October 2008.

E. The Company is exposed to changes in copper prices, resulting in a change in the scrap value of the Company's copper cable infrastructure. For further details, see Note 14(1) in the financial statements.

F. On June 26, 2008, the Company's Board of Directors adopted a policy for management of financial exposure, replacing the former exposure policy. The primary aim of the new policy is to reduce material exposure to market risks that will affect the Group's cash flows and financial results. Based on this policy, the Company will enter into hedging transactions, in part, according to the circumstances and its judgment, primarily to reduce its exposure to changes in the foreign currency exchange and the rate of the CPI.

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

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

“BEZEQ” THE ISRAEL TELECOMMUNICATION CORP. LIMITED

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

SEPTEMBER 30, 2008

(UNAUDITED)

The information contained in these financial statements constitutes a translation of the financial statements published by the Company. The Hebrew version was submitted by the Company to the relevant authorities pursuant to Israeli law, and represents the binding version and the only one having legal effect. This translation was prepared for convenience purposes only.

Condensed Consolidated Interim Financial Statements as at September 30, 2008 (unaudited)

Contents

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

At your request, we have reviewed the consolidated interim balance sheet of "Bezeq" - The Israel Telecommunication Corp. Limited (hereinafter "Company") as at September 30, 2008, as well as the consolidated interim statement of income, the consolidated interim statement of recognised income and expense and the consolidated interim statement 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 associates in which the Company's investments amount to approximately NIS 31 million at September 30, 2008, and the Company's share in the profits in respect thereof amount to approximately NIS 4 million and approximately NIS 2 million for the nine-month and three-month periods then ended, respectively

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

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, the changes in the communications market, and the effects of regulation on the Group's financial position and operating results, as described in Note 1.

2. Claims made against the Group for which the exposure cannot yet be assessed or calculated, and other contingencies as described in Notes 6B and 6C.

3. The financial position of a subsidiary. As mentioned in Note 5A, as at September 30, 2008, DBS meets the financial criteria set for it, following amended stipulations in respect of 2008 received from the banks on March 5, 2008, and June 25, 2008 as adapted to DBS's 2008 annual budget and to certain prescribed operational data. The continuation of the activity of DBS is contingent on, *inter alia*, compliance with the stipulations set for 2008 and/or further relief which may be received during the year.
In the opinion of the management of DBS, the financial resources at its disposal will be sufficient for the requirements of DBS's operations in the coming year, based on the cash flow projections approved by the board of directors of DBS.

Additionally, we draw attention to Note 3A(4) of the consolidated interim financial statements regarding early adoption of IFRS 3 (revised) and IFRS 27 (2008) commencing from January 1, 2008, with restatement of the composition of shareholders' equity and the profit or loss at June 30, 2008 and at March 31, 2008 and for the six-and three-month periods then ended, respectively.

Somekh Chaikin
Certified Public Accountants (Isr.)

November 24, 2008

Condensed Consolidated Interim Balance Sheets at

	September 30 2008	September 30 2007	December 31 2007
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Assets			
Cash and cash equivalents	**1,198**	1,105	1,203
Investments and loans, including derivatives	**61**	980	389
Trade receivables	**2,385**	2,290*	2,403
Other receivables	**218**	192	247
Inventory	**159**	189	203
Current tax assets	**-**	13	11
Assets classified as available for sale	**19**	23	17
Total current assets	**4,040**	4,792	4,473
Trade and other receivables	**584**	519*	535
Investments and loans, including derivatives	**210**	274	233
Broadcasting rights	**264**	224*	243*
Property, plant and equipment	**5,962**	6,075	6,064
Intangible assets	**2,665**	2,526	2,526
Deferred and other expenses	**390**	363	367
Investments in associates accounted by the equity method	**31**	33	37
Deferred tax assets	**592**	743	678
Total non-current assets	**10,698**	10,757	10,683
Total assets	**14,738**	15,549	15,156

Condensed Consolidated Interim Balance Sheets at

	September 30 2008	September 30 2007	December 31 2007
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Liabilities			
Loans and credit	**1,014**	1,971	1,913
Trade payables	**1,243**	1,315	1,533
Other payables, including derivatives	**754**	771*	745
Current tax liabilities	**119**	51	57
Deferred income	**34**	36	47
Provisions	**345**	358	392
Employee benefits	**423**	837*	705
Dividend payable	**835**	760	-
Total current liabilities	**4,767**	6,099	5,392
Debentures	**3,966**	4,425	4,420
Obligations to banks	**1,084**	342	307
Loans from others	**154**	132	136
Loans provided by the minority in a subsidiary	**436**	362	375
Employee benefits	**253**	244	261
Deferred income and others	**14**	37	36
Provisions	**57**	53	57
Deferred taxes	**73**	-	-
Total non-current liabilities	**6,037**	5,595	5,592
Total liabilities	**10,804**	11,694	10,984
Shareholders' Equity			
Share capital	**6,132**	6,132	6,132
Reserves	**721**	685	681
Deficit	**(2,453)**	(2,594)	(2,268)
Total equity attributable to shareholders of the Company	**4,400**	4,223	4,545
Non-controlling interests	**(466)**	(368)	(373)
Total shareholders' equity	**3,934**	3,855	4,172
Total shareholders' equity and liabilities	**14,738**	15,549	15,156

Shlomo Rodav	**Avi Gabbay**	**Alan Gelman**
Chairman of the Board	CEO	Deputy CEO and CFO

Date of approval of the financial statements: November 24, 2008.

* See Note 3C.

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

Condensed Consolidated Interim Statements of Income

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues (Note 9)	**9,345**	9,280	**3,159**	3,139	12,400
Costs and expenses					
Depreciation and amortisation	**1,274**	1,323	**423**	445	1,769
Salary	**1,774**	1,757	**573**	597	2,375
Operating and general expenses (Note 10)	**4,025**	4,307	**1,342**	1,475	5,841
Other operating expenses (income), net	**(14)**	70	**(1)**	26	79
	7,059	7,457	**2,337**	2,543	10,064
Operating income	**2,286**	1,823	**822**	596	2,336
Financing expenses					
Financing expenses	**617**	678*	**225**	357*	796
Financing income	**(148)**	(413)*	**(39)**	(223)*	(487)
Financing expenses, net	**469**	265	**186**	134	309
Profit after financing expenses, net	**1,817**	1,558	**636**	462	2,027
Equity in profits of associates accounted by the equity method	**4**	2	**2**	1	6
Profits before income tax	**1,821**	1,560	**638**	463	2,033
Income tax	**592**	504	**207**	133	672
Profit for the period	**1,229**	1,056	**431**	330	1,361
Attributable to:					
The shareholders of the Company	**1,329**	1,015	**462**	255	1,330
Non-controlling interests	**(100)**	41	**(31)**	75	31
Profit for the period	**1,229**	1,056	**431**	330	1,361
Earnings per share					
Basic earnings per share (in NIS)	**0.51**	0.39	**0.18**	0.10	0.51
Diluted earnings per share (in NIS)	**0.50**	0.38	**0.17**	0.09	0.50

* See Note 3C.

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

Condensed Consolidated Interim Statements of Recognised Income and Expense

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Net change in fair value of financial assets classified as available for sale	**-**	9	**-**	5	4
Net change in fair value of financial assets classified as available for sale transferred to profit and loss	**(5)**	-	**-**	-	-
Actuarial gains from a defined benefit plan (1)	**-**	-	**-**	-	14
Taxes in respect of income and expenses charged directly to equity	**1**	(2)	**-**	(1)	(4)
Foreign currency translation differences	**(9)**	-	**2**	-	-
Income and expenses recognised directly to equity	**(13)**	7	**2**	4	14
Profit for the period	**1,229**	1,056	**431**	330	1,361
Total income and expense recognised for the period	**1,216**	1,063	**433**	334	1,375
Attributable to:					
The shareholders of the Company	**1,316**	1,022	**464**	259	1,344
Non-controlling interest	**(100)**	41	**(31)**	75	31
Total income and expense recognized for the period	**1,216**	1,063	**433**	334	1,375

(1) The Group does not recalculate its actuarial commitment in each interim reporting period unless there are significant changes in the benefit plans or fundamental changes in market conditions during the interim period that affect the Group' actuarial commitment. As a result, actuarial gains or losses in the reporting period are not recognised.

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

Condensed Consolidated Interim Statements of Cash Flows

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cash flows from operating activities					
Profit for the period	**1,229**	1,056	**431**	330	1,361
Adjustments:					
Depreciation	**1,061**	1,116	**354**	375	1,482
Amortisation of intangible assets	**183**	191	**59**	65	270
Amortisation of deferred and other charges	**30**	16	**10**	5	17
Loss from decrease in holding in companies accounted by the equity method	**-**	1	**-**	1	1
Financing expenses. net	**537**	319*	**217**	140*	372
Equity in earnings of associates accounted by the equity method	**(4)**	(2)	**(2)**	(1)	(6)
Capital gain, net	**(21)**	(7)	**(2)**	(2)	(88)
Share-based payment transactions	**53**	-	**18**	-	-
Payments to a former senior officer	**-**	6	**-**	-	6
Income tax expenses	**592**	504	**207**	133	672
Payment in respect of settlement of derivative financial instruments, net	**(48)**	(4)	**(34)**	-	(9)
Change in inventory	**43**	13	**28**	38	(6)
Change in trade receivables	**(31)**	(304)	**101**	(195)	(437)
Change in other receivables	**(14)**	(26)	**-**	-	4
Change in other payables	**(15)**	35*	**(19)**	(3)*	(18)
Change in suppliers	**(280)**	(125)	**(3)**	4	36
Change in provisions	**(48)**	68	**(2)**	23	105
Change in broadcasting rights	**(21)**	(55)	**14**	(19)	(74)
Change in employee benefits	**(289)**	(198)*	**(27)**	(6)*	(300)
Change in deferred and other income	**-**	(5) *	**2**	(2)*	(11)
	2,957	2,599	**1,352**	886	3,377
Interest received	**46**	100	**12**	30	116
Dividend received	**12**	3	**10**	-	3
Income tax paid	**(368)**	(326)	**(140)**	(102)	(430)
Net cash from operating activities	**2,647**	2,376	**1,234**	814	3,066

* See Note 3C.

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

Condensed Consolidated Interim Statements of Cash Flows (Contd.)

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cash flows from investing activities					
Investment in intangible assets and deferred expenses	**(385)**	(168)	**(250)**	(61)	(273)
Proceeds from sale of property, plant and equipment and deferred expenses	**101**	137	**14**	17	177
Current investments, net	**314**	19	**-**	11	647
Purchase of property, plant and equipment	**(962)**	(681)	**(345)**	(271)	(973)
Proceeds from sale of investments and long-term loans	**13**	49	**2**	16	66
Purchase of investments and long-term loans	**(6)**	-	**(2)**	-	-
Investment in an associate	**(1)**	-	**-**	-	(8)
Net cash used for investment activities	**(926)**	(644)	**(581)**	(288)	(364)
Cash flows from financing activities					
Issue of debentures	**-**	1,814	**-**	1,058	1,814
Receipt of loans	**-**	50	**-**	-	50
Repayment of debentures	**(697)**	(1,902)	**(70)**	(1,805)	(1,927)
Repayment of loans	**(112)**	(753)	**(31)**	(605)	(840)
Short-term credit, net	**(5)**	(56)	**(73)**	(33)	(37)
Dividends paid	**(679)**	(2,100)	**-**	-	(2,860)
Interest paid	**(266)**	(357)	**(31)**	(159)	(389)
Receipt in respect of settlement of derivative financial instruments, net	**36**	67	**7**	81	77
Injections by non-controlling interests, less dividend distributed, net	**7**	(4)	**3**	(4)	-
Net cash used for financing activities	**(1,716)**	(3,241)	**(195)**	(1,467)	(4,112)
Net increase (decrease) in cash and cash equivalents					
Cash and cash equivalents at the beginning of the period	**5**	(1,509)	**458**	(941)	(1,410)
Effect of fluctuations in the rate of exchange on cash balances	**1,203**	2,632	**740**	2,063	2,632
	(10)	(18)	**-**	(17)	(19)
Cash and cash equivalents at the end of the period	**1,198**	1,105	**1,198**	1,105	1,203

* See Note 3C.

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

NOTE 1 – REPORTING ENTITY

A. Bezeq – The Israel Telecommunication Corp. Ltd. (hereinafter: 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 condensed consolidated interim financial statements of the Company comprise those of the Company and its subsidiaries (jointly referred to as the Group), and the Group's interests in associates. The Group is a principal provider of communications services in Israel (see also Note 12 – Segment Reporting).

B. In October 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. In September 2008, Ap.Sb.Ar. Holdings Ltd. exercised an option to increase its holdings by 10.66% and its holding in the Company increased to 40.66%. As a result, the percentage of the State's holding decreased to 4.95% and from that date the State ceased to be an interested party in the Company by virtue of its holdings. 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 the basic telephony field. However, at the suggestion of the court (in view of the time elapsed since it was filed), the Company consented to withdraw the appeal. 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.

C. The Company is subject to various systems of laws that regulate and limit its business operations, including its tariffs, which are controlled by Sections 15 to 17 of the Communications Law. The tariffs of the Company's controlled services, which are set in regulations, are updated according to a linkage formula less a reduction factor, as laid down in the regulations and pursuant to the recommendations of public committees with a mandate to examine those tariffs. In March 2008 the Committee for Examining the Policy and Rules of Competition in Communications in Israel submitted its recommendations to the Minister of Communications. On August 13, 2008, the Minister of Communications announced his decision to adopt the conclusions of the committee, subject to a number of changes and emphases, and they will become the policy guiding the Ministry in the years to come. The Minister's decision increases the level of regulatory clarity to some extent.

The intensifying competition and numerous changes in the communications market are expected to 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 condensed interim consolidated financial statements were prepared in accordance with IAS 34 – *Interim Financial Reporting*, and in accordance with Chapter D of the Securities (Periodic and Immediate reports) Regulations, 5730-1970.

B. These reports do not contain all the information required in full annual financial statements, and should be reviewed in the context of the annual financial statements of the Company and its subsidiaries at December 31, 2007 and the year then ended, and their accompanying notes (hereinafter: the annual financial statements). The Group states in the notes to the interim financial statements only the material changes that have occurred in its business and legal environment from the date of the most recent annual financial statements until the date of these interim financial statements.

C. The condensed consolidated interim financial statements were approved by the Board of Directors on November 24, 2008.

NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICIES

The significant accounting policies applied in these condensed consolidated interim financial statements are consistent with those applied in the annual financial statements for the year ended December 31, 2007, except as mentioned in this note.

A. Initial application of accounting standards

Commencing January 1, 2008, the following international financial reporting standards came into force:

(1) Interpretation 11 of the International Financial Reporting Interpretations Committee (IFRIC 11) for IFRS 2 – Group and Treasury Share Transactions. The interpretation requires that a share-based payment in which the entity receives goods and services as consideration for its own equity instruments, be accounted for as equity-settled share-based payment, irrespective of the question of how the equity instruments were obtained. This interpretation did not materially affect the results of the Group's operations and its financial position.

(2) IFRIC 14 for IAS 19 – *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*. The interpretation clarifies when refunds and reductions in future contributions in connection with defined benefit assets must be seen as available, and provides instruction about the influence of minimum contribution requirements on those assets. The interpretation relates to the question of when a minimum deposit requirement establishes a liability. This interpretation did not materially affect the results of the Group's operations and its financial position.

(3) The Group opted for early adoption of IAS 2 – *Share-Based Payment – Vesting and Cancellation*. The standard states that vesting terms are terms that determine whether the group receives the services for which the other part is entitled to share-based payment, and they are limited to terms of service and performance. Non-vesting terms will be reflected in the fair value of the grant on the grant date, and after the grant date the group will not revise the fair value in respect of those terms. In addition, the standard describes the treatment of non-compliance with non-vesting terms. The early adoption did not materially affect the results of the Group's operations and its financial position.

(4) Early adoption of IFRS 3 (revised) and IAS 27 (2008): The Group opted for early adoption of IFRS 3, *Business Combinations (*revised) and IAS 27 (2008) – *Consolidated and Separate Financial Statements.*

   (1) IAS 27 (2008) – *Consolidated and Separate Financial Statements.* The standard addresses accounting treatment of non-controlling interests (minority interests), mainly the accounting treatment of changes in non-controlling interests after achieving control and when losing control of a subsidiary, and attributing profit or loss to the shareholders of the parent company and the non-controlling interests.

   (2) IFRS 3 (2008), *Business Combinations (revised)*. The standard also addresses business combinations achieved by contract alone, the definition of a business combination focusing on achieving control, including contingent consideration. The acquirer can elect to measure the non-controlling interests at fair value at the acquisition date, or at the non-controlling interests' proportionate share of the acquiree's identifiable assets and liabilities. When acquisition is achieved by consecutive purchase of shares (acquisition in stages), the identifiable assets and liabilities of the acquiree are recognized at their fair value when control is achieved (against profit or loss).

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

A. Initial application of accounting standards (contd.)

(4) Early adoption of IFRS 3 (revised) and IAS 27 (2008) (contd.)

Application of the standards affected the share of the shareholders of the Company and the non-controlling rights in the losses of DBS. 58% of the losses of DBS were included in the part of the Company's shareholders, compared with the accounting treatment prior to application of the standards, whereby 100% of the losses of DBS net of financing expenses to the holders of the non-controlling interests, were included in the part of the shareholders of the Company. The standards were applied commencing January 1, 2008, with restatement of the equity component and the profit or loss at June 30, 2008 and March 31, 2008 and for the six-and three-month periods then ended, respectively.

a. Effect on equity

	As previously reported	Effects of early application	Following early application
	(Unaudited)	(Unaudited)	(Unaudited)
	NIS millions	NIS millions	NIS millions
At June 30, 2008			
Balance of deficit	(2,112)	32	(2,080)
Minority rights	(406)	(32)	(438)
At March 31, 2008			
Balance of deficit	(1,870)	13	(1,875)
Minority rights	(386)	(13)	(399)

b. Effect on profit or loss

	As previously reported	Effects of early application	Following early application
	(Unaudited)	(Unaudited)	(Unaudited)
	NIS millions	NIS millions	NIS millions
For the six-month period ended June 30, 2008			
Earnings for the period attributable to:			
Equity holders of the Company	835	32	867
Non-controlling interests	(37)	(32)	(69)
Earnings for the period	798	-	798
For the three-month period ended March 31, 2008			
Earnings for the period attributable to:			
Equity holders of the Company	398	13	411
Non-controlling interests	(13)	(13)	(26)
Earnings for the period	385	-	385

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

B. New standards prior to their application

A number of new standards, amendments to existing standards and interpretations have not yet come into force on September 30, 2008, and therefore were not applied in the preparation of these consolidated financial statements. Since publication of the last annual report, the following standards have been published:

(1) IAS 32 – Financial Instruments: Presentation, IAS1 – Presentation of Financial Statements – Redeemable Financial Instruments and Obligations Arising on Liquidation. According to these amendments, certain redeemable financial instruments and obligations arising on liquidation are to be classified as equity if certain criteria exist. In addition, appropriate disclosure is required for redeemable instruments classified as equity. The amendments will apply to annual periods commencing on or after January 1, 2009. The amendments are not expected to have a material effect on the activities and financial position of the Group.

(2) IFRIC 13 – Customer Loyalty Programs. The interpretation addresses the accounting treatment of companies that grant benefits in customer loyalty programs (such as coupons for future benefits) at the time of purchase of goods or services. The interpretation explains how companies should account for the obligation to supply goods or services in the future, free of charge or at a discount (benefits) to customers who are expected to utilize the benefits. The interpretation applies to annual periods commencing on or after July 1, 2008. The Group is considering the effects of the interpretation on its financial statements.

(3) IFRIC 15 – Agreements for the Construction of Real Estate (in this sub-section: the interpretation). The interpretation provides guidelines for ascertaining whether real estate construction transactions are covered by IAS 18 – Revenue, whereby revenue from the construction of real estate will be recognized similarly, from the aspects of timing and character, to revenue from the sale of a product or service, or are covered by IAS 11 – Construction Contracts, whereby the revenue will be recognized according to the completion stage of the real estate asset. The interpretation will apply to annual periods commencing on or after January 1, 2009, and will be applied retrospectively. Early adoption is permitted, with disclosure. Adoption of the interpretation is not expected to affect the financial statements of the Group.

(4) IFRIC 16 – Hedges of a Net Investment in a Foreign Operation (in this sub-section: the interpretation). The interpretation relates to instances in which an investment is made in a foreign operation, and provides guidelines for hedging such an investment. The interpretation relates, inter alia, to the nature of the hedged risk and the amount of the hedged item for which the hedging is designated, to the location of the hedging item in the group of companies, and to the accounting treatment of the capital reserve on the date of disposal of the foreign operation. This interpretation applies to annual periods commencing on or after October 1, 2008. Early adoption is permitted, with disclosure. Adoption of the interpretation is not expected to influence the financial statements of the Group.

(5) *Improvements to IFRS.* As part of a project for amending the international standards, in May 2008 the IASB published and approved 35 amendments to various international standards on a wide range of accounting issues. The importance of the amendments lies in their indicating the position of the IASB on those issues, and therefore they could affect the accounting treatment even prior to the date of their adoption. Most of the amendments will come into force for periods commencing on or after January 1, 2009, with early adoption permitted, subject to the terms set out for each amendment and subject to the transition provisions relating to initial adoption of IFRS. The Group is considering the effects of the aforementioned on its financial statements.

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

B. New standards prior to their application (contd.)

(6) Hedgeable items, Amendment to IAS 39 – *Financial Instruments: Recognition and Measurement:* (hereinafter: the amendment). The amendment clarifies that changes in cash flows or changes in the fair value of a one-sided risk can be designated as a hedged item, in other words, a risk which is defined as a risk of exposure to fluctuations above or below a certain price or a defined variable. The amendment also clarifies that an inflationary component can be designated as a separate risk, provided it is contractually specified in the cash flows of index-linked debentures, so that it can be identified separately and measured reliably, and if the other cash flows of the instrument are not affected by the inflationary component. The amendment is effective retroactively for annual periods commencing on or after July 1, 2009. Early adoption is permitted, with disclosure. The Group is considering the effects of the amendment on its financial statements. Adoption of the standard is not expected to affect the consolidated financial statements.

C. Classified amounts

The condensed consolidated interim financial statements include reclassification of certain amounts of the comparative figures of the relevant sections, including the classification of broadcasting rights to non-current assets.

D. Index-linked assets and liabilities not measured at fair value

Further to Note 3C(1) to the financial statements at December 31, 2007, concerning index-linked financial instruments, discussion of the matter by IFRIC resulted in the committee's decision that the provisions of IAS 39, *Financial Instruments: Recognition and Measurement,* should be applied with discretion as to the most appropriate application of the standard's guidelines. Furthermore, the committee saw no justification for continuing its discussions of the matter. Nevertheless, the committee will refer the question to the IASB for review of the clarification or a broadening of the instructions for the implementation of IAS 39. In light of the aforesaid, the value of index-linked financial assets and liabilities that are not measured at fair value, is revalued in each period according to the actual rate of rise in the index.

E. Property, plant and equipment

On June 26, 2008, the Board of Directors of the Company resolved to approve the implementation of the NGN project. At that date, the Board approved detailed planning of the project, setting-up of two areas as operational pilots, and the purchase of soft switches. The project will be implemented in modules with Company assessments on a regular basis, and after each stage of implementation it will reconsider the viability of continuing the project, looking at all the variable factors that could influence its viability and therefore the need to revise the project outline. The content, pace of performance and the amounts to be invested in the project will be determined each year in the framework of the annual budget of the Company. In July 2008, an additional investment budget, in excess of the above, was approved for implementation in 2008, which includes, inter alia, management systems, equipment cabinets, MSAG systems, optical equipment and other items. The estimated life of part of the communications infrastructure that will be replaced in the project will vary, and as a result, the Company's depreciation expenses for that part expected to be accelerated. As a result of the aforementioned and despite the pace of performance of the entire project, the lifetime could still change. The estimated life was shortened, and as a result, depreciation expenses increased in the reporting quarter by approximately NIS 7 million. It is expected that the Company's depreciation expense will increase by an average of approximately NIS 55 million per year up to and including 2010, and in 2011 – 2013 it will decrease by approximately NIS 20 million per year on average. The effect of the aforementioned is subject to changes in the pace of deployment of the new network and the scrap value of the copper cables, if any.

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 – GROUP ENTITIES

A detailed description of the Group entities appears in Note 33 to the annual financial statements of the Group at December 31, 2007. Below are details of the material changes that occurred in connection with the Group entities since publication of the last annual report.

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

(1) Since commencing its operations, DBS has accumulated considerable losses. Its losses in 2007 amounted to approximately NIS 118 million and the loss during the nine-month period ended September 30, 2008 is approximately NIS 247 million. As a result of these losses, its capital deficit and its working capital deficit at September 30, 2008 are approximately NIS 2.876 billion and NIS 525 million, respectively.

(2) The Company's investment in DBS (primarily through shareholders' loans) at the balance sheet date amounts to approximately NIS 1.562 billion (without interest and linkage). The balance of DBS's current debt to the Company and its subsidiaries amounts to approximately NIS 110 million, of which approximately NIS 78 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 55.6 million in arrears. Under the arrangement, the debt will be paid in 60 equal monthly instalments plus interest at prime + 1.5%. At the balance sheet date, the debt balance in the arrangement is approximately NIS 33 million, and at the date of approval of the financial statements, DBS is not in compliance with the terms of the arrangement and the credit terms however the parties have reached agreement on the matter. The remainder of the debt to the Company, beyond the aforementioned arrangement, is a current debt for which the agreed terms of payment are the regular credit terms in effect between the Company and its customers..

(3) 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, which is NIS 974 million at September 30, 2008, impose various restrictions on DBS that include, inter alia, restrictions on providing a lien on 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 (hereinafter: the conditions).

a. DBS applied to the banks requesting revision of the stipulations for 2008 so as to adapt them to its budget, and on March 5, 2008, the banks agreed to amend the aforementioned stipulations. DBS also applied to the banks for further revision of a particular operational stipulation, and on June 25, 2008 the banks agreed to amend that stipulation as at June 30, 2008.

b. At September 30, 2008, DBS is in compliance with the financial criteria set for it.

c. The management of DBS believes that the sources of financing available to it will be sufficient for its operational requirements in the coming year, based on the projected cash flow approved by the board of directors of DBS. If additional resources are required to meet its operational requirements during the year, DBS will adapt its operations to preclude the need for additional resources beyond those available to it.

NOTE 5 – GROUP ENTITIES (CONTD.)

B. Pelephone Communications Ltd. (Pelephone)

Further to Pelephone's right to purchase frequencies from the Ministry of Communications as described in Note 18G to the financial statements at December 31, 2007, in February 2008 Pelephone notified the Ministry of Communications that it intends to exercise its right regarding allocation of the frequencies. In exercising its right, on September 7, 2008, Pelephone paid the Ministry of Communications approximately NIS 181 million in frequency fees and license fees.

NOTE 6 – CONTINGENT LIABILITIES

A. Claims

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

In the opinion of the Group’s managements, based, *inter alia*, on legal opinions regarding the likelihood of success of the claims, including applications for certification of the class action lawsuits, appropriate provisions in the amount of approximately NIS 330 million, 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 (in addition to the aforementioned provisions) at September 30, 2008, due to claims filed against the companies in the Group on various matters and the likelihood of realisation, amounts to approximately NIS 12.9 billion, of which approximately NIS 3.4 billion relates to salary-related claims filed by groups of employees or by individual employees which could have a far-reaching effect. The above amounts are stated before the addition of interest.

Concerning applications for certification of lawsuits as class actions 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 (20) to the financial statements as at December 31, 2007, and significant changes as described below.

A detailed description of these claims appears in Note 17A to the Group’s annual financial statements at December 31, 2007. Details of the significant changes to the status of the material contingent liabilities of the Group since December 31, 2007 are provided below.

(1) Further to Note 17A(1) to the financial statements at December 31, 2007, concerning a claim and application for its certification as a class action, which alleges a cartel in public switching, the amount of which is estimated by the plaintiff at approximately NIS 1.750 billion, on November 5, 2008, an application was filed to remove the application for certification as a class action and to dismiss the personal claim, paying expenses to the plaintiff that are not material.

(2) Further to Note 17A(2)(a) to the financial statements at December 31, 2007, concerning a claim filed by 2,343 retired employees who were transferred from the Ministry of Communications to the Company upon its establishment – on February 12, 2008, the plaintiffs filed a written summation of their allegations. The plaintiffs narrowed their claim to an incentive pay salary component and withdrew their claims relating to grossing up of tax and to clothing. Additionally, the claim from January 2007, which was filed by another 85 retired employees, was consolidated with the above claim.

NOTE 6 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(3) Further to Note 17A(3) to the financial statements at December 31, 2007, concerning a class action alleging unlawful collection of collection expenses, the court allowed an agreed notice of the parties whereby the definition of the group representing the application will be changed and will only apply to those charged for collection fees collected by the Company between March 11, 1999 and December 7, 2006 and the court will not be obliged in any way to rule on the matter of certification of the class action in the past. In the matter of another class action described in the same Note, in the amount of NIS 21 million – on July 2, 2008, the court ruled, following the request of the plaintiff's lawyer (following the death of the plaintiff) and the Company's consent, to strike out the claim and the application for its certification as a class action. It is noted that the causes of the two above claims are similar, and the first class action is still pending.

(4) Further to Note 17A(4) to the financial statements at December 31, 2007, concerning a class action against the Company, Bezeq International and the other international call operators concerning the charge of VAT on telephone calls originating from abroad, the Company and Bezeq International were struck out of the claim according to the procedural arrangement in the case.

(5) Further to Note 17A(8) to the financial statements at December 31, 2007, concerning a claim and application for its certification as a class action, which alleges unlawful collection by the Company for surfing the internet at the promised speed – on April 7, 2008, the Company filed a motion for leave to appeal the decision of the District Court.

(6) Further to Note 17A(17) to the financial statements at December 31, 2007, concerning a claim and application for its certification as a class action against the Company in the matter of collection of a regular monthly payment for a fixed telephone line through which high-speed internet infrastructure services are also provided – on June 27, 2008, a decision was given in which the application for certification of the class action and the action itself were struck out without an order to pay costs, with the consent of the parties.

(7) Further to Note 17A(19) to the financial statements at December 31, 2007, concerning a claim and application for its certification as a class action against the Company (the Company was later deleted from the statement of claim), Bezeq International, the Chairman of the Board of Bezeq International and the then CEO of Bezeq International – a hearing was held on April 14, 2008, in which the Court proposed the settlement described in Note 17A(19) above. Bezeq International rejected the settlement proposal and is awaiting the ruling of the Supreme Court on the merits of the appeal, in other words, whether the decision of the District Court to dismiss the application for certification as a class action should be reversed.

(8) Further to Note 17A(30) to the financial statements at December 31, 2007, concerning the class action filed against DBS and against the cable companies in connection with the broadcasting of commercials during the World Cup telecasts – on March 17, 2008, the applicants filed an agreed abandonment motion in the court, without an order to pay costs. On March 18, 2008, the court decided to allow the motion of the applications, and the claim was dismissed.

(9) Further to Note 17A(31) to the financial statements at December 31, 2007, concerning class actions against DBS and against the Sports channel relating to the broadcasts of Channel 5+ – on July 9, 2008, the Cable and Satellite Broadcasting Council announced that it will not appear at the proceeding, while reserving the right to review its position should the need arise later in the proceedings.

(10) Further to Note 17A(32) to the financial statements at December 31, 2007, concerning claims filed against DBS in the matter of interrupted broadcasts – on April 13, 2008, DBS filed its response to the application for certification, in which it denied the plaintiffs' allegations outright.

NOTE 6 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(11) In April 2008, a claim was filed in the Tel Aviv District Court against Pelephone, together with an application for its certification as a class action, in a total amount of approximately NIS 60 million. The claim is for restitution of amounts allegedly over-collected from Pelephone's subscribers in respect of Call Continue service from a voice-mail box and charging for 1-800 destinations.

(12) In May 2008, a financial claim was filed in the Tel Aviv District Court against Pelephone and another defendant. The total amount of the claim is not defined in the claim. The claim is for restitution of amounts by the other defendant, which the plaintiff alleges it collected, through Pelephone, from the members of its customer club for services provided to those customers.

(13) In May 2008, a claim was filed in the Tel Aviv District Court against Pelephone, Cellcom and Partner, together with an application for certification as a class action in a total amount of NIS 50 million. The claim is for the restitution of amounts which the plaintiffs allege was over-collected from the subscribers of the defendants for Callback service (calls made from abroad to Israel by means of a service which Pelephone calls Saver Service).

(14) In June 2008, a claim was filed in the Tel Aviv District Court against Pelephone, together with an application for its certification as a class action in the amount of NIS 64 million. The claim is for restitution of amounts which the plaintiff alleges were collected by Pelephone unlawfully, in contravention of its license, as a commission for payment made by means of a voucher (a commission collected from a customer who does not pay the monthly charge by direct debit, but by individual payment each month).

(15) In July 2008, a claim was filed in the Tel Aviv District Court against Pelephone, together with an application for its certification as a class action in the amount of approximately NIS 240 million. The claim is for restitution of amounts which the plaintiff alleges were over-collected from the defendant's subscribers in respect of Continue Call from the 144 information service, for the collection of arrearage interest from a subscriber who is late in making payment, and for direct debits and payments in respect of voucher payment at a service centre.

(16) In the second quarter of 2008, four claims were filed against Bezeq International in the Tel Aviv District Court concerning Bezeq International's conduct relating to the use of international calling cards to the Philippines, Thailand and Nepal and applications for certification as class actions. The plaintiffs estimate the loss incurred by all members of the group at approximately NIS 200 million in the Filipino citizens' claim, approximately NIS 150 million in the Thai citizens' claim, approximately NIS 58 million in the Nepali citizens' claim, and approximately NIS 332 million in the additional group of Thai citizens.

(17) In July 2008, Bezeq International received a claim that was filed in the Tel Aviv District Court together with an application for its certification as a class action, concerning charging customers at a dollar exchange rate higher than the representative rate. The amount of the claim is not stated, but is estimated by the plaintiff in the tens of millions of shekels. The motion filed by Bezeq International to order the plaintiff to deposit a guarantee to secure its expenses was dismissed.

On July 13, 2008, Bezeq International received another claim in the same matter, together with an application for its certification as a class action, filed in the Tel Aviv District Court by another of its business customers. The application for certification is for the business customers of Bezeq International from whom payment was collected for Bezeq International's services at a dollar exchange rate higher than the representative rate, from September 2007 to the date of filing the claim. The plaintiff estimates the amount of the claim at approximately NIS 93 million. Bezeq International intends to file a motion to order the plaintiff to deposit a guarantee to secure Bezeq International's expenses if the claim is dismissed.

NOTE 6 – CONTINGENT LIABILITIES (CONTD.)

B. Claims which cannot yet be assessed or for which the exposure cannot be 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, 2007. Details of material changes since December 31, 2007 are provided below:

Claims for which the exposure cannot be calculated

(1) Further to Note 17B(1) to the financial statements at December 31, 2007, concerning a claim against the Company and against Makefet Fund which was filed by Company employees who retired under a retirement agreement from November 2007 – in March 2008 an identical claim was filed in the Tel Aviv District Labour Court by another 17 retired Company employees.

(2) Further to Note 17B(2) to the financial statements at December 31, 2007, concerning a claim against the Company, Makefet Fund and the State of Israel, which was filed by the Organization of Bezeq Retirees and six of its retirees, alleging violation of arrangements which were agreed when the employees transferred from the civil service to the Company – on June 5, 2008, the court decided to strike out the claim.

Claims that cannot be assessed

(3) Further to Note 17C(10) to the financial statements at December 31, 2007, following an application by a DBS shareholder holding an insignificant number of shares to the Tel Aviv District Court, an arbitrator was appointed to hear the case. The shareholder filed a claim against the Company and against another DBS shareholder for the revocation of the shareholders agreement at DBS, and for restitution and compensation of NIS 160 million, claiming for losses incurred to the plaintiffs relating to the management of DBS.

(4) In October 2008, a claim was filed in the Tel Aviv District Court against Pelephone, together with an application for its certification as a class action, in the amount of approximately NIS 716 million. The claim is for restitution of amounts collected by the defendant from its subscribers for a 3G internet package. The plaintiff claims that the defendant allegedly requires customers to join the 3G internet package when purchasing a handset, in contravention of its license and the law.

(5) In August 2008 a claim against DBS was filed at the District Court in Tel Aviv together with an application for its certification as a class action in the amount of approximately NIS 19 million. The claim and application for certification are for DBS's termination of broadcasts of the Adventure 1 and Discovery Science channels without reducing the subscriber fees.

(6) On October 30, 2008, a claim was filed against DBS together with an application for its certification as a class action. The plaintiff did not determine the exact amount of the claim, alleging that at this stage it cannot be assessed, however the plaintiff noted that its value exceeds NIS 2.5 million. The matter of the claim and of the application is the failure to disconnect the plaintiff from HOT's multichannel television and the continued charge for these services, despite the agreement with DBS.

C. Other contingencies

For a detailed description of other contingencies, see Note 17C to the Group's annual financial statements as at December 31, 2007. Details of material changes since December 31, 2007, are provided below.

(1) Further to Note 17C(1) to the financial statements at December 31, 2007, in the matter of the Antitrust Commissioner's ruling that the Company abused its status in the market when it disconnected its network from the HOT network – on March 16, 2008, the Company filed an appeal against the Commissioner's ruling.

NOTE 6 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (contd.)

(2) Further to Note 17C(2)(b) to the financial statements at December 31, 2007, in the matter of a shareholder's letter pursuant to Section 194 of the Companies Law, on the matter of approval of transfer of funds from the Company to DBS contrary to decisions of the Ministers of Communications – on April 6, 2008, the shareholder filed an application for leave to file a derivative action against the Company and a statement of claim against directors who were party to the decision, which led to the Company incurring losses of NIS 10 million (the amount called in by the Ministry of Communications from the Company's guarantee). The Company's response was filed on August 7, 2008.

(3) Further to Note 17C(6) to the financial statements at December 31, 2007, in connection with a claim filed by the cable companies (HOT) against DBS – on July 9, 2008, the parties filed an application for approval of a settlement agreement, part of which is a request to strike out the claim without an order to pay costs. On the same date, the court validated the settlement agreement between the parties.

In addition and further to the same Note, in the matter of a claim filed against Pelephone concerning the solicitation of information about the plaintiff's business – in May 2008, the claim was dismissed due to the plaintiff's failure to appear before the court.

(4) Further to Note 17C(7) to the financial statements at December 31, 2007, concerning the operation of facilities that emit electromagnetic radiation – after termination of the strike at the Ministry for Environmental Protection, the proceedings for issue of operating permits for communications and broadcasting installations by the Supervisor of Radiation were completed. In addition, on April 17, 2008, the Company submitted its reservations concerning the proposed draft of National Outline Plan for Communications – NOP/36A Small Broadcasting Installations, and NOP/36B Large Broadcasting Installations. In brief, the reservations are that the plans as proposed, and in particular as they relate to changing the definitions of large and small broadcasting installations create practical difficulties which could prevent the Company from granting the public some of the varied services it provides and is obligated by law to provide.

On July 29, 2008, the Company received notice that in June 2008, National Outline Plan 56 came into force, which regulates the manner of erection and registration of communications installations in the Administrated Territories. The plan includes transition directives for installations erected prior to 1984 and for existing installations. The Company is studying the subject, and at the date of publication of this report is unable to assess its expected effects.

(5) Further to Note 17C(9) to the financial statements at December 31, 2007, concerning an application for certification of a class action against Pelephone in the amount of NIS 12 billion – the action was struck out without an order to pay costs.

(6) In February 2008, the Ministry of Industry, Trade and Labour (hereinafter: the Ministry), instituted an investigation of DBS relating to the terms of employment of a certain group of DBS employees, and DBS was required to submit various documents to the Ministry, which it did. The investigation is still in its initial stages, and its full extent is not yet known.

Furthermore, in December 2007, DBS received a letter from 19 of its employees (18 of whom are no longer employed by DBS), regarding various periods between 2001 and 2007 in which they allege that during the period of their employment at DBS they were not paid all the monies due to them. On April 21, 2008, DBS sent its reply to those employees, rejecting all their allegations. At this stage, the extent of the Ministry's investigation is unknown, and no action has been filed by the employees.

NOTE 7 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES

A. On June 1, 2008, the general meeting of the shareholders of the Company approved the terms of employment of the Chairman of the Board of the Company. Below are the main points of the engagement of the chairman of the Board:

(1) The Chairman is employed under a personal employment agreement as acting Chairman of the Board of Directors of the Company, in a full-time position, effective from September 4, 2007, the date on which the Chairman actually commenced employment with the Company.

(2) The salary of the Chairman is NIS 175,000 per month, linked to the CPI. In addition, the Chairman in entitled to contributions to managers' insurance, study fund and disability insurance. The Company will provide the Chairman with a company car, and will bear all the car maintenance expenses.

(3) The Chairman will be granted 9,000,000 options, as described in Section 8B below.

(4) A decision on the award of an annual bonus will be made at the discretion of the Company Board of Directors, subject to the approval of the Audit Committee of the Board of Directors and the general meeting. The amount of the annual bonus, if awarded, will be between six and eighteen monthly salaries.

(5) Immediately after approval of the agreement by the general meeting, the Company will pay the Chairman a special "signature bonus" of NIS 1.2 million.

(6) The Company will insure the Chairman with directors' and officers' insurance, and will compensate him, from time to time as is customary with respect to other directors in the Company.

(7) The engagement between the Company and the Chairman is for an unlimited period, where each party is entitled to bring it to an end at any time and for any reason by giving 12 months' notice (the Company) or 6 months' notice (the Chairman).

B. On September 28, 2008, the general meeting of the Company's shareholders approved extension of the Company's engagement in the management agreement with a corporation related to Ap.Sb.Ar. Holdings Ltd., the controlling shareholder in the Company, for a period of three years subsequent to the end of the term of the current agreement, on the same terms as the original agreement.

C. On September 4, 2008, the general meeting of the shareholders of DBS approved an annual grant plan for the CEO of DBS for 2009-2010. The approved plan is based on incrementally meeting certain goals as defined in the plan.

D. Further to Note 29F(8) to the financial statements at December 31, 2007, on October 30, 2008, the Board of Directors of the Company approved the purchase of an insurance policy to cover the liability of directors and officers for a period of one year commencing October 11, 2008, with a limited liability of USD 100 million per claim and for the entire period of insurance, and additionally, a limit of liability of USD 30 million per claim and for all claims in the period of insurance in respect of legal expenses in Israel only and a limit of liability of USD 50 million for subsidiaries (as part of the aforementioned limit of liability), this being part of a framework transaction approved by the general meeting of the shareholders of the Company on December 26, 2007. The annual premium in respect of the p9olicy is approximately USD 369,000.

E. For the matter of stock options for senior officers who are key personnel in the Group, see Note 8 below.

NOTE 8 – SHARE-BASED PAYMENTS

A. On November 20, 2007, the Board of Directors of the Company resolved to adopt a new stock options plan for managers and senior employees in the Company and/or in associates, which would allocate up to 65,000,000 non-negotiable options exercisable for up to 65,000,000 shares of the Company and representing approximately 2.5% of the issued capital of the Company, and at full dilution – 2.37% of the share capital.

On December 25, 2007, the Company published an outline for the allocation of up to 65,000,000 options in accordance with the Securities (Details of an outline offer of securities to employees) Regulations, 5760-2000, which described, inter alia, the terms of the plan, as well as a private placement report in accordance with the Securities (Private placement of securities in a listed company) Regulations 5760-2000.

The options plan and the allotment of all the options in accordance with the plan were approved by the general meeting of the Company on January 31, 2008, in accordance with the Company's Articles of Association (since in certain cases, there is also a requirement in law for the further approval of the general meeting).

Exercise of the options under the plan is contingent upon receipt of the appropriate approvals in accordance with the provisions of the Communications (Telecommunications and Broadcasts) (Determination of an essential service provided by Bezeq, The Israel Telecommunications Corp. Ltd.) Order, 5757-1997 (hereinafter: "the Telecommunications Order"). Following the exercise of the options for the purchase of shares by the controlling shareholder in the Company, Ap.Sb.Ar. Holdings Ltd., and the increase in its holding of the Company's shares to 40.66%, exercise of the options under the plans is possible without the amendment of the Telecommunications Order.

The option warrants will vest in three equal annual portions. The vesting dates of each portion will fall at the end of each of the first, second and third years from the grant date, respectively, and the expense for each portion will be spread according to its vesting period. In addition, the plan sets terms which, if met, bring forward the vesting dates.

Exercise of the options for shares will be by using a cashless exercise mechanism, unless the Board of Directors decides otherwise.

The exercise price set for the grant of up to 49,950,000 options is NIS 5.50 (adjusted for distribution of a dividend in cash or in kind). On June 26, 2008, the Board of Directors of the Company resolved that the exercise price for future grants of options, as will be approved by the Board of Directors from time to time, will be the same as the average closing price of the Company's share on the stock exchange in the 30 days' trading prior to the date of the Board's decision to grant options to those offerees.

B. Of the options, 61,550,000 were actually allocated at the date of the financial statements, as follows:

(1) 52,550,000 options warrants whose theoretical economic value is approximately NIS 147 million (of which 17,750,000 option warrants were allocated to the CEO of the Company and to senior officers who are key persons in the Group, the theoretical economic value of which is approximately NIS 45 million), based, inter alia, on the share price on the grant date, a risk-free annual interest rate between 5.09% and 5.68%, a weighted average of expected life of between 4.5 and 5.5 years, the exercise price between 5.5 and 6.35, as noted above and an annual standard deviation between 22.7% and 24.3%. The grant date was set as the later of the date of the general meeting and the date of the notice to the employees. This restriction described above as imposed by the Telecommunications Order was taken into account in calculating the theoretical economic value of the options assuming that the restriction can be resolved.

(2) On April 17, 2008, the Board of Directors of the Company resolved to allocate 9,000,000 options to the Chairman of the Board in accordance with the plan described in Section A. above, subject to a number of changes relating to the terms of the Chairman's options. The allocation of options to the Chairman was approved by the general meeting of the shareholders of the Company on June 1, 2008.

NOTE 8 – SHARE-BASED PAYMENTS (CONTD.)

B. (contd.)

(2) (contd.)

The options will vest in 12 equal quarterly portions. The vesting dates of each portion will fall at the end of each quarter from the grant date, and the expense will be spread for each portion in accordance with its vesting period. In addition, the plan sets terms which, if met, will bring the vesting date forward.

The exercise price of each option warrant is NIS 6.4405 per share. The price was set according to the share price on the date on which the Chairman took up his post – September 4, 2007 (which was NIS 6.649 per share) and after adjustment for distribution of a net dividend in the amount of NIS 0.26 per share, for which the X-day was April 14, 2008. The closing price of the Company's share on June 1, 2008, the date of approval by the general meeting, was NIS 6.494 per share.

The theoretical economic value of the option warrants granted to the Chairman as described above, according to a weighted Black and Scholes model, is approximately NIS 16 million, based, inter alia, on the share price on the grant date, a risk-free annual interest rate of 5.1%, a weighted average expected life of 4 years, the exercise price noted above, an annual standard deviation of 23.11%, and a solution to the restriction described above as imposed by the Telecommunications Order.

C. The terms of the options are as follows:

Grant date / eligible employees	No. of instruments in thousands	Vesting terms	Contractual life of options
A. Grant of options from the State to employees on October 11, 2005	122,698	Immediate (subject to lock-up, commencing at the end of 2 years, and 3 years – one third each year)	4 years
B. Grant of options to employees on February 22, 2007 (1)	78,151	Immediate (subject to lock-up for two years)	5 years
C. Grant to the Chairman of the Board	9,000	12 quarterly portions	4 years
D. Approval and/or grant of options to managers, senior employees and officers up to the date of approval of the financial statements	52,550	Three equal annual portions	8 years
Total stock options granted	262,399		

(1) The expenses in respect of this grant were recorded in 2006 as a promise was made to the employees in 2006, along with the conditions of the grant.

(2) The options referred to in A and B are settled by way of physical delivery of shares. The options referred to in C and D are settled in a cashless exercise mechanism.

NOTE 8 – SHARE-BASED PAYMENTS (CONTD.)

C. **The terms of the options (contd.)**

	Number of options		
	For the nine-month period ended September 30		For the year ended December 31
	2008	2007	2007
	(Unaudited)	(Unaudited)	(Audited)
	(in thousands)	(in thousands)	(in thousands)
Balance in circulation at January 1	**200,849**	200,849	200,849
Options granted during the period	**61,550**	-	-
Options forfeited during the period	**(3,800)**	-	-
Options exercised during the period	**(20,278)**	-	-
Balance in circulation at the end of the period	**238,321**	200,849	200,849
Exercisable at the end of the period, subject to lock-up terms	**159,950**	200,849	200,849
Exercisable at the end of the period not subject to lock-up	**21,371**	--	--

Subsequent to the balance sheet date, approximately 6,289,000 options granted by the State to employees on October 11, 2005 were exercised.

The weighted average exercise price in the nine-month periods ending on September 30, 2008 and in 2007 was NIS 3.13 per share and NIS 2.852 per share, respectively.

The average share price in the nine-month period ended September 30, 2008 and in 2007 is NIS 6.59 per share and NIS 6.82 per share, respectively.

The range of the exercise price of the balance of the issued options at September 30, 2008, is between NIS 2.26 and NIS 6.44, and the weighted average of the remaining contractual life is 3.186 years.

The fair value of the services received in consideration of the options for shares granted is based on the fair value of the options granted, which was measured according to the Black and Scholes model on the basis of the following parameters:

	For the nine-month period ended September 30		For the year ended December 31
	2008	2007	2007
Average of the fair value on the grant date	**NIS 2.65**	-	-
Share price	**NIS 6.18 - 7.049**	-	-
Exercise price	**NIS 5.5 - 6.44**	-	-
Expected volatility	**22.7% - 24.3%**	-	-
Life of the option	**4 - 5.5 years**	-	-
Risk-free interest rate (based on government bonds)	**5.09% - 5.68%**	-	-

Salary expense

	For the nine-month period ended September 30		For the year ended December 31
	2008	2007	, 2007
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Stock options granted in the reporting period (1)	**53**	-	-

(1) In calculating the salary expense, a discount of 5% was taken into account in respect of forfeiture, for each year.

NOTE 9 – REVENUES

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Fixed-line domestic communications					
Landline telephony	**2,630**	2,864	**869**	943	3,798
Internet – infrastructure	**585**	516	**194**	180	711
Transmission, data communication and others	**741**	691	**260**	244	935
	3,956	4,071	**1,323**	1,367	5,444
Cellular telephones					
Cellular services and terminal equipment	**2,824**	2,734	**970**	950	3,669
Sale of terminal equipment	**549**	539	**179**	179	711
	3,373	3,273	**1,149**	1,129	4,380
International communications, internet services and network end point	**920**	917	**314**	303	1,226
Multi-channel television	**1,074**	1,003	**364**	333	1,331
Others	**22**	16	**9**	7	19
	9,345	9,280	**3,159**	3,139	12,400

NOTE 10 – 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
	2008	2007	2008	2007*	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Cellular telephone expenses	**1,303**	1,359	**438**	468	1,828
General expenses	**816**	841	**292**	290	1,187
Materials and spare parts	**597**	647	**170**	217	924
Consumption of satellite services content	**346**	326	**114**	124	426
Services and maintenance by sub-contractors	**248**	286	**78**	94	381
Building maintenance	**240**	247	**84**	81	332
International communication expenses	**198**	275	**65**	90	338
Motor vehicle maintenance expenses	**143**	143	**49**	50	183
Royalties to the State of Israel	**98**	145	**40**	49	194
Collection fees	**36**	38	**12**	12	48
	4,025	4,307	**1,342**	1,475	5,841

* See Note 3C.

NOTE 11 – CONDENSED DATA FROM THE INTERIM SEPARATE FINANCIAL STATEMENTS OF THE COMPANY

A. Income statement

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues (see B below)	**4,150**	4,260	**1,388**	1,425	5,713
Costs and expenses					
Depreciation and amortisation	**643**	709	**214**	236	941
Salary	**905**	964	**289**	328	1,293
General and operating expenses	**1,398**	1,576	**464**	509	2,121
Other operating expenses (income), net	**(14)**	72	**(1)**	25	79
	2,932	3,321	**966**	1,098	4,434
Operating income for the period	**1,218**	939	**422**	327	1,279

B. Revenue segmentation

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2008	2007*	2008	2007*	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Telephony	**2,708**	2,939	**899**	972	3,905
Internet	**585**	517	**194**	179	712
Transmission and data communication	**596**	561	**200**	194	754
Other services	**261**	243	**95**	80	342
	4,150	4,260	**1,388**	1,425	5,713

NOTE 12 – 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 nine-month period ended September 30, 2008 (unaudited)						
	Domestic fixed–line communications	**Cellular telephone**	**International communications, internet and NEP services**	**Multi-channel television**	**Others**	**Adjustments**	**Consolidated**
	NIS millions	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**
Revenues							
Revenues from external sources	**3,900**	**3,373**	**920**	**1,130**	**22**	**-**	**9,345**
Inter-segment revenues	**250**	**202**	**49**	**6**	**35**	**(542)**	**-**
Total revenues	**4,150**	**3,575**	**969**	**1,136**	**57**	**(542)**	**9,345**
Segment results	**1,218**	**774**	**171**	**122**	**1**	**-**	**2,286**

	For the nine-month period ended September 30, 2007 (unaudited)						
	Domestic fixed–line communications	**Cellular telephone**	**International communications, internet and NEP services**	**Multi-channel television**	**Others**	**Adjustments**	**Consolidated**
	NIS millions	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**
Revenues							
Revenues from external sources	4,016	3,273	917	1,058	16	-	9,280
Inter-segment revenues	244	229	53	9	31	(566)	-
Total revenues	4,260	3,502	970	1,067	47	(566)	9,280
Segment results	939	672	159	51	2	-	1,823

NOTE 12 – SEGMENT REPORTING (CONTD.)

	For the three-month period ended September 30, 2008 (unaudited)						
	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues							
Revenues from external sources	**1,313**	**1,149**	**314**	**374**	**9**	**-**	**3,159**
Inter-segment revenues	**75**	**65**	**15**	**1**	**11**	**(167)**	**-**
Total revenues	**1,388**	**1,214**	**329**	**375**	**20**	**(167)**	**3,159**
Segment results	**422**	**293**	**54**	**52**	**1**	**-**	**822**

	For the three-month period ended September 30, 2007 (unaudited)						
	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues							
Revenues from external sources	1,341	1,129	303	359	7	-	3,139
Inter-segment revenues	84	74	23	1	10	(192)	-
Total revenues	1,425	1,203	326	360	17	(192)	3,139
Segment results	327	219	54	(4)	-	-	596

NOTE 12 – SEGMENT REPORTING (CONTD.)

	For the year ended December 31, 2007 (audited)						
	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues							
Revenues from external sources	5,373	4,380	1,226	1,402	19	-	12,400
Inter-segment revenues	340	304	78	12	46	(780)	-
Total revenues	5,713	4,684	1,304	1,414	65	(780)	12,400
Segment results	1,279	805	204	48	-*	-	2,336

NOTE 13 – 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

	September 30 2008	September 30 2007	December 31 2007
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Current assets	**1,912**	1,863*	1,976
Non-current assets	**2,626**	2,387*	2,363
	4,538	4,250	4,339
Current liabilities	**1,092**	1,087	1,106
Non-current liabilities	**1,075**	1,186	1,154
Total liabilities	**2,167**	2,273	2,260
Shareholders' equity	**2,371**	1,977	2,079
	4,538	4,250	4,339

* See Note 3C

B. Income statement

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues from services and sales	**3,575**	3,502	**1,214**	1,203	4,684
Cost of services and sales	**2,404**	2,451	**778**	848	3,347
Gross profit	**1,171**	1,051	**436**	355	1,337
Sales and marketing expenses	**298**	308	**107**	111	430
General and administrative expenses	**99**	71	**36**	25	102
	397	379	**143**	136	532
Operating income	**774**	672	**293**	219	805
Financing expenses	**105**	97	**33**	54	114
Financing income	**(92)**	(84)	**(28)**	(41)	(109)
Financing expenses, net	**13**	13	**5**	13	5
Profit before income tax	**761**	659	**288**	206	800
Income tax	**207**	177	**77**	52	215
Net profit for the period	**554**	482	**211**	154	585

NOTE 13 – 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

	September 30 2008	September 30 2007	December 31 2007
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Current assets	**168**	163*	157*
Non-current assets	**982**	898*	943*
	1,150	1,061	1,100
Current liabilities	**694**	1,427	1,483
Non- current liabilities	**3,332**	2,190*	2,246*
Total liabilities	**4,026**	3,617	3,729
Equity deficit	**(2,876)**	(2,556)	(2,629)
	1,150	1,061	1,100

B. Income statement

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues	**1,136**	1,067	**375**	360	1,415
Cost of sales	**831**	836	**267**	301	1,117
Gross profit	**305**	231	**108**	59	298
Sales and marketing expenses	**99**	104	**28**	37	138
General and administrative expenses	**84**	76	**28**	26	104
	183	180	**56**	63	242
Operating income (loss)	**122**	51	**52**	(4)	56
Financing expenses	**409**	304	**144**	121*	394
Financing income	**(40)**	(216)	**(10)**	(196)*	(226)
Financing expenses (income), net	**369**	88	**134**	(75)	168
Profit (loss) before income tax	**(247)**	(37)	**(82)**	71	(112)
Income tax	**-**	6	**-**	1	6
Net profit (loss) for the period	**(247)**	(43)	**(82)**	70	(118)

* See Note 3C.

NOTE 13 – 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

	September 30 2008	September 30 2007	December 31 2007
	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions
Current assets	**471**	432*	415*
Non-current assets	**490**	452*	472*
	961	884	887
Current liabilities	**269**	351	312
Long-term liabilities	**22**	22	26
Total liabilities	**291**	373	338
Shareholders' equity	**670**	511	549
	961	884	887

* See Note 3C

B. Income statement

	For the nine-month period ended September 30		For the three-month period ended September 30		For the year ended December 31
	2008	2007	2008	2007	2007
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenues	**969**	970	**329**	326	1,304
Cost of sales	**582**	636	**200**	209	859
Gross profit	**387**	334	**129**	117	445
Sales and marketing expenses	**132**	104	**43**	36	147
General and administrative expenses	**79**	71	**27**	26	94
Other expenses, net	**-**	-	**-**	1	-
	211	175	**70**	63	241
Operating income	**176**	159	**59**	54	204
Financing expenses	**11**	9	**2**	6	13
Financing income	**(13)**	(10)	**(2)**	(6)	(14)
Financing income	**(2)**	(1)	**-**	-	(1)
Equity in earnings of an associate accounted for by the equity method	**4**	2	**1**	1	6
Profit before income tax	**182**	162	**60**	55	211
Income tax	**49**	47	**16**	16	58
Net profit for the period	**133**	115	**44**	39	153

* The above financial statements are presented solely in accordance with International Financial Reporting Standards (IFRSs).

NOTE 14 – MATERIAL EVENTS DURING THE REPORTING PERIOD AND EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

A. On March 10, 2008, the Board of Directors of the Company resolved to recommend to the general meeting of the shareholders of the Company the distribution of a cash dividend to the shareholders in the amount of NIS 679 million (which is approximately NIS 0.26 per share). On April 3, 2008, the general meeting approved payment of the dividend and it was paid on April 28, 2008.

B. On March 26, 2008, the Company signed an agreement for the sale of its satellite communications operations (Inmarsat and Bezeq Sat) and related assets, including the satellite communications site in Emek Ha'Ela. Under the agreement, the operation will be sold for a consideration of USD 15 million plus VAT, subject to price adjustments. The sale is subject to various stipulations. On November 4, 2008, the transaction was completed. The Company will record a capital gain of approximately NIS 50 million (before tax) in respect of this transaction.

C. In May 2008, the amendment to the new collective labour agreement was completed, concerning bringing forward completion of the implementation of the organizational structure and the retirement dates and changing the mix of those scheduled to retire by the end of 2008 under the new collective agreement.

On October 2, 2008, the Board of Directors resolved to approve the retirement of 135 employees at a cost of NIS 100 million, in accordance with the collective agreement from December 2006. The cost of the retirement will be recorded in the financial statements of the last quarter of 2008, and the employees will retire during 2009.

D. On July 31, 2008, the Board of Directors of the Company resolved to recommend to the general meeting of the shareholders of the Company that the registered capital of the Company be increased by 251,000,000 shares of NIS 1 par value each. A general meeting has not yet been convened for this subject.

E. On August 20, 2008, the Board of Directors of the Company resolved to recommend to the general meeting of the shareholders of the Company the distribution of a cash dividend to the shareholders in the amount of NIS 835 million (constituting approximately NIS 0.32 per share). On September 28, 2008, the general meeting approved payment of the dividend and it was paid on October 29, 2008.

F. Further to Note 9B to the financial statements at December 31, 2007, the residual value of the copper cables of the Group at September 30, 2008 is approximately NIS 610 million. Subsequent to the balance sheet date and close to the date of approval of these financial statements, and following the downward market trend, the residual value decreased to approximately NIS 315 million. As a result, the depreciation expenses of the Group are expected to increase by approximately NIS 50 million for the year 2009.

NOTE 15 – DETAILS OF ADDITIONAL MOVEMENTS IN THE SHAREHOLDERS' EQUITY

	Share capital	Share premium	Translation reserve	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of assets available for sale	Capital reserve in respect of options for employees	Deficit	Total	Non-controlling interests	Total shareholders' equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
	Relates to holders of the Company's equity									
Nine-month period ended September 30, 2008										
Balance at January 1, 2008 (audited)	**6,132**	**-**	**-**	**390**	**4**	**287**	**(2,268)**	**4,545**	**(373)**	**4,172**
Total revenues and expenses recognised in the period (unaudited)	-	-	(9)	-	(4)	-	1,329	1,316	(100)	1,216
Dividends to Company shareholders (unaudited)	-	-	-	-	-	-	(1,514)	(1,514)	-	(1,514)
Share-based payments (unaudited)	-	-	-	-		53	-	53	-	53
Injections by non-controlling interests (unaudited)	-	-	-	-	-	-	-	-	7	7
Balance at September 30, 2008 (unaudited)	**6,132**	**-**	**(9)**	**390**	**-**	**340**	**(2,453)**	**4,400**	**(466)**	**3,934**

Notes to the Financial Statements as at September 30, 2008

NOTE 15 – DETAILS OF ADDITIONAL MOVEMENTS IN THE SHAREHOLDERS' EQUITY (CONTD.)

	Share capital	Share premium	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of assets available for sale	Capital reserve in respect of options for employees	Deficit	Total	Non-controlling interests	Total shareholders' equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
	Relates to holders of the Company's equity								
Nine-month period ended September 30, 2007									
Balance at January 1, 2007 (audited)	6,309	1,623	384	1	287	(2,849)	5,755	(564)	5,191
Total revenues and expenses recognised in the period (unaudited)	-	-	-	7	-	1,015	1,022	41	1,063
Change in repayment date of a loan extended by non-controlling interests (unaudited)	-	-	-	-	-	-	-	159	159
Dividends to shareholders – distribution that does not meet the earnings test (unaudited)	(177)	(1,623)	-	-	-	-	(1,800)	-	(1,800)
Dividends to Company shareholders (unaudited)	-	-	-	-	-	(760)	(760)	-	(760)
Dividends to non-controlling interests less injections net (Unaudited)	-	-	-	-	-	-	-	(4)	(4)
Payments to a former senior officer (unaudited)	-	-	6	-	-	-	6	-	6
Balance at September 30, 2007 (unaudited)	6,132	-	390	8	287	(2,594)	4,223	(368)	3,855

NOTE 15 – DETAILS OF ADDITIONAL MOVEMENTS IN THE SHAREHOLDERS' EQUITY (CONTD.)

	Share capital	Share premium	Translation reserve	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of assets available for sale	Capital reserve in respect of options for employees	Deficit	Total	Non-controlling interests	Total shareholders' equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
	Relates to holders of the Company's equity									
Three-month period ended September 30, 2008										
Balance at July 1, 2008 (unaudited)	**6,132**	**-**	**(11)**	**390**	**-**	**322**	**(2,080)***	**4,753**	**(438)***	**4,315**
Total revenues and expenses recognised in the period (unaudited)	**-**	**-**	**2**	**-**	**-**	**-**	**462**	**464**	**(31)**	**433**
Dividends to Company shareholders (unaudited	**-**	**-**		**-**	**-**	**-**	**(835)**	**(835)**	**-**	**(835)**
Share-based payments (unaudited)	**-**	**-**	**-**	**-**	**-**	**18**	**-**	**18**	**-**	**18**
Injections by non-controlling interests (unaudited)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**3**	**3**
Balance at September 30, 2008 (unaudited)	**6,132**	**-**	**(9)**	**390**	**-**	**340**	**(2,453)**	**4,400**	**(466)**	**3,934**

*See Note 3A(4).

NOTE 15 – DETAILS OF ADDITIONAL MOVEMENTS IN THE SHAREHOLDERS' EQUITY (CONTD.)

	Share capital	Share premium	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of assets available for sale	Capital reserve in respect of options for employees	Deficit	Total	Non-controlling interests	Total shareholders' equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
	Relates to holders of the Company's equity								
Three-month period ended September 30, 2007									
Balance at July 1, 2007 (audited)	6,132	-	390	4	287	(2,089)	4,724	(599)	4,125
Total revenues and expenses recognised in the period (unaudited)	-	-	-	4	-	255	259	75	334
Dividends to Company shareholders (unaudited)	-	-	-	-	-	(760)	(760)	-	(760)
Change in repayment date of a loan extended by non-controlling interests (unaudited)	-	-	-	-	-	-	-	160	160
Dividends to non-controlling interests less minority injections net (unaudited)	-	-	-	-	-	-	-	(4)	(4)
Balance at September 30, 2007 (unaudited)	6,132	-	390	8	287	(2,594)	4,223	(368)	3,855

NOTE 15 – DETAILS OF ADDITIONAL MOVEMENTS IN THE SHAREHOLDERS' EQUITY (CONTD.)

	Share capital	Share premium	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of assets available for sale	Capital reserve in respect of options for employees	Deficit	Total	Non-controlling interests	Total shareholders' equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Year ended December 31, 2007									
Balance at January 1, 2007 (audited)	6,309	1,623	384	1	287	(2,849)	5,755	(564)	5,191
Total revenues and expenses recognised (audited)	-	-	-	3	-	1,341	1,344	31	1,375
Dividends to Company shareholders (audited)	-	-	-	-	-	(760)	(760)	-	(760)
Dividend to Company shareholders – dividend that does not meet the profit test (audited)	(177)	(1,623)	-	-	-	-	(1,800)	-	(1,800)
Change in due date of a loan provided non-controlling interests (audited)	-	-	-	-	-	-	-	160	160
Payments to a former senior officer (audited)	-	-	6	-	-	-	6	-	6
Balance at December 31, 2007 (audited))	6,132	-	390	4	287	(2,268)	4,545	(373)	4,172