"BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2003

"Bezeq" The Israel Telecommunication Corp. Limited

Interim Consolidated Financial Statements as at September 30, 2003 (unaudited)

Contents

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

Dear Sirs,

Re:Review of the Unaudited Interim Consolidated Financial Statements for the Nine Month and Three Month Periods Ended September 30, 2003

At your request we have reviewed the interim consolidated balance sheet of "Bezeq" - The Israel Telecommunication Corp. Limited and its subsidiaries as at September 30, 2003, as well as the interim consolidated statement of operations, the interim statement of changes in shareholders' equity and the interim consolidated statement of cash flows for the nine month and the three month periods then ended.

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

Reports of other auditors were furnished to us which relate to the review of the interim financial statements of subsidiaries, whose assets as at September 30, 2003, constitute approximately 21.8% of the total assets included in the interim consolidated balance sheet and whose revenues constitute approximately 36.4% and approximately 37.5% of the total revenues included in the interim consolidated statement of operations for the nine months and the three months then ended. Furthermore, the data contained in the interim consolidated financial statements, which relate to the net asset value of the Company's investments in affiliated companies and to its equity in their operating results, is based on interim financial statements which were reviewed by other auditors.

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

In the course of our review, including reviewing the reports of other auditors as mentioned above, nothing came to our attention which would indicate the necessity of making material changes to the said interim financial statements in order for them to be in conformity with generally accepted accounting principles and in accordance with the provisions of Section 4 of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

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

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

2. A program of early retirement, as described in Note 6.

3. Claims made against the Company and against investee companies, as described in Note 7A.

4. The financial position of an affiliated company. As described in Note 4A, the continuation of the activities of the affiliated company is dependent upon the execution of the Amendment to the Financing Agreement which was signed with the banking institutions and the receipt of additional loans from shareholders.

Somekh Chaikin
Certified Public Accountants (Isr.)
A member firm of KPMG International

November 11, 2003

Interim Consolidated Balance Sheet

In adjusted shekels of September 2003

	September 30 2003 (Unaudited)	September 30 2002 (Unaudited)	December 31 2002 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets			
Cash and cash equivalents	**890,766**	1,083,602	977,653
Short-term investments	**1,376,068**	815,430	1,162,482
Trade receivables	**1,719,444**	1,750,833*	1,725,860
Other receivables and debit balances	**463,097**	408,664	507,079
Inventory	**102,058**	177,805	164,885
	4,551,433	4,236,334	4,537,959
Materials and spare parts	**148,534**	158,151	120,366
Investments and long-term receivables			
Investments, deposits and debit balances	**640,998**	1,533,194*	757,346
Investments in investee companies	**288,209**	426,220	384,257
	929,207	1,959,414	1,141,603
Fixed assets			
Cost	**30,401,375**	30,393,799	29,509,683
Less– accumulated depreciation	**21,222,821**	20,441,402	19,688,402
	9,178,554	9,952,397	9,821,281
Other assets			
Deferred charges and other assets	**232,342**	280,643	278,581
Deferred taxes	**456,781**	446,520	396,080
	689,123	727,163	674,661
	15,496,851	17,033,459	16,295,870

	September 30 2003 (Unaudited)	September 30 2002 (Unaudited)	December 31 2002 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current liabilities			
Bank credit	**189,249**	397,727	520,939
Current maturities of:			
Long-term bank loans	**649,889**	588,944	536,934
Debentures	**599,272**	200,319	207,158
Trade payables	**998,645**	911,546	1,136,163
Employee severance benefits	**138,723**	234,155	209,460
Other current liabilities	**1,433,372**	1,084,314*	1,101,428
	4,009,150	3,417,005	3,712,082
Long-term liabilities			
Long-term loans	**1,889,208**	2,322,397	2,071,997
Debentures	**2,253,061**	2,691,760	2,727,831
Employee severance benefits	**780,141**	1,163,315	1,122,822
Deferred revenues	**31,678**	48,203	43,973
	4,954,088	6,225,675	5,966,623
Minority rights	**37**	–	566
Contingent liabilities (Note 7)			
Shareholders' equity	**6,533,576**	7,390,779	6,616,599
	15,496,851	17,033,459	16,295,870

* Reclassified

Adv. Miriam (Miki) Mazar	Amnon Dick	Ron Eilon
Chairperson of the Board	Chief Executive Officer	Chief Financial Officer

Date of approval of the financial statements: November 11, 2003

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

Interim Consolidated Statement of Operations

In adjusted shekels of September 2003

	For the nine month period ended September 30		For the three month period ended September 30		For the year ended December 31
	2003 (Unaudited)	2002 (Unaudited)	2003 (Unaudited)	2002 (Unaudited)	2002 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues from telecommunications services (Note 9)	**6,037,917**	6,102,668*	**2,087,501**	2,055,575*	8,095,909*
Costs and expenses					
Operating and general expenses (Note 10)	**3,372,462**	3,390,127*	**1,163,053**	1,154,368*	4,544,146*
Depreciation	**1,624,829**	1,715,804	**537,975**	573,831	2,279,330*
Royalties to the Government of Israel	**184,023**	186,958	**62,278**	56,094	251,153
	5,181,314	5,292,889	**1,763,306**	1,784,293	7,074,629
Operating income	**856,603**	809,779	**324,195**	271,282	1,021,280
Financing expenses, net	**130,592**	151,896	**46,332**	80,926	165,981
Earnings after financing expenses	**726,011**	657,883	**277,863**	190,356	855,299
Other expenses, net (Note 11)	**321,443**	385,321	**282,154**	390,851	1,224,702
Earnings (loss) before income tax	**404,568**	272,562	**(4,291)**	(200,495)	(369,403)
Income tax	**175,327**	178,231	**9,656**	24,336	208,168
Earnings (loss) after income tax	**229,241**	94,331	**(13,947)**	(224,831)	(577,571)
Equity in losses of affiliates	**228,018**	238,867	**71,521**	114,027	341,896
Minority share in losses of a consolidated company	**(585)**	(2,268)	**(351)**	(739)	(3,019)
Net earnings (loss)	**1,808**	(142,268)	**(85,117)**	(338,119)	(916,448)
Primary and diluted earnings (loss) per NIS 1 par value of common shares (in NIS)	**0.001**	(0.059)	**(0.035)**	(0.140)	(0.380)

* Reclassified

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

Interim Statement of Changes in Shareholders' Equity

In adjusted shekels of September 2003

	Share capital	Capital reserve – share premium	Capital reserve in respect of transactions between the Company and a controlling shareholder	Dividend proposed subsequent to the balance sheet date	Retained earnings (deficit)	Total
	NIS thousands					
Nine months ended September 30, 2003						
Balance as at December 31, 2002 (audited)	**6,140,991**	**941,910**	**37,926**	**187,167**	**(691,395)**	**6,616,599**
Allotment of shares (unaudited)	**23,342**	**77,920**	**–**	**–**	**–**	**101,262**
Dividend paid (unaudited)	**–**	**–**	**–**	**(187,167)**	**1,074**	**(186,093)**
Net earnings (unaudited)	**–**	**–**	**–**	**–**	**1,808**	**1,808**
Balance as at September 30, 2003 (unaudited)	**6,164,333**	**1,019,830**	**37,926**	**–**	**(688,513)**	**6,533,576**
Three months ended September 30, 2003						
Balance as at July 1, 2003 (unaudited)	**6,140,991**	**941,910**	**37,926**	**–**	**(603,396)**	**6,517,431**
Allotment of shares (unaudited)	**23,342**	**77,920**	**–**	**–**	**–**	**101,262**
Net loss (unaudited)	**–**	**–**	**–**	**–**	**(85,117)**	**(85,117)**
Balance as at September 30, 2003 (unaudited)	**6,164,333**	**1,019,830**	**37,926**	**–**	**(688,513)**	**6,533,576**
Nine months ended September 30, 2002						
Balance as at December 31, 2001 (audited)	6,140,991	941,910	37,926	–	412,220	7,533,047
Net loss (unaudited)	–	–	–	–	(142,268)	(142,268)
Balance as at September 30, 2002 (unaudited)	6,140,991	941,910	37,926	–	269,952	7,390,779
Three months ended September 30, 2002						
Balance as at July 1, 2002 (unaudited)	6,140,991	941,910	37,926	–	608,071	7,728,898
Net loss (unaudited)	–	–	–	–	(338,119)	(338,119)
Balance as at September 30, 2002 (unaudited)	6,140,991	941,910	37,926	–	269,952	7,390,779
Year ended December 31, 2002						
Balance as at December 31, 2001 (audited)	6,140,991	941,910	37,926	–	412,220	7,533,047
Net loss (audited)	–	–	–	–	(916,448)	(916,448)
Dividend proposed subsequent to the balance sheet date (audited)	–	–	–	187,167	(187,167)	–
Balance as at December 31, 2002 (audited)	6,140,991	941,910	37,926	187,167	(691,395)	6,616,599

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

Interim Consolidated Statement of Cash Flows

In adjusted shekels of September 2003

	For the nine month period ended September 30		For the three month period ended September 30		For the year ended December 31
	2003 (Unaudited)	2002 (Unaudited)	2003 (Unaudited)	2002 (Unaudited)	2002 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Cash flows from operating activities					
Net earnings (loss)	**1,808**	(142,268)	**(85,117)**	(338,119)	(916,448)
Adjustments to reconcile net earnings (loss) to net cash flows from operating activities (see A below)	**1,983,565**	1,970,805*	**638,618**	869,263*	3,758,017*
Net cash derived from operating activities	**1,985,373**	1,828,537	**553,501**	531,144	2,841,569
Cash flows from investing activities					
Investment in fixed assets	**(1,166,705)**	(907,411)	**(442,840)**	(364,776)	(1,359,365)
Proceeds from disposal of fixed assets	**61,112**	13,570	**52,866**	5,290	24,790
Proceeds from disposal of investment in affiliated companies	**–**	109,950	**–**	–	117,286
Investment in long-term deposits and investments	**(16,427)**	(147,919)*	**(11,441)**	(59,698)*	(287,422)*
Proceeds from long-term deposits and investments	**35,794**	150,714	**9,032**	25,381	160,388
Increase in short-term investments, net	**(169,730)**	(419,454)	**(49,155)**	(420,994)	(757,347)
Decrease (increase) in materials and spare parts	**(21,584)**	(18,989)	**8,646**	(20,114)	22,861
Acquisition of a partnership consolidated for the first time (see B below)	**–**	–	**–**	–	(3,876)
Investment in investee companies	**(158,223)**	(298,654)	**(42,494)**	(77,976)	(360,963)
Investment in other assets	**(43,250)**	(98,822)	**(10,278)**	(13,559)	(126,837)
Net cash used in investing activities	**(1,479,013)**	(1,617,015)	**(485,664)**	(926,446)	(2,570,485)
Cash flows from financing activities					
Issuance of debentures (subsequent to deduction of issuance expenses)	**–**	107,417	**–**	–	107,417
Repayment of debentures	**(180,025)**	(201,093)	**(27,189)**	(25,461)	(222,277)
Receipt of long-term loans	**418,359**	193,814	**217,001**	1,812	208,167
Repayment of long-term loans	**(415,060)**	(548,381)	**(128,900)**	(307,504)	(829,932)
Receipt (repayment) of short-term bank credit, net	**(331,690)**	(46,627)	**(273,599)**	172,701	76,244
Proceeds from allotment of shares	**101,262**	–	**101,262**	–	–
Dividend paid	**(186,093)**	–	–	–	–
Net cash used in financing activities	**(593,247)**	(494,870)	**(111,425)**	(158,452)	(660,381)
Decrease in cash and cash equivalents	**(86,887)**	(283,348)	**(43,588)**	(553,754)	(389,297)
Balance of cash and cash equivalents at the beginning of the period	**977,653**	1,366,950	**934,354**	1,637,356	1,366,950
Balance of cash and cash equivalents at the end of the period	**890,766**	1,083,602	**890,766**	1,083,602	977,653

* Reclassified

The notes to the financial statements are integral part thereof.

Interim Consolidated Statement of Cash Flows (Contd.)

In adjusted shekels of September 2003

	For the nine month period ended September 30		For the three month period ended September 30		For the year ended December 31
	2003 (Unaudited)	2002 (Unaudited)	2003 (Unaudited)	2002 (Unaudited)	2002 (Audited)
	NIS thousands		NIS thousands		NIS thousands
A – Adjustments to reconcile net earnings to net cash flows provided by operating activities					
Revenue and expenses not involving cash flows:					
Depreciation	**1,624,829**	1,715,804	**537,975**	573,831	2,279,330*
Deferred taxes	**8,171**	46,237	**(24,349)**	(3,973)	30,271
Company's equity in losses of affiliated companies	**228,018**	238,867	**71,521**	114,027	341,896
Minority share in losses of a consolidated company	**(585)**	(2,268)	**(351)**	(739)	(3,019)
Decrease in employee severance benefits, net	**(413,418)**	(216,915)	**(353,195)**	(117,200)	(282,101)
Loss (gain) on disposal of fixed assets	**8,574**	(7,184)	**4,707**	(1,785)	(12,790)
Provision for impairment in value of fixed assets	**52,625**	–	**52,625**	–	–
Provision for decrease in value of investments	**63,169**	392,713	**28,008**	392,713	1,237,616
Erosion (appreciation) and interest on long-term investments and debts	**55,368**	(200,766)	**(69,415)**	(26,357)	(205,163)*
Erosion of short-term investments, net	**(43,856)**	66,306	**(21,574)**	4,908	57,145
Appreciation (erosion) of long-term liabilities:					
Debentures	**97,368**	141,718	**97,087**	16,857	205,810
Long-term loans	**(62,720)**	20,580	**56,484**	31,915	(13,434)
Amortization of deferred expenses and other adjustments	**96,637**	177,865	**19,179**	58,621	230,585*
Changes in current assets and liabilities:					
Decrease (increase) in trade receivables	**(8,430)**	(6,074)*	**(15,627)**	(20,220)*	29,540*
Decrease (increase) in receivables and debit balances	**57,899**	(23,564)	**(53,095)**	4,382	4,905
Decrease (increase) in inventory	**61,163**	(56,899)	**13,708**	13,199	(44,983)
Increase (decrease) in trade payables	**(98,130)**	(173,198)	**136,164**	(114,495)	51,263
Increase (decrease) in other current liabilities	**269,178**	(129,737)	**162,583**	(52,135)	(131,945)
Decrease in deferred revenues	**(12,295)**	(12,680)	**(3,817)**	(4,286)	(16,909)
	1,983,565	1,970,805*	**638,618**	869,263*	3,758,017*
B– Partnership consolidated for the first time					
Working capital (excluding cash and cash equivalents)					6,530
Fixed assets					(6,043)
Long-term liabilities					797
Minority rights as at the acquisition date					726
Investment in an affiliated company					1,071
Goodwill					(6,957)
					(3,876)
C– Non-cash transactions					
Acquisition of fixed assets, other assets, materials and spare parts on credit	**171,213**	153,820	**171,213**	153,820	209,091
Sale of fixed assets on credit	**–**	5,821	**–**	5,821	5,824

* Reclassified

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

Notes to the Interim Consolidated Financial Statements as at September 30, 2003 (Unaudited)

NOTE 1 – GENERAL

A. The interim statements were prepared according to generally accepted accounting principles, applicable to the preparation of financial statements for interim financial statements. These statements should be read in conjunction with the Company's annual financial statements as at December 31, 2002 and for the year then ended and the related accompanying notes.

B. In the notes to the interim financial statements, the Company presents only the significant changes in its business and legal environment that occurred from the date of the latest annual financial statements until the date of these interim financial statements. The full and detailed description, including significant changes and developments which occurred in recent years, particularly in the field of cellular telephone services, international communication services, domestic communication services, the opening of these markets to competition and decisions of the Ministerial Committee for Privatization to reduce the State's holdings in the Company, appear in Note 1 to the Company's annual financial statements as at December 31, 2002. The significant changes that occurred from the date of those annual financial statements to the date of these financial statements, are as follows:

1. In March 2003 the Committee for Regulating the Tariffs of Bezeq presented a report containing its recommendations. The recommendations were approved and amended by the Ministers, and on August 5, 2003, the Knesset Finance Committee approved the recommendations with certain modifications. The changes in the Company's tariffs as approved by the Finance Committee are as follows:

   a. Commencing on September 1, 2003, the overall average level of the Company's tariffs will be lowered compared with the level set in the last tariff update (May 1, 2002) by an average of 5.97% in nominal terms, through a combined process whereby call tariffs will be reduced by 23.84%, fixed monthly fees will be increased by 12.8% (monthly fees for reduced use remain unchanged) and call completion tariffs in a telecommunications network and international interconnect tariffs will be reduced by an average 8.2%.

      The lowering of the Company's tariffs includes cancellation of the minimum call tariff (set at 22.5 agorot including VAT), setting tariffs of 13 agorot (including VAT) per call minute during peak hours and 5.5 agorot (including VAT) per call minute in off-peak hours.

   b. Tariff updates in the future will be based on the rise in the CPI less an "efficiency coefficient" of minus 2.5% as long as the Company's average output growth is in the range of minus 1% to minus 3% per year (the efficiency coefficient will decrease by one half of one percent with each decrease of 1% in the growth rate beyond minus 3% and will increase by one half of one percent with each successive rise of one percent in the growth rate beyond minus 1%).

   c. This arrangement will remain in effect until December 31, 2007, with an option to extend it for a further year, where the date of the tariff update (after the first one) will be June 1st of each year.

   The above changes in the Company's tariffs took effect on September 1, 2003, and led to a decrease in the revenues and operating income of the Company. The Company believes, based on its projections, that the above tariff reductions can be expected to have a materially adverse effect on its revenues and operating income.

2. Further to Note 1E(1) in the financial statements as at December 31, 2002, concerning a reduced deduction rate for the cellular companies due to the bad debts component generated in respect of calls from Company subscribers to cellular company subscribers, in July 2003 the Ministry of Communications announced its decision on the matter as follows:

   a. For the period from October 2, 2000, through August 31, 2003, the deduction rate will be 1.1%. This rate will be applied to all the cellular operators even if the Company had reached arrangements with some of them.

NOTE 1 – GENERAL (CONTD.)

b. For the period from September 1, 2003, and thereafter, the Company will be required to transfer interconnect fees to the cellular companies according to actual traffic minutes, with no deduction of any kind. Based on the recommendation in the report of the Committee for Regulating Communications Tariffs, this matter will be reflected in the next Company tariff update in September 2003, subject to receipt of the approvals required by law. (It is noted that in accordance with the decision of the Ministers to approve the recommendations of the Committee for Regulating Communications Tariffs, the additional revenues deriving to the Company in respect of their decision, compared with the recommendations of the committee, include the component of the bad debts).

c. With reference to the period from March 1, 2000, to October 1, 2000 – an appeal filed by Partner against the Company is pending in the Supreme Court. It is proposed that the decision regarding the 1.1% rate of deduction should apply also to this period if the parties agree, subject to the decision of the court.

The significance of such a decision is that the Company's demand for a deduction rate of 2.5% until January 1, 2003, and a rate higher than 1.1% for the period thereafter, which would reflect the bad debts and collection expenses – was not accepted. Both the Company and Partner, each for its own reasons, refused the proposal and notified the court that, even after the Minister's decision, its ruling on the appeal was needed. The legal advisers of the Company are unable, at this stage, to estimate the outcome of the appeal filed by Partner.

In the past, the Company's financial statements included a provision for the effect of the decision of the Minister of Communications on a temporary deduction rate of 1.1% of the volume of traffic for the period starting on October 2, 2000. Therefore, the decision to set that rate as a fixed percentage for that period has no further effect on the Company's financial statements. However, the decision of the Minister of Communications to cancel the deduction starting on September 1, 2003, will mean a decrease of approximately NIS 50 million per year (based on airtime data for 2002 compared with a deduction of 2.5%). The Company has appealed the decision.

3. Further to Note 1E(2) to the financial statements as at December 31, 2002, on August 11, 2003, the Ministry of Communications published draft regulations for the proceedings and conditions for receipt of a general license for providing international telecommunications services. On September 29, 2003, a consolidated company, Bezeq International Ltd., submitted its remarks on the draft. The management of the consolidated company, Bezeq International Ltd. is unable, at this stage, to estimate the implications of opening the market to competition on its financial position and the results of its operations.

4. Further to Note 1E(3) to the financial statements as at December 31, 2002, concerning a petition filed by a cellular company against the Company and against the Minister of Communications, demanding cancellation of a directive issued to it to disconnect the direct connections that it makes for business customers and which bypass the Company's network, the cellular company and the Ministry of Communications reached an agreement whereby a transition period of nine months will be allowed for disconnection of the direct connections. Despite the objection of the Company to the duration of the transition period, the Supreme Court decided to strike the petition as requested by the petitioner.

5. Regarding the settlement agreement between the Company and the State of Israel and the Israel Lands Administration relating to the Company's rights in real estate assets transferred to the Company, see Note 5 below.

6. On July 24, 2003, the State approached several institutions, requesting offers for the purchase of 86,500,000 ordinary shares of par value NIS 1 each of the Company held by the State. Subsequently, on July 29, 2003, the State sold those shares to Gmul Sahar Underwriters Ltd. (which made the highest offer) at NIS 4.338 per share.

NOTE 1 – GENERAL (CONTD.)

This share sale was carried out as part of the framework agreement between the State and the Company as described in Note 8 below. Accordingly, the Company allotted to the State, on July 30, 2003, the entire balance of its unissued registered capital, a total of 23,342,462 ordinary shares of par value NIS 1 each. The total consideration received in respect of this issuance was NIS 101,261,807. After increasing the registered capital of the Company as described in Note 8 below, the Company allotted to the State, on October 30, 2003, the balance of the shares in respect of the shares sold by the State to Gmul Sahar Underwriters Ltd., as well as additional shares in accordance with the framework agreement (a total of 64,398,076 additional shares). The consideration in respect of this additional allotment was NIS 279,364,943. Out of the consideration in respect of these two allotments, the Company transferred to the State a commission of 1% in accordance with the framework agreement (see Note 8A).

NOTE 2 - ACCOUNTING POLICIES

The significant accounting policies employed in preparation of these financial statements, are the same as those employed in the preparation of the latest annual financial statements, except for the following:

1. In July 2001 the Israeli Institute for Accounting Standardization ("IIAS") published two new standards:

   a. Accounting Standard No. 12 – Termination of adjustment of financial statements. This standard eliminates adjustment for the effects of the general purchasing power of the Israeli shekel in financial statements, commencing from January 1, 2003.

      In December 2002, the IIAS published Standard No. 17, postponing the application of Standard No. 12 to January 1, 2004. Thus, the adjustment of the financial statements will end on that date. Until December 31, 2003, the Company will continue to prepare statements adjusted in accordance with Opinion No. 36 of the Institute of Certified Public Accountants in Israel ("ICPAI"). The adjusted amounts included in the financial statements as at December 31, 2003, will serve as the starting point for the nominal reporting commencing on January 1, 2004. Implementation of Standard No. 12 is liable to have material implications for the reported business results of the Company, the extent of which depends on the rate of inflation, the composition of assets and the Company's financing sources.

   b. Accounting Standard No. 13 – Effects of changes in foreign currency exchange rates. The standard deals with the translation of foreign currency transactions and the translation of the financial statements of overseas operations for integration in the financial statements of the reporting corporation. The Standard supersedes the provisions of Clarifications 8 and 9 to Opinion No. 36, which will become null and void when Accounting Standard No. 12, described above, takes effect.

2. In February 2003 the IIAS published Accounting Standard No. 15 – Impairment of Asset Value. The Standard determines procedures with which a corporation must comply in order to ensure that its assets in the consolidated balance sheet are not stated in an amount exceeding their recoverable amount, which is the higher of the net sale price and the present value of the estimated future cash flows expected to derive from the use and realization of the asset. In addition, the Standard lays down rules of statement and disclosure for assets whose value is impaired. The Standard applies to financial statements for the periods starting from January 1, 2003. Application of the Standard has no effect on the interim financial statements.

Notes to the Interim Consolidated Financial Statements as at September 30, 2003 (Unaudited)

NOTE 3 – FINANCIAL STATEMENTS IN ADJUSTED VALUES

The financial statements were prepared on the basis of the historical cost convention adjusted for changes in the general purchasing power of the Israeli currency. The changes that occurred in the Consumer Price Index ("CPI") and in foreign currency exchange rates are as follows:

	Consumer Price Index	Exchange rate of the US dollar	Exchange rate of the euro
	%	%	%
During the nine month period ended:			
September 30, 2003	**(1.481)**	**(6.249)**	**4.336**
September 30, 2002	6.988	10.303	22.830
During the three-month period ended:			
September 30, 2003	**(0.992)**	**2.992**	**5.228**
September 30, 2002	0.648	2.139	1.388
During the year ended December 31, 2002	6.496	7.269	27.182

NOTE 4 – INVESTMENTS IN INVESTEE COMPANIES

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

The Company's investment in DBS as at the balance sheet date amounts to approximately NIS 1,223 million. The Company's share in the accumulated losses of DBS is approximately NIS 940 million, of which approximately NIS 190 million was recorded in the nine months ended September 30, 2003. The balance of the current debt of DBS to the Company and its consolidated companies amounts to approximately NIS 61.8 million.

Further to Note 8E to the financial statements as at December 31, 2002, on August 31, 2003, the additional shares in DBS were allotted to the Company, thereby increasing the Company's holdings in DBS to approximately 49.8%. The increase in the Company's holdings in DBS generated an excess cost to the Company of approximately NIS 129 million.

Since commencing operations DBS has accumulated considerable losses and negative cash flows. The loss for the year 2002 amounted to approximately NIS 712 million and the loss arising in the nine month period ended September 30, 2003, amounted to approximately NIS 416 million. As a result of these losses, the capital deficit and the negative working capital of DBS as at September 30, 2003, amounted to approximately NIS 2,676 million and approximately NIS 1,678 million, respectively. The negative working capital includes bank credit of about NIS 1,242 million.

On May 23, 2001, a financing agreement ("the Financing Agreement") was signed between DBS and certain banks ("the Banks"), stipulating, *inter alia*, undertakings by DBS to meet certain suspending conditions and to comply with cumulative milestones and financial stipulations ("the Conditions").

An economic study carried out by the Banks at the beginning of 2002 determined that in order to finance the operations of DBS, additional financing would be required which considerably exceeds the financing requirements defined in the Financing Agreement.

On December 30, 2002, DBS, the shareholders and the Banks signed an agreement increasing the credit facility from the Banks ("the Interim Credit Facility"), which will be implemented concurrently with additional investments of the shareholders in an amount not less than a sum equal to 150% of the amount that will be injected by the Banks. Receipt of the Interim Credit Facility is subject, *inter alia*, to DBS's compliance with financial and operating conditions set out in this agreement. At the same time as the aforementioned signing, discussions were being held between the parties regarding the expansion of the Interim Credit Facility within the framework of an amendment to the Financing Agreement ("the Amendment Agreement").

As at the date of approval of these financial statements, the shareholders and the Banks have transferred approximately $36 million and approximately $24 million, respectively to DBS, which is their entire obligation in the Interim Credit Facility. Nevertheless, some of the conditions in the Financing Agreement and the Interim Credit Facility are not being met.

An economic study carried out by the Banks during the reporting period determined that the overall financing needs of DBS do not exceed the Interim Credit Facility plus the increment to the Interim Credit Facility as part of the Amendment Agreement (including the proportional part of the shareholders).

On August 6, 2003, the Amendment Agreement was signed by the Banks and DBS. Under that agreement, the Banks will make additional amounts available to DBS, in excess of those made available under the Financing Agreement and the Interim Credit Facility, subject to DBS's compliance with the Conditions and milestones determined in the Amendment Agreement, including additional investments by the shareholders in amounts not less than 150% of the amounts made available by the Banks. The Amendment Agreement will take effect only after certain suspending conditions are met, and at the latest by August 20, 2003, or by a later date agreed upon by the parties. As at the date of these financial statements, not all the suspending conditions have been met. Nevertheless, principal shareholders and the Banks made further credit available to DBS, beyond the Interim Credit Facility and on account of the Amendment Agreement.

NOTE 4 – INVESTMENTS IN INVESTEE COMPANIES (C0NTD.)

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

As at the date of approval of the financial statements, the credit made available by the shareholders and the Banks to DBS on account of the Amendment Agreement amounted to approximately $25.2 million and approximately $10 million, respectively.

The grant of additional loans by the Company to DBS is subject, *inter alia*, to the approval of the Ministerial Committee for Privatization (" the Committee"). On January 14, 2003, the Committee gave its approval for the Company to invest in DBS up to the percentage of its holding in DBS multiplied by $600 million and up to an exposure ceiling of $300 million. The Board of Directors of the Company approved the Company's investment in DBS as derived from the Financing Agreement, the Interim Credit Facility and the Amendment Agreement. The management of DBS estimates that the total investments approved for the Company by the Committee cover the Company's proportional part of the Interim Credit Facility plus its proportional part of the Amendment Agreement.

DBS's continued operation is contingent upon the Amendment Agreement taking effect as aforesaid and upon the receipt of additional loans from the shareholders.

The management of DBS believes that there is a good chance of meeting the aforementioned suspending conditions, of the Amendment Agreement taking effect and of the arrangement of the financial resources required by DBS in the coming year.

B. Goldnet Communications Services – a registered partnership ("the Partnership")

Further to Note 8H to the financial statements as at December 31, 2002, in the matter of notice to the Company of exercise of the Put option held by Malam Systems Ltd. ("Malam") relating to the Company, for the sale of 20.9% of its holding in the Partnership, on May 5, 2003, after receipt of the approvals required by law for the change in the holdings in the Partnership and after the consideration of approximately NIS 6.4 million was paid by the Company, the Company's holdings in the Partnership increased to 74.9%, while the holdings of Malam in the Partnership decreased accordingly to 25.1%. Under the amendment to the Government Companies Law, 5735-1975, in June 2003 that law could apply to the Partnership as long as the Company remains a government company.

C. Adanet For Business Group Ltd. ("Adanet")

Further to Note 8G to the financial statements as at December 31, 2002, and in view of the uncertainty regarding the realization of the business plan of Adanet as planned, as well as regarding the outcome of the discussions with the banks for arranging the financing that Adanet requires, there is considerable concern regarding Adanet's continued existence as a going concern. As noted n the financial statements as at December 31, 2002, the Company, and Clal Information Technologies Ltd. and managers at Adanet have, upon fulfillment of certain conditions, a Call option and a Put option, respectively, for the remaining 50% of Adanet's shares, subject to the approvals required by any law. The exercise price of the aforementioned option is approximately $5.5 million.

In view of the aforesaid, the Company recorded a provision of approximately NIS 52 million in respect of its investments in Adanet, which is included in the line other expenses, net, in the Statement of Operations for the nine month period ended September 30, 2003. On November 10, 2003, Adanet filed an application for a stay of proceedings order while a recovery plan is formulated for the group.

NOTE 4 – INVESTMENTS IN INVESTEE COMPANIES (C0NTD.)

D. Pelephone Communications Ltd. ("Pelephone")

In May 2003 the Company received a partial update of the estimated value of Pelephone, indicating a rise in its value to between $800 million and $1 billion and in August 2003 the Company received an additional partial update indicating a further rise in Pelephone's value to between $900 million and $1.1 billion. In view of the uncertainty of the continuing existence over time of the factors that led to this update, at this stage no change has been made to the provision for impairment in value in Pelephone recorded in 2002. The Company will re-examine the value of Pelephone at a later date.

NOTE 5 – FIXED ASSETS

A. Further to Note 9C to the financial statements as at December 31, 2002, on May 15, 2003, the Company signed a settlement agreement with the Government of Israel on behalf of the State of Israel and the Israel Lands Administration ("the Administration"). The agreement regulates the dispute between them relating to the rights of the Company in various real estate assets that were transferred to the Company when it commenced operations in 1984, under an asset transfer agreement which was signed between the Company and the State ("the Asset Transfer Agreement").

Under the settlement agreement, 14 properties will be returned to the State out of the 28 which are in the Company's possession under renewable lease status (complete properties which were leased to the Company for a period of two years and renewable each time for a further two years, unless the State exercised its right to end the lease on terms and conditions laid down in the Asset Transfer Agreement), in addition to three properties which were returned to the Administration prior to the settlement agreement and the Administration will allocate three substitute properties instead of some of those properties which the Company will return to the State. The remainder of the properties in the Company's possession under renewable lease and properties which were leased to the Company under the Asset Transfer Agreement, will remain in the Company's possession under capitalized lease terms as set out in the Agreement. The Administration will also allocate and lease to the Company, after completion of planning stages, a net area of 70 dunams at the Sakia site, on lease terms set out in the Agreement. The Agreement also includes a number of individual arrangements in the matter of specific disputes between the parties, some of which related to certain of the properties in dispute and some of which related to other properties which were not part of the dispute. Under these arrangements, it was agreed, *inter alia*, that the Company will return several additional properties (one of which was never in dispute), as set out in the Agreement.

The Agreement was approved by the Audit Committee of the Board of Directors of the Company, the Board of Directors and the General Meeting of the Shareholders of the Company conducted on August 6, 2003 (since it is an extraordinary transaction between the Company and its controlling shareholder – the State of Israel) and also requires the approval of the Israel Lands Council. The Agreement will take effect after being validated by a decision of the court in which the claim was filed by the State, the Administration and the Development Authority against the Company in the matter of the dispute.

In the opinion of the Company's Management, the aforementioned is not expected to have a material effect on the financial statements of the Company.

NOTE 5 – FIXED ASSETS (C0NTD.)

B. During September 2003 a proportionally consolidated company signed an agreement for technological upgrading of sites used for the CDMA system to 1X technology. The value of the agreement is approximately $95 million. The upgrade will considerably increase the capacity and quality of the existing network and will allow the provision of advanced services to customers. The deployment of the network is planned in stages, commencing in 2003, with most of the deployment expected to be completed by the end of 2004 and installation being completed in 2006. Concurrently, the company implementing the network upgrade undertook to buy back old equipment for $41 million.

During September 2003 a proportionally consolidated company signed an appendix to an earlier agreement from April 2002, for the additional purchase and installation of a cellular communication system in 1X technology (CDMA 2000) for approximately $19 million (the value of the basic contact is approximately $147 million).

C. In September 2003 the Board of Directors of the Company adopted a resolution to close the Inmarsat station (a satellite communication station) and to attempt to sell the equipment and/or the operation. In view of the uncertainty as to the consideration that will be received, if any, the Company reduced the entire balance of its investments in property relevant to the station by approximately NIS 36 million. The Ministry of Communications notified the Company that it is not authorized to decide on closure of the station. The Company disputes the position of the Ministry and has requested a hearing on the matter.

D. As part of an investigation carried out by a consolidated company with the assistance of an outside expert and following the application of the provisions of Accounting Standard No. 15, the consolidated company charged a deduction for impairment of assets (mainly switching equipment and transmission equipment) in the amount of approximately NIS 17.1 million during the period of the third quarter of 2003 report. The deduction is included in the Statement of Operations in the line Other expenses, net, and its amount was determined in accordance with the provisions of Standard 15, based on the valuation of the outside expert referred to above and the assessment by management of the net selling price and the usage value of the assets of the consolidated company.

NOTE 6 – LIABILITY FOR EMPLOYEE SEVERANCE BENEFITS

A. Early retirement plan

In September 2000, the Company reached an agreement with workers' representatives for extension of the 1997 collective agreement for early retirement. Under the agreement 1,770 additional employees would take early retirement from April 1, 2001, through December 31, 2006, (with an option to extend the final retirement date for certain employees through December 31, 2008). The agreement also stated that the Company would be able to terminate the employment of employees in a severance payment track in excess of the aforementioned quota. In the opinion of the Company's Management, the possibility of additional employees retiring under the aforementioned track is low and accordingly, no provision has been made in the financial statements. Under this plan, 838 employees had taken early retirement by September 30, 2003.

In May 2003 the Knesset approved the Israeli Economy Recovery Plan (Legislative amendments for achieving budgetary goals and the economic policy for fiscal years 2003 and 2004), 5763 - 2003. The law includes, *inter alia*, an amendment of the Supervision of Insurance Business Law, 5741-1981, which relates to the old pension funds operating at a deficit, including the pension fund with which the Company is associated in an agreement. The effect of this amendment on the Company as a whole and on the early retirement plan in particular, are still unclear.

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

A. Early retirement plan (contd.)

The aforementioned amendment has expedited the implementation of the early retirement plan beyond the original plan, and in July and August 2003 347 employees retired. In addition, it was agreed with the workers' representatives that by in 2004 the quota would be 100 employees who would retire in accordance with the provisions and terms of the agreement.

In view of the uncertainty generated by the enactment of the law, including with regard to the possible considerable increase in the costs of implementing the retirement agreement in the future and the manner of its financing, Company Management and the workers' representatives agreed that without derogating from the validity of the agreement, each of the parties may, on its own initiative, hold talks with the other party on everything relating to the changes and/or implementation of the provisions of the agreement and the other party would consent to such talks.

Due to the aforementioned uncertainties, the Company is unable to estimate, at this stage, the effects of the law, if any, and therefore no provision has been made in the financial statements for possible additional costs in respect of the early retirement agreement.

B. The Company filed a claim against the Makefet Fund ("the Fund") by means of which the early retirement plan is executed. Under the collective agreements applicable to labor relations in the Company and in accordance with agreements with the Fund, Company employees who are "transferred employees" have the option to retire on one of two retirement tracks. The method of calculating the cost of early retirement of the transferred employees is determined in the provisions of several agreements and documents which were drawn up between the Company and the Fund during the years 1990-1996, including a letter of understanding drawn up and signed by the parties in 1996. The Company contends that the Fund violated the provisions of the agreements in general and those of the letter of understanding in particular, in that when it calculated the costs of early retirement for transferred employees, the Fund determined those data on the basis of the assumption that those employees had chosen the track with the higher cost of purchase, irrespective of the track which those employees had actually chosen. According to an actuarial opinion prepared for the Company, the gap between the payments collected by the Fund from the Company according to its calculations and the rate of those costs had they been made, as the Company alleges, on the basis of the retirement track actually chosen by those employees, is a nominal cumulative amount of more than NIS 128 million, the reimbursement of which the Company is suing the Fund. On November 3, 2003, the Company submitted to the Fund letters of demand for additional amounts of approximately NIS 80 million. The Company is in talks with the Fund for reaching an arrangement on all the issues in dispute.

NOTE 7 - CONTINGENT LIABILITIES

A. CLAIMS AND CONTINGENT LIABILITIES

The Company and the investee companies have contingent liabilities in respect of which the maximum possible exposure is considerable. A detailed description of these contingent liabilities appears in Note 19A to the Company's financial statements for the year ended December 31, 2002. No significant changes occurred in respect of the contingent liabilities through the date of signing these financial statements, except for the following:

Notes to the Interim Consolidated Financial Statements as at September 30, 2003 (Unaudited)

NOTE 7 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS AND CONTINGENT LIABILITIES (CONTD.)

1. On May 4, 2003, a derivative statement of claim was received at the Company's offices, which includes an application to the court to approve the filing of the claim as a derivative claim (a claim which is filed by a shareholder or director of a company in the name of the company, with the approval of the court). The claim was filed by a shareholder of the Company against 20 directors serving the Company and certain senior managers who were employed by the Company during October and November 2000 ("the Officers") and against the Company. The statement of claim alleges as the main cause of the action, the negligent conduct of the Officers in the "Pelephone-Shamrock" transaction. In that transaction, Motorola Israel Ltd.'s shares in Pelephone were sold to Pelephone Holding L.L.C., a corporation registered in the U.S.A. ("the Foreign Corporation"), in consideration of approximately $591 million.

   The consideration of the purchase was financed partly by a loan of $ 240 million extended by the Company against convertible debentures for 80% of the shares of the Foreign Corporation (a detailed description of the transaction appears in the financial statements of the Company starting from the year 2000). This negligence is mainly reflected, according to the statement of claim, in that the Officers did not ensure that the Company received collateral for the above loan extended to the Foreign Corporation by the Company. The claim further alleges that as a result of the negligence of the Officers, the Company was obliged to record a provision in its books for the full amount of the loan, which is tantamount to an admission that the chances of collecting the loan are non-existent and therefore, the loss to the Company as a result of the Officers' negligence amounts to approximately $ 240 million. The plaintiff petitioned the court to order the Officers to pay the Company the amount of the loss it sustained, i.e. approximately $240 million.

   It is noted that the Company rejected a prior approach sent to it by the plaintiff's lawyer, demanding full exercise of the rights of the Company in the matter by way of filing suit, citing as the reasons, *inter alia*, that the facts creating the cause of action were not described in accordance with the requirements of the Companies Law, 5759 - 1999 and that in any case, since the loan extended by the Company would fall due only in two years' time and since the Company still has an option to convert the loan to shares of the Foreign Corporation, and thus, legally speaking, the claim is speculative. It is further noted that contrary to the statement of claim, which alleges that the Company did not receive collateral for the loan it extended, the Company has registered a second ranking lien on the shares of Pelephone Holding L.L.C. in Pelephone against the same loan (convertible debenture) (after a first lien was given to the bank that financed part of the transaction – see also Note 8D(2) to the financial statements as at December 31, 2002).

   The Company filed an application for the dismissal *in limine* of the claim, citing as its reason that the plaintiff had not filed a preliminary application for approval of his claim as a derivative claim, as required by law. Concurrently, the Company filed an application for extension of the date for filing a statement of defence until a decision will be given on the application for dismissal *in limine*. The Company's application to extend the date was allowed. On January 18, 2004, a hearing will be held on the application to dismiss the claim *in limine*. At this stage, the chances of the claim and of the application filed by the Company for dismissal *in limine* of the claim, cannot be estimated.

NOTE 7 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS AND CONTINGENT LIABILITIES (CONTD.)

2. On May 27, 2003, a statement of claim was received at the Company's offices together with an application for recognition as a class action, which was filed in the Tel Aviv District Court against the Company. The plaintiff, who describes himself as "a private Internet user", alleges in his claim that the Company refuses to install splitters for high speed Internet lines of the broadband ADSL/frame relay type used for Internet service in condominiums and does so in order to increase its profits. The plaintiff, who is seeking to represent all the Internet users in Israel, further alleges that the Company's refusal to install the splitters causes losses of thousands of shekels per year to every private Internet user in Israel, since the connection of a number of tenants in a condominium on one telephone line using the aforementioned splitters would considerably reduce the fees paid to the Company by each consumer. The causes of the claim as appear in the statement of claim, are cited by virtue of the Anti-Trust Law, the Torts Ordinance and the Unjust Enrichment Law. The plaintiff also alleges fraud and material deception under the Consumer Protection Law. The amount of the claim is estimated by the plaintiff at NIS 2.5 billion (NIS 10,000 per consumer), which he alleges is the loss sustained by the plaintiffs. The plaintiff also petitions to charge the Company, in addition, with special and punitive damages, and for an order for the Company give accounts for all private Internet users in respect of the amounts received from them from the time each user started using the service until the date of the reply. On September 30, 2003, the Company filed its response to the application. No hearing of the application has yet been scheduled. The Company, relying on its legal advisers, is unable at this stage to estimate the outcome of the claim and therefore no provision was made in respect of the claim in the financial statements.

3. On June 5, 2003, a statement of claim was received at the Company's offices together with an application for recognition as a class action, which was filed in the Tel Aviv District Court against the Company by two of its subscribers. According to the allegations in the statement of claim, the Company overcharged its subscribers by NIS 0.021 (plus VAT) compared with the charge defined in the regulations, for calls from Company subscribers to subscribers in the cellular networks of Cellcom and Pelephone, during a period (estimated) from June 1996 to August 31st of that year. The plaintiffs allege that in so doing, the Company violated the ban on misleading consumers as laid down in the Consumer Protection Law, breach of duties under the Contracts Law, the Torts Ordinance and the Sale Law, as well as unjust enrichment. The group in whose name the claim is filed is defined by the plaintiffs as "A group of Bezeq subscribers in Israel who dialed to subscribers of Cellcom and Pelephone in June, July, August 1996" and estimated by them as numbering more than four million subscribers. (It is noted that at the relevant time, the Company's subscribers numbered about 2.5 million.) Based on the (erroneous, as aforementioned) estimate of the number of subscribers and the average "loss" to the plaintiffs (NIS 7.5), the plaintiffs estimate the amount of their claim at about NIS 30 million and are claiming compensation in respect of that loss. A calculation made by the Company found that the difference between actual collection and collection by the applicants' method amounts to about NIS 6 million. Alternatively, the plaintiffs are requesting that the court recognize the claim as a claim for declaratory relief or as a claim for a mandamus against the Company. Nevertheless, and according to the statement of claim, claims for similar cause were filed against Cellcom and Pelephone and the claim against Pelephone was dismissed by the District Court, while an appeal in respect of that case is pending in the Supreme Court (the plaintiffs have stated that they are concerned that the ruling of the Supreme Court in this proceeding will be given after elapse of the date for filing their claim, due to limitation). The Company, relying on its legal advisers, is unable at this stage to estimate the chances of the outcome of the claim, and therefore no provision is included in the financial statements in respect of the claim.

4. Further to Note 19A(1) to the financial statements as at December 31, 2002, concerning an application for approval of a claim as a class action against the Company and the consolidated company Bezeq International Ltd. (which was stricken from the proceeding), alleging misleading advertising about the method of debiting international calls, a decision was given on August 11, 2003 in the additional hearing that upheld the decision of the Supreme Court dismissing the plaintiff's application to file a class action.

Notes to the Interim Consolidated Financial Statements as at September 30, 2003 (Unaudited)

NOTE 7 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS AND CONTINGENT LIABILITIES (CONTD.)

5. Further to Note 19A(2) to the financial statements as at December 31, 2002, concerning an appeal against a claim filed in the Regional Labor Court by the Histadrut in the name of a group of employees, in an application for declaratory relief for the pension rights of the employees in the group, who are employees who were transferred from the Ministry of Communications. On September 23, 2003, decision was given by the National Labor Court which rejected the appeal.

6. Further to Note 19A(4)to the financial statements as at December 31, 2002, concerning the claim of senior employees for a wage increment of 33%, the court has given its decision which rejected the claim in full. The plaintiffs have appealed the decision.

7. Further to Note 19A(8) to the financial statements as at December 31, 2002, concerning a claim filed against the Company in respect of violation of undertakings and representations, as it were, that the Company made to the plaintiff for the purchase of public telephone boxes, the court recommended to the parties, on May 5, 2003, that they apply for a conciliation proceeding. Following that recommendation, the case has been transferred for conciliation.

8. Further to Note 19A(11) to the financial statements as at December 31, 2002, concerning denial of an application for approval as a class action against the Company according to which the Company unlawfully collected monies from its subscribers in respect of certain services which it provides, on July 1, 2003, the Supreme Court denied the application for leave to appeal which was filed in respect of that decision (and which was heard as an appeal).

9. Further to Notes 19A(12), 19A(14) and 19A(17) to the financial statements as at December 31, 2002, relating to class actions filed against the Company, for which the source of authority for filing the claims is Regulation 29 of the Civil Procedures Regulations. In April 2003 a ruling of principle and precedent was issued by the Supreme Court in a case in which the Company is not a party, whereby it was determined that a class action cannot be filed by virtue of Regulation 29 of the Civil Procedures Regulations where no specific arrangement has been determined for filing the action in primary legislation. It is noted that in respect of this decision, an application for a further hearing has been filed in the Supreme Court (and has been allowed).

10. Further to Note 19A(12) to the financial statements as at December 31, 2002, concerning an action together with an application for approval of the action as a class action which was filed against the Company, in which it is alleged that the Company unlawfully collected payment differences for the fixed monthly fee for a telephone line, and further to Note 7A(9) above in view of the ruling of the Supreme Court, the plaintiff filed, with the consent of the Company, an application to strike the claim and the application for its approval. The court allowed the application.

11. Further to Note 19A(15) to the financial statements as at December 31, 2002, concerning two class actions and an application for their approval as class actions which were consolidated into one case, in the matter of charging subscribers telephone lease fees, which the plaintiffs allege was unlawful, on June 10, 2003, the Supreme Court denied the application for approval of the claim as a class action. The plaintiffs filed an appeal in the Supreme Court against the decision of the court. According to a decision of the Supreme Court Registrar, the Company must file its written summations in the matter of the appeal by January 5, 2004.

12. Further to Note 19A(17) to the financial statements as at December 31, 2002, concerning an action and an application for recognition as a class action against the Company, Bezeq International and the other international communications operators, alleging that the Company unlawfully collected VAT at 17% for some of the collect calls arriving from abroad and accepted by its subscribers in Israel, and further to Note 7A(9) above, in view of the ruling of the Supreme Court, the court decided, on August 25, 2003, to strike the application for approval of the claim as a class action and, as a result, also the action itself. An appeal has been filed against this decision in the Supreme Court.

NOTE 7 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS AND CONTINGENT LIABILITIES (CONTD.)

13. Further to Note 19A(25) to the financial statements as at December 31, 2002, concerning a letter of demand in the name of the Moshav Porath Committee which was received in October 2001, in April 2003 the Company received at its offices a statement of claim filed in the Tel Aviv District Court against the Company, the Broadcasting Authority and the State of Israel by various plaintiffs from Moshav Porath in the Sharon region, including the estates of deceased persons, for compensation due to physical harm pursuant to the Torts Ordinance. The statement of claim alleges violation of legislated duties and acts and/or failures allegedly perpetrated by the defendants jointly and/or severally in connection with the operation of the “Hillel” broadcasting station, which is near the homes of the plaintiffs. It is alleged that as a result, the plaintiffs were subjected to banned radiation from the broadcasting station and bodily harm, most of which ended in the death of some of the plaintiffs.

    The amount of the claim stated by the plaintiffs is "more than NIS 15 million", and the same claim notes that the plaintiffs will also petition to split the reliefs so that they will reserve the right to sue later for other financial damages which are not bodily harm, such as damage to crops and loss of value of land. According to the notice of the plaintiffs' lawyer, which was given before the claim was filed, this claim is an initial claim and it is intended that additional claims of other residents who have been harmed by radiation from the “Hillel” station will be filed later.

    The Company filed an application for dismissal of the claim *in limine*. Nevertheless, it is unable, at this stage, to estimate the chances of the outcome and the exact financial extent of the claim, or the chances and extent of additional claims that might be filed, if filed, against it. It is noted that in reply to the letter of demand which was sent to the Company by the plaintiffs' lawyer (in October 2001 as referred to above and a short time prior to the filing of the claim), the Company rejected the allegations made by the plaintiffs and repeated that its activities in the “Hillel” station were carried out in accordance with the provisions of the law and the directives and permits granted it by the competent authorities which are responsible for the broadcasting actions taking place in the station. It is further noted that the Company rejected a proposal made by the plaintiffs' lawyer prior to filing the claim, to negotiate a settlement with the plaintiffs before the claim was filed. The hearing of the application to dismiss *in limine* and the other applications are still in progress, except for the application of the Company – which was allowed – to dismiss the claim of some of the plaintiffs that relates to deceased persons who died before the Company commenced operating the broadcasting station.

    Furthermore, on March 16, 2003, the Company received an additional letter demanding that the Company evacuate the “Hillel” station and in which notice was given of the intention to file a claim in respect of liability for health damages as a result of operation of the station. The Company rejected the demand and for the sake of caution, gave notice of the demand to the relevant insurance companies and to the Ministry of Communications, the Ministry for the Environment and the Broadcasting Authority.

    In addition, during April 2003, a petition was filed in the High Court of Justice against the Minister of Environment, the Minister of Defense, the Broadcasting Authority and the Company, by the head of the Zuran Council, in which an order is requested for the immediate cessation of operation of the “Hillel” broadcasting station, since operation of the station is causing radiation that endangers the health of the residents of Moshav Zuran. After the Government decided to close the station until December 31, 2003, the petitioners withdrew the petition on July 2, 2003, and retained the right to renew it if the station is not closed and the antennae are not removed by that date. Subject to the aforesaid, it was decided to strike the petition.

NOTE 7 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS AND CONTINGENT LIABILITIES (CONTD.)

14. Further to Note 19A(26) to the financial statements as at December 31, 2002, concerning private claims of employees and former employees, in the matter of recognition of various wage components as pension components, and to Note 19A(32) to the financial statements as at December 31, 2002, relating to "Notice of a party in a collective dispute" in the matter of recognition of certain payments as pension components, the National Labor Court ruled on the appeal filed by seven former employees of the Company, recognizing one of the above payments as a pension component in view of the factual circumstances in that case. According to the legal advisers of the Company, the ruling significantly increases the risk in respect of that component. Nevertheless, the above ruling does not address a number of legal allegations which were made in the statement of allegations filed on behalf of the Company in its response to the "Notice of a party in a collective dispute" and on which the Court will have to rule.

    In the matter of the ruling given by the National Labor Court in another case (to which the Company is not a party), which could have adversely affected the situation of the Company as regards a different component, on October 20, 2003, the High Court of Justice gave an order *nisi* against that ruling. In the opinion of the legal advisers of the Company, the chances of the Company in the matter of this component cannot be estimated.

    It is noted that the total exposure involved in all these claims could amount to a considerable sum for the Company and may, under certain assumptions, *inter alia* concerning the population of relevant employees and the relevant periods, reach as much as NIS 3.5 billion. In the opinion of the legal advisers of the Company, presentation of the financial implications of the claim before the Court will support and strengthen the legal claims of the Company.

    This being the case, the Management and its legal advisers believe that it is not possible, at this stage, to estimate the outcome of the above claims in relation to certain components, and therefore no additional provision was made in the financial statements beyond the provision made in accordance with the assessment of the Management prior to the decision given by the National Labor Court in the other case, in which the Company is not involved. Nevertheless, in respect of the particular component in which the Company and its legal advisers see a material risk, these financial statements include a provision which was calculated on the basis of certain assumptions which the Company believes to be appropriate.

    In respect of the group of employees who filed a claim against the Company concerning the inclusion of several components as part of the salary which determines the pension, the Company is in discussion with that group of employees. The financial statements include a suitable provision which was made on the basis of the Management's assessment.

15. Further to Note 19A(27) to the financial statements as at December 31, 2002, in connection with guarantees on which the Ministry of Communications of India demanded to foreclose, the proceeding was stricken for "inaction" and an application was filed to revive the proceeding. The Indian lawyer who is handling the case for the Company believes that there is a good chance that the application to revive the proceeding will be allowed.

16. Further to Note 19A(29) to the financial statements as at December 31, 2002, concerning the customer allocation process of a consolidated company, the supplementary referendum which commenced on July 1, 2002, was completed in February 2003, subsequent to postponements. An examination carried out by the consolidated company found that the effects of the results of the referendum on its financial statements are insignificant.

17. Further to Note 19A(34) to the financial statements as at December 31, 2002, concerning a class action against all the cellular companies in Israel and against the Company as a formal defendant, whereby the defendant cellular companies unlawfully collected and collect payments for cellular calls. The parties reached a consensus regarding striking the class action and the action has been stricken by the court.

Notes to the Interim Consolidated Financial Statements as at September 30, 2003 (Unaudited)

NOTE 7 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS AND CONTINGENT LIABILITIES (CONTD.)

18. Further to Note 19A(35) to the financial statements as at December 31, 2002, concerning a claim and an application for recognition of the claim as a class action both by virtue of Regulation 29 of the Civil Procedures Regulations and by virtue of the Anti-Trust Law – following the ruling of the Supreme Court in another case that a class action cannot be filed by virtue of Regulation 29 only, the parties filed an agreed application, which was allowed, to strike the parts relating to approval of the claim as a class action on the basis of Regulation 29. The plaintiffs have filed an amended application relying only on the Anti-Trust Law.

19. Further to Note 19A(36) to the financial statements as at December 31, 2002, relating to a class action filed against Pelephone in respect of over-collection, the claim was stricken on November 14, 2002.

20. Further to Note 19A(38) to the financial statements as at December 31, 2002 in the matter of a petition filed in the High Court of Justice by the Ganei Tikva Local Council against the Minister of Communications, the Company and Golden Channels Co., that the Minister of Communications direct the Company to relocate the cable network which is in the Council's jurisdiction and which the Company maintains for Golden Channels to an underground infrastructure (instead of overhead). The parties acceded to the proposal of the court that the works be carried out by the Company and thereafter the question of liability for the expenses incurred in carrying out the works will be arbitrated. The parties subsequently reached agreement and the petition was stricken.

21. Further to Note 19A(5) to the financial statements as at December 31, 2002, in the matter of the statement of claim and application for recognition of the claim as a class action against the Company, Bezeq International, the Chairman of the Board of Bezeq International and the then CEO of Bezeq International, alleging that Bezeq International unfairly exploited its status in the international calls market and implemented a deliberate policy of misleading the public on the subject of the tariffs of international calls, a hearing was held in the Supreme Court on May 28, 2003, at which it was determined that the District Court had erred procedurally, since it should have decided only in relation to the application to add another plaintiff to the class action and not on the question of dismissal of the application for approval of the claim as a class action. The appeal of Bezeq International was therefore allowed, and the case was returned to the District Court, where a hearing will be scheduled.

22. Further to Note 19A(42) to the financial statements as at December 31, 2002, in the matter of a claim filed against Bezeq International Ltd. in which it was alleged that Bezeq International Ltd. unlawfully cancelled an agreement for the supply and installation of a customer care and billing system – Bezeq International filed a statement of defense on May 26, 2003, and a statement of counter-claim in the amount of NIS 10 million, in which it alleged that the contract was cancelled since the plaintiff violated its undertakings in the agreement. On September 14, 2003, the plaintiff filed a statement of counter-reply in which the allegations of the Company are denied. At this stage, the legal advisers of Bezeq International are unableto estimate the chances of the outcome of the claim and therefore no provision has been made in respect thereof in the financial statements of Bezeq International.

23. On March 25, 2003, an application was filed in the District Court against DBS for approval as a class action of a claim in connection with imposing the cost of the electricity consumption required for operation of satellite receiver dishes on the tenants of the building in which the dish was installed. The group in whose name the application was filed is all the houses in Israel in which a satellite dish was installed. The claim is for declaratory relief determining that DBS must pay for the electricity consumption of the installations connected by and/or for it on the various premises, and that it must reimburse the members of the group for all the monies they paid for the electricity consumption of DBS's installations, as well as compensation and/or restoration of monies paid in respect of such electricity consumption. The amounts assessed as damages for which the applicants are demanding restoration is NIS 25 million.

NOTE 7 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS AND CONTINGENT LIABILITIES (CONTD.)

At this stage, in the opinion of the legal advisers of DBS it is difficult to estimate whether the claim will be approved as a class action and if approved – its chances. Accordingly, DBS has not included a provision in respect of this claim.

24. On April 3, 2003, a petition was filed in the High Court of Justice against DBS, its shareholders (including the Company), the Government of Israel and others, in which the High Court is requested, *inter alia*, to declare DBS a government company in view of the level of the investments of the Company in DBS, and to revoke the decision of the Ministerial Committee for Privatization that enabled the Company to increase its investment in DBS. It is noted that in fact, Bezeq's holdings in DBS today are less than 50%. In the hearing of the petition on July 30, 2003, the Supreme Court recommended that the petitioner withdraw the petition, and subsequently, on the same day, the petitionergave notice on his behalf that he was withdrawing his petition in the hope that the Attorney General would examine and regulate the question raised in its entirety. Following the notice, the petition was denied.

25. In April 2003 an application was filed in the Tel Aviv District Court for approval of a class action in a total amount of NIS 90 million against Pelephone and against all the other cellular operators. The applicants allege that the three cellular companies formed a cartel among themselves for the collection of a tariff of 38 agorot plus VAT for SMS messages coming in to the network of each of them. The plaintiffs allege that this is a uniform, exaggerated, unreasonable and unfair tariff. The period to which the claim relates is March-June 2002 and up to the date of filing the claim. In October 2003 Pelephone filed its response to the application. At this stage Pelephone and its legal advisers are studying the material related to the claim and are unable to estimate the chances of the outcome.

B. On November 3, 2003, the Audit Committee of the Board of Directors and the Board of Directors approved grant of an undertaking to indemnify the officers of the Company in the matter of the framework agreement signed between the Company and the State, including in connection with an allotment of shares to the State as allowed under the framework agreement. The undertaking was limited in amount to NIS 890,000,000 (the amount of capital raised), linked to the Consumer Price Index published after completion of raising the capital for the Company in accordance with the framework agreement, and requires the approval of the General Meeting of the Shareholders of the Company.

C. GUARANTEES

In May 2003 the Company, in accordance with the requirement of the Ministry of Communications, gave a bank guarantee in the amount of $10 million in connection with its general license for carrying out telecommunications activities and for providing telecommunications services.

NOTE 7 - CONTINGENT LIABILITIES (CONTD.)

D. FUTURES CONTRACTS

1. Hedging Contracts

	Currency purchased	Currency payable	Final repayment date	Amounts receivable	Amounts payable
				NIS millions	
Contracts at predetermined interest rates					
	Dollars	CPI-linked NIS	February 2005	787	854
	Euro	CPI-linked NIS	September 2005	1,150	1,036
Contracts at predetermined exchange rate (excluding premium/discount)					
	Dollars	NIS	May 2004	304	330
	Euro	NIS	September 2004	363	375
	CPI-linked NIS	NIS	June 2004	79	79
Call options purchased	Dollar	NIS	March 2004	13	14

2. Contracts not for hedging purposes

	Currency purchased	Currency payable	Final repayment date	Fair value	Amount
				NIS millions	
Transactions at a predetermined exchange rate	Dollar	NIS	December 2003	(8)	89

NOTE 8 – SHARE CAPITAL

A. On January 13, 2002, a framework agreement was signed between the State and the Company, whereby capital would be raised by way of a private sale of the Company shares held by the State in accordance with Sections 15A and 15C(b) of the Securities law, 5728 – 1968 (in one sale or several). Concurrently with that sale, the Company would issue shares to the State for a consideration of the proceeds received by the State in respect of the sale of the shares less a margin of 1%, where the total cumulative number of shares to be issued to the State by the Company will at no time exceed the number of shares sold by the State and the State's holdings in the Company will not fall below 51.02%. The proceeds from raising the capital would be designated to financing the costs involved in the retirement of Company employees.

The framework agreement determined that the price at which the shares would be sold would be not less than NIS 6 net per share. According to a resolution of the General Meeting of the Shareholders of the Company, registered share capital not issued as part of the process of raising capital through February 28, 2003, or until another date on which the State would hold 51.02% (at full dilution) of the share capital of the Company (whichever would be the earlier date) would be cancelled. Since the capital was not raised by February 28, 2003, registered capital of 130,000,000 shares was cancelled.

Subsequently, on July 28, 2003, an amendment to the framework agreement was signed, whereby the minimum price set for sale of the shares (NIS 6) was cancelled and the last date for the final sale according to the framework agreement was cancelled. Instead, it was decided that if the State sold shares in a total number exceeding the limit of the Company's registered share capital on that date and the Company's registered share capital did not have enough shares for issuance to the State, the Company's obligation to allot shares to the State would be postponed against receipt of the consideration in respect thereof not later than 120 hours from the time of increasing the share capital of the Company. In addition, on November 3, 2003, an amendment to the agreement for raising capital for the Company was made such that the limitation on reducing the State’s holding in the Company, subsequent to completion of raising the capital, to a minimum percentage of 51.02% was amended to a minimum of 30%-40%.

With the cancellation of 130,000,000 shares of the Company's share capital (as described above), the Company held 23,342,462 shares as its unissued registered capital. As explained in Note 1 above, the Company allotted these 23,342,462 shares to the State in accordance with the framework agreement.

On October 23, 2003, the registered share capital of the Company was increased by 190,000,000 shares and the registered share capital of the Company was increased to 2,625,000,000 shares. On October 31, 2003, the Company issued 64,398,076 shares to the State in accordance with the terms of the framework agreement described above.

B. On January 27, 2003, the Special General Meeting of the Shareholders of the Company approved the recommendation of the Board of Directors, dated January 2, 2003, that a cash dividend be distributed to the holders of the Company's shares who are registered in the Shareholders Register at the end of the business day on February 5, 2003. The X-date was February 6, 2003, and the payment date was February 20, 2003. The total cash dividend of approximately NIS 190 million represents 7.8784 agorot per share.

Notes to the Interim Consolidated Financial Statements as at September 30, 2003 (Unaudited)

NOTE 9 – REVENUES FROM TELECOMMUNICATION SERVICES

	For the nine month period ending September 30		For the three month period ending September 30		For the year ending December 31
	2003 (Unaudited)	2002 (Unaudited)	2003 (Unaudited)	2002 (Unaudited)	2002 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues from communication services–					
Domestic fixed-line communications	**1,582,053**	1,713,761	**518,211**	576,519	2,272,399
Fixed fees	**1,691,982**	1,562,128	**590,676**	521,423	2,115,423
Cellular telephone	**1,508,090**	1,619,741	**523,309**	559,446	2,102,715
International communications and internet services	**510,510**	501,372	**177,420**	168,472	665,434
Installation and sale of equipment to subscribers	**428,383**	403,379	**163,511**	137,726	528,713
Other	**48,884**	72,475*	**12,626**	21,247*	93,886*
	5,769,902	5,872,856	**1,985,753**	1,984,833	7,778,570
Other revenues	**268,015**	229,812	**101,748**	70,742	317,339
	6,037,917	6,102,668*	**2,087,501**	2,055,575*	8,095,909*

NOTE 10 – OPERATING AND GENERAL EXPENSES

	For the nine month period ending September 30		For the three month period ending September 30		For the year ending December 31
	2003 (Unaudited)	2002 (Unaudited)	2003 (Unaudited)	2002 (Unaudited)	2002 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Salaries and related expenses	**1,490,741**	1,480,969	**507,371**	480,168	1,989,745
General expenses	**557,431**	555,163*	**218,022**	192,840*	730,980*
Materials and spare parts	**433,063**	436,709	**152,807**	150,673	602,149*
Cellular telephone expenses	**350,467**	328,931*	**122,508**	120,192*	475,045
Building maintenance	**262,285**	274,215	**93,800**	90,126	353,098
Services and maintenance by sub-contractors	**205,744**	208,524*	**62,928**	64,560*	256,512*
International communications expenses	**104,775**	115,051	**27,892**	51,712	152,797
Vehicle maintenance expenses	**91,049**	73,370	**30,874**	25,419	97,002
Collection fees	**26,087**	24,479	**5,325**	7,568	34,959
	3,521,642	3,497,411	**1,221,527**	1,183,258	4,692,287
Less – salaries charged to investment in fixed assets	**149,180****	107,284	**58,474**	28,890	148,141
	3,372,462	3,390,127*	**1,163,053**	1,154,368*	4,544,146*

* Reclassified
** See Note 12C

Notes to the Interim Consolidated Financial Statements as at September 30, 2003 (Unaudited)

NOTE 11 – OTHER EXPENSES, NET

	For the nine month period ending September 30		For the three month period ending September 30		For the year ending December 31
	2003 (Unaudited)	2002 (Unaudited)	2003 (Unaudited)	2002 (Unaudited)	2002 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Provision for decrease in value of investment in convertible debentures (1)	**–**	382,430	**–**	382,430	1,214,179
Provision for impairment of value of fixed assets (2)	**52,625**	–	**52,625**	–	–
Provision for decrease in value of investments in other companies	**63,169**	10,296	**28,008**	10,296	23,437
Provision for severance pay (3)	**195,000**	–	**195,000**	–	–
Capital gains, net	**8,574**	(7,184)	**4,707**	(1,785)	(12,790)
Others	**2,075**	(221)	**1,814**	(90)	(124)
	321,443	385,321	**282,154**	390,851	1,224,702

(1) See Note 4D
(2) See Notes 5C and 5D
(3) See Note 7A14

Notes to the Interim Consolidated Financial Statements as at September 30, 2003 (Unaudited)

NOTE 12 – CONDENSED INTERIM FINANCIAL STATEMENTS OF THE COMPANY

A. Statement of Operations

	For the nine month period ending September 30		For the three month period ending September 30		For the year ending December 31
	2003 (Unaudited)	2002 (Unaudited)	2003 (Unaudited)	2002 (Unaudited)	2002 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues from telecommunication services (Note 12B)	**4,006,618**	4,163,756*	**1,348,327**	1,377,607*	5,468,989*
Costs and expenses					
Operating and general expenses (Note 12C)	**1,796,488**	1,797,278*	**621,339**	591,745*	2,409,383*
Depreciation	**1,345,812**	1,427,097	**445,517**	478,306	1,896,111
Royalties to the Government of Israel	**138,064**	132,026	**46,968**	38,812	179,748
	3,280,364	3,356,401	**1,113,824**	1,108,863	4,485,242
Operating income	**726,254**	807,355	**234,503**	268,744	983,747
Financing expenses, net	**50,693**	129,225	**19,408**	54,570	117,606
Earnings after financing expenses, net	**675,561**	678,130	**215,095**	214,174	866,141
Other expenses, net	**291,886**	385,548	**257,311**	390,725	1,212,040
Earnings (loss) before income tax	**383,675**	292,582	**(42,216)**	(176,551)	(345,899)
Income tax	**175,272**	204,726	**9,005**	38,657	230,565
Earnings (loss) after income tax	**208,403**	87,856	**(51,221)**	(215,208)	(576,464)
Company's equity in losses of investee companies	**206,595**	230,124	**33,896**	122,911	339,984
Net earnings (loss)	**1,808**	(142,268)	**(85,117)**	(338,119)	(916,448)

* Reclassified

Notes to the Interim Consolidated Financial Statements as at September 30, 2003 (Unaudited)

NOTE 12 – CONDENSED INTERIM FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

B. REVENUES FROM TELECOMMUNICATIONS SERVICES

	For the nine month period ending September 30		For the three month period ending September 30		For the year ending December 31
	2003 (Unaudited)	2002 (Unaudited)	2003 (Unaudited)	2002 (Unaudited)	2002 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues from communications services					
Domestic fixed-line communications	**1,592,543**	1,732,559	**521,650**	582,817	2,294,826
Fixed fees	**1,612,858**	1,469,227	**562,430**	478,598	1,986,684
Cellular telephone	**356,116**	469,528	**107,636**	158,639	548,328
International communications	**99,656**	110,770	**32,760**	38,119	136,340
Installation and sale of equipment to subscribers	**108,173**	118,682	**41,444**	38,884	152,824
Other	**52,066**	76,782*	**13,773**	22,126*	99,476*
	3,821,412	3,977,548	**1,279,693**	1,319,183	5,218,478
Other revenues	**185,206**	186,208	**68,634**	58,424	250,511
	4,006,618	4,163,756*	**1,348,327**	1,377,607*	5,468,989*

C. OPERATING AND GENERAL EXPENSES

	For the nine month period ending September 30		For the three month period ending September 30		For the year ending December 31
	2003 (Unaudited)	2002 (Unaudited)	2003 (Unaudited)	2002 (Unaudited)	2002 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Salaries and related expenses	**1,119,613**	1,145,625	**369,412**	369,218	1,530,734
General expenses	**249,530**	226,157*	**107,297**	74,832*	305,705*
Materials and spare parts	**68,808**	37,447	**29,459**	14,032	65,988
Building maintenance	**240,514**	238,842	**85,239**	79,543	325,335
Services and maintenance by sub-contractors	**158,096**	165,371*	**51,300**	52,861*	206,748*
International communications expenses	**6,132**	4,232	**1,718**	1,078	4,963
Vehicle maintenance expenses	**77,242**	61,268	**26,191**	20,300	83,176
Collection fees	**25,733**	25,620	**9,197**	8,771	34,875
	1,945,668	1,904,562	**679,813**	620,635	2,557,524
Less– salaries charged to investments in fixed assets	**149,180****	107,284	**58,474**	28,890	148,141
	1,796,488	1,797,278*	**621,339**	591,745*	2,409,383*

* Reclassified

** Commencing February 2003, following the installation of a new reporting system at the Company which enables accurate measurement of direct costs of employees of the Engineering and Information Technologies Divisions, the Company capitalized an additional amount for Company-built fixed assets. The additional amount in respect of the nine month period ended September 30, 2003, is approximately NIS 33 million (and for the three month period then ended, approximately NIS 15 million).

Notes to the Interim Consolidated Financial Statements as at September 30, 2003 (Unaudited)

NOTE 13 – SEGMENTS OF BUSINESS OPERATIONS

The Company and the investee companies operate in various segments of the communications industry. Data on activities by segment are stated according to the segments of operation of those companies.

For the nine month period ended September 30, 2003

	Domestic fixed line communications	Cellular telephone	International communications and Internet services	Others	Adjustments	Consolidated
	NIS thousands					
Revenues						
Revenues from external sources	**3,841,668**	**1,497,662**	**514,882**	**183,705**	**–**	**6,037,917**
Inter-segment revenues	**164,950**	**5,932**	**7,923**	**26,594**	**(205,399)**	**–**
Total revenues	**4,006,618**	**1,503,594**	**522,805**	**210,299**	**(205,399)**	**6,037,917**
Segment results	**726,254**	**49,672**	**63,162**	**17,026**	**489**	**856,603**

For the three month period ended September 30, 2003

	Domestic fixed line communications	Cellular telephone	International communications and Internet services	Others	Adjustments	Consolidated
	NIS thousands					
Revenues						
Revenues from external sources	**1,289,590**	**549,240**	**181,076**	**67,595**	**–**	**2,087,501**
Inter-segment revenues	**58,737**	**973**	**3,257**	**8,714**	**(71,681)**	**–**
Total revenues	**1,348,327**	**550,213**	**184,333**	**76,309**	**(71,681)**	**2,087,501**
Segment results	**234,503**	**56,221**	**14,238**	**19,071**	**162**	**324,195**

For the year ended December 31, 2002

	Domestic fixed line communications	Cellular telephone	International communications and Internet services	Others	Adjustments	Consolidated
	NIS thousands					
Revenues						
Revenues from external sources	5,262,335*	1,966,464	673,148	193,962	–	8,095,909*
Inter-segment revenues	206,654	7,673	8,306	29,563	(252,196)	–
Total revenues	5,468,989*	1,974,137	681,454	223,525	(252,196)	8,095,909*
Segment results	983,747	(62,924)	108,458	(8,649)	648	1,021,280

* Reclassified

NOTE 14 – CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD.

1. BEZEQ INTERNATIONAL LTD.

A. Balance sheet

	September 30 2003	September 30 2002	December 31 2002
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**147,540**	180,549	194,381
Investments	**12,759**	19,675	10,737
Fixed assets	**484,421**	418,672	486,136
Other assets	**3,309**	9,797	8,464
	648,029	628,693	699,718
Current liabilities	**291,719**	319,809	373,178
Long-term liabilities	**172,399**	170,347	171,445
Shareholders' equity	**183,911**	138,537	155,095
	648,029	628,693	699,718

Notes to the Interim Consolidated Financial Statements as at September 30, 2003 (Unaudited)

NOTE 14 – CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD. (CONTD.)

1. BEZEQ INTERNATIONAL LTD. (CONTD.)

B. Statement of Operations

	For the nine month period ending September 30		For the three month period ending September 30		For the year ending December 31
	2003 (Unaudited)	2002 (Unaudited)	2003 (Unaudited)	2002 (Unaudited)	2002 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues from international telecommunication services	**522,805**	509,705	**184,320**	169,973	681,469
Operating expenses	**315,651**	295,596	**117,532**	108,239	381,639
Gross profit	**207,154**	214,109	**66,788**	61,734	299,830
Marketing, general and administrative expenses	**143,992**	148,216	**52,551**	41,001	191,369
Operating income	**63,162**	65,893	**14,237**	20,733	108,461
Financing expenses (income), net	**19,589**	(7,097)	**2,215**	2,963	(1,589)
Earnings after financing, net	**43,573**	72,990	**12,022**	17,770	110,050
Other expenses (income), net	**11,941**	(13)	**7,088**	(5)	(34)
Earnings before income tax	**31,632**	73,003	**4,934**	17,775	110,084
Income tax	**2,194**	1,031	**1,288**	401	10,581
Earnings after income tax	**29,438**	71,972	**3,646**	17,374	99,503
Company's equity in losses (earnings) of an affiliated company	**622**	13,311	**(84)**	2,020	24,284
Net earnings	**28,816**	58,661	**3,730**	15,354	75,219

Notes to the Interim Consolidated Financial Statements as at September 30, 2003 (Unaudited)

NOTE 14 – CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD. (CONTD.)

2. PELEPHONE COMMUNICATIONS LTD.

A. Balance sheet

	September 30 2003	September 30 2002	December 31 2002
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**1,254,246**	1,322,660	1,319,365
Long-term trade receivables	**186,179**	161,209	156,794
Investment in partnership	**1,790**	–	–
Deferred income taxes	**335,361**	313,245	330,854
Fixed assets, net	**2,937,239**	2,699,541	2,752,188
Other assets	**370,989**	483,692	452,812
	5,085,804	4,980,347	5,012,013
Current liabilities	**1,822,597**	1,917,123	2,049,487
Provision for losses of investee company	**5,129**	3,972	4,432
Long-term liabilities	**1,428,543**	1,168,499	1,108,463
Shareholders' equity	**1,829,535**	1,890,753	1,849,631
	5,085,804	4,980,347	5,012,013

Notes to the Interim Consolidated Financial Statements as at September 30, 2003 (Unaudited)

NOTE 14 – CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD. (CONTD.)

2. PELEPHONE COMMUNICATIONS LTD. (CONTD.)

B. Statement of Operations

	For the nine month period ending September 30		For the three month period ending September 30		For the year ending December 31
	2003 (Unaudited)	2002 (Unaudited)	2003 (Unaudited)	2002 (Unaudited)	2002 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues from cellular services, sales and services	**3,007,186**	2,956,946	**1,100,424**	1,017,305	3,948,273
Cost of cellular services, sales and services	**2,446,982**	2,620,261*	**827,165**	899,017*	3,469,045
Gross profit	**560,204**	336,685	**273,259**	118,288	479,228
Sales and marketing expenses	**350,529**	345,761*	**122,531**	118,590*	467,928
General and administrative expenses	**112,430**	113,878*	**39,005**	36,625*	154,475
	462,959	459,639	**161,536**	155,215	622,403
Operating income (loss)	**97,245**	(122,954)	**111,723**	(36,927)	(143,175)
Financing expenses, net	**119,104**	53,301	**47,227**	45,949	93,270
Other income, net	**(1,056)**	(875)	**(452)**	(77)	(1,474)
Loss before income tax	**(20,803)**	(175,380)	**64,948**	(82,799)	(234,971)
(Tax benefit)	**(4,506)**	(56,726)	**(1,502)**	(29,583)	(74,336)
Earnings (loss) after income tax	**(16,297)**	(118,654)	**66,450**	(53,216)	(160,635)
Minority equity in losses of a consolidated company	**–**	(4,537)	**–**	(1,479)	(5,727)
Company's equity in losses (earnings) of an affiliate	**3,799**	326	**2,879**	344	657
Net earnings (loss)	**(20,096)**	(114,443)	**63,571**	(52,081)	(155,565)

* Reclassified