August 14, 2006

"Bezeq" The Israel Telecommunication Corp. Limited

Quarterly Report for the period ending 30.6.06

Update of Chapter A (Description of Company Operations) of the Periodic Report for 2005

Directors' Report on the State of the Company's Affairs for the period ended June 30, 2006

Condensed Interim Consolidated Financial Statements as at June 30, 2006

Update of Chapter A (Description of Company Operations) of the Periodic Report for 2005

Update of Chapter A (Description of Company Operations)[1] of the Periodic Report for the Year 2005 ("the Periodic Report") of "Bezeq", the Israel Telecommunication Corp. Ltd. ("the Company")

1 – Description of General Development of the Group's Operations

To Section 1.1 – Group Activity and Description of its Business Development

To Section 1.1.5 of the Periodic Report – Mergers and acquisitions

On August 2, 2006, the Company and DBS submitted a notice of merger to the Antitrust Commissioner (the "**Commissioner**") regarding exercise of options for shares in DBS by the Company, which is expected to increase the Company's holdings in DBS from approximately 49.8% to approximately 58%. The Commissioner's approval to increase of the Company's holdings in DBS to over 50% had already been given (under certain conditions) in the past (on January 2, 2005), but that approval had expired a year after the date on which it was given, and therefore, the companies applied for approval of the merger yet again.

At the end of July 2006, the Company commenced the process of examining a possible merger of the operations of two wholly owned subsidiaries, BezeqCall Communications Ltd. (which deals in the field of Network End Point ("NEP")), and Bezeq International Ltd. (which deals in the field of internet, international calls and integration solutions for businesses). Such a merger, if and when it takes place, shall require approvals under law, including the approval of competent entities, the approval of the Ministry of Communications and the approval of the Antitrust Commissioner.

It should be noted that BezeqCall Communications Ltd. has commenced negotiations for the purchase of operations in the field of its activities. The scope of the transaction is estimated at approximately NIS 90 million. Consummation of the transaction, if and when it is completed, shall require approvals under law, including the approval of the authorized entities of each of the parties to the transaction.

To Section 1.1.6 of the Periodic Report – Sales

Pursuant to the Company's immediate reports of April 10, 2006, and June 22, 2006, regarding evaluation of holdings in Walla! Communications Ltd. via its subsidiary Bezeq International Ltd, the Company gave notice, in an immediate report dated July 19, 2006, that it had ceased negotiations held in this regard.

On April 30, 2006 an agreement was signed between the Company, Malam Systems Ltd. and the Goldnet Communications Services partnership, on the one hand, and the subsidiary Bezeq International Ltd. on the other, in the matter of the acquisition of all the operations of the Goldnet Communication Services partnership by Bezeq International Ltd. in consideration of the sum of NIS 6.8 million, which would be divided between the Company (NIS 5.1 million) and Malam Systems Ltd. (NIS 1.7 million). In this regard see also the update to Section 4.9 hereunder.

With respect to the memorandum of understanding executed between the Company and a foreign investor relating to sale of the Company's satellite communications operations (Inmarsat and BezeqSat), the Company resolved to negotiate with other potential purchasers as well, after the negotiations with the foreign investor did not amount to an agreement.

To Section 1.4 – Distribution of Dividends

Further to Section 1.4.3 of the Periodic Report in the matter of the resolution of the Company's Board of Directors from March 1, 2006 to recommend to the General Meeting of the Shareholders of the Company the distribution of a cash dividend to the shareholders of the Company, in a total amount of

[1] The update is in accordance with Regulation 39A of the Securities Regulations (Periodic and immediate reports), 5730-1970, and includes material innovations or changes that took place in the corporation's business in any matter that must be described in the Periodic Report. The update pertains to the numbers of the sections in Chapter 1 (Description of Company Operations) in the Periodic Report of the Company for the year 2005.

NIS 1,200,000,193, which constitutes, as at the date of the distribution, NIS 0.4606446 per share and 46.06446% of the issued and paid up capital of the Company, the General Meeting of the Shareholders of the Company approved the distribution of the dividend on March 23, 2006. The dividend was distributed on April 16, 2006.

2 – Fixed-Line Domestic Communications - "Bezeq", the Israeli Telecommunication Corp. Ltd. ("the Company")

To Section 2.1 – General Information regarding the Area of Operations

In the matter of Section 2.1.2 of the Periodic Report on the subject of updating the Company's tariffs –

On July 1, 2006, the Communications Regulations (Telecommunications and Broadcasts) (Payments for Telecommunications Services) 5766-2006 and the Communications Regulations (Telecommunications and Broadcasts) (Calculation of Payments for and Linkage of Telecommunications Services) (Amendment No. 2) 5766-2006 came into force. Under these Regulations, and based on the tariff update formula set out in the Communications (Telecommunications and Broadcasts) (Calculation for Payments for and Linkage of Telecommunications Services) Regulations 5763-2003, reduction of the Company's supervised tariffs prescribed under section 15(a) of the Communications Law, as of July 1, 2006, amounts to an average rate of approximately 0.36% (not including the reduction of VAT by 1% which came into force on the same date). This reduction is based on a change of approximately 2.4% in the consumer price index, less an average cost of living coefficient at the rate of approximately 2.7%. Likewise, the Communications Regulations (Telecommunications and Broadcasts) (Payments for Interconnect) (Amendment) 5766-2006 were enacted on the same date, providing that the reduction of interconnect tariffs as of July 1, 2006 amounts to a rate of approximately 2% (including the reduction of VAT by 1%).

In this regard, see also Note 1(c)(3) to the Company's Financial Statements for the period ended June 30, 2006.

In the matter of Section 2.1.9 of the Periodic Report on the subject of issuing special general licenses for the provision of fixed-line domestic communication services – see Sections 2.6.1 and 2.6.4 below.

To Section 2.2 – Products and Services

The Ministry of Communications has informed the Company that its position is that the Company should have informed it about the provision of IP – Centrex services, which is a virtual private network service before starting to provide the service, and that therefore the Ministry is considering approval of the provision of the service by the Company and its terms. The Company explained to the Ministry that the service is included in its license. The Company replied to all the Ministry's questions and provided the information it requested.

In the matter of Section 2.2.3 of the Periodic Report – on March 7, 2006, the Ministry of Communications published a hearing for all the communication companies in connection with its intention that a united 144 call center would be operated for all the communication companies, with callers being able to obtain the telephone numbers of all the operators' subscribers in a single telephone call. Concurrently, a united website would operate for all the communication companies. In a letter of response submitted by the Company on March 26, 2006, the Company presented its position that the directory assistance service is auxiliary to the telephony services provided by the license holder; that entities that do not hold a general license should not be permitted into the sector and that the service should be retained in its present format as an auxiliary service to the services of the general license holder. The Company's position is that the demand for directory assistance services to be provided free of charge on the internet is unreasonable and disproportionate, places an unreasonable burden on the operators and compromises their rights of ownership. The directory assistance call center provided by the Company is already a "united call center" that provides information services about most telephony subscribers in Israel and, insofar as this depends on the Company – the call center will provide all the information about those telephony subscribers in Israel who request that the information about them be published for the public.

In the matter of Section 2.2.3 of the Periodic Report – internet access service – the number of the Company's ADSL subscribers as at June 30, 2006, is approximately 844,000 (compared with approximately 800,000 subscribers at the end of 2005).

To Section 2.6 – Competition

To the best of the Company's knowledge, negotiations are being held for the possible merger of Netvision, Barak and GlobeCall. Furthermore, according to news publications, Internet Zahav has purchased 60% of the shares in Golden Lines. On July 30, 2006, the Company applied to the

Antitrust Commissioner requesting to state its position prior to the handing down of a decision in this matter. In this regard, see also updates to sections 4.6.1.1 and 4.6.2.1 below.

To Section 2.6.1 of the Periodic Report – Telephony

A. As at the date of publication of this report, according to reports in the media, HOT's telephony service numbers over 125,000 customers.

On August 10, 2006 the Company, via its counsel, wrote to the Minister of Communications requesting the immediate enforcement of fulfillment of HOT's obligations and undertakings under the license, regarding the requirements of structural separation.

B. A license for a paid marketing trial for VoIP services has also been issued to a subsidiary of Pelephone Communications Ltd. On this matter, see update to Section 3.7 hereunder.

On August 31, 2006, Bezeq International's trial license is due to expire, and it has applied to extend it. In this regard, see update to section 4.1.2 below. The trial license granted to Golden Lines was extended by half a year (until January 31, 2007).

C. In the matter of Sections 2.6.1 and 2.6.4 of the Periodic Report on the subject of the issuing of special general licenses for the provision of fixed-line domestic communication services – to the best of the Company's knowledge, such licenses have been issued to GlobeCall Communications Limited Partnership, to Cellcom Fixed-Line Communication Services Limited Partnership and to 012 Telecom Ltd. The subsidiary Bezeq International Ltd. has submitted an application for such a license (see update to Section 4.1.2 below), and the subsidiary Pelephone Communications Ltd is also getting ready to submit an application for a special general license for the provision of fixed-line domestic communications services (see update to Section 3.7 below). Likewise, to the best of the Company's knowledge, "Partner" and "Barak" have also filed an application for a special domestic carrier license.

D. On March 16, 2006, the Company applied to the Ministry of Communications to conduct a marketing trial of paid VOB (despite its clear position that it is entitled to supply that service under its license), receiving a reply in the negative.

To Section 2.6.3 of the Periodic Report – Transmission and Data Communication

On the subject of the Accountant General's tender for the provision of data communication services – on April 11, 2006 the Supreme Court decided to dismiss the appeal filed by the Company against the District Court's ruling and to order it to pay court costs. On July 27, 2006, the Company received a notice from the Accountant General that it had won the tender, the Accountant General having received, at his request, the approval of the Ministry of Communications to the Company's offer, on that date.

At the beginning of July 2006, Partner gave notice that it had completed purchase of the transmission operations of Med1 I.C.-1 (1999) Ltd.

To Section 2.6.4 of the Periodic Report – Competition from the Cellular Companies

In the matter of moderation of the downtrend in the number of voice minutes, *inter alia* as a result of the slowdown in the growth rate of the cellular companies, it is clarified that the downtrend in the number of fixed-line voice minutes is continuing in any event. This is due to the development of alternatives to these calls, mainly by means of internet-based calls. There has also been an increase in calls made from the domestic fixed-line networks to cellular networks.

In the matter of the appeal filed by the Company in 2001 in the Antitrust Court with regard to the Antitrust Commissioner's refusal to change the declaration of the Company's status as a monopoly in basic telephony service (fixed-line domestic telephony) – in the wake of the Company's petition that the Court expedite the hearing of the appeal, the Company agreed, acting on the Court's suggestion (in light of the time that has passed since it was submitted, together with an economic opinion), to withdraw the appeal, which was expunged on August 2, 2006. The Company is preparing to file a new and revised petition to the Antitrust Commissioner. In the Company's opinion, the cellular telepohny market constitutes an alternative market to fixed-line telephony, and this fact is reinforced by new and up-to-date data that has accumulated during the period since the appeal was filed in 2001.

To Section 2.6.5 of the Periodic Report – Additional Factors that could affect Competition

A. Numbering and number portability – during February/March 2006 there was a further exchange of letters with the Ministries of Communications and Finance on the matter of the operators', including the Company's inability to meet the timetables that were set. The Company reiterated that it is preparing for the implementation of number portability but for real and technical reasons, it cannot meet the timetable set for implementation of the plan, and it reserves its legal rights in this matter.

In June 2006, the Company once again applied to the new Minister of Communications, asking the Minister to act to enact an amendment to the Communications Law in order to prescribe a reasonable timetable for implementation of number portability. On August 2, 2006, a letter was sent to the Company from the Supervision Department of the Ministry of Communications, containing a summary of supervision regarding the Company's compliance with the number portability plan. According to the claims made in that letter, the Company is not in compliance with the timetables set for implementation of number portability, and the Company's explanations for such were not accepted. On August 8, 2006, a letter was sent by the Company in response to this letter, explaining that the summary of the discussion was not, in the Company's opinion, in accord with the spirit of the discussion on the matter, that the Ministry's good impression of the Company's acts was not expressed in the summary and that it had not been possible to commence making preparations earlier, prior to the formulation of a characterization plan, and prior to formulation of full characterization by the Ministry of Communications. On August 7, 2006, a letter was sent by the Chairman of the Number Portability Forum to the Minister of Communications, requesting the Minister to act to postpone the date of implementation of the plan.

Note that contemporaneous with its correspondence as aforesaid, the Company is making its best efforts and is investing considerable resources in order to advance implementation of number portability on its systems. Thus, for instance, the Company recently signed a memorandum of understanding stating that it would purchase a number portability system (LNP – Local Number Portability) for the Company's public switching network. Likewise, the Company is expected to sign an agreement in the coming days to implement an LSMS system for number portability, and simultaneously operations are being effected with various companies in order to make other adjustments to the Company's systems, which are required in order to implement number portability.

On April 23, 2006 a letter was received from the Deputy Director General for Engineering and Licensing at the Ministry of Communications, in which he suspends the use of certain ranges of the prefix 076, that was allocated for the Company's use, in the wake of information received by the Ministry indicating that the Company intends to use that allocation for the provision of a service which, ostensibly, has not yet been duly approved – the IP – Centrex service. On July 19, 2006, a letter was received from the director of numbering at the Ministry of Communications, canceling the suspension, following the Company's clarification that use would not be made of the IP-Centrex service in those ranges, until completion of examination by the Ministry of Communications. In this regard, see update to section 2.2 above.

B. Other potential competing infrastructures – on the subject of the allocation of frequencies (WIMAX) – the Company made it clear that its position is that there is no reason and no need to allocate these frequencies, which are a limited State resource, to operators who hold special licenses and who are not obligated to provide universal service. The Company believes that mainly due to the vital need of these frequencies for providing services in outlying areas, the top priority of the policy on the subject of frequency allocation for wireless access systems must be universal service and the creation of conditions that will make it possible to provide it.

Recently, the Municipality of Tel Aviv Yafo wrote to the Ministry of Justice and to the Ministry of Communications regarding the laying of infrastructure by communications companies within its territory, and the use of the Municipality's infrastructure, in an attempt to receive authority and impose additional limitations on communications companies in this regard. The Company objects to the Municipality's position and shall provide a response to the Ministries of Justice and Communications.

To Section 2.6.7 of the Periodic Report – positive and negative factors affecting the Company's competitive status

In the matter of a lack of tariff flexibility – the Ministry of Communications has begun intervening in the marketing campaigns offered by the Company to the public. On April 5, 2006, the Ministry of Communications published a press release addressing the consumer public directly, whereby the legality of the Springtime Campaign that the Company launched a few days previously was being examined. In the Springtime Campaign, customers who buy a telephone and other equipment from the equipment suppliers participating in the campaign are entitled to 200 free call minutes per month for calls made from Bezeq to Bezeq, for a period of one year. The Ministry announced that it is possible that customers who purchase the telephones will not be able to realize the benefit. Previously, the Director General of the Ministry of Communications sent a letter to the Company stating that the campaign was launched without the Ministry's approval. In its reply, the Company noted its fundamental legal position, which was sent to the Ministry and had not yet elicited a response, whereby the Company does not need the Ministry's approval for marketing campaigns. However, without prejudice to this position on the part of the Company, the Company clarified that in any case the campaign in question does not fall under the category of an existing work procedure vis-à-vis the Ministry. After publication of the Ministry's press release, the Company demanded that the Ministry publish a denial or a correction. The Ministry failed to respond and continued to demand information, documents and data. The Company gave the Ministry documents and data, despite its position that the Ministry has no authority in this matter. In addition, the Company announced that it reserves the right to act in this matter. Subsequently, the Ministry of Communications announced its intention to foreclose on a guarantee in the sum of NIS 7 million out of the bank guarantee of $10 million that the Company deposited to guarantee fulfillment of the terms of its license.

On May 24, 2006, the Company submitted an appeal to the Minister of Communications against the decision. The appeal has been heard but no ruling has yet been handed down.

With respect to complaints by communications operators to the Ministry of Communications and to the Antitrust Commissioner against the Company, and the Company's responses in this regard, see Note 1(c)(8) to the Company's Financial Statements for the period ending June 30, 2006.

To Section 2.9 – Human Resources

In the matter of Section 2.9.1 – the Company's Board of Directors approved the appointments to the following new positions: On May 10, 2006, appointment of a Vice President for Regulation, as of June 1, 2006, and on July 12, 2006, appointment of a Deputy CEO of Strategy and Business Development, as of October 1, 2006.

In the matter of Section 2.9.5 – negotiations between the Company's management and the employees' representatives regarding the change in the Company's organizational structure, retirement/dismissal of employees, and a new labor agreement, are at an advanced stage of drafting an agreement. The agreement requires the consent of the New General Trade Union and the board of directors of the Company. Regarding a collective labor dispute declared on April 27, 2006, see note 5 to the financial statements for the period ending June 30, 2006.

To Section 2.10 – Raw materials and suppliers, purchase of equipment and suppliers

For the purpose of fulfilling the duty to implementing number portability between communications licensees, the Company is in the process of contracting with various suppliers in order to purchase new systems and make adjustments to existing systems. These contracts include purchase of additional computing and switching systems to those currently in existence, and the effecting of changes, adjustments and upgrades to the existing systems used by the Company in order to provide services to its customers, and surrounding systems used by the Company to support those systems.

With respect to section 2.10.2 in the table in the Financial Statements for 2005, which contains details of the Company's purchases in 2005, the ratio of purchases out of total purchases in the field of operations as at June 30, 2006 changed with respect to Amdocs (billing) from approximately 5% to approximately 14%, and with respect to Supplier D (transmission equipment) from approximately 12% to approximately 2%.

To Section 2.13 - Financing

To Section 2.13.6 of the Periodic Report – Credit Rating

1. Maalot rating – on April 4, 2006 the Company's existing rating (AA) for the debentures in circulation (private, public and Eurobonds), which had been on the Watch List since May 10, 2005, was ratified and validated, after renewed examination of the business risk, the financial risk and the Company's strategy, and following the sale of the Company's controlling interest to Ap.Sb.Ar. Holdings Ltd. (**"Ap.Sb.Ar."**).
2. Midroog rating – on April 11, 2006 the Company's rating was removed from the Watch List and left as Aa1. However, Midroog decided to lower the Company's outlook from stable to negative in order to reflect the possibility that the change in the Company's ownership will affect the Company's future business and financial profile.

To Section 2.15 – Environmental Protection

In the matter of Section 2.15.2 - the Non-Ionizing Radiation Law, 5766-2006 – on March 26, 2006 the Radiation Supervisor notified the Company and the cellular operators that for the purpose of readiness for most of the provisions of the law coming into effect on January 1, 2007, and with the goal of tightening and improving supervision, he intends to exercise his authority under the Pharmacists Regulations. He further notified that therefore, as of June 1, 2006, those applying for operating permits would be required to comply with the conditions for issuing a permit, including the condition relating to submission of a permit under the Planning and Construction Law. The Company is examining its continued preparations for the new law, taking notice of the said notification, and *inter alia*,. the Company is continuing to act to take out building permits for its broadcast installations. The Company is working with the Ministry of the Interior and the Ministry of the Environment regarding the coming into force of NOP 36B, which deals with building permits for large broadcast installations, and with the requirement under the Radiation Law regarding presentation of a permit under the Planning and Building Law. On July 19, 2006, the Company sent a letter to the Ministry of the Environment requesting that the Law be amended so as to postpone application of the provisions of the Radiation Law regarding presentation of a permit under the Planning and Building Law for three years from the date of entry into force of NOP 36B.

See also update to section 3.18.1.3.2 below, and Note 6A(19) to the financial statements of the Company for the period ending June 30, 2006.

To Section 2.16 – Limitations and Regulation of Company Activity

To Section 2.16.2 of the Periodic Report – the Company's General License

On the subject of volume discounts – on May 24, 2006, the Ministries of Communications and Finance approved a basket of alternative payments (in force as of June 1, 2006) which allow the Company to provide volume discounts at a rate of up to 10%.

On the subject of measuring the Company's market share – on March 15, 2006 the Company submitted a detailed position document to the Ministry of Communications clarifying that the demand for the loss of "market share" – is vague and constitutes fertile ground for disputes, delays and legal resolution; likewise, the Company's position is that the conditions are ripe for granting the Company the possibility of marketing joint packages with its subsidiaries. In any case, in the opinion of the Company, a date should be set for this matter – no later than the end of Q1 2007. The Company stressed that the restrictions should be removed and the Company be permitted to market joint packages in areas in which the Company has lost 15% of market share. In the matter of the parameters for measuring market share (insofar as the demand is not rescinded), the Company believes that the appropriate test is the minutes test and not the revenue test, and that the loss of the Company's market share should be measured in relation to a relevant starting point (November 2004) and that proof that the loss was in favor of certain competitors should not be required. A letter from the VP of Economics at the Ministry of Communications, dated July 12, 2006, stated that the Ministry does not accept the claim that the minutes test is the correct test, and that the revenue test is the test prescribed, whilst the Ministry will determine the normative criteria the purpose of which is to reduce the influence of factors that might alter the revenue estimates. The letter also states that if subsidiaries of the Company are entitled to operate in the field of domestic communications, the Company's market share shall be calculated at the group level. The letter further clarified that the methodology upon which the normative determination of the market share is to be based will be published by the Ministry when the Company's market share reaches around 85%, and that the Ministry may amend such methodology from time to time, in accordance with changes in the market. The Company intends to reply to the Ministry in this regard, mainly due to the vagueness, lack of certainty and harm to the Company because of the Ministry's positions stated above.

To Section 2.16.3 of the Periodic Report – Royalties

In April 2006 the Company paid the sum that was requested by the Ministry in respect of the Company's revenues from interconnect fees on calls from cellular subscribers to Company subscribers (approximately NIS 17 million). It should be noted that the Company has reached agreements with the Ministry regarding various disputes related to royalties. In this regard, see also Note 6A(6) to the Company's Financial Statements for the period ending June 30, 2006.

In connection with the reduction in the rate of royalties from 3.5% to 3% beginning January 1, 2006 – on August 9, 2006, the Finance Committee of the Knesset approved regulations made by the Minister of Communications with the approval of the Minister of Finance regulating a reduction of the rate of royalties for all licensees required to pay royalties, as of January 1, 2006, in the rate of 0.5% per annum up to a rate of payment of royalties of 1% per annum, as of 2010. The Ministry further gave notice that it would act to amend the regulations so as to grant the Company a retroactive exemption, as of January 2004, from the requirement to pay royalties for revenue from services that have been opened to competition. In this regard see Note 1(c)(1) to the Company's Financial Statements for the period ending June 30, 2006.

To Section 2.16.7 of the Periodic Report – Antitrust Laws

To Subsection (C) on the subject of the Company's appeal against the failure to rescind the declaration of the Company as a monopoly in basic telephony – see update to Section 2.6.4 above.

In connection with the Antitrust Authority's application in the matter of claims by certain telecommunication operators, see note 1(c)(8) to the financial statements of the Company for the period ended June 30, 2006.

In connection with the search conducted at the Company's offices on May 23, 2006 and the interrogation of a number of Company employees regarding the alleged abuse of the status of the monopoly and/or an unreasonable refusal to supply an asset or service under the monopoly, and for additional searches and the investigation of a number of other employees of the Company (including officers) which took place following this, see note 1(C)(9) to the Company's financial statements for the period ended June 30, 2006.

To Section 2.16.10 of the Periodic Report – Class Action Suit Law

On March 12, 2006 a new class action law was published, whereby a class action can be filed on various grounds detailed in the addendum to the law and under an explicit provision of the law in the matter of class actions (individual provisions, *inter alia*, in the Antitrust Law, the Consumer Protection Law, and the Banking Law – have been cancelled). Under the law, its provisions will apply also to petitions and actions that were pending on the date of publication of the law. The law includes definitions and expansions of the parties who are permitted to file a motion for a suit to be recognized as a class action, and determines the terms for its filing. The law grants the court discretion in various matters such as compensation, relief, replacement of a plaintiff in a class action and a reservation regarding the approval of the action against a body that provides an essential service to the public. The law makes it very hard to abandon a claim or to reach a settlement, both of which, *inter alia*, require the court's approval. Under the law, a fund for financing class action suits is being established, whose function is to assist representative plaintiffs in financing petitions whose submission is of public and social importance.

To Section 2.16.12 of the Periodic Report – Bill to amend section 13 of the Communications Law

On July 24, 2006, a hearing took place in the Knesset Economics Committee on the amended wording of a bill, adding provisions regarding the hearing of licensees prior to the making of orders, granting of immunity, etc. The definition of "communications crisis" was also expanded, however, the making of orders regarding a communications crisis was reduced. In this hearing, it was determined that within two weeks, the wording of a statutory provision would be proposed under the amendment, enabling the Minister to make orders to a licensee in the event of a fault on the network of another licensee, under certain circumstances.

To Section 2.17 – Substantial Agreements

Management Agreement

On March 23, 2006 the General Meeting of the Shareholders of the Company approved the Company's contractual arrangement under an agreement with a company that would be under the ownership and control of the shareholders of Ap.Sb.Ar., in the framework of which the Company would receive regular management and consulting services, including by means of directors who serve and who will serve from time to time at the Company and/or at its subsidiaries, all in consideration of $1.2 million *per annum*. The term of the contractual arrangement is from October 11, 2005 (the date of closing the acquisition of 30% of the Company's shares by Ap.Sb.Ar.) to December 31, 2008, unless one party gives the other three months' notice of its wish to terminate the agreement. A full description of the terms of the contractual arrangement was provided in the Company's Immediate Report (Amendment) dated March 13, 2006, concerning a transaction between the Company and a controlling shareholder.

To Section 2.18 – Legal Proceedings

For updates on the subject of legal proceedings, see Note 6 to the financial statements of the Company for the period ended June 30, 2006.

3 – Mobile Radio Telephone – Pelephone Communications Ltd. (hereinafter: "Pelephone")

To Section 3.7 - Competition

In the matter of Section 3.7.2 of the Periodic Report – during the first quarter of 2006, Pelephone obtained a license for a marketing trial using VoIP technology, in accordance with an application that it submitted. The license includes a condition which, in the main, stipulates that if, at the end of a hearing which is being held by the Ministry of Communications, the policy document of the Ministry of Communications is amended in a way which prevents Pelephone from providing VOB services, the license for the trial shall expire. The license for the trial allows Pelephone to provide domestic telephony services using VoIP technology in the scope of 8,500 extensions and lines.

On August 2006, Pelephone submitted an application for a special general license for the provision of fixed-line domestic telecommunications services.

To Section 3.18 – Restrictions and Supervision of Pelephone's Activities

In the matter of Section 3.18.1.3.2 – during the first quarter of 2006, notification was received from the Radiation Supervisor (the "**Supervisor**") whereby the implementation of some of the requirements of the Non-Ionized Radiation Law, 5766-2006 (the "**Radiation Law**"), among then making the issue of authorizations contingent upon obtaining a building permit, will be brought forward to June 1, 2006. Pelephone informed the Supervisor of its opposition to the date being brought forward, and that the Supervisor should adhere to the effective date determined in the law, i.e. January 1, 2007. In discussions that took place with the Supervisor and the cellular companies, the Supervisor gave notice of his intention to restrict the term of the operations permits given under the Pharmacists Regulations to sites without building permits, up to January 1, 2007. Pelephone claims that this is exercise of power in contravention of the transitional provisions set out in the Radiation Law, to the effect that permits given to sites under the Pharmacists Regulations which were in force immediately prior to entry into force of the Radiation Law shall be deemed for the duration of their term, to be permits given in accordance with the Radiation Law. At the same time, Pelephone is acting to comply with the provisions of the Law as aforesaid. As at the date of this Report, the proportion of approved sites at which Pelephone operates is approximately 75%[2] of the total number of sites. Pelephone is acting in order to obtain permits and substitute solutions for its other sites. In this regard, see also Note 6(A)(19) to the Company's Financial Statements for the period ending June 30, 2006.

In the matter of Section 3.18.2 (E) – in addition to changes in the Telecommunications Regulations (Interconnect fees), 5760-2000, from December 2004, whereby as of January 1, 2009 the payment for the call completion segment to another cellular network will be according to time units of one second (unlike the present billing method that permits billing according to segments of up to 12 seconds), Pelephone's license was amended in December 2004 so that as of January 1, 2009, the fee for the airtime segment will also be calculated (in addition to the call completion segment as aforesaid) according to time units of one second (rather than the present billing method, which is according to time units of 12 seconds).

In the matter of Section 3.18.2 (G) – a typographical error was made in the Periodic Report for the year 2005, and the following sentence should be deleted from the end of this section: "During the past few months, a hearing took place, both in writing and orally, in the matter of the interconnect fees for all the cellular operators and, as at the date of publication of these statements, Pelephone is awaiting the decision that shall be made by the Finance Ministry and the Ministry of Communications."

In the matter of Section 3.18.3.1:

A. The Ministry of Communications recently amended the licenses of the cellular operators in the matter of limiting users' access to the internet in order to obtain services that include adult content. The amendment stipulates, *inter alia*, that access to erotic services included in a cellular portal or by means of an application such as a search engine which is included in a cellular portal and which enables access to sites on the internet, will be blocked for all subscribers by default, and

[2] This number includes approximately 6% of sites defined as access installations. These installations are exempt from building permits although there are local councils which claim that such a permit is required.

only an adult aged 18 and above will be able to request the removal of the block from his cellular operator, in accordance with a reliable identification procedure. The amendment to the licenses entered into effect on March 30, 2006. At this stage Pelephone does not expect material damage to its revenues as a result of the amendment. “Partner” and “Cellcom” have petitioned the High Court of Justice against this amendment.

B. The Ministry of Communications is holding a hearing with regard to its intention to require a subscriber whose call is routed to a voicemail box be given the option of disconnecting the call with no charge, by means of a preliminary voice message notifying the subscriber that his call is being transferred to a voicemail box, and that he will be charged only from that time. In response to a hearing in writing, Pelephone expressed its objection to this process. If the Ministry of Communications puts its intention into full effect, this is expected to harm Pelephone’s revenues.

This section 3.18.3.1 includes forward-looking information. Forward-looking information is uncertain information about the future, which is based on information that Pelephone has as at the date of the update, and includes Pelephone’s assessments of its intentions as at the date of the update. The circumstances that might cause the forecast described above not to happen include the extent to which the Ministry of Communications implements its intentions, the conduct of the market and the acts of competitors.

With respect to section 3.18.3.3, as at the date of this update, Pelephone has deposited 20 deeds of indemnity with various local councils.

To Section 3.19 – Legal Proceedings

For updates on the subject of legal proceedings, see Note 6 to the financial statements of the Company for the period that ended on June 30, 2006.

4 – International Communication and Internet Services – Bezeq International Ltd. ("Bezeq International")

To Section 4.1 – General

In the matter of Section 4.1.2 – Legislative and Regulatory Restrictions Applicable to Bezeq International – on May 16, 2006 Bezeq International submitted an application for a special general license for the provision of fixed-line domestic communications services to the Ministry of Communications. The issuing of a license, as stated, by virtue of which domestic VOB services will be provided (constituting an essential part of the product mix of internet service providers), will enable Bezeq International to continue to provide its customers with comprehensive communications solutions (of the types that its competitors will offer, some of which have already received similar licenses) and to expand as an equal among equals. Since the Ministry of Communications has not yet replied to Bezeq International’s application to receive a general license, on July 25, 2006, Bezeq International submitted an application to extend the term of the trial license to market VoIP services for payment given to it up to August 31, 2006, up to the date of the decision by the Ministry of Communications regarding grant of the general license.

To Section 4.6.1.1 – Competition in the field of voice

To the best of the Company’s knowledge, “Netvision” and “Barak” are negotiating to examine a merger between them. Likewise, according to publications, Internet Zahav has purchased 60% of the shares of Golden Lines, and the companies intend, in the future, to merge. For these matters, see also the update to section 2.6 above.

If and when the aforesaid mergers come into effect, four competitors will remain in the market: Bezeq International, the Barak-Netvision Group, the Internet Zahav-Golden Lines Group, and Exphone Corp.

To Section 4.6.2.1 – Competition in the field of internet

Upon execution of the mergers set out in section 4.6.1.1 above, there will be 3 main competitors in the market: Bezeq International, the Barak-Netvision Group and the Internet Zahav-Golden Lines Group.

To Section 4.9 – Intangible Assets

On April 30, 2006 Bezeq International signed an agreement with Malam Systems Ltd. (“Malam”) and the Company, for the acquisition of all the operations of the Goldnet Communication Services (“Goldnet”), a registered partnership owned by Malam (25%) and the Company (75%), which provides solutions for the dissemination and transfer of information via secured electronic means between organizations, in consideration of the sum of NIS 6.8 million, which would be paid to Goldnet. In the framework of this acquisition all the agreements between Goldnet and its customers and its suppliers, and the franchise agreements and business cooperation agreements that it has entered into will be endorsed to Bezeq International and all the intellectual property rights, inventory and/or fixed assets of Goldnet will be transferred to the ownership of Bezeq International.

Upon fulfillment of all the suspending conditions stipulated in the acquisition agreement and the payment of the consideration, Goldnet, which conducted its business under the trade name of “Bezeq Gold”, shall cease to provide services. Likewise, for a period of 12 months from the date of completion of the acquisition deal, Goldnet will continue with its contractual arrangements with customers by the power of agreements that it will not be possible to assign to Bezeq International and shall transfer all the receipts in respect thereof to Bezeq International. On June 30, 2006, Goldnet fired most of its employees and paid them the full sums to which they were entitled on account of termination of their employment. A large portion were accepted into various functions at Bezeq International, in accordance with the provisions of the agreement.

After signing of the Agreement, a supplier of services of Goldnet exercised his right to refuse assignment of the contract between him and Goldnet to a contract with Bezeq International. Bezeq International reached an agreement with the supplier under which Bezeq International sold the supplier the right to continue contracting with Goldnet’s existing customers with respect to the services that he supplied, subject to payment of consideration by the supplier, which did not harm the viability of the deal.

For evaluation of the possible merger of operations of Bezeq International and BezeqCall Communications Ltd. (a wholly owned subsidiary of Bezeq dealing in the field of NEP), see update to section 1.1.5 above.

To Section 4.10 – Human Resources

In the matter of Section 4.10.3 - Organizational Structure - on May 15, 2006, Bezeq International consolidated the Technologies Division and the Information Systems Division into a new division to be called Information Technologies, which shall be headed by, as Vice President, the individual who served as director of the Technologies Division up to that time. The reason for the change is the need to adapt the organizational structure to Bezeq International's changing needs and technologies, which stems from the customers' needs.

On July 24, 2006, Bezeq International consolidated its business sales department with its integration and new business department, into a new department called "business solutions", at the head of which will be the person who, up until now, acted as Deputy CEO of Integration and New Businesses. The reason for this change is the need to adjust the organizational structure to the needs of the developing communications market, and provide a total communications solution to business customers.

Likewise, on July 24, 2006, Bezeq International resolved to consolidated the finance, economics and regulation department and the management resources department into a single department to be called "finance and human resources", to be headed by the person who had been Deputy CEO of Finance, Economy and Regulation at the company prior to that.

To Section 4.14 – Investments

During the report period, Bezeq International and others exercised option warrants of Walla (Series 3). In total, Bezeq International exercised 2,564,764 option warrants (Series 3) during Q1 2006, in consideration of a sum total of NIS 4,617 thousand, which was offset from the owners loan balance that Bezeq International extended to Walla. Following the exercise of the option warrants as stated, Bezeq International's holding in Walla grew from 42.85% on December 31, 2005 to 44.56% as at the date of the interim financial statements (fully diluted, as at June 30, 2006 – 33.66%). Following the exercise of the option warrants, goodwill in the sum of NIS 2,313 thousand was generated for the Company.

To Section 4.15 – Financing

With respect to the Company's loan to Bezeq International, described in section 4.15.3 of the Periodic Report for 2005, on February 14, 2006, Bezeq International repaid the entire sum of the loans to the Company, linked to the index as at the date of repayment, in the sum of approximately NIS 173 million.

To Section 4.19 – Legal proceedings

1. In connection with the intention of the Ministry of Communications to impose a financial sanction on Bezeq International in respect of a breach of the terms of its license, due to the provision of access by telephone to erotic services, described in Section 4.19.4 of the Periodic Report, the Director General of the Ministry of Communications informed the Company, on March 29, 2006, of his decision to impose a financial sanction on the Company in the sum of approximately NIS 1,064 thousand; this is in respect of a single breach of provisions of Bezeq International's license and due to an ongoing breach of 115 days. After Bezeq International's request from the Ministry of Communications to delay the payment until the appeal that it intends to file has been clarified was rejected, the said sum was paid in April 2006 and was fully credited to the Statement of Operations.

   On May 9, 2006, Bezeq International filed an appeal to the Tel Aviv Magistrates Court against the said ruling of the Director General of the Ministry of Communications, on the basis of the opinion of Bezeq International's legal advisors whereby there is a good chance that the sum of the sanction will be either cancelled or reduced.

On July 6, 2006, a preliminary hearing was held in which it was held that the State must submit its response to the appeal by July 27, 2006. Appeal proceedings have not yet been set down. In the estimate of Bezeq International, in reliance, *inter alia*, upon its legal counsel, the chances are good that the sum of the sanction will be cancelled or that the amount of the sanction will be reduced.

2. With respect to the claim by a competing international communications operator against the State of Israel for the sum of NIS 11.2 million dated April 4, 2004, under which the State of Israel filed a third party notice against the Company and Bezeq International, set out in section 4.19.2 of the Periodic Report for 2005, on December 5, 2005, the plaintiff submitted affidavits of evidence on its behalf. On April 9, 2006, the State submitted an expert opinion. On May 9, 2006, the Court ruled that given the lack of a factual version at this stage by the State, the Company's and Bezeq International's evidence regarding damage should be adduced on time, however, their evidence regarding liability should only be filed after hearing evidence from the State. On June 13, 2006, a preliminary hearing was held under which the Company and Bezeq International gave notice that they would not be filing an opinion as to damage. The plaintiff and the State also agreed in the hearing that the statement of claim, which another international carrier had filed against the State, the Company, and Bezeq International at the time, would be filed as evidence under agreement. The State also agreed to admit the fact that under the claim by the other international communications carrier, the parties applied to mediation, which ended in an agreement, together with payment by the defendant to the plaintiff.

3. With respect to the claim submitted against Bezeq International and two other international operators claiming breach of patent for a prepaid telephone system in the sum of NIS 10 million by persons claiming to be the inventors and owners of the aforesaid patent, described in section 4.19.3 of the Periodic Report for 2005, on June 25, 2006, the plaintiffs submitted a response by them. In their response, the plaintiffs claim, *inter alia*, that their claim had not expired and was not tainted by laches, estoppel or injunction, that the patent was valid and belonged to them (and not to the State of Israel – Ministry of Communications), and they repeat their claims regarding breach of the patent by the defendants, and their demand to rule the relief sought under the statement of claim. On the same date, the plaintiffs also submitted an application to expunge claims from the statement of defense, regarding the claim that the plaintiff has no right of standing in this matter, and the claim that the general idea of the patent was conceived within the Ministry of Communications, during the period in which the plaintiff acted as Chief Scientist of the Ministry, and that therefore the plaintiffs are not the real owners of the patent. A date for submission of the Company's reply to the application has not yet been set down.

4. For additional updates regarding legal proceedings, see Note 6 to the Company's Financial Statements for the period ended June 30, 2006.

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

To Section 5.1 – General Information on Area of Activity

As at June 30, 2006, the number of DBS subscribers amounted to 534,629 subscribers.

To Section 5.1.3 – Developments in Markets in the Field of Operations

With regard to the government's decision on the free dissemination of certain channels by means of a land-based system of transmitters based on digital technology, supported by a digital satellite system: DBS is conducting negotiations with representatives of the Treasury with regard to the implementation of the said government decision and was told that the Finance Ministry intends to publish a public hearing on the matter.

With regard to the government decision on the subject of obligating the multi-channel television companies to sell the public reduced channel packages, DBS is conducting negotiations with representatives of the Finance Ministry. Legislative amendments regarding implementation of the Government's decision were not included in the Budget Law for 2006, and in discussions in the Knesset Committees, it was decided to separate treatment of them from the enactment of the budget.

To Section 5.6 - Competition

To Section 5.6.5 – Principal Methods for Coping with Competition

In July 2006, the director general of the Ministry of Communications wrote to DBS asking to terminate DBS's campaign offer to its subscribers which, so it was alleged, contained an offer of a "basket of services" which included, *inter alia*, the installation of a Bezeq telephone line at a lower price than that set out in the Communications Regulations (Telecommunications and Broadcasts) (Payments for Telecommunications Services), 5766-2006, such as to give rise to a suspicion of breach of DBS's license which allegedly states that DBS is prohibited from dealing in matters regarding telephony. In DBS's response to the letter, DBS dismissed the allegations of the Ministry of Communications, noting that it had performed activities to market the installation of Bezeq telephone lines, which activities do not require any license, just as such activities are marketed by many other resellers. DBS further noted that the marketing of installation of telephone lines was not part of a total basket of services as alleged, the service itself not being provided by it, but rather by Bezeq, and therefore, its activities do not constitute a breach of the provisions of the law or of DBS's license. Without derogating from its claims, DBS has, at this stage, stopped the campaign offer to its customers. As at the date of this report, the Ministry of Communications reply has yet to be received.

In the matter of VOD – DBS was recently informed by representatives of the Ministry of Communications that it will receive a license for conducting the technological trial within a short period, but as at the date of this report the license for the trial has not yet been received.

To Section 5.10 – Raw Materials and Suppliers

To Section 5.10.1 – Main Raw Materials

In the matter of Sub-Section B – space segments – as at the date of this report, DBS is paying the regular leasehold fees in respect of space segments in the Amos 1 satellite, and remits partial payment on account of the leasehold fee debt in respect of the previous period whose date of payment to Israel Aircraft Industries has passed (in view of the endorsement of the right to receive the leasehold fees from HLL to Israel Aircraft Industries). In view of DBS's delay in payments that were stipulated in the said agreement, Israel Aircraft Industries contacted DBS in March 2006 demanding that the entire debt be settled, and the parties are conducting negotiations on the matter. In addition, there is a dispute between DBS and HLL in the matter of the annual leasehold fees that HLL is entitled to receive in respect of the leasing of space segments in the Amos 2 satellite, which has not yet been arranged, with DBS paying only those sums that are not in dispute.

To Section 5.11 – Working Capital

In Q2 2006 an increase occurred in the working capital deficit of DBS, which totaled approximately NIS 546 million as at June 30, 2006.

To Section 5.12 - Financing

To Section 5.12.2 – Restrictions of the Corporation for the Receipt of Credit

As at March 31, 2006 DBS met the financial criteria, as per the financing agreement (after the banks agreed to amend the targets of these criteria with regard to Q2 2006). In the estimation of the management of DBS, in view of its forecasts with regard to its business results for the years ahead, it is also necessary to adjust the criteria with regard to the period up to the end of the repayment of the bank credit. In consequence, in July 2006 DBS contacted the banks requesting, *inter alia*, an amendment of the relevant provisions of the financing agreement relating to targets for financial criteria. As at the date of this report, the banks' response has not yet been received.

As at the date of this report, DBS has not fully met its undertakings under the financing agreement to take out insurance in connection with its activities and its assets in general, including with regard to its obligation to take out satellite failure insurance with regard to the satellites leased by DBS from the space segments for the purpose of its broadcasts. DBS is conducting negotiations with the banks to obtain concessions with regard to its insurance undertakings, which will enable it to meet these undertakings.

In addition, the delay in DBS's payments to Israel Aircraft Industries (as stated in the update to Section 5.10.1 above) constitutes a *prima facie* breach of the financing agreement; however, the banks have confirmed to DBS that they will not deem the demand by Israel Aircraft Industries for the repayment of the debt to be a breach of the financing agreement on the part of DBS, provided that by December 31, 2006, the parties arrive at a written settlement with Israel Aircraft Industries with regard to the repayment of the said debt and that during the period up to December 31, 2006, Israel Aircraft Industries does not employ any means whatsoever to collect the said debt.

As at the date of approval of the financial statements, DBS is acting in order to obtain additional sources of funding in order to enable it to realize its targets for the coming year. In the event that such sources are not obtained, the Company shall act in accordance with an alternate business plan that does not require additional sources beyond those already in existence.

To Section 5.14 – Restrictions and Supervision of the Corporation

To Section 5.14.1 – Operations being subject to specific laws

On the subject of original (local) productions - DBS has met its obligation for the year 2004 (including the relative share of completing past obligations), apart from immaterial deviations in the subdivision into the various genres, which the Council ordered DBS to amend during 2005. DBS notified the Council that it has met its original productions obligation for the year 2005 (including the relative share of completing past obligations), and the issue is under examination by the Council as at this date.

To the best of DBS's knowledge, as at the date of this report an amendment to secondary legislation has been approved, whereby the rate of royalties applicable to DBS beginning in the year 2006 and thereafter will be gradually reduced to a fixed percentage of 1% as of 2010.

To Section 5.14.3 – The Principal Limitations by virtue of the Law and Broadcasting License

As at the date of this report, the Council has issued an additional broadcasting license to a designated "Israeli Heritage" channel, which is also expected to be aired via DBS's broadcasts. At present, no broadcasts of independent license holders are aired in the framework of DBS's broadcasts.

The decision with regard to the restrictions that apply to DBS as to the percentage of local channels under its ownership which aired in the framework of its broadcasts, was approved by the Council as part of the rules and entered into effect in March 2006.

With respect to administrative guidelines regarding tiering in the subscriber's home: at the beginning of March 2006, the cable companies gave notice to the Director General of the Ministry of Communications to the effect that in light of DBS's breaches of the administrative instructions, they were ceasing to accept disconnection notices sent to them by DBS. And indeed, the cable companies stopped accepting any notices under the administrative guidelines, including connection plans and notices of termination. DBS dismissed the claims of the cable companies and argued that their refusal to accept notices from DBS not only amounted to breach by the cable companies of the administrative guidelines, but also of the provisions of their licenses and of the agreements by which they contracted with their own customers, since they were continuing to charge subscribers subscription fees even though they knew that those customers had disconnected from their broadcasts. DBS also requested the Ministry of Communications to instruct the cable companies to cease charging subscribers immediately upon receipt of notice of disconnection. Following these letters, further correspondence was exchanged between the cable companies and DBS, in which each party repeated its claims. As at this date, no response has been received from the Ministry of Communications on this issue, and the cable companies continue not to accept notices from DBS.

In the estimation of DBS's management, should the Administration's provisions be cancelled, without the existence of a suitable alternative arrangement that will enable one supplier to make use of another supplier's infrastructures at the subscribers' homes, this will constitute a material barrier to the transition of subscribers between the various providers.

To Section 5.17 – Legal Proceedings

In the matter of Section 5.17.1 – application for approval of class action in the matter of telephone communications – after DBS submitted an application to strike out the application *in limine* on March 8, 2006, on April 11, 2006 the applicant's response was submitted, in which it requested that DBS's application be dismissed. No ruling on the application has yet been handed down.

In the matter of Section 5.17.3 – with regard to the arbitration proceedings between DBS and Play TV Ltd., producer of the Playboy and Adult channels ("Play TV"), in connection with the arbiter's ruling and the request for clarification thereof, the parties have arrived at a settlement agreement whereby all the proceedings that were conducted between them that are the object of the arbiter's ruling, have ended. According to the settlement agreement DBS is entitled to receive a certain sum from Play TV. Commercial agreements were also reached between the parties on other matters that were anchored within the bounds of the settlement agreement.

In the matter of Section 5.17.4 – in the matter of the Endemol lawsuit: the parties have arrived at an agreement in principle with regard to the termination of the dispute with a settlement, but this has not yet been formulated into a binding agreement whereby the lawsuit will be annulled, and DBS will pay Endemol approximately $180,000 (including in respect of the purchase of certain content from Endemol).

In addition:

1. on March 15, 2006 a verdict was handed down against DBS and Mr. Shlomo Liran, its former CEO, following DBS's conviction at the Tel Aviv District Labor Court of the offense of disturbing a work supervisor on behalf of the Ministry of Labor and Social Welfare – an offense under Section 26(2) of the Hours of Work and Rest Law, 5711 – 1951 and Sections 36(A)(1) and 36(C) of the Organization of Supervision of Labor Law, 5714 – 1954, and with regard to Mr. Liran, also under Section 27(A) of the Hours of Work and Rest Law, 5711 – 1951 and Section 36(E) of the Organization of Supervision of Labor Law, 5714 – 1954. DBS's conviction was based on the failure to submit documents to a work supervisor, on demand, in contravention of the obligations stipulated by law. The District Court imposed an administrative fine in the sum of NIS 25,800 on DBS and an administrative fine in the sum of NIS 38,700 on Mr. Liran. In May 2006, DBS and Mr. Shlomo Liran appealed to the National Labor Court against their conviction. The appeal was set down for hearing before a panel on December 4, 2006.

2. On July 6, 2005, DBS filed a statement of claim in the District Court at Tel Aviv against Pace Micro Technology Plc., under which DBS requested that the Court charge the defendant with paying the direct expenses borne by DBS in order to repair faulty converters of a particular model, compiled and/or manufactured by the defendant, and supplied to DBS between 2000 and 2001. Under the statement of claim, this model of converter suffered from three serial hardware faults which were under the liability of the defendant and which caused DBS serious damage, mainly due to the need to repair them and to bear the costs involved in such. The claim is for the sum of approximately NIS 31.4 million, and is based on various grounds, including breach of the framework agreement by the defendant and negligence towards DBS, and breach of provisions of the law, DBS reserving its right to sue for

additional damages. Contemporaneous with its filing of the claim, DBS also filed an application to the Court for a permit to serve the process in this file outside of the jurisdiction. On July 17, 2006, the District Court upheld DBS's application for the permit of service as aforesaid, and held that process be translated into English and served upon the defendant personally. Likewise, the Court held that the statement of defense be submitted by the Defendant within 60 days. Service of process was effected at the end of July 2006. A statement of defense has not yet been filed in this matter.

For additional updates regarding legal proceedings, see Note 6 to the Company's financial statements for the period ending June 30, 2006.

August 14, 2006	
Date	"Bezeq", The Israel Telecommunication Corp. Ltd.

Name and title of signatories:

Dov Weissglas, Chairman of the Board
Yacov Gelbard, President & CEO

Directors' Report on the State of the Company's Affairs for the period ended June 30, 2006

August 14, 2006

Directors' Report on the State of the Company's Affairs for the three months ended June 30, 2006

We respectfully present the Directors' Report on the state of affairs of "Bezeq" - The Israel Telecommunication Corp. Limited ("the Company") and the consolidated Group companies (the Company and the consolidated companies are hereinafter collectively referred to as "the Group") for the three-month period ended June 30, 2006 ("the Directors' Report").

The Directors' Report contains a review of its subject matter, in condensed form, and was prepared on the assumption that the reader can also refer to the Directors' Report for the year ended December 31, 2005.

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

1) **Fixed-line domestic communications**

2) **Cellular**

3) **International communications and internet services**

4) **Multi-channel television**

The Company has other areas of operation which are not material to the operations of the Group, and these are included in the financial statements as at June 30, 2006 of the Company as the "Others" business segment, which consists mainly of network end point services, customer center services and content services for the business segment.

1. Financial Position

A. The Group's assets as at June 30, 2006, amounted to approximately NIS 19.17 billion, compared with NIS 20.52 billion on June 30, 2005. Of these, approximately NIS 9.30 billion (approximately 48%) are fixed assets, compared with approximately NIS 10.33 billion (approximately 50%) on June 30, 2005.

The reduction stemmed mainly from the fixed-line domestic communications segment. In this segment, there was a decrease in total assets compared with the previous year, in the sum of approximately NIS 1.0 billion, mainly due to a decrease in the net book value of the fixed assets resulting from the difference between depreciation expenses and the investment made in the reporting period. In addition, there was a decrease in long-term investments and materials and spare parts.

In the cellular segment, assets decreased by approximately NIS 5.4 billion as at June 30, 2006, to a sum of approximately NIS 5.2 billion as at June 30, 2006. This reduction stemmed mainly from steps taken by Pelephone to reduce the inventory balance, a decrease in the deferred tax balance due to utilization of past losses for tax purposes, and additionally a decrease in the net book value of the fixed assets. The reduction was offset by an increase in cash balances and short-term investments.

In the international communications and internet services segment there was a decrease in total assets compared with June 30, 2005, due to a decrease in cash balances and the net investment in fixed assets.

In the multi-channel television segment total assets decreased compared with June 30, 2005, which derived mainly from a decrease in the net investment in fixed assets. The decrease was offset by an increase in the broadcasting rights and the trade receivables balance.

B. Shareholders' equity as at June 30, 2006 amounted to approximately NIS 7.17 billion, comprising approximately 37% of the total balance sheet, compared with approximately NIS 7.77 billion on June 30, 2005, which comprised approximately 38% of the total balance sheet. The decrease in shareholders' equity derived from the distribution of a dividend of NIS 1.2 billion during the reporting period. The decrease was moderated by the net earnings of the Group.

Shareholders' equity as at June 30, 2005 was retroactively adjusted by restatement following recording of the Company's undertaking to its retirees (see Note 2D to the Financial Statements).

C. Total Group debt to financial institutions and debenture holders as at June 30, 2006 amounted to approximately NIS 8.50 billion, compared with approximately NIS 8.77 billion on June 30, 2005. The decrease derived mainly from a decrease in liabilities in the cellular segment and in the domestic fixed-line communications segment. The decrease was partially offset as a result of an increase in liabilities in the multi-channel television segment.

The Company's auditors drew attention to the financial condition of DBS, as mentioned in note 4(A), including DBS management's estimation, based on its updated forecasts and on its business plan, that the prospects are good for arranging the financial resources it will need in the coming year.

D. Group balances in cash and short-term investments as at June 30, 2006 amounted to approximately NIS 3.73 billion compared with approximately NIS 3.62 billion on June 30, 2005. The source of the increase is the cash flow from current operations in the principal segments of the Group's business less the dividend distributed in the reporting period in the amount of NIS 1.2 billion.

2. Results of Operations

A. Principal results

Net earnings for the first half of 2006 amounted to approximately NIS 456 million, compared with net earnings of approximately NIS 444 million in the corresponding period in 2005. The difference in the results derived mainly from changes in operating income of the Group companies, an increase in financing expenses and a decrease in the Company's other income (expenses), net item. Earnings after financing expenses amounted to approximately NIS 661 million compared to NIS 538 million in the corresponding period.

Below are details of the changes in the results of the segments this year as compared with the same period last year.

	For the six-month period ended June 30	
	2006	**2005**
	NIS millions	**NIS millions**
Segment	**Income (loss)**	**Income (loss)**
Fixed-line domestic communications	495	455
Cellular	294	254
International communications and internet services	69	43
Multi-channel television	(17)	(50)
Others	6	1

Earnings per share in the first half of 2006 amounted to NIS 0.175 per NIS 1 par value share, compared with earnings of NIS 0.170 per share in the corresponding period in the prior year.

B. Revenues

Group revenues in the first half of 2006 amounted to approximately NIS 5.65 billion, compared with approximately NIS 5.50 billion in the corresponding period.

Revenues from fixed-line domestic communications decreased from approximately NIS 2.36 billion in the first half of 2005 to approximately NIS 2.33 billion in the first half of 2006 (a decrease of approximately 1%). Most of the decrease in the segment's revenues derived from tariff reductions in June 2005, a decrease in call traffic and in development work. The decrease in revenues was moderated by the ongoing growth in the number of customers who subscribe to high-speed internet service (ADSL). In their review letter, the auditors drew attention to the ongoing opening of the communications industry to competition and to tariff changes.

Revenues from the cellular telephone segment decreased from approximately NIS 2.21 billion in the first half of 2005 to approximately NIS 2.19 billion in the reporting period, resulting from a decrease in revenues from the sale of terminal equipment. Conversely, revenues from Pelephone services increased due to an increase in customers but was offset by a decrease in interconnect tariffs payable to other communications operators..

Revenues from the international communications and internet services segment increased from approximately NIS 403 million in the first half of 2005 to approximately NIS 502 million in the reporting period. The increase was due mainly to an increase in all areas and in global operation, except for a decrease in revenues from outgoing calls as traffic continues to decline and tariffs are eroded due to the expansion of competition.

Revenues from the multi-channel television segment increased from approximately NIS 585 million in the first half of 2005, to approximately NIS 670 million in the reporting period, as a result of the increase in the number of subscribers and in average revenue per customer.

C. General and Operating Expenses

The Group’s general and operating expenses in the first half of 2006 amounted to approximately NIS 3.6 billion, compared with approximately NIS 3.5 billion in the corresponding period.

In the fixed-line domestic communications segment, general and operating expenses increased from approximately NIS 1,129 million in the first half of 2005, to approximately NIS 1,169 million in the reporting period. Most of the increase is attributable to the increase in salary and vehicle maintenance expenses, and were moderated mainly by a decrease in general expenses (mainly advertising) and in expenses for services and maintenance by sub-contractors.

In the cellular segment, general and operating expenses decreased from approximately NIS 1,655 million in the first half of 2005, to approximately NIS 1,548 million in the reporting period, mainly due to lower costs of terminal equipment in parallel with a decrease in revenues from the sale of terminal equipment, a decrease in the cost of spare parts and handsets, and a reduction in expenses for doubtful debts.

In the international communications and internet services segment, general and operating expenses increased from approximately NIS 307 million in the first half of 2005, to approximately NIS 389 million in the reporting period. The increase derived mainly from the increase in expenses for foreign administrations deriving from a significant increase in traffic routed from one foreign operator to another foreign operator, with a corresponding increase in revenues from that service, and also from an increase in expenses attributed to internet customers, advertising and marketing expenses, and customer recruitment.

The general and operating expenses of the multi-channel television segment increased from approximately NIS 476 million in the first half of 2005, to approximately NIS 516 million in the reporting period, as a result of an increase in content expenses and lease fees for satellite segments in parallel with an increase in revenues.

D. Depreciation

The Group’s depreciation expenses decreased from approximately NIS 1,161 million in the first half of 2005, to approximately NIS 1,144 million in the reporting period, due to the cessation of depreciation of fully depreciated fixed assets and a lower level of investment in new assets in the fixed-line domestic communications segment and in the international communications and internet services segment. Most of the decrease was offset by an increase in depreciation expenses in the cellular segment due to the accelerated depreciation expenses of sites designated for dismantling as well as an increase in the multi-channel television segment.

E. Royalties to the Government of Israel

The Group's royalties expense amounted to approximately NIS 89 million, compared with approximately NIS 130 million in the corresponding period, mainly due to a decrease in the provision for royalties in the fixed-line domestic communications segment resulting from an agreement with the Ministry of Communications to end the past dispute up to and including 2002 (see Note 6A(6) to the financial statements) as well as a deduction of the payment for interconnect fees.

F. Operating income

The Group's operating income in the first half of 2006 amounted to approximately NIS 847 million, compared with approximately NIS 703 million in the corresponding period, an increase of approximately NIS 144 million. The increase in operating income derives from the changes in the results of the segments described above in the revenue and expense items. These changes led to an increase in the profitability of the fixed line domestic communications segment, the cellular segment and international and internet services segment, and to improved operating results in the multi-channel television segment.

G. Financing expenses

The Group's net financing expenses in the first half of 2006 amounted to approximately NIS 186 million, compared with approximately NIS 165 million in the corresponding period, an increase of approximately NIS 21 million.

In the domestic fixed line communications segment, financing expenses increased due to an increase in the Consumer Price Index and a decrease in income from the capital market. This increase was offset by the cancellation of a provision resulting from an agreement with the Ministry of Communications to end the past dispute (see Note 6 (A) (6) to the financial statements).

In the multi-channel television segment, financing expenses increased as a result of the increase in the Consumer Price Index and an increase in total loans.

In the cellular segment, financing expenses increased due to the rise in the percentage increase of the Consumer Price Index and a decrease in the Dollar exchange rate.

H. Other income

Other income, net in the first half of 2006 amounted to approximately NIS 31 million compared with income of approximately NIS 153 million in the corresponding quarter.

The income in the corresponding period derived mainly from capital gains of approximately NIS 104 million and a reduction in the provision for early retirement, in the sum of NIS 83 million (due to transition to an insurance company), which was partially offset by an expense of approximately NIS 47 million in amortization of goodwill in respect of companies then consolidated for the first time in the financial statements (see Note 10 to the financial statements). Following publication of Accounting Standard 20 (Amended), effective from the current reporting period, standard amortization of goodwill was terminated.

I. Group's equity in earnings (losses) of affiliates

The Group's equity in earnings of affiliates in the first half of 2006 amounted to approximately NIS 2 million, compared with a loss of approximately NIS 11 million in the corresponding period.

3. Liquidity and sources of financing

Consolidated cash flows generated by operating activities in the first half of 2006 amounted to approximately NIS 1,439 million, compared with approximately NIS 1,270 million in the corresponding period, an increase of approximately NIS 169 million. The source of the increase in cash flow is mainly due to an increase in expenses and a decrease in revenues not involving cash flows as well as a decrease in asset items and an increase in liability items. The changes above were mainly in the cellular segment.

Cash flows generated by operating activities are the principal source of financing of the Group's investments, which during the reporting period amounted to NIS 628 million of which, *inter alia*, approximately NIS 532 million was in the development of communications infrastructures and approximately NIS 76 million was in short-term investments. In the corresponding period, net cash flows used for investments amounted to NIS 1,092 million.

During the reporting period, the Group repaid approximately NIS 570 million of debt, of which approximately NIS 391 million was on account of long-term loans and approximately NIS 179 million on account of debentures. In the reporting period the Group raised new debt in a total amount of approximately NIS 56 million by receipt of short-term bank credit. The net amount of debt repaid during the reporting period amounted to NIS 514 million, compared with the raising of new debt in the amount of NIS 484 million during the corresponding period. In the fixed line domestic communications segment, a dividend in the amount of NIS 1,200 million was distributed on April 16, 2006 (see Note 1.C (6) to the financial statements).

The average monthly short-term credit during the first half of 2006 was approximately NIS 126 million. The average of monthly long-term liabilities in the first half of 2006 was approximately NIS 8,490 million.

Working capital as at June 30, 2006, was positive and amounted to approximately NIS 1,720 million, compared to positive working capital on June 30, 2005 of NIS 1,976 million. The decrease was due to a reduction in working capital in the fixed-line domestic communications segment, multi-channel television segment, and the international communications and internet segment, which was moderated by an increase in working capital in the cellular segment.

4. Comparison of results of Second Quarter 2006 with results of corresponding period last year

	For the period of three months ending June 30	
Segment	**2006** **NIS Millions** **Income (loss)**	**2005** **NIS Millions** **Income (loss)**
Fixed-line domestic communications	255	206
Cellular	155	133
International communications and internet services	36	22
Multi-channel television	(3)	(25)
Other	3	1

Revenues in the second quarter of 2006 increased by NIS 99 million as compared with the corresponding quarter last year.

General and operating expenses increased by NIS 39 million as compared with the corresponding quarter.

Other income, net decreased by approximately NIS 43 million as compared to the corresponding quarter – see Note 10 to the financial statements.

The quarterly results were influenced by the reduction in the provision for royalties and the decrease in financing expenses – see Note 6 (A) (6) to the financial statements.

The behavior of revenue and expense items and the causes of the differences between the quarters are similar to the explanations in the half-year results. The changes described above in the profit and loss items brought about a net profit of approximately NIS 230 million in the second quarter, compared with a net profit of approximately NIS 164 million in the corresponding quarter last year.

5. Group involvement in the community and donations

The Group involves itself in community institutions and social organizations such as the education system in distressed areas and border areas, and additionally, employees volunteer is various community activities.

For example, about 500 Group employees held "Exposure to Modern Communications" workshops, in cooperation with the Ministry of Education, for junior high school students.

In the reporting period, Bezeq donated approximately NIS 248,000 to community institutions and organizations, the main ones being set out below:
In a project entitled "Children and Parents Learn Computers and Internet", which has been in operation for about five years, Company employees tutor parents and children from disadvantaged groups on various aspects of computers and the internet. The cost of the project, in addition to the volunteer employees' time, is approximately NIS 250 thousand per year.
Under a joint decision between management and the employee organization, Passover *Haggadot* were distributed to employees, which contained drawings by autistic children. The cost of the *Haggadot*, at approximately NIS 73,000, was donated to the Association for Children at High Risk.

Pelephone does not have a binding policy on donations, and its management discusses each case on its merits. In the reporting period, Pelephone donated approximately NIS 37,000 to various causes.

Bezeq International is involved in ongoing activities for disadvantaged populations in Petach Tikva, the "adoption" of soldiers without families in Israel and the adoption of a fighting battalion, and also participates in environmental and educational projects. In the reporting period, Bezeq International donations amounted to approximately NIS 250,000.

The Company is taking part in the general efforts to assist those affected by the hostilities in the North. In this framework, it is acting for the sake of the welfare of residents in the confrontation areas by, *inter alia*, installing telephones and internet access in shelters.

6. Details concerning market risk exposure and management thereof

A. Further to the description in the Directors' Report for 2005, as a result of hedging transactions against market risks relating to exposure to changes in exchange rates, the Group's financing expenses connected to such exposure significantly decreased.

B. The report of positions in derivatives as at June 30, 2006, is not significantly different from the report as at December 31, 2005 (see note 6 to the financial statements).

C. The report on linkage bases as at June 30, 2006, is not significantly different from the report as at December 31, 2005.

Surplus monetary liabilities over monetary assets denominated in or linked to a foreign currency as at June 30, 2006, amounted to approximately NIS 2.5 billion in the Group. As a result of forward currency transactions, the net balance of foreign currency liabilities not hedged as aforesaid as at June 30, 2006, amounted to approximately NIS 119 million.

Surplus monetary liabilities over monetary assets linked to the CPI as at June 30, 2006 amounted to approximately NIS 3.9 billion in the Group. Due to this surplus, the Group incurred exceptional financing expenses resulting from the exceptional rise in the Consumer Price Index in the period.

In the main segments of the Group, exposure to the Index is reduced since the computation of tax expenses is calculated based on real earnings.

7. Miscellaneous

Peer review

The Company has expressed its agreement to transfer the material required for a sampling relating to a peer review, following the directive of the Securities Authority published on July 20, 2005. This consent is subject to the maintaining of the confidentiality of the data transferred, as well as guaranteeing prevention of conflict of interests of the reviewers.

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

Dov Weissglas Chairman of the Board	Yacov Gelbard President & CEO

"BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2006

(UNAUDITED)

Condensed Interim Consolidated Financial Statements as at June 30, 2006 (unaudited)

Contents

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

Dear Sirs,

Re: Review of the Unaudited Condensed Interim Consolidated Financial Statements as at June 30, 2006

At your request, we have reviewed the condensed interim consolidated balance sheet of "Bezeq" - The Israel Telecommunication Corp. Limited (hereinafter "Company") as at March 31, 2006, as well as the condensed interim consolidated statements of operations, the condensed interim statements of changes in shareholders' equity and the condensed interim consolidated statements of cash flows for the three-month period then ended.

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

Reports of other auditors were furnished to us which relate to the review of the condensed interim financial statements of consolidated subsidiaries, whose assets as at June 30, 2006, constitute approximately 7% of the total assets included in the condensed interim consolidated balance sheet and whose revenues constitute approximately 12% of the total revenues included in the condensed interim consolidated statement of operations for the six-month period then ended and approximately 12% of the total revenues included in the condensed interim consolidated statement of operations for the three-month period then ended. Furthermore, reports of other auditors were furnished to us which relate to investments in affiliated companies in which the Company's investments amount to approximately NIS 89 million as at June 30, 2006, and the Company’s share in the losses in respect thereof amount to approximately NIS 1,623 thousand and NIS 573 thousand for the three-month and six-month periods then ended.

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 continuing 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 for early retirement as described in Note 5.

3. Contingent claims made against the Company and against invested companies, as described in Note 6A.

4. The financial position of a subsidiary as described in Note 4, including the opinion of the Management of the consolidated company, based on updated forecasts and on the alternative business plan, that the prospects of arranging sources of finance required by the consolidated company in the forthcoming year are good.

We also draw attention also to Note 2D. to the financial statements regarding the adjustment by way of restatement of the financial statements as at June 30, 2005 and December 31, 2005 in order to retroactively reflect the amendment of the accounting treatment of the liability of the Company to its retirees, as described in the abovementioned note.

Somekh Chaikin
Certified Public Accountants (Isr.)

August 14, 2006

Condensed Interim Consolidated Balance Sheets as at

Reported amounts

	June 30 2006	June 30 2005	December 31 2005
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets			
Cash and cash equivalents	**1,256,602**	2,119,303	2,158,773
Short-term investments	**2,469,726**	1,504,507	2,398,525
Trade receivables	**2,077,746**	2,076,741	2,113,512
Other receivables and debit balances	**338,951**	377,719	321,507
Inventory	**214,846**	285,544	220,404
	6,357,871	6,363,814	7,212,721
Materials and spare parts	**89,179**	142,092	88,881
Broadcasting rights, net	**188,996**	159,614	154,500
Investments and long-term receivables			
Investments, deposits and debit balances	**765,183**	924,052	766,840
Investments in investee companies	**88,527**	65,575	75,467
	853,710	989,627	842,307
Fixed assets			
Cost	**31,053,475**	35,030,011	30,627,629
Less– accumulated depreciation	**21,757,314**	24,695,498	20,684,981
	9,296,161	10,334,513	9,942,648
Other assets			
Goodwill	**1,693,685**	1,746,099	1,699,546
Deferred charges and other assets	**368,565**	378,479	380,483
Deferred taxes	**320,883**	407,882	344,786
	2,383,133	2,532,460	2,424,815
	19,169,050	20,522,120	20,665,872

	June 30 2006	June 30 2005	December 31 2005
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current liabilities			
Bank credit	**130,967**	89,151	75,191
Current maturities of:			
Long-term bank loans	**1,047,815**	701,102	1,262,583
Debentures	**424,660**	307,650	527,167
Trade payables	**1,162,538**	1,262,678	1,400,714
Employee severance benefits	**473,170**	635,311*	577,878*
Other current liabilities	**1,398,858**	1,391,540	1,387,955
	4,638,008	4,387,432	5,231,488
Long-term liabilities			
Long-term loans	**1,980,027**	2,915,511	2,151,960
Debentures	**4,919,632**	4,756,884	4,903,056
Employee severance benefits	**382,042**	666,099*	431,427*
Deferred taxes	**38,335**	–	–
Other long-term liabilities	**41,568**	30,417	34,081
Loans extended by minority in a subsidiary:			
Loans	**1,134,500**	1,085,140	1,114,498
Less – minority share in deficit of a consolidated company	**(1,134,500)**	(1,085,140)	(1,114,498)
	7,361,604	8,368,911	7,520,524
Contingent liabilities (Note 6)			
Shareholders' equity	**7,169,438**	7,765,777*	7,913,860*
	19,169,050	20,522,120	20,665,872

* Restated, see Note 2D

Dov Weissglas	**Yacov Gelbard**	**Ron Eilon**
Chairman of the Board	Chief Executive Officer	Deputy CEO and CFO

Date of approval of the financial statements: August 14, 2006.

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

Condensed Interim Consolidated Statements of Operations

Reported amounts

	For the six–month period ended June 30		For the three–month period ended June 30		For the year ended December 31
	2006	**2005**	**2006**	**2005**	**2005**
	(Unaudited)	**(Unaudited)**	**(Unaudited)**	**(Unaudited)**	**(Audited)**
	NIS thousands		**NIS thousands**		**NIS thousands**
Revenues (Note 8)	**5,645,127**	5,500,498	**2,825,872**	2,727,375	11,098,686
Costs and expenses					
General and operating expenses (Note 9)	**3,564,274**	3,505,652	**1,780,624**	1,741,801	7,193,468
Depreciation	**1,144,493**	1,161,317	**572,663**	583,810	2,330,711
Royalties to the Government of Israel	**89,422**	130,171	**26,228**	64,619	257,429
	4,798,189	4,797,140	**2,379,515**	2,390,230	9,781,608
Operating income	**846,938**	703,358	**446,357**	337,145	1,317,078
Financing expenses, net	**186,238**	165,079	**114,265**	110,203	417,309
Earnings after financing expenses	**660,700**	538,279	**332,092**	226,942	899,769
Other income, net (Note 10)	**31,050**	152,742	**21,668**	65,128	109,386
Earnings before income tax	**691,750**	691,021	**353,760**	292,070	1,009,155
Income tax	**237,769**	259,823	**124,267**	126,953	429,594
Earnings after income tax	**453,981**	431,198	**229,493**	165,117	579,561
Equity in earnings (losses) of affiliates	**1,623**	(11,167)	**573**	(7,846)	(12,645)
Minority share in losses (earnings) of subsidiaries	**(26)**	8,979	**–**	7,032	8,942
Earnings before the cumulative effect of a change in accounting principle	**455,578**	429,010	**230,066**	164,303	575,858
Cumulative effect of a change in accounting principle as at the beginning of the period	**–**	15,000	**–**	–	15,000
Net earnings	**455,578**	444,010	**230,066**	164,303	590,858
Primary and diluted earnings per NIS 1 par value of common shares (in NIS):					
Earnings before the cumulative effect of a change in accounting principle	**0.175**	0.165	**0.088**	0.063	0.222
Cumulative effect of a change in accounting principle	**–**	0.005	**–**	–	0.005
Net earnings per share	**0.175**	0.170	**0.088**	0.063	0.227

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

Condensed Interim Statements of Changes in Shareholders' Equity

Reported amounts

	Share capital	Capital reserve – share premium	Capital reserve in respect of transactions between the Company and a controlling shareholder	Dividend proposed after the balance sheet date	Retained earnings (deficit)	Total
	NIS thousands					
Six months ended June 30, 2006						
Balance as at December 31, 2005 (audited)	**6,309,133**	**1,623,423**	**39,010**	**1,200,000**	**(1,257,706)***	**7,913,860***
Net earnings (unaudited)	**–**	**–**	**–**	**–**	**455,578**	**455,578**
Dividend (unaudited)	**–**	**–**	**–**	**(1,200,000)**	**–**	**(1,200,000)**
Balance as at June 30, 2006 (unaudited)	**6,309,133**	**1,623,423**	**39,010**	**–**	**(802,128)**	**7,169,438**
Six months ended June 30, 2005						
Balance as at December 31, 2004 (audited)	6,309,133	1,623,423	37,775	–	(648,564)*	7,321,767*
Net earnings (unaudited)	–	–	–	–	444,010	444,010
Balance as at June 30, 2005 (unaudited)	6,309,133	1,623,423	37,775	–	(204,554)*	7,765,777*
Three months ended June 30, 2006						
Balance as at April 1, 2006 (unaudited)	**6,309,133**	**1,623,423**	**39,010**	**–**	**(1,032,194)***	**6,939,372***
Net earnings (unaudited)	**–**	**–**	**–**	**–**	**230,066**	**230,066**
Balance as at June 30, 2006 (unaudited)	**6,309,133**	**1,623,423**	**39,010**	**–**	**(802,128)**	**7,169,438**
Three months ended June 30, 2005						
Balance as at April 1, 2005 (unaudited)	6,309,133	1,623,423	37,775	–	(368,857)*	7,601,474*
Net earnings (unaudited)	–	–	–	–	164,303	164,303
Balance as at June 30, 2005 (unaudited)	6,309,133	1,623,423	37,775	–	(204,554)*	7,765,777*
Year ended December 31, 2005						
Balance as at December 31, 2004 (audited)	6,309,133	1,623,423	37,775	–	(648,564)*	7,321,767*
Net earnings (audited)	–	–	–	–	590,858	590,858
Payment from the State in respect of privatization of the company (audited)	–	–	1,235	–	–	1,235
Dividend proposed for payment (audited)	–	–	–	1,200,000	(1,200,000)	–
Balance as at December 31, 2005 (audited)	6,309,133	1,623,423	39,010	1,200,000	(1,257,706)*	7,913,860*

* Restated, see Note 2D

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

Condensed Interim Consolidated Statements of Cash Flows

Reported amounts

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Cash flows from operating activities					
Net earnings	**455,578**	444,010	**230,066**	164,303	590,858
Adjustments to reconcile net earnings to net cash flows from operating activities (see A below)	**983,833**	825,791*	**461,413**	513,734*	2,127,730
Net cash generated by operating activities	**1,439,411**	1,269,801*	**691,479**	678,037*	2,718,588
Cash flows from investing activities					
Investment in fixed assets	**(531,941)**	(983,580)	**(225,806)**	(508,072)	(1,694,071)
Proceeds from disposal of fixed assets and sale of operations	**23,360**	125,540	**9,705**	112,972	147,810
Investment in long-term deposits and investments	**(4,849)**	(6,982)	**(1,358)**	(6,982)	(10,068)
Redemption of long-term deposits and investments	**12,884**	8,609	**9,291**	2,291	91,431
Decrease (increase) in short-term investments, net	**(75,507)**	(190,036)	**(44,754)**	85,053	(972,260)
Investment in investee companies	**(10,853)**	(5,746)	**(1,362)**	(3,118)	(18,836)
Investment in other assets	**(40,786)**	(39,442)	**(24,245)**	(15,682)	(91,893)
Net cash used in investing activities	**(627,692)**	(1,091,637)*	**(278,529)**	(333,538)*	(2,547,887)
Cash flows from financing activities					
Issue of debentures (after deduction of issue expenses)	**–**	1,238,236	**–**	425,941	1,702,265
Repayment of other debentures	**(179,056)**	(120,307)	**(30,088)**	(28,704)	(267,332)
Receipt of long-term loans	**–**	417,500	**–**	303,000	474,521
Repayment of long-term loans	**(390,610)**	(1,052,446)	**(226,433)**	(460,896)	(1,365,578)
Receipt (repayment) of short-term bank credit, net	**55,776**	1,049	**9,470**	(14,410)	(12,911)
Dividend paid	**(1,200,000)**	-	**(1,200,000)**	-	-
Net cash generated by (used in) financing activities	**(1,713,890)**	484,032	**(1,447,051)**	224,931	530,965
Increase (decrease) in cash and cash equivalents	**(902,171)**	662,196	**(1,034,101)**	569,430	701,666
Balance of cash and cash equivalents at the beginning of the period	**2,158,773**	1,457,107	**2,290,703**	1,549,873	1,457,107
Balance of cash and cash equivalents at the end of the period	**1,256,602**	2,119,303	**1,256,602**	2,119,303	2,158,773

* Reclassified

The notes to the financial statements are integral part thereof.

Condensed Interim Consolidated Statements of Cash Flows (Contd.)

Reported amounts

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands		NIS thousands		NIS thousands
A – Adjustments to reconcile net earnings to net cash flows from operating activities					
Revenue and expenses not involving cash flows:					
Depreciation	**1,144,493**	1,161,317	**572,663**	583,810	2,330,711
Deferred taxes	**32,240**	73,750	**586**	32,891	144,035
Company's equity in (gains) losses of affiliated companies	**(1,623)**	11,167	**(573)**	7,846	12,645
Minority share in gains (losses) of a subsidiary	**26**	(8,979)	**–**	(7,032)	(8,942)
Decrease in employee severance benefits, net	**(154,093)**	(115,160)	**(132,431)**	(89,874)	(407,265)
Gain on disposal of fixed assets	**(12,187)**	(2,749)	**(2,611)**	(1,019)	(5,715)
Gain from sale of operations	**–**	(103,869)	**–**	(2,009)	(103,869)
Provision for decrease in value of investments	**–**	4,700	**–**	4,700	5,868
Erosion (appreciation) and interest on long-term deposits and investments	**1,130**	13,146	**2,859**	(8,693)	22,170
Erosion (appreciation) of short-term investments, net	**4,306**	(26,662)	**14,830**	(12,286)	(60,396)
Appreciation (erosion) of long-term liabilities:					
Debentures	**101,470**	(118,415)	**35,304**	(34,024)	(69,730)
Long-term loans and other liabilities	**1,569**	76,058	**(13,859)**	50,569	129,032
Amortization of other assets and deferred expenses	**40,652**	95,724	**18,959**	47,788	196,015
Changes in asset and liability items:					
Increase in broadcasting rights	**(34,496)**	(19,118)	**(15,399)**	(8,997)	(14,004)
Decrease (increase in trade receivables	**42,254**	(14,518)	**13,871**	(6,248)	(63,298)
Decrease (increase) in other receivables and debit balances	**13,185**	(23,953)	**60,331**	5,291	24,600
Decrease (increase) in inventory	**7,023**	19,103	**(4,014)**	13,363	75,943
Decrease (increase) in materials and spare parts	**(21,462)**	(33,816)*	**(3,290)**	2,119*	24,952
Decrease in trade payables	**(199,044)**	(169,270)	**(33,076)**	(26,498)	(112,461)
Increase (decrease) in other current liabilities	**10,903**	24,318	**(59,425)**	(38,317)	20,733
Increase (decrease) in deferred revenues	**7,487**	(16,983)	**6,688**	354	(13,294)
	983,833	825,791*	**461,413**	513,734*	2,127,730
B– Non-cash transactions					
Acquisition of fixed assets, other assets, materials and spare parts on credit	**190,328**	72,981	**190,328**	72,981	124,719
Sale of fixed assets on credit	**13,996**	–	**13,996**	–	17,089

* Reclassified

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

Notes to the Financial Statements as at June 30, 2006

NOTE 1 – GENERAL

A. These interim statements were prepared according to generally accepted accounting principles, applicable to the preparation of financial statements for interim periods pursuant to Accounting Standard 14 of the Israeli Accounting Standards Board (hereinafter – the IASB) and to the provisions of Section 4 of the Securities Regulations (Periodic and immediate reports), 5730-1970.

B. These statements should be read in conjunction with the annual financial statements of the Company and its subsidiaries as at December 31, 2005 and for the year then ended, and their accompanying notes (hereinafter – the Annual Reports).

C. The Company presents in the notes to the interim financial statements only those significant changes in its business and legal environment that occurred from the date of the latest annual financial statements, published on March 1, 2006, 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 fields of cellular telephone services, international communication services, domestic communication services and multi-channel television services, appear in Note 1 to the Company's annual financial statements as at December 31, 2005. The significant changes that occurred from the date of the annual financial statements to the date of these financial statements are as follows:

(1) Further to Note 1C. to the financial statements as at December 31, 2005, concerning a gradual reduction in the percentage of royalties from 3.5% to 3% – on August 9, 2006 the Knesset Finance Committee approved regulations promulgated by the Minister of Communications with the approval of the Finance Minister, for a reduction in the royalty rate for all the licensees who are required to pay royalties, effective from January 1, 2006, by 0.5% each year until the rate reaches 1% per year in 2010. In addition, the Ministry announced that it would work for amendment of the regulations in a way that would grant the Company retroactive exemption commencing January 2004 from the duty to pay royalties in respect of revenues from services which have been opened to competition.

With the approval of the regulations concerning the reduction of royalties by 0.5% from January 1, 2006, the Group's royalty expense will be reduced in the next quarter in respect of the six month period ended June 30 2006, by approximately NIS 19 million.

(2) Further to Note 1D. to the financial statements as at December 31, 2005, concerning an appeal filed by the Company in 2001 in the Antitrust Court to change the announcement of the Company's monopoly in the basic telephony service (fixed-line domestic telephony) – following the Company's request that the court expedite the hearing of the appeal, the Company agreed, at the proposal of the court (in view of the time elapsed since it was filed together with an economic opinion), to withdraw the appeal, which was then stricken on August 2, 2006. The Company is preparing to file a new and revised application to the Antitrust Commissioner. In the opinion of the Company, the mobile telephony market is an alternative market for fixed-line telephony, and this fact is reinforced by new and up-to-date data which has accumulated during the period since the appeal was filed in 2001.

(3) Further to Note 1E(1)a. to the financial statements as at December 31, 2005, concerning revision of the Company's tariffs – on July 1, 2006 the Communications Regulations (Telecommunications and broadcasts) (Payment for telecommunications services), 5766-2006 and the Communications Regulations (Telecommunications and broadcasts) (Computation of payments for telecommunications services and their linkage) (Amendment No. 2), 5766-2006, came into effect. According to the regulations and based on the tariff update formula prescribed in the Communications Regulations (Telecommunications and broadcasts) (Computation of payments for telecommunications services and their linkage), 5763-2003, the average reduction of the controlled tariffs of the Company determined according to Section 15(a) of the Communications Law, applicable from July 1, 2006, is 0.36% (excluding the reduction of VAT by 1% which took effect on the same date). This reduction is based on a change of about 2.4% in the Consumer Price Index, less an average efficiency factor of about 2.7%. In addition, the Communications Regulations (Telecommunications and broadcasts) (Payment for interconnect) (Amendment), 5766-2006, whereby interconnect fees were reduced by approximately 2% (including the 1% VAT reduction), came into effect on the same date.

NOTE 1 – GENERAL (CONTD.)

(4) Further to Note 1E(1)c. to the financial statements as at December 31, 2005, concerning regulations relating to proceedings and conditions for receipt of a special general license for providing fixed-line domestic communications services without a universal obligation – to the best of the Company's knowledge, during the first quarter of 2006 another two licenses were granted to two additional operators. The subsidiary Bezeq International Ltd. filed an application for such a license. Since the Ministry of Communications has not yet responded to the subsidiary's application for a general license, on July 25, 2006 the subsidiary filed an application for extension of the term of the marketing trial license for VOIP services which it was granted until August 31, 2006, until the date of the Ministry of Communications' decision on the matter of the general license.

(5) Further to Note 1E(1)f. to the financial statements as at December 31, 2005, concerning a numbering plan for number portability registration – during February and March 2006, further correspondence with the Ministries of Communications and Finance concerned the inability of operators, including the Company, to comply with the timetables set. The Company repeated its notice that it is making its best efforts and investing extensive resources for the implementation of number portability but for pertinent technical reasons would not be able to meet the timetables set for implementation of the plan. The Company requested that the Minister take action for a legislative proceeding for amendment of the Communications Law so that a reasonable timetable would be prescribed for the implementation of number portability. On August 2, 2006 a letter was sent from the Supervisory Department at the Ministry of Communications, stating, among other things, that the Company's explanations regarding non-compliance with the timetables were unacceptable. On August 8, 2006, a letter was sent by the Company in response to that letter, in which it was clarified that the discussion summary did not correspond, in the Company's view, to the gist of the actual discussion, that the Ministry's strong positive impression of the Company's actions was not reflected in the summary, and that earlier preparation could not be commenced before a plan was formulated and because the Ministry of Communications had not formulated a full characterization. On August 7, 2006 the Chairman of the Number Portability Forum, who acts on behalf of the relevant operators, sent a letter to the Minister of Communications, requesting that the Minister take action for postponement of the date set for implementation of the plan..

(6) Further to Note 1H to the financial statements as at December 31, 2005, concerning the resolution of the Board of Directors of the Company on March 1, 2006 to recommend to the General Meeting of the shareholders of the Company the distribution of a cash dividend to the shareholders in the amount of NIS 1,200,000,193, which as at the date of the distribution constitutes NIS 0.4606446 per share – the Special General Meeting of the shareholders of the Company which convened on March 23, 2006, approved the distribution of the dividend. The dividend was distributed on April 16, 2006.

(7) The Ministry of Communications notified the Company on May 9, 2006 of its intention to call in a guarantee of NIS 7 million out of the bank guarantee of $10 million which the Company deposited for securing fulfillment of the terms of its license, due to its position that the Company launched a campaign in a way which deviates from the rules of the regulation applicable to campaigns. The position of the Company is that it does not require the approval of the Ministry for marketing campaigns. The Company intends to exhaust every legal avenue open to it on this matter, and its first step, taken on May 24, 2006, was to appeal the Minister's decision. The appeal has been heard but no decision has yet been made. The financial statements do not include a provision in respect of this matter.

(8) In May 2006 the Company received a letter from the Antitrust Authority concerning complaints of certain communications operators of actions ostensibly being taken by the Company against those operators and a complaint of one of the operators which was received from the Ministry of Communications. According to the operators, the actions constitute abuse of the Company's monopolistic power. The Company was requested to submit to the Authority and to the Ministry both data and answers to questions in the letter, and has done so.

NOTE 1 – GENERAL (CONTD.)

(9) On May 23, 2006 investigators from the Antitrust Authority appeared at the Company's offices and presented an order from the Magistrate's Court permitting them to search the Company's offices and seize any document or object required for their investigation. According to the order, the cause for grant of the order was suspicion of abuse of monopoly status according to Section 29A of the Antitrust Law together with Section 47(A)(4a) of that law and/or unreasonable refusal to provide a monopoly asset or service according to Section 29 of the Antitrust Law. During the search, which has not yet ended, the investigators collected various documents, including computer material, and several employees were requested to accompany the investigators to the Antitrust Authority's offices for questioning. The Company is cooperating fully with the Authority's investigators. The investigation is still in progress, and accordingly, the Company, relying on its external legal adviser who is handling the case on its behalf, is unable, at this stage, to estimate the outcome and implications of the investigation, including the possibility of indictments being filed and/or civil proceedings being instituted against the Company.

(10) Further to Note 1E(2)a. to the financial statements as at December 31, 2005, concerning the decision of the Minister of Communications to oblige the Company to transfer to Cellcom interconnect payments according to actual traffic – a settlement agreement was signed between the Company and Cellcom, under which the Company paid Cellcom the agreed amount. There is no effect on the financial statements of the Company for the reported period, due to a provision recorded in the Company's books in the past.

(11) Further to Note 9F to the financial statements as at December 31, 2005, the negotiations with the foreign investor for the sale of the Company's satellite operations failed to lead to an agreement. The Company has commenced negotiations with other potential investors.

NOTE 2 – REPORTING PRINCIPLES AND ACCOUNTING POLICY

A. GENERAL

The significant accounting policies applied in these financial statements are consistent with those applied in the annual financial statements, except as stated in this Note.

B. INITIAL APPLICATION OF ACCOUNTING STANDARDS

(1) Accounting Standard No. 20 (Amended) – Accounting treatment of goodwill and intangible assets in the acquisition of an investee company

Commencing January 1, 2006, the Company has applied Accounting Standard No. 20 (Amended) ("the Standard") of the IASB. The Standard prescribes the accounting treatment for goodwill and intangible assets upon acquisition of a subsidiary and of an investee company which is not a subsidiary, including a company under joint control.

The principal changes set out in the Standard as compared with the principles applied in the past are: attribution of the surplus cost of the acquisition of investment in an investee company also to identifiable intangible assets of the acquired company; a distinction between intangible assets having a defined useful life and intangible assets of an indefinite useful life; immediate recognition as gain, on the date of acquisition, in the statement of income, of negative goodwill created in the acquisition after deduction of intangible assets and non-financial assets of the investee company; termination of the systematic deduction of positive goodwill and intangible assets with an indefinite useful life; distinction between goodwill of a subsidiary and of an investee company which is not a subsidiary for the matter of impairment. Comparative figures were not restated.

The amounts of amortization of goodwill, the deduction of which was terminated on January 1, 2006, in the six-month and three-month periods ended June 30, 2005 and in the year 2005, were NIS 46,559,000, NIS 23,279,000 and NIS 93,112,000, respectively (see also Note 10).

NOTE 2 – REPORTING PRINCIPLES AND ACCOUNTING POLICY (CONTD.)

B. INITIAL APPLICATION OF ACCOUNTING STANDARDS (CONTD.)

(2) Accounting Standard No. 21 – Earnings per share

Commencing January 1, 2006, the Company has applied Accounting Standard No. 21 (Amended) ("the Standard") of the IASB. Pursuant to the Standard, the Company computes the basic earnings per share with regard to profit or loss, as well as the basic earnings per share with regard to profit or loss from ongoing operations, attributed to the ordinary shareholders. The basic earnings per share is calculated by dividing the profit or loss attributed to the ordinary shareholders, by the weighted average of the number of ordinary shares in circulation during the period.

For the purpose of calculating diluted earnings per share, the Company adjusted the profit or the loss attributed to the ordinary shareholders, and the weighted average of the number of ordinary shares in circulation, in respect of the effects of all the diluted potential ordinary shares. The Company's equity in the earnings of investee companies was computed according to its equity in the earnings per share of those companies, multiplied by the number of shares the Company holds. The initial application of the Standard did not affect the earnings per share of the Company.

(3) Accounting Standard No. 22 – Financial instruments: disclosure and presentation

Commencing January 1, 2006, the Company has applied Accounting Standard No. 22 ("the Standard") of the IASB. The Standard sets out the rules for stating financial instruments in the financial statements and details the proper disclosure required for them. In addition, the Standard determines the manner of classification of financial instruments as financial liability and as shareholders' equity, the classification of interest, dividends, related losses and gains, and the circumstances in which financial assets and financial liabilities should be set off. The Standard cancels Opinion 53 – Accounting treatment of convertible liabilities, and Opinion 48 – Accounting treatment of option warrants. The Standard was adopted on a prospective basis. Comparison figures relating to prior periods were not restated.

Following the first-time adoption of the Standard, the Company set off deferred issuance expenses of approximately NIS 9 million from the debenture and loan items.

(4) Accounting Standard No. 24 – Share-based payment

Commencing January 1, 2006, the Company has applied Accounting Standard No. 24 ("the Standard") of the IASB. Pursuant to the provisions of the Standard, the Company will recognize share-based payment transactions in its financial statements including transactions with employees or other parties that must be settled in equity instruments, in cash or by other assets. Share-based payment transactions in which goods or services are received will be reported at their fair value.

Regarding transactions which are settled in capital instruments, the Standard applies to grants made after March 15, 2005 but which had not yet vested by January 1, 2006. In the same manner, the Standard applies to changes which occurred in the terms of the transactions settled in capital instruments which were made after March 15, 2005, even if the grants in respect of which the changes were made were prior to that date. The first-time application of the Standard did not affect the results of operations and the financial condition of the Group.

NOTE 2 – REPORTING PRINCIPLES AND ACCOUNTING POLICY (CONTD.)

B. INITIAL APPLICATION OF ACCOUNTING STANDARDS (CONTD.)

(5) Accounting Standard No. 25 – Income

Commencing January 1, 2006, the Company has applied Accounting Standard No. 25 ("the Standard") of the IASB. The Standard deals with recognition of income from three types of transactions: the sale of goods, the provision of services, and the use made by others of the company's interest-yielding assets, royalties and dividends, and it prescribes the accounting treatment required (rules of recognition, measurement and disclosure) for those three types of transaction. The initial application of the Standard did not affect the results of operations and the financial condition of the Group.

As of January 1, 2006, the Company has applied the IASB published Clarification No. 8 – "Reporting income on a gross basis or a net basis" ("the Clarification"). The Clarification is based on the professional publication EITF 99-19 of the Emerging Issues Task Force in the USA. According to the Clarification, an entity operating as an agency or as a broker without bearing the risks and yields deriving from the transaction, will state its income on a net basis. Conversely, an entity operating as a principal supplier and bearing the risks and yields deriving from the transaction, will state its income on a gross basis. The Clarification provides a list of indicators to be considered in order to determine the basis on which income should be reported – gross or net. Since in the past the Company treated the matter of gross or net income in accordance with the provisions of EITF 99-19, the first-time application of the new Clarification had no material effect on the Company.

C. DISCLOSURE OF THE EFFECTS OF NEW ACCOUNTING STANDARDS IN THE PERIOD PRIOR TO THEIR APPLICATION

Accounting Standard No. 29 – Adoption of international financial reporting (IFRS)

In July 2006 the IASB published Accounting Standard No, 29 - Adoption of international financial reporting standards (IFRS) ("the Standard"). The Standard states that entities subject to the Securities Law, 5728-1968 and required to report in accordance with the regulations of that law, will prepare their financial statements according to IFRS standards for periods commencing January 1, 2008. The Standard enables earlier adoption, from the financial statements which will be published after July 31, 2006. The IFRS standards will be adopted for the first time together with application of the provisions of IFRS Standard 1 – First-time Adoption of IFRS Standards, for the purpose of the transition. The Company is examining the effects of the Standard on its financial statements, including the possibility of early application of the IFRS standards.

D. RESTATEMENT

Further to Note 2(FF) to the financial statements as at December 31, 2005, the financial statements as at June 30, 2005 and December 31, 2005 were adjusted retroactively by way of restatement in order to reflect the recording of a liability of the Company to its retirees, as shown below:

(1) Effect on the Consolidated Balance Sheet as at June 30, 2005

	As previously reported	Effect of restatement	As reported in these financial statements
	NIS thousands	NIS thousands	NIS thousands
Current liabilities	4,377,432	10,000	4,387,432
Long-term liabilities	8,234,911	134,000	8,368,911
Shareholders' equity	7,909,777	(144,000)	7,765,777

NOTE 2 – REPORTING PRINCIPLES AND ACCOUNTING POLICY (CONTD.)

D. RESTATEMENT (CONTD.)

(2) Effect on the Consolidated Balance Sheet as at December 31, 2005

	As previously reported	Effect of restatement	As reported in these financial statements
	NIS thousands	NIS thousands	NIS thousands
Current liabilities	5,221,488	10,000	5,231,488
Long-term liabilities	7,386,524	134,000	7,520,524
Shareholders' equity	8,057,860	(144,000)	7,913,860

(3) Effect on Retained Earnings (Deficit)

	As at March 31	As at June 30	As at March 31	As at December 31	
	2006	2005	2005	2005	2004
	NIS thousands				
As previously reported	**(888,194)**	(60,554)	(224,857)	(1,113,706)	(504,564)
Effect of restatement	**(144,000)**	(144,000)	(144,000)	(144,000)	(144,000)
As reported in these financial statements	**(1,032,194)**	(204,554)	(368,857)	(1,257,706)	(648,564)

The effect of the amendment on the statement of operations in the reported periods is marginal.

NOTE 3 – RATES OF CHANGES IN THE CONSUMER PRICE INDEX AND FOREIGN CURRENCY EXCHANGE RATES

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

	Consumer price index	Exchange rate of the US dollar	Exchange rate of the euro
	%	%	%
For the six-month period ended:			
June 30, 2006	**1.55**	**(3.54)**	**3.62**
June 30, 2005	(0.50)	6.17	0.50
For the three-month period ended:			
June 30, 2006	**0.96**	**(4.82)**	**(0.33)**
June 30, 2005	1.17	4.88	1.10
For the year ended December 31, 2005	2.39	6.85	(7.33)

NOTE 4 – INVESTMENTS IN INVESTEE COMPANIES

A. D.B.S. SATELLITE SERVICES (1998) LTD. ("DBS")

In January 1999, DBS received a license from the Ministry of Communications for satellite television broadcasts, and commenced provision of services in July 2000. Since starting operations, DBS has accumulated considerable losses. The loss for 2005 amounted to approximately NIS 328 million and the loss for the six-month period ended June 30, 2006 amounted to approximately NIS 140 million. As a result of these losses, DBS's capital deficit and working capital deficit as at June 30, 2006 amounted to approximately NIS 3,734 million and NIS 546 million respectively.

The Company's investment in DBS (mainly shareholders' loans) as at the balance sheet date is approximately NIS 1,562 million (before interest and linkage). The Company's equity in the accumulated losses of DBS since its investment (excluding deduction of goodwill) is approximately NIS 1,707 million, of which approximately NIS 132 million was recorded in the six-month period ended June 30, 2006 (DBS's losses for the period, net of the increase in new loans given by minority shareholders). The balance of DBS's current debt to the Company and its consolidated companies amounts to approximately NIS 100 million. This debt has not yet been repaid, even though the due date for most of the amount has passed and the Company is working with DBS on its collection.

The terms of the long-term loans which DBS received from banks, the balance of which as at June 30, 2006 is NIS 1,328 million (including current maturities), impose various restrictions on DBS, which include, *inter alia* – restrictions relating to encumbrance or sale of certain assets, restrictions on receipt of credit from other banks without prior approval, a restriction on repayment of shareholders loans, and a demand to comply with financial criteria ("the Conditions"). As at June 30, 2006, DBS is in compliance with the Conditions prescribed in the financing agreements (after a benefit which was granted in connection with the financial criteria in respect of the second quarter of 2006). In view of the projections of the Management of DBS regarding its business results for the coming years, DBS is working with the banks to revise the financial directives in the financing agreement. DBS is also negotiating with the banks to settle a dispute relating to insurance obligations prescribed in the financing agreement.

In March 2006, Israel Aircraft Industries ("IAI") demanded that DBS clear its entire debt to IAI, following DBS's failure to make the payments prescribed in the payment arrangement between the parties. As at the date of approval of the financials statements, DBS is in discussions with IAI for a solution that will be satisfactory to the parties. The failure to comply with the payment arrangements constitutes a violation event under the financing agreement with the banks. Following IAI's demand, DBS reported the event to the banks. On May 14, 2006 a letter was received from the banks in which they confirm that they will not see IAI's demand as a breach by DBS of the amended financing agreement, provided that by August 1, 2006, the parties arrive at a written arrangement with IAI for repayment of the aforementioned debt to IAI and provided that during the period up to August 1, 2006 inclusive, IAI does not take any steps for collecting that debt. As at the date of approval of these financial statements, DBS had received another letter from the banks, extending the period in which DBS can arrive at a written arrangement with IAI to December 31, 2006.

In March 2004, the Board of Directors of the Company approved an additional investment of NIS 440 million in DBS by the end of 2005 ("the Additional Injection"), of which, by 11 October, 2005, the Company had transferred approximately NIS 284 million of the Additional Injection to DBS.

On December 31, 2004 and February 14, 2005, the Company and DBS were notified of decisions of the then Minister of Communications relating to the Additional Injection. Those decisions determined, *inter alia*, that –

(1) The total amount of the planned Additional Injection (NIS 440 million) was limited to a maximum of NIS 350 million.
(2) With regard to the NIS 195 million of the Additional Injection already transferred by the Company at that time to DBS, no additional action was taken.
(3) The balance of the sum, a maximum of NIS 155 million, would be transferred once every quarter in equal portions during 2005.

Notes to the Financial Statements as at June 30, 2006

NOTE 4 – INVESTMENTS IN INVESTEE COMPANIES (C0NTD.)

A. D.B.S. SATELLITE SERVICES (1998) LTD. ("DBS") (CONTD.)

(4) The Company would not be permitted to provide a guarantee to the shareholders of DBS, to banks or to institutional entities, or to make any other similar commitment, for securing their part in the Additional Injection or in credit granted to DBS by them.

In April and May 2005, the Company and DBS filed petitions in the High Court of Justice for grant of an order *nisi* against the Minister of Communications, declaring that the decisions described above are null and void. The petitions, which were heard on October 11, 2005, raised questions of principle which are far from simple, both factually and legally, which were brought into sharp focus during the hearing. The Court has not yet given its decision.

On March 21, 2006, the Company received a latter from the Minister of Communications, stating that after examining the implications of further injections of funds into DBS for the promotion and consolidation of competition in fixed-line domestic communications, and based on the business plans of DBS for 2006 which were presented to the Minister of Communications, according to which the injections needed in 2006 amount to NIS 55 million, the Minister of Communications is considering placing a limit on injections of funds in 2006 in the following manner:

(1) The Company's part in the total injections into DBS would not exceed 40%.
(2) The part of the other DBS shareholders and of the banks or financing institutions would not exceed 60%.
(3) The Company or an entity acting on its behalf would not provide a guarantee to the shareholders, the banks or institutional financing entities, or any similar commitment, for securing their part in the injections or in credit granted by them to DBS.
(4) Towards the end of 2006, the subject of the injections, insofar as required in future years, would be re-examined.

The Company sent its response to the letter on April 2, 2006, in which it gave notice that it opposes the decision being considered by the Ministry of Communications, which it believes to be *ultra vires*, and is requesting a hearing to explain its position and make its arguments orally before the Minister of Communications. As at the date of publication of these financial statements, the Company had not yet been invited to argue its position before the Minister.

On January 31, 2006 the Board of Directors of DBS approved its budget for 2006, which requires DBS to obtain additional external financing for the year. As at the date of approval of the financial statements, DBS is working to obtain additional financial resources which will enable it to achieve its targets for the coming year. If those resources cannot be obtained, DBS will operate in accordance with an alternative business plan which does not necessitate additional resources beyond those already existing. The Management of DBS believes, based on the 2006 budget and on the alternative business plan, that the prospects for arranging the financial resources required by DBS in the coming year are good.

On August 2, 2006 the Company and DBS filed merger notices to the Antitrust Commissioner ("the Commissioner"), concerning exercise of options for DBS shares by the Company, which would increase the percentage of the Company's holding in DBS from approximately 49.8% to approximately 58%. The Commissioner's approval for increase the Company holding in DBS to more than 50% has already been given (on certain conditions) in the past (on January 2, 2005), but expired one year later, and therefore the companies have submitted a renewed request for approval of the merger.

B. GOLDNET COMMUNICATION SERVICES, A REGISTERED PARTNERSHIP ("GOLDNET")

On April 30, 2006 an agreement was signed between the Company, Malam Systems Ltd. and Goldnet of the first part, and the subsidiary Bezeq International of the other part, for acquisition of all the operations of Goldnet by Bezeq International, in consideration of NIS 6.8 million, which will be divided between the Company (NIS 5.1 million) and Malam Systems (NIS 1.7 million).
Upon fulfillment of all the suspending terms prescribed in the acquisition agreement and payment of the consideration, Goldnet will cease to provide services.

NOTE 4 – INVESTMENTS IN INVESTEE COMPANIES (C0NTD.)

C. MERGER OF THE OPERATIONS OF BEZEQCALL COMMUNICATIONS LTD. AND BEZEQ INTERNATIONAL LTD.

After the balance sheet date, the Company began examining a possible merger of the operations of the wholly-owned subsidiary BezeqCall Communications Ltd. (whose business is in network end points) and the wholly-owned subsidiary Bezeq International Ltd. (internet, international calls and integration solutions for businesses). Such a merger, if and to the extent accomplished, would require approvals prescribed in law, among them of competent entities, the Ministry of Communications and the Antitrust Commissioner.

In addition, after the balance sheet date, BezeqCall commenced negotiations for acquisition of another operation in its area of business. The scope of the transaction is estimated at approximately NIS 90 million. If the transaction is closed, it too will require approvals, among them the approvals of the competent organs of the parties.

NOTE 5 – LIABILITY FOR EMPLOYEE SEVERANCE BENEFITS

EARLY RETIREMENT PLAN

Further to Note 16D to the financial statements as at December 31, 2005 – the negotiations between the Company's Management and the Union in connection with a change in the organizational structure, retirement / layoff of employees and a new labor agreement, are at an advanced stage of drafting an agreement. The agreement will require the approval of the New General Federation of Workers ("the Histadrut") and the Board of Directors of the Company.

On April 27, 2006 the Company received a "Notice of strike action or work to rule" pursuant to the Resolution of Labor Disputes Law, 5717-1957 ("the Notice"). The Notice related to a strike at the Company from May 14, 2006 onwards, which was declared by the Histadrut and approved, according to the contents of the Notice, by the representative trade union.

The issues in dispute, according to the Notice, are as follows:

"a. Serious foreseen implications for workers as a result of the severe damage to the strength of the Company due to the failure to arrange the matter of the grant of discounts, reduction of royalties of the Company, tariff flexibility and against a background of grant of licenses to competitors on terms which are extremely detrimental to the Company.

b. Disregarding the workers' representation and its demands and bad faith and unacceptable conduct in collective labor relations in general and, in labor relations in public service, in particular."

Following serious disruptions and malfunctions caused by workers' sanctions, on May 18, 2006 the Company turned to the Labor Court. In the hearing, it was decided that the workers must return to work and intensive negotiations held for arriving at an agreed solution not by way of sanctions or strike.

NOTE 6 – 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 annual financial statements of the Company as at December 31, 2005 and published on March 1, 2006. No material changes in contingent liabilities have occurred up to the date of signing these financial statements, other than the following:

(1) Further to Note 19A(4)(b) to the financial statements as at December 31, 2005 concerning different claims relating to recognition of various salary components as pension components and of the notice of a party to the collective dispute ("the Claim") which was filed by the New General Federation of Workers ("the Histadrut") in the name of all the employees of the Company, in which the Histadrut alleged that grossing up payments, the administrative on-call component and clothing allowances ("the Components") which were and are paid to Company employees, are regular pay which form part of the determining salary of every employee, including for the calculation of payments upon retirement, redemption of holidays, grants, acclimatization payments, percentage increments and hourly pay value and that various payments and provisions should be made in respect thereof, including for pension purposes. On April 4, 2006 the decision of the Jerusalem Regional Labor Court dismissed the Claim and all its component parts filed by the Histadrut in the name of all Company employees.

In its decision, the Court allowed in full the argument of the Company, that the conduct of the parties over so many years indicates unequivocally that the demands of the Histadrut directly contradict the agreements applicable in the relations of the parties, which are binding in the circumstances, and therefore those demands should be dismissed. The Court further determined that even if the Components are examined on their merits, the Claim would be dismissed since according to case law, all three Components fall within the definition of "extras" and not "pay", and therefore do not grant entitlement to the reliefs claimed by the Histadrut.

Further to Note 19A(4)c. to the financial statements as at December 31, 2005, concerning the claim of a group of employees in the matter of including a number of components as part of the determining salary for pension, on August 6, 2006 a decision was given dismissing the claim and all its parts, and the court ruled that the salary increments are not fictitious extras but genuine and conditional increments and therefore are not part of the basic salary for the computation of the pension or of severance pay, vacation pay, sick pay, retirement grant and acclimatization grant. The decision is subject to a right of appeal by the plaintiffs.

The financial statements contain a provision of NIS 50 million in respect of the administrative on-call component and in respect of the Components claim. The Company has examined the significance and implications of the decision described above, and has concluded that the conditions are not yet ripe for canceling or reducing the provision or part of it.

(2) Further to Note 19A(9) to the financial statements as at December 31, 2005 concerning a claim filed by a competing international communications operator against the Company and against Bezeq International in the amount of NIS 57 million, for a number of causes relating, *inter alia*, to postponement of implementation of the customer allocation proceeding, a mediation proceeding was commenced between the parties and is now in progress. The Company, relying on its legal advisers, believes that the chances of the claim being dismissed are greater than the chances of it being allowed. The management of Bezeq International believes, concerning the rationale that its part in the amount of the claim is approximately NIS 29 million and the estimation of its legal advisers that there is a reasonable but not definite chance that Bezeq International will be ordered to pay some part of that amount, that Bezeq International will not sustain material loss beyond the amounts included in the financial statements.

NOTE 6 – CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS AND CONTINGENT LIABILITIES (CONTD.)

(3) Further to Note 19A(11) to the financial statements as at December 31, 2005 concerning a claim and application for recognition as a class action, in the matter of reimbursement of a commission which the plaintiff alleges was collected unlawfully, for calls in Israel from a public telephone operated by means of a BezeqCard – on April 16, 2006 the applicant filed an application to amend the application for recognition as a class action pursuant to the new Class Actions Law, 5766-2006. The Company opposed the application. The Court has not yet given its decision. In the opinion of the legal advisers who are handling the claim on behalf of the Company, against a background of developments and the possibility that the court will allow the applicants to amend their claim following amendment of the Telecommunications Regulations, the chances that the claim will prevail cannot be assessed at this stage.

(4) Further to Note 19A(14) to the financial statements as at December 31, 2005 concerning the dismissal of a class action filed against the Company in May 2003, alleging that the Company abuses its monopolistic power and collects enormous sums of money from internet users in that it refuses to install splitters on high-speed (ADSL) lines – on March 27, 2006 the plaintiff filed an appeal in the Supreme Court, in which he petitions for the decision of the District Court dismissing his claim, to be cancelled. The Company believes, based on the opinion of its external legal advisers, that the chances of the appeal being allowed are lower than the chances of its dismissal, and accordingly, no provision was included in the financial statements in respect of this claim.

(5) Further to Note 19A(16) to the financial statements as at December 31, 2005 concerning an action for declaratory relief filed in the Regional Labor Court by the Organization of Bezeq Retirees and six Company retirees against the Makefet Fund, the State of Israel and the Company, alleging breach of agreements for binding arrangements which were made at the time when the employees transferred from the civil service to the Company – in the decision on the application for dismissal *in limine* which was filed by the Company, the court decided not to strike out the Organization as a plaintiff and effectively put an end to the claim against Makefet. Regarding the claim against the Company and the State, the court directed that an amended statement of claim be filed, which has been done, and the Company is now required to respond with a statement of defense.

(6) Further to Note 19A(20) to the financial statements as at December 31, 2005 concerning the dispute between the Company and the Ministry of Communications relating to the payment of royalties in respect of revenues for interconnection from cellular subscribers to Company subscribers, the Company reached an agreement with the Ministry for ending past disputes concerning royalties up to and including 2002, except for two negligible revenue components. As part of this agreement, the Company paid the sum of approximately NIS 17 million to the Ministry. In the past, the Company's financial statements included a provision for royalties which, in view of the agreement with the Ministry of Communications, is superfluous. Accordingly, the royalty expenses to the Government of Israel were reduced in the quarter by approximately NIS 36 million, and financing expenses in respect of the royalties were reduced by approximate NIS 31 million. The financial statements still contain a provision for possible disputes commencing from 2003, which the Company's Management believes to be appropriate.

(7) On April 6, 2006 the Company received a claim together with an application for recognition as a class action, which was filed by a private (and inactive) company which is a subscriber of the Company. According to its allegations, the claim concerns the plaintiff being subscribed for the "Free From 7" track and being debited according to that track tariff, without having ordered the service. According to the plaintiff, it has cause of claim in the circumstances of the matter, under the Consumer Protection Law, 5741-1981, the Contracts Law (General part), 5733-1973, and the Unjust Enrichment Law, 5739-1979. The amount of the personal claim is assessed by the plaintiff at NIS 239.18.

Notes to the Financial Statements as at June 30, 2006

NOTE 6 – CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS AND CONTINGENT LIABILITIES (CONTD.)

(7) (contd.)

The plaintiff has applied for the claim to be recognised as a class action in the name of all the subscribers who were debited unlawfully in debit tracks and for certain services of the Company which are listed in the claim. The plaintiff estimates that the financial loss of the members of the group included in the class action could reach millions of shekels per year. The Company filed an application for the claim to be struck *in limine*, and the date for the Company's response to the claim has been postponed until a decision is made on its application (which has not yet been given). Relying on its legal advisers, the Company is unable, at this stage, to estimate the prospects of the claim.

(8) On May 15, 2006, the Company received a claim with an application for recognition as a class action, which was filed pursuant to Section 5 of the Class Actions Law, 5766-2006. The Statement of Claim alleges that the Company collected from the plaintiff arrearage interest on amounts of value added tax which the plaintiff should have paid to the Company and which are not part of the services provided by the Company. The amount of the plaintiff's personal claim is NIS 0.33. The plaintiff does not make any assessment of the amount of the class action. The Company is studying the claim and is unable, at this stage, to estimate its prospects.

(9) On May 25, 2006 a claim was filed in the Tel Aviv District Court together with an application for recognition as a class action under the Consumer Protection Law and the Class Action Law, alleging deception in advertising in the matter of a charge for calls from a Bezeq line to a cellular line. According to the plaintiff, the Company deceived the public in its advertisements, which stated that the price of a call from a Bezeq line to a cellular line would be "approximately 44 agorot per minute", whereas the exact price per call minute was 44.57 agorot, nor did it disclose that the charge for interconnect was made according to segments of 12 seconds, which means that the actual average charge was 49 agorot per minute. The plaintiff estimates the amount of the claim at approximately NIS 68.5 million (the amount of the personal claim is NIS 11). The Company is unable, at this stage, based on the lawyer who is handling the claim on his behalf, to estimate the chances of the application for approval.

(10) Various municipalities and local councils have submitted demands to the Company for retroactive payment of municipal taxes in respect of an increase in the areas of buildings and changes in classification for municipal tax purposes. These claims amount to approximately NIS 55 million. The financial statements include a provision which the Company's Management, relying on the legal advisers who are handing the claims for it, considers appropriate.

(11) On May 18, 2006, a claim was filed in the Tel Aviv District Court together with an application for recognition as a class action against the cable companies and against the Company. According to the plaintiff, on May 17, 2006 a fault occurred in his telephone line in the HOT network and it is possible that Company employees (who were imposing sanctions at that time) played some part in the malfunction. The plaintiff alleges that as a result of the malfunction, he incurred financial damages, harm to his goodwill and distress. The amount of the claim is estimated by the plaintiff at approximately NIS 100 million (the amount of the personal claim is assessed at about NIS 1,000). On July 16, 2006, the Company filed an application for dismissal *in limine* of the application for approval, arguing that the claim cannot be filed as a class action since it is not among the types of claims defined in the Class Actions Law and there are no provisions in any other law by virtue of which the claim can be filed. Accordingly, the date for filing the Company's response to the application for approval was postponed until a decision is given on the application for dismissal. Relying on its legal advisers, the Company is unable, at this stage, to assess the chances of the application for approval.

(12) Further to Note 19A(34) to the financial statements as at December 31, 2005 concerning notice of the filing of an application to add Pelephone to an appeal proceeding filed by the owners of rights in land adjoining a cellular communication site operated by Pelephone together with others in Ramat Gan, Pelephone's objection to joining the proceeding as a whole was allowed. Pelephone believes, relying on its legal advisers at this stage of the proceeding, that it is at no risk of exposure.

NOTE 6 – CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS AND CONTINGENT LIABILITIES (CONTD.)

(13) A number of proceedings were recently submitted to Pelephone, in which local committees were requested to add Pelephone as a party to various appeals filed in appeals committees against dismissal of claims of impairment of value under Section 197 of the Planning and Construction Law, in respect of the erection of communications installations. Pelephone is studying each application on its merits and making its decisions accordingly. Pelephone believes, relying on its legal advisers, that it is not at risk of material exposure at this stage of these proceedings.

(14) A number of legal proceedings are in progress against Pelephone (whether in administrative petitions, appeals or civil actions), which were filed against the licensing and/or erection of communications sites. Pelephone, the respondent in these proceedings, opposes the applied for reliefs. Pelephone believes, relying on its legal advisers, that it is not at risk of material exposure in these proceedings.

(15) On July 12, 2006 a claim was filed against Pelephone in the District Court, together with an application for recognition as a class action, in the amount of approximately NIS 251 million. The claim relates to the interpretation of the agreement with Pelephone signed by the plaintiff, concerning the reimbursement of payments he was charged by Cellcom when he switched from Cellcom to Pelephone. According to the plaintiff, Pelephone should have paid NIS 3,000 in respect of those payments, even though he did not comply with the terms of the agreement. At this stage, Pelephone is unable to asses the chances or the implications of the action.

(16) On August 10, 2006, an application for approval as a class action was received by Pelephone, which was filed against Pelephone, Cellcom, and Partner. The amount of the action (consolidated against all three companies) is NIS 100 million (no separate amount was attributed to Pelephone). The action relates to the time of disconnection of calls made from a cellular network to the Company's network, an alleges that in such a call, where the Company customer initiates its termination, a surplus charge is applied until the actual disconnection of the call. At this stage, Pelephone is unable to assess the prospects and implications of the action. Pelephone is studying the claim and will respond as necessary.

(17) Further to Note 19A(25) to the financial statements as at December 31, 2005 concerning a claim filed against Bezeq International by a supplier of a system in the amount of approximately NIS 18.5 million, for enforcement of an agreement for the delivery and installation of a customer relations management and billing system, following a mediation proceeding between the parties a settlement was reached for the mutual clearance of the claims in the case, against payment of a non-material sum by Bezeq International to the plaintiff. On June 19, 2006 the court validated the settlement agreement and instructed that the court fees paid by the parties be returned to them in full.

(18) On June 14, 2006 an application was filed in the Tel Aviv District Court for approval of a claim as a class action against DBS and against the cable companies in connection with the broadcasting of advertisements during World Cup games ("the Application for Approval"). According to the applicants, the broadcasting of advertisements which they allege were integrated into the first three days of broadcasts on the World Cup channel as part of the games and the World Cup studio, was against the law, contrary to the contract between DBS and its customers and contrary to the terms laid down in the decision of the Council to approve the broadcasting of the 2006 World Cup games. The Applicants estimated the amount of the claim at NIS 530 for each subscriber who purchased the World Cup package, and in total – approximately NIS 106 million for all the members of the group (based on 200,000 World Cup subscribers from the cable companies and DBS together). The Applicants wish to sue DBS on the basis of the Class Actions Law, 5766-2006 by cause of deception, violation of a legislated duty, unjust enrichment and breach of a contractual undertaking, in respect of three damages categories: impairment of the value of the World Cup package, harm to autonomy, and causing distress. The response of DBS to the application for approval of the claim as a class action must be filed in the court by September 15, 2006. DBS, relying on its legal advisers, is unable to assess the chances of the claim at this preliminary stage.

NOTE 6 – CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS AND CONTINGENT LIABILITIES (CONTD.)

(19) For the provisions of their services, the Company and the subsidiary Pelephone operate installations which emit electromagnetic radiation. The operation of such installations is subject to the Non-ionizing Radiation Law, 5766-2006, most of whose provisions will come into force on January 1, 2007 ("the Radiation Law"), and the Pharmacists Regulations (Radioactive elements and their products), 5740-1980, which regulate the erection and operation of installations and their supervision, including a demand for permits for that purpose. Erection and operation permits are granted by the Supervisor of Radiation at the Ministry for Protection of the Environment, and grant of an operator's license necessitates presentation of a permit under the Planning and Construction Law. The Company and Pelephone are at an advanced stage of preparation and adaptation of their installations for operation in accordance with the provisions. The Company is operating to obtain building permits, to the extent required, for its broadcasting installations, as well as working with the Ministry of the Interior and the Ministry for Protection of the Environment on the implementation of National Outline Plan 36B (“NOP 36B”), which deals with building permits, insofar as required, for large broadcasting installations. On July 19, 2006 the Company sent a letter to the Ministry for Protection of the Environment, requesting that the Radiation Law be amended so that the application of its provisions concerning the presentation of a permit according to the Planning and Construction Law be postponed for three years from the date on which NOP 36B take effect. The subject of electromagnetic radiation and its effects has not yet been thoroughly investigated in Israel or elsewhere. The Company and Pelephone are using their best efforts to meet the requirements of the Radiation Law, including concerning the permits required. Nevertheless, the Company and Pelephone are unable to assess whether the approvals will be received within the time prescribed in the Radiation Law, whether the Ministry for Protection of the Environment will accede to the Company's request to postpone the date for presentation of the permits, and what the aforementioned implications might be.

B. FORWARD TRANSACTIONS

Future Currency Transactions – Accounting Hedging Transactions

Consolidated

	Currency purchased	Currency payable	Final repayment date	Amounts receivable	Amounts payable
				NIS millions	
Forward contracts at predetermined exchange rate					
(excluding premium/discount)	Dollar	NIS	September 2006	222	232
	Euro	NIS	August 2007	1,710	1,736
	CPI-linked NIS	NIS	December 2010	1,115	1,146

Future Currency Transactions – Contracts not for Accounting Hedging Purposes

	Purchased currency	Currency payable	Last repayment date	Scope of commitment
				NIS millions
Forward contracts at predetermined exchange rate				
(excluding premium/discount)	Dollar	Shekel	August 2006	457
	Index	Shekel	December 2006	50

Notes to the Financial Statements as at June 30, 2006

NOTE 7 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES

A. Further to Note 27C to the financial statements as at December 31, 2005, on March 23, 2006 the general meeting of the shareholders of the Company approved the Company entering into an agreement with a company which will be owned and controlled by the shareholders of Ap.Sab.Ar. and will provide the Company with regular management and consultation services , including by means of serving directors and directors who will serve from time to time in the Company and/or in its subsidiaries, for US $1.2 million per year. The term of the agreement is from October 11, 2005 the date of closing the purchase of 30% of the shares of the Company by Ap.Sab.Ar.) to December 31, 2008, unless one of the parties gives the other three months' notice of its wish to terminate it.

B. **BENEFITS FOR DIRECTORS AND CEO**

1. On May 15, 2006 the Audit Committee and the Board of Directors approved the terms of employment of the Chairman of the Board, and on June 21, 2006 the terms were approved by the general meeting. Below are the details of the terms of his employment:

    a. The Chairman will be employed at an 80% position under a personal employment agreement, at a monthly salary of NIS 150,000 and standard social benefits (senior employees insurance, supplementary study fund, company car, driver, expense account, telephone, etc.).

    b. In addition to his regular monthly salary, a once yearly payment (with no accompanying conditions of any kind) in the amount of one million two hundred thousand shekels (linked to the Consumer Price Index.

    c. The commitment will be for an undefined period, where each party has the right to bring the commitment to an end by giving three months' notice.

    d. Insofar as the Company has an employee stock options plan, the Chairman will be included in it in accordance with the criteria of that plan.

2. On August 14, 2006 the Board of Directors of the Company approved the sale of a real estate asset of the Company to the CEO of the Company (through a company in his control), for $630,000 plus VAT. The consideration was set according to the valuation of an external appraiser and after no higher offer was received from other bidders.

C. Further to Note 27B to the financial statements of the Company as at December 31, 2005, concerning the new commercial agreement signed between the Company and the Ministry of Defense on behalf of the State of Israel for the provision of communications services by the Company – as at the date of publication of these financial statements, no agreed alternative had been found for the agreement and the parties are in dispute as to the method of accounting until an agreement is achieved on the matter. The financial statements include revenue from the Ministry of Defense at the tariffs in the agreement from May 8, 2005, which is NIS 25 million lower than the tariffs under the agreement from July 2002 and approximately NIS 45 million lower than the Company's normal tariffs. Up to June 2006 the Ministry of Defense paid the Company according to the tariffs in the June 2002 agreement. On June 21, 2006 the Ministry of Defense notified the Company that for the reasons set out in the letter, it intends to pay the invoices in accordance with the principles of the agreement from May 8, 2005, that it would make a retroactive accounting and that the balance of the payment for 2006 would be paid accordingly.

Notes to the Financial Statements as at June 30, 2006

NOTE 8 – REVENUES FROM COMMUNICATION SERVICES

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues from communication services –					
Traffic	**672,508**	716,460	**331,966**	348,223	1,436,615
Fixed fees	**1,300,307**	1,267,564	**650,507**	643,194	2,559,559
	1,972,815	1,984,024	**982,473**	991,417	3,996,174
Cellular telephone	**1,870,766**	1,823,987	**943,961**	896,623	3,643,795
International communications and internet services	**474,472**	380,755	**242,355**	192,189	775,532
Multi-channel television	**635,283**	576,136	**320,320**	292,002	1,171,318
Installation and sale of equipment to subscribers and miscellaneous	**564,239**	609,156	**269,609**	294,949	1,246,947
	5,517,575	5,374,058	**2,758,718**	2,667,180	10,833,766
Other revenues	**127,552**	126,440	**67,154**	60,195	264,920
	5,645,127	5,500,498	**2,825,872**	2,727,375	11,098,686

NOTE 9 – OPERATING AND GENERAL EXPENSES

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Salaries and incidental expenses –					
Operations	**899,792**	875,475	**444,441**	441,541	1,794,458
General and administrative	**359,891**	326,697	**187,815**	164,254	684,290
Total salaries and related expenses	**1,259,683**	1,202,172	**632,256**	605,795	2,478,748
General expenses	**570,364**	613,743	**279,031**	314,229	1,209,169
Materials and spare parts	**414,059**	499,155	**211,735**	242,609	1,016,735
Consumption of content from satellite services	**216,157**	202,251	**107,715**	102,053	419,309
Cellular telephone expenses	**512,936**	477,642	**256,177**	223,121	991,066
Building maintenance	**167,518**	169,805	**83,369**	82,998	366,630
Services and maintenance by sub-contractors	**214,994**	210,637	**100,693**	104,876	422,416
International communications expenses	**195,706**	130,121	**99,300**	66,094	277,210
Vehicle maintenance expenses	**91,961**	81,164	**46,559**	41,078	181,385
Collection fees	**25,273**	24,755	**12,945**	12,682	49,196
	3,668,651	3,611,445	**1,829,780**	1,795,535	7,411,864
Less – salaries charged to investment in fixed assets	**104,377**	105,793	**49,156**	53,734	218,396
	3,564,274	3,505,652	**1,780,624**	1,741,801	7,193,468

Notes to the Financial Statements as at June 30, 2006

NOTE 10 – OTHER INCOME, NET

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Provision for employee severance benefits upon early retirement	**–**	83,000	**–**	90,000	83,000
Disposals of assets and impairment of value of fixed assets	**–**	–	**–**	–	(830)
Provision for impairment and other liabilities in respect of the value of investments in other companies	**(7,147)**	(4,700)	**(7,147)**	(4,700)	(5,868)
Compensation in respect of a settlement agreement	**–**	14,483	**–**	–	14,483
Amortization of goodwill	**–**	(46,559)	**–**	(23,279)	(93,112)
Capital gain from sale of operation	**-**	103,869	**-**	2,009	103,869
Dividend (1)	**26,010**	-	**26,010**	-	-
Capital gains, net	**12,187**	2,749	**2,611**	1,019	5,715
Others	**–**	(100)	**194**	79	2,129
	31,050	152,742	**21,668**	65,128	109,386

(1) On May 14, 2006 the Company received the notice of Eurofund 2000 Partnership, a venture capital fund which invests mainly in start-ups in communications, software, internet, semiconductors and homeland security ("the Fund"), of a distribution, following the sale of the Fund's holdings (approximately 18%) in an optical network equipment company for approximately US $42 million (the Fund had invested $2 million in the company). As a result of the distribution, the Company recorded a capital gain of approximately NIS 26 million.

Notes to the Financial Statements as at June 30, 2006

NOTE 11 – CONDENSED INTERIM FINANCIAL STATEMENTS OF THE COMPANY

A. Statements of Operations

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues (Note 11B)	**2,331,700**	2,355,190	**1,160,991**	1,159,472	4,723,734
Costs and expenses					
Operating and general expenses (Note 11C)	**1,168,596**	1,129,235	**592,003**	567,231	2,346,451
Depreciation	**643,205**	700,478	**319,800**	351,083	1,390,435
Royalties to the Government of Israel*	**25,165**	70,106	**(5,855)**	34,720	135,575
	1,836,966	1,899,819	**905,948**	953,034	3,872,461
Operating income	**494,734**	455,371	**255,043**	206,438	851,273
Financing expenses, net	**25,224**	31,023	**7,022**	25,096	80,897
Earnings after financing expenses	**469,510**	424,348	**248,021**	181,342	770,376
Other revenues, net	**40,593**	199,400	**29,496**	88,629	201,012
Earnings before income tax	**510,103**	623,748	**277,517**	269,971	971,388
Income tax	**152,454**	198,688	**87,254**	95,642	332,118
Earnings after income tax	**357,649**	425,060	**190,263**	174,329	639,270
Company's equity in earnings (losses) of investee companies	**97,929**	3,950	**39,803**	(10,026)	(63,412)
Earnings before the cumulative effect of change in accounting principle	**455,578**	429,010	**230,066**	164,303	575,858
Cumulative effect of change in accounting principle as at the beginning of the year	**–**	15,000	**–**	–	15,000
Net earnings	**455,578**	444,010	**230,066**	164,303	590,858

* See Note 6A6.

Notes to the Financial Statements as at June 30, 2006

NOTE 11 – CONDENSED INTERIM FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

B. REVENUES FROM TELECOMMUNICATIONS SERVICES

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Fixed-line domestic communications -					
Traffic	**684,405**	744,070	**337,961**	363,610	1,460,076
Fixed fees	**1,214,087**	1,190,425	**607,467**	604,531	2,404,970
Total revenues from fixed-line communications	**1,898,492**	1,934,495	**945,428**	968,141	3,865,046
Cellular telephone	**185,904**	185,466	**93,041**	92,806	370,706
International communications	**58,175**	53,978	**28,916**	25,459	109,207
Installation and sale of equipment to subscribers and miscellaneous	**94,850**	74,274	**41,631**	20,099	167,904
	2,237,421	2,248,213	**1,109,016**	1,106,505	4,512,863
Other revenues	**94,279**	106,977	**51,975**	52,967	210,871
	2,331,700	2,355,190	**1,160,991**	1,159,472	4,723,734

C. OPERATING AND GENERAL EXPENSES

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Salaries and related expenses –					
Operations	**570,758**	552,371	**281,287**	274,904	1,140,482
General and administrative	**170,792**	136,773	**93,471**	68,133	288,804
Total salaries and related expenses	**741,550**	689,144	**374,758**	343,037	1,429,286
General expenses	**130,373**	154,034	**65,141**	80,274	298,767
Materials and spare parts	**42,279**	38,375	**24,054**	17,485	97,294
Building maintenance	**151,274**	153,088	**75,088**	74,862	320,700
Services and maintenance by sub-contractors	**94,184**	102,987	**45,675**	52,846	195,820
International communications expenses	**13,309**	9,875	**6,061**	4,800	30,033
Vehicle maintenance expenses	**66,888**	57,407	**33,428**	28,977	128,961
Collection fees	**18,731**	18,238	**9,423**	9,441	36,735
	1,258,588	1,223,148	**633,628**	611,722	2,537,596
Less – salaries charged to investments in fixed assets	**89,992**	93,913	**41,625**	44,491	191,145
	1,168,596	1,129,235	**592,003**	567,231	2,346,451

Notes to the Financial Statements as at June 30, 2006

NOTE 12 – BUSINESS SEGMENTS

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

	For the six-month period ended June 30, 2006 (unaudited)						
	Domestic fixed-line communications	Cellular telephone	International communications and Internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS thousands						
Revenues							
Revenues from external sources	**2,190,601**	**2,178,145**	**491,819**	**660,638**	**123,924**	**–**	**5,645,127**
Inter-segment revenues	**141,099**	**7,551**	**9,929**	**8,985**	**47,675**	**(215,239)**	**–**
Total revenues	**2,331,700**	**2,185,696**	**501,748**	**669,623**	**171,599**	**(215,239)**	**5,645,127**
Segment results*	**494,734**	**294,238**	**69,049**	**(17,033)**	**5,950**	**–**	**846,938**

	For the six-month period ended June 30, 2005 (unaudited)						
	Domestic fixed-line communications	Cellular telephone	International communications and Internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS thousands						
Revenues							
Revenues from external sources	2,220,879	2,204,227	392,789	576,136	106,467	–	5,500,498
Inter-segment revenues	134,311	7,565	9,754	8,797	60,817	(221,244)	–
Total revenues	2,355,190	2,211,792	402,543	584,933	167,284	(221,244)	5,500,498
Segment results*	455,371	254,320	42,884	(49,793)	576	–	703,358

	For the three-month period ended June 30, 2006 (unaudited)						
	Domestic fixed-line communications	Cellular telephone	International communications and Internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS thousands						
Revenues							
Revenues from external sources	**1,087,813**	**1,093,204**	**251,866**	**333,640**	**59,349**	**–**	**2,825,872**
Inter-segment revenues	**73,177**	**4,067**	**5,030**	**3,936**	**23,084**	**(109,294)**	**–**
Total revenues	**1,160,990**	**1,097,271**	**256,896**	**337,576**	**82,433**	**(109,294)**	**2,825,872**
Segment results*	**255,041**	**155,010**	**35,901**	**(3,198)**	**3,603**	**–**	**446,357**

* Segment results do not include Other income (expenses), net, as stated in Note 10.

Notes to the Financial Statements as at June 30, 2006

NOTE 12 – BUSINESS SEGMENTS (CONTD.)

	For the three-month period ended June 30, 2005 (unaudited)						
	Domestic fixed-line communications	Cellular telephone	International communications and Internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS thousands						
Revenues							
Revenues from external sources	1,088,439	1,097,947	198,977	291,742	50,270	–	2,727,375
Inter-segment revenues	71,033	3,524	4,395	4,529	33,571	(117,052)	–
Total revenues	1,159,472	1,101,471	203,372	296,271	83,841	(117,052)	2,727,375
Segment results*	206,438	133,051	22,367	(25,340)	629	–	337,145

	For the year ended December 31, 2005 (unaudited)						
	Domestic fixed-line communications	Cellular telephone	International communications and Internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS thousands						
Revenues							
Revenues from external sources	4,457,189	4,413,421	795,176	1,200,865	232,035	–	11,098,686
Inter-segment revenues	266,545	14,854	21,488	20,997	104,511	(428,395)	–
Total revenues	4,723,734	4,428,275	816,664	1,221,862	336,546	(428,395)	11,098,686
Segment results*	851,273	466,165	97,978	(99,535)	1,197	–	1,317,078

* Segment results do not include Other income (expenses), net, as stated in Note 10.

Notes to the Financial Statements as at June 30, 2006

NOTE 13 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., DBS SATELLITE SERVICES (1998) LTD, AND BEZEQ INTERNATIONAL LTD.

1. PELEPHONE COMMUNICATIONS LTD.

A. Balance sheets

	June 30 2006	June 30 2005	December 31 2005
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**1,683,464**	1,632,512	1,881,982
Long-term trade receivables	**326,422**	321,600	338,281
Investment in investee companies	**4,923**	4,283	3,565
Deferred income tax	**–**	51,129	19,799
Fixed assets, net	**2,847,106**	3,061,145	3,009,219
Other assets	**338,293**	330,053	337,787
	5,200,208	5,400,722	5,590,633
Current liabilities	**1,396,101**	1,378,262	1,558,012
Long-term liabilities	**1,545,146**	1,750,652	1,666,193
Shareholders' equity	**2,258,961**	2,271,808	2,366,428
	5,200,208	5,400,722	5,590,633

NOTE 13 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., DBS SATELLITE SERVICES (1998) LTD, AND BEZEQ INTERNATIONAL LTD. (CONTD.)

1. PELEPHONE COMMUNICATIONS LTD. (CONTD.)

B. Statements of Operations

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues from Pelephone services, sales and services	**2,185,695**	2,211,792	**1,097,271**	1,101,471	4,428,277
Cost of Pelephone services, sales and services	**1,635,565**	1,686,130	**808,752**	826,979	3,415,885
Gross profit	**550,130**	525,662	**288,519**	274,492	1,012,392
Sales and marketing expenses	**201,051**	215,172	**101,821**	110,192	432,808
General and administrative expenses	**46,024**	49,968	**22,870**	25,051	107,218
	247,075	265,140	**124,691**	135,243	540,026
Operating income	**303,055**	260,522	**163,828**	139,249	472,366
Financing expenses, net	**(41,853)**	(39,448)	**(38,471)**	(29,321)	(115,264)
Other expenses (income), net	**2,185**	(107)	**778**	(65)	(1,136)
Earnings before income tax	**259,017**	221,181	**124,579**	109,993	358,238
Income tax	**66,484**	72,995	**29,356**	36,393	113,333
Earnings after income tax	**192,533**	148,186	**95,223**	73,600	244,905
Company's equity in losses of an affiliate	**–**	6,408	**–**	2,904	8,507
Net earnings	**192,533**	141,778	**95,223**	70,696	236,398

NOTE 13 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., DBS SATELLITE SERVICES (1998) LTD, AND BEZEQ INTERNATIONAL LTD. (CONTD.)

2. DBS SATELLITE SERVICES (1998) LTD.

A. Balance sheets

	June 30 2006	June 30 2005	December 31 2005
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**159,374**	137,105	154,567
Broadcasting rights, net	**188,986**	159,613	154,500
Fixed assets, net	**994,963**	1,078,155	1,047,994
	1,343,323	1,374,873	1,357,061
Current liabilities	**705,402**	604,918	613,379
Long-term liabilities	**1,399,578**	1,348,381	1,419,257
Loans from shareholders	**2,971,867**	2,764,591	2,893,024
Capital deficit	**(3,733,524)**	(3,343,017)	(3,568,599)
	1,343,323	1,374,873	1,357,061

B. Statements of Operations

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2006	2005	2006	2005	2005
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues from DBS services	**669,622**	584,933	**337,576**	296,271	1,221,863
DBS operating expenses	**575,653**	523,797	**286,959**	267,382	1,089,835
Gross profit	**93,969**	61,136	**50,617**	28,889	132,028
Sales and marketing expenses	**59,102**	66,707	**27,491**	33,284	140,665
General and administrative expenses	**45,529**	37,990	**22,919**	17,846	77,055
	104,631	104,697	**50,410**	51,130	217,720
Operating income (loss)	**(10,662)**	(43,561)	**207**	(22,241)	(85,692)
Financing expenses, net	**129,098**	100,801	**72,904**	61,382	241,335
Other expenses, net	**202**	88	**1**	8	830
Net loss	**(139,962)**	(144,450)	**(72,698)**	(83,631)	(327,857)

Notes to the Financial Statements as at June 30, 2006

NOTE 13 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., DBS SATELLITE SERVICES (1998) LTD, AND BEZEQ INTERNATIONAL LTD. (CONTD.)

3. BEZEQ INTERNATIONAL LTD.

A. Balance sheets

	June 30 2006	June 30 2005	December 31 2005
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**259,405**	285,371	366,078
Long-term investments and debit balances	**37,150**	28,194	28,702
Fixed assets	**317,449**	326,519	305,826
Other assets	**21,880**	16,522	23,625
	635,884	656,606	724,231
Current liabilities	**249,987**	220,766	401,126
Long-term liabilities	**25,754**	183,614	14,835
Shareholders' equity	**360,143**	252,226	308,270
	635,884	656,606	724,231

Notes to the Financial Statements as at June 30, 2006

NOTE 13 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., DBS SATELLITE SERVICES (1998) LTD, AND BEZEQ INTERNATIONAL LTD. (CONTD.)

3. BEZEQ INTERNATIONAL LTD.

B. Statements of Operations

	For the six-month period ended June 30		For the three-month period ended June 30		For the year ended December 31
	2006 (Unaudited)	2005 (Unaudited)	2006 (Unaudited)	2005 (Unaudited)	2005 (Audited)
	NIS thousands		NIS thousands		NIS thousands
Revenues from international telecommunication services	**501,749**	402,543	**256,897**	203,372	816,664
Operating expenses	**326,828**	266,472	**165,852**	133,637	530,806
Gross profit	**174,921**	136,071	**91,045**	69,735	285,858
Marketing, general and administrative expenses	**105,873**	93,187	**55,145**	47,368	193,297
Operating income	**69,048**	42,884	**35,900**	22,367	92,561
Financing income (expenses), net	**523**	(3,563)	**(290)**	(1,974)	(3,361)
Earnings after financing, net	**69,571**	39,321	**35,610**	20,393	89,200
Other income (expenses), net	**(195)**	46	**11**	(294)	1,377
Earnings before income tax	**69,376**	39,367	**35,621**	20,099	90,577
Tax benefit (Income tax)	**(21,851)**	9,978	**(11,047)**	3,200	15,226
Earnings after income tax	**47,525**	49,345	**24,574**	23,299	105,803
Company's equity in earnings of an affiliated company	**4,013**	1,297	**2,389**	1,093	4,583
Net earnings	**51,538**	50,642	**26,963**	24,392	110,386