"BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2001

Contents

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

Dear Sirs,

Re: **Review of the Unaudited Interim Consolidated Financial Statements for the Three Month Period Ended March 31, 2001**

At your request we have reviewed the interim consolidated balance sheet of "Bezeq" The Israel Telecommunication Corp., Limited as at March 31, 2001, as well as the interim consolidated statements of operations, changes in shareholders' equity and 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 Shareholders Meetings and of meetings of the Board of Directors and its committees, as well as making inquiries of persons responsible for financial and accounting matters.

Reports of other auditors were furnished to us which relate to the review of the interim financial statements of subsidiaries whose assets constitute approximately 4.67% of total consolidated assets as at March 31, 2001 and whose revenues constitute approximately 9.57% of the total consolidated revenues for the three months then ended. Furthermore, the data included in the financial statements relating to the net asset value of the Company's investments in affiliates and its equity in their operating results is based on their interim financial statements reviewed by other auditors.

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

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

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

1. The anticipated opening of the communications sector to competition, changes in tariffs and their effect on the Company's financial position and operating results, as described in Note 1.
2. A plan for further organizational change, as described in Note 5.
3. Claims made against the Company and against investee companies, as described in Note 6A.
4. The financial situation of an affiliated company, as explained in Note 4C.

Yours truly,

Somekh Chaikin
Certified Public Accountants (Isr.)

May 29, 2001

Interim Consolidated Balance Sheet

In terms of shekels of March 2001

	March 31, 2001 (Unaudited)	March 31, 2000 (Unaudited)	December 31, 2000 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets			
Cash and cash equivalents	1,108,394	436,853	1,525,416
Short-term investments	217,994	136,346	187,452
Trade receivables	1,385,742	1,383,581	1,366,095
Other receivables and debit balances	461,439	601,586*	473,650
Inventory	169,566	107,902	133,770
	3,343,135	2,666,268	3,686,383
Materials and spare parts	197,771	192,864	184,282
Investments and long-term receivables	1,320,098	261,574	288,085
Deposits and debit balances	313,966	155,837	171,835
Investee companies			
	1,634,064	417,411	459,920
Fixed assets	29,115,778	28,932,211	28,900,493
Cost	17,963,332	16,671,632	17,349,821
Less - accumulated depreciation			
	11,152,446	12,260,579	11,550,672
Other assets			
Deferred and other charges	383,225	295,010	376,248
Deferred taxes	603,020	188,185	630,262
	986,245	483,195	1,006,510
	17,313,661	16,020,317	16,887,767

*Reclassified

	March 31, 2001 (Unaudited)	March 31, 2000 (Unaudited)	December 31, 2000 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Current liabilities			
Short-term bank credit	849,645	449,791	731,561
Current maturities of:			
Debenture issued to the Government of Israel	-	234,998	-
Long-term bank loans	1,038,339	1,062,282	375,748
Other debentures	229,129	208,634	223,496
Trade payables	895,361	866,751	1,041,787
Employee severance benefits	336,796	234,489	343,101
Other current liabilities	987,975	870,727*	962,667
	4,337,245	3,927,672	3,678,360
Long-term liabilities			
Long-term loans	2,151,610	3,222,133	2,811,026
Other debentures	2,505,732	1,139,157	2,141,593
Employee severance benefits	1,249,493	67,315	1,245,495
Deferred taxes	3,785	22,144	14,362
Deferred revenues	67,387	76,047	69,461
	5,978,007	4,526,796	6,281,937
Convertible debentures	-	82,768	67,760
Contingent liabilities			
Shareholders' equity	6,998,409	7,483,081	6,859,710
	17,313,661	16,020,317	16,887,767

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

Date of approval of the financial statements: May 29, 2001

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

Interim Consolidated Statement of Operations
In terms of shekels of March 2001

	For the three months ended March 31,		For the year ended December 31,
	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from telecommunications services (Note 8)	2,030,166	2,245,283*	8,361,316
Costs and expenses			
Operating and general expenses (Note 9)	1,045,492	1,229,761*	4,262,969
Depreciation	644,261	677,732	2,687,134
Royalties to the Government of Israel	79,465	81,491	313,025
	1,769,218	1,988,984	7,263,128
Operating income	260,948	256,299	1,098,188
Financing expenses, net	51,806	130,846	341,563
Earnings after financing expenses	209,142	125,453	756,625
Other income (expenses), net	15,995	89,910	(1,266,456)
Earnings (loss) before income tax	225,137	215,363	(509,831)
Tax benefit (income tax)	(97,627)	(95,674)	152,576
Earnings (loss) after income tax	127,510	119,689	(357,255)
Equity in losses of affiliated companies	58,506	26,315	194,208
Minority share in losses of consolidated company	1,918	-	4,872
Net earnings (loss)	70,922	93,374	(546,591)
Primary and diluted earnings (loss) per NIS 1 par value of common shares (in NIS)	0.029	0.040**	(0.225)

* Reclassified
** Restated due to issue of bonus shares.

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

Interim Statement of Changes in Shareholders' Equity

In terms of shekels of March 2001

	Share capital	Capital reserve for distribution of bonus shares	Share premium capital reserve	Capital reserve in respect of transactions between the Company and a controlling shareholder	Retained earnings	Total
Three months ended March 31, 2001						
As at December 31, 2000 (audited)	4,127,323	1,590,714	819,175	35,476	287,022	6,859,710
Net earnings (unaudited)	-	-	-	-	70,922	70,922
Conversion of convertible debentures (unaudited) (1)	5,905	-	61,872	-	-	67,777
Distribution of bonus shares (unaudited) (4)	1,611,003	(1,590,714)	-	-	(20,289)	-
Balance as at March 31, 2001 (unaudited)	5,744,231	-	881,047	35,476	337,655	6,998,409
Three months ended March 31, 2000						
Balance as at December 31, 1999 (audited)	4,112,740	-	648,682	35,476	2,425,741	7,222,639
Net profit (unaudited)	-	-	-	-	93,374	93,374
Erosion of dividend offered in a previous year and paid this year (unaudited)	-	-	-	-	(1,414)	(1,414)
Tax benefit in respect of shares to employees (unaudited)	-	-	21,653	-	-	21,653
Conversion of convertible debentures (unaudited) (2)	13,107	-	133,722	-	-	146,829
Balance as at March 31, 2000 (unaudited)	4,125,847	-	804,057	35,476	2,517,701	7,483,081
Year ended December 31, 2000						
Balance as at December 31, 1999 (audited)	4,112,740	-	648,682	35,476	2,425,741	7,222,639
Net loss (audited)	-	-	-	-	(546,591)	(546,591)
Erosion of dividend offered in a previous year and paid this year(audited)	-	-	-	-	(1,414)	(1,414)
Tax benefit in respect of shares to employees (audited)	-	-	21,653	-	-	21,653
Conversion of convertible debentures (audited) (3)	14,583	-	148,840	-	-	163,423
Capitalization of undesignated earnings to a reserve fund for the distribution of bonus shares (audited) (4)	-	1,590,714	-	-	(1,590,714)	-
Balance as at December 31, 2000 (audited)	4,127,323	1,590,714	819,175	35,476	287,022	6,859,710

(1) 59,754,681 par value convertible debentures were converted into 5,904,612 ordinary shares with a par value of NIS 1 each.
(2) 132,655,287 par value convertible debentures were converted into 13,108,230 ordinary shares with a par value of NIS 1 each.
(3) 147,652,429 par value convertible debentures were converted into 14,590,161 ordinary shares with a par value of NIS 1 each.
(4) See Note 7

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

Interim Consolidated Statement of Cash Flows

In terms of shekels of March 2001

	For the three months ended March 31,		For the year ended December 31,
	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Cash flows generated by operating activities			
Net earnings (loss)	70,922	93,374	(546,591)
Adjustments to reconcile net earnings (loss) to net cash flows generated by operating activities (see A below)	754,584	611,810	3,795,908
Net cash inflow generated by operating activities	825,506	705,184	3,249,317
Cash flows generated by investing activities			
Acquisition of fixed and other assets	(390,814)	(527,947)	(1,717,236)
Proceeds from disposal of fixed assets	11,589	4,954	34,426
Proceeds from disposal of investment in affiliated company	-	-	170,287
Investment in investee companies	(200,637)	(107,022)	(323,138)
Investment in deposits and long-term investments	(1,010,811)	(15,932)	(59,535)
Disposal of deposits and long-term investments	3,894	30,854	59,727
Decrease (increase) in short-term investments, net	(27,448)	166,796	115,139
Decrease (increase) in materials and spare parts. Net	(9,022)	14,255	57,677
Investments in other assets	(54,310)	(71,618)	(261,720)
Net cash flow used for investing activities	(1,677,559)	(505,660)	(1,924,373)
Cash flows generated by financing activities			
Repayment of debentures issued to the Government of Israel	-	(235,435)	(469,322)
Issue of other debentures (after deduction of issue expenses)	501,005	-	1,088,513
Repayment of other debentures	(111,192)	(127,859)	(225,152)
Receipt of long-term loans	1,940	304,793	799,027
Repayment of long-term loans	(74,806)	(243,767)	(1,813,961)
Receipt of short-term bank credit., net	118,084	180,105	461,875
Dividend paid	-	(301,510)	(301,510)
Net cash flows generated by (used for) financing activities	435,031	(423,673)	(460,530)
Increase (decrease) in cash and cash equivalents	(417,022)	(224,149)	864,414
Cash and cash equivalents at the beginning of the period	1,525,416	661,002	661,002
Cash and cash equivalents at the end of the period	1,108,394	436,853	1,525,416

The notes to the financial statements are integral part thereof.

Interim Consolidated Statement of Cash Flows (contd.)

In terms of shekels of March 2001

	For the three months ended March 31,		For the year ended December 31,
	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands	NIS thousands	NIS thousands
A - Adjustments to reconcile net earnings (loss) to net cash flows generated by operating activities			
Revenues and expenses not involving cash flows:			
Depreciation	644,261	677,732	2,687,134
Provision for decrease in value of fixed assets	-	-	10,959
Deferred taxes	14,548	95,047	(306,692)
Company's equity in losses of investee companies, net	58,506	26,315	194,208
Minority share in losses of a consolidated company	(1,918)	-	(4,872)
Increase (decrease) in employee severance benefits, net	(2,307)	(125,751)	1,161,040
Gain on disposal of fixed assets	(18,095)	(495)	(1,334)
Gain on disposal of investment in an affiliate	-	-	(138,061)
Erosion (appreciation) of and interest on long-term deposits and investments and forward transactions	(76,806)	29,186	15,350
Appreciation of short-term investments, net	(3,094)	(3,468)	(2,918)
Appreciation (erosion) of long-term liabilities:			
Debenture issued to the Government of Israel	-	1,772	662
Other debentures	(20,041)	3,715	26,808
Long-term loans	82,093	(53,104)	(73,429)
Amortization of deferred charges and other adjustments	49,269	29,900	149,728
Changes in asset and liability items:			
Decrease (increase) in trade receivables	(2,812)	132,498	150,413
Decrease (increase) in other receivables and debit balances	39,120	(144,354)*	(82,184)
Decrease (increase) in inventory	(34,575)	5,607	(14,642)
Decrease in trade payables	(14,561)	(84,913)	(86,273)
Increase in other current liabilities	43,070	24,472*	118,946
Decrease in deferred revenues	(2,074)	(2,349)	(8,935)
	754,584	611,810	3,795,908
B - Non-cash transactions			
Acquisition of fixed assets, materials and spare parts on credit	181,718	123,446	299,566
Sale of fixed assets on credit	24,468	22,939	8,815

* Reclassified

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

Notes to the Interim Consolidated Financial Statements as at March 31, 2001 (Unaudited)

NOTE 1 - GENERAL

A. The interim statements have been prepared in accordance with generally accepted accounting principles, applicable to the preparation of interim periodic financial statements. These statements should be read in conjunction with the Company's annual financial statements and accompanying notes as at December 31, 2000 and for the year then ended.

B. The Company presents in the notes to the interim financial statements only the significant changes in its business and legal environment which occurred between the date of the previous annual financial statements and the date of these interim financial statements. The extensive and detailed description, including significant changes and developments which occurred in recent years, particularly in the fields of cellular services, international communications services, domestic communications services, the opening of these markets to competition, and the decisions of the Ministerial Committee for Privatization to reduce the State's holdings in the Company, appears in Note 1 to the Company's annual financial statements as at December 31, 2000. The significant changes which occurred from the date of the annual financial statements to the date of these financial statements are detailed below:

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

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

3. According to a notice from the Company to the cellular communication service operators, (hereinafter - the Operators), starting on March 1, 2000, the arrangement between them for billing was canceled and a new arrangement was introduced, whereby the Company transfers to the Operators only the amounts which it actually collects in respect of airtime, less a collection commission (in the previous arrangement, money was transferred on the basis of customer charges without deducting a collection commission). The Operators opposed the change, and one operator filed a claim in the District Court, in which it requested that the Company be ordered to continue the previous arrangement. The court dismissed the claim and confirmed the validity of the new arrangement as introduced by the Company. The Operator has appealed in the Supreme Court. Concurrently, the Company and the Operators are negotiating in an attempt to settle the dispute.

   As a result of the aforementioned change in the billing arrangements, since March 1, 2000, the cellular revenues and expenses of the Company do not include airtime. Airtime included in revenues and expenses from cellular in the corresponding report period last year are approximately NIS 290 million.

4. On April 29, 2001 the Anti-Trust Commissioner rescinded the announcement naming Bezeq International Ltd. a monopoly in the provision of international telephone services.

Notes to the Interim Consolidated Financial Statements as at March 31, 2001 (Unaudited)

NOTE 2 - ACCOUNTING POLICIES

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

Restatement

The Company adjusted, by way of restatement, its unaudited consolidated interim financial statements for the period ended March 31, 2000, so as to reflect therein, retroactively, amendment of the accounting treatment in the capitalization of the costs of acquiring subscribers at Pelephone Communications Ltd. - a proportionally consolidated company. In its original statements, until 1999, Pelephone Communications Ltd. charged subscriber acquisition costs to profit and loss. Starting with the statements for the year ended December 31, 1999, the costs of subscriber acquisition also for the years up to 1999 appear in the balance sheet under the Other assets and are depreciated over 36 months. Amended statements for the period ended March 31, 2000 were published on August 15, 2000.

(1) Effect on the consolidated balance sheet as at December 31, 1999

	As previously reported*	Influence of restatement	As reported in these financial statements
	NIS thousands	NIS thousands	NIS thousands
Deferred and other expenses	293,859	1,146	295,005
Long-term liabilities – deferred taxes	21,730	414	22,144
Shareholders' equity	7,482,226	732	7,482,958

(2) Effect on net earnings

	For the three month period ended March 31, 2000
	(Unaudited)
	NIS thousands
Net earnings as previously reported*	94,091
Influence of restatement:	
Increase in operating and general expenses	(1,120)
Decrease in taxes on income	403
	93,374

(3) Effect on net earnings per NIS 1 par value

	For the three month period ended March 31, 2000
	(Unaudited)
	NIS
Net earnings per NIS 1 par value of shares, as previously reported*	0.04**
Net earnings per NIS 1 par value of shares, as reported in these financial statements	0.04**

* Refers to the interim consolidated financial statements (unaudited) for the period ended March 31, 2000, prior to adjustment of the financial statements by way of restatement.

** Restated due to the issue of bonus shares.

NOTE 3 - FINANCIAL STATEMENTS IN ADJUSTED VALUES

The financial statements were prepared on the basis of historical cost adjusted for the changes in the general purchasing power of the Israeli currency. Below are the changes which occurred in the Consumer Price Index and the U.S. dollar exchange rates:

	Consumer Price Index	U.S. dollar exchange rates	Euro exchange rates
	%	%	%
In the three month period ended on			
March 31, 2001	(0.49)	3.74	(1.93)
March 31, 2000	(1.22)	(3.06)	(7.81)
In the year ended December 31, 2000	0.00	(2.69)	(9.87)

NOTE 4 - INVESTMENTS IN INVESTEE COMPANIES

A. PELEPHONE COMMUNICATIONS LTD. ("PELEPHONE")

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

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

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

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

3. The Company can exercise the Options within six months of the date of purchase of the shares ("the Short Option") or starting from the end of 24 months from the date of purchase of the shares until the elapse of four years from the date of the purchase ("the Long Option").

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

NOTE 4 - INVESTMENTS IN INVESTEE COMPANIES (CONTD.)

B. EMITEL TELECOMMUNICATION CORP. LTD.

In December 2000, Aphrodite B.V. ("Aphrodite"), which is indirectly held by the Company (66.7%), signed an agreement for the sale of all its holdings in Emitel. In consideration, Aphrodite will receive a sum calculated according to a stipulated formula and which will not be less than 46.5 million US dollars. Closing of the transaction is contingent upon receipt of approvals from the Hungarian Minister of Communications (granted in February 2001) and from the Hungarian Anti-Trust Authority, which has not yet been granted. The indirect investment in Emitel is recorded in the Company's books of account at equity value, and amounts to approximately NIS 45 million as at March 31, 2001. If the sale is executed, the Company can expect to include in its financial statements a pre-tax capital gain of about NIS 85 million.

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

The Company holds 30% of the shares of D.B.S. Satellite Services (1998) Ltd. (hereinafter - DBS). In January 1999, DBS received a license from the Ministry of Communications for satellite television broadcasts, in exchange for payment of NIS 30 million and a guarantee in the amount of NIS 30 million. DBS foresees considerable losses and negative cash flow from operations in the first years of its activities. Its losses in 2000 amounted to approximately NIS 541 million, and for the three months ended March 31, 2001 amounted to approximately NIS 183 million. These losses have led to an increase in its working capital deficit to NIS 855 million (including NIS 567 million in short-term bank credit). The sources of finance for DBS's operations are shareholders' loans and bank credit.

According to a decision of the Ministerial Committee for Privatization on January 21, 2001, the maximum cumulative exposure of the Company in connection with this investment shall at no time exceed the rate of the Company's actual holding in DBS, multiplied by $400 million (approximately NIS 1.6 billion). The Committee also approved an increase of the Company's holding in DBS to 50% of DBS's share capital, the approval being contingent upon amendment of the Telecommunications Regulations (or the Telecommunications Law) in the matter of limitations on a holding of means of control in DBS by anyone who is a controlling interest in a broadcasting franchisee. The Regulations were amended on March 14, 2001. The Company applied for a further amendment of the decision of the Ministerial Committee for Privatization, which would enable it to inject funds at the maximum rate of holding permitted (50%) rather than at the actual rate of holdings, and to increase the Company's permitted maximum cumulative exposure to the percentage of its holdings multiplied by $480 million.

On August 1, 2000, DBS signed a memorandum of terms with banks, which indicates the terms and stipulations likely to be included in a financing agreement between them and under which the banks will be willing to consider consenting in principle to participate in the financing of DBS's operations. The memorandum states, inter alia, preconditions for drawing funds from the credit line, including an undertaking by DBS to comply with cumulative milestones. The memorandum also states: "If the financing agreement is not signed by September 30, 2000, this memorandum shall not be valid." In the period from October 1, 2000 to the date of signing the financial statements, the signatory banks to the above memorandum made another NIS 156 million of credit available to DBS. DBS management estimates, following the agreement reached between certain shareholders in connection with their proportional part in the injection of additional funds, that most of the obstacles which gave rise to the delay in signing the financing agreement have now been removed.

The Company has presented the banks with a continuing guarantee for payment of the debts of DBS, up to a maximum of 30% of the value as DBS as derives from disposal of the pledged shares of the other shareholders. If the Company participates in a sale as part of disposal of the pledged shares of the other shareholders, the amount of the guarantee will not exceed the consideration which the Company will receive from the sale of its shares in DBS. The deed of guarantee includes numerous restrictions on the Company in disposing of the shares it holds, and specifies infringing events which enable the banks to foreclose on the guarantee.

NOTE 4 - INVESTMENTS IN INVESTEE COMPANIES (CONTD.)

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

On May 23, 2001 (after approval of the financial statements of DBS as at March 31, 2001), the financing agreement with the banks was signed. Concurrently with signing the financing agreement, the Company, together with some of the other shareholders in DBS, signed a deed of undertaking in favor of the banks, which includes, inter alia, an undertaking to inject additional funds into DBS at the same time as the banks, and after signing, the banks made another NIS 78 million of credit available. However, the financing agreement will take effect only when the Company's deed of undertaking, appended thereto, takes effect, when the Company's actual holdings in DBS are increased, or alternatively, when the decision of the Ministerial Committee for Privatization is further amended as requested by the Company.

On May 6, 2001, the Anti-Trust Authority notified the Company that in view of the domestic operator license received by a company in the Eurocom Group, as a result of which the Company and the Eurocom Group can be seen as competitors, the cross-holding of the companies in DBS, which is a major part in a communications joint venture, is liable to reduce the competition between them and as such, can be construed as constituting a cartel. The parties were requested to act as quickly as possible to approve their joint venture in one of the ways prescribed in the Anti-Trust Law. The Anti-Trust Commissioner also stated that without derogating from the aforesaid, he was willing to try to arrive at an agreed solution within 60 days. In response, the Company notified the Anti-trust Commissioner that the partnership between it and Eurocom in the satellite enterprise does not constitute a cartel, that all its activities in this field were accomplished in accordance with lawful approvals, and that without derogating therefrom, it has no objection to discussing and clarifying the matter with the Commissioner. A first meeting on the subject was held shortly after the dispatch of the Company's response.

In July 2000, DBS completed the development stage and started to provide its customers with multi-channel satellite broadcasting services.

The Company's investment in DBS as at the date of the balance sheet is approximately NIS 459 million. The Company's equity in the cumulative loss of DBS is approximately NIS 242 million, of which about NIS 54 million were recorded in the report period.

NOTE 5 - EMPLOYEE SEVERANCE BENEFITS

EARLY RETIREMENT PLAN

A. As part of the plan for organizational change in the Company, which was approved by the Board of Directors in March 2000, between December 31, 1999 and March 31 2001, 396 employees retired from the Company.

B. In the wake of privatization of the Company and the opening of the telecommunications market to competition, additional workforce changes are required at the Company; accordingly, the Company reached agreement with the workers' representatives in September 2000, to extend the early retirement collective agreement from 1997. The new arrangement states that from April 1, 2001 to December 31, 2006 (with an option to extend the final retirement date for certain employees to December 31, 2008), another 1,770 employees will take early retirement. Furthermore, pursuant to the agreement, the Company's management will be able to dismiss employees under a compensation arrangement over and above the number stated in the agreement.

NOTE 5 - EMPLOYEE SEVERANCE BENEFITS (CONTD.)

EARLY RETIREMENT PLAN (CONTD.)

B. (Contd.)

The financial statements for the year 2000 include an expense of approximately NIS 1,371 million in respect of the expected cost of implementation of this plan. The Company's management estimates that the possibility of additional employees retiring under a compensation arrangement is slight, and accordingly, no provision was made therefor in the financial statements.

NOTE 6 - CONTINGENT LIABILITIES

A. Claims and contingent liabilities

The Company and investee companies have contingent liabilities in respect of which the maximum possible exposure is considerable. A detailed description of these contingent liabilities appears in Note 21A to the annual financial statements of the Company as at December 31, 2000. No material changes occurred in the contingent liabilities up to the date of signing these financial statements, except for the following:

1. Further to Note 21A(4) to the financial statements of December 31, 2000 concerning a class action in which the plaintiff alleges that the tariffs for international telecommunications services in the years 1996 and 1997 were exorbitant and unreasonable, the Supreme Court allowed the appeal of the Company and Bezeq International Ltd. and the decision of the District Court in the matter of approval of the action as a class action was overruled. The class action was stricken, while reserving the right of the plaintiff to file it anew and while retaining all the allegations of the litigants.

2. Further to Note 21A(21) to the financial statements of December 31, 2000, the (first) action was amended, as was the application for approval of the action as a class action, so that the amount of the action is now estimated at more than one billion shekels (rather than about 750 million shekels as in the original application). In addition, the application for combining the hearing of the two claims referred to in the Note was approved, and the plaintiffs are required to file a revised statement of claim.

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

4. Further to Note 21A(26) to the financial statements of December 31, 2000, concerning the provision of a blocking service for every Company telephone line subscriber against outgoing calls to the area code of mobile phones, as a positive default, the Company gave notice that it does not oppose providing such a service, but emphasized that it would require the approval of the Ministry of Communications. The Ministry of Communications stated that it sees no room for approving a block to cellular phones or for the promulgation of regulations in the matter.

5. On May 10, 2001 a claim was served on an affiliate in which the plaintiff alleges that the affiliate is misleading consumers in its advertisements in connection with the possibility for the consumer to purchase certain channels only, and with regard to the number of channels offered. It is also alleged that the affiliate requires its subscribers to consume a maximum channel package even if they do not choose that package.

NOTE 6 - CONTINGENT LIABILITIES (CONTD.)

A. Claims and contingent liabilities (Contd.)

5. (Contd.)

The plaintiff filed the claim as the representative of the subscribers of the affiliate, and together with the claim also filed an application for recognition of the claim as a class action under the Consumer Protection Law. The alleged personal losses of the plaintiff are negligible, and the sum stated as accumulated loss for all members of the class is approximately NIS 177 million. The Court ordered the affiliate to respond to the application within 20 days of its submission to it, i.e. by May 30, 2001. The affiliate has not yet filed its response, and intends to file an application for dismissal of the claim. The legal advisers of the affiliate believe that the company has a good defense against the action as a class action.

B. Forward Exchange Contracts

The Company has entered into forward exchange contracts as a hedge against exposure resulting from changes in the exchange rate of the US dollar in relation to changes in the CPI. As at March 31, 2001, the Company contracted to purchase approximately US $305 million (approximately NIS 1,278 million) for which it will pay approximately NIS 1,248 million linked to the CPI, and approximately 76 million euros (approximately NIS 281 million), for which it will pay approximately NIS 277 million linked to the CPI. The contracts mature on various dates, the last of which is May 2002. The Company also contracted to purchase approximately US $199 million (approximately NIS 836 million), for which it will pay approximately NIS 826 million at predetermined rates, and approximately 225 million euros (NIS 830 million), for which it will pay approximately NIS 854 million at predetermined rates, and approximately NIS 477 million linked to the CPI, for which it will pay approximately NIS 482 million.

NOTE 7 - SHARE CAPITAL

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

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

Notes to the Interim Consolidated Financial Statements as at March 31, 2001 (Unaudited)

NOTE 8 - REVENUES FROM TELECOMMUNICATION SERVICES

	For the three months ended March 31,		For the year ended December 31,
	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from telephone services -			
Domestic fixed-line communications	609,995	666,924	2,513,398
Cellular telephone (1)	493,133	658,563	2,135,089
Usage fees	513,649	490,680	1,978,965
International communications and Internet services	191,533	202,575*	842,248
Installation and sale of equipment to subscribers	111,551	130,786	493,852
Other	36,070	39,741	139,705
	1,955,931	2,189,269	8,103,257
Other revenues	74,235	56,014	258,059
	2,030,166	2,245,283	8,361,316

NOTE 9 - OPERATING AND GENERAL EXPENSES

	For the three months ended March 31,		For the year ended December 31,
	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses	464,440	436,792	1,668,018
Cellular telephone expenses (1)	71,887	287,399	507,246
General expenses	171,041	162,319*	677,005
International communications expenses	57,766	67,915	249,842
Materials and spare parts	111,595	94,939	416,065
Building maintenance	99,450	94,815	386,767
Services and maintenance by sub-contractors	76,247	98,229	396,165
Vehicle maintenance expenses	19,389	16,576	72,245
Collection fees	9,210	9,623	38,818
	1,081,025	1,268,607	4,412,171
Less - salaries charged to investment in fixed assets	35,533	38,846	149,202
	1,045,492	1,229,761	4,262,969

(1) See Note 1B(3)

* Reclassified

NOTE 10 - CONDENSED INTERIM FINANCIAL STATEMENTS OF THE COMPANY

A. STATEMENTS OF OPERATIONS

	For the three months ended March 31,		For the year ended December 31,
	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from telecommunication services (Note 10B)	1,484,068	1,765,722	6,221,813
Costs and expenses			
Operating and general expenses (Note 10C)	590,989	871,471	2,523,827
Depreciation	534,491	562,942	2,235,358
Royalties to the Government of Israel	51,399	53,488	199,897
	1,176,879	1,487,901	4,959,082
Operating income	307,189	277,821	1,262,731
Financing expenses, net	28,916	117,005	292,904
Earnings after financing expenses	278,273	160,816	969,827
Other income (expenses), net	18,246	105,454	(1,226,852)
Earnings before taxes on income	296,519	266,270	(257,025)
Tax benefit (income tax)	(112,496)	(96,156)	138,116
Earnings (loss) after taxes on income	184,023	170,114	(118,909)
Company's equity in losses of investee companies	113,101	76,740*	427,682
Net earnings (loss)	70,922	93,374	(546,591)

* Reclassified, see Note 2

Notes to the Interim Consolidated Financial Statements as at March 31, 2001 (Unaudited)

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

B. REVENUES FROM TELEPHONE SERVICES

	For the three months ended March 31,		For the year ended December 31,
	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from communication services -			
Domestic fixed-line calls	615,350	671,478	2,534,214
Cellular telephone (1)	159,211	396,434	838,388
Usage fees	487,922	460,223	1,873,195
International communications	79,548	88,583	386,575
Installation and sale of equipment to subscribers	37,237	55,279	210,254
Other	36,204	40,121	143,420
	1,415,472	1,712,118	5,986,046
Other revenues	68,596	53,604	235,767
	1,484,068	1,765,722	6,221,813

C. OPERATING AND GENERAL EXPENSES

	For the three months ended March 31,		For the year ended December 31,
	2001 (Unaudited)	2000 (Unaudited)	2000 (Audited)
	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses	368,893	354,816	1,306,266
Cellular telephone expenses (1)	---	289,959	301,363
General expenses	57,433	57,817	232,511
International communications expenses	2,558	3,022	12,086
Materials and spare parts	19,106	8,089	38,831
Building maintenance	87,000	84,366	342,216
Services and maintenance by sub-contractors	65,705	88,273	339,056
Vehicle maintenance expenses	16,644	14,475	62,108
Collection fees	9,183	9,500	38,594
	626,522	910,317	2,673,031
Less - salaries charged to investment in fixed assets	35,533	38,846	149,204
	590,989	871,471	2,523,827

(1) See Note 1B(3).

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

1. BEZEQ INTERNATIONAL LTD.

A. Balance sheet

	March 31, 2001	March 31, 2000	December 31, 2000
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	289,665	323,929	265,484
Investments	34,158	23,219	37,981
Fixed assets	362,617	326,827	357,934
Other assets	16,504	16,142	18,111
	702,944	690,117	679,510
Current liabilities	465,574	385,962	496,969
Long-term liabilities	115,990	-	32,581
Quasi-capital receipt	157,703	157,703	157,703
Shareholders' equity (deficit)	(36,323)	146,452	(7,743)
	702,944	690,117	679,510

B. Statement of Operations

	For the three month period ended March 31,		For the year ended December 31,
	2001	2000	2000
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from international telecommunications services	161,098	174,416*	668,420
Operating expenses	125,556	152,059	557,177
Gross profit	35,542	22,357	111,243
Marketing expenses	30,972	35,908	164,583
General and administrative expenses	24,781	20,725*	94,821
	55,753	56,633	259,404
Operating loss	(20,211)	(34,276)	(148,161)
Financing income (expenses), net	(3,046)	1,723	(3,164)
Loss after financing, net	(23,257)	(32,553)	(151,325)
Other expenses, net	(1,500)	(14,640)	(39,523)
Loss before taxes on income	(24,757)	(47,193)	(190,848)
Income tax	-	-	(1,612)
Loss after taxes on income	(24,757)	(47,193)	(192,460)
Company's equity in losses of investee company	(3,823)	(1,480)	(10,408)
Net loss	(28,580)	(48,673)	(202,868)

* Reclassified

Notes to the Interim Consolidated Financial Statements as at March 31, 2001 (Unaudited)

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

2. PELEPHONE COMMUNICATIONS LTD.

A. Balance sheets

	March 31, 2001	March 31, 2000	December 31, 2000
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	1,199,049	949,002	1,124,457
Long-term trade receivables	87,459	39,717	70,908
Investment in affiliate	381	-	1,433
Reserve for compensation fund, net	-	2,529	-
Fixed assets, net	2,809,179	2,559,525	2,849,022
Other assets	691,836	538,790	676,113
	4,787,904	4,089,563	4,721,933
Current liabilities	2,249,673	1,528,424	2,073,509
Provision for losses of investee company	-	6,377	-
Long-term liabilities	739,869	584,662	789,676
Shareholders' equity	1,798,362	1,970,100	1,858,748
	4,787,904	4,089,563	4,721,933

B. Statements of Operations

	For the three month period ended March 31,		For the year ended December 31,
	2001	2000	2000
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Revenues from Pelephone services, sales and services	869,520	824,689	3,425,369
Cost of Pelephone services, sales and services	743,179	668,647	2,862,320
Gross profit	126,341	156,042	563,049
Sales and marketing expenses	123,536	90,184	446,201
General and administrative expenses	51,027	50,314	199,150
	174,563	140,498	645,351
Operating income (loss)	(48,222)	15,544	(82,302)
Financing expenses, net	39,469	34,785	97,524
Other expenses (revenues), net	(539)	249	(1,707)
Loss before taxes on income	(87,152)	(19,490)	(178,119)
Tax benefit	24,939	5,207	51,190
Loss after taxes on income	(62,213)	(14,283)	(126,929)
Minority equity in losses of a consolidated company	3,835	-	9,743
Company equity in losses of an affiliate	2,008	2,419	10,870
Net loss	(60,386)	(16,702)	(128,056)