Chapter B of the Periodic Report

Directors' Report on the State of the Company's Affairs
For the six month period ended June 30, 2008

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

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

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

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

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

The net earnings in the six-month period amounted to NIS 798 million, compared to net earnings of NIS 725 million in the corresponding period in 2007. The increase in net earnings is due to an increase in earnings in all segments with the exception of the multi-channel television segment, where there was an increase in the loss. See below for further details.

1. Financial position

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

B. The Group's assets on June 30, 2008, amounted to NIS 14.51 billion, compared to NIS 16.58 billion on June 30, 2007. Of these, NIS 5.97 billion (41%) are property, plant and equipment, compared to NIS 6.21 billion (37%) on June 30, 2007.

The decrease is due to the domestic fixed-line communications segment. There was a decline in total assets in this segment, not including investment in subsidiaries, compared to the corresponding period in the prior year, in the amount of NIS 2.71 billion, mainly due to the decrease in cash and cash equivalents and the sale of financial assets held for trading which were used for financing and investment activities. In addition, there was a decrease in the net book value of property, plant and equipment resulting from the difference between the depreciation expense and investment made during the reporting period. The decrease in total assets was offset by an increase in trade receivables, mainly due to the transition from advanced billing of fixed user fees for telephone lines to retroactive billing.

In the cellular segment, assets increased from NIS 4.13 billion on June 30, 2007 to NIS 4.57 billion on June 30, 2008. The increase was mainly due to an increase in the cash balances and frequency rights. Additionally, there was an increase in the trade receivables balance mainly due to the discounting of credit card payments. On the other hand, there was a reduction in the tax asset due to the sale of the asset recorded in the past for losses.

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

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

C. The equity attributable to the shareholders of the Company on June 30, 2008, amounted to NIS 4.72 billion, representing 32% of the total balance sheet, the same as the shareholders' equity on June 30, 2007, which represented 28% of the total balance sheet. During the period, a dividend was paid in the amount of NIS 1.44 billion, similar to the earnings in this period.

D. Group debt to financial institutions and debenture holders on June 30, 2008, amounted to NIS 6.28 billion, compared to NIS 8.06 billion on June 30, 2007.The decrease is mainly due to repayment of debentures in the amount of NIS 2.34 billion in the domestic fixed line communications segment. Total repayment of debentures and loans in the Group amounted to NIS 3.23 billion.

The decrease was offset mainly by the sale of debentures in the amount of NIS 443 million to institutions in the domestic fixed-line communications segment and issue of debentures in the amount of NIS 644 million in the multi-channel television segment in July 2007.

The Company's auditors have highlighted the financial position of DBS in the financial statements. As mentioned in Note 6, as of June 30, 2008, the subsidiary meets the financial criteria set for it, following the amended stipulations in respect of 2008 placed upon it by the banks on March 5, 2008, and June 25, 2008 as adapted to the subsidiary's 2008 annual budget and to certain prescribed operational data. The continuation of the operations of DBS is also conditional on compliance with conditions set for 2008 and/or further relief to be received during the year. The management of DBS believes that the financial resources available to it will be sufficient for its operational requirements in the coming year based on the forecasted cash flow approved by the board of directors of DBS.

E. The Group's cash and other current investment balances on June 30, 2008, amounted to approximately NIS 806 million compared to approximately NIS 3.071 billion on June 30, 2007. The decrease is mainly due to a decrease in the cash balances and the sale of securities held for trading in the domestic fixed-line communications segment, which were used for financing and investment activities. The decrease was offset by the positive cash flows from current operations in the principal segments of the Group's operations.

2. Results of operations

A. Principal results

Net earnings attributable to the shareholders of the Company for the first half of 2008 amounted to approximately NIS 835 million, compared to net earnings of approximately NIS 760 million in the corresponding period in the prior year.

Below are details of the changes in the results of the segments compared to the corresponding period in the prior year.

Segment	**Six months ended June 30, 2008 NIS millions Operating profit**	**Six months ended June 30, 2007 NIS millions Operating profit**
Domestic fixed-line communications	796	612
Cellular	481	453
International communications, internet services and NEP	117	104
Multi-channel television	69	56
Others	1	2
Total	1,464	1,227

Basic diluted earnings per share in the first half of 2008 amounted to NIS 0.32 per NIS 1.00 par value compared to NIS 0.29 per NIS 1 par value share in the corresponding period in the prior year.

B. Revenue

Group revenue in the first half of 2008 amounted to approximately NIS 6.19 billion compared to approximately NIS 6.14 billion in the corresponding period in the prior year.

Revenue from fixed-line domestic communications decreased from approximately NIS 2.84 billion in the first half of 2007 to approximately NIS 2.76 billion in the reporting period. The decrease in the segment's revenue is due to a decrease in interconnect fees to the cellular networks (as well as a decrease in expense). An additional decrease is due to a decrease in the number of lines (mainly due to number portability), a reduction in call traffic and a decrease in tariffs in June 2007 and June 2008. The decrease in revenue was moderated mainly by ongoing growth in revenues from high-speed internet service (ADSL) and by an increase in income from data communication services. The Company's auditors continue to draw attention to the growing competition, changes in the in the communications market and the impact of regulation on the financial situation of the Group and the results of its operations.

Revenues from the cellular telephone segment increased from approximately NIS 2.30 billion in the first half of 2007 to approximately NIS 2.36 billion in the reporting period. The increase is mainly due to an increase in the number of subscribers, which led to an increase in revenue from interconnect and revenue from content services, which was partially offset by a decrease in average revenue per user, mainly due to erosion of fees for outgoing calls and a decrease in interconnect fees.. There was also an increase in revenue from sale of terminal equipment, due to an increase in the number of handsets sold and upgraded.

Revenue in the international communications, internet and NEP services segment amounted to NIS 644 million in the first half of 2007, compared to approximately NIS 640 million in the reporting period. In this segment there was a decrease in operations relating to transfer of calls between communication operators around the world offset by an increase in revenue from internet broadband service and outgoing calls due to an increase in the market share.

Revenue from the multi-channel television segment increased from approximately NIS 708 million in the first half of 2007 to approximately NIS 761 million in the reporting period, mainly due to an increase in average revenue per user.

C. Depreciation and amortization

The Group's depreciation and amortization expenses decreased from approximately NIS 877 million in the first half of 2007 to approximately NIS 851 million in the reporting period, mainly due to a decrease in the depreciation expenses in the domestic fixed-line communication segment resulting from full depreciation of property plant and equipment and a decrease in investments in new assets. The decrease was partially offset by an increase in depreciation expenses in the cellular segment as a result of the accelerated depreciation of the 1X network due to the establishment of a UMTS network.

D. Salary

The Group's salary expenses increased from approximately NIS 1.16 billion in the first half of 2007 to approximately NIS 1.201 billion in the reporting period. In the domestic fixed line communications segment there was a decrease in salary expenses due to retirement of employees. This decrease was partially offset by an increase in salaries and share-based payments. In the other segments there was an increase in salary expenses mainly due to an increase in the number of employees in response to the increase in operational requirements.

E. General and operating expenses

The Group's operating and general expenses in the first half of 2008 amounted to approximately NIS 2.68 billion, compared to approximately NIS 2.83 billion in the corresponding period in the prior year.

In the domestic fixed-line communications segment, operating and general expenses decreased from approximately NIS 1.067 billion in the first half of 2007 to NIS 934 million in the reporting period. The decrease is mainly due to a reduction in interconnect fees to cellular operators alongside a decrease in income, from the update of the provision for royalties and from implementation of streamlining steps that resulted in a decrease in operating expenses.

In the cellular segment, operating and general expenses decreased from approximately NIS 1.32 billion in the first half of 2007 to approximately NIS 1.292 billion in the reporting period. The decrease is mainly due to a decrease in prices of terminal equipment due to a decrease in the dollar exchange rate and advertising expenses which was partially offset by an increase in content expenses and connectivity as well as an increase in revenues.

In the international communications, internet services and NEP segment there was a decrease in general and operating expenses from approximately NIS 374 million in the first half of 2007 to approximately NIS 352 million in the reporting period. The decrease is mainly due to a reduction in operations relating to call transfers between communication operators around the world alongside a decrease in revenues.

In the multi-channel television segment, general and operating expenses increased from approximately NIS 433 million in the first half of 2007 to approximately NIS 470 million in the reporting period, due to an increase in consumption of content due to broadcasts of original productions and an increase in maintenance services by subcontractors.

F. Other operating expenses (income), net

The Group’s other net operating revenue derived from the domestic fixed-line communications segment. These revenues amounted to approximately NIS 13 million in the reporting period, compared to expenses of approximately NIS 44 million in the corresponding period in the prior year. This is mainly due to provisions recorded for lawsuits in the corresponding period in the prior year compared to capital gain and a decrease of provisions in the reporting period.

G. Operating income

The Group's operating income in the first half of 2008 amounted to approximately NIS 1.464 billion, compared to approximately NIS 1.227 billion in the corresponding period in the prior year, an increase of approximately NIS 237 million. The increase in operating income is due to the changes in the results of the segments described above in the revenue and expenses sections.

H. Financing expenses, net

The Group’s net financing expenses in the first half of 2008 amounted to approximately NIS 283 million compared to approximately NIS 131 million in the corresponding period in the prior year, an increase of NIS 152 million.

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

In the domestic fixed line communications segment, net finance expenses in the reporting period amounted to approximately NIS 41 million compared to net financing revenue amounting to approximately NIS 32 million in the corresponding period. The increase in net finance expenses compared to the corresponding period is mainly due to a decrease in revenues in the capital market and realization of deposits and securities and a decrease in their return. Additionally, in this segment there is an increase in expenses due to revaluation of CPI-linked liabilities, which was partially offset by hedging transactions.

In the cellular segment, there was an increase in net finance expenses, mainly due to the increase in expenses for revaluation of CPI-linked liabilities as a result of a rise in the index, which was partially offset by capitalized credit costs for qualified assets and a decrease in net debt.

In the multi-channel television segment, net financing expenses in the reporting period amounted to approximately NIS 234 million compared to approximately NIS 163 million in the corresponding period in the prior year. The increase in the CPI led to an increase in financing expenses due to the revaluation of CPI-linked liabilities and an increase in the Company's financial debt.

I. Income tax

The Group's tax expenses in the reporting period amounted to approximately NIS 385 million, representing approximately 33% of profit before taxes, compared to approximately NIS 373 million in the corresponding period in the prior year, representing 34% of profit before taxes. Most of the decrease in the tax expenses from profit before income taxes is due to a reduction in the tax rate and the cancellation of the Income Tax (Taxation under Conditions of Inflation) Law. The decrease was moderated by the increase in the losses of DBS that are not deductible for tax purposes.

3. Liquidity and sources of financing

Consolidated cash flows generated by operating activities in the first half of 2008 amounted to approximately NIS 1.413 billion, compared to NIS 1.562 billion in the corresponding period in the prior year, a decrease of approximately NIS 149 million. The decrease in cash flows generated by operating activities is mainly due to an increase in payments for early retirement, a decrease in the balance of liabilities to suppliers in the domestic fixed-line segment and an increase in the trade receivables balance, due to the abovementioned reasons. The decrease in cash flow from operating activities was moderated by the increase in operating income of the Group's segments.

Cash flows generated by operating activities are one of the sources of financing of the Group's investments, which during the reporting period included approximately NIS 617 million invested in development of communications infrastructures, compared to investments amounting to approximately NIS 413 million in the corresponding period.

During the reporting period, the Group repaid net debts and paid interest of approximately NIS 846 million, of which approximately NIS 627 million was on account of debentures, NIS 81 million in loans and approximately NIS 235 million in interest payments. On the other hand, the Company received approximately NIS 68 million in short-term credit and net consideration from realization of derivative financial instruments in the amount of approximately NIS 29 million compared to payment of net debt and interest payments in the amount of approximately NIS 481 million in the corresponding period in the prior year.

In the reporting period, cash dividends in the amount of NIS 679 million were paid, compared to NIS 2.1 billion paid in the corresponding period in the prior year.

The monthly average short-term credit average from banks in the first half of 2008 amounted to approximately NIS 105 million. The monthly average of long-term liabilities to financial institutions and debenture holders in the first half of 2008 amounted to approximately NIS 6.412 billion.

The working capital deficit on June 30, 2008, amounted to approximately NIS 426 million, compared to NIS 1.917 billion in the corresponding period in the prior year. The improvement in working capital is due to an increase in working capital in all the segments in which the Group operates, with the exception of the domestic fixed-line communications segment.

The improvement derives mainly from the multi-channel television segment, where there was a decrease in deficit of approximately NIS 1.257 billion, mainly from classification of bank loans as long-term loans, in view of compliance with the terms of the financing agreement with the banks.

4. Comparison: 2008 second quarter to the results of the corresponding quarter

Segment	Three months ended June 30, 2008 NIS millions Operating income	Three months ended June 30, 2007 NIS millions Operating income
Domestic fixed-line communications	428	243
Cellular	266	240
International communications, internet services and NEP	63	53
Multi-channel television	43	31
Others	-	4
Total	800	571

Revenue in the second quarter of 2008 increased by approximately NIS 33 million compared to the corresponding quarter in the prior year.

Total costs and expenses decreased by approximately NIS 196 million compared to the corresponding quarter in the prior year.

Net financing expenses increased by approximately NIS 109 million compared to the corresponding quarter in the prior year.

The income and expenses items and the reasons for the differences between the quarters are similar to the explanations in the half-year results. The abovementioned changes in the income statement items led to net earnings of approximately NIS 437 million in the second quarter, compared to net profit of approximately NIS 361 million in the corresponding quarter.

5. Group involvement in the community and donations

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

During the reporting period the Group was involved in the community and donated approximately NIS 1,417 million. The principal recipients are listed below:

A. In the project Youth Employment at Bezeq, which has been ongoing for some 14 years, the Company’s employees voluntarily mentor youth at risk with the aim of integrating them into normative life.

B. The Company initiated and established a photography exhibition of the country's leaders. The exhibition, which was free of charge, was open to the general public for one month. The cost of the exhibition amounted to approximately NIS 645,000.

C. The Yom Tov project – a special broadcast for contribution to youth at risk. The Company contributed approximately NIS 330,000.

D. Music Academy – the Company awarded scholarships amounting to NIS 40,000 to musicians from outlying areas.

E. The Company contributed approximately NIS 100,000 to the construction of a monument to commemorate victims of the Beit Lid terrorist attack, in which a graduate of the Bezeq school lost his life.

F. The Company continues to support the Dialogue in the Dark project at the Children’s Museum in Holon, and many other activities.

G. Pelephone contributed approximately NIS 148,000 to various associations.

H. Bezeq International is involved in ongoing operations on behalf of underprivileged communities in Petach Tikva, it adopted “lone” soldiers and a combat division and participated in projects for children with special needs.

I. DBS donated NIS 50,000 to the Shirutrom telethon for soldiers.

6. Exposure to and management of market risks

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

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

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

The surplus monetary liabilities over monetary assets in or linked to foreign currency on June 30, 2008, amounted to approximately NIS 113 million in the Group. Forward currency transactions on June 30, 2008, amounted to approximately NIS 284 million. The transactions were also intended hedge against off-balance sheet liabilities in or linked to foreign currency.

The excess of liabilities over monetary assets linked to the CPI on June 30, 2008, amounted to approximately NIS 5.717 billion in the Group. As a result of hedging transactions, on June 30, 2008, the net CPI-linked liabilities, which are not hedged by forward transactions, amounted to NIS 4.418 billion.

7. Critical accounting estimates

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

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

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

The financial statements were discussed at the balance sheet committee and submitted to the Board of Directors for approval. The following officers attended the board discussion: board members – Shlomo Rodav, Eyal Yaniv, Menachem Inbar, Michael Grabiner, Ran Gottfried, Yoav Rubenstein, Elon Shalev, Ki Kiarie, David Gilboa, Rami Nomkin, Yitzhak Idelman and Yehuda Porat. In addition, the following officers attended: Avi Gabbay – CEO, Alan Gelman – Deputy CEO and CFO, and Bosmat Chelouche – legal consultant. Representatives of the Company Auditors’,,Somekh Chaikin, also participated in the discussion.

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

A. On June 1, 2008, the general shareholders meeting approved, this subsequent to the approval by the board of directors on April 17, 2008, the employment conditions for the chairman of the board as described in Note 8 to the financial statements., The directors examined each component in the compensation package and the package as a whole, and in their opinion the general compensation package is appropriate and reasonable under the circumstances and is compatible with the nature of the position and the challenges facing the chairman and the expectations of the board. The compensation package was also compared with other large companies in Israel and was found to be within the high range of the benchmarks.

B. On July 31, 2008, the Company's Board of Directors (after approval of the Board's audit committee) resolved to approve the extension of the Company's management agreement with a corporation connected to Ap.Sb.Ar. Holdings Ltd., the Company's controlling shareholder, for an additional three years subsequent to the expiry of the current agreement, under the same terms as the original agreement. Extension of the agreement is subject to approval of the general meeting of the Company's shareholders.

C. As of June 30, 2008, the Group's net dollar-linked contractual liabilities (including off-balance sheet) amounted to approximately NIS 894 million. The Group's net CPI-linked liabilities (including off-balance sheet) amounted to NIS 5.519 billion. The dollar exchange rate rose by 6.7% between June 30, 2008, and the date of approval of the financial statements. The CPI rose by 1.1% in July 2008.

The Company is exposed to changes in copper prices which leads to a change in the scrap value of the Company's copper cable infrastructure. The value of the Company's copper cables on June 30, 2008, amounts to NIS 591 million (based on an external assessment dated December 31, 2007, with adjustments, as required). A change in the price of copper could affect the Company's depreciation expenses and any consideration and capital gain from the sale of scrap.

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

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

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