"BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

FINANCIAL STATEMENTS

DECEMBER 31, 2006

Contents

Somekh Chaikin

216 Jaffa Road
PO Box 212, Jerusalem 91001
Israel

Telephone 972 2 531 2000
Fax 972 2 531 2044
Internet www.kpmg.co.il

Auditors' Report to the Shareholders of
"Bezeq" The Israel Telecommunication Corp. Limited

We have audited the accompanying consolidated balance sheets of "Bezeq" The Israel Telecommunication Corp. Limited (the Company) as at December 31, 2006 and 2005, and the related statements of income, statements of recognised statements of income and expense, changes in shareholders' equity and cash flows for each of the two years ended on December 31, 2006. These financial statements are the responsibility of the Company's Board of Directors and its Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of consolidated subsidiaries, whose assets included in the consolidation constitute approximately 6% and approximately 6% of the total consolidated assets as at December 31, 2006 and 2005, respectively and whose revenues included in the consolidation constitute approximately 11% and 10% of the total consolidated revenues for the years ended December 31, 2006 and 2005, respectively. Furthermore, we did not audit the financial statements of associates in which the investment was approximately NIS 32 million and approximately NIS 11 million as at December 31, 2006 and 2005, respectively, and the Group's equity in their profits is approximately NIS 11 million for the year ended December 31, 2006, and equity in their losses is approximately NIS 3 million for the year ended December 31, 2005. The financial statements of those aforementioned subsidiaries and associates were audited by other auditors whose reports thereon were furnished to us and our opinion, insofar as it relates to amounts emanating from the financial statements of those subsidiaries, is based solely on the said reports of the other auditors.

In addition we did not audit the financial statements of subsidiaries whose assets were included in the consolidation, according to their restatement in accordance with International Financial Reporting Standards, constitute approximately 30% of the total consolidated assets as at December 31, 2005 and whose revenues included in the consolidation, according to their restatement in accordance with International Financial Reporting Standards, constitute approximately 48% of the total consolidated revenues for the year ended on the aforementioned date. The aforementioned financial statements, according to their restatement in accordance with International Financial Reporting Standards, were audited by other auditors whose reports thereon were furnished to us and our opinion, insofar as it relates to amounts included therein , is based solely on the said reports of the other auditors. We audited the adjustment described in Note 33 and other adjustments implemented in order to restate the 2005 financial statements in accordance with International Financial Reporting Standards (IFRSs). In our opinion these reconciliations are proper and have been applied properly.

We conducted our audits in accordance with generally accepted auditing standards in Israel, including standards prescribed by the Auditors' Regulations (Manner of Auditor's Performance), 1973. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors and by Management of the Company, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and on the reports of the other auditors noted above, the financial statements referred to above present fairly in accordance with International Financial Reporting Standards (IFRSs), in all material respects, the financial position as at December 31, 2006 and 2005 and the results of operations the changes in shareholders' equity and cash flows for each of the years ended December 31, 2006 Furthermore, in our opinion, the financial statements referred to above are prepared in accordance with the Securities Regulations (Preparation of annual financial statements), 1993.

Without qualifying our opinion, we draw attention to the uncertainties relating to the following matters, the maximum possible exposure of which is significant:

1. The continuing opening of the communications sector to competition and the effects of regulation on the Group's financial position and operating results, as described in Note 1.

2. Contingent claims made against the Group of which the exposure cannot yet be assessed or calculated, and other contingencies as described in Notes 17B and 17C.
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3. The financial position of a subsidiary, as mentioned in Note 32(3). In the opinion of the management of the subsidiary, based on the 2007 budget and on the alternative business plan, the prospects of arranging sources of finance required by the subsidiary in the forthcoming year are good.

Additionally, we draw attention to Note 33u to the Group financial statements regarding the adjustment by way of restatement of the financial statements as at December 31, 2005 and 2004 and for the year ended December 31, 2005, in order to retroactively reflect the depreciation of property, plant and equipment and the related tax effects thereon, in respect of the presentation of receipts from interconnect to the cellular networks and in respect of a reduction of lease payments of land from the Israel Lands Administration as described in the aforementioned note. These aforementioned corrections were implemented on the data presented in the Note of restatement to IFRSs in order to properly reflect the financial position of the Group in the transition to IFRSs in accordance with generally accepted accounting principles in Israel.

Somekh Chaikin
Certified Public Accountants

March 31, 2007

Consolidated Balance Sheets for the Year Ended December 31

	Note	2006 NIS thousands	2005 NIS thousands
Assets			
Cash and cash equivalents	5	**2,631,790**	2,158,773
Trade receivables	6	**2,111,451**	2,114,882
Other receivables	6	**250,657**	141,857
Inventory	3H	**204,669**	231,284
Broadcasting rights	3E	**169,017**	154,500
Investments and loans, including derivatives	7	**960,561**	2,403,413
Current tax assets		**11,105**	18,134
Total current assets		**6,339,250**	7,222,843
Trade and other receivables	6	**417,144**	361,013
Investments and loans, including derivatives	7	**342,175**	456,721
Property, plant and equipment	9	**6,492,362**	7,246,497
Intangible assets	10	**2,554,242**	2,611,034
Deferred and other expenses	11	**373,749**	391,738
Investments in associates accounted by the equity method	12	**32,122**	20,368
Deferred tax assets	8	**993,616**	1,077,624
Total non-current assets		**11, 205,410**	12,164,995
Total assets	28	**17,544,660**	19,387,838

	Note	2006 NIS thousands	2005 NIS thousands
Liabilities			
Loans and borrowing	13	**3,637,347**	3,160,652
Trade payables	14	**1,393,568**	1,548,457
Other payables, including derivatives	14	**802,747**	856,996
Current tax liabilities		**121,704**	6,218
Deferred income		**57,879**	56,111
Provisions	15	**288,851**	259,811
Employee benefits	16	**906,203**	717,723
Proposed dividend		**300,000**	-
Total current liabilities		**7,508,299**	6,605,968
Debentures	13	**3,169,441**	4,891,340
Obligations to banks	13	**480,830**	748,053
Loans from others	13	**169,182**	107,732
Loans provided by the minority in a subsidiary	13	**564,250**	505,280
Employee benefits	16	**373,036**	396,353
Deferred income and others		**37,020**	25,511
Provisions	15	**51,857**	52,359
Total non-current liabilities		**4,845,616**	6,726,628
Total liabilities	28	**12,353,915**	13,332,596
Shareholders' Equity	20		
Share capital		**6,309,133**	6,309,133
Share premium		**1,623,423**	1,623,423
Reserves		**671,820**	389,937
Deficit		**(2,849,381)**	(1,761,971)
Total equity attributable to shareholders of the Company		**5,754,995**	6,560,522
Minority equity in capital deficit of a consolidated company		**(564,250)**	(505,280)
Total shareholders' equity		**5,190,745**	6,055,242
Total shareholders' equity and liabilities		**17,544,660**	19,387,838

Dov Weissglas	**Yacov Gelbard**	**Ran Oz**
Chairman of the Board	President & CEO	Deputy CEO and CFO

Date of approval of the financial statements: March 31, 2007.

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

Consolidated Statements of Income for the Year Ended December 31

	Note	2006 NIS thousands	2005 NIS thousands
Revenue	21	**12,231,830**	11,924,718
Costs and expenses			
Depreciation and amortisation	9, 10	**1,864,035**	1,933,777
Wages	22	**2,586,437**	2,585,780
Operating and general expenses	23	**5,966,616**	5,978,066
Other operating expenses (income), net	24	**249,540**	(99,841)
		10,666,628	10,397,782
Operating income	28	**1,565,202**	1,526,936
Financing costs	25		
Financing expenses		**694,393**	804,592
Financing income		**(356,425)**	(433,294)
		337,968	371,298
Profit after financing expenses		**1,227,234**	1,155,638
Equity in profits (losses) of associates accounted by the equity method	12	**11,184**	(3,320)
Profits before income tax		**1,238,418**	1,152,318
Income tax	8	**488,393**	532,015
Profit for the year		**750,025**	620,303
Attributable to:			
The shareholders' of the Company		**808,995**	666,411
Minority in a consolidated company		**(58,970)**	(46,108)
Profit for the year		**750,025**	620,303
Earnings per share	27		
Basic earnings per share (in NIS)		**0.311**	0.256

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

Consolidated Statements of Recognised Income and Expense for the Year Ended December 31

	Note	2006 NIS thousands	2005 NIS thousands
Net change in fair value of financial assets classified as available for sale	7	**(1,464)**	539
Net change in fair value of financial assets classified as available for sale transferred to profit and loss	7	**(5,218)**	(104,582)
Actuarial gains (losses) from a defined benefit plan	16	**3,427**	(15,211)
Taxes in respect of income and expenses attributable directly to equity	8	**2,227**	40,692
Income and expenses recognised directly to equity		**(1,028)**	(78,562)
Profit for the period		**750,025**	620,303
Total recognised income and expense for the period		**748,997**	541,741
Attributable to:			
The shareholders' of the Company		**807,967**	587,849
Minority in a consolidated company		**(58,970)**	(46,108)
Total recognised income and expense for the period		**748,997**	541,741

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

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Statement of Changes in Shareholders' Equity

	Share capital	Share premium	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of assets available for sale	Retained earnings	Total	Minority interest in a capital deficit of a consolidated company	Total equity
	NIS Thousands							
	Relates to shareholders of the Company							
Balance at January 1, 2005	6,309,133	1,623,423	37,775	72,004	(2,416,571)	5,625,764	(466,842)	5,158,922
Profits for the year	-	-	-	-	666,411	666,411	(46,108)	620,303
Change in the fair value of financial assets available for sale, less tax	-	-	-	338	-	338	-	338
Profits from monetary assets available for sale attributable to profit and loss, less tax	-	-	-	(67,089)	-	(67,089)	-	(67,089)
Actuarial gains and losses in a defined benefit plan, less tax	-	-	-	-	(11,811)	(11,811)	-	(11,811)
Total profits recognised for the period						587,849	(46,108)	541,741
Payment from the State to employees in respect of Company privatisation	-	-	1,235	-	-	1,235	-	1,235
Share-based payments to Company employees from its shareholders	-	-	345,674	-	-	345,674	-	345,674
Minority interest in respect of a benefit deriving from a change in the terms of shareholder loans	-	-	-	-	-	-	7,670	7,670
Balance at December 31, 2005	6,309,133	1,623,423	384,684	5,253	(1,761,971)	6,560,522	(505,280)	6,055,242

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

Statement of Changes in Shareholders' Equity

	Share capital	Share premium	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of assets available for sale	Capital reserve in respect of option warrants for employees	Retained earnings	Total	Minority interest	Total equity
	NIS Thousands								
	Relates to shareholders of the Company								
Balance at January 1, 2006	**6,309,133**	**1,623,423**	**384,684**	**5,253**	**-**	**(1,761,971)**	**6,560,522**	**(505,280)**	**6,055,242**
Earnings for the year	**-**	**-**	**-**	**-**	**-**	**808,995**	**808,995**	**(58,970)**	**750,025**
Change in the fair value of financial assets available for sale, less tax	**-**	**-**	**-**	**(1,023)**	**-**	**-**	**(1,023)**		**(1,023)**
Earnings from monetary assets available for sale attributable to profit and loss, less tax	**-**	**-**	**-**	**(3,600)**	**-**	**-**	**(3,600)**	**-**	**(3,600)**
Actuarial gains and losses in a defined benefit plan, less tax	**-**	**-**	**-**	**-**	**-**	**3,595**	**3,595**	**-**	**3,595**
Total profits recognised for the period							**807,967**	**(58,970)**	**748,997**
Dividends to Company shareholders	**-**	**-**	**-**	**-**	**-**	**(1,900,000)**	**(1,900,000)**	**-**	**(1,900,000)**
Share-based payments	**-**	**-**	**-**	**-**	**286,506**	**-**	**286,506**	**-**	**286,506**
Balance at December 31, 2006	**6,309,133**	**1,623,423**	**384,684**	**630**	**286,506**	**(2,849,381)**	**5,754,995**	**(564,250)**	**5,190,745**

Regarding distribution of cash dividend in the amount of NIS 1.8 billion, in a distribution not in compliance with the earnings test See Note 20.

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

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Statements of Cash Flows for the Year Ended December 31

	Note	2006 NIS thousands	2005 NIS thousands
Cash flows from operating activities			
Net earnings for the year		**750,025**	620,303
Adjustments:			
Depreciation	9	**1,591,054**	1,666,304
Amortisation of intangible assets	10	**247,557**	241,110
Amortisation of deferred and other charges	11	**25,424**	26,363
Gain from decrease in holdings in associates	12	**(595)**	(721)
Net financing costs	25	**440,429**	352,365
Equity in earnings of associates accounted by the equity method	12	**(11,184)**	3,320
Net capital gain principally due to disposal of property	24	**(159,017)**	(8,646)
Share-based payment transactions	26	**286,506**	345,674
Income tax expenses	8	**488,393**	532,015
Change in inventory		**23,014**	77,385
Change in trade receivables	6	**109,100**	(56,592)
Change in other receivables	6	**(107,854)**	(15,753)
Change in trade payables	14	**(56,778)**	63,009
Change in suppliers	14	**(79,046)**	(106,278)
Change in provisions	15	**27,327**	7,532
Change in broadcasting rights		**(14,517)**	(14,004)
Change in employee benefits	16	**168,758**	(403,753)
Change in deferred income		**11,509**	(13,079)
		3,740,105	3,316,554
Interest paid		**220,078**	177,451
Dividend received		**26,010**	-
Income tax paid		**(277,573)**	(332,014)
Net cash from operating activities		**3,708,620**	3,161,991
Cash flows from investment activities			
Investment in intangible assets	10	**(209,733)**	(224,318)
Proceeds from sale of property, plant and equipment	9	**47,804**	21,299
Investment in financial instruments available for sale		**(15,436)**	(15,839)
Financial assets held for trading, net		**1,491,439**	(903,068)
Purchase of property, plant and equipment	9	**(953,226)**	(1,477,412)
Investment in associates including loans, net	12	**-**	(9,403)
Proceeds from sale of investments and long-term loans		**62,729**	95,765
Purchase of investments and long-term loans		**(4,287)**	3,501)
Net cash from (used for) investment activities		**419,290**	(2,516,477)

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

Statements of Cash Flows for the Year Ended December 31 (Contd.)

	Note	2006 NIS thousands	2005 NIS thousands
Cash flows from financing activities			
Proceeds from issue of debentures	13	**-**	1,700,147
Receipt of loans	13	**50,000**	457,000
Repayment of debentures	13	**(280,350)**	(267,332)
Repayment of loans	13	**(1,268,656)**	(1,382,578)
Short-term credit, net	13	**43,146**	30,412
Dividends paid	20	**(1,600,000)**	-
Interest paid		**(601,752)**	(484,550)
Net cash from (for) financing activities		**(3,657,612)**	53,099
Net increase in cash and cash equivalents		**470,298**	698,613
Cash and cash equivalents at January 1		**2,158,773**	1,457,107
Effect of fluctuations in the rate of exchange on cash balances		**2,719**	3,053
Cash and cash equivalents at December 31	5	**2,631,790**	2,158,773

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

Appendix to Statements of Cash Flows for the Year Ended December 31 (Contd.)

	2006 NIS thousands	2005 NIS thousands
Appendix of activities not effecting cash flows		
Purchase of property, plant and equipment, other assets, materials and spare parts on credit	**141,518**	217,361
Sale of property, plant and equipment on credit	**161,800**	-

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

NOTE 1 – THE REPORTING ENTITY

A. Bezeq – The Israel Telecommunication Corp. Ltd. ("the Company") is a company resident in Israel whose shares are traded on the Tel Aviv Stock Exchange. The official address of the Company is 132 Menachem Begin Road, Tel Aviv. The consolidated financial statements of the Company at December 31, 2006 include those of the Company and of its subsidiaries ("the Group"), as well as the rights of the Group in affiliated companies. The Group is a principal provider of communications services in Israel (see Note – Segments).

B. On October 11, 2005, control in the Company was transferred from the State to Ap.Sb.Ar. Holdings Ltd. and the Company ceased to be a government company. The Company was declared a monopoly in the main area in which it operates. An appeal filed by the Company was pending in the Antitrust Court against the non-revocation of its monopoly status in basic telephony; however, at the suggestion of the court (in view of the time elapsed since it was filed), the Company consented to withdraw the appeal and is preparing a revised appeal for submission to the Antitrust Commissioner. All the segments of operation of the Group are subject to competition. The activities of the Group are, in general, subject to government control and regulation. It is expected that the intensifying competition together with all the changes in the communications market, will have an adverse effect on the business results of the Group – an effect which the Group is unable to estimate.

NOTE 2 – BASIS OF PRESENTATION

A. Statement of implementation of International Financial Reporting Standards

The consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards ("IFRS"), and in addition, in accordance with the Securities Regulations (Preparation of annual financial statements), 5753-1993.

The Company first adopted IFRS in 2006, with a transition date of January 1, 2005. In these financial statements IFRS1 has been implemented, the Company's first-time adoption of IFRS. Its last financial statements prepared in accordance with generally accepted accounting standards in Israel were in respect of the year ended December 31, 2005.

An explanation as to how the transition to IFRS has affected the financial position of the Company and the results of its operations and cash flows, are provided in Note 33.

B. Definitions

In these financial statements –

(1) the Company – Bezeq, The Israel Telecommunication Corp. Limited.

(2) the Group - Bezeq, The Israel Telecommunication Corp. Limited and its investee companies, as listed in Note 32 – List of Group Entities.

(3) Subsidiaries – Companies, whose financial statements are fully consolidated, directly or indirectly, with the financial statements of the Group.

(4) Associates – Companies, including a partnership, in which the Groups's investment is stated, directly or indirectly, in the consolidated financial statements on the equity basis.

(5) Investee companies – Subsidiaries or associates.

(6) Related parties – As defined in IAS 24.

(7) Interested parties – As defined in Paragraph (1) of the definition of an "Interested Party" in a corporation, in Section 1 of the Securities Law.

(8) Controlling shareholder – As defined in the Securities Regulations (Presentation of transactions between a company and its controlling shareholder in financial statements), 5756-1996.

NOTE 2 – BASIS OF PRESENTATION (CONTD.)

C. Basis of measurement

The consolidated financial statements were prepared on the basis of historical cost except for the following items:

* Derivative financial instruments are measured at fair value.
* Financial instruments at fair value through profit and loss are measured at fair value.
* Financial assets classified as available-for-sale are measured at fair value.
* Liabilities in respect of share-based payment arrangements are measured at fair value.
* Assets stated at deemed cost, as described in Note 9.
* Liabilities in respect of decommissioning sites and the assets to which the liabilities are attributed, as described in Note 15
* Liabilities in respect of employee benefits, as described in Note 16.

The methods by which the fair value is measured are explained in Note 4.

D. Functional currency of operation and presentation currency.

The consolidated financial statements are stated in New Israel Shekels (“NIS”), which is the functional currency of the Group. The financial information is stated in NIS, rounded to the nearest thousand.

E. Activity in hyper-inflationary economic conditions

Through December 31, 2003, Israel was considered a country with a prevailing hyper-inflationary economy, and accordingly, the non-monetary items in the balance sheet (such as: property, plant and equipment except for property, plant and equipment valued at deemed cost), intangible assets and capital items) were adjusted for changes in the Consumer Price Index (“the Index”) through that date. From that date onwards, the indexed amounts serve as the basis for reporting in the subsequent periods.

F. Use of estimates and judgment

When preparing the financial statements, Management is required to make judgments, estimates, assessments and assumptions that affect implementation of the accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from the estimates used.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to the accounting estimates are recognised in the period in which the estimate is revised and in future periods affected by them.

Information regarding main matters of uncertainty in estimates and judgment which are critical to the implementation of the accounting policy and have a determining effect on the amounts presented in the financial statements, are provided in the following Notes:

*Note 6 -	Provision for doubtful debts.
*Note 8 -	Utilisation of losses for tax purposes and deferred tax assets and liabilities recognised.
*Note 9 -	Estimated useful life of items of property, plant and equipment and determined deemed cost.
*Note 10 -	Measurement of recoverable amounts of cash-generating units.
*Notes 15 and 17	Provisions and contingent liabilities.
*Note 16 -	Measurement of a defined benefit obligation and employee benefits.
*Note 26 -	Measurement of share-based payments.
*Note 30 -	Financial instruments.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES

The accounting policies described below have been applied consistently to all the periods presented in these consolidated financial statements and in preparing the opening balance sheet at January 1, 2005 (the date of transition to IFRS), for the purposes of the transition to international reporting standards. The accounting policies were applied consistently by the Group entities..

A. Basis of Consolidation

(1) Subsidiaries

Subsidiaries are entitles controlled by the Group. Control exists when the Group has the ability to control the financial and operating policies of an entity in order to achieve benefits from its operations. In assessing control, Group potential voting rights that are exercisable or convertible are taken into account. The financial statements of the subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

(2) Special-purpose entity

The Company set up a special-purpose entity ("SPE") for investment purposes. SPEs are included in consolidation if, based on an assessment of the significance of the relationship with the Group and the risks and benefits of the SPE, the Group concluded that it controls the SPE. Such an entity controlled by the Group, was established with conditions which imposed strict limitations on the power of the management of the SPE to make decision and which allow the Group to enjoy all the benefits related to the activities and to the net assets of the SPE.

(3) Associates (accounted by the equity method)

Associates are entities in which the Group has a significant influence, but not control, over financial and operating policies.. Associates are accounted for in accordance with the equity method. The consolidated financial statements include the Group's share in the results of investee entities, on an equity accounted basis, subsequent to adjustments required to reconcile the accounting policy to that of the Group, from the date on which the significant influence commences until the date that significant influence ceases.

(4) Transactions eliminated on consolidation

Intragroup balances and any unrealised income and expenses arising from intragroup transactions are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with associates are eliminated to the against the investment up to the limit of the rights of the Group in the associate. Unrealised losses were cancelled in the same way as unrealised gains , but only to the extent that there is no evidence of impairment.

(5) Minority

Minority shareholders in a consolidated company which has a capital deficit, participated in their share of the losses of that company up to the amount of the loans and liabilities (including the interest accrued in respect of those loans) and the commitments to provide loans. Accordingly, the minority interest in the loses of the consolidated company appears as a separate item in he balance sheet.

B. Foreign currency transactions

Transactions in foreign currency are translated into the functional currency of the Group at the exchange rate ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the foreign exchange rate ruling at that date. Exchange rate differences in respect of monetary items represent the difference between the depreciated cost in the currency of operation at the commencement of the period, which is adjusted for the effective interest and the payments during the period, and the depreciated cost in the foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies and measured at fair value, are translated into the functional currency at the exchange rate in effect on the date on which the fair value was determined. Exchange rate differences deriving from re-translation are recognised in the profit and loss, except for differences deriving from re-translation of shares classified as available for sale.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

C. Financial Instruments

(1) Non-derivative financial instruments

Non-derivative financial instruments include investments in shares and debentures, customer credit and other accounts receivable, cash and cash equivalents, loans and credit received, supplier credit and other accounts payable, and debentures issued by the Group and loans taken out by the Group.

The initial recognition of non-derivative financial instruments is by the fair value method plus, in respect of instruments not stated at fair value through profit and loss, all the attributable direct costs of the transaction. Subsequent to initial recognition, non-derivative financial instruments are measured as described below.

A financial instrument is recognised when the Group takes upon itself the contractual terms of the instrument. Financial assets are disposed of when the contractual rights of the Group to the cash flows deriving from the financial assets expire, or when the Group transfers the financial assets to others without retaining control of the asset or of all the risks and benefits deriving from the asset. The purchase and sale of financial assets made in the normal way, are recognised on the date of the transaction, i.e. on the date on which the Group undertook to purchase or sell the asset. Financial liabilities are deducted when the Group’s obligation, as detailed in the agreement, expires, or when it is discharged or cancelled.

Cash and cash equivalents

Cash or cash equivalents comprise cash balances and call deposits which can be withdrawn on demand (up to three months from the date of their deposit). A bank overdraft which is repayable on demand and forms an integral part of the Group’s cash management is included as a component of cash and cash equivalents for the purpose of the statement of cash flows.
The accounting treatment of financing income and expenses is described in Note 3O below.

Financial instruments available for sale

The Group’s investments in shares, certain debentures and a venture capital fund are classified as financial assets available for sale. Subsequent to the initial recognition, these investments are measured at fair value, where the changes in them, except for the accrual of interest, deductions, loss from impairment of value (see Note 3J1)) and profits or losses from changes in the exchange rate of monetary items classified as available for sale (see Note 3B), are recognised directly as capital. Where the investment is disposed of, the profits or losses accumulated as capital are transferred to profit and loss.

Investments measured at fair value through profit and loss

A financial instrument is classified as measured at fair value through profit and loss, if it is held for current trading or if the instrument is a derivative.

(2) Derivative financial instruments

The Group holds derivative financial instruments to hedge its exposure to foreign exchange risks and Index risks. Embedded derivatives are separated from the host contract and treated separately if: (a) there is no close relationship between the economic characteristics and the risks of the host contract and the embedded derivative; (b) a separate instrument with the same terms as the embedded instrument would meet the definition of a derivative, and (c) the embedded instrument is not measured at fair value through profit and loss.

The initial recognition of derivatives is at fair value: the attributable costs of the transaction are recognized in profit and loss upon realisation. Subsequent to initial recognition, derivative financial instruments are measured at fair value, where the movements in the fair value are recognised in income and expense as incurred.

Economic hedging

Where a derivative financial instrument is used to hedge economically monetary assets or liabilities, no hedge accounting is applied. The changes in the fair value of these derivatives are recognised in the income statement.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

C. Financial Instruments (contd.)

Separable embedded derivatives
Changes in the fair value of separable embedded derivatives are recognised immediately in the income statement.

(3) Share capital – Ordinary shares
Incremental costs relating directly to an issue of ordinary shares and options for shares, are presented as a deduction from the capital.

D. Property, plant and equipment

(1) Recognition and measurement
The cost includes expenses attributable directly to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials, direct wages and financing costs, as well as any additional cost attributable directly to transporting the asset to the required location and position so that it can operate in the manner intended by Management, as well as the costs of dismantling and removing the items and restoring the site on which they are located in cases where the Group has an obligation to vacate and restore the site. The cost of purchased software which is an integral part of the related asset, is recognised as part of the cost of that asset.

Where some of the property, plant and equipment have a different useful life, they are treated as separate items (material components) of the property, plant and equipment.

Under IFRS1, the Group chose a relief whereby:
(a) the liability at the date of transition to IFRS, is measured in accordance with IAS 37;
(b) the amount that would have been included as the cost of the asset on the date when the liability was first created, is stated by capitalising the liability at the same date, according to the historical capitalization rates; and additionally
(c) the accumulated depreciation on the same amount is calculated at the date of transition to IFRS.

Items of property, plant and equipment are stated at cost less accumulated depreciation and losses from impairment in value. Certain items of property, plant and equipment that had been revalued to fair value on the date of transition to IFRS, are measured on the basis of their deemed cost, being the revalued amount at the transition date (January 1, 2005), in accordance with the Group's assessments based on a third party appraisal.

(2) Subsequent costs
The cost of replacing part of a property, plant and equipment item is recognized as part of the carrying value of that item if it is probable that the future economic benefits embodied with the item will flow to the Group and that the cost of the item can be reliably measured. The costs of ongoing maintenance are recognised the income statement as incurred.

(3) Capitalisation of borrowing costs
The costs of specific borrowing and the costs of non-specific borrowing are capitalized as qualifying assets as defined in IAS 23 – Borrowing Costs, during the period required for completion and construction through the date on which they are ready for their intended use. Non-specific borrowing costs are capitalised in the same way for the same investment in qualifying assets or for that part of the period not financed by specific borrowing, using a rate which is the weighted average of the rates of cost for those borrowing sources whose cost was not specifically capitalized. Other borrowing costs are recognized in the income statement at the time they are incurred.

(4) Depreciation
Depreciation is recognised in the income statement on a straight-line basis over the estimated useful life of each part of an item of property, plant and equipment. Leased assets are depreciated over the shorter of the term of the lease and the period of use of the asset.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

D. Property, plant and equipment (contd.)

(4) Depreciation (contd,)

Leasehold improvements are depreciated over the term of the lease, which includes the option for the extension of the lease held by the Group and which it intends to exercise.

The estimated useful lives for the current period and comparative periods are as follows:

	Years	Main depreciation %
Digital switching equipment	4-20	10
Transmission and power equipment	5-10	20
Network equipment	5-20	5
Terminal equipment (cellular)	2-3	33
Subscriber equipment and public telephones	5	20
Fleet	7	15
Internet equipment	4-7	20
Office equipment	5-15	10
Electronic equipment, computers and internal communication systems	3-7	33
Cellular infrastructure equipment	5-10	10
Digital satellite decoders	6	17
Broadcasting and reception equipment (satellite)	7	15
Buildings	25	4

The method of depreciation, useful life and residual value were reassessed at every balance sheet date.

E. Broadcasting rights

Broadcasting rights are stated at cost, net of rights exercised.

The costs of purchased broadcasting rights for screening films and television programs include the amounts paid to suppliers of rights, plus the direct costs incurred for adaptation of the films and other programs for screening in Israel. The broadcasting rights are depreciated in accordance with the terms of the agreement for their purchase, on the basis of actual screenings out of the total number of screenings permitted under the agreement (where the portion not depreciated by the end of the term of the agreement is depreciated in full upon its termination), or according to the term of the rights agreement.

F. Intangible assets

(1) Goodwill

Goodwill is generated from the acquisition of subsidiaries and associates.

Acquisitions prior to January 1, 2005

As part of the transition to reporting in accordance with IFRS, the Group chose to treat, according to IFRS 3, only those business combinations which occurred after January 1, 2005. Regarding acquisitions which occurred prior to January 1, 2005, the goodwill reflects the amount recognized by the Group according to accepted accounting principles in Israel. In respect of these acquisitions, the accounting treatment was not adjusted to IFRS 3 for preparation of the opening balance sheet of the Group.

Acquisitions subsequent to January 1, 2005

In respect of acquisitions subsequent to January 1, 2005, the goodwill reflects the excess cost of the acquisition over the rights of the Group to the net fair value of the identified assets, liabilities and contingent liabilities of the acquired entity.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

F. Intangible assets (contd.)

(1) Goodwill (contd.)

Subsequent measurement

Goodwill is measured at cost less accumulated losses from impairment of value. Goodwill in respect of investments, which are accounted for by the equity method, is included at the book value of the investment.

(2) Software development costs

Software development costs are capitalised only if the costs of development of the software which are technically and commercially applicable, can be measured reliably, if a future economic benefit is expected from the development, and the Group intends and has sufficient resources to complete the development and use the software. The capitalised expense includes the cost of the materials, direct wages and overhead expenses directly attributable to preparation of the asset for its intended use. Other development expenses are recognized in the income statement as incurred.

Capitalised development costs are measured at cost less amortisation and accumulated losses from impairment of value.

(3) Subscriber acquisition

Incremental direct sale commissions paid in respect of sales and upgrades to subscribers who have signed a commitment to remain customers, are recognised as an intangible asset. Subscriber acquisition amortisation expenses are recorded in the income statement over the period of the subscriber’s commitment, which is up to 36 months.

(4) Software

The Group’s assets include computer systems consisting of hardware and software. Software which is an integral part of the hardware, which cannot function without the programs installed on it, is classified as property, plant and equipment. However, the licenses for the software, which are a separate item and add functionality to the hardware, are classified (mostly) as intangible assets. The depreciation in respect of software is recognized in the income statement under the straight-line method, over the estimated useful life of the asset. The estimated useful life is 3-10 years.

(5) Frequency usage rights

Frequency usage rights relate to cellular communication frequencies in respect of which the Group won a tender published by the Ministry of Communications (see Note 18(7) below).

(6) Other intangible assets

Other intangible assets purchased by the Group, which have a defined useful life, are measured at cost less amortisation and accumulated losses from impairment of value.

(7) Subsequent expenses

Subsequent expenses are capitalised only when they increase the future economic benefit inherent in the asset for which they were incurred. Any other expense, including an expense relating to amortised goodwill or brand, is recognised in the income statement as incurred.

(8) Amortisation

Amortisation, except for goodwill, is recognised in the income statement by the straight line method over the estimated useful life of the intangible assets, from the date on which the assets are available for use.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

F. Intangible assets (contd.)

(8) Amortisation (contd.)

The estimated useful lives for the current period and comparative periods are as follows:

* Capitalised development expenses	4-7 years
* Other rights	3 and 10 years, depending on the useful life
* Subscriber acquisition costs	Depending on the contractual commitment with the subscriber
* Computer programs and licenses to use them	Over the term of the license or the estimated duration of use

G. Leased properties

Leases, in which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. At the date of initial recognition, the leased properties are valued at the lower of the fair value and the present value of the minimum lease fees. Subsequent to the initial recognition, the property is treated according to the accounting policy customary for that property.
Other leases, including leases from the Administration, are classified as operating leases, where the leased properties are not recognized in the balance sheet of the Group.
The Group applies IFRIC 4 – Determining Whether an Arrangement Contains a Lease, which defines criteria for determining the commencement of the arrangement, whether a right to use the property constitutes a lease arrangement. In addition, it defines when thereafter the arrangement should be re-examined. The Group applied the relief laid down in IFRS1, whereby the examination of whether an arrangement contains a lease was made on the basis of the facts and circumstances prevailing on January 1, 2005 (the date of transition to IFRS).

H. Prepaid expenses in respect of a right to use capacities

In accordance with IFRIC 4, as mentioned above, transactions for purchasing an indefeasible right of use (“IRU”) of undersea cable capacities were treated as receipt of a service transaction. The prepaid expense balance is amortised by the straight line method over the shorter of the term stated in the agreement and the estimated useful life of those capacities.

I. Inventory

Inventory is stated at the lower of the cost and net realizable value. The cost of the inventory is determined by the moving weighted average method, and includes the expenses for purchasing the inventory and bringing it to its present place and position. The net realisable value is an estimate of the selling price during the normal course of business, less the estimated cost to completion and the estimated costs required for making the sale.

The inventory of a consolidated company includes terminal equipment intended for sale, as well as spare parts used for repairs in the repair service it provides to its customers. As part of its normal operations, the subsidiary upgrades the terminal equipment for its customers, and therefore the inventory also includes used handsets and accessories returned by customers.

J. Impairment

(1) Financial assets

The Group reviews a monetary asset for impairment when there is objective evidence that one or more events have impacted negatively on the estimated future cash flows of the asset.

A loss from impairment of a monetary asset, which is stated at net book value, is calculated as the difference between the book value of the asset and the present value of the estimated future cash flows, discounted at the original effective interest rate. A loss from impairment of a monetary asset, classified as available for sale, is calculated on the basis of its current fair value.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

J. Impairment (contd.)

Review of the requirement for impairment in value, in respect of monetary assets with significant amounts, is made for each asset separately. The requirement to review the remainder of the other monetary assets is assessed collectively, in groups with similar credit risk characteristics. In addition, the financial statements include specific provisions for doubtful debts, which properly reflect, according to Management's assessment, the loss grossed up with the debts in debts whose collection is in doubt..

All the losses from impairment are recognized in the income statement. An accumulated loss relating to a monetary asset classified as available for sale, which was formerly charged to capital, was transferred to the income statement when the asset value became impaired.

A loss from impairment is reversed when it can be objectively attributed to an event that occurred after recognition of the loss from impairment. Reversal of a loss from impairment of monetary assets is stated at depreciated cost, and in respect of financial assets classified as available for sale which are debt instruments, are recognized in the income statement. Reversal of the loss from impairment in respect of a monetary asset classified as available for sale which is shares, is charged directly to capital.

(2) Non-monetary assets

The book value of the Group's non-monetary assets which are not inventory or deferred tax assets, is reviewed at each reporting date to determine whether there are any indications of impairment. If there are such indications, the estimated recoverable amount of the asset is calculated. On January 1, 2005 the date of transition to the IFRS, the Group reviewed goodwill, for impairment. In subsequent periods, the Group makes an assessment, every year, of the recoverable amount of goodwill and assets which are not available for use.

An impairment loss is recognized whenever the carrying amount of an asset or its cash-generating unit to which the asset belongs, exceeds its recoverable amount. A cash-generating unit is the smallest identified group of assets that generates cash flows, largely independent of assets in other groups.

Impairment losses are recognized in the income statement. Losses from impairment which were recognized for cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to cash-generating units, and then to a reduce the carrying amount of the other assets in the unit on a pro rata basis.

The recoverable amount of an asset or of a cash-generating unit is the greater of the value in use and the net selling price (fair value less selling costs). In determining the value in use, the Group capitalizes the net present value of the estimated future cash flows before taxes, which reflects the market assessments for the time value of the money and the specific risks related to the asset.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses which were recognized in prior periods are reviewed on each reporting date to determine whether there are any indications that the losses have been reduced or no longer exist. A loss from impairment is reversed if there has been a change in the estimates used to determine the recoverable amount, only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if the loss from impairment had not been recognised.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

K. Non-current assets held for sale

Non-current assets (or groups designated for disposal that include assets and liabilities) which are expected to be realized by way of sale and not by way of continued use are classified as assets held for sale. Immediately prior to their classification as assets held for sale, the assets (or the components of groups designated for disposal), are stated according to the Group's accounting policies. Thereafter, the assets (or groups designated for disposal) are stated at the lower of the book value and the fair value, less selling costs. Every loss from impairment of the group designated for disposal is initially attributed to goodwill, and thereafter, pro rata, to the remaining assets and liabilities, except that a loss is not attributed to inventory, to monetary assets, deferred tax assets or employee benefit assets, which continue to be measured by the accounting policies of the Group. Losses from impairment at the time of initial classification of an asset classified as held for sale, and subsequent gains or losses as a result of re-measurement, are recognised in the income statement. Gains are recognized up to the accumulated amount of a loss from impairment recorded in the past.

L. Employee benefits

The Group has a number of retirement benefit plans. The plans are usually financed by deposits in insurance companies, and are classified as defined contribution plans and as defined benefit plans.

(1) Defined contribution plans

The Group's commitments to make deposits in a defined contribution plan, are recognized in the income statement as an expense on the date on which the commitment to make the deposits is made.

(2) Defined benefit plans

The Group's net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of the future benefit that employees have earned in return for their service in the current and in prior periods. That benefit is stated at present value less the fair value of the plan's assets. The discount rate is the yield at the balance sheet date, on government bonds, whose currency and maturity dates are similar to the terms of the Group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

Where the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised as an expense in the income statement on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised as incurred in the income statement.

The Group recognises as incurred directly to equity, all the actuarial gains and losses derived from a defined benefit plan.

The actuarial gains and losses at January 1, 2005, the date of transition to IFRS, were charged to reserves.

(3) Other long-term service benefits

The Group's net obligation in respect of long-term service benefits, other than pension plans, is the amount of future benefit that employees have earned in return for their services in the current and prior periods. The amount of the benefits is capitalised at their present value, net of the fair value of the assets related to this commitment. The discount rate is the yield at the balance sheet date on corporate bonds that have maturity dates approximating to the terms of the Group's obligations. The obligation is calculated using the projected credit method and is discounted to its present value and the fair value of any related assets is deducted. Actuarial gains and losses are recognized in the income statement in the period in which they arise.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

L. Employee benefits (contd.)

(4) Severance pay and voluntary retirement benefits

Employee severance pay is recognised as an expense when the Group has a clear obligation, with no real possibility of cancellation, for employee terminations before they reach the accepted retirement date according to a detailed formal plan. Employee benefits upon voluntary retirement are recognised when the Group proposes a plan encouraging voluntary retirement to the employees, the plan is expected to be accepted and the number of those who will benefit from the plan can be reliably estimated.

(5) Short-term benefits

Obligations in respect of short-term service benefits are measured on a non-equity basis, and the expense is recognised at the time the relevant service is rendered. A provision for short-term service benefits in respect of a cash bonus or a profit-sharing plan, is recognized when the Group has a legal or constructive obligation to pay an amount for a service rendered by the employee in the past, and that amount can be reliably estimated.

(6) Share-based payment transactions

The fair value of options granted is recognised as an employee expense with a corresponding increase in equity and spread over the period during which the employee become unconditionally entitled to the options. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest.

The fair value of the options granted to the employees by the State for the period when the State was the controlling shareholder of the Company was recognised at the date the employees were entitled to the options.

M. Provisions

A provision is recognized when the Group has a present legal or constructive obligation as a result of a past event, which can be reliably estimated and it is probable that an outflow of economic benefits will be required to settle the obligation. The provisions are measured by discounting the expected future cash flows at a pre-tax interest rate that reflects current market assessments for the time value of the money and the risks specific to the liability.

(1) Contingent liabilities

The financial statements include appropriate provisions in respect of claims against the Group companies which in the opinion of those companies will not be dismissed or abated, despite the fact that the claims are denied by the Group companies. In addition, there is also a low number of legal proceedings, recently received, the risks of which cannot be assessed at this stage, and therefore no provisions have been made in respect thereof.

The treatment of pending legal claims is according to IAS 37 and its related provisions. Accordingly, the claims are classified by probability of realisation of the exposure to risks, as follows:

1. Probable – more than 50% probability.
2. Possible – more than remote and less than or equal to 50% .
3. Remote – probability less than or equal to 20%.

Regarding claims which are probable, the financial statements include provisions which in the opinion of the Group's Management, based, among others, on the opinions of its legal advisers retained in respect of those claims, are appropriate to the circumstances of each case.

Note 17 contains details of the additional exposure due to contingent claims whose amounts are significant, and in which the likelihood of realisation is possible or remote.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

M. Provisions (contd.)

(2) Restructuring

A provision for restructuring is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced publicly. Future costs are not provided for.

(3) Onerous contracts

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligation under the contract. The provision is recognised at the lower of the present value of the cost of contract cancellation and the present value of the net cost of meeting the contract obligations.

(4) Site dismantling and clearing costs

A provision in respect of an obligation to dismantle and clear sites is recognised in accordance with IAS 37. The provision is recognised in respect of those rental agreements under which the Group is obliged at the end of the rental period to restore the rental property to its original state, after dismantling and transferring the site and restoration of the site as necessary. In connection with recognition of a provision for the costs of dismantling and clearing sites at the date of transition to IFRS, the Group selected the relief in accordance with IFRS1, as described in Note 3D(1).

(5) Warranty

A consolidated company recognised a provision for warranty in respect of first-year insurance for cellular handsets. The warranty is limited to technical malfunctions defined by the Company, and does not include warranty as a result of customer damages. However, an asset exists in respect of the manufacturer's warranty for those handsets, which is limited to technical malfunctions defined by the manufacturer.

N. Income

The Group's income consists mainly of revenues from fixed-line communication services, cellular services, international communication services, satellite television services, customer centre services, provision of communication services for other communications providers, sale and installation of communications equipment, and internet services. Revenues are measured at the fair value of the consideration received or about to be received, less returns, commercial discounts and quantity discounts.

(1) Equipment sales

Revenue from sales of equipment are recorded at the time of delivery to the customer, upon transfer of the main risks and rewards related to ownership of the equipment sold.

(2) Services

Revenue from services is charged proportionately over the term of the agreement or upon providing the service if the flow of the economic benefits associated with providing the service is certain. Revenue from calls, including revenue from prepaid call cards, are recognised when the call is made by the customer.

(3) Operating lease

Lease payments are recognised in income and expense by the straight line method, over the term of the lease. Lease incentives granted are recognised as an integral part of all revenues from rentals, over the term of the lease.

(4) Interest and dividends

Interest income on debentures and loans is recognised in income and expense on a cumulative basis, using the effective interest method. Income from dividend is charged to the income statement on the effective date of entitlement to a dividend.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

N. Income (contd.)

(5) Sales on credit

Revenues from sales transactions on credit that include a financing transaction, are recorded at their present value, so that the difference between the fair value of the transaction and the stated amount of the consideration will be recognised inthe income statement as interest income, using the effective interest rate.

(6) Multi-component sale agreements

Revenues from sale agreements that do not contain a general right for return, which include a number of components, such as an appliance, service, and support agreements, are split into separate accounting units and recognised separately for each accounting unit. A component constitutes a separate accounting unit if, and only if, it has a separate value for the customer. In addition, there is reliable and objective evidence of the fair value of all the components in the agreement / the fair value of the components not yet supplied. Components not split into an accounting unit due to non-compliance with the conditions described above, are grouped together into one accounting unit. Recognition of revenues from the various accounting units takes place when the conditions are met for recognition of revenues from the components in that accounting unit, depending on their type, and only up to the amount of the consideration which is not contingent upon completion / performance of the other components in the contract.

(7) Reporting revenues on a gross or net basis

In cases where the Group acts as agent or broker without bearing the risks and returns arising from the transaction, its revenues are stated net. Conversely, where the Group acts as main supplier and bears the risks and returns arising from the transaction, its revenues are stated gross.

(8) Lease of satellite decoders

A consolidated company collects deposits from its customers for the digital satellite decoders situated on the customer site, in an amount which does not exceed the cost of the decoders, and at the end of the agreement, the customers are entitled to the remaining portion of the deposit in accordance with in their agreement.

Revenues from deduction of the deposit are recognised in the income statement, in accordance with the terms of the agreement with the customers (over five or 10 years).

O. Financing income and expenses

Financing income includes interest income in respect of amounts invested, income from dividends, interest income from recognising deferred income in respect of the sale of terminal equipment in instalments, gains from the sale of monetary assets classified as available for sale, changes in the fair value of monetary assets stated at fair value through income, gains from foreign currency and gains from hedging instruments recognised in profit and loss. Interest income is recognised as accrued, using the effective interest method. Dividend income is recognised on the date on which the Company's right to receive payment is established which in the case of quoted securities is usually the ex-dividend date.

Financing expenses include interest expenses on loans received, debentures issued, commissions paid, changes in the time value in respect of provisions, foreign currency losses, changes in the fair value of monetary assets stated at fair value in income, losses from impairment in value of monetary assets and losses from hedging instruments recognised in income. All borrowing costs are recognised in the profit and loss using the effective interest rate.

P. Income tax expense

Income tax expense comprises current and deferred taxes and is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.
Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted a the balance sheet date, and any adjustment to tax payable in respect of previous years.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

P. Income tax expense (contd.)

Deferred taxes are provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts to be used for taxation purposes. Deferred taxes for the following temporary differences are not recognised: initial recognition of goodwill, initial recognition of assets and liabilities in a business combination transaction which does affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries and jointly-controlled entities to the extent that they will probably not reverse in the foreseeable future. The amount of deferred taxes is measured using tax rates expected to be applicable to the temporary timing differences at the date of their realisation, based on laws enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences may be utilised. Deferred tax assets are reviewed at each balance sheet date, and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Additional income taxes that arise from the distribution of dividends are recognised at the same time as the liability to pay the related dividend.

Q. Earnings per share

The Group presents basic and diluted earnings per share data in respect of its ordinary share capital. The basic earnings per share is calculated by dividing the profit or loss attributed to the ordinary shareholders of the Group by the weighted average number of ordinary shares which were in circulation during the period. The diluted earnings per share is determined by adjustment of the loss or gain to the ordinary shareholders and adjustment of the weighted average of the ordinary shares in circulation for the effects of all the potential dilutions to ordinary shares, including notes convertible to shares, share options and share options granted to employees.

R. Segment reporting

A segment is a distinguishable component of the Company that is engaged in providing services to each other (business segment) which is subject to risks and rewards that are different those other segments. The main form of the Company’s segment reporting is based on business segments.

S. Dividend declared subsequent to the balance sheet date

An obligation relating to a dividend proposed or declared subsequent to balance sheet date is recognised only in the period in which the declaration was made.

T. New standards and interpretations not yet adopted

A number of new standards, amendments to existing standards and interpretations, were not yet effective on December 31, 2006, and therefore were not applied in the preparation of these consolidated financial statements.

IFRS 7 – Financial Instruments: Disclosures and the amendment to IAS 1 – Presentation of Financial Statements: Capital Disclosures, require extensive disclosures concerning the significance of the financial instruments on the financial position and performance of the Group, and disclosures of quality and quantity regarding the nature and scope of the risks. IFRS 7 and the amended IAS 1, will be applicable to the financials statements of the Group for 2007 and will require additional extensive disclosures relating to Group financial instruments and share capital.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

T. New standards and interpretations not yet adopted (contd.)

IFRIC 7 – Financial Reporting in Applying the Restatement Approach under IAS 29 in Hyperinflationary Economies, relates to the application of IAS29 when an economy becomes hyperinflationary for the first time, and in particular the accounting treatment related to deferred tax. IFRIC 7, which will apply to the financial statements of the Group for 2007, is not likely to affect the consolidated financial statements.

IFRIC 8 – Scope of IFRS 2 – Share-based Payment, relates to the accounting treatment of share-based payment transactions in which some or all of the goods or services received cannot be specifically identified, IFRIC 8 will apply to the financial statements of the Group for 2007, and adoption will be by way of retroactive application. The effect of IFRIC 8 on the consolidated financial statements depends on the existence of of the type of the aforementioned transactions..

IFRIC 9 – Reassessment of Embedded Derivatives, determines that reassessment with regard to the need to separate an embedded derivative from a host contract will arise only when changes in the contract occur. The effect of IFRIC 9, which will apply to the financial statements of the Group for 2007, depends on the existence of the aforementioned changes.

IFRIC 10 – Interim Financial Reporting and Impairment, prohibits the cancellation of a loss from impairment which was recognised in a prior interim period in respect of goodwill, investment in a capital instrument or a monetary asset stated on a cost basis. IFRIC 10 will apply to the financial statements of the Group for 2007. The adoption of IFRIC 10 is not likely to affect the consolidated financial statements of the Group.

IFRIC 11 – Group and Treasury Share Transactions is an interpretation dealing with the application of IFRS 2: Share-based Payment, in share-based transactions related to the capital instruments of the corporation itself or the equity instruments of another corporation in the same group. IFRIC 11 will be applicable to the annual periods commencing March 1, 2007 or thereafter. Early adoption is permitted. The effects of adoption of IFRIC 11 on the consolidated financial statements depends on future grants of share-based payments by the Group.

IFRIC 12 – Service Concession Arrangements is an interpretation relating to the accounting treatment of operators from the private sector which provide public infrastructure assets and services. IFRIC 12 creates a distinction between two types of arrangements for service concessions. In one, the operator receives a monetary asset, an unconditional contractual right to receive cash or a other monetary asset from the government in exchange for the construction or upgrading of a public asset. In the other, the operator receives an intangible asset, a right to collect payment for the use of the public asset it is constructing or upgrading. The right to collect payment from users is not an unconditional right to receive cash, since the amounts depend on the scope of use the public will make of the service. The interpretation will apply to annual periods commencing on January 1, 2008 or thereafter, and early adoption is permitted. The adoption of IFRIC 12 is not likely to affect the consolidated financial statements.

IFRS 8 – Segment Reporting, describes how a corporation should report on segment operations in the annual financial statements, and relates to selected details concerning segments in interim reports. In addition, the standard relates to the disclosure required regarding products and services, geographical areas and principal accounts. The standard allows the corporation to determine the rationale for division into segments, so that segmental reporting will be based on factors under Management's supervision for operational decision-making. The standard will apply to annual periods commencing on January 1, 2009 thereafter. The standard permits early application, and requires amendment of comparative numbers on adoption of the standard. The adoption of IFRS 8 is not likely to significantly affect the consolidated financial statements.

NOTE 4 – DETERMINING FAIR VALUE

The accounting policies and the disclosure requirements require the Group to determine the fair value of monetary and non-monetary assets and liabilities. The fair values were determined for the purposes of measurement and/or disclosure using the methods described below. Additional information regarding the assumptions used in determining the fair values can be found in the notes relevant to the particular asset or liability.

A. Property, plant and equipment

Certain items of property, plant and equipment were revalued at fair value on the date of transition to IFRS. Determination of the deemed cost of the items is based on an assessment of the value performed by an external appraiser using the depreciated replacement cost method.

B. Investments in shares and debentures

The fair value of monetary assets is measured at fair value through profit and loss, which are classified as available for sale, is determined using their offer price in the market or according to a model for non-negotiable assets at the balance sheet date.

C. Customers and other trade receivables

The fair value of customers and other long-term trade receivables was determined using the present value of the future cash flows, discounted at the market interest rate on the balance sheet date.

D. Derivatives

The fair value of foreign currency or Indexed forward contracts is based on their quoted market prices, if available and if unavailable, particularly regarding embedded derivatives, according to estimated value.

E. Non-derivative financial liabilities

The fair value, determined for disclosure, is calculated at the present value of the future cash flows in respect of the principal and the interest, discounted at the market interest rate on the balance sheet date.

F. Share-based payments

The fair value of stock options for employees is measured using the Black and Scholes model. The assumptions of the model include the share price on the date of measurement, the exercise price of the instrument, expected volatility (based on the weighted average of historical volatility, adjusted for changes expected from information available to the public), the weighted average of the projected useful life of the instruments (based on past experience and the general behaviour of the option-holders), expected dividends, and the risk-free interest rate (based on government bonds). Conditions of service and performance which are not market conditions, are not taken into account in determining the fair value.

NOTE 5 – CASH AND CASH EQUIVALENTS

	Consolidated	
	December 31 2006	December 31 2005
	NIS thousands	NIS thousands
Bank balances	**66,015**	75,591
Demand deposits	**2,565,775**	2,083,182
Cash and cash equivalents	**2,631,790**	2,158,773

The effective interest rate on the demand deposits in 2006 was 4.8% - 5.3% (2005 – 3.7% - 4.3%). For deposits, the average maturity period was 3-7 days (2005 – 5-7 days).

NOTE 6 –TRADE AND OTHER RECEIVABLES

	Consolidated	
	December 31 2006	December 31 2005
	NIS thousands	NIS thousands
Trade receivables		
Trade receivables that are related parties and interested parties	**98,129**	92,247
Open debts	**912,352**	997,291
Credit cards and checks for collection	**455,021**	415,059
Others	**202,978**	218,955
Current maturities of long-term trade receivables	**442,971**	391,330
	2,111,451	2,114,882
Receivables		
Government institutions	**1,309**	-
Prepaid expenses	**93,977**	126,971
Other receivables	**155,371**	14,886
	250,657	141,857
Long-term trade receivables (1)	**388,652**	359,900
Other long-term receivables (1)	**28,492**	1,113
	417,144	361,013
	2,779,252	2,617,752

(1) For the repayment dates and the discounted interest rates, see Note 30.

At December 31, 2006, trade receivables are shown net of the provision for doubtful debts in the amount of NIS 289,010 thousand (2005 – NIS 338,062 thousand). The loss from impairment recognised in the current year amounted to NIS 55,920 thousand (2005 – NIS 69,166 thousand).

Trade and other receivables denominated in currencies which are not the functional currency include NIS 74,045 thousand of receivables denominated in US dollars (2005 – NIS 52,256 thousand), and NIS 7,421 thousand of receivables denominated in euro (2005 – NIS 2,189 thousand).

NOTE 7 – INVESTMENTS AND LOANS, INCLUDING DERIVATIVES

A. Segmentation by investment classification

	Consolidated	
	December 31 2006	December 31 2005
	NIS thousands	NIS thousands
Current investments		
Financial assets measured at fair value trough profit and loss	**893,975**	2,316,826
Structured instruments (1)	**60,361**	-
Financial assets available for sale (2)	**-**	78,547
Derivatives	**2,983**	4,458
Other investments	**3,242**	3,582
	960,561	2,403,413
Non-current investments		
Bank deposit for providing loans to employees (3)	**185,291**	192,621
Structured instruments (1)	**-**	65,597
Financial assets available for sale	**121,123**	119,157
Loans and long-term debit balances	**35,761**	79,346
	342,175	456,721
	1,302,736	2,860,134

(1) The carrying amount of structured instruments includes debentures. The instruments are dollar-linked and bear LIBOR for six months and three months plus a margin of 3.4% and 1.65%, respectively.

(2) The carrying amount of an interest-bearing financial asset available for sale at December 31, 2006, is NIS 78,547 thousand. The asset, which bears interest at 4%, was realised in 2006.

(3) The deposit is used as collateral for the provision of bank loans to Company employees. The deposit is unlinked, and the effective interest rate at December 31, 2006 is 2.93% (2005 – 2.53%). The Company is liable for loans to employees. The deposit is shown at its present value, taking into account the repayment schedule of the loans, based on a discounted rate of 5.56% on average (2005 – 5.84%). Deferred salary expenses were added to the deposit amount.

NOTE 7 – OTHER INVESTMENTS, INCLUDING DERIVATIVES (CONTD.)

B. Segmentation by types of securities

	December 31, 2006			December 31, 2005		
	Marketable	Others	Total	Marketable	Others	Total
	Equity value	Equity value	Equity value	Equity value	Equity value	Equity value
	NIS thousands			NIS thousands		
Government bonds –						
Linked to the consumer price index	**188,939**	**-**	**188,939**	764,631	-	764,631
Unlinked	**200,496**	**-**	**200,496**	372,075	-	372,075
Linked to the dollar	**482**	**-**	**482**	1,740	-	1,740
Corporate debenture	**329,297**	**-**	**329,297**	639,923	-	639,923
Foreign securities	**55,360**	**-**	**55,360**	245,642	-	245,642
Short-term loan	**88,493**	**-**	**88,493**	143,547	-	143,547
Investments in shares and options	**28,957**	**74,675**	**103,632**	63,999	79,932	143,931
Participation in trust funds	**7,972**	**-**	**7,972**	161,578	-	161,578
Investments in debentures convertible to shares	**1,800**	**-**	**1,800**	5,361	-	5,361
Structured instruments	**-**	**60,361**	**60,361**	-	65,597	65,597
Bank deposit for providing loans to employees	**-**	**185,291**	**185,291**	-	192,621	192,621
Investment in hedge fund	**-**	**38,627**	**38,627**	-	36,102	36,102
Loans and long-term debit balances	**-**	**35,761**	**35,761**	-	79,346	79,346
Other investments	**-**	**6,225**	**6,225**	-	8,040	8,040
	901,796	**400,940**	**1,302,736**	2,398,496	461,638	2,860,134

C. Details of linkage base and interest terms – non-current investments

	December 31, 2006				
	Interest %	Unlinked	CPI-linked	Linked to foreign currency	Total
		NIS thousands	NIS thousands	NIS thousands	NIS thousands
Deposit in bank for providing loans for employees	2.93%	**185,291**	**–**	**–**	**185,291**
Capital notes	5.85%	**–**	**15,497**	**–**	**15,497**
Loan	6.25%	**–**	**20,264**	**–**	**20,264**
Financial asset available for sale	Interest-free	**–**	–	**38,627**	**38,627**
		185,291	**35,761**	**38,627**	**259,679**

	December 31, 2005				
	Interest %	Unlinked	CPI-linked	Linked to foreign currency	Total
		NIS thousands	NIS thousands	NIS thousands	NIS thousands
Deposit in bank for providing loans for employees	2.53%	192,621	–	–	192,621
Capital notes	5.8%-5.85%	–	56,990	–	56,990
Loan	6.25%	–	22,356	–	22,356
Financial asset available for sale	Without interest	–	–	36,102	36,102
Structured instruments	LIBOR 3 months + 1.65%	–	–	32,799	32,799
Structured instruments	LIBOR 6 months + 3.4%	–	–	32,798	32,798
		192,621	79,346	101,699	373,666

NOTE 8 – INCOME TAX

A. General

	2006	2005
	NIS thousands	NIS thousands
Current tax expense		
In respect of the current period	**397,180**	307,680
Adjustments in respect of prior years	**4,978**	(29,281)
	402,158	278,399
Deferred tax expense		
Reduction in the tax rate	**-**	83,529
Origination and reversal of temporary differences	**91,228**	195,127
Movement in the value of temporary differences not recognised	**(4,993)**	(25,040)
	86,235	253,616
Income tax expense from ongoing activities	**488,393**	532,015

B. Reconciliation of effective tax rate

	2006	2005
	NIS thousands	NIS thousands
Net earnings	**750,025**	620,303
Income tax	**488,393**	532,015
Earnings before tax	**1,238,418**	1,152,318
Statutory tax rate	**31%**	34%
Income tax at the local tax rate applicable to the group	**383,910**	391,788
Differences in the tax rate	**7,479**	83,529
Differences in definition of capital and assets	**(5,316)**	(60,272)
Expenses not recognised for tax purposes	**15,443**	48,002
Recognition of losses for tax purposes not previously recognised	**-**	4,514
Deferred taxes due to temporary differences not previously recognised	**(4,993)**	(25,040)
Losses generated during the period, for which a deferred tax asset was not recognised	**87,644**	129,023
Agreed tax assessments	**-**	(7,619)
Losses of a partnership	**665**	(3,550)
Change in temporary provisions not recognised	**(3,610)**	(12,029)
Taxes in respect of prior years	**4,978**	(29,281)
Others	**2,193**	12,950
	488,393	532,015

C. Income tax attributable directly to equity

	2006	2005
	NIS thousands	NIS thousands
Financial assets classified as available for sale	**(6,682)**	(104,043)
Actuarial gains and losses	**3,427**	(15,211)
Expenses recognised directly in equity	**(3,255)**	(119,254)
Total tax recognised directly in equity	**2,227**	40,692

NOTE 8 – INCOME TAX (CONTD.)

D. Deferred tax assets that were not recognised

Calculation of the deferred taxes does not take into account the taxes that would be applicable in case of realisation of the investment in subsidiaries and associates, since the Group intends to retain the investment. Deferred taxes in respect of a distribution of profit in those subsidiaries and associates were also not taken into account, since the dividends are not taxable. In addition, unutilised deferred tax assets in respect of losses carried forward and tax assets carried forward, were not recognised in cases where future taxable income against which they can be utilised, is not foreseen.

Deferred tax assets not recognised

Deferred tax assets were not recognised in respect of the following items:

	2006	2005
	NIS thousands	NIS thousands
Deductible temporary differences	**18,247**	7,951
Losses for tax purposes	**225,148**	337,174
	243,395	345,125

Under existing tax laws, there is no time limit on utilising tax losses or on utilising deductible temporary differences. Deferred tax assets were not recognised in respect of these items since it is not anticipated that there will be taxable income against which the tax benefits may be utilised.

E. Recognised deferred tax assets and liabilities

Tax assets and deferred tax liabilities are attributed to the following items:

	Assets		Liabilities		Net	
	2006	2005	2006	2005	2006	2005
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Property, plant and equipment	**56,519**	94,036	**70,407**	7,109	**(13,888)**	86,927
Doubtful debts	**51,102**	65,233	**–**	–	**51,102**	65,233
Intangible assets	**–**	–	**9,517**	5,527	**(9,517)**	(5,527)
Monetary assets measured at fair value through profit and loss	**3,856**	–	**1,929**	11,915	**1,927**	(11,915)
Monetary assets classified as available for sale	**3,477**	4,483	**1,283**	980	**2,194**	3,503
Derivatives	**–**	357	**233**	–	**(233)**	357
Employee benefit plan	**546,981**	479,794	**–**	–	**546,981**	479,794
Share-based payments	**135,755**	64,255	**–**	–	**135,755**	64,255
Provisions	**4,611**	5,920	**–**	–	**4,611**	5,920
Other assets	**10,936**	9,417	**–**	–	**10,936**	9,417
Deferred expenses in connection with agreed assessments	**9,330**	14,111	**–**	–	**9,330**	14,111
Losses from partnerships	**3,098**	–	**–**	–	**3,098**	–
Tax losses carried forward	**251,320**	365,549	**–**	–	**251,320**	365,549
	1,076,985	1,103,155	**83,369**	25,531	**993,616**	1,077,624

NOTE 8 – INCOME TAX (CONTD.)

F. Changes in temporary differences during the year

	Balance at January 1, 2005	Recognised in profit and loss	Recognised in equity	Balance at December 31, 2005	Recognised in profit and loss	Recognised in equity	Balance at December 31, 2006
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Property, plant and equipment	66,671	20,256	-	86,927	**(100,815)**	**-**	**(13,888)**
Doubtful debts	85,475	(20,242)	-	65,233	**(14,131)**	**-**	**51,102**
Intangible assets	(7,091)	1,564	-	(5,527)	**(3,990)**	**-**	**(9,517)**
Monetary assets measured at fair value through profit and loss	(21,982)	10,067	-	(11,915)	**13,842**	**-**	**1,927**
Monetary assets available for sale	(24,802)	(8,988)	37,293	3,503	**(3,368)**	**2,059**	**2,194**
Derivatives	-	357	-	357	**(590)**	**-**	**(233)**
Employee benefits	629,820	(153,425)	3,399	479,794	**67,019**	**168**	**546,981**
Share-based payments	-	64,255	-	64,255	**71,500**	**-**	**135,755**
Provisions	38,479	(32,559)	-	5,920	**(1,309)**	**-**	**4,611**
Deferred expenses in connection with other items	9,270	147	-	9,417	**1,519**	**-**	**10,936**
Agreed assessments	17,607	(3,496)	-	14,111	**(4,781)**	**-**	**9,330**
Losses and partnerships	-	-	-	-	**3,098**	**-**	**3,098**
Losses carried forward for tax purposes	497,101	(131,552))	-	365,549	**(114,229)**	**-**	**251,320**
	1,290,548	(253,616)	40,692	1,077,624	**(86,235)**	**2,227**	**993,616**

G. Changes during the year in unrecognised deferred tax assets and liabilities

	Balance at January 1, 2005	Changes	Amounts recognised	Balance at December 31, 2005	Changes	Amounts recognised	Balance at December 31, 2006
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Deductible temporary differences (taxable)	68,779	(12,521)	(25,040)	31,218	**1,774**	**(4,993)**	**27,999**
Losses for tax purposes	900,000	113,346	(195,413)	817,933	**69,364**	**(13,077)**	**874,220**
	968,779	100,825	(220,453)	849,151	**71,138**	**(18,070)**	**902,219**

NOTE 8 – INCOME TAX (CONTD.)

H. Amendments to the Income Tax Ordinance

On July 25, 2005, the Knesset passed the Amendment to the Income Tax Ordinance Law (Number 147 and temporary order), 5765-2005 ("Amendment 147"). Amendment 147 provides for a gradual reduction in the corporate tax rate in the following manner:
In the 2006 tax year, the corporate tax rate will be 31%, in 2007 the rate will be 29%, in 2008 – 27%, in 2009 – 26% and from 2010 and thereafter, the corporate tax rate will be 25%. In addition, commencing in 2010 and with the reduction in the company tax rate to 25%, any real capital gain will be taxed at 25%.

Current taxes and deferred tax balances at December 31, 2005 and at December 31, 2006 are calculated at the new tax rates as provided in Amendment 147. The effect of the change on the consolidated financial statements at the beginning of 2005 is an increase in the income tax expense in the income statement and a decrease in the deferred taxes included in the consolidated balance sheet in the amount of NIS 83 million.

I. Final tax assessments

(1) The Company, Bezeq International, Pelephone, Bezeq On Line and Bezeqcall have final assessments up to and including the 2003 tax year.

(2) BezeqCall Communications has a final tax assessment up to and including the 2002 tax year.

(3) DBS has received final tax assessments up to and including the year 2004.

J. Effect of IFRS on the tax liability

The Income Tax Authority set up a committee to make recommendations concerning the effects of application of IFRS on the tax liability. The recommendations have not yet been published.

NOTE 9 – PROPERTY, PLANT AND EQUIPMENT

A. Composition and movement

	Land & buildings	Switching, transmission and power equipment	Network equipment	Subscriber equipment	Motor Vehicles	Office equipment and computers	Total
				NIS thousands			
Cost or deemed cost							
Balance at January 1, 2005	1,997,039	7,166,935	12,007,631	2,547,166	190,735	1,144,385	25,053,891
Additions	48,811	583,799	169,133	426,793	4,796	152,294	1,385,626
Disposals (d)	(4,871)	(3,801,531)	(24,625)	(137,992)	(46,765)	(74,039)	(4,089,823)
Balance at December 31, 2005	2,040,979	3,949,203	12,152,139	2,835,967	148,766	1,222,640	22,349,694
Balance at January 1, 2006	**2,040,979**	**3,949,203**	**12,152,139**	**2,835,967**	**148,766**	**1,222,640**	**22,349,694**
Additions	**25,356**	**350,074**	**104,022**	**319,714**	**1,351**	**108,523**	**909,040**
Disposals	**(116,371)**	**(356,744)**	**(36,363)**	**(140,560)**	**(39,433)**	**(104,356)**	**(793,827)**
Balance at December 31, 2006	**1,949,964**	**3,942,533**	**12,219,798**	**3,015,121**	**110,684**	**1,226,807**	**22,464,907**
Depreciation and losses from impairment							
Balance at January 1, 2005	1,310,170	4,407,230	9,208,007	1,624,298	135,667	804,215	17,489,587
Depreciation for the year	96,275	746,227	300,708	366,484	19,248	137,362	1,666,304
Cancellation in respect of disposals (d)	(2,010)	(3,791,216)	(24,625)	(122,242)	(39,789)	(72,812)	(4,052,694)
Balance at December 31, 2005	1,404,435	1,362,241	9,484,090	1,868,540	115,126	868,765	15,103,197
Balance at January 1, 2006	**1,404,435**	**1,362,241**	**9,484,090**	**1,868,540**	**115,126**	**868,765**	**15,103,197**
Depreciation for the year	**104,456**	**693,354**	**276,764**	**372,881**	**13,450**	**130,149**	**1,591,054**
Cancellation in respect of disposals	**(83,824)**	**(353,604)**	**(36,363)**	**(110,263)**	**(35,036)**	**(102,616)**	**(721,706)**
Balance at December 31, 2006	**1,425,067**	**1,701,991**	**9,724,491**	**2,131,158**	**93,540**	**896,298**	**15,972,545**
Net carrying value							
At January 1, 2005	686,869	2,759,705	2,799,624	922,868	55,068	340,170	7,564,304
At December 31, 2005	636,544	2,586,962	2,668,049	967,427	33,640	353,875	7,246,497
At December 31, 2006	**524,897**	**2,240,542**	**2,495,307**	**883,963**	**17,144**	**330,509**	**6,492,362**

NOTE 9 – PROPERTY, PLANT AND EQUIPMENT (CONTD.)

A. COMPOSITION AND MOVEMENT (CONTD.)

a. Determination of fair value as deemed cost – Certain items of property, plant and equipment from the switching, transmission and power group of equipment, principally switching equipment, which were revalued to fair value on the date of transition to the IFRS, were measured on the basis of their deemed cost, which was determined according to their fair value on the transition date (January 1, 2005), as assessed by the Group based on valuation an external appraiser. See Note 33(a).

b. Residual value – The residual value of the Group's copper cables as assessed at the end of the reporting year. The residual value is approximately NIS 409 million and NIS 598 million at December 31, 2005 and December 31, 2006 respectively.

c. Cost of dismantling and removal of assets – The cost of items of property, plant and equipment includes dismantling and removal costs, as well as other restoration costs to which the Group has an obligation. These costs are depreciated according to the expected useful life of the sites. Capitalisation of the costs of property, plant and equipment and the calculation of the accumulated depreciation at January 1, 2005 (the date of transition to the IFRS) are shown in Note 33. During 2006, the Group capitalised approximately NIS 1,210 thousand costs for dismantling and removal of assets (2005 – NIS 2,442 thousand).

d. Property, plant and equipment in the Group is disposed of at the year end upon reaching full depreciation, except for land, buildings and vehicles, which are disposed of on their sale. In 2006, the Group disposed of fully depreciated property at a cost of approximately NIS 565 million (2005 – NIS 3,996 million). .

e. The cost includes NIS 1,207 thousand in the Group, representing real financing expenses, which were capitalised in the statement period in respect of loans and credit in the construction period calculated at a real average interest rate of approximately 4.3% per year (prior year – 4.8%).

f. On December 31, 2006, Pelephone has a commitment to purchase terminal equipment during 2007, for a total amount of NIS 272 million.

g. At the balance sheet date, there are agreements to purchase property, plant and equipment totalling approximately NIS 608 million (the amounts include the remarks in sub-section f. above).

h. Concerning liens, see Note 19.

NOTE 10 – INTANGIBLE ASSETS

	Goodwill	Computer software and licenses and discounted development costs	Subscriber acquisition, net	Right of use of frequencies	Others	Total
	NIS thousands					
Cost						
Balance at January 1, 2005	1,792,658	1,025,947	173,593	220,104	49,243	3,261,545
Developed by the Group or purchased separately	-	147,670	52,192	-	82	199,944
Balance at December 31, 2005	1,792,658	1,173,617	225,785	220,104	49,325	3,461,489
Balance at January 1, 2006	1,792,658	1,173,617	225,785	220,104	49,325	3,461,489
Acquisitions in business combinations	**83**	**-**	**-**	**-**	**-**	**83**
Developed or purchased separately by the Group	**-**	**147,306**	**49,064**	**-**	**177**	**196,547**
Balance at December 31, 2006	**1,792,741**	**1,320,923**	**274,849**	**220,104**	**49,502**	**3,658,119**
Reductions and losses from impairment						
Balance at January 1, 2005	-	470,953	121,144	-	17,248	609,345
Amortisation for the year	-	176,426	59,910	-	4,774	241,110
Balance at December 31, 2005	-	647,379	181,054	-	22,022	850,455
Balance at January 1, 2006	**-**	647,379	181,054	-	22,022	850,455
Amortisation for the year	**-**	**200,171**	**44,856**	**-**	**2,530**	**247,557**
Loss from impairment	**5,865**	**-**		**-**		**5,865**
Balance at December 31, 2006	**5,865**	**847,550**	**225,910**	**-**	**24,552**	**1,103,877**
Net carrying value –						
At January 1, 2005	1,792,658	554,994	52,449	220,104	31,995	2,652,200
At December 31, 2005	1,792,658	526,238	44,731	220,104	27,303	2,611,034
At December 31, 2006	**1,786,876**	**473,373**	**48,939**	**220,104**	**24,950**	**2,554,242**

NOTE 10 – INTANGIBLE ASSETS (CONTD.)

Total value of goodwill allocated to each unit is as follows:

	2006 NIS thousands	2005 NIS thousands
Pelephone Communications Ltd. (1)	**1,026,696**	1,026,696
D.B.S. Satellite Services (1998) Ltd. (2)	**760,097**	760,097
Others	**83**	5,865
	1,786,876	1,792,658

(1) The value of the holding in Pelephone was calculated by the Discount Cash Flow (DCF) method, and was based on the following assumptions:

A detailed projected cash flow for 5 years, which is a reasonable assessment range for which a detailed cash flow can be prepared.

- An income forecast was constructed on the basis of a forecast for the number of subscribers and average revenue per user (ARPU) according to the structure of revenues from departments plus revenues from sales of handsets. The subscriber forecast is based on a cellular company market model, taking into account market saturation, population growth, and assuming an increase of 1% - 1.3% in Pelephone's market share in the forecast periods.
- The ARPU forecast is based on the following: a decrease in call minutes compared with the average in 2005 (in the forecast for 2006). Following a significant decline in call minutes in 2006, a rise in call minutes was assumed for 2007, a rise in prices is expected in the first year of the forecast, a reduction in interconnect prices, and an increase in revenues from value added services.
- The operating and the sales and marketing expenses were adjusted for the anticipated volume of operations. Tax was deducted from the profit at the statutory tax rate in each year.
- Investments were taken according to Pelephone's investment plan, which consists mainly of the set-up and deployment of third generation sites, set-up of the HSUPA network, investment in IT and in subscriber acquisition.
- The capitalisation rate taken, 9.5% and 9.6% for 2005 and 2006 respectively , was calculated by the WACC model and based on a capital price of 11.5% and 12% respectively, and a debt price of approximately 6.75%.
- Beyond the fifth year, growth of about 1% was assumed, taking into account population growth, the stabilization of the market among the cellular companies, and the competition possible future and alternatives.

The value obtained from these assumptions is highly sensitive to the following:

- An increase of one half of one percent in the capitalisation rate reduces the value by approximately 7.5%.
- A decrease of one percent in ARPU in the first year, decreases the value by 6.5%, and by 8% in 2006 and 2005 respectively.

As an additional indicator, the value of the holding in Pelephone was tested by the comparison with similar companies. Using this method, EV/EBITDA multipliers (enterprise value / earnings before tax, depreciation and amortization) were compared. The value obtained by this method is higher than the value obtained using the DCF method.

(2) The value of the holdings of DBS was calculated by the discounted cash flow method (DCF), and was based on the following data:

- A detailed projected cash flow was prepared for 10 years, the period in which the multi-channel television market is expected to stabilize.
- Transition to the tenth year assumed growth of approximately 1.8%, taking into account the growth in population, the balance between DBS and the cables, as well as competition and possible future alternatives.
- The income forecast was prepared on the basis of projected number of subscribers and average revenue per user (ARPU) which provide the revenue from the services. The subscriber forecast is based on the business plan of DBS for the coming year and on continued growth based on the growth forecasts for households in Israel, the customer churn rate based on past experience, global trends, and a forecast of the stabilization of competition and lower churn rates, where it was assumed that the market share of DBS would increase over the years at the expense of the cable companies, to about 40% (compared with 33% today).
- The ARPU is based on a price rise implemented during 2006, and on future price rises of approximately 2% per year, based on adding value-added services while taking into consideration competition and the weight of the expense in the total household expense.

NOTE 10 – INTANGIBLE ASSETS (CONTD.)

- The operating and the sales and marketing expenses were adjusted for the anticipated volume of operation, while assuming that the content expenses, which are DBS's principal expense item, would be about 33% of income from 2008 onwards.
- DBS has considerable losses for tax purposes. Accordingly, tax was not taken in the forecast period. After the forecast period, tax was taken at 25%, in respect of the part of the profit exceeding the cumulative loss at that date.
- Investments are mainly in installations, and in decoders which are a function of new subscribers, net, and the accepted level of decoder replacement, based on past data. In addition, engineering investments for preserving what is and developing new areas.
- The capitalisation rate taken, 13% -13.5%, takes into account DBS's dependence on external financing, limitations and dependence on changes in regulation, and the equity structure of DBS.
- The calculated value was attributed initially to the new shareholder loans (which were provide after July 2002) of about one billion shekels, since under the agreement they will be paid before the old loans. The Company's part in the loans is approximately 85%. The balance was attributed to repayment of the shareholder loans, in which the Company's part is approximately 51%.

The value calculated with the above assumptions is highly sensitive to the following:

- An increase of one half of one percent in the capitalisation rate taken will reduce the value by 7% (2006) to 15% (2005).
- A decrease of one percent in the ARPU in the first year, reduced the value by 4% (2006) to 11% (2005).

NOTE 11 – DEFERRED AND OTHER EXPENSES

	2006	2005
	NIS thousands	NIS thousands
Land lease rights (1)	**220,734**	230,301
Long-term prepaid expenses in respect of use of capacities (2)	**146,775**	154,249
Long-term prepaid expenses in respect of lease agreement	**6,240**	7,188
	373,749	391,738

(1) Most of the real estate assets used by the Company were transferred to it by the State of Israel pursuant to and at the consideration stated in an agreement from January 31, 1984. Some of these assets are leased for 49 years, with an option to extent for another 49 years, and some are rented for two years, renewable each time for another two years.
On May 15, 2003, the Company signed a settlement agreement with the Government of Israel on behalf of the State, and Israel Lands Administration, regulating the dispute between them in the matter of the Company's rights in various real estate assets which were transferred to the Company when it commenced operation in 1984 under the asset transfer agreement signed between the Company and the State.
The rights are amortized over the course of the lease period.

(2) See Note 3H.

NOTE 12 – INVESTEES ACCOUNTED FOR BY THE EQUITY METHOD

A. Below are condensed financial data regarding a principal investee company accounted for by the equity method, without adjustment for percentage ownership held by the Group.

	Rate of ownership	Current assets	Non-current assets	Total assets	Current liabilities	Non-current liabilities	Total liabilities	Income	Profit/loss
		NIS thousands							
2005									
Walla! Communications Ltd.	42.85%	37,471	12,906	50,377	16,070	7,661	23,731	75,644	10,649
2006									
Walla! Communications Ltd.	44.04%	**66,639**	**25,360**	**91,999**	**26,515**	**4,163**	**30,678**	**100,977**	**25,242**

NOTE 12 – INVESTEES ACCOUNTED FOR BY THE EQUITY METHOD (CONTD.)

B. The investment in an associate company comprises the investment of a consolidated subsidiary in Walla! Communications ("Walla") (an associate), an Israeli company whose shares are listed on the stock exchange in Tel Aviv and whose business is the provision of internet services and the operation of portals to the internet.

Composition of the investment

	December 31 2006	December 31 2005
	NIS thousands	NIS thousands
Cost of shares (1)	**79,615**	74,504
Exercisable option warrants	**102**	615
Share in equity reserve in respect of financial assets classified as available for sale	**707**	688
Share in accumulated losses, net	**(28,066)**	(39,845)
	52,358	35,962
Index-linked interest-free loans (2)	**872**	5,514
	53,230	41,476
Deductions in respect of impairment (1)	**(21,108)**	(21,108)
	32,122	20,368

(1) The balance at December 31, 2006 and 2005 includes goodwill, the cost of which at those dates amounts to NIS 46,132 thousand and NIS 44,199 thousand respectively, and the net book value at the same dates amounts to NIS 6,584 thousand and NIS 4,374 thousand, respectively.

(2) During 2006 and 2005, Bezeq International exercised, as did others, option warrants of Walla (series 3). In all, Bezeq International exercised 2,564,764 and 213,397 option warrants (series 3) in 2006 and 2005 respectively, in consideration of NIS 4,617 thousand and NIS 384 thousand respectively, which were offset against the balance of the shareholder loans which Bezeq International provided to Walla. Following exercise of the options warrants, Bezeq International recognised a surplus cost of NIS 2,313 thousand and NIS 154 thousand in 2006 and 2005, respectively. In accordance with the provisions of IFRS 3, the cost of the purchase was attributed to the fair value of intangible assets, based on the Purchase Price Allocation (PPA) made by an external appraiser.
At December 31, 2006, Bezeq International holds 44.04% of the rights in Walla (at full dilution – 33.66%).
After the balance sheet date and by the date of publication of the financial report, Bezeq International's holding in Walla decreased to approximately 42.57% (at full dilution – 33.66%), as a result of additional option warrants (series 3) exercised by others.
At December 31, 2006 Bezeq International held 44.04% of the rights in Walla (fully diluted – 33.66%).
Subsequent to the balance sheet date and through the date of publication of these financial statements the percentage holding of Bezeq International in Walla was reduced to 42.57% (fully diluted (33.66%), this being the result of additional exercises of the options warrants (Series 3) by others.

(3) The market value of Bezeq International's holding in Walla shares at December 31, 2006 is NIS 122.6 million, and the market value of the option warrants (series 3) is approximately NIS 3.2 million (2005 – market value of shares approximately NIS 75.6 million and option warrants approximately NIS 12.7 million).

NOTE 12 – ASSOCIATES ACCOUNTED FOR UNDER THE EQUITY METHOD (CONTD.)

C. Movement in investments in 2006 is as follows:

	NIS thousands
Balance at the beginning of the year	**20,368**
Movement during the year:	
Investment in shares	**5,111**
Repayment of loans, net	**(4,642)**
Group's equity in investee company's earnings	**11,184**
Groups share in profit from decrease in holding	**595**
Decrease in exercisable option warrants	**(513)**
Increase in share in equity reserve in respect of financial assets classified as available for sale	**19**
Balance at the end of the year	**32,122**

NOTE 13 – LOANS AND BORROWINGS

This Note provides information about the contractual terms of the interest-bearing loans and borrowings. For more information about the exposure of the Group to interest rate and foreign currency risks, see Note 30.

A. Composition

	Consolidated	
	December 31, 2006	December 31, 2005
	NIS thousands	NIS thousands
Current liabilities to banks		
Short-term borrowings	**118,330**	75,184
Current maturities of debentures	**1,992,640**	526,709
Current maturities of bank loans	**1,526,377**	2,558,759
	3,637,347	3,160,652
Non-current liabilities to banks and others		
Debentures	**3,169,441**	4,891,340
Bank loans	**480,830**	748,053
Loans from institutional entities (see C below)	**169,182**	107,732
	3,819,453	5,747,125
	7,456,800	8,907,777
Loans provided by the minority in a consolidated company	**564,250**	505,280

NOTE 13 – LOANS AND BORROWINGS (CONTD.)

B. Terms and debt repayment table

	Currency	Nominal interest rate %	Redemption year	December 31, 2006 Par value	December 31, 2006 Carrying value	December 31, 2005 Par value	December 31, 2005 Carrying value
				NIS thousands			
Short-term borrowings	Shekel	Prime + (0.5)-1.2	2007	**118,330**	**118,330**	75,184	75,184
Loans from banks and others:							
In foreign currency	Dollar	LIBOR + (0.65-0.45)	2006	**-**	**-**	517,563	563,867
Linked to the consumer price index	Shekel	11.0-3.9	2007-2015	**1,485,852**	**1,5 28,390**	1,820,865	1,878,202
In foreign currency	Dollar/shekel	4.36-3.67	2006	**-**	**-**	230,150	230,150
Unlinked	Shekel	Prime + (1.15-1.2)	2007-2013	**647,999**	**647,999**	742,235	742,325
					2,294,719		3,489,728
Debentures issued to the public:							
Linked to the consumer price index (series 4 and 5) (1)	Shekel	4.8-5.3	2008-2016	**1,636,967**	**1,704,322**	1,636,967	1,714,244
In foreign currency (2)	Euro	6.5	2007	**1,630,340**	**1,628,733**	1,595,825	1,591,647
Unlinked	Shekel	Bank of Israel Interest + 0.5	2006	**-**	**-**	36,443	36,423
					3,333,055		3,342,314
Debentures issued to financial and other institutions:							
Linked to the consumer price index	Shekel	4.4-6.35	2007-2015	**1,726,497**	**1,798,647**	1,930,513	2,045,999
Linked to the euro	Shekel	LIBOR + 0.8	2008	**22,000**	**30,379**	22,000	29,736
					1,829,026		2,075,735
Total interest-bearing liabilities					**7,456,800**		8,907,777
Loans provided by the minority in a consolidated company	Dollar	0-11	2013	**1,009,902**	**564,250**	1,100,255	505,280

NOTE 13 – LOANS AND BORROWINGS (CONTD.)

B. Terms and debt repayment table (contd.)

(1) The balance of the par value of the debentures is NIS 3,586,967,000, of which NIS 1,636,967,000 par value were issued to the public.

a. The balance of the par value of the debentures (series 4) is 1,200,000,000 of NIS 1 par value each, repayable in 4 equal annual instalments in each of the years 2008 – 2011. The interest rate determined for these debentures in 4.8% p.a.

b. The balance of the par value of the debentures (series 5) is 2,386,867,000 of NIS 1 par value each, of which 436,967,000 debentures were issued to the public and to institutional investors, and the balance of 1,950,000,000 to Bezeq Zahav Holdings Ltd. (wholly controlled by the Company). The debentures are payable in 6 equal annual instalments in each of the years 2011-2016. The interest rate determined for these debentures is 5.3%.

The debentures were registered on the stock exchange and trading in a portion of them will be subject to the lock-up limitations prescribed in the Securities Law

(2) The balance of the par value of the debentures held by the public is 293,000,000 euro.

C. (1) In March and April 2005, DBS signed agreements with three institutional entities, whereby those entities would provide loans to DBS in a total amount of NIS 50 million.

The three institutional entities were granted an option to provide additional loans in the same amount, provided that the amounts of the loans are required by the business plan of DBS. During 2005, the three institutional entities exercised the above option, and provided DBS with additional loans amounting to NIS 50 million.

The Company undertook, in connection with the aforementioned loans, that if by December 31, 2013 the loans (all or some of them) were not repaid or upon fulfilment of certain other conditions, the lenders could demand that it repay the lower of the balance of the loans (principal, interest and linkage) and an amount computed according to a formula which was determined, which takes into account the value of DBS at that date. In view of the Company's undertaking, on June 22, 2005 the Company received a letter from the Director General of the Ministry of Communications, giving notice of the decision of the Ministry to call in a guarantee in the amount of NIS 10 million out of the bank guarantee the Company had provided in accordance with the provisions of its general license. According to the Director General's notice, the decision to call in the guarantee was made in view of the fact that the Company had made a commitment to the institutional entities in a manner which contravenes the directive of the Minister of Communications. The Company's position is that there is no legal or other basis for forfeiture the guarantee. An appeal against the decision was submitted to the Minister of Communications, and in the meantime, implementation of the forfeiture is frozen (see also Note 32(3)).

(2) In December 2006, DBS signed an agreement with another institutional entity for receipt of a loan of NIS 50 million.

DBS was granted an option for an additional loan in the same amount. Under the agreement, if DBS takes additional financing not for which does not represent the rolling over of the existing loans and as result of taking it, DBS's total debt does not comply with a certain EBITDA limitation defined in the loan agreement, then the interest rate on the loan from the institutional entity will change to 9%. DBS intends to exercise an option for an additional loan of NIS 50 million from the same institutional entity.

(3) The balance of the loans from institutional entities at December 31, 2006 includes accrued interest of NIS 17,353 thousand (2005 – NIS 5,605 thousand).

NOTE 13 – LOANS AND BORROWINGS (CONTD.)

D. Charges and collateral

(1) The debentures of the Company, whose book amount at December 31, 2006 is NIS 4,176,079,000 (net of deferred expenses), are not secured except for a symbolic charge, but the Company under took that as long as the debentures are in circulation, it will not encumber its property with other charges.

The lenders have a right to call for immediate payment of the debentures in cases where the Company does not pay the debentures or violates their terms, if a significant attachment is imposed on its assets (which is not lifted within 60 days), if a receiver is appointed for the Company's assets or a liquidation order is given against the Company, if the Company ceases to run its business, or if the holder of another charge realises the charge it has on the assets of the Company.

In addition, some of the lenders, from whom the balance of the debentures at December 31, 2006 amounts to NIS 228,917,000, may call for immediate payment of the debentures due to a decrease in the State's holdings in the share capital of the Company to less than 26%. For this reason, the balance in the financial statements is shown as a short-term liability.

In addition, for a balance of NIS 1,628,733,000 (net of deferred expenses) of debentures listed on the stock exchange in Luxembourg, which were issued to the public in euro, upon the occurrence of an event enabling other loans of the Company (except for such an event deriving from a decrease in the State's holdings in the Company) and of its material subsidiaries, as defined in the text of the debentures (Pelephone is the only company that matches the definition of a material subsidiary according to these debentures; it is noted that DBS is not considered a material subsidiary as defined in the debentures) to be called for immediate repayment, if the Company does not meet the payments determined in respect of the debentures, if the Company or its material subsidiaries cease to run their businesses or they enter receivership, liquidation or similar proceedings, and upon the occurrence of additional events of non-fulfilment of the undertakings of the Company and its material subsidiaries, as described there.

In connection with the Company's approach to the tax authorities for approval of an exemption from the withholding tax from interest paid in respect of these debentures, the Company reached agreement with the assessing officer whereby it would be exempt from withholding the tax from August 1, 2004 until final payment of the debentures. It was also agreed that if the debt-equity ratio at the Company is higher than 1:1.5, the Company's financing expenses would be adjusted in the tax year, but not more than the amount of the financing expenses for the debentures. This arrangement will be examined in the quarterly statements of the Company and applied each quarter. On this matter, "debt" – any interest-bearing liability or linkage differentials, the value of which varies as a result of changes in the interest rate or the linkage differentials, except for a liability to employees or former employees.

The Company's position is that at the balance sheet date, the Company is in compliance with these terms.

The Company created a negative pledge in favour of the aforementioned debenture-holders.

(2) a. The bank loans and debentures ("credit providers") of Pelephone, the carrying amount of which at December 31, 2006 is NIS 1,320 million, are secured by an irrevocable liability in favour of the credit providers, whereby Pelephone created a negative pledge to their credit.

The liability includes, *inter alia*:

(1) A declaration that Pelephone will not encumber its assets (as may be from time to time), in whole or in part, in any manner and by means of a floating lien or a fixed lien of any type or rank, in favour of any third party, without the prior written consent of the credit providers.

NOTE 13 – LOANS AND BORROWINGS (CONTD.)

D. Charges and collateral (Contd.)

(2) (Contd.)

(2) Compliance with the following financial stipulations:

a. An undertaking that Pelephone's debt will not exceed three times its shareholders' equity and an undertaking that as long as that ratio exceeds 2.5, dividends will not be distributed and management fees will not be paid to the shareholders.

b. Pelephone undertook that the amount of its debts will not exceed NIS 3.8 billion (linked to the known Index in January 2002).

c. An undertaking towards a certain bank that its total debt to it will not exceed 40% of its total debts to all the financial entities.

At the date of the financial statements, Pelephone is in compliance with its undertakings and the financial stipulations with which it undertook to comply for the banks.

b. Under its general license for cellular services, Pelephone is not permitted to sell, lease or pledge any of its assets used for performance of the license, without the consent of the Minister of Communications, except –

(1) charge of one of the license assets in favour of a bank operating lawfully in Israel, for receipt of bank credit, provided that it submitted notice to the Ministry of Communications concerning the charge it intends to register, noting that the charge agreement includes a clause ensuring that in any case, exercise of the rights by the bank will not harm in any way the provision of the services pursuant to the license;

(2) the sale of items of equipment when implementing an upgrade proceeding, including sale of equipment by the trade-in method.

(3) The terms of long-term loans which DBS received from banks, the balance of which at December 31, 2006 is NIS 1,394 million, impose restrictions with regard to the encumbrance or sale of certain assets of DBS: a restriction on receipt of credit from banks and others (without the approval of the lending bank), a restriction on the distribution of a dividend, a restriction with regard to repayment of shareholder loans and restrictions on transactions with interested parties, a restriction on changes in the percentage of shareholders' holdings, a restriction relating to DBS's compliance with the various licenses granted to it, a restriction related to the purchase of securities by DBS and the establishment of a subsidiary, restrictions relating to the allocation of shares or other securities of DBS.

In addition, the terms of the loans impose various restrictions, including a demand to comply with the following financial covenants:

a. Minimum total income.
b. Minimum operating surplus (as defined in the financing agreement).
c. Minimum operating surplus less investment in decoders (as defined in the financing agreement).
d. Maximum churn rate.
e. Total financing needs (as defined in the financing agreement).
f. Maximum supplier credit.
g. Minimum cover of bank debt and debt balances (as defined in the financing agreement).

The values for compliance with the financial criteria vary, and are measured each quarter. Non-compliance with the financial criteria grants the banks a right to demand early repayment of the loans DBS received.

NOTE 13 – LOANS AND BORROWINGS (CONTD.)

D. Charges and collateral (Contd.)

(3) (contd.)

At December 31, 2006, DBS is in compliance with the above terms (after a relief granted it in December 2006), but DBS's Management does not expect that DBS will comply with the terms in 2007 and thereafter. In view of this forecast, the bank loans are presented as part of short-term liabilities.

In light of the forecast of DBS's Management for its business results in 2007, DBS approached the banks for planning and adjusting the dates for full repayment of the bank credit. At the date of approval of the financial statements, these terms are not yet finalised. The Management of DBS is also negotiating with the banks for settlement of a dispute relating to insurance obligations set out in the financing agreement.

To secure these liabilities (and guarantees of NIS 40 million), DBS registered a charge on all its assets, including shareholders' equity and goodwill.

E. Debenture issue expenses

The expenses for issuing the debentures amounted to approximately NIS 22 million for 2006 and 2005, and are presented after deduction of accumulated amortisation of NIS 14,328 thousand (2005 – NIS 11,938 thousand).

NOTE 14 – TRADE AND OTHER PAYABLES, INCLUDING DERIVATIVES

	December 31, 2006	December 31, 2005
	NIS thousands	NIS thousands
Trade payables		
Open debts	**1, 221,288**	1, 272,253
Notes payable	**84,399**	161,821
Trade payables due to related and interested parties	**87,881**	111,036
Other trade payables	**–**	3,347
Total trade payables	**1,393,568**	1,548,457
Other payables, including derivatives		
Government of Israel in respect of royalties	**65,411**	80,212
Liabilities to employees and other liabilities for salary	**298,101**	823,955
Government institutions	**105,032**	128,191
Liabilities to related parties and interested parties	**49,067**	42,168
Accrued interest	**135,606**	150,704
Derivatives	**27,525**	75,657
Payables and other credit balances	**122,005**	96,109
Total other payables, including derivatives	**802,747**	856,996
	2,196,315	2,405,453

Amounts payable denominated in a currency other than the functional currency include approximately NIS 380,967 thousand in respect of suppliers denominated in US dollars (2005 – NIS 504,866 thousand), and approximately NIS 95,242 thousand in respect of suppliers denominated in euro (2005 – NIS 126,838 thousand).

NOTE 15 – PROVISIONS

	Legal claims and other disputes	Employee compensation claims	Dismantling and clearing of sites	Onerous contracts	Warranty and others	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Balance at January 1, 2006	206,331	50,469	43,225	9,135	3,010	312,170
Provisions created during the period	**49,102**	**55,000**	**1,210**	**–**	**7,700**	**113,012**
Provisions used during the period	**–**	**–**	**(2,150)**	**(953)**	**–**	**(3,103)**
Provisions cancelled during the period	**(84,699)**	**–**	**–**	**(388)**	**–**	**(85,087)**
Effect of the elapse of time in respect of capitalisation	**1,938**	**–**	**1,833**	**(55)**	**–**	**3,716**
Balance at December 31, 2006	**172,672**	**105,469**	**44,118**	**7,739**	**10,710**	**340,708**
Current	172,672	105,469	–	–	10,710	288,851
Non-current	–	–	44,118	7,739	–	51,857
	172,672	105,469	44,118	7,739	10,710	340,708

Legal claims
For salary claims filed against the Group and legal claims and other disputes, see also Note 17.

Dismantling and clearing of sites
The provision in respect of the debts of a consolidated company for clearing sites it leases.

Onerous contracts
A consolidated company entered into agreements granting it usage rights in transmission equipment (an old generation of sea-bed cables), for periods ending between 2016 and 2024. Under these agreements, the subsidiary is obligated to pay fixed monthly amounts, irrespective of the extent of the use it makes of the cables. The Management of the consolidated company believes that the unavoidable costs of compliance with these agreements exceed the economic benefits expected to accrue from use the cables. This assessment, together with Management's decision not to operate the sea-bed cables, was the rationale for making a provision in the financial statements. The balance of the provision reflects the discounted value of all the unavoidable costs which the subsidiary must pay to the owner of the cables until the end of the term of the agreements.

NOTE 16 – EMPLOYEE BENEFITS

A. Composition

	December 31, 2006	December 31, 2005
	NIS thousands	NIS thousands
Present value of unfunded obligations	**245,317**	139,649
Present value of funded obligations	**196,544**	174,891
Total present value of obligations	**441,861**	314,540
Fair value of the plan assets	**(130,236)**	(113,650)
	311,625	200,890
Past service cost – non vested benefit	**(72,936)**	-
Recognised liability in respect of a defined benefit plan	**238,689**	200,890
Liability for vacation	**95,595**	84,980
Liability for sickness	**65,429**	55,955
Liability for voluntary early retirement	**879,526**	772,251
Total employee benefits	**1,279,239**	1,114,076
Stated in the balance sheet as follows:		
Short-term	**906,203**	717,723
Long-term	**373,036**	396,353
	1,279,239	1,114,076

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

A. Composition (Contd.)

	December 31, 2006	December 31, 2005
	NIS thousands	NIS thousands
Movement in a liability in respect of a defined benefit plan		
Liability in respect of a defined benefit plan at January 1	**314,540**	276,602
Benefits paid according to the plans	**(20,468)**	(14,626)
Current service cost and interest (see below)	**46,282**	36,546
Past service cost– non vested benefit	**72,936**	-
Past service cost - vested benefit	**31,799**	-
Actuarial (gains) losses recognised in equity (see below)	**(3,228)**	16,018
Liability in respect of a defined benefit plan at December 31	**441,861**	314,540
Movement in the assets of the plan		
Fair value of the assets of the plan at January 1	**11 3,650**	96,528
Amounts deposited in the plan	**21,538**	16,339
Benefits paid	**(9,030)**	(4,116)
Expected return on plan assets	**3,879**	4,092
Actuarial gains (losses) recognised in equity (see below)	**199**	807
Fair value of the assets of the plan at December 31	**130,236**	113,650
Expense recognised in the income statement		
Current service cost	**34,304**	23,031
Interest on the obligation	**11,978**	13,515
Expected return on the assets of the plan	**(3,880)**	(4,092)
Past service cost - vested benefit	**31,799**	-
	74,201	32,454
The expense was included in the following items in the income statement		
Salary expenses	**66,501**	24,020
Financing expenses	**7,700**	8,434
	74,201	32,454
Actual return on the plan assets	**2,629**	6,584
Actuarial gains and losses recognised directly in equity		
Amount accrued at January 1	**15,211**	-
Amounts recognised during the period	**(3,427)**	15,211
Amount accrued at December 31	**11,784**	15,211

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

B. Actuarial assumptions

The principle actuarial assumptions at the date of the report:

1. Mortality rates are based on the rates published in Insurance Circular 3-1-2007 of the Ministry of Finance, except for early retirement, which was calculated using pension table 2000/1, and including future improvements in the mortality rate.

2. Leaving rates were determined on the basis of the past experience of the Company and the subsidiaries, distinguishing between employees entitled to supplementary compensation and those who are not, depending on the number of years of employment in addition to the above distinction made. In the company – the leaving rate is determined, additionally, with a distinction made between permanent employees (between 3.5% in the first year to 0.5% over 10 years'), personal contract employees (5.5% per year), senior employees (20% per year), and temporary employees (34% in the first year to 25% over 7 years).
Bezeq International – The leaving rate includes a distinction made between headquarters employees with compensation (between 2.2% for the first year up to 4% over 11 years), headquarters employees without compensation (between 17.6% for the first year to 2% from the seventh year onwards), non-headquarters' employees with compensation (3.3% in the first year to 4% over 11 years), headquarters employees without compensation (48.1% in the first year to 3% over 6 years). Pelephone – The leaving rate includes a distinction made between senior employees with compensation (8% per year), senior employees without compensation (12% for the first year and 2.5% over 11 years), non-senior employees with compensation (5% for the first year and 25% from the second year), and non-senior employees without compensation (45% for the first year and 7% from the third year). DBS – The leaving rate for all employees (about 20% in the first year and up to 2% over 5 years).

3. The discounted rate is based on yield on government bonds at a fixed interest rate which have a lifetime equal to that of the gross liability.

	December 31, 2006	December 31, 2005
	Discounted rate	**Discounted rate**
Compensation	**3.7%**	3.7%
Sick leave	**3.6%**	3.8%
Vacation	**3.6%**	3.8%
Retirement benefit – holiday gift	**5.2%**	5.2%
Retirement benefit – clubs and activities	**3.6%**	3.8%
Early notice to senior employees	**3.6%**	-

4. Assumptions regarding salary increments were made on the basis of the Company's experience and Management's assessments, distinguishing between groups of employees as explained in sub-section 2 above over the period of their service to retirement. The rate of salary costs fluctuates mostly between 1% per year for older employees to 16% per year for younger employees.
The Company – For permanent employees and personal contract employees, the average salary increment is 6% per year at age 20, and from that age onwards the salary increment decreases linearly and stabilises at a rate of 1.75% at age 60. For senior employees the salary increment is 6% per year throughout their period of service. For temporary employees, the salary increment decreases by about 1% each year, and stabilises at an increment rate of about 1% from age 40 onwards. For non-headquarters employees, the salary increment rate was assumed to be an average of 1% per year.
Pelephone – For senior employees at age 21, salary costs of 4% increases linearly to 14% at age 28, and from that age onwards, decreases linearly to 2.5% at age 39. For non-senior employees from age 21 to age 28 a salary increment of 16%, and from that age a linear decrease to 2.5% at age 39.

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

B. Actuarial assumptions (Contd.)

DBS – For all employees, the salary increment rate is 5% per year throughout the period of service.

5. The growth rate foreseen in the assets accumulated in all the companies in the Group except those of the Company, is 3% per year – a rate reflecting an expected value return of 4% and less 1% management fees, while in the Company, the growth rate in accumulated assets is only 2%. This rate reflects the fact that most of the funds are in old pension funds in which the yield rate is fixed.

C.

	December 31, 2006	December 31, 2005	January 1, 2005
	NIS thousands	NIS thousands	NIS thousands
Present value of liability in respect of a defined plan	**441,861**	314,540	276,602
Fair value of the plan assets	**(130,236)**	(113,650)	(96,528)
Plan deficit	**311,625**	200,890	180,074
Adjustments for assets arising from prior experience	**3,987**	11,577	
Adjustments for liabilities arising from prior experience	**(3,579)**	77	

In 2007, the Group expects to pay NIS 19,520 thousand as a deposit in a defined benefit plan.

D. Defined deposit plans

1. The pension rights of Company employees in respect of the period of their employment in the civil service through January 31, 1985, are covered by a pension fund ("Makefet Fund"), which took upon itself the State's commitment following an agreement between the Government of Israel, the Company, and Histadrut and the Fund.

2. Liabilities for employee benefits at retirement age in respect of the period of their service in the Company and in the investee companies, are covered in full by regular payments to pensions funds and insurance companies.

3. The severance pay liability for those who leave their employment on terms entitling them to compensation, is covered, for the period from February 1, 1985. by regular deposits in pension funds and insurance companies as aforesaid (in accordance with Section 14 of the Severance Pay Law). Severance pay in respect of the period of employment in the civil service up to January 31, 1985, is actually paid by the Company, and the monies accumulated in Makefet Fund in respect of that period is maintained in a fund that will be used for the employees' rights. For a small number of the employees (employed under special contracts), the Company has a liability to pay them severance pay in excess of the amount accumulated in the compensation fund in the employees' name.

E. Defined benefit plan

1. The severance liability include in the balance sheet represents the balance of liabilities not covered by deposits and/or insurance policies in accordance with the existing labour agreements, the Severance Pay Law, and the salary components which the Managements of the companies believe entitle the employees to receipt of compensation. In respect of this part of the liability, there is a reserve deposited in the Company's name in a recognised compensation fund. The reserves in compensation funds include accrued linkage differentials and interest accrued and deposited in compensation funds in banks and insurance companies. Withdrawal of the reserve monies is contingent upon fulfilment of detailed provisions in the Severance Pay Law.

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

E. Defined benefit plan (Contd.)

2. The new collective agreement from December 5, 2006, provides, among others, that employees who transferred from the civil service to the Company, who end their employment due to retirement after December 31, 2013, are entitled to a supplement to close the gap between the two Civil Service Law tracks and the regulations governing Makefet.
As a result of this clause in the agreement, the benefit to these employees is enhanced. The Company includes in its financial statements the liability net of the cost of prior service not yet vested. This benefit will be spread on a straight line basis over a period of 18.75 years (the average period to vesting of the benefit).

3. Through December 2006, liability in respect of early notice for senior employees was not included in the financial statements. In September 2006, the Company's Management decided that this benefit should be paid upon severance. Accordingly, the liability is included in the financial statements in accordance with the employment agreement and an actuarial calculation. The increase in the benefit in respect of this change is recorded as cost of prior service vested immediately, and is therefore recognised immediately in profit and loss.

4. Company retirees receive, in addition to the pension payments, benefits which consist mainly of a holiday gift, financing of the maintenance of retiree clubs and of social activities. The Company's liability in respect of these costs accumulates during the service period. The Company includes in its financial statements the expected costs in respect of the post-employment period, based on an actuarial calculation for existing retirees and for the serving employees entitled to this benefit according to retirement age. The actuarial assumptions include those noted in section B above, and another assumption relating to this section – that there is no real increase in the benefits in accordance with Company policy. (It is noted that in practice, the holiday gift benefit is linked to the dollar exchange rate.)

F. Other long-term employee benefits

Provision for sick leave

The financial statements include a provision in respect of redemption and utilisation of sick leave for all Group employees and redemption of sick leave only for employees eligible under the terms of the employment agreement and the collective agreement from December 5, 2006. The provision was calculated on the basis of actuarial calculations. The actuarial assumptions include those noted in section B above, as well as assumption in connection with this section based on the Company's experience according to positive accumulation of days by most of the employees, utilisation of days by the LIFO method.

Provision for vacation

The financial statements include the provision for redemption and utilisation of vacation on the basis of an actuarial calculation. The actuarial assumptions include those noted in section B above, as well as assumptions in connection with this section, positive accumulation of days by most of the employees, utilisation of days by the LIFO method, and statistical tests for the amount of utilisation and the amount of redemption.

G. Benefits in respect of severance and voluntary retirement

A number of collective agreements concerning early retirement were signed in recent years. Below are details of the relevant agreements.

In September 2000, the Company reached an agreement with the Union to extend the early retirement collective agreement from 1997 ("the Retirement Agreement"). Under the Retirement Agreement, commencing April 1, 2001 and through December 31, 2006 (with an option to extend the date of final retirement for certain employees through December 31, 2008), another 1,770 employees will take early retirement, of whom 300 employees who are not transferred employees.

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

G. Benefits in respect of severance and voluntary retirement (Contd.)

On April 17, 2005, a special collective agreement was signed between the Company and the Union and the Histadrut, enabling early retirement of employees through a substitute for Makefet Fund. On June 28, 2005, an agreement between the Company and Harel Insurance Co, Ltd. ("Harel") was completed and signed. The agreement regulates pension payments in respect of early retirement, as well as old age and survivor pension payment differences arising from legislative amendments to the Israel Economic Recovery Plan Law (Legislative amendments for attaining budget targets and the economic policy for the 2003 and 2004 financial years), 5763-2003, for employees who retired commencing at the end of 2003 and until the beginning of 2004, and/or who will retire from the Company in accordance with the special collective agreement for retirement signed in September 2000, as amended on March 18, 2004 ("the Retirement Agreement"). Following execution of the agreement with Harel, the aforementioned special collective agreement between the Company, the Union and the Histadrut was revised and amended on the same date (June 28, 2005)..
It is noted that all the approvals required were obtained, both for the agreement with Harel to come into force, and for the collective agreement from June 17, 2005 and its amendment to come into force, as signed between the Company and the Union and the Histadrut regarding regulation of the early retirement of the employees through Harel, as the substitute entity for Makefet, as noted above.

H. Other

(1) On December 3, 2006, the Board of Directors of the Company approved a new collective agreement between the Company and the Union and the Histadrut. The agreement regulates the labour relations in the Company following the transfer of control in the Company from the State of Israel, and delineates a new organisational structure for the Company. Below are the main points of the agreement:

a. All the agreements, arrangements and customs existing in the Company prior to execution of the agreement, including a mechanism for linking salaries to the public sector, will continue to apply only to the veteran permanent employees in the Company to whom the agreement applies, subject to changes inserted specifically in the present agreement. The hiring of existing and new temporary employees will be on the basis of monthly or hourly salary agreements based on a market salary model by occupation, with a high degree of managerial flexibility.

b. An organisational change was agreed upon, including on the basis, *inter alia*, of transition from a geographical structure to a functional structure, which will be implemented gradually over two years.

c. In 2006-2008, 975 permanent employees (325 in each of those years) will retire from the Company in early pension or increased compensation tracks. The quota of retirees includes the employees who were scheduled to retire in accordance with the previous early retirement agreements but have not yet done so. In addition, the Company may, at its discretion, terminate the service of another 1,225 permanent employees (245 permanent employees in one or more of the years 2009-2013). The terms of retirement that will be granted to retirees will be largely the same as the terms of retirement prevailing in the Company today.

d. On the subject of managerial flexibility and changes in existing agreements and arrangements, the Company may determine procedures and change them from time to time at its discretion (without derogating from the rights of employees under the collective agreements applicable to them). The Company has authority in all management matters, the organization, work arrangements, work processes, etc.

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

H. Other (Contd.)

(1) (Contd.)

e. The Union declared that it would agree to and support the distribution of a dividend of NIS 1.8 billion to the shareholders which does not comply with the earnings test, which the Company intends to distribute with the approval of the court. The Company undertook that within 45 days of the date of completing the distribution, it would issue stock options to employees amounting to 3% of the Company's issued share capital (subject to increasing its registered capital and the approval of the authorised institutions of the Company), at an exercise price of 50% of the share price on the date of issue of the options. If issue of the options is not approved, the benefit will be awarded to the employees in cash. (See Note 26.)

f. In addition, the Company will pay the employees a special bonus for the period through December 31, 2006, in a total amount of NIS 44 million (out of this sum, the Company has paid NIS 40 million and will pay the additional NIS 4 million at a later date). Commencing in 2007, the bonus system customary in the Company (as a State-controlled company) would be changed in the manner detailed in the agreement.

g. The term of the agreement is from the date of its execution through December 31, 2011. The Company has an option to extend it for two additional years, through December 31, 2013. The term of the retirement section in the agreement (see section C above), will in any case be through December 31, 2013.

(2) Under the collective agreements applicable to labour relations in the Company, and in accordance with agreements with the Makefet Fund ("the Fund"), an option is reserved for Company employees, who are Transferred Employees, to retire under one of two retirement tracks. The method of calculation of the cost of the early retirement of the Transferred Employees was laid down in the provisions in a number of agreements and documents drawn up between the Company and the Fund between 1990 and 1996, including a letter of understanding prepared and signed by them in 1996. The Company contends that the Fund violated the provisions of the agreements in general, and those in the letter of understanding in particular, in that when making the calculations of early retirement costs for Transferred Employees, the Fund determined those data on the basis of the assumption that those employees had chosen the track in which the cost of acquisition is higher, while disregarding the track which those employees had actually chosen. According to an actuarial opinion prepared for the Company, the difference between the payments collected by the Fund from the Company according to its calculation, and the rate of those costs if made as contended by the Company, based on the retirement track actually chosen by the employees, is a cumulative nominal amount of more than NIS 128 million, the restitution of which the Company is claiming in a claim it filed against the Fund. On November 20, 2003, the Company filed another claim against the Fund for additional amounts, in respect of other components, amounting to approximately NIS 80 million. The Fund transferred data on the earlier retirees. Based on these data and on the previous file, a revised actuarial opinion was prepared, which quantified the total amount of the claim on the date of its filing at approximately NIS 280 million. The Fund filed defence documents in the court, in which it rejects the allegations of the Company and alleges that it acted in accordance with the agreements between it and the Company.

NOTE 17 – CONTINGENT LIABILITIES

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

In the opinion of the managements of the Group's companies, which is based, *inter alia*, on legal opinions regarding the risks related to the claims, including the applications for certification of the class action suits, appropriate provisions have been included in the financial statements (Note 15), where such provisions were required, to cover the exposure resulting from such claims.

In the opinion of the managements of the Group's companies the additional exposure due to claims filed against the companies in the Group on various matters and in which the probability of realisation is remote or likely, amounts to approximately NIS 31 billion, of which approximately NIS 3.2 billion relates to salary claims filed by employees.

Concerning applications for certification as class action suits regarding which the Group has exposure beyond the aforesaid (since the claims do not state a specific amount), see claims in sections A(4), (5), (7) and (19) below.

Below are details of the status of the significant contingent liabilities of the Group at December 31, 2006.

A. Claims

(1) a. In December 1998 the Antitrust Commissioner published a notice concerning the investigation of *prima facie* suspicion of restrictive agreements in the field of public switching to which the Company was a party. The Antitrust Court recently approved an agreed order whereby the Company would pay NIS 2 million to the State Treasury without admitting violation of provisions of the Antitrust Law, and the Antitrust Authority would refrain from instituting proceedings in connection with the affair.

b. In September 2004, a claim and an application for certification as a class action were filed in the Jerusalem District Court against the Company and several other defendants (including Telrad and Tadiran) and against the State of Israel - Ministry of Communications as a formal defendant. The claim alleges that public switching cartels existed which gave rise to unnecessary expenditure for the Company, and an unjustified increase in its tariffs of an accumulated amount of NIS 1,750 million.

(2) A number of claims are pending against the Company concerning recognition of various salary components as pension components and recognition of various components in the determining salary for severance pay, as follows:

a. In September 2000, a claim was filed in the Jerusalem Regional Labour Court against the Company by 2,423 retired employees of the Company who were employees transferred from the Ministry of Communications to the Company when it commenced operations. The plaintiffs are seeking declaratory relief from the Labour Court, such that it will be determined that the payments they received for grossing up of tax, clothing allowance and incentive pay are considered part of the regular salary and therefore should be considered as part of their determining wage for the purpose of calculating their pension and the payments made to them upon retirement, and should be included in the calculation of hourly pay value and the calculation of the percentage increments. The plaintiffs are also seeking declaratory relief which will determine that their last, determining, salary for pension should be calculated according to the last salary which was paid to each of them for the last month of work, and not according to the average staff grade which each of them held. In 2004 the claim was dismissed *in limine*. An appeal filed against the decision was allowed, and the decision of the Regional Labour Court was set aside.

It is noted that in January 2007, another claim was filed by 85 retirees who transferred to the Company from the Ministry of Communications, seeking declaratory relief determining that payment of the grossing up of tax, clothing allowance and incentive pay should be included in the determining salary in the matter of rights by virtue of the Hours of Work and Rest Law and the Annual Vacation Law.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (Contd.)

(2) (Contd.)

b. In February 2002, a notice of a party to a collective dispute ("the Notice"), was filed in the Jerusalem Regional Labour Court by the New General Federation of Workers ("the Histadrut") in the name of all Company employees. The applicant alleges that payments for grossing up of tax, the component of administrative on-call duty benefits and clothing allowances which were and are paid to Company employees, are regular pay which form part of the determining salary of each employee, including with respect to the calculation of payments upon retirement, redemption of holiday pay, grants, acclimatisation payments, percentage increments and hourly pay value, and that various payments and provisions should be made in respect thereof, including for pension purposes. The Attorney General joined the claim. In April 2006, the Jerusalem Regional Labour Court issued its decision, dismissing all parts of the claim An appeal was filed against the decision, in which it was alleged that the decision is procedurally void, and the hearing was returned, with the consent of the parties and the Attorney General, to the Regional Labour Court.

c. In November 1995, a group of employees filed a claim against the Company in the Tel Aviv Regional Labour Court, concerning the inclusion of a number of components as part of the determining pay for pension. In August 2006, a decision was given in the case, dismissing the claim and all its component parts, and the Court ruled that the salary increments are not fictitious increments but true and conditional increments, and accordingly, are not part of the basic salary for the purpose of calculating the pension or severance pay, holiday pay and sick pay.

d. Some additional individual claims are pending against the Company, filed by employees and former employees, concerning recognition of various salary components as pension components, and recognition of various components in the determining salary for severance pay.

The maximum total exposure in respect of the above salary component claims is approximately NIS 3.2 billion.

(3) In September 2000, an action and an application for certification as a class action were filed against the Company in the Tel Aviv District Court. The amount of the claim is estimated at approximately NIS 110 million. According to the plaintiff, the Company unlawfully collected "collection fees" for Company bills which were not paid by their due date, since in fact the Company took no collection action until 14 days after the last date for payment as written in the telephone bill. The Court certified the claim as a class action suit. The Company filed an application for leave to appeal in the Supreme Court, which returned the case to the District Court for reconsideration of the application for certification in the accordance with the Class Action Law.

In October 2001, an additional class action was filed in the Tel Aviv District Court on exactly the same matter – unlawful charging of collection fees on Company bills not paid on time, before the Company had started any collection action. The amount of the class action was estimated by the plaintiff at approximately NIS 21 million. The Court approved suspension of the proceeding until after the decision on its certification as a class action or a ruling in the claim described above, due to the similarity in the cause of claim in the two cases.

(4) In September 2000, three plaintiffs filed a claim in the Tel Aviv District Court, together with an application for certification as a class action, against the Company, Bezeq International and the other international call operators, concerning the charge of VAT on international calls which originated from abroad. The plaintiffs estimated the total value of the claim in millions of shekels per year. The application for certification was dismissed, and the plaintiffs filed an appeal against the decision. Proceedings are in progress for filing an amended application in which the Company (a formal respondent) will be struck from the case.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(5) a. In March 2003, a claim was filed in the Tel Aviv District Court against the Company, the Broadcasting Authority and the State of Israel, by various plaintiffs from Moshav Porath in the Sharon region, including the estates of deceased persons, for compensation due to physical harm allegedly caused by prohibited radiation from the Hillel broadcasting station. The amount of the claim stated by the plaintiffs is "more than NIS 15 million", and the same claim notes that the plaintiffs will also petition to split the reliefs so that they will reserve the right to sue later for other financial damages which are not bodily harm, such as damage to crops and loss of value of land.

It is noted that following an application for dismissal *in limine* filed by the Company, a partial decision was given in favour of the Company, dismissing the claim of five of the plaintiffs, who died before the Company started operating the station.

b. In June 2004, another claim was filed in the Tel Aviv District Court by 25 plaintiffs from Moshav Porath and Moshav Ein Vered, including 11 heirs to the estates of deceased persons, against the Company, the Broadcasting Authority and the State of Israel, for compensation in respect of bodily harm. The claim alleges violation of legislated duties, as well as and/or acts of omission by the defendants in connection with the operation of the Hillel station. The amount of the compensation demanded in the additional claim is not estimated (although the claim is in the jurisdiction of the District Court, i.e. more than NIS 2.5 million), and the compensation is based on financial and non-financial damages items which are listed in respect of each plaintiff, together with punitive compensation.

c. In May 2005, the Company received a claim for approximately NIS 46 million in damages, which was filed by 14 plaintiffs who were and/or are residents of the Moshavs Porath, Ein Vered, Ein Sarid and community of Kadima, against the Company, the Broadcasting Authority and the State of Israel. The claim alleges the violation of legislated duties in connection with the Hillel station, which resulted in bodily harm to he plaintiffs due to prohibited radiation.

The plaintiffs in these three claims have filed an application for consolidation of the hearings.

d. In May 2005, the Company received a claim for approximately NIS 141 million in damages, which was filed in the Tel Aviv District Court against the Company, the Broadcasting Authority and the State of Israel. The claim alleges the violation of legislated duties in connection with the Hillel station, which resulted in property and financial damage. An application to split reliefs was also filed, which would enable future claims for damages. Twenty-three of the plaintiffs withdrew from the claim, and the amount of the claim of the remaining 30 plaintiffs was reduced to approximately NIS 35 million.

It is noted that on December 31, 2003, the Company ceased all services from the station, at the behest of the State and the Broadcasting Authority. Since that date, the Hillel station has not been a broadcasting site.

(6) In January 2002 a claim for payment of monetary compensation of approximately NIS 57 million and for writs of mandamus were filed in the Tel Aviv District Court by an international communications operator against the Company and Bezeq International. The claim is for damages allegedly sustained by that operator due to acts of commission and/or omission in connection with the customer allocation to the international call operators. Alternatively, the plaintiff alleges that it is entitled to reimbursement of access fees which it paid to the Company. The file was transferred for mediation.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(7) In July 2002, the Company received a claim for monetary and declaratory relief, together with an application for certification as a class action. The claim alleges unlawful excess collection of interest in respect of arrears also in respect of payment which the Company collects for other communications providers. The total amount of the claim, if certified as a class action, is estimated by the plaintiffs in the tens of millions of shekels. The plaintiffs are petitioning for declaratory relief that the Company abused its monopolistic status and enriched itself unjustly. The request for certification of the claim was refused. The decision has been appealed in the Supreme Court.

(8) In May 2003, the Company received a claim and application for certification as a class action, which were filed against the Company in the Tel Aviv District Court. The amount of the claim is estimated at approximately NIS 2.5 billion (NIS 10,000 per consumer), which the plaintiff alleges is the loss suffered by the plaintiffs. The claim alleges that the Company refuses to install splitters for high speed internet lines, in order to increase its profits resulting in losses to private internet users. The court dismissed the claim, and the plaintiff appealed the decision.

(9) On December 25, 2005, a claim was filed against the Company in the Tel Aviv District Court, together with an application for certification as a class action, under the Consumer Protection Law, 5741-1981 alleging that the Company collects unlawfully, payments for surfing the internet with WOW's service, even though is technically unable to provide the service in certain areas at the promised speed. The plaintiffs estimate the amount of the class action at approximately NIS 100 million for all subscribers.

(10) In May 2006, a claim was filed in the Tel Aviv District Court together with an application for certification 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 such a call 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 individual’s claim is NIS 11).

(11) Various municipalities and local councils submitted demands for retroactive payments of municipal property taxes for the increased area of buildings and a change of the classification for municipal tax purposes. The demands together total approximately NIS 80 million.

(12) In May 2006, a claim was filed in the Tel Aviv District Court together with an application for certification 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 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 individual’s claim is assessed at NIS 1,000).

(13) In November 2006, a claim and application for certification as a class action were filed in the Tel Aviv District Court, for the sum of approximately NIS 79 million. The claim alleges that the Company charged customers who connected to its ADSL service a monthly fee rather than a two-monthly fee, due to which they sustained losses and expenses.

(14) In November 2006, a claim and application for certification as a class action were filed against the Company in the Tel Aviv District Court, for the sum of approximately NIS 183 million, alleging unlawful collection of money in cases of disconnection due to non-payment.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(15) In November 2006, a claim and application for certification as a class action were filed by subscribers of the Company, Pelephone, Cellcom, Partner and HOT against the aforementioned companies, amounting to approximately NIS 158 million. The claim alleges that the plaintiffs were charged for a service they did not receive. The plaintiffs allege that upon termination of a call from a cellular to a fixed line, when the call is terminated by the fixed-line owner who received the call (and not by the cellular owner who initiated the call), the Company and HOT delay transmission of the disconnect signal for about 60 seconds. This results in damages suffered, reflected in airtime cost and interconnection fees.

(16) In November 2006, the claim and application for certification as a class action were filed in the Jerusalem District Court for the sum of approximately NIS 10.6 billion, against the Company, HOT, Pelephone, Cellcom and Partner, concerning the failure to implement number portability. See also section C(7) below.

(17) The Company has received a demand for the forfeiture of a guarantee in the amount of approximately $6.5 million related to a project (HBTL) in a basic telephony tender in 1995 in India, in which the Company participated, together with others. An appeal against an order given at the request of the project, preventing forfeiture of the guarantees, is being heard in the Appeals department of the High Court in Delhi. The Company has applied to the court in Delhi for release of the bank guarantees it provided.

(18) In November 1997 a claim was filed in the District Court, which together with an application for certification as a class action, against the Company, Bezeq International, the Chairman of the Board of Directors of Bezeq International and the then CEO of Bezeq International. The claim alleges, *inter alia*, that the Antitrust Commissioner had determined that Bezeq International had abused its status in the international calls market and had implemented a deliberate policy of misleading the public on the subject of overseas call tariffs in that it refrained from clarifying to the public that only those who registered as Bezeq International subscribers would enjoy the reduced tariffs. The amount of the class action is estimated by the plaintiffs at approximately NIS 50 million. In December 1997 the Company was struck from the claim. In June 2001, the District Court decided to deny the application for certification. In September 2001, the decision of the District Court on this matter was appealed in the Supreme Court. The Supreme Court allowed the appeal in view of a procedural error of the District Court, and the case was returned to the District Court. In November 2005 the Court dismissed the application for certification as a class action and upheld the previous decision made by the court, adding that the application should also be dismissed since the applicant had no personal cause. In January 2006, the applicant filed notices of appeal in the Supreme Court.

(19) In September 2001, a revised statement of claim and an application for certification as a class action were filed against Bezeq International and the State of Israel. The plaintiff alleges that the tariffs for international telecommunication services during the period from May 10, 1996 through July 8, 1997, were exorbitant and unreasonable, and abused the status of Bezeq International as a monopoly, against a backdrop of falling prices as the international calls market was opening up to competition. In December 2003, the court allowed the application by virtue of the Antitrust Law and not on the basis of a cause arising from the Unjust Enrichment Law, and certified the claim as a class action. In February 2004, the plaintiff filed an appeal in the Supreme Court against the decision of the District Court relating to the cause prescribed in the Unjust Enrichment Law. The Management of Bezeq International believes that if the claim is eventually certified as a class action by the Supreme Court and if it is allowed, the amount of the action could reach hundreds of millions of shekels.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(20) In December 2000, a claim was filed in the Tel Aviv District Court against Pelephone by the State of Israel, in respect of royalties allegedly payable for the period from January 1994 to February 1996. The amount of the claim is approximately NIS 260 million (including principal, linkage differentials and interest).

An examination conducted as part of a mediation proceeding found that the maximum amount of royalties on the revenues of Pelephone from January 1, 1994 to February 7, 1996 is only approximately NIS 118 million (before interest and linkage).

On February 16, 2004, the Company provided an undertaking to Pelephone, as approved by the Board of Directors on February 12, 2004, that if the mediation proceeding fails, the Company will pay Pelephone any sum it is ordered to pay to the State, if charged in a peremptory decision in respect of royalties for revenues from the provision of cellular services during the period from January 1, 1994 to October 10, 1994. According to the Company, it paid the State for that period under the settlement agreement between it and the State dated November 29, 1995. The undertaking to indemnify is subject to the presentation of the Company's arguments in the proceeding, and the consent of Pelephone for the Company to join the action as a third party should the Company request to do so.

(21) In September 2001, a claim was filed in the Ramallah District Court by the General Public Palestinian Communications Company ("Paltel"), against Pelephone and another company.

The plaintiff alleges that its license grants it, *inter alia*, the full right and authority to set up, operate, supply, sell and manage services and stations for telephone communication, both landline and cellular, for the supply of fixed and cellular communications services in the territory of the Palestinian Authority for an extended period, part of which being granted exclusivity. According to the plaintiff, it commenced providing cellular communications services in September 1999, and despite its requests to the defendants, they are continuing to provide cellular communications services to the inhabitants of the West Bank and the Gaza Strip, without restraint and without a license from the Palestinian Communications Authority, thereby violating various provisions of the law, prejudicing the exclusive rights of the plaintiff and causing it losses and damages. The reliefs requested are a permanent judicial injunction preventing the defendants from providing communications services in the areas of the Palestinian National Authority and a financial action for approximately NIS 676 million from Pelephone alone.

As at the date of signing these financial statements, the process of transferring the claim through the Attorney General has ceased and the alternative process of delivery effected by registered mail has been returned through the Ministry of Justice, and therefore this claim is not counted among the claims currently pending against Pelephone. It should also be noted that Pelephone does not recognize the jurisdiction of the court in Ramallah.

Pelephone learned that the Ramallah Court may have given a decision on the aforementioned claim. According to the Emergency Order (Judea, Samaria and the Gaza Strip – Jurisdiction in offences and legal aid) (Territories of the Palestinian Authority – Legal aid in civil matters), 5759-1999, enforcement of decisions given by a court of the Palestinian Authority may only be executed if approved by the Commissioner for Legal Aid at the Ministry of Justice. Pelephone considers that such a ruling – if made – was made without jurisdiction, contrary to public order and contrary to the provisions of the interim agreement and the Extension of the Effect of the State of Emergency Regulations Law (Judea, Samaria and Gaza Strip – Jurisdiction in offences and legal aid), 5727-1967.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(21) (Contd.)
If an attempt is made to submit this decision for the approval of the Commissioner, or to enforce it in any way whatsoever, Pelephone will act to prevent such approval and/or enforcement and/or execution proceedings or the voidance of the reasons noted above which were behind the Commissioner's decision to prevent the service of the claim on Pelephone from the outset, as well as fact of the claim being heard in the Ramallah court without service of process in accordance with the order and the agreement constitutes a breach of the agreement and harms the autonomy of Israel, and that any decision given in such a claim is without validity.

(22) In November 2002, an application was filed for leave to appeal the decision of the Tel Aviv District Court from October 2002 to dismiss the application for certification of the applicant's claim against Pelephone as a class action. The claim was based on an allegation that throughout the years that Pelephone was a monopoly in the cellular market, it abused that status and collected inflated prices for its services. Therefore, the applicants requested that Pelephone be ordered to repay the surplus profits it collected to its customers, which they allege to be the amount of the claim (NIS 12.3 billion). On February 2, 2003, Pelephone filed its response to the application for leave to appeal.

(23) In December 2002, a claim, together with an application for certification as a class action, was filed in the Tel Aviv District Court against Pelephone and other cellular companies, for the amount of approximately NIS 4 billion, of which approximately NIS 2.4 billion is against Pelephone.

The claim relates to amounts collected by Pelephone and another cellular company for incoming calls from May 10, 1996 to October 2, 2000. The applicants, through their lawyers, base their claim on the following allegations:

a. Every cellular operator is a monopoly in the incoming call service to its network. Pelephone and the other cellular operator abused their monopoly status in that they set high and unfair prices for the incoming call service to their networks. The correct and fair tariff for the incoming call service is 25 agorot per minute, and not as collected in the past by Pelephone and the other cellular company or as stipulated today in the Telecommunications Regulations (Payments for interconnect), 5760-2000.

b. Pelephone and the other cellular company violated obligations legislated under the authority of the Telecommunications Law, their licenses and the duty of good faith which require a reasonable price for a telecommunications service for which no price is set.

In July 2003 Pelephone filed its response to the application.

(24) In April 2003, an application was filed in the Tel Aviv District Court for certification of a class action in a total amount of approximately NIS 90 million, against all the cellular companies. The applicants allege that the three cellular companies formed a cartel among themselves for the collection of a tariff of 38 agorot plus VAT for SMS messages coming in to the network of each of them. The plaintiffs allege that this is a uniform, inflated, unreasonable and unfair tariff. The period to which the claim relates is from March-June 2002 through the date of filing the claim.

(25) In July 2006, a claim and an application for its certification as a class action were filed in the District Court against Pelephone, in the amount of approximately NIS 251 million. The claim relates to the interpretation of an agreement which the plaintiff signed with Pelephone for 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. Pelephone is conducting procedural discussions with the plaintiff, in view of new applications he filed for amendment of the application for the class action. Pelephone will respond appropriately when these discussions are completed.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(26) In August 2006, a claim was filed in the District Court, together with an application for its certification as a class action, against Pelephone, Cellcom and Partner. The amount of the class action (consolidated against the three companies) is NIS 100 million. The claim relates to the time of disconnection of calls made from the cellular network to the Bezeq network, and alleges that in cases where the Bezeq customer initiated the call, a surplus charge is made until actual disconnection of the call.

(27) In February 2007, Pelephone received an application for certification of a class action filed against it in the Tel Aviv District Court. The claim concerns an allegation of misleading the defendant's subscribers who reside in Eilat, who were charged VAT for the cellular communication service. According to the claim, this charge contravenes the law in that Eilat is a free trade zone and therefore exempt from payment of VAT. The amount of the claim is approximately NIS 33 million. It is noted that other class actions have been filed against Partner and Cellcom for the same reason and in similar amounts.

Pelephone's Management, relying on its legal advisers, believe that a position cannot yet be formulated regarding this claim, especially since the entire question of VAT collection in Eilat will be referred to the State, the beneficiary of the collected VAT.
It is further noted that a similar class action was filed several years ago, which was eventually struck out by consent, in view of the position of the VAT Authority and the recommendation of the court.

(28) In June 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 commercials during the 2006 World Cup Games ("the Application for Approval"). According to the applicants, the broadcasting of commercials, 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 106 million for all the members of the group (based on 200,000 World Cup subscribers of the cable companies and DBS together, calculated at NIS 530 per subscriber who purchased the World Cup package). On January 16, 2007, a hearing was held in the District Court, where it was decided that the Council for Cable and Satellite Broadcasts would file its position on the matters of the action within 45 days, after which the parties would be given time to respond to that position. In addition, it was decided that the applicants would furnish a copy of the statement of claim to the Attorney General within seven days.

(29) Miscellaneous claims – Various claims are pending against the Company and the Group Companies arising from the normal course of business. It is the opinion of the companies' managements that the latent risk in each of these claims will not cause material financial losses beyond the amounts included in the financial statements.

B. Claims in respect of which the exposure cannot yet be assessed or calculated

(1) In January 2004, a claim was filed in the Tel Aviv Regional Labour Court against the Company and against the Makefet Fund, by employees who retired under a retirement agreement signed in November 1997. The plaintiffs allege that they chose the Pension Track B after having been promised an increment pursuant to the "Yellow Note" agreement, and that this promise was not kept. The claim was originally filed by 66 retirees and today, the number of plaintiffs is approximately 300.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

B. Claims in respect of which the exposure cannot yet be assessed or calculated (contd.)

(2) In July 2004, an action for declaratory relief was filed in the Tel Aviv Regional Labour Court against the Makefet Fund, the State of Israel and the Company, by the Organization of Bezeq Retirees and six of its members, alleging that the defendants breached agreements for binding arrangements that were made upon the transfer of the employees from the civil service to the Company. According to the plaintiffs, their rights as retirees were acquired by the State and the Company in full actuarial balance and under binding agreements, and therefore, the pension reform that followed a change in legislation on June 1, 2003, does not apply to them.

(3) In February 2007, an action and application for its certification as a class action were filed in the Tel Aviv District Court against Pelephone, Cellcom and Partner, in a total amount of NIS 449 million. The amount attributed to Pelephone is NIS 167 million. The plaintiffs are suing for restitution of excess amounts which they allege were collected from the subscribers of the defendants, claiming that the defendants charged their subscribers for calls they made or received while they were abroad, according to a larger time segment than they were ostensibly permitted to charge, thereby seemingly violating the license. Pelephone is currently studying the claim.

(4) A number of proceedings have been served on Pelephone, in which local councils are seeking to join it as a party to appeals filed in appeals committees against the dismissal of claims for impairment under Section 197 of the Planning and Construction Law, in respect of the erection of communications installations. Pelephone studies each application on its merits, and decides on its course of action accordingly.

(5) In December 2005, an application was filed in the District Court which for approval of a claim against DBS as a class action. The reliefs applied for are as follows:

a. Monetary compensation for every customer who entered into an agreement with DBS by telephone and not in writing (leaving the amount to the discretion of the court. In the plaintiff's personal individual’s claim, NIS 20,000 is requested in compensation.).
b. Financial compensation in the amount which was overcharged, for whoever actually paid more than the amount agreed upon by telephone with representatives of DBS's service.
c. A declaratory order to DBS determining that from now on, whoever enters into an agreement with it by telephone will receive the arrangement in writing within 21 days.

On March 8, 2006, DBS filed an application for dismissal of the claim *in limine* before the decision was handed down.

C. Other contingencies

(1) On May 2006, investigators from the Antitrust Authority appeared in the Company's offices and presented an order of the Magistrate's Court permitting them to search the Company's offices and seize any document or object required for the investigation. According to the order, the cause of its grant was suspicion of abuse of status by a monopoly according to Section 29A of the Antitrust Law and Section 47(a)(4a) of the Antitrust Law and/or unreasonable refusal to provide an asset or service which is provided in monopoly as in Section 29 of the Antitrust Law. During the search, which has not yet been completed, the investigators collected various documents, including computerised material, and a number of employees were called for questioning at the Antitrust Authority offices. The Company cooperated fully with the Authority investigators. To the best of the Company's knowledge, the investigation has not yet ended, and accordingly, the Company believes, relying on its external legal advisor who is handling the case on its behalf, the results and implications of the investigation cannot be assessed at this stage, including the possibility that indictments will be filed ad/or civil proceedings will be instituted against the Company.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (Contd.)

(2) The Company received a letter on March 15, 2007, from a shareholder of the Company pursuant to Section 194 of the Companies Law, in which the Company is required to institute legal proceedings against the former CEO of the Company and the former VP Marketing of the Company, on the matter of the liability of a consolidated company, DBS, to the Company, and to take action for the collection of the debts of DBS to the Company. The Company intends to reject this demand, since, among other reasons, the debts were generated as a result of lawful activities of DBS as a marketer for the Company, and since the Company is acting to collect the debts, and has even reached a payment arrangement with DBS and DBS is repaying its debts regularly in accordance with the arrangement. The Company is unable to assess whether a claim will be filed on this matter by the shareholder, and at this stage is also unable to assess whether such a claim, if filed, is more likely than not to be successful.

(3) In August 2005 a claim was filed against the Government of Israel, the National Council, the Ministry of the Interior, the head of the Noise and Radiation Abatement Division (at the Ministry for Protection of the Environment), the cellular companies, including Pelephone, and a company named Elidav – Building & Investments Ltd. (the owner of a house in Ramat Hasharon on the roof of which cellular antennae were installed). The claim concerns the liability for claims under Section 197 of the Planning and Construction Law for the issuance of building permits for cellular antennae. The central allegation in the claim, as far as the cellular companies are concerned, is that in the proceedings for approval of National Outline Plan 36A, the cellular companies undertook to indemnify the local committees in respect of compensation those committees would be ordered to pay in claims under the aforementioned Section 197, and that the National Outline Plan was approved on the basis of that undertaking. According to the plaintiffs, the undertaking is tantamount to "a contract in favour of a third party" in their favour and in favour of the other local committees.

The plaintiffs also allege that the Government and the National Council were negligent in that they did not anchor that undertaking in the National Outline Plan, and once it transpired – after approval of the Plan – that the cellular companies were unwilling to indemnify the local committees, the Government and the National Council should have cancelled or suspended the Plan and should also have cancelled the franchises of the cellular companies.

The plaintiffs are petitioning for a large number of reliefs (about 20), all declaratory. The principal reliefs are to declare that the cellular companies and the other defendants must pay the compensation ruled against the local committees in claims under the aforementioned Section 197.

(4) In 2001, the Ministry of Communications issued administrative directives which regulate how a subscriber switches from the services of the cable companies to DBS and vice versa, and the use of infrastructures in the subscriber's home. The directives also prescribe a duty to pay monthly usage fees for infrastructure owned by the other multi-channel television service provider. Since the administrative directives were issued, DBS and the cable companies have submitted mutual complaints of violation of the directives by the other party, and voluminous correspondence has been exchanged between DBS and the Ministry of Communications on the matter. On August 15, 2005, the Ministry of Communications notified DBS and the cable companies that in view of their numerous violations of the administrative directives, it had re-examined the matter and was now considering their cancellation, *inter alia*, in view of the mechanism for purchasing the wiring prescribed in the Communications Law, which enables a subscriber to purchase the wiring in his home for NIS 120.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (Contd.)

(4) (Contd.)

On November 2, 2005, DBS submitted its position to the Ministry of Communications, stating that the administrative directives should remain in place, while cancelling the early notice prescribed in them, which requires that notice be given to a party whose subscribers disconnect from its services. DBS also contended that the provisions of the law granting ownership of infrastructure to the multi-channel television provider that installs it in the homes of its subscribers, should be rescinded. At the very least, contended DBS, if the directive remains in place, its proper interpretation should not grant the cable companies ownership of the wiring it installed in private houses. DBS also stated that the amount prescribed in the law as the consideration to be paid for purchasing the wiring (NIS 120), is baseless and that if the directive is retained, the amount should be considerably reduced.

(5) On May 29, 2005, the media published a news item stating that Israel Police are conducting an investigation into "industrial espionage" by computerized means (a "Trojan horse" program), in which it was stated that the Company's subsidiaries Pelephone, Bezeq International and DBS, were involved

It is noted that a number of senior employees of the Company were called in by the Police immediately after the affair was publicised, to testify about confidential documents of the Company which were found on the premises of competing entities, and to assess the extent of the damage which the Company could expect as a result. The Company examined the matter and took immediate action to minimize, as far as possible, the risk of information being removed from the Company. It is further noted that some of the employees of these subsidiaries were called in for questioning.

In May 2005, the cable companies ("HOT") filed an *ex parte* application in the Tel Aviv District Court ("the First Application"), in which the court was requested to grant, among other things, an order for the appointment of a receiver, who would be authorised to search and seize, at all the sites held by DBS, commercial secrets of HOT as well as other information of HOT which is confidential or restricted by law, as well as other temporary reliefs, principally to prohibit DBS from using the commercial secrets of HOT.

The background to the filing of HOT's application was the publicity given in the press to the industrial espionage affair by means of Trojan horse software, where according to HOT, DBS ostensibly acted unlawfully, through the Modi'in Ezrachi investigation firm with which it had engaged, to enable it to obtain confidential information of HOT, thereby committing the tort of robbery of a commercial secret.

After dismissal of its application, HOT filed a claim against DBS, which does not include an application for any financial relief, in which the court is requested to grant a number of declaratory reliefs and *mandamuses* and injunctions concerned with prohibiting DBS from making use of commercial secrets of HOT.

In response to the application, DBS rejected HOT's allegations and gave notice that without waiving any of its allegations, it was willing to undertake to refrain from making any use of documents related to HOT's business which had come into its possession from Modi'in Ezrachi, and that should any such document or information be found, that document would be sealed in an envelope and placed in a safe. On July 7, 2005, the court, with the consent of the parties, issued a decision, which validated as a court judgement, DBS's notice not to make any use of documents and information transferred to DBS by Modi'in Ezrachi. In practical terms, this means that the court dismissed HOT's applications for appointment of a receiver and for grant of a temporary injunction of broader scope than DBS's commitment.

On June 30, 2005, DBS filed a defence in court, in which it denied the allegations in the claim made by HOT. A hearing has not yet been scheduled.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (Contd.)

(5) (Contd.)

On July 12, 2005, HOT field an application to split reliefs so as to enable it to file a financial claim against DBS in a separate claim. On September 18, 2005, DBS filed a response, requesting dismissal of HOT's application.

On September 5, 2006, the court issued a decision directing HOT to give notice of whether it intends to continue with its application to split reliefs. On September 26, 2006, HOT filed notice in court that it intends to continue with the application and that it requests that the court allow the application as is until the pre-trial date of the claim. On the same date, the court gave its decision allowing HOT's request to leave the application as is until the pre-trial date.
The first pre-trial hearing is scheduled for May 21, 2007.

DBS, noting the fact that no financial claim has yet been filed, the fact that no decision has yet been given on the application to split reliefs, as well as the innovation and complexity of the legal questions arising in the claim, and relying on its legal advisers, cannot assess, at this stage, whether the claim is more likely than not to succeed.

In addition, in November 2005, a claim was filed in the Tel Aviv District Court against Pelephone, for an order to provide a financial report, together with an application to split reliefs. The cause of claim revolved around allegations whereby, as it were, Pelephone had "ordered" business information about the Plaintiff's business and this was supplied by defendant no. 2 (Modi'in Ezrachi) by way of violating a number of provisions of law and as part of the Trojan horse affair. The defence has not yet been filed.

(6) For the provision 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, (“the Radiation Law”) the majority of whose instructions are valid from January 1, 2007, and the Pharmacists Regulations (Radioactive elements and their products), 5740-1980, which regulate the erection, operation and supervision of these installations, including a requirement 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 acting 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, which deals with building permits for large broadcasting installations. 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 managements of the Company and Pelephone are unable to assess whether all the approvals will be received within the time prescribed in the Radiation Law, and what the implications of the above might be.

(7) On March 29, 2005, the Knesset enacted the Economic Policy Law for the 2005 Financial Year (Legislative amendments), 5764-2004 which includes, *inter alia*, amendment of the Communications Law (Telecommunications and broadcasts), 5742-1982 whereby the Minister of Communications will prepare a plan for number portability for general license-holders (including holders of special general licenses) for fixed-line domestic communication services, and a general license-holder for the provision of cellular services, and will instruct them concerning its application and operation by September 1, 2006 (if the Ministers of Communications and Finance see a genuine need and special reasons, they may postpone, in an order approved by the Knesset Economics Committee, postponement of the application and operation of the plan for not more than three months).

On August 22, 2005, the Ministry of Communications signed a numbering portability plan.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (Contd.)

(6) (Contd.)

As the Company noted in the position paper it submitted to the Ministry of Communications, the timetables set in the law for application of the plan cannot be met. Furthermore, the Company believes that the implementation of number portability could require it to make considerable financial investments in replacing software and hardware versions in its switching network, and that large investments will be required in its information systems, which could also lead to postponement of the Company's development plans in this area. In addition, the operation of number portability involves costs in respect of shared records and management with the relevant operators – costs which cannot be assessed at this stage. As well as these costs, the implementation of number portability, which is expected to ease the transition of customers from the Company's networks to competing networks, could have an adverse effect on the ability to of the Company and the other companies in the Group, to compete.

On August 23, 2006, the Ministers of Communications and Finance announced that implementation of the plan would not be postponed beyond September 1, 2006,. Their notice also stated that the Director General of the Ministry of Communications recommended that if the plan is not implemented and operated by September 1, 2006, "… the relevant communications companies would be declared in violation of the law, together with all relevant implications thereof." Following that decision, on August 24, 2006, both the Company and Pelephone (together with other cellular companies), filed petitions in the High Court of Justice, for an order *nisi* against the Government of Israel and the Minister of Communications. The petitioners contend, *inter alia*, that even though they had worked assiduously to apply the plan, investing considerable resources for that purpose, they are unable to comply with the unrealistic timetables laid down in the law. In the background – the Ministry of Communications, according to the petitioners, has not prepared a numbering plan for number portability and had not determined the payment structure which would apply between the entities involved, as it was required to do according to the provisions of the law. The State filed its initial response to the High Court of Justice, in which it sought dismissal of the petition *in limine*. The hearing of the petition was postponed to July 30, 2007.

(8) For possible demand for early repayment of bank loans, see Note 13.

NOTE 18 - COMMITMENTS

(1) Commitments for lease agreements and rentals

Contractual rental payments in the next 5 years, calculated according to the rent in effect at December 31, are as follows:

For the year ended December 31,	**NIS thousands**
2007	**214,927**
2008	**175,708**
2009	**136,312**
2010	**109,508**
2011 and onwards	**160,371**
	796,826

(2) At December 31, 2006, DBS has agreements for the purchase of broadcasting rights amounting to approximately NIS 137 million.

NOTE 18 - COMMITMENTS (CONTD.)

(3) DBS entered into an agreement for leasing space segments of the Amos 1 and 2 satellites with Israel Aircraft Industries ("IAI") and with the satellite communications company Spacecom Limited ("Space"). The contractual annual lease fees in the coming years under those agreements are as follows:

	NIS thousands
2007	**109,005**
2008	**112,554**
2009	**98,918**
2010	**101,611**
2011	**101,611**
From 2012 until the termination of the contract	**474,199**
	997,898

In May 2003, an agreement was signed with IAI, regulating the debts of DBS in respect of leasing the space segments for the period up to May 2002. At the date of approval of the financial statements, only partial payment has been made on account of the lease fee debt for the prior periods which are overdue. In view of DBS's arrears in the payments prescribed in the above agreement, in March 2006 IAI demanded settlement of the entire debt and the interest on it. Since IAI's demand, DBS and IAI have been negotiating settlement of the debt. Based on this situation, the balance of the liabilities is shown under short-term borrowing, including a provision for arrearage interest in accordance with an assessment made by DBS's Management.

In addition, DBS and Space are in dispute in respect of the amount of the annual payments, concerning DBS's entitlement to a certain discount on the lease fees. DBS pays Space the amounts not in dispute, and also paid an additional one-off amount. On February 12, 2007, Space notified DBS that it was still insisting that the amount in dispute be deposited with a trustee until settlement of the dispute, a position which DBS rejects. Up to the date of approval of the financial statements, Space has taken no action to enforce its rights.

(4) The Group has a number of operation lease agreements for periods of 3 to 4 years in respect of vehicles it uses. The contractual annual lease fees, calculated according to the fees in effect at December 31, 2006, are approximately NIS 233 million.

(5) In accordance with the requirements of the license and the principles laid down by the Council for Cable and Satellite Broadcasts, in 2006 and 2007 DBS must invest in content broadcasts not less than 8% of its revenues from subscriber fees in local productions.

(6) At December 31, 2006, DBS has agreements to buy purchased channels. In the year ended December 31, 2006, the expenses for consumption of purchased channels amounted to approximately NIS 251 million.

(7) Right to purchase a usage right in frequencies

The grant of frequencies which Pelephone won in a tender published by the Ministry of Communications (see Note 32(1)), was made subject to terms which include, among others, payment of NIS 225 million (plus Accountant General's interest, except on the first, Index-linked payment) for the new frequency ranges, and provision of a guarantee in the amount of $20 million to secure the terms of the license, which was amended in 2004 to $10 million. The payment due upon winning the tender was supposed to have been made in six different instalments, spread over the period to 2006.

On March 16, 2004, Pelephone agreed to a proposal of the Ministries of Communications and Finance concerning a reduction of NIS 33 million from the original payment set in the tender, against (1) payment of the balance of the license fee of approximately NIS 99 million during 2004; (2) return of the frequencies to the State, so that Pelephone would not owe payment of frequency fees for them from 2003 onwards.

NOTE 18 - COMMITMENTS (CONTD.)

(7) (Contd.)

In addition and concurrently, Pelephone was granted a right to a future allocation of these frequencies, for the exercise of which, Pelephone would pay the amount deducted, plus the frequency fees in respect of the relevant period, plus customary linkage differentials and interest. Between March and August 2004, Pelephone paid the aforementioned balance of the license fee – NIS 99 million.

On May 4, 2004, Pelephone received a letter from the Ministry of Communications, informing it that in an amended calculation made by the Ministries of Communications and Finance, the amount Pelephone would be required to pay upon future allocation of the frequencies, is NIS 51 million, and not the NIS 33 million agreed in March 2004. Pelephone has not presented its position on this to the Ministries.

(8) On December 13, 2006, Bezeq International signed a transaction for the purchase of 100% of the shares of Actcom – Active Communications Ltd. ("Actcom"), the oldest-established provider of internet access services in Israel, from its two founders, in consideration of US $3 million (10% of the amount of the consideration was contingent upon the transfer of at least 90% of Actcom's existing customers on the date of signing the agreement). The purchase transaction was closed on January 3, 2007. As a result of the acquisition, Bezeq International generated a surplus cost of approximately NIS 16 million, which will be attributed, in accordance with IFRS 3 provisions, to the fair value of tangible assets, intangible assets and liabilities acquired at the date of closing the purchase transaction, based on a PPA (Purchase Price Allocation) paper.

(9) In February 2004, Bezeq International entered into an agreement with Mediterranean Nautilus Ltd. ("Med Nautilus"), for the purchase of an indefeasible right to use sea-bed cable capacity. In addition, the agreement grants Bezeq International options for an additional purchase from Med Nautilus of an indefeasible right to use sea-bed cable capacity. Some of the options were exercised in 2004, and the remainder were exercised in June 2006. In October 2006 another agreement was signed with Med Nautilus, for an additional purchase of an indefeasible right to use sea-bed cable capacity in 2007, in a total amount of approximately NIS 74 million. This agreement also grants an option for an additional purchase of capacity from Med Nautilus in the future.

(10) For engagements for the purchase of property, plant and equipment, see Note 9G.

NOTE 19 – SECURITIES, CHARGES AND GUARANTEES

(1) In May 2003, the Company provided, at the behest of the Ministry of Communications, a bank guarantee of $10 million in connection with its general license for implementing telecommunications operations and for providing telecommunication services. On June 22, 2005, the Company received a letter from the Director General of the Ministry of Communications, giving notice of the decision of the Ministry to call in NIS 10 million of the $10 million bank guarantee provided by the Company in connection with its general license. The Director General's letter stated that the decision to foreclose was made in light of the fact that the Company had made commitments to the institutional investors who provided loans to DBS, in which the Company holds 49.8% of the share capital, in a way which contravenes the directives of the Minister of Communications.

It is noted that since the Minister of Communications made her decision to impose restrictions and conditions on the Company's injections to DBS, both DBS and the Company acted without regard for their legal position on the absence of authority of the Minister of Communications to intervene in the matter of injections made by shareholders and other financing entities to DBS, with the purpose of complying with the conditions and restrictions imposed by the Minister of Communications and at the time also by the Antitrust Commissioner, as well as the legal action they had instituted both in the High Court of Justice and in the Antitrust Court (in a proceeding which has already been terminated, since the term of the restriction imposed by it had elapsed). The position of the Company is that there is no legal or other basis for calling in part of the guarantee of which the Director General notified the Company, and therefore no provision was made in the financial statements. An appeal against the decision was submitted to the Minister of Communications, due to which, for the time being, implementation of the foreclosure is frozen. As noted in Note 32(3) below, the hearing of the appeal of

NOTE 19 – SECURITIES, CHARGES AND GUARANTEES (CONTD.)

(1) (Contd.)

the Company and DBS in the High Court of Justice against the Minister of Communications, was held on October 11, 2005, but no ruling has yet been given in the proceeding.

(2) The Company provided a guarantee in favour of banks in connection with credit of up to NIS 70 million granted to a subsidiary.

(3) For guarantees provided by the Company for its past investments in India, see Note 17A(17).

(4) The Company provided a guarantee of approximately NIS 10 million for DBS in respect of a bank guarantee of approximately NIS 33 million which DBS had provided in favour of the State of Israel. The guarantee is valid until December 31, 2010.

(5) In February 2002 and May 2005, at the demand of the Ministry of Communications, Bezeq International provided bank guarantees of approximately NIS 9.4 million and NIS 1.4 million respectively, for fulfilment of all the terms of the license to provide international telecommunication services. In December 2004, at the behest of the Ministry of Communications, Bezeq International provided a bank guarantee of approximately NIS 340,000 for fulfilment of the terms of a special license granted it for a marketing trial for the provisions of VOB services. At the balance sheet date, Bezeq International had provided additional bank guarantees in a total amount of approximately NIS 3.2 million.

(6) Pelephone provided guarantees of approximately NIS 72 million in favour of third parties, of which approximately NIS 42 million in favour of the Ministry of Communications, in connection with a guarantee for fulfilment of the terms of its license.

(7) To secure its liabilities, DBS provided documentary credit and guarantees amounting to approximately NIS 39 million (including a bank guarantee of NIS 33 million in favour of the State of Israel).

(8) The shareholders in DBS (except for one of them) have encumbered their shares in favour of the banks. In view of a negative pledge of the Company (see Note 13), the Company provided the banks with a perpetual guarantee for payment of the debts of DBS. The guarantee is up to a maximum amount equal to the percentage of the Company's holding in DBS, multiplied by the value of DBS as derives from realisation of the pledged shares of the other shareholders. If the Company joins the sale in the framework of realisation of the pledged shares of the other shareholders, the amount of the guarantee will not exceed the amount of the proceeds the Company will receive from realisation of its shares in DBS. The guarantee note includes numerous restrictions on the Company in realising the shares it holds, and lists violation events which, if committed, will enable the banks to call in the guarantee. Furthermore, the Company also undertook to put its shares up for sale if the shares pledged by the bank are sold, and agreed that in case of realisation of collateral provided by the other shareholders, the Company would forgo repayment of shareholder loans provided for DBS and that the guarantee would apply, *mutatis mutandis*, also to stock options which the Company receives from DBS and to the right to receive them.

The shareholders in DBS, except for one of them, undertook towards the banks not to oppose the sale or other realisation of their shares in DBS, which were encumbered or for which a guarantee was provided (by the Company), in a way that will enable the banks to accomplish a friendly liquidation.

(9) For securities, charges and stipulations given by the Company and associates in connection with loan covenants, see Note 13.

NOTE 20 – SHAREHOLDERS' EQUITY

A. Share capital

	Registered		Issued and paid in	
	December 31, 2006	December 31, 2005	December 31, 2006	December 31, 2005
	No. of shares	No. of shares	No. of shares	No. of shares
Ordinary shares of NIS 1 par value	**2,625,000,000**	2,625,000,000	**2,605,045,611**	2,605,045,611

B. Following completion of the sale of 30% of the State's shares in the Company to Ap.Sb.Ar. (see also Note 1) on October 11, 2005, the State's holdings in the Company decreased to 16.38%.

C. The Board of Directors of the Company, at its meeting on March 1, 2006, decided that resolutions concerning distribution of a dividend would be passed specifically, in accordance with the financial results of the Company, its financial situation and other relevant circumstances and data. This resolution superseded earlier resolutions in the matter of dividend policy.

D. The Company also issued options for shares to employees (see Note 26).

Capital reserve for assets available for sale
A fair value reserve includes the net cumulative change in the fair value of financial assets available for sale, until the assets are disposed of.

Capital reserve for activities between the Company and a controlling shareholder
This reserve relates to benefits granted by the State as controlling shareholder in the Company, to employees, in cash and in equity instruments of the Company.

Capital reserve for employee stock options
This reserve relates to a benefit granted to employees by means of share-based payments.

Dividends
The following dividends were announced and paid by the Group:

	For the year ended December 31	
	2006	2005
	NIS thousands	NIS thousands
In April 2006 a cash dividend was distributed (NIS 0.46 per share)	**1,200,000**	–
In October 2006 a cash dividend was distributed (NIS 0.15 per share)	**400,000**	–
In November 2006 a cash dividend was distributed (NIS 0.12 per share) (1)	**300,000**	–
	1,900,000	–

(1) The dividend was paid in January 2007.

E. On December 28, 2006, the general meeting of the shareholders of the Company approved the recommendation of the Board of Directors of the Company concerning distribution of a cash dividend of NIS 1,800,000,030 (comprising NIS 0.69 per share), as a distribution not in compliance with the earnings test. The distribution was subject to the approval of the court, and on December 31, 2006 the Company filed an application in the court for approval of the distribution. On February 4, 2007, the court approved the distribution, and the distribution was made on February 26, 2007. No liability in respect of this distribution was recorded in the financial statements.

F. After the balance sheet date, the general meeting of the Company approved an increase in the registered capital of the Company by 124,000,000 ordinary shares of NIS 1 par value each, which will be equal in all their rights to the ordinary shares of NIS 1 par value of the Company, so that together with the balance of the existing registered capital, the registered capital of the Company will be 2,749,000,000 ordinary shares of NIS par value each.

NOTE 21 – REVENUE

	For the year ended December 31	
	2006	2005
	NIS thousands	NIS thousands
Fixed-line domestic communications	**5,086,022**	5,165,393
Cellular telephone	**3,493,541**	3,302,393
Multi-channel television	**1,284,337**	1,171,318
Sale of equipment to subscribers, installations and miscellaneous	**1,170,771**	1,246,897
International communications and internet services	**963,942**	773,794
	11,998,613	11,659,795
Other revenues	**233,217**	264,923
	12,231,830	11,924,718

NOTE 22 – SALARIES

	For the year ended December 31	
	2006	2005
	NIS thousands	NIS thousands
Salaries and related expenses –		
Operating	**1,784,674**	1,809,396
General and administrative	**727,142**	649,106
Share-based payments	**286,506**	345,674
Total salaries and incidentals	**2,798,322**	2,804,176
Less – Salaries attributable to investments in property, plant and equipment	**211,885**	218,396
	2,586,437	2,585,780

NOTE 23 – OPERATING AND GENERAL EXPENSES

	For the year ended December 31	
	2006	2005
	NIS thousands	NIS thousands
General expenses	**1,169,107**	1,257,809
Materials and spare parts	**922,449**	930,666
Consumption satellite services content	**441,268**	419,309
Cellular telephone expenses	**1,854,347**	1,816,301
Building maintenance	**347,849**	366,736
Services and maintenance by sub-contractors	**428,424**	422,416
International communication expenses	**383,496**	276,819
Motor vehicle maintenance expenses	**190,079**	181,385
Royalties to the Government of Israel	**179,589**	257,429
Collection fees	**50,008**	49,196
	5,966,616	5,978,066

NOTE 24 – OTHER EXPENSES (INCOME), NET

	For the year ended December 31	
	2006	**2005**
	NIS thousands	**NIS thousands**
Provision (cancellation of provision) in respect of severance pay in early retirement	**309,108**	(83,000)
Net capital gains mostly from realisation of real estate	**(159,017)**	(8,646)
Provision in respect of contingent liabilities	**96,322**	-
Others	**3,127**	(8,195)
	249,540	(99,841)

NOTE 25 – FINANCING EXPENSES, NET[1]

	For the year ended December 31	
	2006	**2005**
	NIS thousands	**NIS thousands**
Interest income from bank deposits, investments and others	**194,651**	158,279
Income in respect of borrowing grossed up in sales net of discounted fee	**49,405**	44,482
Interest income from financial assets available for sale and from embedded derivatives	**30,233**	8,790
Net earnings from financial assets available for sale transferred from the equity	**5,218**	104,582[2]
Net gain in respect of rate of exchange differences	**-**	81,600
Other financing income	**76,918**	35,561
	356,425	433,294
Interest expenses in respect of financial liabilities	**477,171**	494,418
Net loss in respect of linkage differentials	**5,775**	126,529
Net loss in respect of exchange rate differences	**11,760**	-
Net movement in the fair value of financial assets measured at fair value through profit and loss	**153,221**	127,887
Other financing expenses	**46,466**	55,758
	694,393	804,592
Financing expenses, net	**337,968**	371,298
(1) Net of amounts capitalised in the amount of	**1,207**	7,797

(2) The Company held 0.7405% in the satellite corporation Intelsat. On November 17, 2004, Intelsat gave notice confirming the intention to sell the corporation. The Company's share in the consideration was approximately NIS 104 million. A capital gain in the full amount was recorded in 2005.

NOTE 26 – SHARE-BASED PAYMENTS

a. Following the offer for sale to the public in a prospectus of the Company and the State dated May 24, 2004, and completion of the sale of the controlling interest in the Company from the State to Ap.Sb.Ar on October 11, 2005, the Company's employees are entitled to compensation for these sales by means of an allocation of 4.71% of the shares of the Company which are held by the State. Allocation of the shares will be by means of a stock options plan in accordance with an outline published by the Company on November 15, 2005.

b. Following the agreement signed with the employees (see Note 16E) in the matter of an employee stock options plan comprising 3% of the issued and paid up share capital of the Company, the Board of Directors of the Company gave its final approval for the employee stock options plan on February 22, 2007. The options were allocated on March 25, 2007 (except for options to two employee-directors, the allocation of which will be subject to and after approval of the general meeting, which is scheduled for April 15, 2007). The expenses for this grant were recorded in 2006, since the promise was made to the employees that year, with the terms of the grant, and the value of its grant was determined at February 22, 2007, which was the date of the grant.

The terms of the grants are as shown below (all the options are settled by way of physically handing over the shares):

Date of grant / eligible employees	No. of instruments in thousands	Vesting	Contractual duration of the options
Grant of options from the State to employees on October 11, 2005	122,698	Immediate (subject to lock-up – commencing at the end of two to three years – one third each year)	4 years
Grant of options to employees on February 22, 2007[(1)]	78,151	Immediate (subject to lock-up for two years)	5 years
Total options for shares	200,849		

(1) Including 59,000 options to two employee-directors, as noted in sub-section b. above.

The number and the weighted average of the exercise price of the options stock options are as follows:

	No. of options 2006	No. of options 2005
Balance at January 1	**122,698**	122,698
Options granted during the period	**78,151**	-
Options for exercise as at December 31	**200,849**	122,698

The weighted average of the exercise price on 2006 and 2005 is NIS 3.494 per share and NIS 4.057 per share, respectively.

For the balance of the options issued at December 31, 2006, the exercise price is in the range of NIS 3.327 to NIS 3.339, and the weighted average contractual life is 4.4 years.

The fair value of the services received in consideration of the stock options granted, is based on the fair value of the granted options measured on the Black and Scholes model, based on the following parameters:

NOTE 26 – SHARE-BASED PAYMENTS (CONTD.)

The fair value of the options and the assumptions

	2006	2005
Fair value at the time of grant	**3.653**	2.817
Share price	**6.678**	6.400
Exercise price	**3.339**	4.037
Anticipated volatility (weighted average)	**21.00%**	25.25%
Useful life of the option (anticipated weighted average)	**3.00**	3.39
Risk free interest rate (based on government debentures)	**3.20%**	2.45%

Salary expense

	2006	2005
	NIS thousands	NIS thousands
Share options granted in 2005	**-**	345,674
Share options granted in 2006	**286,506**	-
Total expenses charged to salary expenses	**286,506**	345,674

c. After the balance sheet date, on February 27, 2007, the Board of Directors of the Company approved an allocation of 56,836,888 options to the senior management of the Group, exercisable for up to 56,836,888 ordinary shares of NIS 1 par value each of the Company, which are approximately 2.1818% of the issued capital of the Company before allocation of the options.

In view of the enquiry of the Securities Authority into the matter, and as a result of an investigation carried out by the Company into the process of approval of the plan, the Board of Directors of the Company resolved, on March 15, 2007, to cancel this stock options plan and the outline published for it. The Board of Directors intends to act for the formulation of a compensation plan for the senior managers instead of the one cancelled.

d. (1) The employment agreement of DBS with a number of senior employees provides that if DBS adopts an employee stock options plan in which employees will be granted a right to purchase shares of DBS, the plan will include those employees. The exact number of options each employee will receive in the plan will be determined at the exclusive discretion of the Management of DBS. At the date of signing the financial statements, DBS has not adopted an employee stock options plan, and therefore, no options have been allocated.

(2) Under the employment agreements of DBS with a number of senior employees, DBS undertook to grant each such employee options warrants whereby each of them will be entitled to purchase from DBS, by way of an allocation of ordinary shares of NIS 1 par value each, in consideration of their par value, so that after exercise of the option warrants, the number of shares that will be held by any one employee will be approximately 0.2% of the issued share capital of DBS, based on the issued share capital on the date of signing the employment agreement with that employee, and noting certain protections against dilution which are included in some of those agreements. Each employee may exercise the option warrants for shares in accordance with the terms provided in the agreement with him. These options have not yet been granted. The allocation requires the approval of the board of directors of DBS and of the banks. In view of the aforesaid, the provisions of IFRS 2 were not applied on the matter of equity grants to employees.

NOTE 26 – SHARE-BASED PAYMENTS (CONTD.)

(d) (Contd.)

(3) Under the employment agreement of the CEO of DBS, DBS undertook to allocate to him options exercisable for ordinary shares of NIS 1. The options will be allocated free of charge, and will be exercisable free of charge, for shares comprising, on the date of the agreement, 0.5% of the issued share capital of DBS.

The entitlement of the CEO of DBS to shares will be established gradually, along the period of his employment at DBS. At the date of approval of these financial statements, these options have not been allocated. The allocation requires the approval of the board of directors of DBS and of the banks. In view of the aforesaid, the provisions of IFRS 2 were not applied on the matter of equity grants to employees.

NOTE 27 – EARNINGS PER SHARE

Basic and diluted earnings per share

Calculation of the basic and diluted earnings per share at December 31, 2006 was based on the earnings attributable to the ordinary shareholders, of NIS 808,995 thousand (2005 – NIS 666,411 thousand), and on a weighted average number of ordinary shares in circulation of 2,605,046,000 shares, as follows:

	2006	2005
	NIS thousands	NIS thousands
Profit (loss) attributable to the ordinary shareholders		
Profit (loss) attributable to the ordinary shares	**808,995**	666,411
Weighted average of the number of ordinary shares		
Weighted average of the number of ordinary shares	**2,605,046**	2,605,046

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NOTE 28 – SEGMENT REPORTING

The Group operates in various segments in the communications sector, so that every company in the Group operates in a separate business segment. The primary reporting format, by business segments, is based on the Group's management and internal reporting structure.

Each company provides services in the segment in which it operates, using the property, plant and equipment and the infrastructure it owns. The infrastructure of each company is used only for providing its services. Each of the companies in the Group is exposed to different risks and yield expectations, mainly in the matter of the technology and the competition in the segment in which it operates,

Accordingly, the separating component in the Bezeq Group which provides a service or a group of related services, and which is exposed to different risks and yield expectations than those of other segments, is every company in the Group.

Based on the above, the business segments of the Group are as follows:

- Bezeq, The Israel Telecommunication Corp. Ltd. – fixed line domestic communications.
- Pelephone Communications Ltd. – cellular communications.
- Bezeq International Ltd. – international communications and internet services.
- D.B.S. Satellite Services (1998) Ltd. – multi-channel television.

The other companies in the Group are presented in other sections.

Inter-segment pricing is set at the price determined in a transaction between unrelated parties.

NOTE 28 – SEGMENT REPORTING (CONTD.)

The results, assets and liabilities of a segment include items directly attributable to a segment, as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly investments (excluding real estate for investment) and the income from them, loans and borrowings and their related expenses, corporate assets and expenses of the Group, and assets and liabilities for taxes.

Segment capital expenditure is the total cost incurred during the period to acquire property, plant and equipment and intangible assets which are not goodwill.

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation

	Year ended December 31, 2006						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues							
Revenues from external sources	5,193,493	4,462,077	1,016,300	1,338,826	221,134	-	12,231,830
Inter-segment revenues	605,503	15,910	21,519	23,563	97,545	(764,040)	-
Total revenues	5,798,996	4,477,987	1,037,819	1,362,389	318,679	(764,040)	12,231,830
Segment results	746,320	691,682	131,416	7,707	(11,923)	-	1,565,202
Financing costs, net							(337,968)
Net earnings							1,227,234
Equity in profits of investees accounted by the equity method							11,184
Earnings before income tax							1,238,418
Income tax							488,393
Net profit							750,025
Attributed to:							
Shareholders of the Company							808,995
Minority interest in a consolidated company							(58,970)
Earnings for the year							750,025

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2006						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Segment assets	9,756,868	3,375,001	454,918	838,793	186,391	172,230	14,784,201
Investment in investees accounted by the equity method							32,122
Unallocated assets							2,728,337
Total assets							17,544,660
Segment liabilities	2,319,960	756,043	272,219	583,524	107,151	208,823	4,247,720
Unallocated liabilities							8,106,195
Total liabilities							12,353,915
Capital expenses	511,488	337,424	39,713	208,032	9,013		
Depreciation	874,759	407,289	35,047	268,411	5,548		
Amortisation of intangible assets	128,216	63,301	20,205	24,561	11,274		
Losses from impairment of intangible assets and property, plant and equipment	5,314	-	-	-	551		
Share-based payments	286,506	-	-	-	-		

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2005						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenue							
Revenues from external sources	5,285,006	4,413,423	825,801	1,200,866	199,622	-	11,924,718
Inter-segment revenues	60 7,947	14,854	21,488	20,997	104,511	(769,797)	-
Total revenue	5, 892,953	4,428,277	847,289	1,221,863	304,133	(769,797)	11,924,718
Segment results	919,138	585,183	99,644	(78,440)	1,411	-	1,526,936
Financing costs, net							(371,298)
Net earnings							1,155,638
Equity in losses of investees accounted by the equity method							(3,320)
Revenue before income tax							1,152,318
Income tax							532,015
Net profit							620,303
Attributed to:							
Shareholders of the Company							666,411
Minority interest in a consolidated company							(46,108)
Earnings for the year							620,303

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2005						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Segment assets	9,638,637	3,591,679	525,114	941,693	218,100	198,372	15,113,595
Investment in investees accounted by the equity method							20,368
Unallocated assets							4,253,875
Total assets							19,387,838
Segment liabilities	2,325,410	740,838	238,555	592,299	118,752	186,616	4,202,470
Unallocated liabilities							9,130,126
Total liabilities							13,332,596
Capital expenses	763,649	503,885	36,095	266,034	15,824		
Depreciation	970,853	380,294	46,499	257,959	10,254		
Amortisation of intangible assets	130,738	58,265	18,118	26,078	7,911		
Share-based payments	345,674	-	-	-	-		

NOTE 28 – SEGMENT REPORTING (CONTD.)

B. Segmentation of the Group's income

Below is further information of the segmentation of the Group's income by customer use. The attribution of the costs relating to this income is not possible, since the Group's expenses relating directly to them cannot be identified, nor can they be reasonably allocated.

	For the year ended December 31	
	2006	2005
	NIS thousands	NIS thousands
Telephony – domestic calls, fixed fees and installations	**4,139**	4,274
Cellular telephone	**4,262**	4,191
Multi-channel television services to subscribers	**1,284**	1,171
Internet	**982**	867
International communications	**722**	562
Transmission services and data communication	**590**	584
Fixed line infrastructure and maintenance works	**200**	221
Others	**53**	55
Total	**12,232**	11,925

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES

A. The Company and its consolidated companies provide a range of communication services, such as telephony, access, information and data communication, transmission, satellite and video, infrastructure, international communications and internet, multi-channel television, cellular, network end point, and others ("the Services").

Among the entities for which the Company and its consolidated companies provide the Services, there are also parties with an interest in the Company, including Ap.Sb.Ar, which holds 30% of the Company's shares, the State of Israel, which holds 16.38% of the Company's shares, and the Zeevi group, which holds 17.75% of the Company's shares through a receiver appointed for those shares on behalf of certain banks.

In view of the above, as far as parties with an interest in the Company are concerned, which are not the State of Israel, the Services provided for them by the Company and its subsidiaries are negligible transactions, and accordingly, in accordance with Article 64(3)(d)(1) of the Securities Regulations (Preparing annual financial statements), 5753-1993 ("the Regulations"), they are not described in these financial statements.

With regard to the State of Israel as a party with an interest in the Company – prior to Amendment of the Regulations – Securities Regulations (Preparing annual financial statements) (Amendment), 5766-2005, since the description of transactions in connection with regular provision of the Services involved many difficulties (these were a range of services to the State and its many branches, including Government ministries, state companies, and government authorities and companies), the Company was exempted from describing them. Now, in view of the aforesaid amendment to the Regulations, a general description is provided of the transactions, their characteristics and scope, in accordance with Article 64(3)(d)(2) of the Regulations.

(1) The services involved are the Services defined above.

(2) The consideration for most of the transactions which the Company has with State authorities are paid at tariffs set in the Regulations. The other transactions carried out by the Company with the State, (i.e. those for which the consideration is not paid at those tariffs), such as for services for which the regulations do not set a tariff, custom-ordered work, contract work, excavation and installation, and maintenance of transmitters, as well as transactions carried out by the Company's consolidated companies with the State authorities – all these are transactions in the normal course of business at market prices, and each individual transaction or service, of itself, is not material for the Company.

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

A. (Contd.)

(3) For details of the transactions with government ministries, see section F below.

Arrangements which are not in compliance with these terms are disclosed separately in the financial statements.

B. Most of the Companies in the Group are required to pay royalties to the Government of Israel. Commencing January 2001, the income base requiring the payment of royalties was broadened, concurrently with a gradual reduction in the rate of the royalties, until a uniform rate was arrived at for all communications operators. In August 2006, an amendment to the royalties regulations was published, which regulates the reduction of 0.5% per year in their rate for all the licensees required to pay them, commencing January 1, 2006, until a rate of 1% per year is reached in 2010. The Ministry of Communications also gave notice that it will work for amendment of the regulations so that the Company will be exempted retroactively, from January 2004, from the duty to pay royalties in respect of revenues from services which have been opened to competition. A draft regulation was distributed in March 2007.

In the matter of the dispute between the Company and the Ministry of Communications relating to royalties in respect of revenues from interconnect from cellular subscribers to Company subscribers, the Company reached agreement with the Ministry to end past disputes relating to royalties up to and including 2002, except for two negligible revenue components. Under this agreement, the Company paid approximately NIS 17 million to the Ministry of Communications. In the past, the Company's financial statements included a provision for royalties, which, in light of the agreement with the Ministry of Communications, is over-provided. Accordingly, expenses for royalties to the Government of Israel were reduced in 2006 by approximately NIS 36 million, and the financing expenses in respect of royalties were reduced by approximately NIS 31 million. A provision remains in the financial statements in respect of possible disputes commencing 2003, which the Company's Management deems appropriate.

C. On August 1, 2004, a temporary order came into force, whereby for a period of two years or until a gap of up to 1.05 billion traffic minutes opens up between the Company's network and the network of another national domestic operator (except for a special license-holder and the Company), whichever is earlier, interconnect fees will not be paid for terminating a call between domestic operators, as noted. The Company receives compensation for non-payment of interconnect fees, by means of a reduction in the royalties it pays to the Government. That compensation will be up to NIS 40 million. This arrangement ended on November 25, 2006. The Ministry of Communications intends to extend this arrangement for 9 months, in a different format of setting off the royalties which HOT owes the State. The Company has expressed its opposition to the arrangement, and to the best of its knowledge, no amendment to the royalties regulations has yet been brought before the Knesset Finance Committee.

D. On May 8, 2005, a new commercial agreement was signed between the Company and the Ministry of Defence on behalf of the State of Israel, for the provision of communication services by the Company. The agreement was approved beforehand by the Audit Committee of the Board of Directors and by the Board of Directors on May 3, 2005, and required, since the Company was at that time under government control, the approval of the general meeting of the shareholders of the Company (by a special majority), as required by the Security regulations (Transactions between a company and its controlling shareholder), 5761-2001. Approval of the agreement was delayed due to the request of the Ministry of Communications and the Antitrust Commissioner for the Company's remarks on the questions they had raised. On August 23, 2006, the Company received a letter from the Antitrust Authority to the legal representative of the Ministry of Defence and the IDF, in which the Authority gave notice that the agreement does not contravene the provisions of the Antitrust Law, 5748-1988, and that the Authority sees no justification, at the present time, for insisting on cancellation of the agreement. The Company forwarded a copy of the letter to the Ministry of Communications. Based on the contents of the letter, the agreement came into force and the parties operate in accordance with it. The financial statements include the revenue according to the new agreement. However, the Ministry of Communications believes that the agreement includes discounts which the Company is not authorised to grant, and that it was signed for too long a term.

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

D. (Contd.)

On March 27, 2007, the Ministry demanded (following an earlier request on December 4, 2006), that the agreement be amended so as not to violate the provisions of the law and of the Company's license. On March 28, 2007, the Company requested the response of the Ministry of Defence to the letter of the Ministry of Communications, and has not yet formulated its position on the matter.

On December 16, 2003, the Company filed a claim in the Tel Aviv District Court against the Ministry of Defence, for payment of approximately NIS 57 million in connection with a dispute on the matter of a discount of 18% which the Ministry of Defence deducted as noted above in section (3), and on March 16, 2004, the State filed its defence. On May 17, 2004, the Company filed a response. At the suggestion of the court, the parties agreed to refer the case to mediation proceedings, but subsequently decided to try to resolve their differences of opinion out of court. In April 2005, a settlement agreement was signed, which was approved by the Audit Committee of the Board of Directors and by the Board of Directors. The general meeting of the shareholders of the Company approved the agreement on June 2, 2005, as required by the Securities Regulations (Transaction between a company and its controlling shareholder), 5761-2001. In June 2005, the settlement agreement was approved by the court and validated as a court decision.

Below are the main points of the settlement agreement:

(1) For settlement of a financial claim for approximately NIS 37.4 million (principal) plus interest at an estimated amount of approximately NIS 20 million, filed by the Company against the State in the matter of deduction of discounts of 18% on various charges included under the "miscellaneous" item in the telephone bills of the IDF, the Ministry of Defence will pay the Company a total sum of NIS 28.5 million (including VAT where applicable), in three equal payments of NIS 9.5 million each, which will be paid by the following dates: June 30, 2005, January 31, 2006, and June 30, 2006.

(2) Arrears of one of the payments will require the Ministry of Defence to pay Accountant General's arrearage interest.

(3) Subject to the above, neither party will have any allegation and/or demand and/or claim against the other in this matter.

As a result of the settlement agreement, the Company cancelled a provision of approximately NIS 15 million.

E. On March 23, 2006, the general meeting of the shareholders of the Company approved the Company's entering into an agreement with a corporation owned and controlled by the shareholders of Ap.Sb.Ar., whereby the Company will be granted regular management and consultation services, including by means of currently-serving and future directors of the Company and/or its subsidiaries, in consideration of US $1.2 million per year. The term of the agreement is from October 11, 2005 (the date on which Ap.Sb.Ar. purchased 30% of the shares of the Company), and ends on December 31, 2008, unless one of the parties notifies the other of its wish to terminate the agreement by giving three months' notice.

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

F. Transaction with interested parties and related parties

	For the year ended December 31	
	2006	2005
	NIS thousands	NIS thousands
Sales of products and services		
Telephony services –		
From the State of Israel	**368,487**	423,653
Others	**3,267**	2,563
Expenses –		
State of Israel –		
Royalties	**180,941**	257,445
Frequencies	**29,342**	30,762
Others (mainly purchase of satellite segments)	**124,256**	115,979

		For the year ended December 31	
		2006	2006
	Interest rate	NIS thousands	NIS thousands
Balances with related parties – Loans and long-term debts of interested parties			
Loans and debts – index-linked, without date to maturity	0%	**872**	5,514

For other balances with related parties, see relevant notes

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

G. Benefits to directors and the CEO

	For the year ended December 31	
	2006	2005
	NIS thousands	NIS thousands
Total cost of salary of the CEO and the Chairman of the Board *	**10,986**	8,025
Bonus to manager **	**2,400**	-
Number of employees	**2**	3
Compensation for members of the Board of Directors who are not Company employees***	**167**	1,643
Number of directors receiving compensation***	**2**	8
Remuneration of employee-directors****	**1,010**	653
Number of directors receiving the remuneration	**2**	1
Management fees to a controlling company*****	**5,000**	1,250

* The cost for 2005 includes salary and bonuses for the term of office of the CEO of the Company as CEO of Pelephone , as well as salary and months of early notice for the outgoing CEO, and salary and retirement compensation for the outgoing Chairman of the Board. The salary includes options which were distributed to the outgoing CEO and the outgoing Chairman, according to the employee stock options plan as described in an outline dated November 15, 2005.

** Following an enquiry by the Securities Authority on the subject of the bonus to senior employees, the bonus to the CEO was cancelled. See Note 35.

*** From the date of transfer of control in the Company to Ap.Sb.Ar., the directors serving on the Board of Directors of the Company, except for the external directors, do not receive compensation from the Company.

**** Salary paid to employee-directors for their work in the Company, and they receive no additional payment for their service as directors in the Company, over and above the options allocated to them – see Note 26.

***** A provision of NIS 5 million in respect of payment of management fees to Ap.Sb.Ar. – see section E above.

(1) On December 3, 2003, the general meeting of the shareholders of the Company approved a commitment to indemnify officers of the Company in the matter of the framework agreement signed between the Company and the State, including in connection with an allotment of shares to the State pursuant to the framework agreement. The commitment was limited to NIS 890 million (the amount of capital raised), linked to the Consumer Price Index published after completion of raising the capital in accordance with the framework agreement.

(2) On May 13, 2004, the general meeting of the shareholders of the Company approved a commitment to officers in the matter of indemnity and insurance, as follows:

a. An obligation of the Company regarding the provision of a loan to officers to financing reasonable litigation expenses in legal proceedings, and an undertaking of the Company to purchase insurance policies for officers at reasonable cost.

b. Provision of indemnification letters in advance to officers of the Company in the following matters:

(1) A claim of a shareholder who held 15% or more of the share capital of the Company. The total amount of indemnity will not exceed $150 million, plus $30 million for legal expenses (a claim of this kind was excluded under the officers' insurance policies of the Company).

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

G. Benefits to directors and the CEO (contd.)

(2) In all matters relating to a prospectus for an offer for sale of securities of the Company by the State of Israel and an offering by the Company, which was published at the end of May 2004. The total amount of the indemnity (including undertakings to indemnify in advance which was given through publication of the prospectus and for an undertaking to indemnify in advance which will be given, if given, immediately prior to the transfer of control in the Company by the State), will not exceed 25% of the shareholders' equity of the Company (according to the 2003 financial statements, linked to the November 2003 Index).

(3) On April 20, 2004, the Board of Directors of the Company resolved that the Company will indemnify the employees of the Group who participated in the preparation of the prospectus that was intended to be published in May 2004, and who are not officers of the Company, for a financial liability which will be imposed upon them and for reasonable litigation expenses they would incur, regarding all matters relating to the prospectus, in the format of the indemnification letter which was given to the officers.

(4) On April 6, 2005, the general meeting of the shareholders approved an indemnification commitment in respect of a financial liability that would be imposed on officers of the Company and in respect of reasonable litigation expenses which they would incur, related directly or indirectly, to a proceeding for the sale of the State's holdings in the Company.
The indemnification commitment will be provided to officers who served and/or were appointed and/or will be appointed by the Company, commencing from the start of the Company's preparations for the sale proceeding and until the date of the closing of the sale proceeding.

The total amount of the indemnification will not exceed 25% of the shareholders' equity of the Company (according to the 2004 financial statements, linked to the November 2004 Index), including in respect of undertakings to indemnify in advance which were provided through the date of issuance of the letter of indemnification, together with an undertaking to indemnify in advance in accordance with the letter of the Minister of Finance dated April 21, 2004, which will be given, if given, immediately prior to transfer of the controlling interest in the Company by the State.

(5) On May 16, 2005, the general meeting of the shareholders approved the insurance of the officers of the Company, as follows:

Approval of the exercise of an option to purchase a run-off policy for the officers liability to the Company, with the terms of the current policy, with the following changes:

a. For a period of seven years from the date of the closing of the transfer of the State's shares in the Company which are being sold pursuant to the decision of the Ministerial Committee for Privatisation Affairs on July 19, 2004 ("the Sale Closing Date").
b. The total amount of the insurance cover will not exceed \$150 million, plus \$30 million in respect of legal expenses in Israel only.
c. Limits of liability:
   (1) Cover for the first 3 years at a limited liability of \$150 million, plus \$30 million in respect of legal expenses in Israel only.
   (2) Cover for an additional 3 years at a limited liability of \$75 million, plus \$15 million in respect of legal expenses in Israel only.
   (3) Cover for the seventh year at a limited liability of \$25 million, plus \$5 million in respect of legal expenses in Israel only.
   It should be noted that there is one limited liability for each run-off policy.
d. The premium for the entire period of insurance - \$3 million (in a one-time advance payment).

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

G. (Contd.)

(6) The same general meeting on May 16, 2005 approved grant of an undertaking in advance to indemnify the officers of the Company who were serving with the Company at the time the indemnification commitment was provided, which will apply on the Sale Closing Date, or who served during the seven years prior to that date, due to a financial liability that would be imposed upon that person, in each of the events listed in the documents of indemnification and on the terms set out therein, where the officer acted in good faith and had reasonable grounds for assuming that the action is in the best interests of the Company. The to indemnification commitment will not apply regarding an event for which an insurer acknowledged liability under an insurance policy, but if the officer was charged, due to an indemnifiable event, with a sum exceeding the amount paid to him by the insurer, the Company will indemnify him with the difference, and subject to the amount of the indemnity for all the officers in the Company not exceeding $150 million plus $30 million in respect of legal expenses in Israel only per claim, and in total for a year of insurance in the period of insurance. Upon closing the transaction of sale of the State's shares to the Ap.Sb.Ar (October 11, 2005), this undertaking comes into force.

The resolutions noted in sections 4, 5 and 6 above will be applied from the Closing Date (October 11, 2005).

(7) On August 3, 2005, the special general meeting of the shareholders of the Company approved the extension of the term of the officers' insurance policy, including a run-off option, for a period of up to 4 months, at a cost of $112,500 per month, commencing July 31, 2005 (the date of expiry of the prior insurance policy). Upon closing the transaction for the sale of the State's shares to Ap.Sb.Ar. (October 11, 2005), the run-off option was exercised and that policy expired.

(8) On November 24. 2005 the general meeting of the shareholders approved the purchase of an insurance policy for officers in the Company for a period of one year commencing October 11, 2005, with a limit of liability of $150 million per claim and for the each year insured, plus $30 million per claim and for a total of all the claims for the period of insurance, in respect of legal expenses in Israel only. The limit of liability for subsidiaries – $50 million (as part of the aforementioned limit of liability). Annual premium – $675,000 + 1.5% stamp duty (it is noted that the scope of the insurance cover is the same as the officers insurance which prevailed until then in the Company, while the annual premium is considerably lower than the premium paid in the past, in view of the run-off insurance paralleling this insurance).

In addition, the general meeting approved a "framework transaction" for the Company's engagement, during the normal course of business, in future insurance policies (after expiry of the current policy referred to above), to cover directors and officers liability, as may be from time to time, including directors and officers who are or are likely to be considered controlling shareholders in the Company, and all by way of a "framework transaction" as defined in the Companies Regulations (Reliefs in transactions with interested parties), 5760-2000, at an annual premium of $675,000 plus a sum constituting up to 20% of that premium in respect of the amount of the insurance cover existing today (and noted above), as well as $30 million per claim and for all the claims in the period of insurance in respect of legal expenses in Israel only. Limit of liability for subsidiaries - $50 million (as part of the aforementioned limit of liability). If an amount of insurance cover is purchased which differs from the amount existing today, the option to increase the premium is up to a ceiling of 20% of the amount of the premium of the present policy ($675,000), i.e. the maximum premium (after the increase) will not exceed, in any case, US $810,000.

(9) On January 17, 2007, the general meeting of the Company approved making a commitment to indemnify the officers in the Company in accordance with a note of indemnity, for any liability or expense imposed on the officer due to his actions in his capacity as an officer in the Company (including his actions in subsidiaries), within the limitations provided in the Companies Law. The total amount of the indemnity was limited to a ceiling of 25% of the shareholders' equity of the Company as may be at the time of actually paying the indemnity. The note of indemnity will apply to types of events listed in an addendum to the note.

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

H. Ap.Sb.Ar., which holds 30% of the shares of the Company, notified the Company that it is considering granting special remuneration to the former CEO of the Company, as a gesture for his contribution to the Company. The special remuneration, if decided upon, will be paid entirely by Ap.Sb.Ar. Under accounting principles, an appropriate expense will be recorded in the Company's books even though the Company is not bearing the payment. The expense that will be recorded, if and when the remuneration is paid, is not expected to be material for the Company.

I. On May 15, 2006, the Audit Committee of the Board of Directors 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 main points of the terms of his employment:

a. The employment is an 80% position under a personal employment agreement, at a monthly salary of NIS 150,000 plus the standard incidentals (senior employees insurance, study fund, car and driver, expenses account, telephone, etc.).
b. In addition to the regular monthly salary, a payment once a year (with no strings attached), of NIS 1.2 million (linked to the CPI).
c. The commitment will be for an undefined period, where each party is entitled to bring it to an end by giving three months' notice.
d. If the Company introduces a stock options plan, the Chairman will be included in it on the basis of the provisions of the plan.

J. On August 14, 2006, the Board of Directors of the Company approved the sale of a property of the Company to the CEO of the Company (through a company he controls), in consideration of $630,000 plus VAT. The price was set according to the valuation of an external appraiser and after no higher offer was received from others.

K. For guarantees to related parties, see Note 19.

NOTE 30 – FINANCIAL INSTRUMENTS

Exposure to credit, interest rate and currency risks arises in the normal course of the Group's business. Derivative financial instruments are used by the Group to hedge exposure to fluctuations in foreign exchange rates and interest rates.

Credit risk

Management has a credit policy in place and the exposure to credit risks is monitored on a regular basis. Credit evaluations are performed by the Group on all customers requiring credit over a certain amount. The Group requires collateral in respect of financial assets.

The Group invests in marketable liquid securities of the Government and of companies with an investment rating. Transactions involving derivative financial instruments are made with companies which have a high credit rating.

The Group's Management regularly monitors customer debts, and the financial statements include provisions for doubtful debts which properly reflect, in Management's estimation, the loss inherent in debts whose collection is in question.

At the balance sheet date, there are no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying value of each financial asset, including derivative financial instruments, in the balance sheet.

Interest rate risk

The Group is exposed to changes in the fair value as a result of investments in debentures bearing fixed interest and as a result of credit it receives at fixed interest. The Group is exposed to movements in cash flows as a result of investments in debentures bearing variable interest and as a result of credit it receives bearing variable interest. The Group's investments in shares and amounts receivable and payable in the short-term, do not expose it to an interest rate risk.

NOTE 30 – FINANCIAL INSTRUMENTS (CONTD.)

Effective interest rates and maturity dates/movements in interest rates

The table below shows the book values of a group of financial instruments which are exposed to fair value risk and/or cash flow risk in respect of interest rate, according to the earlier of the contractual dates of maturity or dates of repricing.

		2006								
		Average effective interest rate	Total	At least 6 months	6-12 months	1-2 years	2-3 years	3-4 years	4-5 years	Over five years
	Note	%	NIS-000	NIS-000	NIS-000	NIS-000	NIS-000	NIS-000	NIS-000	NIS-000
Fixed-interest instruments										
Long-term trade receivables	6	7.55%	831,623	230,021	212,950	278,063	103,249	4,660	2,680	-
Long-term receivables	6	5.25%	157,269	73,574	55,203	25,502	2,990	-	-	-
Deposit regarding provision of loans to employees	7	5.56%	185,291	40,332	31,483	38,508	21,062	14,226	8,536	31,144
Long-term loan	7	6.40%	22,291	1,013	1,01 4	2,026	2,026	2,026	2,026	12,160
Investments in capital notes	7	5.85%	15,497	-	-	-	-	-	-	15,497
Loans from banks and others –										
CPI-linked shekel	13	6.2%	(1,528,390)	(776,026)	(102,353)	(161,732)	(75,557)	(66,045)	(62,387)	(284,290)
Debentures –										
CPI-linked shekel	13	5.0%	(3,502,969)	(307,090)	(56,817)	(631,738)	(623,991)	(623,052)	(866,228)	(394,053)
Euro, fixed		6.5%	(1,628,733)	-	(1,628,733)	-	-	-	-	-
			(5,448,121)	(738,176)	(1,487,253)	(449,371)	(570,221)	668,185	(915,373)	(619,542)
Variable-interest instruments	7									
Structured instruments		7.29%	60,361	-	60,361	-	-	-	-	-
Short-term deposit		4.00%	3,242	3,242						
Loans from banks and others –	13									
Short-term borrowing, unlinked shekel		6.90%	(118,330)	(118,330)	-	-	-	-	-	-
Unlinked shekel		7.40%	(647,999)	(647,999)	-	-	-	-	-	-
Debentures –										
Euro-linked shekel	13	4.70%	(30,379)	-	-	(30,379)	-	-	-	-
			(733,105)	(763,087)	60,381	(30,379)	-	-	-	-
Loans provided by a minority in a consolidated company	13	12.00%	(564,250)	-	-	-	-	-	-	(564,250)

NOTE 30 – FINANCIAL INSTRUMENTS (CONTD.)

		2005								
		Average effective interest rate	**Total**	**At least 6 months**	**6-12 months**	**1-2 years**	**2-3 years**	**3-4 years**	**4-5 years**	**Over five years**
	Note	**%**	**NIS-000**	**NIS-000**	**NIS-000**	**NIS-000**	**NIS-000**	**NIS-000**	**NIS-000**	**NIS-000**
Fixed-interest instruments										
Long-term trade receivables	6	7.02%	751,230	194,693	196,637	243,551	112,967	1,883	1,499	-
Deposit for providing loans to employees	7	5.84%	192,621	42,328	33,414	41,040	21,742	14,589	8,754	30,754
Long-term loan	7	6.40%	24,388	1,016	1,016	2,032	2,032	2,032	2,032	14,228
Investments in capital notes	7	5.81%	56,990	-	-	-	-	-	-	56,990
Debentures available for sale	7	4.00%	78,547	78,547	-	-	-	-	-	-
Loans from banks and others –										
CPI-linked shekel	13	5.9%	(1,878,202)	(899,992)	(156,947)	(231,310)	((112,551)	(111,114)	(101,568)	(264,720)
Unlinked shekel		7.2%	(79,728)	(79,728)	-	-	-	-	-	-
In foreign currency shekel/dollar		4.0%	(230,150)	(230,150)	-	-	-	-	-	-
Debentures –	13									
CPI-linked shekel		5.0%	(3,760,243)	(434,683)	(55,603)	(131,239)	(635,723)	(625,421)	(624,482)	(1,253,092)
Euro, fixed		6.5%	(1,591,647)	-	-	(1,591,647)	-	-	-	-
			(6,436,194)	(1,327,969)	18,517	(1,667,573)	(611,533)	(718,031)	(713,765)	(1,415,840)
Variable-interest instruments	7									
Structured instruments		4.54%	65,597	-	-	65,597	-	-	-	-
Short-term deposit		4.00%	3,123	3,123	-	-	-	-	-	-
Loans from banks and others –	13									
Short-term borrowing, unlinked shekel		7.2%	(75,184)	(75,184)	-	-	-	-	-	-
Unlinked shekel		7.4%	(662,597)	(662,597)	-	-	-	-	-	-
Dollar, fixed		5.6%	(563,867)	(69,045)	(460,300)	(34,522)	-	-	-	-
Debentures –	13									
Unlinked shekel		4.5%	(36,423)	(36,423)	-	-	-	-	-	-
Euro-linked shekel		3.8%	(29,736)	-	-	-	(29,736)	-	-	-
			(1,299,087)	(840,126)	(460,300)	31,075	(29,736)	-	-	-
Loans provided by a minority in a consolidated company	13	12.00%	(505,280)	-	-	-	-	-	-	(505,280)

NOTE 30 – FINANCIAL INSTRUMENTS (CONTD.)

Foreign currency risk
The Group is exposed to foreign currency risks on sales, purchases and borrowings denominated in currencies which are not the functional currency of the Group. The risks relate primarily to the Index, the US dollar and the euro.

Forecast transactions
The Company's policy is to reduce the exposure to changes in the foreign currency market and consumer price index in order to prevent losses from this exposure. The Company has future currency contracts for hedging forecast transactions. These transactions do not meet the criteria for hedging for accounting purposes, and therefore the change in the fair value is recognised directly to profit and loss.

Recognised assets and liabilities
At December 31, 2006, the fair value of forward exchange contracts that hedge economically financial assets and liabilities denominated in foreign currencies, represents surplus liabilities of approximately NIS 37,547 thousand (2005 – NIS 70,543 thousand) and is presented in the derivatives item.

The fair value at December 31, 2006 of forward Index contracts on the index, used for economic hedging of monetary assets and liabilities linked to the Index, is surplus liabilities of approximately NIS 13,675 thousand (2005 – NIS 16 thousand).

The Group has monetary assets that include, among others, cash and cash equivalents, trade receivables and debit balances, and financial liabilities that include, among others, trade payables, service providers and other payables and credit balances. Due to the nature of these monetary assets, their fair value corresponds to or is close to the value at which they are stated in the financial statements.

NOTE 30 – FINANCIAL INSTRUMENTS (CONTD.)

Fair value

The following table shows the differences in respect of the book value and the fair value of groups of financial instruments, where there is a significant difference between them. The fair value of the long-term loans provided by the minority in a consolidated company is close to their value in accounts, since these loans bear interest at a rate close to the accepted market interest rate.

		2006		2005	
		Book value	Fair value	Book value	Fair value
	Note	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Loan provided	7	**22,291**	**24,887**	24,388	25,789
Investment in capital notes	7	**15,497**	**16,254**	56,990	60,848
		37,788	**41,141**	81,378	86,637
Unrecognised profit			**3,350**		5,259
Short-term borrowing	13	**118,330**	**118,330**	75,184	75,184
Secured bank loans	13				
Dollar-linked					
CPI-linked		**-**	**-**	563,867	569,483
Foreign currency shekel/dollar		**1,528,390**	**1,450,661**	1,878,202	1,887,505
Unlinked		**-**	**-**	230,150	233,687
		647,999	**647,999**	742,325	742,818
Debentures issued to the public	13				
CPI-linked		**1,704,322**	**1,761,732**	1,714,244	1,763,531
Denominated in euro		**1,628,733**	**1,691,478**	1,591,647	1,733,622
Unlinked		**-**	**-**	36,423	36,564
Debentures issued to financial institutions and others	13				
CPI-linked		**1,798,647**	**1,828,986**	2,045,999	2,121,520
Euro-linked		**30,379**	**32,567**	29,736	30,381
		7,456,800	**7,531,753**	8,907,777	9,194,295
Unrecognised loss			**74,953**		286,518

Estimation of fair values

The methods used to estimate the fair values of financial instruments are described in Note 4.

Interest rates applied in the determination of fair value

	2006	2005
	%	%
Long-term trade receivables	**7.6**	7.0
Loans and receivables	**5.6**	6.4
Loans	**6.4**	5.3
Debentures	**4.4**	4.0
Deposit for loans for employees	**5.0**	5.7

NOTE 31 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY

Balance sheet

	2006	2005
	NIS thousands	NIS thousands
Assets		
Cash and cash equivalents	**2,262,037**	1,679,244
Trade receivables	**856,797**	897,416
Other receivables	**214,335**	283,059
Inventory	**13,000**	7,000
Other investments, including derivatives	**957,222**	2,050,789
Current tax assets	**-**	7,128
Total current assets	**4,303,391**	4,924,636
Investments and loans, including derivatives	**355,873**	397,877
Property, plant and equipment	**4,244,841**	4,728,521
Intangible assets	**230,038**	270,830
Deferred and other expenses	**220,734**	230,301
Investments in investees accounted by the cost method	**5,973,124**	5,669,953
Deferred tax assets	**739,197**	625,560
Total non-current assets	**11,763,807**	11,923,042
Total assets	**16,067,198**	16,847,678

NOTE 31 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

Balance sheet (Contd.)

	2006	2005
	NIS thousands	NIS thousands
Liabilities		
Loans and borrowings	**1,877,040**	942,229
Trade payables	**393,757**	540,459
Other payables, including derivatives	**605,033**	631,654
Current tax liabilities	**78,440**	-
Provisions	**207,759**	195,652
Employee benefits	**863,406**	680,169
Proposed dividend	**300,000**	-
Total current liabilities	**4,325,435**	2,990,163
Debentures	**4,381,322**	6,002,528
Obligations to banks	**-**	34,522
Other long-term liabilities	**27,081**	16,151
Employee benefits	**335,544**	373,945
Total non-current liabilities	**4,743,947**	6,427,146
Total liabilities	**9,069,382**	9,417,309
Equity		
Share capital	**6,309,133**	6,309,133
Share premium	**1,623,423**	1,623,423
Reserves	**669,791**	389,246
Deficit	**(1,604,531)**	(891,433)
Total equity	**6,997,816**	7,430,369
Total equity and liabilities	**16,067,198**	16,847,678

NOTE 31 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

Statement of income

	2006	2005
	NIS thousands	NIS thousands
Income	**5,798,996**	**5,892,953**
Costs and expenses		
General and operating expenses	**3,723,898**	3,825,998
Depreciation	**1,026,469**	1,109,385
Other expenses (income), net	**228,893**	(97,143)
Royalties	**66,269**	135,575
	5,045,529	4,973,815
Operating income	**753,467**	919,138
Financing expenses (income), net	**(368,504)**	85,633
Profit after financing	**1,121,971**	833,505
Other income	**(320,000)**	(49,792)
Profit before income tax	**1,441,971**	883,297
Income tax	**253,883**	375,361
Earnings for the year	**1,188,088**	507,936

NOTE 31 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

Statement of changes in shareholders' equity

	Share capital	Share premium	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of assets available for sale	Capital reserve in respect of option warrants to employees	Retained earnings	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Balance as January 1, 2005	6,309,133	1,623,423	37,775	70,265	-	(1,386,659)	6,653,937
Profits for the year	-	-	-	-	-	507,936	507,936
Change in the fair value of financial assets available for sale, less tax	-	-	-	1,386	-	-	1,386
Profits from financial assets available for sale attributable to profit and loss, less tax	-	-	-	(67,089)	-	-	(67,089)
Actuarial gains and losses in a defined benefit plan, less tax	-	-	-	-	-	(12,710)	(12,710)
Payment from the State to employees in respect of Company privatisation	-	-	1,235	-	-	-	1,235
Share-based payments to Company employees from its shareholders	-	-	345,674	-	-	-	345,674
Balance as at December 31, 2005	6,309,133	1,623,423	384,684	4,562	-	(891,433)	7,430,369
Changes for 2006							
Profits for the year	**-**	**-**	**-**	**-**	**-**	**1,188,088**	**1,188,088**
Change in the fair value of financial assets available for sale, less tax	**-**	**-**	**-**	**(2,361)**	**-**	**-**	**(2,361)**
Profits from financial assets available for sale attributable to profit and loss, less tax	**-**	**-**	**-**	**(3,600)**	**-**	**-**	**(3,600)**
Actuarial gains and losses in a defined benefit plan, less tax	**-**	**-**	**-**	**-**	**-**	**(1,186)**	**(1,186)**
Dividends to shareholders	**-**	**-**	**-**	**-**	**-**	**(1,900,000)**	**(1,900,000)**
Share-based payments	**-**	**-**	**-**	**-**	**286,506**	**-**	**286,506**
Balance as at December 31, 2006	**6,309,133**	**1,623,423**	**384,684**	**(1,399)**	**286,506**	**(1,604,531)**	**6,997,816**

NOTE 31 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

Statement of cash flows

	2006	2005
	NIS thousands	NIS thousands
Cash flows from operating activities		
Net earnings	**1,188,088**	507,936
Adjustments to earnings	**1,459,675**	1,981,385
Net cash from operating activities	**2,647,763**	2,489,321
Cash flows stemming from (used for) investment activities	**629,858**	(1,371,310)
Cash flows used for financing activities	**(2,699,963)**	(767,905)
Net increase in cash and cash equivalents	**577,658**	350,106
Cash and cash equivalents as at January 1	**1,679,244**	1,327,731
Effect of fluctuations in the rate of exchange on cash balances	**5,135**	1,407
Cash and cash equivalents as at December 31	**2,262,037**	1,679,244

Appendix of non-cash operations

	2006	2005
Acquisition of property, plant and equipment, other assets, materials and spare parts on credit	**72,074**	120,023
Sale of property, plant and equipment on credit	**161,800**	-

NOTE 32 – GROUP ENTITIES

Significant subsidiaries

	Country of registration	Rate of ownership For the year ended December 31, 2006	2005
Pelephone Communications Ltd. (1)	Israel	**100**	**100**
Bezeq International Ltd. (2) (4)	Israel	**100**	100
D.B.S. Satellite Services (1998) Ltd. (3)	Israel	**49.8**	49.8
BezeqCall Communications Ltd. (4)	Israel	**100**	100
Bezeq On Line Ltd. (5)	Israel	**100**	100
Bezeq Zahav (Holdings) Ltd. (6)	Israel	**100**	100
Stage One (7)	Israel	**83**	100
Goldnet Communication Services – registered partnership (8)	Israel	**100**	74.9

(1) Pelephone Communications Ltd. ("Pelephone") is a wholly-owned subsidiary of the Company. Pelephone provides cellular services, and sells and repairs terminal equipment.

Pelephone operates under an operating license of the Ministry of Communications – a general license for cellular services ("the License"). The License, in its updated form, was received on February 7, 1996 for a period of 10 years from its commencement date of January 1, 1994, with an option for extension for another 6 years ("the Additional Period") and for renewal for an additional one or more periods of 6 years beyond the Additional Period.

In the framework of winning an additional band of frequencies in December 2001, Pelephone's License was extended to 2022.

(2) Bezeq International Ltd. ("Bezeq International") is wholly-owned by the Company, and was established on April 5, 1995 to engage in international communications, in accordance with a Government decision dated December 28, 1994 and following a change in the general license of the Company. Since 1999, Bezeq International has also been providing internet access services. Bezeq International has holdings in the Walla! Communications Group Ltd. (see Note 12).

(3) D.B.S. Satellite Services (1998) Ltd. ("DBS") was incorporated in Israel on December 2, 1998. In January 1999, DBS received a license from the Ministry of Communications to transmit satellite television broadcasts in Israel ("the License"). The License was granted for a period of ten years from the date of its receipt, and could be extended under certain conditions for an additional six years. In June 2002, the term of the License was extended for five additional years beyond the first term.

In July 2000, DBS ended the preparation stage and began to provide its customers with multi-channel television broadcasts in accordance with the License granted pursuant to the Communications Law.

Since commencing operations, DBS has accumulated considerable losses. DBS’s losses in 2006 and 2005 amounted to approximately NIS 320 million and NIS 346 million, respectively. As a result of these losses, its capital deficit and its working capital deficit at December 31, 2006 amounted to approximately NIS 2,861 million and NIS 1,551 million respectively.

The Company's investment in DBS (primarily in shareholder loans) at the balance sheet date amount to approximately NIS 1,562 million (without interest and linkage). The balance of the current debt of DBS to the Company and its consolidated companies amounts to approximately NIS 131 million. This debt has not yet been repaid in full, and the Company recently came to an arrangement with DBS for its collection, whereby the past debt will be paid in 60 equal monthly instalments plus interest at prime + 1.5%.

During 2005, the banks completed the provision of the entire credit facility to which DBS was entitled under the financing agreements.

NOTE 32 – GROUP ENTITIES (CONTD.)

Significant subsidiaries (Contd.)

(3) (Contd.)
The terms of the loans and the credit facility which DBS received from the banks, the balance of which at December 31, 2006 was NIS 1,394 million, impose various restrictions on DBS which include, *inter alia*, restrictions on the encumbrance or sale of certain assets, a restriction on receipt of credit from other banks without prior approval, a restriction concerning repayment of shareholder loans, and a requirement for compliance with financial criteria ("the Conditions").

At December 31, 2006, DBS is in compliance the Conditions laid down in the financing agreements (after a relief granted in connection with the financial criteria in respect of the fourth quarter of 2006), but the Management of DBS does not expect that it will be in compliance with the Conditions in 2007 and thereafter. In view of this forecast, the bank loans are stated as part of current liabilities. DBS approached the banks for amendment and adjustment of the maturity dates for full repayment of the bank credit. At the date of approval of the financial statements, these terms have not yet been agreed.

Following decisions of Ministers of Communications during 2004 and 2005, which limit injections to DBS by the Company, on February 17, 2005, the Board of Directors of the Company resolved that it stands behind its resolution of March 30, 2004 to continue investing in DBS according to the approved work plan, together with other shareholders and financing entities. This resolution was based, among others, on an external legal opinion that the Minister of Communications does not have the authority to prohibit injections of funds by the Company to DBS.

During April and May 2005, the Company and DBS filed petitions in the High Court of Justice for an order *nisi* against the then Minister of Communications, according to which the aforementioned decisions of the Ministry of Communications are void *ab initio*. The petitions, which were heard on October 11, 2005, raise questions of principle which are far from simple, both factually and legally, and which were brought into sharp focus during the hearing. The ruling of the High Court has not yet been handed down, and the Company, relying on its legal advisers, is unable to assess the probability of the petitions' success. It is noted that at the same time as the proceeding, the Ministry of Communications gave notice of his intention to call in NIS 10 million out of the Company's guarantee. On July 7, 2005, the Company, in accordance with its right under the general license, filed an appeal against the Ministry's decision to call in the guarantee.

On March 21, 2006, the Company received a letter from the Minister of Communications, which stated that subsequent to examining the implications of the continued injections of funds to DBS, in order to advance and consolidate competition in fixed-line domestic communications, and based on the business plan of DBS for 2006, which was presented to the Minister, he was considering limiting the injection of funds to DBS in 2006 in the following manner:

1. The Company's part in the total injections of funds to DBS would not exceed 40%.
2. The other shareholders' part in DBS and of the banks or institutional financing entities in the injections, would not be less than 60%.
3. The Company or an entity acting on its behalf, would not provide a guarantee for the shareholders, the banks or the institutional financing entities, or any other similar commitment, to secure their part in the injections or credit granted to DBS by them.
4. Towards the end of 2006, the matter of the injections would be re-examined, to the extent required in the following years.

The Company notified the Minister of Communications that there was neither place nor justification for such restrictions, and requested a hearing before the Minister. At the date of publication of the financial statements, the Company has not been invited to put its position to the Minister.

For DBS's non-compliance with payment arrangement with suppliers, see Note 18(3).

NOTE 32 – GROUP ENTITIES (CONTD.)

Significant subsidiaries (Contd.)

(3) (Contd.)

On January 2, 2005, the Antitrust Commissioner gave his conditional approval for a merger of the Company and DBS (increasing the holdings of the Company in DBS to more than 50%). The merger was not realised. With the elapse of a year from the date of the approval, a new consent is required. On August 2, 2006, the Company and DBS submitted new merger notices to the Antitrust Commissioner, in the matter of exercise of options for shares in DBS by the Company, which would increase the Company's holdings in DBS from approximately 49.8% to approximately 58%. On December 31, 2006, the Antitrust Authority gave notice of the Commissioner's opposition to the merger, and on February 18, 2007 it gave the reasons for the opposition. The Company intends to appeal the decision.

On December 24, 2006, the board of directors of DBS approved the budget for 2007. According to this budget, in 2007 DBS will require additional external financing. At the date of approval of the financial statements, DBS is working to obtain additional sources of finance that will enable it to attain the budget targets for the coming year. If those sources cannot be found, DBS will operate in accordance with an alternative business plan which does not necessitate financial resources beyond those available to it. The Management of DBS estimates, based on the 2007 budget and on the alternative business plan, that it is more likely than not that the sources of financing required by DBS in the coming year can be arranged.

(4) Bezeqcall Communications Ltd. ("Bezeqcall"), is a wholly-owned subsidiary of the Company. Bezeqcall commenced operations in 1995 and operates principally in the network end point market, access networks and providing total communication solutions. On August 23, 2006, Bezeq International and Bezeqcall signed a merger agreement, whereby upon fulfilment of the suspending conditions provided in the agreement, the parties would merge so that all the operations of Bezeqcall, including all its assets and liabilities, would transfer as is to Bezeq International, commencing January 1, 2007. The approval of the Antitrust Commissioner for the merger was received on October 5, 2006, and on December 31, 2006 the Ministry of Communications approved assignment of Bezeqcall's network end point license to Bezeq International. On February 11, 2007, the Registrar of Companies confirmed that in accordance with the provisions of Section 323 of the Companies Law, 5759-1999 ("the Law"), Bezeq International had absorbed Bezeqcall and that from that date, Bezeqcall no longer existed.

On October 15, 2006, an agreement was signed between Bezeqcall and Tadiran – Telecom Communication Services in Israel – a limited partnership ("Tadiran"), concerning the acquisition of all the operations of Tadiran for a consideration of approximately NIS 93 million (subject to certain adjustments depending on the date of closing the transaction). The closing in respect of the transaction is subject to receipt of approvals, including from the Antitrust Commissioner. In March 2007, the Company learned that the Commissioner does not approve the transaction. Bezeq International and Tadiran are considering their actions in the matter.

(5) Bezeq On Line Ltd. ("Bezeq On Line") was established in December 2000 and commenced operations in 2001. Bezeq On Line provides call centre outsourcing services.

(6) Bezeq Zahav (Holdings) Ltd. ("Bezeq Zahav") is wholly-owned and controlled by the Company. Bezeq Zahav was established in September 1995 and commenced operations in May 2004. Bezeq Zahav holds debentures issued by the Company.

(7) This is a venture capital fund in which the management rights are held by the SOCI, and the Company has rights in the profits – see Note 3A(2).

(8) On April 30, 2006, an agreement was signed between the Company and Malam Systems Ltd., who are partners in Goldnet Communication Services ("Goldnet") – a registered partnership, which provides solutions for the secure electronic distribution and transfer of information between organizations and the subsidiary Bezeq International. Under the agreement, Bezeq International acquired all the operations of Goldnet.

NOTE 32 – GROUP ENTITIES (CONTD.)

Significant subsidiaries (Contd.)

(8) (Contd.)

After compliance with all the suspending conditions set out in the acquisition agreement, in July 2006 Goldnet, which operated under the commercial name of Bezeq Zahav, ceased to provide services and its operation merged into Bezeq International.

NOTE 33 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION

As stated in Note 2A, these are the Group's first consolidated financial statements prepared in accordance with IFRS.

The accounting policies set out in Note 3 have been applied in preparing the financial statements for the year ended December 31, 2006, the comparative information in the financial statements for the year ended December 31, 2005, and in the preparation of an IFRS opening balance sheet at January 1, 2005 (the Group's date of transition to IFRS).

In preparing its IFRS opening balance sheet, the Group has adjusted amounts reported previously in financial statements prepared in accordance with its old basis of accounting (Israeli GAAP).

An explanation of how the transition from Israeli GAAP to IFRS has affected the Group's financial position, financial performance and cash flows, is set out in the following tables and in the notes that accompany them.

NOTE 33 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

Reconciliation of equity

	Note	Israeli GAAP	Effect of transition to IFRS	IFRS	Israeli GAAP	Effect of transition to IFRS	IFRS
			January 1, 2005			December 31, 2005	
		NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Current assets							
Cash and cash equivalents		1,457,107	-	1,457,107	2,158,773	-	2,158,773
Trade receivables	R	2,115,070	1,600	2,116,670	2,113,512	1,370	2,114,882
Other receivables	E, R	416,113	(287,947)	128,166	321,507	(179,650)	141,857
Inventory	R	314,549	12,322	326,871	220,404	10,880	231,284
Broadcasting rights		140,496	-	140,496	154,500	-	154,500
Other investments, including derivatives	I	1,287,809	177,949	1,465,758	2,398,525	4,888	2,403,413
Current tax assets	R	-	13,224	13,224	-	18,134	18,134
Total current assets		5,731,144	(82,852)	5,648,292	7,367,221	(144,378)	7,222,843
Materials and spare parts	R	130,922	(130,922)	-	88,881	(88,881)	-
Trade and other receivables		302,079	-	302,079	361,013	-	361,013
Investments and loans, including derivatives	J, P	570,496	58,322	628,818	405,827	50,894	456,721
Property, plant and equipment	A-E, G, R	*10,522,971	(2,958,667)	7,564,304	*9,762,307	(2,515,810)	7,246,497
Intangible assets	D and H	2,180,562	471,638	2,652,200	2,080,029	531,005	2,611,034
Deferred expenses	E, R	-	391,895	391,895	-	391,738	391,738
Investments in associates accounted for by the equity method	P	70,308	(55,649)	14,659	75,467	(55,099)	20,368
Deferred tax assets	A-C, I-N	*516,395	774,153	1,290,548	*398,742	678,882	1,077,624
Total non-current assets		14,293,733	(1,449,230)	12,844,503	13,172,266	(1,007,271)	12,164,995
Total assets		20,024,877	(1,532,082)	18,492,795	20,539,487	(1,151,649)	19,387,838

* Restated – see section (u) below.

NOTE 33 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

Reconciliation of equity (Contd.)

	Note	Israeli GAAP	Effect of transition to IFRS	IFRS	Israeli GAAP	Effect of transition to IFRS	IFRS
			January 1, 2005			December 31, 2005	
		NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Current liabilities							
Loans and borrowings	O	1,633,499	-	1,633,499	1,864,941	1,295,711	3,160,652
Trade payables	E	1,790,569*	(4,067)	1,786,502	1,514,714*	33,743	1,548,457
Other payables, including derivatives	I, J, M, R	1,287,140*	(348,540)	938,600	1,273,955*	(354,630)	919,325
Provisions	R	-	249,769	249,769	-	259,811	259,811
Employee benefits	M	602,474	135,260	737,734	577,878	139,845	717,723
Total current liabilities		5,313,682	32,422	5,346,104	5,231,488	1,374,480	6,605,968
Liabilities							
Debentures	R	3,824,539	(13,434)	3,811,105	4,903,056	(11,716)	4,891,340
Obligations to banks	O	2,860,934	-	2,860,934	2,151,960	(1,403,907)	748,053
Loans from others		47,375	(8,786)	38,589	34,081	99,162	133,243
Loans provided by the minority in a subsidiary	Q	1,057,988	(601,558)	456,430	1,114,498	(609,218)	505,280
Less – minority interest in deficit of a subsidiary	Q	(1,057,988)	1,057,988	-	(1,114,498)	1,114,498	-
Employee benefits	M	814,096	(45,812)	768,284	431,427	(35,074)	396,353
Provisions		-	52,427	52,427	-	52,359	52,359
Minority rights	R	(10,412)	10,412	-	-	-	-
Total non-current liabilities		7,536,532	451,237	7,987,769	7,520,524	(793,896)	6,726,628
Total liabilities		12,850,214	483,659	13,333,873	12,752,012	580,584	13,332,596
Equity							
Share capital		6,309,133	-	6,309,133	6,309,133	-	6,309,133
Share premium		1,623,423	-	1,623,423	1,623,423	-	1,623,423
Reserves	I	37,775	72,004	109,779	39,010	350,927	389,937
Dividend proposed subsequent to the balance sheet date		-	-	-	1,200,000	(1,200,000)	-
Retained earnings (deficit)	A-C, F, G-J, M	(795,668)**	(1,620,903)	(2,416,571)	(1,384,091)**	(377,880)	(1,761,971)
Total equity attributable to equity holders of the Company		7,174,663	(1,548,899)	5,625,764	7,787,475	(1,226,953)	6,560,522
Minority interest	G	-	(466,842)	(466,842)	-	(505,280)	(505,280)
Total equity		7,174,663	(2,015,741)	5,158,922	7,787,475	(1,732,233)	6,055,242
Total equity and liabilities		20,024,877	(1,532,082)	18,492,795	20,539,487	(1,151,649)	19,387,838

* Restated.
** Restated – see section (u) below.

NOTE 33 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

Notes to the reconciliation of equity

The impact on deferred tax of the adjustments described below, is set out in section (s) below.

a. At the transition date, the Group chose to state some of the property, plant and equipment items (the switching, transmission and power group) at their fair value and to determine that value as deemed cost, in accordance with the relief under IFRS 1. The deemed cost was based on an external expert opinion. As a result, the property, plant and equipment balances decreased by NIS 1,782 million at January 1, 2005 (NIS 1,415 million at December 31, 2005), to a fair value of approximately NIS 2,124 million at January 1, 2005, while the deferred tax balances deriving from the differences in the measurement of the property, plant and equipment for tax purposes changed compared with the presentation of property, plant and equipment for accounting purposes, by approximately NIS 540 million and NIS 401 million at January 1, 2005 and December 31, 2005 respectively. The reserve balances were reduced on those dates by the respective net amounts. The depreciation expense for 2005 decreased by NIS 365 million.

b. On the date of transition to IFRS, in accordance with the directives of IAS 16, the residual value of the property, plant and equipment not included in the calculation of depreciation according to accepted accounting principles in Israel was measured. The effect was to increase the property, plant and equipment balances and to reduce the depreciation expense for 2005 by approximately NIS 32 million. Another effect was to change the deferred tax balances derived from the differences in the measurement of the property, plant and equipment for tax purposes as compared with the presentation of property, plant and equipment for accounting purposes. In addition, the reserves' balances were reduced by the same amount at the above dates.

c. Under IAS 37, the Group is required to recognise liabilities to bear the costs of site decommissioning and clearing. Under IFRS 1, the expected costs of decommissioning and clearing sites at the transition date. As a result, the reserve balance by approximately NIS 17 million (net of tax). The balance of the property, plant and equipment at January 1, 2005 and at December 31, 2005 increased by NIS 19 million and NIS 18 million respectively.

d. Under IFRS, computer software and capitalised software development costs which are not an integral part of the hardware attributed to them, are treated as intangible assets. Accordingly, with the transition to IFRS, the carrying balances at January 1, 2005 and at December 31, 2005, of NIS 546 million and NIS 516 million respectively, relating to computer software and to capitalised software development costs, were reclassified from the property, plant and equipment item to the intangible assets item.

e. Under accepted accounting principles in Israel, agreements granting the Group an indefeasible right of use of sea-bed cable capacity was treated as a finance lease and an asset relating to them was recognised in the balance sheet within the property, plant and equipment account. Under IFRS and as provided in IFRIC 4, which determine whether an arrangement includes a lease, there are criteria for determining whether a right to use an asset is an arrangement having the form of a lease. If it is not a lease, the arrangement should be classified as an arrangement for receipt of services. The effect of application of the provisions of IFRIC 4 and in the absence of the criteria required for the transactions to be defined as having the form of a lease, the amounts paid to the suppliers for a future right of use of sea-bed cable capacity were classified as deferred and other long-term expenses.

   The effect of the transition to IFRS is to decrease property, plant and equipment by approximately NIS 187 million and approximately NIS 171 million at January 1, 2005 and December 31, 2005 respectively, to decrease trade and service provider payables by approximately NIS 21 million at January 1, 2005, against an increase in the following items:
   (1) Other accounts receivable (prepaid expenses) of approximately NIS 19 million and approximately NIS 17 million at January 1, 2005 and December 31, 2005 respectively.
   (2) Other long-term assets (long-term prepaid expenses in respect of a right of use of capacity), of approximately NIS 147 million and NIS 154 million respectively.

NOTE 33 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

Notes to the reconciliation of equity (Contd.)

f. Under accepted accounting principles in Israel, the Group recognised as an asset the net direct costs paid to a third party in respect of sale to subscribers who signed a commitment to remain customers of the Group. These costs included the commissions paid to external dealers. In addition, the costs of subsidising the terminal equipment for customers were recognised as assets ("Subscriber Acquisition"). This Subscriber Acquisition was depreciated to profit and loss over the term of the customer commitment, which is up to 36 months.

Under IAS 38, the Group capitalises the incremental direct sales commissions to employees and to external dealers in respect of sales to those subscribers who signed a commitment to remain customers of the Group. These costs are depreciated to profit and loss over the term of the commitment of the subscribers, which is up to 36 installments. As a result, the reserve balance at January 1, 2005 and at December 31, 2005, was reduced by approximately NIS 46 million (net of tax).

g. Under accepted accounting principles in Israel, customer acquisition costs in a consolidated company were partially capitalised to property, plant and equipment and depreciated over 6 years, and part was charged as a current expense to profit and loss. Under IFRS, these costs were capitalised and depreciated over the terms of the contractual engagement of the subscriber, which are usually one year.

The difference between the accumulated depreciation under accepted accounting principles in Israel and the accumulated depreciation under IFRS at January 1, 2005 and at December 31, 2005, amounts to NIS 330 million and NIS 295 million respectively.

h. The Group has chosen the relief in IFRS 1, whereby it will apply the provisions of IFRS 3 only in respect of business combinations that occurred after January 1, 2005 (the date of transition to IFRS). Accordingly, commencing January 1, 2005, under IFRS principles, the Group ceased amortisation of goodwill.

As a result, an increase of approximately NIS 94 million was recorded in the intangible assets item at December 31, 2005, and a corresponding decrease in the other expenses (income), net, item at the same date.

i. Unlike accepted accounting principles in Israel, under the IFRS, financial instruments are classified as available for sale, and all the derivative financial instruments are recognised assets or as liabilities at their fair value.

The effect of the transition to IFRS on January 1, 2005, is an increase in other investments, including derivatives, of approximately NIS 100 million; in other investments, including short-term derivatives, of approximately NIS 3 million; in other payables, including derivatives, of approximately NIS 11 million; in surpluses of approximately NIS 6 million (net of tax), and in a capital reserve in respect of assets available for sale, of approximately NIS 72 million. The effect at December 31, 2005, is a decrease of approximately NIS 3 million in investments and loans, including non-current derivatives, a decrease in other payables, including derivatives, of approximately NIS 3 million, a decrease of approximately NIS 16 million in financing expenses for 2005, a decrease of approximately NIS 3 million in reserve balances, and an increase of approximately NIS 5 million in a capital fund in respect of assets available for sale.

j. Under IAS 39, the Group separated embedded derivatives from the host contract and stated them at fair value. The effect of transition to IFRS at January 1, 2005 is an increase of approximately NIS 2 million in non-current investments, an increase of approximately NIS 2.5 million in liabilities, and an increase of approximately NIS 2.5 million (net of tax) in reserve balances. The effect of the transition to IFRS at December 31, 2005 is an increase of approximately NIS 11 million in liabilities, an increase of approximately NIS 15 million in financing expenses, and a reduction of approximately NIS 4 million to the tax expense.

NOTE 33 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

Notes to the reconciliation of equity (Contd.)

Receivables in respect of derivative financial instruments of approximately NIS 77 million at January 1, 2005 and of approximately NIS 5 million at December 31, 2005, were reclassified from the other receivables item to the other investments including short-term derivatives item.

k. Under IFRS, deferred tax assets are classified as non-current assets, even if the expected date of their realisation is expected to be in the short term. Under accepted accounting principles in Israel, deferred tax assets were classified as current or non-current assets, depending on the classification of the assets in respect of which they were generated.
Accordingly, with the transition to IFRS, the balance of short-term deferred taxes was reclassified, at January 1, 2005 and at December 31, 2005, amounting to approximately NIS 234 million and approximately NIS 194 million respectively, from the accounts receivable and debit balances item under current assets, to the deferred tax item under non-current assets.

l. Under accepted accounting principles in Israel, the transition to Standard 19 was effected by way of cumulative effect at the beginning of 2005. The effect of transition to IFRS was by way of amendment of reserves at January 1, 2005 in the amount of approximately NIS 15 million.

m. Under accepted accounting principles in Israel, severance pay liabilities were recognised on the basis of the full liability, assuming that all the employees would be terminated on terms entitling them to full compensation, irrespective of capitalisation rates, future salary increment rates and future cessation of employment. In addition, liabilities in respect of vacation and sick leave were calculated on the basis of estimated utilisation and redemption, respectively. On the date of transition to IFRS, all the net liabilities for service benefits after retirement and other long-term benefit plans are measured in accordance with IAS 19, and the difference of approximately NIS 14 million and approximately NIS 4 million at January 1, 2005 and at December 31, 2005 respectively, was credited to reserves (net of tax).

The effect of the transition to IFRS for 2005 is to reduce the liability for service benefits by NIS 21 and NIS 7 million at January 1, 2005 and at December 31, 2005 respectively, to decrease salary expenses by NIS 17 million, to increase financing expenses by NIS 15 million, and to charge actuarial losses of NIS 11 million to surpluses (net of tax) for the year ended December 31, 2005.

The liabilities in respect of vacation, amounting to NIS 110 million at January 1, 2005 and December 31, 2005, were reclassified from the other payables including derivatives item, to the short-term employee benefits item.

The liabilities in respect of sick leave, amounting to NIS 47 million at January 1, 2005 and NIS 55 million at December 31, 2005, were reclassified from the long-term employee benefits item, to the short-term employee benefits item.

n. The Group has applied IFRS 2 for share-based payments made after January 1, 2005. The Group has granted equity-settled share-based payments in 2005 and 2006.

Under accepted accounting principles in Israel, principles similar to those of IFRS 2 were applied only for grants made subsequent to March 15, 2005, provided they vested not before January 1, 2006.

The effect of measuring equity-settled share-based payments at fair value is to increase the salary expense by approximately NIS 346 million for the year ended December 31, 2005. The adoption of IFRS 2 is equity-neutral for equity-settled transactions. The expense recognised for employee services given in consideration of share options granted, will be deductible for tax purposes when the share options are exercised, limited to the amount of the benefit according to income tax rules.

o. Under IFRS, bank loans in a consolidated company were stated as short-term loans, while under accepted accounting principles in Israel these loans were classified as long-term loans. The change in classification was made since the consolidated company failed to meet financial criteria set by the banks for those loans on the balance sheet date.

NOTE 33 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

Notes to the reconciliation of equity (Contd.)

p. Under IFRS, the Group consolidated its investments in a Special Purpose Entity (SPE), since that entity, which is controlled by the Group was established on terms which impose severe limitations on the decision-making powers of the SPE's management, in contrast to the accepted accounting principles in Israel, under which the investment was stated as an investment in an investee company, since the Group does not control it the entity. The effect is a decrease the investments in investees accounted by the equity method and an increase mainly in investments and loans, including derivatives, amounting to approximately NIS 56 million at January 1, 2005 and NIS 55 million at December 31, 2005. In addition, the Company's equity in the losses of an investee decreased by approximately NIS 9 million, with a corresponding increase in the financing expenses in 2005.

q. Under accepted accounting principles in Israel, the minority item in the Company is measured at the amount of the loans provided by the minority for DBS, a consolidated company, at their carrying value in the investee company, and stated net of those loans.

Under IFRS, the minority rights are stated in the consolidated balance sheet as a separate component of the shareholders' equity, in the amount of the loans provided by the minority for a consolidated company at their fair value, plus the costs of financing in respect of those loans, accumulated from the acquisition date to the balance sheet date. The minority equity in the capital deficit of the consolidated company is stated under distribution of earnings between the majority shareholders and the minority shareholders.

r. Other classifications made in accordance with IFRS:

1. Leases of land from Israel Lands Administration classified as operating leases, of approximately NIS 233 at January 1, 2005 and of approximately NIS 221 at December 31, 2005, were transferred from the property, plant and equipment item to the deferred expenses item.
2. Materials and spare parts which were stated in a separate item between the current assets item and the property, plant and equipment item, were reclassified to the inventories item and the property, plant and equipment item amounting to NIS 12 and NIS 11 respectively, at January 1, 2005 and to NIS 11 and NIS 78, respectively, at December 31, 2005.
3. Current tax liabilities of approximately NIS 13 at January 1, 2005 and of approximately NIS 18 at December 31, 2005, were transferred from the other payables item to a separate item in the Group's balance sheet.
4. Prepaid expenses for rentals of approximately NIS 8 at January 1, 2005 and of approximately NIS 7 at December 31, 2005, were reclassified from the other assets and deferred expenses item to the deferred expenses item.
5. Provisions amounting to approximately NIS 250 at January 1, 2005 and approximately NIS 260 at December 31, 2005, were reclassified from the other payables including derivatives item to a separate item in the Group's balance sheet.
6. Other income, net, was classified under other operating income, net.
7. The debentures are stated net of deferred issuance expenses of approximately NIS 13 million and NIS 12 million at January 1, 2005 and December 31, 2005 respectively.
8. The Group made additional adjustments which are not material.

s. The above changes increased (decreased) the deferred tax liability (asset) as follows:

		January 1, 2005	December 31, 2005
	Note	NIS thousands	NIS thousands
Property, plant and equipment	A-C	561,538	399,573
Intangible assets	F	31,307	27,723
Financial instruments	I-J	(36,909)	2,166
Employee benefits	M	(6,249)	(2,780)
Share-based payments	N	-	64,255
Increase in deferred tax assets		549,687	490,937

The effect of the transition to IFRS on the income statement for the year ended December 31, 2005, was to increase the tax expense reported in the past in respect of the period, by NIS 100 million.

NOTE 33 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

Notes to the reconciliation of equity (Contd.)

t. Effect of the above adjustments on shareholders' equity:

	Note	January 1, 2005 NIS thousands	December 31, 2005 NIS thousands
Property, plant and equipment	A, B, C, G	(2,145,302)	(1,714,751)
Intangible assets	F - J	(68,032)	30,665
Financial instruments	I, J	(15,946)	(21,436)
Employee benefits	M	19,740	6,938
Share-based payments to employees in the Company	N	-	(345,674)
Others		1,850	(24,752)
Deferred taxes	S	586,787	491,130
Total adjustment of reserve balances		(1,620,903)	(1,577,880)
Financial assets available for sale		109,104	5,446
Share-based payments to employees in the Company		-	345,674
Deferred taxes	S	(37,100)	(193)
Total adjustment of funds and capital		72,004	350,927
Attributed to:			
Holders of the Company's capital		(1,548,899)	(1,226,953)
Minority rights		(466,842)	(505,280)
		(2,015,741)	(1,732,233)

u. **Restatement**

The financial statements at the date of transition, at December 31, 2005 and for the year ended December 31, 2005, were adjusted by way of restatement in order to retroactively reflect the following changes:

(1) Recording a reduction in lease payments of land from Israel Lands Administration over the term of the lease and not as reduced since the establishment of the Company (4%). The effect of this amendment will be the addition of approximately NIS 100 million and NIS 105 million to property, plant and equipment, and of approximately NIS 75 million and NIS 80 million to the balance of shareholders' equity at December 31, 2004 and 2005 respectively. The amendment does not significantly affect the profit for the year.

(2) Statement of receipts from interconnect to the cellular networks, which were not stated commencing 2000, as part of the Company's revenue and correspondingly as an operating expense in the same amount, following examination of the criteria under international standards and in order to present them as accepted in Israel and worldwide. The affect of this amendment is an increase to income and a corresponding increase to operating and general expenses of approximately NIS 828 million.

(3) Amendment of the accounting treatment of the amortisation of property, plant and equipment not used by Pelephone, and the resulting tax implications. The effect of this amendment is to reduce property, plant and equipment by approximately NIS 320 million and NIS 285 million, and to reduce the balance of shareholders' equity by approximately NIS 220 million and NIS 205 million at December 31, 2004 and 2005 respectively, as well as to reduce depreciation expenses by approximately NIS 32 million and to increase net profit by approximately NIS 17 million for 2005.

NOTE 33 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

Notes to the reconciliation of equity (Contd.)

u. **Restatement (Contd.)**

(1) Effect on the consolidated balance sheet under accepted accounting principles in Israel at December 31, 2005

	As previously reported	Effects of restatement	As reported in these financial statements
	NIS thousand	NIS thousand	NIS thousand
Property, plant and equipment	9,942,648	(180,341)	9,762,307
Deferred tax assets	344,786	53,956	398,742
Shareholders' equity	7,913,860	(126,385)	7,787,475

(2) Effect on the consolidated balance sheet under accepted accounting principles in Israel at January 1, 2005

	As previously reported	Effects of restatement	As reported in these financial statements
	NIS thousand	NIS thousand	NIS thousand
Property, plant and equipment	10,740,334	(217,363)	10,522,971
Deferred tax assets	446,136	70,259	516,395
Shareholders' equity	7,321,767	(147,104)	7,174,663

(3) Effect on undesignated retained earnings (deficit) under accepted accounting principles in Israel

	As at December 31 2005	As at December 31 2004
	NIS thousand	NIS thousand
As previously reported	(1,257,706)	(648,564)
Effect of restatement	(126,385)	(147,104)
	(1,384,091)	(795,668)

(4) Effect on profit and loss under accepted accounting principles in Israel

	For the year ended December 31, 2005
	NIS thousand
Net earnings as reported in the past	590,858
<u>Effect of restatement</u>	
Increase in income	828,000
Decrease in depreciation expenses and reductions	37,022
Increase in operating and general expenses	(828,000)
Increase in income tax	(16,303)
Net earnings as reported in these financial statements in the note on adjustment to IFRS	611,577

NOTE 33 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

Notes to the reconciliation of equity (Contd.)

Reconciliation of profit for 2005

	Note	Israeli GAAP 2005 NIS thousands	Effect of the transition to IFRS 2005 NIS thousands	IFRS 2005 NIS thousands
Income	r	11,926,686(2)	(1,968)	11,924,718
Costs and expenses				
Depreciation and amortization	a-c, f-h	2,377,813(1)(2)	(444,036)	1,933,777
Salaries	m, n	2,260,352(1)	325,428	2,585,780
Operating and general expenses	f, g	5,934,421(1)(2)	43,645	5,978,066
Other operating income, net	r	-	(99,841)	(99,841)
		10,572,586	(174,804)	10,397,782
Operating income		1,354,100	172,836	1,526,936
Financing costs	l, j, m, p			
Financing expenses		773,783	(36,224)	737,559
Financing income		(465,860)	99,599	(366,261)
Financing expenses, net		307,923	63,375	371,298
Earnings after financing expenses		1,046,177	109,461	1,155,638
Equity in loss of investees accounted by the equity method	p	(12,645)	9,325	(3,320)
Earnings before income tax		1,033,532	118,786	1,152,318
Income tax	a-c, j	445,897(2)	86,118	532,015
Earnings before cumulative effect of a change in accounting method		587,635	32,668	620,303
Cumulative effect at the beginning of the year of a change in accounting method	l	15,000	(15,000)	-
Earnings for the year		602,635	17,668	620,303
Attributable to:				
Shareholders of the Company		611,577	54,834	666,411
Minority in a consolidated company	q	(8,942)	(37,166)	(46,108)
Earnings for the year		602,635	17,668	620,303
Earnings per share				
Basic and diluted earnings per share (in NIS)		0.231	0.007	0.238

(1) Reclassified
(2) Restated

NOTE 33 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

Notes to the reconciliation of equity (Contd.)

Explanation of significant adjustments to the statement of cash flows for 2005

1. The effects of fluctuations in the exchange rates of cash balances in the amount of NIS 3 million were classified as cash flows from current operations under Israeli GAAP. Under IFRS, the effects of exchange rate fluctuations on cash balances are presented in a separate item.

   There are no other significant differences between the statement of cash flows according to IFRS and the statement of cash flows according to Israeli GAAP.

2. Interest paid in the amount of approximately NIS 485 million was classified as cash flows from current operations under accepting accounting principles in Israel. Under IFRS, interest paid was classified as cash flows from financing activities.

3. Following the transition to IFRS and the treatment of subscriber acquisition costs as intangible assets, as noted in section (f) of the details presented above, the investment in intangible assets under cash flow from investment activities decreased by approximately NIS 72 million, against an increase in the current expenses included under cash flow from current operations.

4. Following the transition to IFRS and the treatment of customer acquisition costs in a consolidated company, as noted in section (g) of the details presented above, the investment in intangible assets under cash flows used for investment activities increased, against a decrease in the current expenses included under cash flow from current operations, of NIS 50 million.

NOTE 34 – SELECTED CONDENSED DATA FROM THE FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD.

1. Pelephone Communications Ltd.

A. Balance sheet

	December 31, 2006	December 31, 2005
	NIS thousands	NIS thousands
Current assets	**1,451,006**	1,837,664
Non-current assets	**2,52 0,473**	2,877,169
	3,971,479	4,714,833
Current liabilities	**1,089,973**	1,572,159
Long-term liabilities	**1,383,859**	1,707,408
Total liabilities	**2,473,832**	3,279,567
Shareholders' equity	**1,497,647**	1,435,266
	3,971,479	4,714,833

B. Income statement

	For the year ended December 31,	
	2006	2005
	NIS thousands	NIS thousands
Revenues from services and sales	**4,477,987**	4,428,277
Cost of services and sales	**3,250,303**	3,301,475
Gross profit	**1,277,684**	1,126,802
Sales and marketing expenses	**417,178**	428,200
General and administrative expenses	**110,008**	107,218
	527,186	535,418
Operating income	**700,498**	591,384
Financing expenses, net	**(17,687)**	(123,630)
Equity in losses of investee partnership	**-**	(8,507)
Earnings before income tax	**682,811**	459,247
Income tax	**196,910**	172,369
Net earnings	**485,901**	286,878

NOTE 34 – SELECTED CONDENSED DATA FROM THE FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD. (CONTD.)

2. D.B.S. Satellite Services (1998) Ltd.

A. Balance sheet

	December 31, 2006	December 31, 2005
	NIS thousands	NIS thousands
Current assets	**338,662**	346,292
Non-current assets	**677,732**	757,903
	1,016,394	1,104,195
Current liabilities	**1,889,416**	1,946,780
Non-current liabilities	**1,987,634**	1,699,698
Total liabilities	**3,877,050**	3,646,478
Capital deficit	**(2,860,656)**	(2,542,283)
	1,016,394	1,104,195

B. Income statement

	For the year ended December 31	
	2006	2005
	NIS thousands	NIS thousands
Revenues	**1,355,735**	1,221,863
Cost of income	**1,139,308**	1,072,103
Gross profit	**216,427**	149,760
Sales and marketing expenses	**122,996**	141,588
General and administrative expenses	**94,313**	74,662
Operating loss	**(882)**	(66,490)
Financing expenses, net	**318,925**	279,455
Net loss	**(319,807)**	(345,945)

NOTE 34 – SELECTED CONDENSED DATA FROM THE FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD., D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD. (CONTD.)

3. Bezeq International Ltd.

A. Balance sheet

	December 31, 2006	December 31, 2005
	NIS thousands	NIS thousands
Current assets	**332,526**	367,285
Non-current assets	**340,734**	337,816
	673,260	705,101
Current liabilities	**307,724**	342,621
Non-current liabilities	**15,613**	13,536
Total liabilities	**323,337**	356,157
Shareholders' equity	**349,923**	348,944
	673,260	705,101

B. Income statement

	For the year ended December 31	
	2006	2005
	NIS thousands	NIS thousands
Revenues	**1,021,573**	814,926
Operating expenses	**662,244**	(529,738)
Gross profit	**359,329**	285,188
Sales and marketing expenses	**148,594**	135,736
General and administrative expenses	**71,806**	57,561
Other income (expenses), net	**7,064**	(1,377)
Operating income	**131,865**	93,268
Financing costs, net	**(6,965)**	(9,157)
Equity in earnings of an associate accounted for by the equity method	**11,051**	4,560
Earnings before income tax	**135,951**	88,671
Income tax (expenses) benefit	**(40,391)**	15,722
Net earnings	**95,560**	104,393

NOTE 35 – EVENT AFTER THE BALANCE SHEET DATE

1. Following an enquiry of the Securities Authority, it was decided to appoint an external examiner to investigate the matter of compensation for officers n the Company since the transfer of control in the Company from the State to Ap.Sb.Ar. Holdings Ltd. (including approval of the stock options plan for employees and managers, and approval of bonuses for officers), and to investigate the matter of restatement in the Group's financial statements at December 31, 2004 and 2005.

2. The Board of Directors of the Company acceded to the request of the CEO to take leave of absence until the date of submission of the interim findings by the examiner, in order to remove even the slightest suspicion regarding the complete freedom of action of the external examiner.