August 13, 2007

"Bezeq" The Israel Telecommunication Corp. Limited

Quarterly Report for the period ending 30.6.07

Update of Chapter A (Description of Company Operations) of the Periodic Report for 2006

Directors' Report on the State of the Company's Affairs for the period ended June 30, 2007

Condensed Interim Consolidated Financial Statements as at June 30, 2007

Update of Chapter A (Description of Company Operations) of the Periodic Report for 2006

Update Of Chapter A (Description Of Company Operations)[1] Of The Periodic Report For 2006 ("The Periodic Report") Of “Bezeq” – The Israel Telecommunications Corp. Ltd. (Hereinafter: “The Company”)

In this report, which contains an update of the chapter regarding the description of the Group’s business from the periodic report for 2006, the Group has included forward-looking information, as defined in the Securities Law 5728-1968 (hereinafter: the “Securities Law”) with respect to both itself and the market. Such information includes forecasts, targets, appraisals and assessments which apply to future events or matters the realization of which is not certain and is not under the Group’s control. Forward-looking information in this report will usually be identified specifically, or by employing statements such as “the Company expects”, “the Company assesses”, “it is the Company’s intention”, and similar statements.

Forward-looking information is not a proven fact and is based only on the Group’s subjective assessment, based, inter alia, on a general analysis of the information available at the time of drafting of this report, including public announcements, studies and surveys, and they contain no undertakings as to the correctness or completeness of the information contained therein, and the Group does not independently check the correctness thereof.

In addition, the realization and/or otherwise of the forward-looking information will be affected by factors that cannot be assessed in advance, and which are not within the control of the Group, including the risk factors that are characteristic of its operations as set out in this report, and developments in the general environment, and external factors and the regulation that affects the Group’s operations, as set out in this report.

1. Description of General Development of Group Operations

Section 1.1 – Group Activity and Description of its Business Development

Section 1.1.5 – Mergers and acquisitions

With respect to the merger of the Company and DBS (sub-section A) – on May 15, 2007, the Company filed an appeal against the decision of the Antitrust Commissioner in which the Commissioner objected to the Company’s merger with DBS.

With respect to the agreement for the purchase of the operations of Tadiran Telecom – Communications Services in Israel (Limited Partnership) (the “**Partnership**”) by the subsidiary BezeqCall Communications Ltd. (which has, in the meantime, merged into the subsidiary Bezeq International Ltd.) – in April 2007, the agreement was rescinded in light of the decision of the Antitrust Authority not to allow the transaction, and following notice by the Partnership of a decision to rescind the agreement.

Section 1.4 – Distribution of Dividends

On August 13, 2007, the board of directors of the Company resolved to recommend to the general meeting of shareholders o the Company to pay a cash dividend to the shareholders in the sum total of NIS 760 million (constituting NIS 0.2917415 per share).

2. Fixed-Line Domestic Communications –

“Bezeq” – The Israel Telecommunications Corp. Limited (“the Company”)

Section 2.1 – General information on areas of operation

On June 1, 2007, the Communications (Telecommunications and Broadcasts) (Payments for Telecommunications Services) Regulations, 5767-2007 and the Communications (Telecommunications and Broadcasts) (Calculation and Linkage of Payments for Telecommunications

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[1] The update is pursuant to Article 39A of the Securities Regulations (Periodic and Immediate Reports), 5730-1970, and includes material changes or innovations that have occurred in the corporation in any matter which must be described in the Periodic Report. The update relates to the section numbers used in Chapter A (Description of Company Operations) in the Company's Periodic Report for 2006.

Services) (Amendment) Regulations, 5767-2007 came into force. Under the above regulations, and based on the draft tariff update set out in the Communications (Telecommunications and Broadcasts) (Calculation and Linkage of Payments for Telecommunications Services) Regulations, 5763-2003, reduction of the Company's supervised tariffs as of June 1, 2007, is expected to be at an average rate of approximately 3.13%. This reduction is based on a reduction of approximately 0.1% in the consumer price index less the average rationalization coefficient at a rate of approximately 3.038%. Likewise, the Communications (Telecommunications and Broadcasts) (Payments for Interconnect) (Amendment) Regulations, 5767-2007 came into force on the same date, prescribing that the reduction of interconnect tariffs as of June 1, 2007 is at a rate of approximately 4.01%. The aforesaid tariff update is expected to have a substantial adverse effect on the Company's revenues from services the tariffs for which are under supervision as aforesaid.

On June 7, 2007, the Communications (Telecommunications and Broadcasts) (Payments for Telecommunications Services) (Amendment) Regulations, 5767-2007 were signed, under which as of October 1, 2007, the criterion for entitlement to reduced service fees shall be amended from a criterion of reduced service to entitlement granted to whomever receives a pension under the Assurance of Income Law, 5741-1980 – the National Insurance Office has provided the Company with details of this – and has a single subscriber telephone line registered in his name in an apartment that is used for residential purposes only. This change is not expected to have a substantial effect on the Company's revenues.

Section 2.1.3 – Changes in scope of operations in the field, and in profitability

	First Half of 2007	First Half of 2006
Revenues (NIS millions)	2,835	2,895
Operating profit (NIS millions)	612	588
Number of active subscriber lines at end of period (thousands)	2,778	2,822
Average monthly revenue per line (NIS)*	76.9	80.5
Number of outgoing usage minutes (millions)	7,666	8,524
Number of incoming usage minutes (millions)	2,111	1,758
Number of ADSL subscribers at end of period (thousands)	924	844
Average monthly revenue per ADSL subscriber (NIS)	57.9	57.2

* Not including income from data communications and transmission services, services to communications providers, contract and other work, and income from incoming traffic.

Section 2.1.9 – Structure of competition in the areas of operation and changes thereto

Competition in this sector is also dependent upon the recommendations formulated by the Grunau Commission regarding the communications industry in Israel, and on the way in which those recommendations are adopted and applied.

Section 2.2 – Products and Services

The Company is in the throes of setting up a Data Center website, which shall enable the provision of a total solution for customers, in terms of back up and survivability services. The service planned is following a large increase in demand by customers for DRP sites (disaster recovery program – a program for continuing working in the event of disaster) and for true back-up of information at all organizational levels. This site is expected to provide the Company's customers with a variety of solutions, including: hosting of the organization's central site, taking into account needs of survivability, electricity, air conditioning, etc., backing up organizational information on a reliable and protected system so that when necessary, it will be possible to recover the information required, remote back-up of organizational information, full DRP to the organization's central site, storage of the organization's important information in a protected underground site. The Data Center service is planned to be launched during the month of October 2007.

Section 2.2.2 – Telephony

As part of the Company's marketing strategy, it is working intensively to develop and introduce new services in both the private and commercial sectors. During the second quarter of 2007, the Company launched a broad variety of services, the most prominent of which, in the field of telephony, is: the short message service (SMS) in the voice service field, music streamer (an electronic music player) in the field of terminal equipment. During the second half of 2007, the Company plans to continue launching additional products in accordance with market trends and customer requirements.

Section 2.2.3 – Internet access services

For changes in the number of the Company's ADSL subscribers and average monthly income per ADSL subscriber, see the update to section 2.1.3 above.

Section 2.2.5 D – IP-Centrex

The Company has submitted a service portfolio to the Ministry of Communications with respect to this service.

Section 2.3 – Split of revenues and profits of products and services

For updates of the split of the Company's revenues by product and service, see Note 12B to the financial statements of the Company for the period ended June 30, 2007.

Section 2.5 – Marketing, distribution and service

Section 2.5.1 – the Company operates 17 points of sale and service (BezeqStores) around the country.

Section 2.6 – Competition

With respect to the Commission for Formulation of Recommendations regarding Policy and Rules of Competition in the Field of Communications in Israel (the "**Grunau Commission**"), the Company's position as expressed in a document submitted to the Commission and as presented to the Commission is as follows:

The Commission is to create a clear regulatory horizon for the entire communications market, and for the Company in particular, so as to enable the Company to provide better and more efficient services, including upgrading the Company's infrastructure by investing in an advanced communications network (the New Generation Network – NGN) which is a precondition for innovative communications services such as IPTV (a service for provision of digital television services for subscribers over internet infrastructure). In the absence of such a horizon, the Company cannot continue investing the sums involved.

The Company also requests that the Commission give the Company a real possibility for dealing with competition by way of: absolute tariff flexibility; absolute freedom in marketing service packages; absolute cancellation of the structural and corporate separation duties, amendment of the Company's license to permit the Company to provide IPTV services.

Likewise, as with many other countries around the world, the Company expects to be given a regulatory safety net in which it was have exclusivity of use of the NGN network and of provision of services on such network for 5 years from the date on which the network becomes available.

The Company further explains that the "normative revenue" test currently used by the Ministry of Communications as a basis for prescribing the date on which the market is to be opened to competition is an inappropriate test. The Company wishes to convert the existing formula for calculating loss of market share by the Company so as to prescribe a time barrier, based on the earlier of January 1, 2008 and a drop below 85% market share, according to the Ministry of Communication's method. Since if this is not done, then the Company's commercial rivals will in fact have the power to determine when, if at all, true competition will commence in the communications market. Likewise, with respect to competition under a model enabling unbundling (the significance of which is to force the Company to sell infrastructure components to competitors), the Company clarifies that the Grunau Commission shall be required to adopt the recommendations of the previous committee which dealt with rules of competition (the Kroll Committee), to the effect that competition in the communications market must be based on independent infrastructure.

The Commission's recommendations, which are supposed to relate to matters that are of the greatest substance to the communications market and to the Company, might bring about changes in the rules of competition employed to date, and the Company is unable to estimate the trends or influences that these may have.

Section 2.6.1 – Telephony

With respect to the petition filed by the Company to the High Court of Justice regarding breach of the duty of structural separation by HOT – on April 1, 2007, the Company received a ruling of the Court, following the consent of the parties, that the Ministry of Communications would make a decision within 6 months regarding structural separation of HOT. After receipt of the Ministry's decision, the parties will submit an updated notice in that regard to the Court, following which, a decision will be made as to continued handling of the petition.

On May 2, 2007, the Company contacted the Ministry of Communications, requesting that it be informed as to the full exercise of the Ministry of Communications' instruction to HOT (based on the Ministry's notice to the High Court of Justice) to appoint separate chief executive officers to HOT Telecom and HOT Cable Communications Systems, without any the one being administratively subordinate to the other, and to make the entire administrative level of HOT Telecom subordinate to the chief executive officer to be appointed to that corporation, no later than May 1, 2007. On May 21, 2007, the Director General of the Ministry of Communications responded to the Company that HOT had informed the Ministry that it was intending to act in order to implement the provisions regarding appointment of separate chief executive officers. The Company repeated this request on June 5, 2007, and asked to know the timetable for implementing the provision. On July 10, 2007, the Company wrote to the State Attorney's Office expressing an objection to amendment of the license of HOT which would permit it to market a parcel of services including HOT Telecom service and broadcasting services provided by HOT's broadcasting company, and asked that it be cancelled. The State Attorney's Office rejected the Company's claims in a letter dated July 12, 2007 On August 13, 2007, a letter was sent by counsel for the Company to the State Attorney's Office, in which the Company rejected the claims made by the State Attorney's Office, which, in its view, contradicted the legal obligations imposed upon the State, and the notice given by the State to the High Court of Justice.

With respect to the grant of special general licenses for the provision of domestic fixed line communications services to various communications providers, the providers which received such licenses have commenced providing the services in accordance with their licenses.

Sections 2.6.1 and 2.6.2

As seen from the reports of HOT – Cable Communications System Ltd., HOT's telephony and internet subscriptions continue to increase.

Section 2.6.4 – Competition by cellular companies

With respect to the refusal of the Antitrust Commissioner to alter the monopoly declaration pertaining to the Company in the field of fixed-line telephony services, the Company is examining its continued handling of the matter.

Section 2.6.5 – VOD service provision policy

In July 2007. an amendment to the Communications Law was authorized enabling additional content providers, apart from HOT, to provide a service supplying content upon subscriber demand, over an broadband access network, using IP technology. The significance of this amendment is that subsidiaries of the Company, including Walla (but not including DBS) will not be entitled to provide this service. In this regard, see also the update to section 5.6.5 below.

Section 2.6.6A – Numbering and number portability

The Company is preparing for the operational implications of implementation of the number portability program. In the Company's assessment, the extent of harm to its revenues as a result of implementation of the program is expected to be substantial, but it cannot, at this stage, assess the actual extent. This information includes forward-looking information based on the Company's assessments. The actual outcome might be substantially different from the above assessments, if there is a change in any one of the factors taken into account in these assessments.

On May 24, 2007, the Company received a notice from the Director General of the Ministry of Communications, stating that he is considering imposing a financial sanction on the Company under Chapter G1 of the Communications Law, 5742-1982, in respect of violation of the duty to provide number portability commencing 1.9.06, as follows:

1. For the period from September 1, 2006 to the date of the Director General's notice – a financial sanction of NIS 2,031,750.

2. For the period from May 25, 2007 to November 30, 2007 or until the date of remedy of the alleged violation (whichever is earlier) by the Company – NIS 6,450 for each additional day the violation continues.

3. For the period from December 1, 2007 (which is, according to the notice, the reasonable date required by the relevant licensees to remedy the alleged violation) until the date of remedy of the alleged violation – a financial sanction as described in sections 37B(b) and 37C(a) of the Communications Law after Amendment 36. [It is noted that according to the provisions of those sections, the rate of the relevant sanction is 7 times the penalty laid down in section 61(a)(4) of the Penal law (which is NIS 202,000), plus 0.25% of the annual income of the Company, plus a financial sanction of one fiftieth of such sanction for each day on which the violation continues.]

   The subsidiaries Pelephone Communications Ltd. ("Pelephone") and Bezeq International Ltd. ("Bezeq International"), received similar notices. In the Ministry's notice, the Company, Pelephone and Bezeq International were given an opportunity to state their positions to the Director General of the Ministry of Communications by June 24, 2007. As noted in the Company's Periodic Report for 2006, the Company and Pelephone (together with other cellular companies) petitioned the High Court of Justice on this matter, contending, *inter alia*, that it was the Ministry of Communications which had not prepared a number portability plan as required by the provisions of the law. On July 5, 2007 (after receiving an extension), the Company replied to the notice of the Director General of the Ministry of Communications, setting out its position that the Company's position was not in breach of the provisions of the Law or the license, that the matter is pending before the High Court of Justice, and that in any event, in these circumstances, it would be unreasonable to impose sanctions on the Company, including in light of the date prescribed by the Ministry of Communications as being reasonable in this regard for implementation of number portability (December 1, 2007).

Section 2.6.7 – the Company's preparations for coping with increasing competition

With respect to sub-section (g) regarding agreements with business customers – on April 11, 2007, following the setting aside of the Company's petition to the High Court of Justice, the Ministry of Communications forfeited the sum of NIS 8 million out of the guarantee deposited by the Company under the provisions of its general license.

Section 2.6.8 – Negative factors affecting the Company's competitive status

Competition – the extent to which competition affects the Company depends, as aforesaid, on the recommendations of the Grunau Commission on communications in Israel, and on the manner in which such will be adopted and applied, and the Company is unable to assess what these might be.

With respect to the Company's lack of flexibility with regard to marketing campaigns – on April 26, 2007, an additional sum of NIS 7 million was forfeited out of the above guarantee. This forfeit followed a decision by the High Court of Justice dated April 10, 2007 not to award an interim injunction in a petition filed by the Company, which has not yet been heard, against the Minister of Communications and the Director General of the Ministry of Communications, against forfeiture of the guarantee and the setting aside of the Company's appeal against such, with respect to a campaign under which call minutes were given to subscribers of the Company who purchased terminal equipment (the "Spring Campaign").

Section 2.7 – Property, plant & equipment

Section 2.7.1 – Fixed-line domestic telecommunications infrastructure (and section 2.6.7(j) and 2.19.2 – network

With respect to sub-section (a) (switches) – during 2007, the Company's Nortel switches are due to be upgraded to a new ISN09 switch. This upgrade is supposed to enable continued use of the Company's switching network, which is based on Nortel's switches, until the end of 2008, subject to the conditions of the agreement with Nortel. Should the Company be required to continue holding the switches beyond the above date, this will entail substantial additional expense.

Section 2.7.4 – Real estate

With respect to sub-section (c) – the total number of properties sold by the Company over the years (both before and after the settlement agreement) amounts to approximately 40 properties (in whole or in part) out of the leased properties which were privatized in the agreement for the transfer of assets, such that as at the date of this update to the periodic report, the group of leased properties numbers approximately 180 properties.

With respect to sub-section (d) – during the first half of 2007, the Company sold an additional 7 real estate properties, of a total area of approximately 10,900 sqm of land plus approximately 4,730 sqm built-up, at a total sum of approximately 7.68 million dollars.

Likewise, during the first quarter of 2007, sale of the Hillel Station premises has been completed (as set out in the Company's immediate report dated November 15, 2006). The area of the premises is approximately 956 dunams, and the consideration received for sale of it is approximately $ 20.8 million.

The board of directors has instructed management of the Company to re-examine the procedures regarding management and realization of the Company's real estate assets, and to make recommendations to the board of directors regarding the Company's policy in this area.

Section 2.9 – Human resources

Section 2.9.1 – Organizational structure, and employees according to organizational structure

On June 28, 2007, a VP Economics and Budgets was appointed to the Company, whose areas of responsibility are economics, budgeting and control, and collection, which had previously been under the responsibility of the Deputy CEO and CFO. The VP Economics and Budgets reports to the Deputy CEO and the CFO, and to the Acting CEO of the Company.

On June 28, 2007, an Acting Internal Auditor was appointed to the position of Internal Auditor of the Company.

On July 16, 2007, a new Company Secretary was appointed to the Company, who reports to the Chairman of the Board of Directors (and who shall take office as of the second half of August 2007). This job has been handled, since October 2005 and up until entry of the Company Secretary into office, by the Company's General Counsel.

As of August 1, 2007, the Company's VP Regulation has also been appointed Internal Compliance Officer for Anti-Trust Practices.

Section 2.9.2 – Personnel according to employment framework

During the first half of 2007, the number of employees fell from 8,096 as at December 31, 2006 to 7,489 as at June 30, 2007 (a net reduction of 607 employees) as a result of retirement of employees from the Company.

Section 2.9.6 – Employee remuneration schemes

With respect to the allocation of options to two directors from amongst the employees under the option scheme for all of the employees of the Company, which requires the approval of the general meeting of shareholders of the Company – in light of publication of the interim report of the external examiner as set out in the update to section 2.20 below, and in light of the questions raised, prior to commencement of the discussion, by some of the persons present at the general meeting convened for April 15, 2007 in order to approve the allocation, it was decided that the meeting would not be held. The Company is acting to reauthorize the allocation of the options to the two directors elected from amongst the employees and in this regard, the board of directors of the Company, on June 18, 2007, authorized an amendment of the Collective Agreement between the Company and the Employees' Representation, enabling the allotment of the options to the two directors elected from amongst the employees, at an exercise price identical to the exercise price granted to all of the Company's employees. The issue of the options to the directors elected from amongst the employees will be brought before the Audit Committee, the Board of Directors and the General Meeting for approval.

Section 2.9.7 – Company officers and senior executives

As at the date of publication of this report, there are 14 directors acting in the Company[2] and 14 members of senior management. Note that following the departure of the CEO of the Company on April 30, 2007, an Acting CEO has been acting in the Company (between April 30, 2007 and June 26, 2007, this position was held by Ika Abravanel, and as of that date, Avi Gabbay has held this position). Likewise, on July 17, 2007, the chairman of the board of directors gave notice that he intended to terminate his office as chairman of the board of directors, and that his office would end upon appointment of another chairman for the board of directors. On July 30, 2007, the Company gave notice of the convening of an annual general meeting of shareholders of the Company for September 4, 2007, on the agenda of which is, *inter alia*, the election of directors. Following the election of directors at the general meeting, the board of directors is expected to elect a new chairman.

With respect to grants to office-bearers – following the recommendations contained in the report of the external examiner, Dr. Yoram Danziger, dated April 26, 2007 (see update to section 2.20 below), on May 22, 2007, the board of directors of the Company approved grants to office-bearers for 2006 in the total sum of NIS 1,059,566. In addition, the board of directors at the same meeting approved the award of grants to office-bearers for 2005 in the total sum of NIS 210,000. In the opinion of the board of directors, award of these grants does not constitute an extraordinary transaction, as that term is defined in the Companies Law, 5759-1999.

In addition, on May 22, 2007, the board of directors, having received the consent of the Audit Committee in its meetings of May 15, 2007 and May 22, 2007, approved the award of grants to the following office-bearers as follows, which, in the opinion of the board of directors, constituted extraordinary transactions:

Ika Abravanel – Deputy CEO (and as of March 29, 2007 – acting CEO) – NIS 768,000, constituting 80% of the salary in fact paid to him for 2006.

Ron Eilon – Deputy CEO and Chief Financial Officer from October 11, 2005 until August 28, 2006 – NIS 640,000, constituting 80% of the salary in fact paid to him for 2006 for the period of his employment by the Company.

Yuval Rachlevsky – VP Human Resources as of April 1, 2006 – NIS 540,000 constituting 80% of the salary in fact paid to him in 2006.

With respect to the grants unlawfully paid to the former CEO of the Company Mr. Yacov Gelbard, for 2005 and 2006, his obligation to return the respective grants to Pelephone and to the Company still remains. The Company resolved that if these grants are not returned to the Company, it shall institute all available legal measures to collect this debt.

Some of the office-bearers will repay the Company the difference (if any) between the grants they received in the past and the grants approved for them as aforesaid. The total repayment is approximately NIS 590,000 (all of the sums set out above are in gross terms – before tax).

In this regard, see also the Company's immediate report dated May 22, 2007.

Section 2.13 – Finance

Section 2.13.4 – Sums of credit received after December 31, 2006

During the period between May 27, 2007 and July 16, 2007, the Company raised approximately NIS 1,200 million via sale of 1,070 million par value debentures (Series 5) of the Company. The sale of the debentures was effected by the subsidiary Bezeq Gold (Holdings) Ltd. ("**Bezeq Gold**") and the aforesaid consideration was transferred to the Company as repayment of the loan granted by the Company to Bezeq Gold, for the purpose of purchasing the above debentures. This fundraising was effected at an average interest rate of 3.71% (the debentures are linked to the CPI). See update to section 2.13.7 below.

Section 2.13.6 – Credit rating

On May 1, 2007, Ma'alot, which rates all of the debenture series of the Company and Pelephone, announced that following recent discoveries and following the examination report submitted by the

[2] Including two external directors and two directors elected from among the employees.

external examiner (see update to section 2.20 below) regarding subtraction of property plant and equipment at Pelephone, at this stage, no change is expected to be made to the rating of Pelephone's undertakings or the Company's undertakings.

Section 2.13.7 – Estimate of raising funds in the coming year (2007) and sources of financing

On May 14, 2007, the board of directors of the Company approved the raising of debt of up to NIS 1,200 million during 2007, for the purpose of repayment of an existing debt of the Company. The Company completed this fundraising as set out in the update to section 2.13.4 above. Note that on August 8, 2007, the Company repaid the principal of the Eurobonds which it had issued in 2000, in the total sum of EUR 293 million.

Section 2.15 – Environmental protection

The draft of the new Non-Ionized Radiation Regulations prescribes payment of commissions for the filing of an application for a permit for a radiation source. If and to the extent that the above regulations are approved, the Company is expected to be required to pay commissions in a sum estimated at approximately NIS 6 million, which is expected to be spread over a number of years.

The Company wrote to the Ministry for the Environment, via the Ministry of Communications, requesting that it amend the method of calculating the safety range limit proposed in the above draft Regulations which, in the Company's view, increases the safety range beyond the current limits, meaning a reduction in the broadcast sites operated by the Company.

Section 2.15.2 – The Non-Ionized Radiation Law, 5766-2006 (the "Radiation Law")

During the first half of 2007, the Company acted for issue by the Commissioner for Non-Ionized Radiation in the Ministry of the Environment (the "**Commissioner**") of operating permits, in accordance with the Non-Ionized Radiation Law which came into force at the beginning of 2007. Following this activity, the Company received operating permits for the communications installations that it operates, with a few exceptions in respect of which there is still a radiation permit in force under the Pharmacists Regulations. The Company is acting to receive operating permits under the Radiation Law for these few installations as well. Note that the Commissioner may require building permits as a condition of the continued force of the operating permits for the communications installations (including broadcast installations) granted by the Commissioner. Likewise, the Commissioner may require an affidavit regarding an exemption from a building permit for "wireless access installations" which are under a "class permit" granted to the Company by the Commissioner. See also updated to section 2.16.11 below.

Section 2.16 – Limitation and regulation of Company activities

Section 2.16.2 – The Company's general license

With respect to measurement of the Company's market share, and the review dates: On April 22, 2007, a letter was received from the Ministry of Communications stating that the Ministry had commenced the process, however, it was not able to effect a quantitative review at a sufficiently reliable level, because the Company had not yet provided amended data in the format that it requested. When the data is provided, the Ministry will continue its review. On July 15, 2007, the Company responded to another letter from the Ministry of Communications (dated June 13, 2007) alleging that it disputed the objections of the Ministry of Communications regarding the data provided by the Company to the Ministry, and that in any event, such objections ought not postpone the review. Later on, the Company provided the data requested in a format acceptable to both parties.

For the Company's position on measurement of the market share in the document that was submitted to the Grunau Commission, see the update to section 2.6 above.

To the best of the Company's knowledge, the Ministry of Finance is initiating a government resolution as part of its activities in view of the Arrangements Law for 2008, the purpose of which shall be to instruct the Minister of Communications to do all acts required so that no later than December 31, 2007, a general licensee for the provision of domestic fixed line telecommunications services will not be permitted to make provision of broadband access to the internet conditional upon the provision of basic telephone services. This resolution, if and to the extent that it is passed, could have a substantial effect on the Company and on its tariff structure, and these effects cannot be assessed at this stage.

Section 2.16.7 – Antitrust Laws

With respect to the Antitrust Commissioner's investigation of May 2006 – on May 27, 2007 the Company received notice from the Antitrust Authority (the "**Authority**") stating that the Antitrust Commissioner (the "**Commissioner**") is considering a determination, pursuant to her authority under Section 43(a)(5) of the Antitrust Law, 5748-1988 (the "**Law**"), that the Company abused its status, contrary to the provisions of Section 29A of the Law, in view of the findings of an investigation carried out in recent months by the investigations department of the Authority. The notice states that the Commissioner is considering determining that –

1. In the first half of 2006, and in particular in April and May 2006, the Company's employees imposed sanctions concerning delay in the performance of works or not performing works for the connection or expansion of an existing connection of domestic operators to the Company's network.

2. During the afternoon of May 17, 2006, an existing connection between HOT Telecom and the Company's network was disconnected and was not repaired, due to sanctions of Company employees, until the night of May 18, 2006.

3. The Company failed to act as required in order to prevent or minimize these events and the harm to domestic operators, competition and the public.

4. In this way, the Company abused its status, in contravention of Section 29A of the Law.

The notice also states that before the Commissioner makes her decision, the Company is given the opportunity to state its position to the Commissioner.

It is noted that under Section 43(e) of the Law, such a determination by the Commissioner, if and insofar as made, will serve as *prima facie* evidence of the contents of the determination in any legal proceedings.

The Company is preparing for exercise of the right to a hearing and it is to provide its written position to the Commissioner by September 15, 2007.

Section 2.16.8 – The Telegraph Ordinance

With respect to the disputes with the Ministry of Communications regarding frequency levies and the Ministry's requirement that the Company pay such – following clarification proceedings with the Ministry with respect to such disputes, most of them have been resolved. The principal sum remaining in dispute amounts, as at June 30, 2007 to approximately NIS 46 million.

Section 2.16.9 – Proposed legislation regarding termination of contractual relations

On May 14, 2007, another hearing was held in the Economics Committee of the Knesset, but the statute has not yet received the full approval of the Committee.

Section 2.16.11 – Construction of communications installations – NOP 36

With respect to sub-section (a) – NOP 36A – with respect to "wireless access installations", there are a number of initiatives for cancelling the exemption from a building permit. If the Company is required to issue an affidavit regarding an exemption from a building permit as set out in the update to section 2.15.2 and/or if the exemption from building permit is cancelled, this might have substantial adverse implications which the Company is unable to assess at this stage.

With respect to sub-section (d) – General – if the Company is required to take out a building permit for communications installations (including broadcast installations), this might have substantial adverse implications which the Company is unable at this stage to assess. The aforesaid information is forward-looking information, based on the Company's assessments. The actual outcome might be substantially different from the above assessments, if any of the factors taken into account in these assessments changes.

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

A bill authorized to amend the Communications Law was published on December 3, 2006. The amendment, *inter alia*, gives the Minister of Communications authority to give instructions to a licensee in the event of a fault or significant cessation fo the provision of communications services, not in circumstances of emergency.

Section 2.16.13 – Restrictions and supervision on the Company's activities regarding the Government Resolution relating to the proposed amendment of the Communications Law under the Arrangements Law.

To the best of the Company's knowledge, the Ministry of Finance is initiating an amendment to the Second Authority for Television and Radio Law, 5750-1990, as part of the indirect amendments under the Arrangements Law for 2008, the purpose of which is that the Second Authority for Television and Radio will set up and operate a terrestrial broadcasting set-up based on digital technology, backed up by a digital satellite system for distributing the television broadcasts of the television broadcast franchisees freely to the public at large in Israel, and nationally, so that such distribution will be effected no later than December 1, 2008.

Section 2.17 – Substantial agreements

Section 2.17.5 – management agreement – on July 29, 2007, a management agreement was signed between the Company and a corporation owned and controlled by the shareholders of Ap.Sb.Ar. Holdings Ltd. The agreement is in force as of October 11, 2005, and the main points of it are set out in the periodic report for 2006.

Section 2.18 – Legal proceedings

For updates on the subject of legal proceedings, see Note 8 to the financial statements of the Company for the period ended June 30, 2007.

Section 2.20 – Event or matter outside the normal course of business

Sub-section (b) – appointment of external examiner

A. On April 12, 2007, the Company published an immediate report setting out the interim report of the external examiner. On the same date, the board of directors of the Company held a discussion of the interim report and appointed a committee of the board of directors which was authorized to examine the immediate steps which the findings of the interim report required be taken. Likewise, the board of directors agreed to the request of the CEO of the Company, on the date, to extend his leave of absence until discussion by the board of directors of the final report of the external examiner, and determined that up until such date, Mr. Yitshak (Ika) Abravanel would continue to act in lieu of the CEO.

B. On April 26, 2007, the Company published an immediate report setting out the final report of the external examiner. As a result of that, on April 30, 2007, the board of directors of the Company held a special meeting on the final report, and decided, *inter alia*:

1. To authorize a joint notice, signed on April 30, 2007 by the Company and Mr. Yacov Gelbard, a copy of which was attached to the Company's immediate report of the same date, to the effect that Mr. Gelbard's office as CEO of the Company would terminate on April 30, 2007.
2. To set up a committee to find a new chief executive officer for the Company, the committee to recommend a candidate or candidates for the position of CEO to the board of directors.
3. Mr. Ika Abravanel will continue acting in lieu of the chief executive officer of the Company (until a resolution to some other effect is passed by the board of directors).
4. The audit committee of the board of directors is to endeavour to find a candidate to act as permanent internal auditor of the Company.
5. To recommend to the audit committee to appoint external director Mr. Eyal Yaniv as chairman of the audit committee.
6. To appoint a secretary for the Company and an external legal counsel to the board of directors, in addition to the Company's General Counsel.
7. To make immediate changes to some of the working procedures of the board of directors and its committees so that minutes of discussions are detailed, the meetings are held in Hebrew (and where necessary, with simultaneous interpretation into English), and so that the board of directors holds a meeting on the last Thursday of every calendar month, at which it shall discuss the ongoing management of the Company, and at which the managers of the Divisions of the Company and by the CEOs of the subsidiaries shall present reviews of operations to members of the board of directors.

In addition, the board of directors received a review from the committee comprised of members of the board of directors which had been set up for the purpose of examining the board's working procedures as a result of the interim report by the external examiner. This review related, *inter alia*, to prescription of a new and more detailed set of work procedures for the board of directors, committees of the board, reporting and control of the subsidiaries (from the point of view of the board of directors) subject to regulatory restrictions, internal audit and management reports to the board of directors. The committee was asked to submit a final report to the board of directors within 30 days of April 30, 2007. (Accordingly, and at the committee's request, on May 28, 2007, the board of directors of the Company authorized postponement of the filing of the final report by thirty days.)

C. On July 1, 2007, pursuant to the requirements of the Securities Authority, the Company published an immediate report setting out details of the steps taken by the Company following the report of the external examiner. This report relates, *inter alia*, to adoption of new working procedures for the board of directors, the setting up of committees of the board of directors, including a committee to locate a CEO and a committee to examine and make recommendations regarding the structure of management of the Company and its control of the subsidiaries, and three permanent committees (balance sheet, business, and remuneration, organization and administration) in addition to the Audit Committee, the Security Committee and the Regulation Committee which already exist in the Company. In this regard, see also the above immediate report. Note that no external legal counsel has yet been appointed to the board of directors and this shall be discussed after a new chairman is appointed to the board of directors.

D. On June 7, 2007, a special general meeting of the shareholders of the Company was convened at the request of the Government Companies Authority, which discussed the examination report of the external examiner Dr. Yoram Danziger, and the implications thereof. During the course of this discussion, the Company provided a review of its operations following the findings set out in the report. The meeting took place in order to discuss the report, and no resolutions were passed at it. In this regard, see also the Company's immediate report of June 7, 2007.

E. Note that on May 1, 2007, an application was received at the offices of the Company pursuant to Article A of Chapter 3 of Part V of the Companies Law, 5759-1999 (derivative claim), sent by a plaintiff claiming to be a public shareholder in the Company. According to the applicant, in his final report the external examiner indicates a long list of failures and deficiencies relating directly to the procedures of the board of directors, the committees of the board and the members of the board of directors and the former CEO of the Company, and the significance of a large portion of the findings of the report is that those directors and other officers of the Company who were involved in passing the various resolutions in the Company prima facie breached their duty of care and/or trust. Therefore, the application requests that the Company take legal steps against the directors and other officers of the Company who were responsible for such. On July 19, 2007, the Company gave notice to the applicant of its decision to dismiss the application with respect to submission of the derivative claim, *inter alia* on the grounds that the claim in this matter was not to the Company's benefit and for the reason that the Company was, is and will continue to act to fix the defects disclosed by the report of the external examiner. In this regard, see also Note 8 to the financial statements of the Company for the period ended on June 30, 2007.

F. It should be further noted that on May 13, 2007, a claim was received at the offices of the Company together with an application to recognize it as a class action, submitted by a plaintiff who claimed to have purchased shares in the Company in 2006. The claim was filed against the Company, two former CEOs of the Company, directors acting at the time relevant to the claim or at present on the Company and against Ap. Sab. Ar. Holdings Ltd, which holds 30% of the shares of the Company. The claim relates to the allegation that the financial statements of the Company for 2004 and 2005 included substantial information that was false and misleading, including with respect to the annual profit, property plant & equipment and shareholders' equity, in light of the Company's notice in an immediate report dated March 26, 2007 regarding a retroactive subtraction of approximately NIS 320 million in property plant & equipment which was not in use by the subsidiary Pelephone Communications Ltd. According to the Plaintiff, he suffered damage as a result of publication of the misleading information, *inter alia* because he had purchased shares at a higher price than that which he would have purchased had the aforesaid information been available on the market on the date on which the plaintiff purchased the shares. The Group which the plaintiff seeks to have the claim apply to is a group of plaintiffs who purchased shares of the Company in the course of trade on the stock exchange during the period between March 5, 2005 (the first day following publication of the report for 2004) and March 26, 2007 (the date of publication of the aforesaid immediate report), and held shares after March 26, 2007. The sum of the personal claim is NIS 194 and the total sum of the claim for the group is NIS 56.5 million.

G. For re-approval of bonuses for 2005 and 2006, see update to section 2.9.7 above.

3. Cellular – Pelephone Communications Ltd. ("Pelephone")

Section 3.1

Section 3.1.5.3

As part of the process of choosing a supplier, Pelephone received a response to a request for proposals (RFP) and is currently in negotiations with three potential suppliers. In July 2007, the board of directors of Pelephone approved proceedings to chose a supplier for the HSDPA/UMTS network. The final set-up program for the network is subject to the approval of Pelephone's authorized bodies.

Section 3.7 – Competition

Section 3.7.2

As part of an examination by the Ministries of Finance and Communications of the question of operation of virtual operators in Israel (MVNO), the Ministry of Communications has hired the services of a consulting firm and has requested that the carriers provide it with information on the cellular sector, for use in this examination. The Ministry of Communications has asked the consulting firm to submit its conclusions by the end of June 2007. After receiving the conclusions, and prior to making a final decision on the matter, the Ministry is expected to hold a hearing for the carriers. Pelephone, with the assistance of a consulting firm hired for this purpose, is getting ready to present its position to the Ministry of Communications, and is preparing a response to the expected hearing.

During the month of June 2007, Pelephone, Cellcom and Partner entered into an agreement with a joint consultation company in accordance with the consent of the Antitrust Commissioner, for the purpose of obtaining advice regarding competition in the cellular market in Israel, and on the issue of MVNO, pending the Ministry's hearing. As at the date of this update, the Ministry of Communications has not yet accepted the recommendations of the consultancy company hired by it to look into the issue of introduction of MVNO. In addition, to the best of Pelephone's knowledge, the Budgets Department of the Ministry of Finance is initiating an amendment to the Communications Law as part of the indirect amendments made under the Arrangements Law for 2008, the purpose of which is to provide tools for enforcing the right of use of a cellular network on a virtual carrier.

Section 3.7.3

On May 24, 2007, Pelephone received notice from the Ministry of Communications stating that it was considering imposing a financial sanction on Pelephone for alleged breach of the obligation to provide number portability as of September 1, 2006, as follows:

A. For the period between September 1, 2006 and the date of the notice of the Director General of the Ministry, a financial sanction in the sum of NIS 2,031,750.

B. For the period between May 25, 2007 and November 30, 2007, or up to the date of remedy by Pelephone of the alleged breach (whichever is the earlier) – the sum of NIS 6,450 for each additional day during which the breach continues.

C. For the period between December 1, 2007 (which is, according to the provisions of the notice, the reasonable date necessary for the relevant licensees with respect to amendment of the alleged breach) and until the date of remedy of the alleged breach – the financial sanction set out in sections 37B(b) and 37C(a) of the Communications Law (note that under the provisions of those sections, the rate of the relevant sanction is seven times the fine set out in section 61(a)(4) of the Penal Law (which is NIS 202,000) plus 0.25% of the Pelephone's annual revenues, plus a financial sanction in the sum of one fiftieth of such sanction for each day on which the breach continues).

According to the provisions of the notices of the Ministry of Communications, Pelephone was given an opportunity to make its own claims to the CEO of the Ministry of Communications by June 24, 2007.

As set out in the financial statements for December 31, 2006, Pelephone (together with the other cellular companies) petitioned the High Court of Justice, alleging, *inter alia*, that it was the Ministry of Communications that had not prepared the number portability program as required under the provisions of the Law. On July 5, 2007 (after receiving an extension), Pelephone submitted its response to the aforesaid hearing. As at the date of drafting this update, the Ministry's response to the response submitted has not yet been received.

Pelephone is preparing for the operational and marketing implications of implementation of the number portability program, and it expects harm to its revenues as a result of implementation of the program. At this stage, it is not possible to assess the scope of the harm. This information includes forward-looking information, based on Pelephone's assessments. The actual outcome might be substantially different from the above assessments, if there is a change in any of the factors taken into account in making these assessments.

On this matter, see also the update of Section 2.6.6(a).

Section 3.15 – Financing

Section 3.15.6 – Credit rating

On May 1, 2007, Ma'alot, which rates all of the Company's debenture series, announced that following recent discoveries and following the examination report submitted by the external examiner (see update to section 2.20 above) regarding reduction of property plant and equipment at Pelephone, at this stage, no change is expected to be made to the rating of Pelephone's undertakings (see also update to section 2.13.6 above).

Section 3.17 – Environmental protection

During the course of 2007, Pelephone has been adjusting its broadcast sites on the basis of an annual plan to comply with the requirements of the Non-Ionized Radiation Law, 5766-2005. In this context, Pelephone is receiving new operations permits for broadcast sites, in force for five years. With respect to certain kinds of broadcast installations that have a very slight effect on the environment, such as internal transmissions, Pelephone has received new class permits, which are in force for five years. See the update to section 3.18.3.3 below.

Section 3.18 – Restriction and supervision of Pelephone's activities

Section 3.18.3.1 A

In April 2007, the Ministry of Communications published its decision regarding amendment of the license on the matter of changing the mechanism used for identifying users of erotic services as being an adult. Under the amendment, removal of the obstruction of access to receipt of erotic services is to be by way of submission of a written application together with a photocopy of an identity card or by physically appearing before a service representative. The amendment, which was supposed to come into force on May 25, 2007, has been delayed in the meantime by virtue of a temporary injunction awarded by the Supreme Court, pending hearing of the application for injunction and petition before a panel of three judgments. This injunction was given under a private petition to the High Court of Justice against this amendment, which was filed during the month of May. The petition includes an application for an interim injunction to suspend entry of the amendment into force. Pelephone intends to join this petition.

On April 17, 2007, the Ministry of Communications published a hearing document to carriers regarding repeal of a clause in the MRT licenses permitting the marketing of plans with alternate billing segments to 12 second billing segments. If the aforesaid amendment of the license comes into force, Pelephone will be allowed to market plans with 12 second billing segments only, and as of January 1, 2009, plans with 1 second billing segments only. Pelephone submitted its response to the hearing at the end of May 2007, and has not yet received the Ministry's response, as at the date of this update.

Section 3.18.3.3

Certain local authorities and planning committees are trying to attack the legality of the use made by Pelephone and other cellular companies of an exemption from a building permit granted to wireless access installations used by the cellular networks under the Planning and Building Law, 5725-1965. In a number of judgments, the courts of local affairs have recognized the legality of use of such exemptions. Recently, the Court of Local Affairs handed down a ruling which contradicted previous rulings in the same court, to the effect that the above exemption does not apply to access installations that operation on cellular networks. Additional proceedings in this matter, including appeal proceedings in the District Court, have not yet been ruled upon. Recently, a High Court petition was also filed in this regard, in an attempt to attack the legality of use of the above exemption. Pelephone is operating in accordance with the exemption proceedings, erects and operates such access installations as aforesaid in accordance with detailed radiation permits granted under the Non-Ionized Radiation Law, 5766-2005. For this issue, see also the update to section 3.18.1.3 above.

Section 3.19 – Legal proceedings

For updates on the subject of legal proceedings, see Note 8 to the financial statements of the Company for the period ended June 30, 2007.

4. International Communications and Internet Services – Bezeq International Ltd. (“Bezeq International”)

Section 4.1 – General

Section 4.1.1 – Structure and changes to area of operations

In addition to the services set out in this chapter of the periodic report, Bezeq International has, since its full merger with BezeqCall Communications Ltd. (“**BezeqCall**”) on February 11, 2007 (the “**date of full merger**”), been providing NEP (network end point) services (“**NEP Services**”), including data communications infrastructure services, passive infrastructure installation services and low voltage systems, sale of exchange systems including IP telephony communications systems, and provision of installation and maintenance services for these systems.

Section 4.1.2 – Legislative and statutory restrictions applicable to Bezeq International

Section 4.1.2.1 – On July 11, 2007, the Bill for an amendment to the Communications (Telecommunications and Broadcasting) Law, 5742-1982, which is parallel to the Limitation of Access to Adult Internet Sites Bill, 5766-2006, of Knesset Member Amnon Cohen, was approved by the Ministerial Committee and submitted to the Economic Committee of the Knesset. The Bills, which were discussed by the Economics Committee, propose restricting access to sites that contain pornographic content, gambling, or violence; *inter alia* by imposing an obligation on internet service providers, including Bezeq International, to activate mechanisms that oversee access to such sites. Due to the many questions raised in the Committee relating to the constitutionality of the amendment, as well as to the technical aspects involved in implementation of it, the Committee requested that the Ministry of Communications present it with data prior to its making any decision in this regard. At this stage, the basic format of the proposed law has not yet been prescribed, and it is not possible to assess the implications of this Law, if and when it is passed, on the commercial operations of Bezeq International.

4.1.2.5 – Network End Point License

On December 31, 2006, the Ministry of Communications approved transfer of BezeqCall’s NEP License to Bezeq International. As of the date of the full merger, Bezeq International has been providing NEP services under this license.

Section 4.2 – Products and Services

Section 4.2.5 – NEP Services

In the NEP Services sector Bezeq International provides: Sale, installation and maintenance of exchange systems, installation and maintenance of data communications infrastructure, installation and maintenance services for passive infrastructure and low voltage systems, placing an emphasis on integrative solutions that are tailored to business and institutional customers on their premises.

Section 4.4 – New products

As of the date of full merger, all of the products and services that BezeqCall sold and supplied at that date were received by Bezeq International. In this regard, see update to section 4.2 above – Products and Services.

Section 4.6 – Competition

Section 4.6.4 – NEP Services

The traditional field of telephone exchanges is characterized by a large number of competitors and by fierce competition, which has given rise to an erosion of prices for services. The most prominent competitors are: Tadiran, Eurocom, Telrad, GlobeCall, Gil International, Tel-Yad.

The data communications and IP telephony field is characterized by the entry of new players – IT companies – into the world of voice. These are companies such as: Binat, Teldor, Netcom, IBM. These companies are substantially different from the traditional NEP companies and are of a higher technological level. There is also a trend of communications companies conglomerating and of entry of new carriers, intending to provide customers with total communications solutions – telephony, transmission, data communications, internet, information security, etc.

Section 4.9 – Intangible Assets

Section 4.9.3 – Acquisition of Actcom – Active Communications Ltd.

On July 9, 2007, the Registrar of Companies approved the merger of Actcom and Bezeq International Ltd., under the provisions of section 323 of the Companies Law, 5759-1999; such that Bezeq International received Actcom (all of its assets, rights and liabilities) and Actcom was expunged from the Register.

Section 4.10 – Human Resources

On June 18, 2007, the appointment of the then Deputy CEO of Bezeq International as Acting CEO of Bezeq International was approved, in place of CEO of Bezeq International, who had been appointed Acting CEO of the Company. The position of Deputy CEO of Bezeq International was cancelled.

Section 4.10.2 – Organizational Structure

Management of Bezeq International has resolved, with the consent of the board of directors, to alter the organizational structure of the company, in the following way:

A. Organization and Methods Department will be transferred to the management of the Finance Department;

B. Human Resources will be separated from the Finance Department into an independent department, under the management of a manager reporting to the CEO of Bezeq International;

C. Operations Department will be merged into the Service Department, under the management of the VP Services.

Section 4.11 - Suppliers

As of the date of full merger, all of the rights and obligations of BezeqCall under joint venture, marketing and sale agreements to which BezeqCall had been a party, were transferred to Bezeq International, giving it the right to market and supply installation, support and maintenance services for the equipment sold as part of the NEP services; the most significant of these are the agreements with: LG, Nortel, Cisco and Tadiran.

Section 4.13 – Credit Policy

Section 4.13.1 – Customer credit

As part of the provision of NEP services, Bezeq International effects sales to its customers by way of payments in many instalments. In this way, Bezeq International gives its customers credit, which they repay in instalments. In order to reduce the exposure which might stem from providing credit for lengthy periods to its customers, Bezeq International checks their financial resilience, sets ceilings for the maximum credit available to customers and registers a charge over the equipment sold, pending full repayment of the credit.

Section 4.14 - Investments

As at June 10, 2007, Bezeq International held 42.84% (33.66% under full dilution) of the share capital of Walla! Communications Ltd. During the second quarter of 2007, Bezeq International exercised the rest of the options available to it, in return for shareholders loans it provided to Walla!

Section 4.15 – Finance

During the month of January 2007, Bezeq International repaid on-call loans provided to BezeqCall by a number of banks, in the total sum of approximately NIS 20.3 million.

Section 4.16 – Taxation

During the month of February 2007, Bezeq International paid income tax down payments for the 2006 tax year, in the sum of approximately NIS 36.3 million.

Section 4.19 – Legal proceedings

1. With respect to section 4.19.4 of the Company's periodic report for 2006 regarding the petition to the Supreme Court sitting as the High Court of Justice, filed by Bezeq International on February 5, 2006, to cancel the decision of the Minister of Communications of January 31, 2007, to amend the Ministry of Communications' policy regarding licensing of VOB services, a decision under which Bezeq International would only be granted a license to operate domestic fixed line telephony services using VOB technology after the Company's market share in the field of domestic fixed line telephony fell below 85%, the Supreme Court accepted Bezeq International's application and on July 8, 2007, awarded an interim injunction instructing 012 Telecom to focus its requests to contracts regarding fixed line domestic telephone on their own customers only, by direct mail, rather than by applying to the public; this injunction resulted in the cancellation of a broad media campaign by 012 Telecom regarding VOB services offered by it by virtue of its domestic license. On August 5, 2007, 012 Telecom, in respect of whose services the above injunction was issued, filed an application to reduce and/or clarify the interim injunction and to instruct the Company to deposit a guarantee for its costs, in the sum of NIS 5 million. As at the date of this report, the Company's response to that application has not yet been filed.

2, On June 6, 2007, HOT Telecom Limited Partnership ("**HOT**") filed a claim against the Company in the District Court at Tel Aviv, under which it sought declaratory relief and an interim injunction under which Bezeq International would not do any act, directly or indirectly, to obtain confidential information belonging to it, and would not make any use of such information should it be obtained; that following an investigation that it had undertaken which showed, it claimed, that Bezeq International was operating unlawfully to obtain the details of customers who had joined as subscribers to its internet access infrastructure services.

   Bezeq International filed its response to the application for temporary injunction to the Court, in which it alleged that HOT's claims against Bezeq International and its managers regarding the existence of methodical and systematic operations at Bezeq International aimed at unlawfully obtaining information about HOT's customers are insubstantial and that in any event, there is no evidentiary infrastructure for such, and that if any of Bezeq's representatives has indeed acted as alleged by HOT, such person acted of their own accord, in absolute contravention of the instructions of Bezeq International.

   On July 23, 2007, the Court acceded to HOT's application and awarded an injunction prohibiting Bezeq International and/or any of its employees and/or persons acting on its behalf and/or any representative of it from contacting the employees of HOT and/or its representatives directly or indirectly in order to obtain confidential information regarding the identity of its customers, by way of grant of benefits and/or making use of such information that may have reached it. In light of Bezeq International's clear policy, which existed even prior to the filing of this claim, and which prohibits unauthorized receipt and use of such information, it would appear that the injunction granted by the Court will not have any implications on Bezeq International's operations or its financial results. As at the date of this report, Bezeq International's response to the principal claim (regarding the declaratory relief) has not yet been submitted; however, at this stage, given the causes of action and the clear policy of Bezeq International regarding the receipt of information relating to customers of infrastructure suppliers, it would appear that the claim will not substantially affect the conduct of Bezeq International's business, or require it to use substantial resources to remove such.

3. On July 29, 2007, Bezeq International filed a claim against HOT in the District Court at Tel Aviv in the sum of NIS 23.2 million for damages caused to it by HOT since the latter decided, in contravention of the provisions of its license, not to allow Bezeq International to participate in the joint parcels offered by it (joint parcels for access services and for infrastructure services which offer a total price which is attractive to customers). The claim was filed following a decision by the Ministry of Communications, in October 2006 (passed following a complaint by Bezeq International in this regard) that HOT had breached the conditions of its license and therefore was required to integrate Bezeq International into the joint parcels, together with the other internet access service providers in competition with Bezeq International. In the statement of claim, Bezeq International claims loss of profits in the sum of NIS 23.2 million over a period of approximately two years (2005-2007) in which HOT blatantly refused to cooperate with it. According to Bezeq International, during this period it lost many customers who wished to enjoy its services but wanted to have HOT's infrastructure services. Due to HOT's conduct, Bezeq International was in fact obstructed from accessing a whole swathe of customers which it could not bring into its services or retain. As at the date of this report, HOT has not yet filed a statement of defense.

4. Further to the provisions of the update to section 2.6.6A above, on May 27, 2007, Bezeq International received a letter from the Director General of the Ministry of Communications, giving notice to Bezeq International that he intended to impose a financial sanction upon it in the sum of NIS 2,031,750 for failure to implement and operate the number portability plan, commencing on September 1, 2006.

   In response to the Ministry of Communications, Bezeq International claimed that as holder of a general license for the provision of international telecommunications services, it does not allocate numbers to its customers and therefore, in any event, is not part of number portability, which is effected by domestic carriers and cellular carriers. Bezeq International's part in this matter amounts only to creating the interfaces required with respect to incoming calls to cellular and/or domestic carriers, in accordance with the characterization of the form of number portability prescribed by the cellular and domestic carriers, and checks done with them. Bezeq International performed its duties under the law by preparing itself as required and it was ready, prior to the date set down for implementation of the portability program on September 1, 2006, to do all that was required to implement the program, in whatever manner the domestic carriers might decide to employ, and its acts did not prevent the effecting of portability from any number or customer whatsoever.

   Therefore, there are no grounds for the Ministry of Communications' claim in this regard, since not only is it in contradiction to the facts of the matter, but also causes harm to Bezeq International, which has invested immense resources in this regard and which acted without delay to implement what was required of it on time and in the manner prescribed by the relevant persons. In light of all of the above, it is clear that Bezeq International has implemented number portability faultlessly, and that it should be deemed to be a party prepared for number portability, in accordance with the provisions of the law and on the date set out in such provisions.

For further updates on the subject of legal proceedings, see Note 8 to the financial statements of the Company for the period ended June 30, 2007.

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

<u>Section 5.1 – General information on areas of operation</u>

As at June 30, 2007, DBS had 543,031 subscribers.

<u>Section 5.4 – New Products</u>

High Definition TV (HDTV) – DBS is currently completing its preparations for marketing a decoder enabling the reception of high definition broadcasts. In DBS's assessment, the service is expected to be launched by the end of 2007. The aforesaid is forward looking information and realization of it is dependent, *inter alia*, upon technical preparations and third parties, and therefore, this assessment may not come into being or may come into being in a substantially different manner.

Viewing Programs on the Internet - DBS is currently completing its preparations to launch a content website in cooperation with Walla! Communications Ltd. aimed at presenting content intended for viewing over the internet.

Section 5.6.5 – Competition

With respect to section 5.6.5F - VOD, in July 2007, the Knesset approved the Communications (Telecommunications and Broadcasts) (Amendment No. 37) Law, 5767-2007 in second and third readings. This law, *inter alia*, authorizes the Minister of Communications to provide satellite broadcast licensees to provide services upon demand (VOD) to its subscribers, in whole or in part, after consulting with the Council and taking into account the considerations set out in the Communications Law, if it finds that there is a difficulty in transmitting VOD broadcasts via satellite in the scope and format similar to those broadcast by the general licensee for cable broadcasts. In this regard, see also update to section 2.6.5 above.

Section 5.10 – Raw materials and suppliers

For the lawsuit between DBS and Hillel which is being heard by an arbitrator, see update to section 5.17 below.

Section 5.12 – Finance

Section 5.12.2 – Credit restrictions applicable to the corporation

In July 2007, the financing agreement was amended under which, *inter alia*, the targets of the financial conditions which DBG is required to comply with starting with the second quarter of 2007 and ending in 2013 (the date for full repayment of the bank credit) were amended. A mechanism was also prescribed as part of this amendment setting out the rate of receipts from the issue of Debentures (Series A) of the Company, including future increases of the series, if any, to be used to repay the bank credit. For further details with respect to this issue, see Note 7A to the financial statements of the Company for the period ended on June 30, 2007.

The banks extended the date for DBS to reach an arrangement with the Israel Aviation Industry regarding DBS' debt to it, so that such debt and the call for payment of it not be deemed to be a breach by it of the financing agreement, to September 30, 2007, and provided that as at such date, no proceedings are instituted against DBS by the IAI.

Private issue of debentures

In July 2007, DBS raised the sum of approximately NIS 620 million as part of a private issue to institutional investors of registered Debentures (Series A) intended for listing on TACT Institutional at TASE (the "**Debentures**").

For the purpose of this issue, the Debentures were rated by Maalot the Israel Securities Rating Company Ltd. at BBB- / stable. For further details with respect to this issue, see Note 7A to the financial statements of the Company for the period ended on June 30, 2007.

Section 5.13 – Taxation

DBS is in the process of discussing tax deduction assessments for the years 2002-2004. DBS has made an appropriate provision on its books.

Section 5.17 – Legal proceedings

For the claim of DBS v. Pace (section 5.17.1 of the Periodic Report): On March 18, 2007, the registrar of the District Court set aside the defendant's application to cancel the permit of service. On April 10, 2007, the defendant appealed that decision to the District Court, and hearing of the appeal was set down for June 11, 2007.

Pursuant to agreements reached by the parties, the appeal was struck out on May 28, 2007, without any order being made as to costs.

On July 15, 2007, a statement of defense was filed by Pace, simultaneously with a statement of counter-claim by it against DBS and Eurocom Digital Communications Ltd., in which an interested party is also an interested party in DBS ("**Eurocom Communications**"), jointly and severally, relating to a monetary claim in the sum of NIS 42,640,000. For this counter-claim, see also Note 8 to the financial statements of the Company for the period ended June 30, 2007.

With respect to the Al-Jazeera claim (section 5.17.2 of the Periodic Report): Following negotiations, the parties have reached an agreement with respect to continued broadcast of the channel, as part of DBS' transmissions. On May 9, 2007, Al-Jazeera signed a memorandum of understanding which anchored this agreement and set out that an application to strike out the claim would be filed within 7 days of execution of the memorandum of understanding. On May 17, 2007, an application was filed to strike out the claim, and on May 21, 2007, the Court upheld the application to strike.

With respect to the class action regarding the Sports Channel: On February 28, 2007, the court's ruling was published stating that the value of the benefit was $ 10,000,000, and costs at a rate of 6% of the sum of the benefit were ruled for counsel for the plaintiffs, and a total sum of NIS 2,514,000 plus VAT, plus remuneration to the plaintiffs in the sum of NIS 400,000 (including VAT). DBS and the cable companies agreed that the division between the parties would be 70-30, and accordingly, on April 26, 2007, DBS's portion (30% of the total sum) was transferred to counsel for the representative plaintiff. On April 16, 2007, the representative plaintiffs filed an appeal to the Supreme Court against the sum ruled as remuneration to the plaintiffs, and an application to increase it. DBS plans to file a counter-appeal regarding appraisal of the value of the benefit (and accordingly, with respect to the fees of counsel for the plaintiffs), and with respect to the remuneration to the plaintiff. On May 16, 2007, DBS, together with the Cable Company, filed a counter-appeal regarding the appraisal of the value of the benefit (and accordingly, with respect to the fees of counsel for the plaintiffs) and with respect to the remuneration to the plaintiff. The date of hearing of the appeal and the counter-appeal has been set down for September 3, 2007.

Proceedings regarding deficit demand from the Customs Department: In December 2006, a deficit demand was sent to Eurocom Digital Communications Ltd. ("Eurocom Communications") from the Customs Department, for payment of purchase tax and VAT (including linkage differentials, interest and fines) in the sum total of approximately NIS 10 million, for decoders purchased by DBS from Eurocom Communications, and imported by it for DBS, smart cards belonging to DBS having arrived with such decoders. Eurocom Communications and DBS have mounted objection proceedings against the deficit demand, the dispute dealing with the proper classification of the smart cards for the purposes of purchase tax. DBS has provided the sureties required by the Customs Department for assurance of the taxes in dispute and DBS and Eurocom Communications have agreed that DBS will bear any payments required under the deficit demand, if any. In the opinion of DBS' and Eurocom Communications' legal advisers, there is a reasonable chance of no effective debt in respect of the sum of approximately NIS 5 million out of the deficit demand, which is in respect of VAT, and there is a reasonable chance of subtraction or cancellation of the linkage differentials, interest and fines included in the deficit demand. As at the date of this report, a decision has not yet been made with respect to the objection to the deficit demand.

Arbitration with Halal Communications: A dispute has arisen between the Company and Halal Communications Ltd. ("Halal") in which an interested party is also an interested party in DBS, regarding the sum of the monthly payment to Halal for the leasing of space segments on the Amos 2 satellite under the agreement between the parties dated May 16, 2000 (the "agreement"), due to the Company's claim that it is entitled to an annual discount on the rental that it owes under the agreement, due to the number of space segments that it leases on Amos 2, whilst Halal claims that it is not entitled to such discount, since two of the segments leased from Halal are segments transferred from Amos 1. The parties negotiated in an attempt to solve the dispute, under which the Company made an ex gratia payment of the sum of $700,000 out of the sum in dispute, and later deposited the sum in dispute with a trustee, at the rate of such at such time. In May 2007, an initial pre-arbitration session was held – in order to determine the procedures for hearing Halal's claim regarding the debt, amounting at present to $ 1,575,000, including the sum of $ 700,000 above (the alleged debt increasing by $ 75,000 each month). On June 14, 2007, Halal filed a statement of claim and on July 8, 2007, DBS filed a statement of defense. Pursuant to the arbitrator's ruling, Halal is required to submit affidavits of evidence by August 31, 2007 and the Company shall be entitled to submit affidavits of evidence in chief by September 30, 2007.

Class action regarding decoder depreciation (section 5.17.3 of the periodic report) - pursuant to a procedural arrangement reached by the parties, DBS filed its response to the application for approval on February 13, 2007. No response has yet been filed to the response, and the Attorney-General's position has not yet been submitted. A hearing date has been set down for November 12, 2007.

New class action regarding Pizza Meter campaign – on July 12, 2007, an application to approve submission of a class action against DBS and Pizza Meter Ltd. (hereinafter: "Pizza Meter") was filed with the District Court at Tel Aviv with respect to a campaign by DBS under which subscribers who joined the campaign were entitled to 52 coupons for a family-sized pizza from Pizza Meter for one year (hereinafter: the "Application for Approval"). According to the applicant, in May 2007, there was a change in the policy for exercising these vouchers, mainly in that delivery services were no longer provided, and this made it impossible to exercise the vouchers, in contravention of the conditions promised to subscribers when they joined the campaign. The class action is estimated to be in the sum of approximately NIS 7 million. DBS has not yet filed its response to this Application for Approval.

For additional updates on the subject of legal proceedings, see Note 8 to the financial statements of the Company for the period ended June 30, 2007.

13.8.2007	
Date	Bezeq – The Israel Telecommunication Corp. Ltd.

Names and titles of signatories:

Dov Weisglass, Chairman of the Board
Avi Gabbay, Acting CEO

Directors' Report on the State of the Company's Affairs for the period ended June 30, 2007

Chapter B of the Periodic Report

Directors Report on the State of the Company's Affairs
For the six months ending June 30, 2007

We respectfully present the Directors' Report on the state of the affairs of "Bezeq" – The Israel Telecommunication Corp. Limited (hereinafter: the "Company") and the consolidated Group companies (the Company and the consolidated companies hereinafter collectively referred to as the "Group"), for the six-month period ending June 30, 2007 (hereinafter: "the Directors' Report").

The Directors' Report contains a review, in condensed form, of the matters dealt with by the board of directors, and is drafted taking into account the fact that the reader of the Report is also equipped with a copy of the Directors' Report for the year ended December 31, 2006.

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

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

The Company has an additional area of operations which is not substantial to the Group's operations, and which has been included in the financial statements for June 30, 2007 as a business sector, which mainly includes customer call center services and investment in a venture capital fund.

The financial statements are drafted in accordance with the International Financial Reporting Standards (IFRS). The financial statements for the first half of 2006 have been redrafted in accordance with IFRS. The effect of the transition to reporting in accordance with international standards, on the Company's financial situation and on the results of its operations and cash flows are set out in Note 14 to the financial statements. In order to properly reflect the financial situation of the Group under Israeli accepted accounting rules prior to the transition to IFRS, the Financial Statements of the Group were adjusted by way of restatement as set out in Note 14L to the financial statements.

1. Financial Position

A. The Group's assets, as at June 30, 2007, amount to approximately NIS 16.58 billion, compared with approximately NIS 18.05 billion as at June 30, 2006. Of these, approximately NIS 6.21 billion (approximately 37%) are property, plant and equipment, compared with approximately NIS 6.83 billion (approximately 38%) as at June 30, 2006.

Most of the decrease stems from the fixed-line domestic communications segment. There was a decline in total assets in this segment compared with the previous year, in the sum of approximately NIS 1.61 billion, mainly due to the realization of commercially held financial assets which were mainly used for the distribution of dividends. In addition, there was a decrease in the depreciated cost of property, plant and equipment resulting from the difference between depreciation expenses and the investment made in the reporting period. The decrease was set off mainly due to an increase in cash balances.

In the cellular segment, the segment's assets decreased from approximately NIS 4.34 billion as at June 30, 2006 to the sum of approximately NIS 4.13 billion as at June 30, 2007. The decrease stemmed mainly from realization of a tax asset recorded in the past for losses. In addition, financial assets held for trade and used in the payment of dividends and of liabilities were also realized, and there was a drop in the amortized cost of property plant and equipment. This reduction was set off by an increase in cash balances.

In the international communications, internet and NEP services segment, there was an increase in total assets compared with June 30, 2006, mainly due to the merger with BezeqCall which commenced in January 2007.

In the multi-channel television segment, there was a decrease in total assets compared with June 30, 2006, which stemmed mainly from a decrease in the balance of net investments in property, plant and equipment.

B. The shareholders' equity ascribed to the shareholders of the Company as at June 30, 2007 amounted to approximately NIS 4.72 billion, comprising approximately 28% of the total balance sheet, compared with approximately NIS 5.96 billion as at June 30, 2006, which comprised approximately 33% of the total balance sheet. The decrease in shareholders' equity stemmed from a dividend paid in the sum of NIS 2.5 billion. The decrease was partially offset by the Group's net profit and share-based payments to Company employees.

C. The Group's total debt amounted to approximately NIS 8.65 billion as at June 30, 2007, compared with approximately NIS 9.04 billion as at June 30, 2006. The Group's debt to financial institutions and debenture holders as at June 30, 2007 amounted to approximately NIS 8.06 billion, compared with approximately NIS 8.5 billion as at June 30, 2006. The decrease stemmed from payment of liabilities in the cellular segment which was set off in part against sale of debentures to institutional investors in the domestic fixed line communications segment.

The Company's auditors continue to draw attention to the financial position of DBS, as set out in Note 7A of the financial statements, including the assessment made by management of DBS that the consideration from the placement of debentures raised by DBS in July 2007 enables the financial sources required for it for the coming year to be put in order.

D. The Group's cash and other current investment balances as at June 30, 2007 amounted to the sum of approximately NIS 3.07 billion compared with approximately NIS 3.74 billion as at June 30, 2006. The decrease stemmed mainly from the realization of commercially held securities in the domestic fixed-line communications segment and in the cellular segment, which were used in the payment of a dividend in the sum of NIS 2.5 billion, and for payment of liabilities. The decrease was partially offset due to cash flow from current operations in the principal segments of the Group's operations.

2. Results of Operations

A. Principal Results

Net earnings ascribed to shareholders of the Company for the first half of 2007 amounted to approximately NIS 760 million as opposed to net earnings of approximately NIS 603 million for the corresponding period. The increase in net earnings stemmed mainly from an increase in operating profit and a decrease in financing costs.

The following are details of changes in the results of the various segments, compared with the corresponding period:

Segment	**For the six months ending June 30, 2007 NIS millions profit (loss)**	**For the six months ending June 30, 2006 NIS millions profit (loss)**
Fixed-line domestic communications	612	588
Cellular	453	364
International communications, internet services and NEP	104	70
Multi-channel television	56	10
Others	2	-

Basic and diluted earnings per share for the first half of 2007 amounted to NIS 0.29 per NIS 1.00 par value compared with a profit of NIS 0.23 per share for the corresponding quarter.

B. Revenues

The Group's revenues in the first half of 2007 amounted to approximately NIS 6.14 billion compared with approximately NIS 6.03 billion in the corresponding period.

Revenues from fixed-line domestic communications decreased from approximately NIS 2.89 billion in the first half of 2006 to approximately NIS 2.84 billion in the reporting period (a decrease of approximately 2%). The decrease in the segment's revenues stemmed from a reduction of tariffs as of July 2006 and June 2007, and from a reduction in call traffic. The decrease in revenues was offset primarily by ongoing growth in the number of customers who subscribe to high-speed internet service (ADSL). The Company's auditors continue to draw attention to the continued opening up of the communications sector to competition and the effects of regulation.

Revenues in the cellular segment increased from the sum of approximately NIS 2.19 billion in the first half of 2006 to approximately NIS 2.30 billion in the reporting period. The increase stemmed from an increase in revenues from sale of terminal equipment, stemming mainly from an increase in the quantity of handsets sold and upgraded during the first half of 2007. In addition, there was an increase in revenues from cellular services, following an increase in content revenues and an increase in the number of subscribers, which was set off mainly by price erosion.

Revenues in the international communications, internet and NEP services segment increased from the sum of approximately NIS 641 million in the first half of 2006 to approximately NIS 644 million in the reporting period. The increase stemmed from an increase in internet revenues due to sale of capacity and from an increase in revenues from outgoing calls, alongside a decrease in operations relating to transfer of calls between communications carriers around the world.

Revenues from the multi-channel television segment increased from the sum of approximately NIS 670 million in the first half of 2006 to approximately NIS 708 million in the reporting period, as a result of an increase in the number of subscribers and an increase in average revenue per customer.

C. Depreciation and amortization

The Group's depreciation and amortization expenses decreased from the sum of approximately NIS 932 million in the first half of 2006 to the sum of approximately NIS 877 million in the reporting period, mainly as a result of a decrease in depreciation expenses due to the end of depreciation of property, plant & equipment and a decrease in investments in new property in the principal segments in which the Company operates.

D. Salaries

The Group's salary expenses increased from the sum of approximately NIS 1,139 million in the first half of 2006 to the sum of approximately NIS 1,160 million in the report period, due mainly to an increase in salary expenses in the cellular segment and in the international communications, internet and NEP services segment.

In the domestic fixed-line communications segment, there was no change compared with the corresponding period. A reduction in salary expenses on account of retiring employees and a reduction in the number of jobs was set off against salary increases under labor agreements.

E. General and Operating Expenses

The Group's general and operating expenses for the first half of 2007 amounted to approximately NIS 2.83 billion compared with approximately NIS 2.86 billion during the corresponding period.

Revenues in the domestic fixed-line communications segment decreased from the sum of approximately NIS 1,091 million in the first half of 2006 to approximately NIS 1,067 million in the reporting period. The decrease stemmed mainly from a decrease in cellular expenses, services and maintenance by sub-contractors and materials, and spare parts, which was set off by an increase in royalty expenses and general expenses.

In the cellular segment, general and operating expenses increased from the sum of approximately NIS 1,287 million in the first half of 2006 to the sum of approximately NIS 1,320 million in the reporting period, mainly as a result of an increase in costs of terminal equipment due to an increase in the quantity of handsets sold.

In the international communications, internet and NEP services segment, there was a decrease in general and operating expenses from the sum of NIS 404 million in the first half of 2006 to the sum of approximately NIS 374 million in the report period. The decrease stemmed mainly from a reduction in operations relating to call transfers between communications carriers around the world.

Revenues in the multi-channel television segment decreased from the sum of approximately NIS 440 million in the first half of 2006 to approximately NIS 433 million in the reporting period, as a result of a decrease in content expenses and in royalty expenses.

F. Other operating expenses (income), net

The Group's net other operating expenses is mainly in the domestic fixed line communications segment. These expenses decreased from the sum of approximately NIS 71 million in the first half of 2006 to approximately NIS 44 million in the reported period, due mainly to higher provisions made for contingent liabilities recorded in the first half of 2006.

G. Operating income

The Group's operating income during the first half of 2007 amounted to approximately NIS 1,228 million, compared with approximately NIS 1,032 million in the corresponding period, an increase of approximately NIS 196 million. The increase in operating income stems from changes in the results of the segments as described above under the revenue and expense items. These changes brought about an increase in operating income in all of the main segments in which the Group operates.

H. Financing expenses, net

The Group's net financing expenses in the first half of 2007 amounted to approximately NIS 131 million compared with approximately NIS 192 million in the corresponding period, a reduction of approximately NIS 61 million.

This decrease arises out of a decrease in financing expenses in the cellular segment and the multi-channel television segment, stemming from an erosion of CPI-linked loans. In addition, in the cellular segment, there was a reduction in debt.

In the domestic fixed line communications segment, total net financing expenses were similar to expenses during the corresponding period. On the one hand, there was a reduction in financing expenses, which stemmed from erosion of CPI linked and Euro-linked liabilities. And on the other hand, during the corresponding period, revenue had been received from a dividend from a venture capital fund and the provision for termination of past disputes with the Ministry of Communications had been cancelled.

3. Liquidity and sources of financing

The consolidated cash flows from current operations for the first half of 2007 amounted to approximately NIS 1,548 million, compared with approximately NIS 1,724 million in the corresponding period, a decrease of approximately NIS 176 million. The decrease in cash flows from current operations is due mainly to revenues and expenses which do not involve cash flows, and changes in asset and liability items which were partly offset by an increase in net earnings and by an increase in tax expenses less tax payments.

Cash flows generated by operating activities are one of the sources of financing of the Group's investments, which during the reported period included, *inter alia*, approximately NIS 410 million in the development of communications infrastructure, compared with an investment in the sum of approximately NIS 511 million in the corresponding period. During the reported period, the Group realized investments in net financial assets in the sum of approximately NIS 41 million compared with a net investment in the sum of approximately NIS 93 million during the corresponding period.

During the reporting period, the Group repaid debts and paid interest in the total sum of approximately NIS 467 million, of which, approximately NIS 97 million in debentures, approximately NIS 149 million in loans, approximately NIS 23 million in short-term credit, and approximately NIS 198 million in interest payments. During the report period, the Group raised new debt in a total sum of approximately NIS 807 million by taking loans in the sum of approximately NIS 50 million and sale of debentures to institutional investors in the sum of approximately NIS 757 million, compared with payment of net debt and interest payments in the sum of approximately NIS 747 million in the corresponding period. In the reporting period, cash dividends in the sum of NIS 2.1 billion were paid, with the sum of NIS 1.2 billion in the corresponding period.

The monthly average short-term credit average from banks in the first half of 2007 amounted to approximately NIS 100 million. The monthly average of long-term liabilities to financial institutions and debenture holders in the first half of 2007 amounted to approximately NIS 7,554 million.

The working capital as at June 30, 2007 was negative, and amounted to approximately NIS 1,666 million, compared with positive operating capital as at June 30, 2006, which amounted to approximately NIS 366 million. The decrease stems from the domestic fixed-line communications segment, as a result of an increase in current debenture maturities and exercise of commercially held financial assets, which was set off by an increase in cash balances in the segment. The decrease was moderated to some extent by an increase in the working capital of the other principal Group companies.

4. Comparison of the results of the second quarter of 2007 with the results of the corresponding quarter.

Segment	**For the three months ending June 30, 2007 NIS millions profit (loss)**	**For the three months ending June 30, 2006 NIS millions profit (loss)**
Fixed-line domestic communications	243	281
Cellular	240	190
International communications and internet services	54	34
Multi-channel television	32	11
Other	2	-

Revenues during the second quarter of 2007 increased by approximately NIS 34 million compared with the corresponding quarter in the prior year.

Total costs and expenses decreased by approximately NIS 21 million compared with the corresponding quarter last year.

Net financing expenses decreased by approximately NIS 37 million compared with the corresponding quarter.

The results of the quarter, compared with the corresponding quarter, were affected by a decreased in expenses for royalties and financial expenses recorded in the corresponding quarter in the domestic fixed line communications segment, due to an agreement with the Ministry of Communications to terminate past disputes up to and including 2002.

The behavior of the various income and expense items, and the causes of the differences between the quarters are similar to the explanations set out in the half-yearly results. The changes described above in the profit and loss statements brought about a net profit ascribed to shareholders of the Company of approximately NIS 361 million in the second quarter, compared with a net profit of approximately NIS 289 million in the corresponding quarter.

5. Group involvement in the community and donations

The Group is active in the community through its involvement in social institutions and organizations such as the education system in underprivileged areas and the confrontation line. In addition, employees of the Group volunteer for a variety of other communal activities.

During the report period, the Company donated approximately NIS 143,000.

In the project "Children and Parents Study Computer and Internet", which has been ongoing for some six years, the Company's employees voluntarily mentor underprivileged parents and children on selected subjects in the field of computers and the internet.
The Company's employees and retirees have set up a charitable association called Halav. The association works together with local councils to locate families in distress, with the aim of providing them with basic food products.

Pelephone has no binding policy regarding donations and its management discusses each case on an individual basis. During the reporting period, Pelephone donated approximately NIS 28,000 to various associations.

Bezeq International is involved in ongoing operations on behalf of underprivileged communities in Petach Tikva, it adopted "lone" soldiers, adopted a fighting division and participated in projects for special needs children. During the reporting period, Bezeq International's expenses amounted to approximately NIS 250,000.

6. Details Concerning Exposure to and Management of Market Risks

A. Further to the statements made in the Directors' Report for 2006, hedging transactions against the market risks involved in exposure to exchange rate fluctuations substantially reduced this exposure.

B. The report on positions on derivatives for June 30, 2007 is not significantly ifferent from the report as at December 31, 2006.

C. Analyses of sensitivity to fair value and the affect of the change in market prices on the fair value of the balance-sheet and off-balance-sheet surpluses in respect of which there are strong contracts as at June 30, 2007, are not significantly different from the report as at December 31, 2006. This is except for an analysis of sensitivity to fluctuations in the rates of index-linked securities due to the sale of debentures to institutional investors during the report period, as follows:

Analysis of sensitivity to fluctuations in index-linked securities

	Profit (Loss) due to CPI increase		Fair Value	Profit (Loss) due to CPI decrease	
	2%	1%		-1%	-2%
CPI linked debentures	10,792	5,396	539,621	(5,396)	(10,792)
Debenture 4	(25,934)	(12,967)	(1,296,720)	12,967	25,934
Debenture 5	(24,895)	(12,447)	(1,244,736)	12,447	24,895
Total	(40,037)	(20,018)	(2,001,835)	20,018	40,037

D. The report on linkage bases for June 30, 2007 is not significantly different from the report as at December 31, 2006.

The Group's surplus monetary liabilities over monetary assets denominated in or linked to foreign currency as at June 30, 2007 amounted to approximately NIS 1.76 billion. As a result of forward currency transactions as at June 30, 2007, the net balance of foreign currency liabilities not hedged by such forward transactions amounted to approximately NIS 269 million.

Surplus monetary liabilities over monetary assets linked to the CPI as at June 30, 2007 amounted to approximately NIS 5.78 billion in the Group.

The Group's main segments have hedging policies which reduce CPI exposures caused by tax expenses being calculated on real profit.

7. <u>Disclosure regarding internal auditor at the Company</u>

A. The internal auditor's procedures were updated and approved by the audit committee of the board of directors on January 4, 2005.

B. During the course of 2006, the internal auditor's term of office at the Company terminated and an acting replacement was appointed. Later on, in June 2007, the acting internal auditor was appointed as internal auditor of the Company. During 2007, in the framework of the Company's reorganization and streamlining measures, the unit was reduced by another six audit employees.

C. The audit plan approved for 2007 is for 10,000 work hours (compared with the work plan of 12,000 hours in 2006).

D. During the course of 2007, CEO discussions were held on twelve audit reports (some dating to 2006). The Audit Committee discussed three audit reports.

E. As of May 15, 2007, the external director Eyal Yaniv has been acting as chairman of the audit committee.

8. <u>Disclosure regarding process of approval of financial statements at the Company</u>

The organ responsible for overseeing at the Company is the Board of Directors. The Board of Directors of the Company appointed a balance sheet committee, whose composition and functions are as follows:

A. Most of the members of the committee are to have accounting and finance qualifications, and at least one of them is to be an external director.

B. The balance sheet committee is to discuss the financial statements prior to discussion of them on the board of directors, and is to make recommendations to the board regarding approval of them. The committee is to invite the auditors to participate in these discussions. The balance sheet committee is to discuss and make recommendations to the board of directors with respect to the following matters: prescription of accounting policy and setting down procedures relating to financial reporting and recording.

C. The balance sheet committee is to follow-up changes in accounting rules and to discuss the effect of such on the Company, is to discuss matters that might arise during financial audits and is to discuss changes in internal reporting mechanisms.

D. The balance sheet committee is to follow up and supervise implementation of the prescribed accounting policy and implementation of the procedures prescribed for financial reporting and recording.

E. The balance sheet committee is to provide its opinion on the above issues and on other financial and accounting issues, when it discusses the financial statements and whenever a specific issue of a substantial size arises in any of these areas.

F. The balance sheet committee is to advise the board of directors on the scope of work done by the auditors, and on their fees.

G. The balance sheet committee is to be responsible for contact between the board of directors and the auditors, with respect to their work.

The financial statements were discussed during two meetings of the balance sheet committee and presented to the board of directors for approval. The following office bearers took part in the discussions of the board of directors Dov Weissglas, Menachem Inbar, Ran Gottfried, David Blumberg, Eyal Yaniv, Zehavit Cohen, Yoav Rubinstein, Michael Grabiner, Key Kiarie, Rami Nomkin, and Yehuda Porat. In addition, the following office bearers also participated: Avi Gabbay – Acting CEO, Ran Oz – Deputy CEO and CFO, and Bosmat Chelouche – General Counsel. Representatives of the Company's accountants, Somekh Chaikin, also participated in the discussions.

9. Critical Accounting Estimates

The preparation of the financial statements according to international accounting principles obligates the management to make estimates and assessments that influence the reported values of assets and liabilities, income and expenses, and disclosure relating to contingent assets and liabilities. Management bases its estimates and assessments on past experience and on estimating values and opinions and additional factors which it believes are relevant, taking into account the circumstances. The actual results can differ from those assessments based on various assumptions and conditions. The main issues of uncertainty regarding critical estimates and considerations involved in implementing accounting policy are similar to those that were implemented in the annual statements (see Note 4 to the Financial Statements). We are of the opinion that these estimates and assessments are critical because any change in the estimates and presumptions has the potential of substantially affecting the financial statements.

10. Miscellaneous

Event subsequent to the date of the financial statements

Following a query by the Securities Authority, it was resolved to appoint an external examiner to examine the issues arising out of the immediate reports of the Company of March 20, 2007 regarding approval of the option scheme for employees and directors, the immediate report of the Company of March 26, 2007 regarding approval of grants to office bearers, and the immediate report of the Company of March 26, 2007 regarding restatement, pursuant to the provisions of the letters of the Securities Authority to the Company dated March 25, 2007 and March 28, 2007. The external examiner's findings and the subsequent resolutions of the board of directors, including approval of the notice of Mr. Yacov Gelbard regarding termination of office as CEO of the Company, and commencement of office of Mr. Avi Gabbay in the post of Acting CEO, are set out in Note 16 to the financial statements and in section 2.20 of the Periodic Report, and in the Company's immediate reports published since then.

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

Dov Weisglass	**Avi Gabbay**
Chairman of the Board of Directors	**Acting CEO**

Chapter C – Financial Statements

"BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

JUNE 30, 2007

(UNAUDITED)

Contents

Somekh Chaikin

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

At your request, we have reviewed the condensed interim consolidated balance sheet of "Bezeq" - The Israel Telecommunication Corp. Limited (hereinafter "Company") as at June 30, 2007, as well as the condensed interim consolidated statement of income, the condensed statement of recognised income and expense and the condensed interim consolidated statement of cash flows for the six and three-month periods then ended.

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

Reports of other auditors were furnished to us which relate to the review of the condensed interim financial statements of subsidiaries, whose assets as at June 30, 2007, constitute approximately 7% of the total assets included in the condensed interim consolidated balance sheet and whose revenues constitute approximately 11% and 12% of the total revenues included in the condensed interim consolidated statement of income for the six and three-month periods then ended, respectively. Furthermore, reports of other auditors were furnished to us which relate to investments in associates in which the Company's investments amount to approximately NIS 33 million as at June 30, 2007, and the Company's share in the losses in respect thereof amount to approximately NIS 1,644 thousand and NIS 1,171 thousand for the six and three-month period then ended, respectively.

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

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

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

1. The continuing opening of the communications sector to competition 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 8B and 8C.

3. The financial position of a subsidiary. As mentioned in Note 7A, in accordance with the 2007 annual budget, the continuation of the activity of the subsidiary is contingent on arranging sources of finance required by the subsidiary in the forthcoming year. In the opinion of the management of the subsidiary, the receipts from the debentures issued by the subsidiary in July 2007 facilitate the arrangement of the sources of finance required for the coming years.

Additionally, we draw attention to Note 14L to the Group financial statements regarding the adjustment by way of restatement of the financial statements as at June 30, 2006, 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 (Isr.)

August 13, 2007

Condensed Consolidated Interim Balance Sheets as at

	June 30, 2007 (Unaudited) NIS thousands	June 30, 2006 (Unaudited) NIS thousands	December 31, 2006 (Audited) NIS thousands
Assets			
Cash and cash equivalents	**2,063,408**	1,256,603	2,631,790
Trade receivables	**2,161,238**	2,079,960	2,111,451
Other receivables	**230,984**	165,257	250,657
Inventory	**228,844**	231,115	204,669
Broadcasting rights	**205,327**	188,986	169,017
Investments and loans, including derivatives	**1,007,495**	2,478,899	960,561
Current tax assets	**11,886**	11,147	11,105
Total current assets	**5,909,182**	6,411,967	6,339,250
Trade and other receivables	**452,413**	368,690	417,144
Investments and loans, including derivatives	**279,271**	458,662	342,175
Property, plant and equipment	**6,210,952**	6,833,535	6,492,362
Intangible assets	**2,540,921**	2,571,682	2,554,242
Deferred and other expenses	**362,862**	389,075	373,749
Investments in associates accounted by the equity method	**33,231**	24,890	32,122
Deferred tax assets	**788,750**	990,123	993,616
Total non-current assets	**10,668,400**	11,636,657	11,205,410
Total assets	**16,577,582**	18,048,624	17,544,660

Condensed Consolidated Interim Balance Sheets as at

	June 30, 2007	June 30, 2006	December 31, 2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Liabilities			
Loans and credit	**4,187,307**	2,873,564	3,637,347
Trade payables	**1,332,783**	1,324,091	1,393,568
Other payables, including derivatives	**856,971**	881,132	802,747
Current tax liabilities	**70,206**	55,516	121,704
Deferred income	**37,142**	38,306	57,879
Provisions	**331,806**	255,040	288,851
Employee benefits	**758,716**	617,889	906,203
Proposed dividend	**-**	-	300,000
Total current liabilities	**7,574,931**	6,045,538	7,508,299
Debentures	**3,350,062**	4,918,177	3,169,441
Obligations to banks	**391,914**	595,399	480,830
Loans from others	**125,772**	114,791	169,182
Loans provided by the minority in a subsidiary	**598,785**	541,482	564,250
Employee benefits	**328,766**	336,076	373,036
Deferred income and others	**28,394**	25,989	37,020
Provisions	**54,140**	51,722	51,857
Total non-current liabilities	**4,877,833**	6,583,636	4,845,616
Total liabilities	**12,452,764**	12,629,174	12,353,915
Shareholders' Equity			
Share capital	**6,132,636**	6,309,133	6,309,133
Share premium	**-**	1,623,423	1,623,423
Reserves	**680,506**	387,539	671,820
Deficit	**(2,089,539)**	(2,359,163)	(2,849,381)
Total equity attributable to shareholders of the Company	**4,723,603**	5,960,932	5,754,995
Minority equity in capital deficit of a consolidated company	**(598,785)**	(541,482)	(564,250)
Total shareholders' equity	**4,124,818**	5,419,450	5,190,745
Total shareholders' equity and liabilities	**16,577,582**	18,048,624	17,544,660

Dov Weissglas	**Avi Gabbay**	**Ran Oz**
Chairman of the Board	Acting CEO	Deputy CEO and CFO

Date of approval of the financial statements: August 13, 2007.

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

Condensed Consolidated Interim Statements of Income

	For the six month period ended June 30		For the three month period ended June 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues (Note 10)	**6,141,354**	6,030,989	**3,052,675**	3,018,890	12,231,830
Costs and expenses					
Depreciation and amortisation	**877,332**	931,630	**436,133**	471,550	1,864,035
Salary	**1,159,671**	1,139,105	**584,274**	571,891	2,586,437
Operating and general expenses (Note 11)	**2,832,382**	2,857,520	**1,409,612**	1,401,086	5,966,616
Other operating expenses (income), net	**44,430**	70,573	**52,106**	58,563	249,540
	4,913,815	4,998,828	**2,482,125**	2,503,090	10,666,628
Operating income	**1,227,539**	1,032,161	**570,550**	515,800	1,565,202
Financing costs					
Financing expenses	**320,916**	427,123	**158,529**	181,037	694,393
Financing income	**(189,736)**	(235,182)	**(85,217)**	(71,078)	(356,425)
Net financing expenses	**131,180**	191,941	**73,312**	109,959	337,968
Profit after financing expenses	**1,096,359**	840,220	**497,238**	405,841	1,227,234
Equity in profits of investees accounted by the equity method	**1,644**	4,013	**1,171**	2,422	11,184
Profits before income tax	**1,098,003**	844,233	**498,409**	408,263	1,238,418
Income tax	**372,696**	277,627	**158,169**	139,719	488,393
Profit for the period	**725,307**	566,606	**340,240**	268,544	750,025
Attributable to:					
The shareholders of the Company	**759,842**	602,808	**361,092**	288,706	808,995
Minority in a consolidated company	**(34,535)**	(36,202)	**(20,852)**	(20,162)	(58,970)
Profit for the period	**725,307**	566,606	**340,240**	268,544	750,025
Earnings per share					
Basic and diluted earnings per share (in NIS)	0.29	0.23	0.14	0.11	0.31

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

Condensed Consolidated Interim Statements of Recognised Income and Expense

	For the six month period ended June 30		For the three month period ended June 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Net change in fair value of financial assets classified as available for sale	**4,613**	1,887	**3,641**	(987)	(1,464)
Net change in fair value of financial assets classified as available for sale transferred to profit and loss	**-**	(5,218)	**-**	(27,069)	(5,218)
Actuarial gains from a defined benefit plan (1)	**-**	-	**-**	-	3,427
Taxes in respect of income and expenses attributable directly to equity	**(1,677)**	933	**(1,400)**	9,989	2,227
Income and expenses attributable directly to equity	**2,936**	(2,398)	**2,241**	(18,067)	(1,028)
Profit for the period	**725,307**	566,606	**340,240**	268,544	750,025
Total recognised income and expense for the period	**728,243**	564,208	**342,481**	250,477	748,997
Attributable to:					
The shareholders' of the Company	**762,778**	600,410	**363,333**	270,639	807,967
Minority in a consolidated company	**(34,535)**	(36,202)	**(20,852)**	(20,162)	(58,970)
Total recognised income and expense for the period	**728,243**	564,208	**342,481**	250,477	748,997

(1) The Group does not recalculate its actuarial provisions in each interim reporting period, unless there are significant changes in the benefit plan or fundamental changes in market terms during the interim period. As a result, there are no actuarial earnings or losses in the reporting period.

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

Condensed Consolidated Interim Statements of Cash Flows

	For the six month period ended June 30		For the three month period ended June 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Cash flows from operating activities					
Net earnings for the period	**725,307**	566,606	**340,240**	268,544	750,025
Adjustments:					
Depreciation	**740,797**	807,746	**364,688**	393,834	1,591,054
Amortisation of intangible assets	**125,983**	111,831	**66,221**	71,686	247,557
Amortisation of deferred and other charges	**10,552**	12,053	**5,224**	6,030	25,424
Gain from decrease in holdings in associates	**346**	(584)	**28**	(61)	(595)
Net financing costs	**187,916**	239,754	**176,059**	178,563	440,429
Equity in earnings of associates accounted by the equity method	**(1,644)**	(4,013)	**(1,171)**	(2,422)	(11,184)
Net capital (gain) loss	**(5,461)**	(7,974)	**11,382**	2,591	(159,017)
Share-based payment transactions	**-**	-	**-**	-	286,506
Payments to a former senior officer	**5,750**	-	**5,750**	-	-
Income tax expenses	**372,696**	277,627	**158,169**	139,719	488,393
Change in inventory	**(25,587)**	1,631	**22,076**	(8,584)	23,014
Change in trade receivables	**(108,644)**	27,245	**(95,685)**	(11,004)	109,100
Change in other receivables	**(25,626)**	(9,327)	**26,630**	23,252	(107,854)
Change in trade payables	**17,382**	18,349	**(38,093)**	(32,284)	(56,778)
Change in suppliers	**(129,177)**	(127,296)	**(161,830)**	32,214	(79,046)
Change in provisions	**45,238**	(5,408)	**29,889**	(26,797)	27,327
Change in broadcasting rights	**(36,310)**	(34,486)	**(4,841)**	(15,385)	(14,517)
Change in employee benefits	**(191,757)**	(160,111)	**(106,851)**	(137,088)	168,758
Change in deferred and other income	**(8,626)**	478	**(46,476)**	1,661	11,509
	1,699,135	1,714,121	**751,409**	884,469	3,740,105
Interest received	**70,073**	127,307	**27,005**	33,178	220,078
Dividend received	**3,084**	26,010	**3,084**	26,010	26,010
Income tax paid	**(224,390)**	(143,286)	**(86,502)**	(75,228)	(277,573)
Net cash from operating activities	**1,547,902**	1,724,152	**694,996**	868,429	3,708,620
Cash flows from investing activities					
Investment in intangible assets	**(92,128)**	(82,003)	**(42,629)**	(58,163)	(209,733)
Proceeds from sale of property, plant and equipment	**116,395**	12,905	**97,084**	4,847	47,804
Proceeds from realisation of deferred expenses	**4,213**	272	**-**	-	-
Current investments, net	**7,375**	(92,669)	**(108,441)**	(45,243)	1,491,439
Purchase of property, plant and equipment	**(410,326)**	(511,255)	**(232,833)**	(209,410)	(953,226)
Investment in deferred expenses and others	**(2,615)**	(5,365)	**(1,790)**	(3,324)	-
Proceeds from sale of investments and long-term loans	**33,380**	11,888	**25,510**	7,624	62,729
Purchase of investments and long-term loans	**-**	(12,328)	**-**	(2,821)	(19,723)*
Purchase of a subsidiary	**(12,468)**	-	**-**	-	-
Net cash from (used for) investment activities	**(356,174)**	(678,555)	**(263,099)**	(306,490)	419,290

* Reclassified

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

Condensed Consolidated Interim Statements of Cash Flows (Contd.)

	For the six month period ended June 30		For the three month period ended June 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Cash flows from financing activities					
Receipt of loans	**50,000**	-	**50,000**	-	50,000
Issue of debentures	**756,813**	-	**756,813**	-	-
Repayment of debentures	**(96,874)**	(179,056)	**(15,241)**	(30,088)	(280,350)
Repayment of loans	**(148,663)**	(387,263)	**(79,646)**	(226,182)	(1,268,656)
Short-term credit, net	**(22,769)**	55,578	**9,254**	9,262	43,146
Dividends paid	**(2,099,920)**	(1,200,000)	**-**	(1,200,000)	(1,600,000)
Interest paid	**(198,571)**	(236,348)	**(123,198)**	(147,013)	(601,752)
Net cash from (used for) financing activities	**(1,759,984)**	(1,947,089)	**597,982**	(1,594,021)	(3,657,612)
Net increase (decrease) in cash and cash equivalents	**(568,256)**	(901,492)	**1,029,879**	(1,032,082)	470,298
Cash and cash equivalents at the beginning of the period	**2,631,790**	2,158,773	**1,032,988**	2,290,704	2,158,773
Effect of fluctuations in the rate of exchange on cash balances	**(126)**	(678)	**541**	(2,019)	2,719
Cash and cash equivalents at the end of the period	**2,063,408**	1,256,603	**2,063,408**	1,256,603	2,631,790

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

Appendix to Condensed Consolidated Interim Statements of Cash Flows

	For the six month period ended June 30		For the three month period ended June 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Appendix of activities not affecting cash flows					
Purchase of property, plant and equipment, and intangible assets	**199,549**	120,140	**199,549**	120,140	141,518
Sale of property, plant and equipment on credit	**74,506**	13,996	**74,506**	13,996	161,800

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

NOTE 1 – REPORTING ENTITY

A. Bezeq – The Israel Telecommunication Corp. Ltd. ("the Company") is a company domiciled 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 comprise those of the Company and its subsidiaries (jointly referred to as the "Group"), and the Group's interests in affiliated companies. The Group is a principal provider of communications services in Israel (see Note 13 – Segment Reporting).

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 areas 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 the basic telephony field; 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 considering its continued handling of the matter. All the segments of operation of the Group are subject to competition. The activities of the Group are, in general, subject to government regulation and control. It is expected that the said regulation and control, as well as the intensifying competition including implementation of the number portability program, together with all the changes in the communications market, will have an adverse effect on the business results of the Group, an effect that the Group is unable to estimate.

NOTE 2 – BASIS OF PRESENTATION

A. The interim consolidated financial statements were prepared in accordance with the International Financial Reporting Standards ("IFRS"), as required for the preparation of interim financial statements in accordance with standard IAS 34 – Interim Financial Reporting, and in accordance with Section 4 of the Securities (Periodic and immediate reports) Regulations, 5730-1970.

B. These reports should be reviewed in the context of the annual financial statements of the Company and its subsidiaries as at December 31, 2006 and the year then ended, and their accompanying notes ("the annual financial statements"). The Group states in the notes to the interim financial statements only the material changes that have occurred from the date of the most recent annual financial statements until the date of these interim financial statements.

NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICY

The significant accounting policies applied in these financial statements are consistent with those applied in the annual financial statements for the year ended December 31, 2006.

A. Initial application of accounting standards

Commencing January 1, 2007, the Group applies several standards and interpretations of the international accounting standards that have come into effect, as follows:

(1) IFRIC 7 – "Applying the Restatement Approach under IAS 29 - Financial Reporting in Hyperinflationary Economies", that relates to the application of IAS 29 when an economy becomes hyperinflationary for the first time, and in particular the accounting treatment of deferred tax.

(2) IFRIC 8 – "Scope of IFRS 2 - Share-based Payment", that 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.

(3) IFRIC 9 – "Reassessment of Embedded Derivatives", that determines that reassessment with regard to the need to separate an embedded derivative from a host contract will arise only when changes occur in the contract.

NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICY (CONTD.)

A. Initial application of accounting standards (contd.)

(4) IFRIC 11 – "Group and Treasury Share Transactions" is an interpretation dealing with the application of "IFRS 2 - Share-based Payment", in share-based payment transactions related to the equity instruments of the Group.

(5) IFRIC 10 – "Interim Financial Reporting and Impairment", prohibits the cancellation of an impairment loss that was recognised in a prior interim period in respect of goodwill, investment in an equity instrument or a monetary asset stated on a cost basis. IFRIC 10 applies to the financial statements of the Group for the year 2007.

The application of the new standards has no effect on the Group's results of operations and its financial position.

B. New standards during the period not yet adopted

(1) IFRIC 12 – "Segment Reporting Arrangements". This interpretation relates to the accounting treatment of operators from the private sector that provide public assets and infrastructure services. IFRIC 12 distinguishes between two types of arrangements for service concessions. In one, the operator receives a financial asset, an unconditional contractual right to receive cash or other financial assets from the government in exchange for the construction or upgrading of a public asset. In the other, the operator receives an intangible asset and the right to collect payment in return 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 expected to effect the financial statements of the Group.

(2) In June 2007 the IFRIC published Interpretation 13 ("the Interpretation") – "Customer Loyalty Programmes". The Interpretation addresses the accounting treatment of companies that grant benefits in frame of Customer Loyalty Programmes (e.g. "points" or "Frequent Flyer") upon the purchase of goods or services. IFRIC 13 determines how companies should account for their obligation to provide in the future free or discounted goods or services (benefits) to customers that are expected to utilize the benefits. The Interpretation will apply to annual periods commencing on July 1, 2008 or thereafter. The adoption of IFRIC 13 is not expected to significantly effect the financial statements of the Group.

(3) In July 2007 the IFRIC published Interpretation 14 ("the Interpretation") - "IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction". The Interpretation addresses three issues: a) when are amortizations in future funding requirements or returns considered "available" in the context of IAS 19 – "Employee Benefits". b) How does a minimum funding requirement affect the availability of reductions in future contributions. C) when does a minimum funding requirement create a liability. The interpretation will apply to annual periods commencing on January 1, 2008 or thereafter. The adoption of IFRIC 14 is not expected to significantly effect the financial statements of the Group.

(4) IFRS 8 – "Segment Reporting" sets how a company should report on segment operations in its annual financial statements, and addresses selected details pertaining to segments in interim reports. In addition, the standard addresses the required disclosure about products and services, geographic regions and major customers. The standard sets that the identification of segments will be based on reporting to the management that is used to make operational decisions. The standard will apply to annual periods commencing on January 1, 2009 or thereafter. The standard permits early adoption, and requires amendment of comparative numbers on adoption of the standard. The adoption of IFRS 8 is not expected to significantly effect the financial statements of the Group.

NOTE 3 – REPORTING PRINCIPLES AND ACCOUNTING POLICY (CONTD.)

B. New standards during the period not yet adopted (contd.)

(5) In March 2007 an amendment to IAS 23 – "Borrowing Costs" was published. The amendment removes the option of immediately recognising in the income statements all borrowing costs if specific borrowing costs were generated from the purchase, set-up or production of a qualifying asset. The amendment to the standard requires that such costs will be capitalised as part of the cost of such assets. The rest of the borrowing costs will be recorded in the income statement on their generation. The standard will be in effect beginning with the 2009 reports, and is not expected to have a significant effect on the financial statements of the Group.

NOTE 4 – ESTIMATES

The preparation of interim financial statements requires Management to make judgments and use estimates, assessments and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.
The significant estimations applied in these interim statements do not differ significantly from those applied to the annual financial statements.

NOTE 5 – RATES OF CHANGES IN THE CONSUMER PRICE INDEX AND FOREIGN CURRENCY EXCHANGE RATES

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

	Consumer Price Index	Rate of exchange of the US dollar	Rate of exchange of the euro
	%	%	%
For the six month period ended on:			
June 30, 2007	**0.97**	**0.57**	**2.68**
June 30, 2006	1.55	(3.54)	3.62
For the three month period ended on:			
June 30, 2007	**1.21**	**2.26**	**3.23**
June 30, 2006	0.96	(4.82)	(0.33)
For the year ended December 31, 2006	(0.10)	(8.21)	2.16

NOTE 6 – PROPERTY, PLANT AND EQUIPMENT

During the reporting period, the Group companies initiated examination of the useful lives of their property, plant and equipment in order to determine whether significant circumstances exist that justify changing the estimated useful lives of the same.

The findings of the examination to date indicate that due to the Company's intention to replace switches in its fixed-line network, it is necessary to shorten the useful lives of these switches. As a result of the aforesaid, depreciation expenses will increase in 2007 by approximately NIS 18 million, in 2008 by approximately NIS 18 million and in 2009 by approximately NIS 14 million, net before tax.

The findings of the examination also revealed that there are assets whose useful lives might exceed the present estimate, but at this stage a new estimate cannot be established. The companies will continue to examine whether the circumstances that support this assessment are significant, also considering the clarification of the Securities Authority that its decision regarding extension of the depreciation period of property, plant and equipment should also be implemented by corporations that report in accordance with IFRS, unless the Authority shall publish otherwise.

NOTE 7 – GROUP ENTITIES

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

Since commencing its operations, DBS has accumulated considerable losses. Its losses in 2006 amounted to approximately NIS 320 million and the loss in the six-month and three-month periods ended June 30, 2007, amounted to approximately NIS 113 million and approximately NIS 65 million, respectively. As a result of these losses, its capital deficit and its working capital deficit as at June 30, 2007 amounted to approximately NIS 2,974 million and approximately NIS 1,595 million, respectively.

The Company's investment in DBS (primarily through shareholders' 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 subsidiaries amounts to approximately NIS 121 million, of which approximately NIS 99 million is owed to the Company. The Company has come to an arrangement with DBS for the collection of a debt balance of approximately NIS 55.6 million in arrears. Under the arrangement, the debt will be paid in 60 equal monthly instalments plus interest at prime + 1.5%, as at the balance sheet date the debt balance in the arrangement is approximately NIS 47 million. The remainder of the debt to the Company is a current debt balance, for which the terms of payment are the regular credit terms in effect between the Company and its customers.

On July 31, 2007 DBS issued to institutional investors, in frame of a private placement, debentures (Series A) at a total nominal value of approximately NIS 620 million, that will be registered in the TACT-institutional system (TACT - Tel Aviv Continuous Trading) of the Tel Aviv Stock Exchange. Towards the issuance, the debentures were rated by Maalot - The Israel Securities Rating Company Ltd. ("the Rating Company") at BBB-/stable.

The debentures are payable in 8 annual principal and interest payments every 5th of July in each of the years 2010 to 2017. The principal payments in each of the years 2010 to 2013 will be at a rate of 8% of the nominal value of the debentures, and the principal payments in each of the years 2014 to 2017 will be at a rate of 17% of the nominal value of the debentures. The debentures linked to the consumer price index commencing on June 2007, and bear linked annual interest at the annual rate of 7.9% (subject to various possible adjustments according to the debenture terms), that will be paid in semi-annual payments in January and July of each of the years 2009 – 2017.

DBS did not undertake to list the debentures on the stock exchange, but in the event that they shall be listed the linked annual interest paid for them commencing on the listing date will be reduced to 7.4%. In the event that the debentures shall not listed until July 31, 2008, the linked annual interest paid for them will be increased to 8.4%, while they are not listed (in the event of subsequent listing, the linked annual interest rate will be reduced to 7.4% commencing on the listing date).

In the event that the rating of the debentures shall be reduced by two rating levels while the debentures are not listed, the linked annual interest rate shall be increased to 8%, until the debentures return to their original rating or until they are listed on the stock exchange (in this event, the aforesaid interest rate decrease will also apply). In addition, should DBS fail to comply with the terms set in the financing agreement it had entered into with the banks, and as a condition for the banks ceding the said breach, DBS will undertake to pay to the banks additional interest to that of the bank interest margin, and if the debentures are not listed at the time, then as long as the said margin supplement is paid to the banks and the debentures are not listed, DBS will pay the holders of the debentures an annual interest supplement at the same rate.

The debentures are secured by a first floating lien on all of DBS' assets (other than exceptions as dictated by the provisions of the Communications Law), unlimited in amount. They are further secured by a first fixed charge, unlimited in amount, on DBS' rights and assets that were attached by it in favor of banks (other than exceptions as dictated by the provisions of the Communications Law). The said securities are first level and pari pasu to the floating liens and the fixed charge created by DBS in favor of the banks, in order to secure the bank credit.

NOTE 7 – GROUP ENTITIES (CONTD.)

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

The debentures issuance required the approval of the banks, and such an approval was obtained, subject to the terms set in the letter of agreement of the banks. The said debentures do not include collateral (or any other similar undertaking) of the Company to secure the payments to the holders of the debentures. The Company signed a letter of agreement in favour of the banks financing the DBS operations according to which: (a) it will take all steps required and will set in motion its influence as a shareholder in DBS in order that DBS will fulfil its commitments regarding the continued rating of the debentures. (c) It agrees to set a ceiling for the bank debts and the debt due to the DBS debentures for the purpose of beginning repayment of certain shareholders loans which were given by the Company to DBS (it should be mentioned that no restriction applies, as mentioned above, on the debts and supplier credit in respect of equipment and/or services from shareholders and on the spreading of DBS' past debt to the Company relating to fees for use of the Company's ADSL services).

As of the date of approval of the financial statements, the capital raised in the issue was received.

The loans that the minority in the consolidated Company put up were included in the statements at the fair value at the time received. As part of the debenture rating process of the consolidated company with the rating company, it was agreed to defer the dates on which the shareholders could initially demand settlement of the loans. When a change applies to the anticipated settlement dates of the loans, the difference between the current values of the anticipated cash flows due to the repayment of the loans (hereinafter – the difference) is credited according to the new repayment dates and according to the interest rates that are taken into account on the date the loans were received, and their value in the statements on the date of change (similar to the handling upon receipt of the loans) to the capital reserve. The said difference in the amount of NIS 164 million is expressed in the financial statements of the third quarter of 2007. The difference which will be credited to the capital reserve, as mentioned, is expected to affect the Group's financing costs in the future.

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

The terms of the loans and the credit facility that DBS received from the banks, the balance of which as at June 30, 2007 is NIS 1,368 million, impose various restrictions on DBS that 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 shareholders' loans, and a requirement for compliance with financial criteria ("the Conditions").

On July 22, 2007 DBS and the banks entered into the eighth supplement ("the Supplement") to the financing agreement. This Supplement provided for the following subjects, *inter alia*:

(1) The terms set in the financing agreement were updated.
As at the date of approval of the financial statements, DBS is in compliance with the conditions set in the Supplement. However, since DBS prepares its financial statements in accordance with International Financial Reporting Standards (IFRS) that require an examination of DBS' compliance with the conditions as at the date of the financial statements, the loans are classified in these financial statements in frame of the short term liabilities.

(2) The designation of the capital raised in frame of the debenture issuance was set as aforesaid. According to the Supplement, the debenture issuance will be used by DBS for partial repayment of its bank credit, to repay the loan it had taken from an institutional body in 2006 (including a bridge loan granted by that body to DBS in June 2007), in the amount of NIS 100 million, and for DBS' current operations.

During 2005-2006 DBS was granted loans in the total amount of NIS 100 million by institutional bodies. In December 2006, DBS entered into an agreement with another institutional body for a loan in the amount of NIS 50 million. DBS holds an option to receive an additional loan in an identical amount to the amount already received. DBS exercised this option in June 2007. Further to the said debenture issuance, the loan agreement was amended and the parties agreed that DBS will repay the loan principal, in the total amount of NIS 100 million, on receipt of the capital raised in

NOTE 7 – GROUP ENTITIES (CONTD.)

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

the issuance, as aforesaid, since the institutional body purchased debentures in frame of the issuance. Accordingly, the loan was classified as being current.

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, and a new consent was 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 its reasons for the opposition. On May 15, 2007, the Company filed an appeal against the decision.

As at the date of approval of the financial statements, DBS exceeds the credit terms set in agreements with certain suppliers. DBS is acting to reduce the balances owed to these suppliers.

On December 24, 2006, the Board of Directors of DBS approved its budget for 2007. According to this budget, DBS will require additional external financing in 2007. As at the date of approval of the financial statements, DBS closed a private placement of debentures to institutional investors, in the total amount of NIS 620 million, as aforesaid. DBS' management estimates that the consideration of the said debenture issuance will provide it with the sources of financing required by DBS in the forthcoming year.

B. Bezeq International Ltd.

Further to Note 32(4) to the Group's financial statements for the year 2006, regarding an agreement with Bezeqcall Communication Ltd. for the acquisition of all operations of Tadiran – Telecom Communication Services in Israel ("Tadiran") for a consideration of approximately NIS 93 million, the said agreement has been cancelled in light of the Antitrust Authority's decision to withhold approval of the transaction and following Tadiran announcement of its decision to cancel the agreement.

NOTE 8 – CONTINGENT LIABILTIES

A. Claims

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

In the opinion of the managements of the Group's companies, based, *inter alia*, on legal opinions regarding the probability of success of the claims, including the applications for certification of the class action lawsuits, appropriate provisions in the amount of NIS 320 million, where such provisions were required, have been included in the financial statements to cover the exposure resulting from such claims.

In the opinion of the managements of the Company and the consolidated companies, the additional exposure (in addition to the above provisions) as at June 30, 2007, due to claims filed against the companies in the Group on various matters and the probability of realisation of which is remote or likely, amounts to approximately NIS 30 billion, of which approximately NIS 3.4 billion relates to claims filed by employees.

Concerning applications for certification as class action of lawsuits in respect to which the Group has exposure beyond the aforesaid (since the claims do not state a specific amount), see claims in Note 17A(4), (5), (7) and (19) to the financial statements as at December 31, 2006 .

For a detailed description of these claims, see Note 17A to the Group's annual financial statements as at December 31, 2006. Details of the significant changes to the status of the material contingent liabilities of the Group since December 31, 2006 are provided below:

(1) Further to Note 17A(4) to the financial statements as at December 31, 2006, on April 10, 2007 a ruling granted effect to the procedural arrangement, in frame of which the Company and Bezeq International will be struck off the claim (after undertaking to transfer any sum transferred to them by the Department of Customs and VAT, if at all, in connection with the claim, as instructed by the court).

(2) Further to Note 17A(27) to the financial statements as at December 31, 2006, regarding application for certification of a class action against Pelephone concerning the allegation of the misleading of the defendant's subscribers who reside in Eilat, who were charged VAT for cellular communication service, the claim was rejected without a cost payment order.

(3) Further to what is mentioned in Note 17a(18) to the financial statements as at December 31, 2006, on June 11, 2007, a hearing was held during which the Court ignored all the facts of the case requiring the rejection of the request for class action and stressed the fact that in the minutes of the Bezeq International's board of directors meetings some unfortunate things were heard relating to the management of Bezeq International opening the market to competition. Under these circumstances, the Court suggested that Bezeq International publish some form of apology and make some sort of contribution for public benefit. On June 24, 2007, Bezeq International sent notice to the Court stating that there was no need for an apology or a contribution, since there was no deception and/or misleading advertising. Furthermore, Bezeq International stated that in view of the respect it has for the Court, it would make a contribution to the public, which cannot be bound to the class action. As of the date of this report, no response has yet been received that contests this notice.

(4) In May 2007, a claim arrived at the Company's offices, together with a request to recognise it as a class action, that was filed with the District Court in Tel Aviv by a plaintiff claiming to have purchased shares of the Company in 2006. The claim was filed against the Company, two former CEOs of the Company, directors who served in the Company during the relevant period, as well as Ap.Sb.Ar. Holdings Ltd., that holds 30% of the Company's shares.

NOTE 8 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

The claim involves the assertion that the Company's financial statements for the years 2004 and 2005 contained false and misleading material information, including with respect to the annual profit, to property, plant and equipment and to shareholders' equity, in light of a retroactive depreciation amounting to approximately NIS 320 million in respect of property, plant and equipment that was not in use by the subsidiary Pelephone Communications Ltd.

The amount of the personal action is NIS 194, and the total amount of the claim for the Group is NIS 56.5 million.

(5) In April 2007, an application was filed with the District Court for certification of a class action against DBS and against Sports Channel Ltd. (the producer of Channel 5, Channel 5+, Channel 5 live and Channel 5 gold)and its managers, in connection with the broadcasts of Channel 5 live ("the Certification Application"). According to the applicant, the broadcasts of Channel 5 live involve the transfer of content from Channel 5+ to Channel 5 live, which contravenes "the basic promise of DBS as ratified in earlier legal proceedings". The applicant, whose cause of claim against DBS is violation of a contractual undertaking, breach of the duty of good faith in a contractual engagement and unjust enrichment, estimates the amount of the action at approximately NIS 63 million.

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

For a detailed description of the claims in respect of which the exposure cannot yet be assessed or calculated, see Note 17B to the Group's annual financial statements as at December 31, 2006. Details of material changes since December 31, 2006 are provided below:

(1) In June 2007, a claim was filed against Pelephone with the District Court in Tel Aviv, along with a request to recognise it as a class action. The aggregate amount of the claim is approximately NIS 239 million, and it concerns a group of customers that belong to the Russian sector and that the pricing plans, subject matter of the claim, were offered to them.

The claim raises allegations of Pelephone misleading of the customer at the time the agreement was entered into with him, conducting itself in bad faith, and continuously misleading the customer – it offered him the pricing plan without warning him that the charge is based on rounding up to 60 seconds units, rather than on 12-second charge units (according to the plaintiffs, this is provided for in the license).

In addition, it is claimed that Pelephone failed to attach the price list to the pricing plan as is required by its license, in order to advance its intention of misleading. The claim is being studied and a position about its effect cannot yet be formed. Pelephone will study the claim and will respond as required.

(2) In August 2007, the Company received a claim to which was attached an application to approve class action which was filed against the Company in the Tel Aviv District Court by a claimant claiming to be a customer of the Company who signed a contract with the subsidiary company DBS to receive infrastructure services for broad band internet (ADSL). The claimant is demanding reimbursement of all the fixed monthly payments made by the claimant for maintaining a land line telephone for which the claimant no longer has any use, since he claims that these payments were unlawfully collected since from the technological aspect, the provision of broad band internet could have been supplied without the land line being used. The claimant is claiming that the said claim be open to all the Company's customers and/or DBS customers who were subscribers of the Company's broad band internet services during the past two years and who requested disconnection of the Company's land line telephone and/or who stopped using it but continued paying the fixed monthly payments for it. The claimant requested that his claim be approved as a class action in the name of the customers as specified above and estimates the scope of the class action case as NIS 108 million. The Company is reviewing the claim and it is not possible at this stage to estimate the outcome.

NOTE 8 – CONTINGENT LIABILITIES (CONTD.)

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

(3) In July 2007, a statement of defense was filed on behalf of a body that was sued by DBS. At the same time, this body filed a statement of counter claim in the sum of approximately NIS 42.6 million against DBS and another company, in which the interested party is an interested party in DBS, jointly and severally. In the framework of the statement of defense and the statement of counter claim, it was charged that the liability for the faults in the decoders falls on DBS and/or the other company, *inter alia* since in its view, the decoders were not characterized properly by the defendants, were not properly checked by the defendants and since the decoders, at least in part, were not properly installed at the homes of DBS subscribers. In light of these and other claims, according to the statement of counter-claim, it suffered, in its view, various kinds of damage relating to the need to repair the decoders even after the warranty period under the contract, to provide spare parts, to provide human resources services and due to various payments made, it alleges, to the other company. In the alternative, the body is suing for expenses and loss of profits caused to it, it alleges, due to the acts and omissions of DBS and/or the other company, in the sum of US $ 15 million. For the purpose of fees, the claim has been set, as aforesaid, in the sum of approximately NIS 42.6 million. No statement of counter-defense has yet been filed. At this preliminary stage, before the position of DBS has been formed and before gathering the relevant data for preparing the response, the chances of the claim, if approved, cannot be assessed.

C. Other contingencies

For a detailed description of other contingencies, see Note 17C to the Group's annual financial statements as at December 31, 2006. Details of material changes since December 31, 2006 are provided below:

(1) In May 2007, a request arrived at the Company's offices, pursuant to Article 194 of the Companies Law, that was sent by an applicant who claims to be a holder of the Company's publicly owned shares. According to the request, following the findings of the external examiner appointed by the Company to examine the manner in which various decisions are made and as well as the Company's conduct, that point to a multitude of shortcomings and failures related directly to the work of the Board of Directors, its committees, its members and the former CEO of the Company, the Company is requested to take legal action against the Board of Directors and the Company's other officers who were responsible for the same. The Company's Board of Directors rejected the demand and informed the applicant to that effect.

(2) Further to Note 17C(2) to the Group's annual financial statements for the year 2006, regarding commissions paid to DBS and the debts of DBS to the Company, the Company's Board of Directors rejected the demand and informed the applicant to that effect.

(3) Further to Note 17C(1) to the Group's annual financial statements for the year 2006, on May 27, 2007 the Antitrust Commissioner announced that it is considering exercising its authority under Article 43(A)(5) to the Antitrust Law, 5748-1988, to determine that the Company had abused its status, thus violating the provisions of Article 29A to the Law. This in view of the findings of an investigation carried out over the past few months by the Investigation Department of the Antitrust Authority.

The Commissioner is considering ruling that –

a. In the first half of 2006, and in particular in April and May 2006, the Company's employees initiated sanctions, in frame of which they delayed or failed to carry out works involving the connection of inland operators (Cellcom, Globcall and Golden Lines) to the Company's network.

NOTE 8 – CONTINGENT LIABILTIES (CONTD.)

C. Other contingencies (contd.)

b. During the afternoon hours of May 17, 2006, the existing connection between HOT Telecom and the Company's network was disconnected and was not repaired, due to sanctions of Company employees, until the night of May 18, 2006.

c. The Company failed to act as required in order to prevent or minimise these events and the ensuing damage to inland operators, to competition and to the public.

d. Thus the Company abused its status, in contravention of Article 29A to the Law.

Under Article 43(e) of the Antitrust Law, the Antitrust Commissioner's said ruling, if and insofar as made, shall serve as *prima facie* evidence in any legal proceeding.
The Company is required to submit in writing its position to the Antitrust Commissioner by September 15, 2007.

It should be noted that in May 2006, a claim was filed against the Company and against the cable companies, along with an application for certification as a class action, regarding a malfunction in HOT's telephone line that had occurred on May 17, 2006. On this matter see Note 17A12 to the Company's annual financial statements for the year ending December 31, 2006. The Antitrust Commissioner's said ruling will require reviewing this claim, based on the content of the determination and the extent of its implication on the matter in dispute.

(4) Further to Note 17C(7) to the Group's annual financial statements for the year 2006, concerning number portability, on May 24, 2007 the Company received a notice from the Director General of the Ministry of Communications, stating that he is considering imposing on the Company a financial sanction due to the alleged violation of the duty to provide number portability commencing on September 1, 2006, as follows:

a. For the period from September 1, 2006 to the date of the Director General's notice – a financial sanction in the amount of NIS 2,031,750.

b. For the period commencing on May 25, 2007 and ending on November 30, 2007 or until the date of remedy of the alleged violation (the earlier of the two) by the Company – NIS 6,450 for each additional day on which the violation continues.

c. For the period commencing on December 1, 2007 (which, according to the notice, allows the relevant licensees reasonable time to remedy the alleged violation) and ending on the date of remedy of the alleged violation – a financial sanction as specified in Articles 37B(b) and 37C(a) of the Communications Law following Amendment 36 (it should be noted that according to the provisions of these Articles, the relevant sanction amount is seven times the fine set in Article 61(a)(4) of the Penal Law (that is NIS 202,000), plus 0.25% of the annual income of the Company, plus a financial sanction of one fiftieth of such sanction for each day on which the violation continues.)

The subsidiaries Pelephone Communications Ltd. and Bezeq International Ltd. received similar notices. According to the notices from the Ministry of Communications, Pelephone and Bezeq International were given an opportunity to bring their positions before the Director General of the Ministry of Communications by June 24, 2007. In its response, the Company argued that its position does not constitute a violation of the provisions of the Law or of its license, that the matter is pending before the High Court of Justice, and that in any case, under the circumstances it will be unreasonable to impose sanctions on the Company, including in view of the date set by the Ministry of Communications as reasonable for implementation of the numbers portability (December 1, 1007). As noted in the financial statements as at December 31, 2006, the Company and Pelephone (together with other mobile operators) petitioned the High Court of Justice on this matter, contending, *inter alia*, that it was the Ministry of Communications that had failed to prepare a number portability plan as required by the provisions of the law.

NOTE 8 – CONTINGENT LIABILTIES (CONTD.)

C. Other contingencies (contd.)

(5) Further to Note 17C(6) to the Group's annual financial statements for 2006, in the first half of 2007, the Company took steps to obtain operation permits from the Supervisor of Non-Ionizing Radiation at the Ministry of the Environment, pursuant to the Radiation Law that came into effect at the beginning of 2007. Following these steps, the Company received operation permits for the communication facilities that it operates, with the exception of a few which still have a valid radiation permit by virtue of the Pharmacists Regulations. The Company is taking steps to obtain operation permits under the Radiation Law for these few facilities.

D. Claim against affiliated company

In July 2007, a statement of claim was filed in the Jerusalem District Court against an affiliate of Bezeq International, the Israeli Police, the State of Israel, and 7 other defendants from the telecommunications field for a total amount above NIS 65 million for bodily damages allegedly caused to the plaintiff, regarding publication of lies and libel regarding the involvement of the defendant in securities violations and conspiracy to commit murder. In the opinion of the affiliated company and its legal advisors, since the claim is not supported by concrete evidence and as the affiliated company is not the principal party in the claim, the chances of the claim against the affiliated company are low and therefore the affiliated company did not make provisions for this claim in its financial statements.

NOTE 9 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES

A. Further to Note 29D to the Company's financial statements as at December 31, 2006, concerning the cancellation of discount arrangements included in the agreement between the Company and the Ministry of Defence dated May 8, 2005 (hereinafter "the 2005 agreement"), on April 22, 2007 the Company informed the Ministry of Communications and the Ministry of Defence of its decision to comply with this demand. It should be noted that the Company received a copy of the letter sent by the Ministry of Defence to the Ministry of Communications, that contained a request to freeze the instruction regarding cancellation of the discount arrangements set in the agreement between the parties, until the convening of a work meeting between the Ministry of Defence and the Ministry of Communication that will discuss the subject. However, as at the date of publication of this report, the Company has yet to receive a different instruction from the Ministry of Communications. It should be noted that in the Company's opinion, it was entitled to enter into the agreement in accordance with its general license. In addition, according the Antitrust Authority's notice dated August 2006, the agreement does not contravene the provisions of the Antitrust Law, and the Authority saw no justification, at that time, to insist on cancellation of the agreement. The Company already notified the Ministry of Communications of the Antitrust Authority's position in August 2006. It is further noted, that according to the agreement between the Company and the Ministry of Defence, according to which should one of the parties be unable to fulfil its undertakings provided for in the agreement due to a legal directive or resolution of a competent authority, the same shall not constitute breach, and the parties shall negotiate another agreement, the terms of which shall reflect, to the extent possible, the wishes of the parties in accordance with the agreement. The Company has requested an urgent negotiation meeting with the Ministry of Defence, but this request has not yet been granted. On July 22, 2007 the Company informed the Ministry of Defence, that commencing on April 22, 2007 the Ministry of Defence will be charged based on rates set in a prior agreement entered into with it, dated July 21, 2002 (hereinafter "the 2002 agreement"), and that this arrangement will apply unless otherwise agreed between the parties, or alternatively unless an explicit instruction of the Ministry of Communications is received, that freezes or cancels its previous instruction regarding cancellation of the discount arrangement provided for in the agreement dated May 8, 2005. On August 5, 2007 the Ministry of Defense informed the Company that the settling of accounts between the Company and the Ministry of Defense according to the fees in the 2002 agreement contradicts the provisions of the 2005 agreement and the Ministry of Defense pays its suppliers only according to agreements signed under the State Property Law.

NOTE 9 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES (CONTD.)

The Company is unable to assess the developments at this stage, and therefore the financial statements include income from the Ministry of Defence that is based on the rates provided for in the agreement dated May 8, 2005, that are estimated to be lower than the rates in the previous agreement from 2002 and lower than the Company's regular rates (for the period commencing in October 2005 and ending on June 30, 2007).

B. Further to Note 26B to the financial statements as at December 31, 2006 regarding options to two employee directors, it was resolved not to hold the shareholders' meeting convened for this purpose and the Company is working to re-approve allocation of the options by its competent organs.

C. Further to Note 29E to the financial statements as at December 31, 2006, on July 29, 2007 an agreement was entered into with a company owned and controlled by Ap.Sb.Ar., in the framework of which the Company will be provided regular management and consulting services in consideration for 1.2 million US dollars annually, in the period commencing on October 11, 2005 and ending on December 31, 2008.

D. Further to Note 29H to the financial statements as at December 31, 2006, on July 28, 2007 Ap.Sb.Ar., that owns 30% of the Company's shares, informed the Company that it has entered into an agreement with the former CEO of the Company, Mr. Amnon Dick, according to which Ap.Sb.Ar. will pay him special compensation in the amount of NIS 5,750 thousand, as a gesture for his contribution to the Company. The remuneration is recorded in the Company's ledgers as a salary expense and at the same time in the capital reserve operating between the Corporation and the controlling shareholder.

E. Further to Note 29G in the financial statements as at December 31, 2006, in the matter of cancellation of the bonus for the former CEO, Mr. Yacov Gelbard, the Company decided that if this bonus is not returned to the Company, it will take all legal steps to collect the debt.

NOTE 10 – REVENUES

	For the six month period ended June 30		For the three month period ended June 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Fixed-line domestic communications	**2,524,095**	2,535,863	**1,265,927**	1,262,255	5,086,022
Cellular telephone	**1,767,696**	1,708,032	**886,037**	863,822	3,493,541
Multi-channel television	**670,677**	626,365	**338,325**	316,452	1,284,337
Sale of equipment to subscribers, installations and miscellaneous	**631,526**	564,238	**317,923**	268,484	1,170,771
International communications and internet services	**433,746**	469,105	**181,056**	240,307	963,942
	6,027,740	5,903,603	**2,989,268**	2,951,320	11,998,613
Other revenues	**113,614**	127,386	**63,407**	67,570	233,217
	6,141,354	6,030,989	**3,052,675**	3,018,890	12,231,830

NOTE 11 – OPERATING AND GENERAL EXPENSES

	For the six month period ended June 30		For the three month period ended June 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
General expenses	**551,104**	531,601	**294,398**	253,189	1,169,107
Cellular telephone expenses	**891,262**	916,915	**439,154**	456,973	1,854,347
Materials and spare parts	**429,355**	413,164	**209,406**	215,872	922,449
Consumption of satellite services content	**201,736**	216,157	**97,690**	107,715	441,268
Services and maintenance by sub-contractors	**192,256**	211,859	**90,347**	100,665	428,424
Building maintenance	**165,752**	170,204	**83,849**	85,947	347,849
International communication expenses	**185,451**	191,407	**86,884**	95,001	383,496
Motor vehicle maintenance expenses	**93,211**	91,518	**47,380**	46,550	190,079
Royalties to the Government of Israel	**96,003**	89,422	**47,639**	26,228	179,589
Collection fees	**26,252**	25,273	**12,865**	12,946	50,008
	2,832,382	2,857,520	**1,409,612**	1,401,086	5,966,616

NOTE 12 – CONDENSED DATA FROM THE INTERIM SEPARATE FINANCIAL STATEMENTS OF THE COMPANY

A. Income statement

	For the six month period ended June 30		For the three month period ended June 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues (See B below)	**2,835,163**	2,894,531	**1,392,821**	1,440,015	5,798,996
Costs and expenses					
Depreciation and amortisation	**472,518**	516,096	**235,103**	258,420	1,026,469
Salary	**635,768**	635,994	**325,989**	325,107	1,557,000*
General and operating expenses	**1,066,971**	1,091,216	**534,066**	524,918	2,233,167*
Other expenses (income), net	**47,445**	63,417	**54,384**	51,514	228,893
	2,222,702	2,306,723	**1,149,542**	1,159,959	5,045,529
Operating income for the period	**612,461**	587,808	**243,279**	280,056	753,467

* Reclassified

B. Revenues segmentation

	For the six month period ended June 30		For the three month period ended June 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Telephony	**1,942**	2,050	**947**	1,018	4,088
Internet	**337**	298	**172**	149	608
Transmission and data communication	**366**	350	**184**	175	711
Other services	**190**	197	**90**	98	392
Total	**2,835**	2,895	**1,393**	1,440	5,799

NOTE 13 –SEGMENT REPORTING

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

For the six-month period ended June 30, 2007 (unaudited)

	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP 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	**2,674,274**	**2,144,348**	**624,641**	**689,570**	**8,521**	**-**	**6,141,354**
Inter-segment revenues	**160,889**	**154,541**	**19,571**	**18,296**	**21,088**	**(374,385)**	**-**
Total revenues	**2,835,163**	**2,298,889**	**644,212**	**707,866**	**29,609**	**(374,385)**	**6,141,354**
Segment results	**612,461**	**453,039**	**104,420**	**55,682**	**1,937**	**-**	**1,227,539**

For the six-month period ended June 30, 2006 (unaudited)

	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP 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	2,753,569	2,015,410	600,921	651,720	9,369	-	6,030,989
Inter-segment revenues	140,962	170,285	39,818	17,902	17,922	(386,889)	-
Total revenues	2,894,531	2,185,695	640,739	669,622	27,291	(386,889)	6,030,989
Segment results	587,808	364,631	69,806	9,699	217	-	1,032,161

NOTE 13 –SEGMENT REPORTING (CONTD.)

For the three-month period ended June 30, 2007 (unaudited)

	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP 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	**1,312,158**	**1,076,542**	**318,872**	**339,653**	**5,450**	**-**	**3,052,675**
Inter-segment revenues	**80,663**	**74,914**	**2,698**	**14,627**	**9,675**	**(182,577)**	**-**
Total revenues	**1,392,821**	**1,151,456**	**321,570**	**354,280**	**15,125**	**(182,577)**	**3,052,675**
Segment results	**243,279**	**239,920**	**53,595**	**31,681**	**2,075**	**-**	**570,550**

For the three-month period ended June 30, 2006 (unaudited)

	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP 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	1,367,007	1,013,064	304,328	329,771	4,720	-	3,018,890
Inter-segment revenues	73,008	84,207	19,345	12,853	8,905	(198,318)	-
Total revenues	1,440,015	1,097,271	323,673	342,624	13,625	(198,318)	3,018,890
Segment results	280,056	189,867	34,228	11,344	305	-	515,800

Notes to the Financial Statements as at June 30, 2007

NOTE 13 –SEGMENT REPORTING (Contd.)

	For the year ended December 31, 2006 (audited)						
	Domestic fixed–line communications	Cellular telephone	International communications, internet and NEP 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	5,514,799*	4,140,771*	1,016,300	1,338,826	221,134	-	12,231,830
Inter-segment revenues	284,197*	337,216*	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

* Reclassified.

NOTE 14 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION

As noted in the financial statements for the year 2006, the Group first adopted IFRS in 2006, with January 1, 2005 set as the transition date. In preparing its opening balance sheet in accordance with IFRS and in the Group balance sheet as at January 1, 2006, the Group has adjusted amounts reported previously in financial statements prepared in accordance with its previous basis of accounting (Israeli GAAP).

Explanations of the material effects of the transition from Israeli GAAP to IFRS on the Group's financial position and on its results of operation as of June 30, 2006 and for the three-month period then ended, are provided below. For the full explanations in respect to the transition from Israeli GAAP to IFRS on the transition date and in respect to the reserve balance as at January 1, 2006, see Note 33 to the Group's financial statements for the year 2006.

Material adjustments to the balance sheet line items

	Note	Israeli GAAP NIS thousands	Effect of the transition to IFRS June 30, 2006 NIS thousands	IFRS NIS thousands
Property, plant and equipment	a-f, k, l	9,131,967*	(2,298,432)	6,833,535
Intangible assets	d, g	1,693,685	877,997	2,571,682
Deferred tax assets	a-c, g, h, l	532,866*	457,257	990,123
Equity capital	a-c, f-g, j, l	7,060,677*	(1,641,227)	5,419,450

Material adjustments to the income statement line items for the six-month period ended June 30, 2007

	Note	Israeli GAAP NIS thousands	Effect of the transition to IFRS June 30, 2006 NIS thousands	IFRS NIS thousands
Revenues	l	6,045,223*	(14,234)	6,030,989
Costs and expenses	a-c, f-g, j, l	5,176,869*	(178,041)	4,998,828
Net earnings for the period (attributable to shareholders of the Company)	a-c, f-g, j, l	471,405*	131,403	602,808
Earnings per share				
Basic and diluted earnings per share (in NIS)		0.18*	0.05	0.23

* Restated – see section (l) below.

NOTE 14 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

Material adjustments to the income statement line items for the three-month period ended on June 30, 2006

	Note	Israeli GAAP	Effect of the transition to IFRS June 30, 2006	IFRS
		NIS thousands	NIS thousands	NIS thousands
Revenues	l	3,024,968*	(6,078)	3,018,890
Costs and expenses	a-c, f-g, j, l	2,566,195*	(63,105)	2,503,090
Net earnings for the period (attributable to shareholders of the Company)	a-c, f-g, j, l	239,161*	49,545	288,706
Earnings per share				
Basic and diluted earnings per share in NIS)		0.09*	0.02	0.11

* Restated – see section (l) below.

Notes to the material adjustments

a. In accordance with the relief under IFRS 1, as of the transaction 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 this value as deemed cost. The deemed cost was based on an external expert opinion. As a result, the property, plant and equipment balance decreased by NIS 1,246 million at June 30, 2006, to a fair value of approximately NIS 1,336 million at that date, 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 356 million as at June 30, 2006. The reserve balances were reduced on that date by the net amounts. The depreciation expenses for the six- and three-month periods ended on June 30, 2006 decreased by NIS 169 million and NIS 83 million, respectively.

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 revaluation was based on an opinion of an external appraiser. The effect was to increase the property, plant and equipment balances by approximately NIS 55 million and to reduce the depreciation expense for the six- and three-month periods ended on June 30, 2006 by approximately NIS 23 million and NIS 11 million, respectively. 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 fin the financial statements. The reserve balances were reduced by the same net amounts as 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 Group selected a relief that allowed it to capitalise the expected costs of decommissioning and clearing sites at the transition date at historical capitalization rates.

   As a result, the property, plant and equipment balances as at June 30, 2006 increased by NIS 16 million, and the reserve balance decreased by approximately and NIS 9 million (net of tax) as at the same date.

d. Under IFRS, computer software and capitalised software development costs that do not constitute an integral part of the hardware attributed to them, are treated as intangible assets. Accordingly, with the transition to IFRS, the carrying balances at June 30, 2006, of approximately NIS 478

NOTE 14 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

Notes to the material adjustments (cont.)

million, 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 were treated as a finance lease and a related asset was recognised in the balance sheet in the property, plant and equipment item. Under IFRS and as provided for in IFRIC 4, that determines 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 IFRS and in the absence of the criteria required for the said arrangements to be defined as 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 was to decrease property, plant and equipment by approximately NIS 190 million at June 30, 2006, against an increase in the following items:

(1) Other accounts receivable (prepaid expenses), of approximately NIS 19 million as at June 30, 2006.
(2) Other long-term assets (long-term prepaid expenses in respect of a right of use of capacity), of approximately NIS 149 million.

f. Under accepted accounting principles in Israel, customer acquisition costs in a subsidiary were partially capitalised to property, plant and equipment and depreciated over 6 years, and a part of the same was charged as a current expense to profit and loss. Under IFRS, these costs were capitalised and are depreciated over the term of the contractual engagement of the subscriber,that is usually one year.

The difference between the accumulated depreciation under accepted accounting principles in Israel and the accumulated depreciation under IFRS for the three-month period ended on June 30, 2006 amounts to approximately NIS 287 million (decrease in property, plant and equipment), and the effect on the depreciation expenses for the six- and three-month periods ended on June 30, 2006 is a decrease of approximately NIS 19 million and NIS 10 million, respectively.

g. 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 as well as the losses in respect of subsidising equipment. These costs included the commissions paid to external dealers, as well as the losses in respect of subsidising the terminal equipment for customers (“Subscriber Acquisition”). This Subscriber Acquisition was depreciated to profit and loss over the term of the customer commitment, that is, up to 36 months.

Under IAS 38, the Group defers only 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. The losses in respect of subsidising the telephones is attributed to profit and loss and are not deferred. As a result, the Subscriber Acquisition asset as at June 30, 2006 was reduced by approximately NIS 67 million. This adjustment has no material effect on profit and loss for the six-month period ended June 30, 2006, whilst the effect on profit and loss for the three-month period ended June 30, 2006 is an increase of approximately NIS 4 million before tax.

h. 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.

NOTE 14 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

Notes to the material adjustments (cont.)

Accordingly, with the transition to IFRS, the balance of short-term deferred taxes was reclassified, as at June 30, 2006, in the amount of approximately NIS 202 million, from the accounts receivable and debit balances item under current assets, to the deferred tax item under non-current assets (in this Note, the deferred taxes are stated after the above reclassification).

i. Under IFRS, bank loans to a subsidiary, of approximately NIS 1,269 million, were stated as short-term loans, while under accepted accounting principles in Israel these loans were classified as long-term loans. The classification was changed due to the transition to IFRS and since the subsidiary failed to meet financial criteria set by the banks for these loans on the balance sheet date.

j. 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 subsidiary, at their carrying value in the consolidated 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 subsidiary 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 subsidiary is stated under distribution of profits between the majority shareholders and the minority shareholders.

k. Other material classifications made in accordance with the provisions of IFRS:

1. Leases of land from Israel Lands Administration classified as operating leases, of approximately NIS 224 million at June 30, 2006, were reclassified from the property, plant and equipment item to the deferred expenses item.
2. Materials and spare parts that were stated in a separate item between the current assets item and the property, plant and equipment item were reclassified to property, plant and equipment in the amount of NIS 73 million as at June 30, 2006.
3. Other income, net, was classified under other operating income, net.

l. Restatement

The financial statements as at June 30, 2006, were adjusted by way of restatement in order to retroactively reflect the following changes:

(1) Recording of amortisation of lease payments in respect of land from the Israel Lands Administration over the term of the lease and not as amortised since the establishment of the Company (4%). The effect of this amendment is the addition of approximately NIS 108 million to property, plant and equipment, and of approximately NIS 82 million to the balance of shareholders' equity as at June 30, 2006. The amendment does not have a material effect on the profit for the six- and three-month periods ended June 30, 2006.

(2) Presentation of receipts from interconnect to the cellular networks, that were not stated commencing 2000 as part of the Company's income, 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 effect of this amendment for the six- and three-month periods ended June 30, 2006 is an increase to income and a corresponding increase to operating and general expenses of approximately NIS 400 million and NIS 199 million, respectively.

(3) Amendment of the accounting treatment of the depreciation of property, plant and equipment not used by Pelephone, and the resulting tax implications. The effect of this amendment is to depreciate property, plant and equipment by approximately NIS 265 million, and to reduce the balance of shareholders' equity by approximately NIS 190 million June 30, 2006, as well as to reduce depreciation expenses by approximately NIS 20 million and NIS 10 million and to

NOTE 14 – TRANSITION TO INTERNATIONAL STANDARDS (IFRS) – EXPLANATION (CONTD.)

I. Restatement (Contd.)

increase net profit by approximately NIS 15 and NIS 7 million for the six- and three-month periods ended on June 30, 2006, respectively.

The table below shows the effect of restatement as aforesaid on the comparative numbers according to accepted accounting principles in Israel at June 30, 2006, before the effects of IFRS.

(1) Effect on the consolidated balance sheet

	As previously reported	Effects of restatement	As reported in these financial statements prior to their adjustment to IFRS
	NIS thousand	NIS thousand	NIS thousand
Property, plant and equipment	9,289,159*	(157,192)	9,131,967
Deferred tax assets	484,435	48,431	532,866
Shareholders' equity	7,169,438	(108,761)	7,060,677

* Reclassified

(2) Effect on undesignated retained earnings (deficit)

	As at June 30 2006
	NIS thousand
As previously reported	(802,128)
Effect of restatement	(108,761)
	(910,889)

(3) Effect on net earnings

	For the six-month period ended June 30, 2006	For the three-month period ended June 30, 2006
	NIS thousand	NIS thousand
Net earnings as reported in the past	455,578	230,066
<u>Effect of restatement</u>		
Increase in revenues	400,096	199,096
Decrease in depreciation expenses and amortisation	21,416	12,257
Increase in operating and general expenses	(400,096)	(199,096)
Increase in income tax	(5,589)	(3,162)
Net earnings as reported in these financial statements in the note on adjustment to IFRS	471,405	239,161

NOTE 15 – CONDENSED FINANCIAL STATEMENTS OF PELEPHONE COMMUNICATIONS LTD. D.B.S. SATELLITE SERVICES (1998) LTD., AND BEZEQ INTERNATIONAL LTD.

1. Pelephone Communications Ltd.

A. Balance sheet

	June 30, 2007	June 30, 2006	December 31, 2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**1,726,904**	1,660,715	1,451,006
Non-current assets	**2,401,214**	2,683,403	2,520,473
	4,128,118	4,344,118	3,971,479
Current liabilities	**1,053,611**	1,406,681	1,089,973
Long-term liabilities	**1,251,050**	1,549,234	1,383,859
Total liabilities	**2,304,661**	2,955,915	2,473,832
Shareholders' equity	**1,823,457**	1,388,203	1,497,647
	4,128,118	4,344,118	3,971,479

B. Income statement

	For the six month period ended June 30		For the three month period ended June 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues from services and sales	**2,298,889**	2,185,695	**1,151,456**	1,097,271	4,477,987
Cost of services and sales	**1,603,062**	1,569,114	**794,841**	776,313	3,250,303
Gross profit	**695,827**	616,581	**356,615**	320,958	1,227,684
Sales and marketing expenses	**196,470**	197,109	**94,045**	99,403	417,178
General and administrative expenses	**46,318**	46,024	**22,650**	22,870	110,008
	242,788	243,133	**116,695**	122,273	527,186
Operating income	**453,039**	373,448	**239,920**	198,685	700,498
Financing expenses, net	**253**	35,084	**8,132**	32,232	17,687
Earnings before income tax	**452,786**	338,364	**231,788**	166,453	682,811
Income tax	**125,591**	87,774	**58,677**	42,133	196,910
Net earnings	**327,195**	250,590	**173,111**	124,320	485,901

NOTE 15 – CONDENSED 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

	June 30, 2007	June 30, 2006	December 31, 2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**377,011**	366,532	338,662
Non-current assets	**669,196**	725,635	679,783*
	1,046,207	1,092,167	1,018,445
Current liabilities	**1,972,415**	1,993,067	1,889,416
Long-term liabilities	**2,047,392**	1,822,367	1,989,685*
Total liabilities	**4,019,807**	3,815,434	3,879,101
Equity capital	**(2,973,600)**	(2,723,267)	(2,860,656)
	1,046,207	1,092,167	1,018,445

* Reclassified

B. Income statement

	For the six month period ended June 30		For the three month period ended June 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues	**707,866**	669,622	**354,280**	337,576	1,355,735
Cost of income	**535,048**	563,343	**265,312**	280,818	1,139,308
Gross profit	**172,818**	106,279	**88,968**	56,758	216,427
Sales and marketing expenses	**67,564**	60,269	**32,848**	27,779	122,996
General and administrative expenses	**49,585**	43,870*	**24,743**	21,896*	92,398*
Operating earnings	**55,669**	2,140	**31,377**	7,083	1,033
Financing expenses, net	**163,091**	181,456	**90,979**	102,927	318,925
Loss before income tax	**(107,422)**	(179,316)	**(59,602)**	(95,844)	(317,892)
Income tax	**5,522**	1,668*	**5,231**	942*	1,915*
Net loss for the period	**(112,944)**	(180,984)	**(64,833)**	(96,786)	(319,807)

* Reclassified

NOTE 15 – CONDENSED 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

	June 30, 2007	June 30, 2006	December 31, 2006
	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands
Current assets	**429,398**	263,677	332,526
Non-current assets	**426,867**	349,319	340,734
	856,265	612,996	673,260
Current liabilities	**338,459**	235,856	307,724
Long-term liabilities	**45,977**	15,853	15,613
Total liabilities	**384,436**	251,709	323,337
Shareholders' equity	**471,829**	361,287	349,923
	856,265	612,996	673,260

B. Income statement

	For the six month period ended June 30		For the three month period ended June 30		For the year ended December 31
	2007	2006	2007	2006	2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues	**644,212**	496,381	**321,570**	254,848	1,021,573
Operating expenses	**426,711**	319,344	**211,246**	161,765	662,244
Gross profit	**217,501**	177,037	**110,324**	93,083	359,329
Sales and marketing expenses	**67,967**	71,862	**32,589**	37,296	148,594
General and administrative expenses	**46,371**	34,011	**24,660**	17,849	71,806
Other expenses (income), net	**(1,257)**	195	**(520)**	(11)	7,064
Operating income	**104,420**	70,969	**53,595**	37,949	131,865
Financing income (costs), net	**935**	(9,257)	**1,572**	147	(6,965)
Earnings of an associate accounted for by the equity method	**1,644**	4,013	**1,170**	2,389	11,051
Earnings before income tax	**106,999**	65,725	**56,337**	40,485	135,951
Income tax	**(31,033)**	(19,319)	**(16,875)**	(11,723)	(40,391)
Earnings for the period	**75,966**	46,406	**39,462**	28,762	95,560

* The above financial statements are presented solely in accordance with International Financial Reporting Standards (IFRS). In addition, commencing January 1, 2007, the financial statements include the operations of BezeqCall Communications Ltd.

NOTE 16 – MATERIAL EVENTS DURING THE REPORTING PERIOD AND EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

A. On February 27, 2007 the Company's Board of Directors approved the allocation to the Company's executives of 56,836,888 options that are exercisable into 56,836,888 ordinary shares of the Company, par value NIS 1 each, each representing 2.1818% of the Company's issued capital before issue of the shares.

Following an enquiry of the Securities Authority in this matter and the results of the Company's review of the plan approval process, the Company's Board of Directors resolved in March 15, 2007 to have this options plan and the publicized profile in respect of the same cancelled. The Board of Directors intends to work towards the formation of a compensation plan for executives, that will replace the one cancelled.

B. In May – July 2007, the subsidiary Bezeq Zahav (Holdings) Ltd. ("Bezeq Zahav") sold 1,069,900,000 par value of debentures (Series 5) of the Company in private placements and on the Tel Aviv Stock Exchange, out of the debentures (Series 5) it purchased from the Company prior to the publication of the Company's prospectus dated May 24, 2004 ("the Prospectus"), and that had been listed for trading in accordance with the Prospectus and out of the debentures (Series 5) it had purchased from the Company in frame of a private placement in December 2004 (under blocking restrictions by law). The execution prices of the sales ranges between 111.8 and 112.5 (reflecting a yield to redemption of approximately 3.6% - 3.9%).

The proceeds from the said sale, in the approximate amount of NIS 1,199,961 thousand, were transferred to the Company by Bezeq Zahav in (partial) repayment of the loan granted to Bezeq Zahav by the Company for purchasing the Debentures (Series 5), as provided in the loan agreements between the parties.

C. Following an enquiry of the Securities Authority, it was decided to appoint an external examiner to investigate the matter of compensation granted to officers in the Company since the transfer of control in the Company from the State to Ap.Sb.Ar. Holdings Ltd. (including approval of the stock option plan for employees and managers, and approval of grants for officers), and to investigate the matter of restatement in the Group's financial statements as at December 31, 2004 and 2005. On April 26, 2007, the examiner submitted a report detailing the findings of his examination. The report specifies the shortcomings in the Company's work and methods to prevent their recurrence in the future, in respect of all matters examined. The Company's Board of Directors discussed the findings of the reports and resolved, *inter alia*, to work towards implementation of the recommendations and to draw the necessary conclusions, as required by the report. The Board of Directors also approved a joint announcement to the Company and its CEO, stating that the CEO will end his tenure as CEO of the Company, and as of June 26, 2007 Mr Avi Gabbay is the Company's Acting CEO. Decisions were made concerning, *inter alia*, the work procedures of the Board of Directors and the composition of its committees. Further to this, on June 28, 2007 the Company's Board of Directors adopted a new work procedure, that pertains to its meetings and to the manner of their management, as well as to the Board committees, their authorities and their work rules. For details on the matter of contingent liabilities submitted to the Company in respect of the aforementioned, see Notes 8A and 8C.

Further to this, the Board of Directors of the Company discussed and re-approved the grant of bonuses to officers in respect of the years 2005 and 2006.

D. On August 13, 2007, the Board of Directors of the Company resolved to recommend to the general meeting of the shareholders of the Company to pay a cash dividend to the shareholders in the total sum of NIS 760 million (constituting NIS 0.29 per share).

NOTE 17 – DETAILS OF ADDITIONAL MOVEMENTS IN THE SHAREHOLDERS' EQUITY

	Share capital	Premium on shares	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of financial assets available for sale	Capital reserve in respect of option warrants for employees	Balance of deficit	Total	Minority rights in capital deficit of a subsidiary	Total equity
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
	Refers to shareholders of the Company								
Six-month period ended June 30, 2007									
Balance as at January 1, 2007 (audited)	**6,309,133**	**1,623,423**	**384,684**	**630**	**286,506**	**(2,849,381)**	**5,754,995**	**(564,250)**	**5,190,745**
Total earnings (losses) recognised in the period (unaudited)	**-**	**-**	**-**	**2,936**	**-**	**759,842**	**762,778**	**(34,535)**	**728,243**
Dividends to shareholders of the Company which do not comply with the earnings test (unaudited)	**(176,497)**	**(1,623,423)**	**-**	**-**	**-**	**-**	**(1,799,920)**	**-**	**(1,799,920)**
Payments to a former senior officer (Note 9c) (Unaudited)	**-**	**-**	**5,750**	**-**	**-**	**-**	**5,750**	**-**	**5,750**
Balance as at June 30, 2007 (unaudited)	**6,132,636**	**-**	**390,434**	**3,566**	**286,506**	**(2,089,539)**	**4,723,603**	**(598,785)**	**4,124,818**
Six-month period ended June 30, 2006									
Balance as at January 1, 2006 (audited)	6,309,133	1,623,423	384,684	5,253	-	(1,761,971)	6,560,522	(505,280)	6,055,242
Total earnings (losses) recognised for the period (unaudited)	-	-	-	(2,398)	-	602,808	600,410	(36,202)	564,208
Dividends to shareholders of the Company (unaudited)	-	-	-	-	-	(1,200,000)	(1,200,000)	-	(1,200,000)
Balance as at June 30, 2006 (unaudited)	6,309,133	1,623,423	384,684	2,855	-	(2,359,163)	5,960,932	(541,482)	5,419,450

* On December 28, 2006, the general assembly of the shareholders of the Company approved the proposal of the Board of Directors regarding allocation of a cash dividend of approximately NIS 1.8 billion (at NIS 0.69 per share) as a dividend which does not meet the income test. On February 4, 2007 a court approved the dividend and as such the allocation was carried out on February 26, 2007.

** For the resolutions of the board of directors recommending that the general meeting of shareholders of the Company pay a dividend, see Note 16D.

NOTE 17 – DETAILS OF ADDITIONAL MOVEMENTS IN THE SHAREHOLDERS' EQUITY (CONTD.)

	Share capital	Premium on shares	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of financial assets available for sale	Capital reserve in respect of option warrants for employees	Balance of deficit	Total	Minority rights in capital deficit of a subsidiary	Total equity
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
	Refers to shareholders of the Company								
Three-month period ended June 30, 2007									
Balance as at April 1, 2007 (audited)	**6,132,636**	**-**	**384,684**	**1,325**	**286,506**	**(2,450,631)**	**4,354,520**	**(577,933)**	**3,776,587**
Total earnings (losses) recognised in the period (unaudited)	**-**	**-**	**-**	**2,241**	**-**	**361,092**	**363,333**	**(20,852)**	**342,481**
Payments to a former senior officer (Note 9c) (Unaudited)	**-**	**-**	**5,750**	**-**	**-**	**-**	**5,750**	**-**	**5,750**
Balance as at June 30, 2007 (unaudited)	**6,132,636**	**-**	**390,434**	**3,566**	**286,506**	**(2,089,539)**	**4,723,603**	**(598,785)**	**4,124,818**
Three-month period ended June 30, 2006									
Balance as at April 1, 2006 (audited)	6,309,133	1,623,423	384,684	20,922	-	(2,647,869)	5,690,293	(521,320)	5,168,973
Total earnings (losses) recognised for the period (unaudited)	-	-	-	(18,067)	-	288,706	270,639	(20,162)	250,477
Balance as at June 30, 2006 (unaudited)	6,309,133	1,623,423	384,684	2,855	-	(2,359,163)	5,960,932	(541,482)	5,419,450

NOTE 17 – DETAILS OF ADDITIONAL MOVEMENTS IN THE SHAREHOLDERS' EQUITY (CONTD.)

	Share capital	Premium on shares	Capital reserve in respect of a transaction between a corporation and a controlling shareholder	Capital reserve in respect of financial assets available for sale	Capital reserve in respect of option warrants for employees	Balance of deficit	Total	Minority rights	Total equity
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
	Refers to shareholders of the Company								
The year ended December 31, 2006									
Balance as at January 1, 2006 (audited)	6,309,133	1,623,423	384,684	5,253	-	(1,761,971)	6,560,522	(505,280)	6,055,242
Total earnings (losses) recognised for the period (audited)	-	-	-	(4,623)	-	812,590	807,967	(58,970)	748,997
Dividends to shareholders of the Company (audited)	-	-	-	-	-	(1,900,000)	(1,900,000)	-	(1,900,000)
Share-based payments made by the Company (audited)	-	-	-	-	286,506	-	286,506	-	286,506
Balance as at December 31, 2006 (audited)	6,309,133	1,623,423	384,684	630	286,506	(2,849,381)	5,754,995	(564,250)	5,190,745