23 November, 1999

Directors' Report on the state of the Company's affairs for the nine months ended September 30, 1999

We are pleased to present the Directors' Report for "Bezeq" - The Israel Telecommunication Corp. Limited (hereinafter: "the Company") and the consolidated Group companies (hereinafter collectively referred to as "the Group") for the nine months ended September 30, 1999 (hereinafter: "the Directors' Report"). The report was prepared in accordance with the Securities Regulations (Periodic and immediate reports), 5730-1970 and the Securities Regulations (Rules for reporting on preparations for solving the Y2K bug problem) (Temporary Order), 5759-1998.

The Directors' Report contains a review of its subject matter in condensed form, and has been prepared assuming that the reader also has access to the Directors' Report of December 31, 1998.

The financial data in the Directors' Report are presented in adjusted shekels of September 1999.

1. The Company and its Business Environment

During and immediately following the period of the Directors' Report, several events and changes occurred in the Group's affairs and its business environment, the most noteworthy of which are described below:

a) In February 1999, as part of the Arrangements Law, the Law for Cancellation of Section 50 of the Telecommunications Law, 5742-1982 was approved. Section 50 grants the Company exclusivity in providing national telecommunications services in a nationwide network of telephones under the general license. The cancellation took effect on June 1, 1999; however, the activities of the new operators in domestic mobile telecommunications will become possible only from the date on which the Ministry of Communications grants them a general license. As at the date of this Report, no such license has been granted and the provision of nationwide mobile telecommunications services by new competitors has not yet commenced. On August 22, 1999, the government adopted two decisions, both of which concern acceleration and increase of the competition in domestic communications during 1999 and in personal mobile communications during the year 2000. On October 19, 1999, the Ministerial Committee for Legislation concerning the Arrangements Law, approved amendment to the Telecommunications Law as part of the steps taken full opening of the domestic market to competition. Within the framework of the amendment, the Minister of Communications was granted authority in certain matters, such as cross-ownerships, reciprocal relations, numbering plans and the imposition of financial sanctions on licensees.

   The anticipated opening of domestic communications services to competition, in addition to the growing competition in the cellular field and the field of international communications, are expected to cause a significant decrease in the Company's business results, which cannot be estimated at this stage.

b) The Ministry of Communications notified the Company that the Ministers of Communications and Finance had decided to adopt the recommendations of the committee for the arrangement of the Company's tariffs with certain amendments. On March 22, 1999 the Ministry of Communications sent a revised notice which superseded the earlier one. As a result, on March 22, 1999 the Knesset Finance Committee approved the Telecommunications Regulations (Payments for the telecommunications services listed in the addendum to the law), 5759-1999, and the Telecommunications Regulations (Method of calculation of payments for telecommunications services and the linkage thereof), 5759-1999.

   The principal recommendations and their amendments, as well as the Company's reservations in their regard and the approval of the regulations by the Finance Committee are described in Note 1B to the financial statements.

   Pursuant to the Regulations, on April 1, 1999 the Company's tariffs were reduced by an average 8%. This has led to a significant decrease in the Company's business results.

c) As part of the program for efficiency and restructuring of the Company, the employee retirement program is continuing. The number of employees expected to retire within the framework of this program is higher than the Company's forecasts during its preparation, and is about 2,050 employees rather than 1,800. In fact, approximately 1,680 employees actually retired between January 1998 and September 30, 1999, and the remainder are expected to retire by the end of 1999. The financial statements include a provision of NIS 110 million for the adjustment of the expected cost of the up-to-date retirement data.

The results of the organizational change continue to be reflected in the Company's salary costs during the period.

Following the adoption of the recommendations of the committee for arrangement of the Company's tariffs by the Ministers of Finance and Communications, on March 4, 1999 the Board of Directors directed the Company's Management to present to the Board within 90 days, a proposed plan for preparation of the Company in view of the adoption of the recommendations of the committee. Management believes that implementation of an effective program in this context will require further change in the organizational structure of the Company, one of which will be a further reduction of the Company's workforce by means of a new retirement plan.

The Company is currently working to prepare a plan which is based on a significant change in its organizational and functional perception, in a format similar to the change already made in several similar companies in the telecommunications arena upon their transition to functioning in a competitive environment. Preparation of the plan is a complex process that is likely to continue for several months. Its completion is expected to be further delayed, among other things, due to the replacement of the Company CEO, who received the approval of the Company's Board of Directors to prepare a program by the end of February 2000. As at the Report date the Company does not yet have a substantiated estimate of the program's possible cost.

Against this backdrop and owing to the need for a preliminary estimate of the extent of the costs of the Company's preparation, Company Management has formulated a plan which is based on a number of changes which it believes can be implemented as part of its existing organizational and functional framework. This plan indicates a need for the retirement of approximately 530 employees, and the Company has recorded a provision of approximately NIS 277 million in its financial statements, which is the estimated cost of this retirement plan.

It is the Company's intention, if possible and if found viable, to implement the new plan, while the plan for which the provision was created in the financial statements constitutes, at this stage, only an alternative option in case implementation of the new plan proves impossible or is postponed for a considerable time. As mentioned, the cost of the new plan cannot be estimated at this stage, and is likely to differ considerably from the cost of the alternative plan for which the provision was made.

d) Pursuant to an amendment to the licenses of international telecommunications operators from January 17, 1999, these operators will be permitted to connect their subscribers by direct trunk, subject to fulfilling their obligation to pay the Company access fees for the traffic minutes in the direct trunk lines.

On September 26, 1999, the High Court of Justice, with the agreement of the parties, ruled on the manner of allocation of subscribers to the international operators, and in accordance with this ruling, amendments were added to the licenses of the international operators and to the Company's general license. (see Note 1B(2) to the financial statement).

The aforementioned allocation process could have a significant effect on the Company's subsidiary Bezeq International Ltd. ("Bezeq International").

Bezeq International ended the nine-month period ended September 30, 1999 with an operating loss. Based on the assessment of Bezeq International, the Company estimates that following changes in the business environment in which Bezeq International has been operating since the start of the competition, changes may occur in the area of international communications, including, inter alia, in rates, market share and traffic ratio, which may result in a significant decrease in the Group's financial results.

In the year 2000 the international call market will be opened to competition among many, a fact which is liable to change the business environment in which Bezeq International operates, and to have a significant negative influence on the results of its activities.

e) On November 15, 1998, the holder of the "Bezeq" portfolio in the Histadrut announced a collective labor dispute concerning the intention of the Government to cancel Section 50 of the Telecommunications Law, 5742-1982 and to open up domestic telecommunications to competition as well as its intention to adopt the recommendations of the committee for arrangement of the Company's tariffs. In its announcement, the workers' representation is demanding that the Company negotiate a special collective labor agreement which will define the terms of dismissal for those workers likely to be dismissed as a result of the aforesaid and which will put in place certain guarantees to secure the rights of dismissed workers and of those remaining in the Company. The workers' representation is also demanding that a new financial soundness arrangement be negotiated with the State to secure the above.

On March 3, 1999 a new notice was sent by the Histadrut, stating that in view of the Government's announcement of its decision to implement the recommendations of the committee for arrangement of the Company's tariffs, the workers are renewing the labor dispute. On March 16, 1999, the Regional Labor Court issued a back-to-work order and recommended that the parties meet with the authorized Government entity and try to resolve the dispute. Following meetings of representatives of Management, the workers and the Ministers of Communications and Finance, the Minister of Communications issued a letter on March 22, 1999 concerning the Company's tariffs, which contains changes in the rates of the efficiency factor compared with the rates which were determined in the committee's recommendations. No agreement has yet been formulated with regard to the terms of dismissal and the securing of the rights of dismissed workers.

f) On May 12, 1999 the General Meeting of the Company's Shareholders resolved to approve changes in the Bylaws of the Company in the format proposed by the State, some of which are effective immediately and some of which will take effect upon reduction of the State's holding in the Company to 50% or less. The principal changes which took immediate effect concern a change in the method of appointment of directors to that of election at the General Meeting by a 60% majority of the votes of the shareholders who are present and vote (excluding abstentions). Prior to this amendment, the right to appoint a director existed for a holding of 7% of the share capital of the Company. Among the other changes in the Bylaws which will take effect upon reduction of the State's holding to 50% or less, are provisions which will continue to require the Company to obtain Government approval for certain material resolutions, and to apply conditions of qualification to the Chairman of the Board and the CEO, and methods of their appointment in accordance with the Government Companies Law. The result of the said provisions is that the Government will continue to control the Company even after a decline in the State's holding to 50% or less so long as the State holds 10% or more of the Company's share capital, unless another entity controls the Company, pursuant to approval in accordance with the Telecommunications Order. For the decision of the Ministers Committee for Privatization regarding the possible sale of a controlling interest in the Company, see Note 1B(5) to the financial statements.

The resolution of the General Meeting on the changes to the Articles of Association as described above, was adopted as a result of the decisions of the Ministerial Committee for Privatization from August 4, 1998 and January 1, 1999, made as part of the Company's public offering proceedings which were supposed to result in a reduction of the State's holding in the Company to not less than 40% of the Company's share capital. In April 1999 the Company submitted a draft prospectus to the Securities Authority, for an offering of Company securities to the public. The issue proceedings were postponed at that stage, following a decision of the Attorney General from May 13, 1999, whereby the offering cannot be implemented before clarification of the dispute between the Israel Lands Administration and the Company concerning the Company's rights in some of the real estate assets which were transferred to it as part of the asset transfer agreement from 1984. (Regarding the continuing privatization of the Company, see Note 1B to the financial statements, and regarding the dispute with the Israel Lands Administration, see Note 4B to the financial statements.)

g) In October 1998, the third cellular operator commenced partial provision of services. The entry of this operator, and the fact that it will use a different telecommunication technology (GSM), has increased competition in the telecommunications market in general, and in cellular communications in particular. The entry of additional cellular operators pursuant to the Government decision of August 22, 1999 is also expected to intensify competition in this field (see (a) above). In the fourth quarter of 1998, Pelephone Communications Ltd. ("Pelephone") introduced commercial operation of infrastructure which operates with CDMA digital technology. The operation of this system led to a decline in Pelephone's operating profit in the fourth quarter of 1998 and even more significantly so in the nine-month period ended on September 30, 1999. The growing competition in this sector, the erosion of Pelephone's rates, the future influence of the reduction of capitalizing costs in respect of the subscribers acquisition as described in Note 2B to the financial statements, as well as the ongoing commercial operation and expansion of the CDMA system, are expected to continue to have a detrimental effect on Pelephone's profitability.

An additional factor having a negative effect on Pelephone's profitability in the first nine months of 1999, was the perpetration of fraudulent acts by "cloning" subscribers' numbers in the analog network. Pelephone took steps to minimize and prevent this phenomenon. Following completion of most of these steps during the third quarter of the year, its management expects a significant decline in the scope of the fraud and its effect on earnings in subsequent report periods.
Due to the cumulative effect of all the factors described above, Pelephone ended the third quarter of 1999 with a loss from ordinary operations.

h) In January 1999, D.B.S. Satellite Services (1998) Ltd. ("DBS"), in which the Company has a right to approximately 30% of the issued and paid-up share capital, received a license for satellite television broadcasts in consideration of NIS 30 million and the presentation of a guarantee in the amount of NIS 30 million. DBS foresees considerable losses and negative cash flow from activities in the first years of operation. In September 1999 the Board of Directors of the Company approved an increase in the Company's exposure as a result of updating the DBS business plan, subject to certain conditions, including the approval of the Government. At the end of October 1999, DBS notified the Company that as a result of changes in the regulatory environment within which DBS operates, DBS is reconsidering its strategy and consequently is also re-examining the business plan. The Company believes that this re-examination could lead to additional significant changes in the business plan. The Company's investments in DBS according to an updated business plan, which the Company has requested be submitted to it, are subject to the approval of its Board of Directors and of the Government.

i) On May 12, 1999, the Board of Directors of the Company decided to adopt the recommendations of Management, which were based on the report of a firm of outside consultants, concerning recommendations for a change in the depreciation policy and the depreciation rates for the Company's assets. For details of this decision, see Note 4A to the financial statements.

j) As part of the implementation of the Company's strategic plan, including the intention to expand the Company's activities in Internet and broadband communications, in July 1999 the Company entered into two transactions. In the first, the Company will purchase, in consideration of $1.6 million, 28% (26% at full dilution) of the share capital of Infogate Online Ltd. ("Infogate"), with an option to increase its holdings up to 45%. Infogate focuses mainly on the development and provision of data processing services in ASP concept, whereby computers are linked in a broadband network to a central server from which they receive various services. All the competent authorities have approved this transaction. In the second transaction, the Company received, free of charge, two option warrants: one enabling it to purchase 26% of the issued and paid up share capital of Walla! Communications Ltd. ("Walla") in consideration of NIS 24.6 million, and the other enabling it to purchase additional shares of Walla which will constitute, together with the shares underlying the first option, 50% of Walla's share capital, in consideration of an additional NIS 51.8 million. Walla provides Internet services, mainly the operation of a portal to the Internet, and builds, develops and hosts Internet sites. This transaction has been approved by the competent authorities with a number of reservations and restrictions, in light of which the Company is currently re-examining the viability of exercising the options.

k) In October 1999 the Group, a group headed by Bezeq International committed with another group in a document of principles, for receipt of rights in an international consortium that is being formed for the purpose of laying and operating a global network of optical communications cables. The overall scope of the investment in the consortium's capital, at the present stage, amounts to approximately $500 million, of which the two groups will each invest, under conditions to be determined between them, up to $250 million. Completion of the transaction depends on the results of a due diligence process, on material conditions specified in the above document of principles, and on various approvals that have not yet been received. Therefore, despite the parties' intentions, it is not possible to determine, at this stage, that the commitment will crystallize into a transaction.

l) In August 1999 Pelephone purchased 51% of the rights of ownership and control of Safe Car Communication Ltd. The company's main activity focuses on the locating of vehicles.

m) In August 1999 the CEO of the Company gave notice of his decision to end his term of office. In November 1999 the new CEO took office.

2. Financial Position

a. The Group's assets as at September 30, 1999 amount to approximately NIS 17.49 billion, of which NIS 12.94 billion (approximately 74%) are fixed assets.

b. The Group's shareholders' equity as at September 30, 1999 amounted to approximately NIS 7.24 billion, which comprise 41.4% of the total balance sheet, compared with approximately NIS 7.17 billion on September 30, 1998 which comprised approximately 39.3% of the total balance sheet. The increase during the period derived mainly from the increase in retained earnings and from the exercise of option warrants and convertible securities.

c. Total Group debt to financial institutions and to the holders of its debentures as at September 30, 1999 amounted to approximately NIS 7.16 billion compared with approximately NIS 7.94 billion on September 30, 1998.

   The decline in the amount of financial debt derives from a positive cash flow from current operations, of which only part was used for investment activities.

d. The balances of the Group's cash and short-term investments as at September 30, 1999 amounted to approximately NIS 1.33 billion, compared with approximately NIS 1.12 billion on September 30, 1998.

e. The Group's surplus monetary liabilities in US dollars over dollar-linked monetary assets as at September 30, 1999 amounted to approximately NIS 3.2 billion.

   During the report period, the Company carried out forward currency transactions to reduce its exposure, and it intends to continue with this policy.

   As at September 30, 1999, the net balance of dollar liabilities that were not hedged by such forward transactions amounted to approximately NIS 276 million.

f. The Group’s surplus CPI-linked liabilities over linked monetary assets as at September 30, 1999 amounted to approximately NIS 3.8 billion. This exposure is partly covered by a mechanism for updating tariffs, which takes into account price increases in the economy (see Note 1B to the financial statements).

3. Results of Operations

a. Principal results

Net earnings for the first nine months of 1999 amounted to approximately NIS 51.9 million, compared with a net profit of approximately NIS 607.3 the comparative period last year.

Neutralizing the provision for costs of financing the restructuring plan in the amount of NIS 386.8 million (before tax), compared with income of NIS 83.7 million (before tax) in the comparative period last year, net earnings for the first nine months of 1999 amount to approximately NIS 299.4 million, compared with approximately NIS 553.7 million in the comparative period last year.

The decline in the Group's profitability was the result of decrease in the business results of the principal companies in the Group, particularly in the second quarter of the year. This was the result of the reductions in tariffs as noted in the description of the business environment above. This, despite the decrease in salary expenses achieved as a result of the implementation of the employee retirement plan. In addition, the ongoing deterioration in the results of Pelephone Communications Ltd. and Bezeq International Ltd. have led to a deterioration in the consolidated Group's business results.

Earnings per share for the first nine months of 1999 amounted to NIS 0.07 per NIS 1 par value share, compared with earnings of NIS 0.78 per share in the comparative period last year.

b. Revenues

Group revenues for the first nine months of 1999 amounted to approximately NIS 6,720.3 million, compared with approximately NIS 7,060.4 million in the comparative period last year, a decrease of approximately NIS 340.1million. The decline in revenues is mainly the result of the reduction in the Company's tariffs by an average of 8% from April 1, 1999. This was reflected in a decline in revenues from domestic calls, interconnect fees from international and cellular operators, and in an increase in revenues from fixed fees which moderated the overall decline. The decline in the revenues of Bezeq International was mainly the result of lower prices and international accounting rates.

c. Costs and expenses

The Group's operating and general expenses for the first nine months of 1999 amounted to approximately NIS 3,706.2 million, compared with approximately NIS 3,725 million in the comparative period last year, a decrease of approximately NIS 18.8 million. The decrease in operating and general expenses derived from a decline of approximately NIS 209.7 million in salaries expense, owing mainly to the considerable decline in the workforce as a result of the early retirement plan, as a result of assignment, in 1998, of the value of a benefit to employees in respect of an offering and sale of shares by the State, and as a result of a reduced provision for an employee bonus. The decrease was tempered by the increase in salary expenses of Bezeq International and Pelephone. An additional factor is the decline of approximately NIS154.9 million in expenses for international communications, which arose from a change in activity and in accounting fees with international communications operators. This decline was offset by an increase in general expenses and in cellular telephone expenses, deriving mainly from an increase in the operating expenses of Pelephone, marketing expenses and a one-time write-off of NIS 15 million for the cost of purchase of Internet access operations by Bezeq International at the end of 1998, and from the costs involved in adapting information systems to the Year 2000.

Depreciation expense increased during the first nine months of 1999 compared with the comparative period by approximately NIS 143.6 million, mainly as a result of a change in depreciation rates of the Company's assets. (See Note 4A to the financial statements.)

d. Operating income

The Group's operating income for the first nine months half of 1999 amounted to approximately NIS 754.5 million compared with approximately NIS 1,182.6 million in the comparative period last year, a decrease of approximately NIS 428.2 million. The decrease in operating income derived from the changes described above, and its source is the decrease in the business operations of the Group's main companies.

e. Financing expenses

The Group's financing expenses for the first nine months of 1999 amounted to approximately NIS 265.6 million, compared with approximately NIS 273.3 million in the comparative period last year, a decrease of NIS 7.7 million.

A decrease occurred in interest payments during the Report period, owing to the significant decrease in the Group's total interest-bearing debt, and the Group's income increased from its investments in shekel deposits. In contrast, the Group's net expense during the Report period increased owing to hedging transactions against dollar-denominated liabilities, as a result of the material differential created between the interest premium included in transaction costing and the change in the Consumer Price Index. In addition, there was also a decrease in income from the erosion of the Group's liabilities linked to the Consumer Price Index, as a result of the differences between the "known index" and "index in respect of the balance sheet month" compared to the comparative period last year.

f. Other income (expense)

In the first nine months of 1999, a provision of NIS 386.8 million was included for the restructuring plan, compared with the first nine months of 1998, which included a reduction of a provision of approximately NIS 83.7 million (see Note 6 to the financial statements).

4. Liquidity and sources of financing

Consolidated cash flows generated by operating activities during the first nine months of 1999 amounted to approximately NIS 1,917.3 million, compared with approximately NIS 2,142.7 million in the comparative period last year. The decrease in cash flows derived mainly from a decline in net earnings, an increase in inventory and a decline in current liabilities and trade receivables. The decline was partially offset by a decline in the balance of customers and in payments for early retirement, compared with the corresponding period last year. Cash flows generated by operating activities are the Group's principal source of financing, and are earmarked mainly for financing investments in developing communications infrastructures, which amounted to approximately NIS 1,102.95 million, and for investments in investee companies and other assets. Most of the remaining cash flow was used during the report period to reduce the Group's financial debt - in the first nine months of 1999, long-term loans of approximately NIS 688.0 million were repaid, as well as NIS 189.1 million of debentures and NIS 702.5 million in a debenture given to the State, for a total of approximately NIS 1,579.6 million. On the other hand, the Group received long-term loans in a total amount of approximately NIS 466.5 million, issued debentures for approximately NIS 260.9 million, and received short-term bank credit of approximately NIS 206.6 million, and in total, approximately NIS 934.0 million were raised. The monthly average short-term credit for the period was approximately NIS 130 million. The monthly average long-term liabilities for the period was approximately NIS 7.4 billion.

Working capital as at September 30, 1999 was negative and amounted to approximately NIS 1,645.2 million, compared with approximately NIS 1,587.2 million at September 30, 1998. The improvement in the Group's working capital is material. It derived mainly from a decrease in current liabilities, primarily due to employee severance benefits as a result of implementation of the restructuring plan and the decrease in trade receivables, other current liabilities, and current maturity of the debenture issued to the Government. The negative working capital does not restrict the Group in its activities, since the cycle of collection of revenues from customers is short.

5. Comparison of the results of the third quarter of 1999 with those of the third quarter of 1998

Revenues in the third quarter of 1999 declined by approximately NIS 183.6 million compared with the corresponding quarter in 1998, a decline of 7.5%. Operating and general expenses increased compared with the corresponding quarter last year by approximately NIS 40.4 million (about 3.3%) as a result of the increased operating expenses of the Group's investee companies.
Depreciation expenses in the third quarter of 1999 increased by approximately NIS 44.5 million, which are approximately 7%.

The decrease in revenues together with the rise in costs and expenses, caused a decline in operating profit in the quarter in the amount of NIS 254 million compared with the corresponding quarter last year - which derived mainly from the decline in operating profits of the Group's principal companies.

Financing expenses in the third quarter of 1999 decreased by approximately NIS 24.3 million compared with the corresponding quarter last year. The behavior of the revenues and expense items and the causes for the change were as explained in the results for the first nine months.

The third quarter of 1999 included a provision of NIS 110 million in order to adjust the anticipated cost of the present employee retirement plan to the updated retirement data.

The changes described above in the Statement of Operations items, led to net earnings of approximately NIS 9.5 million in the third quarter of 1999, compared with approximately NIS 240.4 million in the corresponding quarter last year, a decline of NIS 230.8 million. Neutralizing the provision for reorganization which was recorded in the second quarter of last year, shows a decline of NIS 79.9 million.

6. Effect of external factors

a. On June 30, 1998 the Company's general license was amended and stipulated an arrangement forbidding the Company from appointing one of its employees as a director in a subsidiary, if within his capacity he is likely to have access to "commercial information" (as defined in the amendment to the license) concerning the licensees who are in competition with that subsidiary, where the use of such information by the subsidiary is liable to harm the competition between them. The amendment also froze for one year the provision which limits the Company in the appointment of both the Chairman of the Board of its subsidiary and of most of the directors of the subsidiary who are appointed to represent the Company from among the directors or the employees of the Company. The Company approached the Ministry of Communications and requested cancellation of the above restriction or alternatively, extension of the period of the freeze for an additional period. On May 6, 1999 the Company's general license was amended to extend the freeze period until June 30, 2000.

   On the same date, an additional amendment was inserted in the Company's general license, dealing, inter alia, with the compliance with the provisions for providing telecommunications services to the security forces: installation of facilities, telecommunications activities including access to a facility, compliance with the directives of the General Security Services or Israel Police regarding the security classification of Company officers who are exposed to classified information for reasons of State security or the public peace. Under the amendment, payment to the Company will be determined in agreement, based on reasonable expenses and taking into account the current price for the service, if any. In the absence of agreement - the payment will be determined by an appointee of the Attorney General, with the consent of the parties to the extent possible. On October 18, 1999 the Knesset approved an amendment to Section 13 of the Telecommunications Law, whose main points are similar to the above amendment to the Company's license.

b. Regarding additional amendments to the general license of the Company and relevant legislation, see the section "Business Environment" above.

c. In September 1999, a hearing was held in the matter of Globecall's application that the High Court of Justice issue writs regarding the determination of ownership of customer premises equipment infrastructures, the Company's (alleged) duty to transfer these infrastructures to others, and the determination of prices to be paid to the Company for the transfer of these infrastructures. The parties agreed, with the approval of the High Court of Justice, to the appointment of a financial expert who would determine the price for the transfer of infrastructures from Bezeq to customers. The parties reached agreement on the identity of the expert and are now negotiating the text of an agreed letter of appointment. At this stage, the interlocutory injunction given in the petition, which prevents the transfer of the customer premises equipment infrastructures, is still in force.

7. **Distribution of dividend** - The Board of Directors of the Company approved, at the time of approval of the financial statements, the distribution of an interim dividend to the shareholders for 1998, in the total amount of NIS 301,565 thousand, which are, at the time of the decision, 38.53 agorot per share.

8. **Details of preparation plans for solving the Y2K (Year 2000) problem** - in accordance with Regulation 2 of the Securities Regulations (Rules for reporting on preparation for solving Y2K bug problems) (Temporary Order), 5759-1998.

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

Israel Tapoohi Chairman of the Board	Ilan Biran CEO

Pursuant to Regulation 2 of the Securities Regulations (Rules for reporting on preparation for solving Y2K bug problems) (Temporary Order), 5759-1998, below are details of the Company's preparation for solving the Y2K (Year 2000) problem[(1) (2)]

1. **Details of preparation plans for solving the Y2K problem**

   a. No change.

   b. The Group has identified the critical systems.

   c.+d. Operation of the Group's computer systems and computer-integrated systems is carried out by the Group, except for the salaries system of the Company and of an associated company, which are operated by outside suppliers. The companies have maintained contact with these suppliers to ascertain their readiness for the year 2000.

   e.+f. No change.

   g. Not relevant.

   h. No change.

2. **Cost of preparation for solving the Y2K problem**

   Below are details of the investments in preparation for solving the Y2K problem, per fiscal year:

Fiscal year	Have costs or budgets been earmarked	Activities included in planned costs	Amounts, in NIS millions
1998	Yes	Advisory services, systems conversion and adaptation	38
1999	Yes	Advisory services, systems conversion and adaptation, acceleration of investments, integration tests and preparation of contingency plans	206[(3)]
2000	No (at this stage)	---	---

   In addition to the above, other indirect costs exist relating mainly to inputs of staff engaged in conversion work.

   As at the report date, the Company does not expect to exceed the planned investment budget.

3. **Human resources involved in the preparation**

   No change.

(1) This report refers to the Company and its affiliated companies, that are preparing individually for the solution to the Y2K problem.

(2) The changes described in this report are as compared with the Directors Report of December 31, 1998.

(3) The previous Directors' report, reported investments for 1999 in the amount of NIS 221 million, compared with NIS 206 million in this report, a decrease that reflects the updating of investment forecasts for this year, compared with the investments which were forecast at the beginning and found expression in the previous report.

4. **Outside professional assistance**

The Group's companies have hired external professional help - each the type of help it required - including for the following: evaluation of the problem, performing system repairs, replacement of systems, internal control, training, supplier evaluation, examination of communication systems for third parties, project management, preparation and implementation of compliance tests and performance of adaptation verification.

5. **Progress assessment**

a. Method of assessing progress of preparation

(1) No change.

(2) No change.

(3) The internal audit units of the Group's companies are also monitoring the progress of the preparation, as are the outside consultants appointed by some of the Group's companies. On August 10, 1999 the Office of the State Comptroller published a report on the Company's preparations for the Y2K computer problem. The report referred to a number of faults which the Company is acting to correct.

b. No change.

6. **Timetable**

In most cases, the Company and its subsidiary companies are each adhering to the timetables they have set themselves for the solution to Y2K. The Company has completed the adaptation and examination of its main systems, but changes have occurred in the timetable for completion of a number of systems, since some of the suppliers are not adhering to the timetables set by the Company. No damage is anticipated to any of the services provided by the Company to its customers, as the Company has prepared programs for the supply of services in case the adaptation of the aforesaid systems will not be completed during the fourth quarter of 1999.

7. **Contingency plans**

The companies of the Group are in the process of preparing contingency plans for the Y2K bug problem, which some have already completed. These plans relate to the possibility of uninterrupted provision of vital services to the Company's customers, the activities of the companies on the transition date to the year 2000, and plans in the event of non-provision of vital services to the Company by other suppliers (such as electricity, fuel, etc.). The contingency plans have not yet been finally formulated. Failure in one of the main operating systems of the Company is liable to prevent it from continuing to provide services.

The Company has set up a central body to formulate the emergency plans. As at the date of signing of this report, the Company has run three extensive drills in which its readiness and preparations for the transition dates were examined.

The emergency plans, both the ones already completed and those currently in preparation cannot prevent disruptions which might to be caused to the Company owing to the interruption of operation of one or more of the Company's main systems.

8. **Third party systems**

No change.

9. Additional information

Note 7B to the financial statements contains additional reference on this subject.

The Group cannot guarantee that all aspects of the Y2K problem which affect the Group, including and in particular those which relate to its readiness for the Year 2000 of its customers, suppliers and other outside entities, including infrastructure suppliers, whose activity influences the companies, will be fully solved. Failure to complete the conversion on time and in a suitable manner is liable to cause disruptions in the operation of the information systems and communications systems of the Group, damage to its current operations and damage to essential systems - to the point of halting its operations, loss of revenues and even monetary claims against it. Furthermore, completion of the deployment and adaptation of all the Group's systems for the Year 2000 on time, does not guarantee that the Y2K issue will not cause damages as aforesaid.