"BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED

DECEMBER 31, 2007

The information contained in these financial statements constitutes a translation of the annual report published by the Company. The Hebrew version was submitted by the Company to the relevant authorities pursuant to Israeli law, and represents the binding version and the only one having legal effect. This translation was prepared for convenience purposes only.

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

We have audited the consolidated balance sheets of "Bezeq" The Israel Telecommunication Corp. Limited (the Company) as at December 31, 2007 and 2006, and the related statements of income, statements of recognised income and expense and cash flows, consolidated, for each of the three years ended on December 31, 2007. These financial statements are the responsibility of the Company's Board of Directors and its Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of companies which were consolidated, whose assets included in the consolidation constitute approximately 6% of the total consolidated assets at December 31, 2006 and whose revenues included in the consolidation constitute approximately 11% and approximately 10% of the total consolidated revenues for the years ended December 31, 2006 and 2005, respectively. Furthermore, we did not audit the financial statements of associates in which the investment was approximately NIS 37 million and approximately NIS 32 million as at December 31, 2007 and 2006, respectively, and the Group's equity in their profits (losses) is approximately NIS 6 million, approximately NIS 11 million and approximately NIS (3) million, for the years ended December 31, 2007, 2006 and 2005, respectively. The financial statements of those aforementioned consolidated companies and associates were audited by other auditors whose reports thereon were furnished to us and our opinion, insofar as it relates to amounts emanating from the financial statements of those companies, is based solely on the said reports of the other auditors.

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

Somekh Chaikin, a partnership registered under the Israeli Partnership Ordinance, is the Israeli member firm of KPMG International, a Swiss cooperative.

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

In our opinion, based on our audits and on the reports of the other auditors noted above, the financial statements referred to above present fairly in accordance with International Financial Reporting Standards (IFRSs), in all material respects, the financial position as at December 31, 2007 and 2006 and the results of operations, recognised income and expenses and cash flows for each of the three years ended December 31, 2007. Furthermore, in our opinion, the financial statements referred to above are prepared in accordance with the Securities Regulations (Preparation of annual financial statements), 1993.

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

1. The intensifying competition, the entirety of changes in the communications market, and the effects of regulation on the Group's financial position and operating results, as described in Note 1.

2. Contingent claims made against the Group of which the exposure cannot yet be assessed or calculated, and other contingencies as described in Notes 17B and 17C.

3. The financial position of a subsidiary, as mentioned in Note 33(3). The subsidiary, as at the date of the financial statements, is not in compliance with the financial stipulations determined in the financing agreement. Subsequent to the balance sheet date the subsidiary is in compliance with the financial criteria at December 31, 2007, subsequent to a relief received from the banks at the same date. The Company has requested the banks to update the stipulations for 2008 in order that they reflect the subsidiary's budget. At the date of approval of the financial statements the banks have approved the subsidiary's request, that the stipulations be updated for 2008. The continuation of the subsidiary's activities is dependent on, inter alia, compliance with the stipulations determined in respect of 2008 and/or further reliefs which will be received during the year. In the opinion of the management of the subsidiary, the sources of finance available to it will be sufficient for the subsidiary's operating requirements for the forthcoming year, this being in accordance with the cash flow forecast approved by the subsidiary's board of directors.

Somekh Chaikin
Certified Public Accountants

March 10, 2008

Consolidated Balance Sheets at December 31

	Note	2007 NIS millions	2006 NIS millions
Assets			
Cash and cash equivalents	5	**1,203**	2,632
Investments and loans, including derivatives	6	**389**	961
Trade receivables	7	**2,403**	2,065*
Other receivables	7	**247**	251
Inventory	3J	**203**	205
Broadcasting rights	3F	**243**	169
Current tax assets		**11**	11
Assets classified as held for sale		**17**	-
Total current assets		**4,716**	6,294
Trade and other receivables	7	**535**	463*
Investments and loans, including derivatives	6	**233**	342
Property, plant and equipment	9	**6,064**	6,492
Intangible assets	10	**2,526**	2,554
Deferred and other expenses	11	**367**	374
Investments in associates accounted by the equity method	12	**37**	32
Deferred tax assets	8	**678**	994
Total non-current assets		**10,440**	11,251
Total assets	28	**15,156**	17,545

	Note	2007 NIS millions	2006 NIS millions
Liabilities			
Loans and borrowings	13	**1,913**	3,637
Trade payables	14	**1,533**	1,393
Other payables, including derivatives	14	**745**	803
Current tax liabilities		**57**	122
Deferred income		**47**	58
Provisions	15	**392**	289
Employee benefits	16	**705**	906
Proposed dividend		**-**	300
Total current liabilities		**5,392**	7,508
Debentures	13	**4,420**	3,170
Obligations to banks	13	**307**	481
Loans from others	13	**136**	169
Loans provided by the minority in a subsidiary	13	**375**	564
Employee benefits	16	**261**	373
Deferred income and others		**36**	37
Provisions	15	**57**	52
Total non-current liabilities		**5,592**	4,846
Total liabilities	28	**10,984**	12,354
Shareholders' equity	20		
Share capital		**6,132**	6,309
Share premium		**-**	1,623
Reserves		**681**	672
Deficit balance		**(2,268)**	(2,849)
Total equity attributable to shareholders of the Company		**4,545**	5,755
Minority equity		**(373)**	(564)
Total shareholders' equity		**4,172**	5,191
Total shareholders' equity and liabilities		**15,156**	17,545

* See Note 3T.

Shlomo Rodav Chairman of the Board	**Avi Gabbay** President & CEO	**Alan Gelman** CFO and Deputy CEO

Date of approval of the financial statements: March 10, 2008.

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

Consolidated Statements of Income for the Year Ended December 31

	Note	2007 NIS millions	2006 NIS millions	2005 NIS millions
Revenue	21	**12,400**	12,232	**11,925**
Costs and expenses				
Depreciation and amortisation	9,10,11	**1,769**	1,864	1,934
Wages	22	**2,375**	2,586	2,586
Operating and general expenses	23	**5,841**	5,967	5,978
Other operating expenses (income), net	24	**79**	250	(100)
		10,064	10,667	10,398
Operating income	28	**2,336**	1,565	1,527
Finance costs	25			
Finance expenses		**796**	694	805
Finance income		**(487)**	(356)	(433)
Finance expenses, net		**309**	338	372
Profit after finance expenses		**2,027**	1,227	1,155
Equity in profits (losses) of associates accounted by the equity method	12	**6**	11	(3)
Profit before income tax		**2,033**	1,238	1,152
Income tax	8	**672**	488	532
Profit for the year		**1,361**	750	620
Attributable to:				
The shareholders' of the Company		**1,330**	809	666
Minority interest		**31**	(59)	(46)
Profit for the year		**1,361**	750	620
Earnings per share	27			
Basic earnings per share (in NIS)		**0.51**	0.31	0.26
Diluted earnings per share (in NIS)		**0.50**	0.31	0.26

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

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

	Note	2007 NIS millions	2006 NIS millions	2005 NIS millions
Net change in fair value of available-for-sale financial assets	6, 25	**4**	(1)	1
Net change in fair value of available-for-sale financial assets transferred to profit or loss	6, 25	**-**	(5)	(105)
Defined benefit plan actuarial gains (losses)	16	**14**	3	(15)
Income tax on income and expense recognised directly in equity	8	**(4)**	2	41
Income and expenses recognised directly in equity		**14**	(1)	(78)
Profit for the year		**1,361**	750	620
Total recognised income and expense		**1,375**	749	542
Attributable to:				
Shareholders of the Company		**1,344**	808	588
Minority interest		**31**	(59)	(46)
Total recognised income and expense		**1,375**	749	542

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

Consolidated Statements of Cash Flows for the Year Ended December 31

	Note	2007 NIS millions	2006 NIS millions	2005 NIS millions
Cash flows from operating activities				
Net profit for the year		**1,361**	750	620
Adjustments:				
Depreciation	9	**1,482**	1,591	1,666
Amortisation of intangible assets	10	**270**	248	241
Amortisation of deferred and other charges	11	**17**	25	27
Loss (gain) from decrease in holdings in associates accounted by the equity method	12	**1**	(1)	(1)
Share in losses (profits) of associates accounted by the equity method	12	**(6)**	(11)	3
Net financing costs	25	**372**	512*	408*
Net capital gain	24	**(88)**	(159)	(9)
Share-based payment transactions	26	**-**	287	346
Payments to a former senior officer		**6**	-	-
Income tax expenses	8	**672**	488	532
Payment for the removal of derivative financial instruments, net		**(9)**	(27)*	(3)*
Change in inventory		**(6)**	23	78
Change in trade receivables	7	**(437)**	109	(57)
Change in other receivables	7	**4**	(108)	(16)
Change in other payables	14	**(18)**	(14)*	41*
Change in suppliers	14	**36**	(79)	(106)
Change in provisions	15	**105**	27	8
Change in broadcasting rights		**(74)**	(15)	(14)
Change in employee benefits	16	**(300)**	169	(404)
Change in deferred and other income		**(11)**	1*	(13)
		3,377	3,816	3,347
Interest received		**116**	220	177
Dividend received		**3**	26	-
Income tax paid		**(430)**	(277)	(332)
Net cash from operating activities		**3,066**	3,785	3,192
Cash flows from investment activities				
Investment in intangible assets and in deferred expenses	10	**(273)**	(210)	(224)
Proceeds from sale of property, plant and equipment and deferred expenses		**177**	48	21
Investment in financial assets available for sale		**-**	-*	(16)
Financial assets held for trade, net		**647**	1,491	(903)
Purchase of property, plant and equipment	9	**(973)**	(953)	(1,477)
Investment in associates including by way of loans	12	**-**	-	(9)
Proceeds from sale of investments and long-term loans		**66**	63	96
Purchase of investments and long-term loans		**(8)**	(20)*	(4)
Net cash from (used for) investment activities		**(364)**	419	(2,516)

* See Note 3T.

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

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

	Note	2007 NIS millions	2006 NIS millions	2005 NIS millions
Cash flows from financing activities				
Proceeds from issue of debentures	13	**1,814**	-	1,700
Receipt of loans	13	**50**	50	457
Repayment of debentures	13	**(1,927)**	(280)	(267)
Repayment of loans	13	**(840)**	(1,269)	(1,382)
Short-term credit, net	13	**(37)**	43	30
Dividend paid	20	**(2,860)**	(1,600)	-
Interest paid		**(389)**	(602)	(485)
Receipt (payment) for defraying derivative financial instruments		**77**	(76)*	(30)*
Net cash from (used for) financing activities		**(4,112)**	(3,734)	23
Net increase (decrease) in cash and cash equivalents		**(1,410)**	470	699
Cash and cash equivalents at January 1		**2,632**	2,159	1,457
Effect of fluctuations in the rate of exchange on cash balances		**(19)**	3	3
Cash and cash equivalents at December 31	5	**1,203**	2,632	2,159

* See Note 3T.

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

Consolidated Statements of Cash Flows for the Year Ended December 31 - Appendix

	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Appendix of non-cash activities			
Purchase of property, plant and equipment and other assets on credit	**183**	142	217
Sale of property, plant and equipment on credit	**126**	162	–

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 registered in Israel whose shares are traded on the Tel Aviv Stock Exchange. The official address of the Company is 132 Menachem Begin Road, Tel Aviv. The consolidated financial statements of the Company at December 31, 2007 include those of the Company and of its subsidiaries ("the Group"), as well as the rights of the Group in associates. The Group is a principal provider of communications services in Israel (see also Note 28 – 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 basic telephony; however, at the suggestion of the court (in view of the time elapsed since it was filed), the Company consented to withdraw the appeal. All the segments of operation of the Group are in competition. The activities of the Group are, in general, subject to government regulation and control. It is expected that the intensifying competition together with all the changes in the communications market, will have an adverse effect on the business results of the Group – an effect which the Group is unable to estimate.

C. The Company is subject to various sets of laws that regulate and restrict its business activities, including its tariffs. Arrangements pursuant to Sections 15 – 17 of the Communications Law apply to the Company tariffs on services which are prescribed in regulations which are automatically updated in accordance with a linkage formula less an efficiency factor, all as provided in the regulations and relying on the recommendations of public committees which have a mandate to review the Company's tariffs.

NOTE 2 – BASIS OF PRESENTATION

A. Statement of compliance with International Financial Reporting Standards

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

The Company first adopted IFRSs in 2006, with a transition date of January 1, 2005. The last annual financial statements of the Company prepared in accordance with generally accepted accounting standards in Israel ("Israeli GAAP") were for the year ended December 31, 2005.

B. Definitions

In these financial statements –

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

(2) the Group - Bezeq The Israel Telecommunication Corp. Limited and its investee companies, as listed in Note 33 – List of Group Entities.

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

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

(5) Investee companies – Subsidiaries or associates.

(6) Related parties – As defined in International Accounting Standards 24 – Related Party Disclosures.

(7) Interested parties – As defined in Paragraph (1) of the definition of "Interested Party" in a corporation, in Section 1 of the Securities Law, 5728-1968.

NOTE 2 – BASIS OF PRESENTATION (CONTD.)

C. Basis of measurement

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

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

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

D. Functional currency of operation and presentation currencies

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

E. Activity in hyper-inflationary economic conditions

Until December 31, 2003, Israel was considered a country with a prevailing hyper-inflationary economy, and accordingly, the non-monetary items in the balance sheet (such as property, plant and equipment (except for property, plant and equipment which was assessed according to deemed cost) intangible assets and capital items) were adjusted for changes in the Consumer Price Index ("the Index") up to that date. From that date onwards, the indexed amounts have served as the basis for the reporting in the subsequent periods.

F. Use of estimates and judgment

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

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

Information regarding significant areas where there is uncertainly in estimates and critical judgements in applying accounting policies that have the most significant effect on the amounts presented in the financial statements is included in the following notes:

*Note 3J	-	Inventory
*Note 7	-	Provision for doubtful debts.
*Note 8	-	Utilisation of losses for tax purposes and deferred tax assets and liabilities recognised.
*Note 9	-	Estimated useful life and residual value of items of property, plant and equipment and determining deemed cost.
*Note 10	-	Measurement of recoverable amounts of cash-generating units.
*Notes 15 and 17	-	Provisions and contingent liabilities.
*Note 16	-	Measurement of a defined benefit obligation and employee benefits.
*Note 26	-	Measurement of share-based payments.
*Note 30	-	Financial instruments.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES

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

A. Basis of Consolidation

(1) Subsidiaries

Subsidiaries are entitles controlled by the Group. Control exists when the Group has the ability to control the financial and operating policies of an entity in order to achieve benefits from its operations. In assessing control, potential voting rights that are exercisable by the Group are taken into account (see Note 33(3)(b). The financial statements of the subsidiaries are included in the consolidated financial statements from the date that control is acquired until the date that control ceases.

(2) Special-purpose entity

The Company set up a special-purpose entity (“SPE”) for investment purposes. SPEs are included in consolidation if, based on an assessment of the substance of its relationship with the Group and the SPEs’ risks and rewards, the Group concludes that it controls the SPE. Such an entity controlled by the Group, was established under terms that impose strict limitations on the decision-making powers of the SPE's management and that result in the Group receiving the majority of the benefits related to the SPEs’ operations and to the net assets.

(3) Associates (accounted by the equity method)

Associates are those entities in which the Group has significant influence, but not control, over financial and operating policies. Associates are accounted for using the equity method. The consolidated financial statements include the Group’s share in the results of investee entities, on an equity accounted basis, after adjustments to align the accounting policies with those of the Group, from the date that significant influence commences until the date that significant influence ceases.

(4) Transactions eliminated on consolidation

Intra-group balances and any unrealised income and expenses arising from intra-group transactions are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of the Group’s interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

(5) Minority

The minority shareholders in a consolidated company which has an equity deficit, participated in the losses of that company only up to the amount of the loans of the minority shareholders as presented in the financial statements. The minority interest in the losses of the consolidated company appears as a separate item in equity.

B. Foreign currency transactions

Transactions in foreign currency are translated into the functional currency of the Group at the exchange rate on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies on the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between the amortised cost in the functional currency at the beginning of the period, adjusted for the effective interest and the payments during the period, and the amortised cost in the foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies and measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on the retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale investments.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

C. Financial Instruments

(1) Non-derivative financial instruments

Non-derivative financial instruments comprise investments in equity and debentures, trade and other receivables, cash and cash equivalents, loans and borrowings, trade and other payables, and also debt securities issued by the Group and loans taken out by the Group.

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any attributable direct costs of the transaction. Subsequent to initial recognition, non-derivative financial instruments are measured as described below.
A financial instrument is recognised when the Group takes upon itself the contractual terms of the instrument. Financial assets are disposed of when the Group contractual rights to the cash flows deriving from the financial assets expire, or when the Group transfers the financial assets to others without retaining control of the asset or is exposed to all the risks and rewards arising from the asset. The acquisition and sale of financial assets performed in the regular way are recognised on the date of the transaction, i.e. on the date on which the Group undertook to acquire or sell the asset. Financial liabilities are disposed of when the Group's obligation, as detailed in the agreement, expires, or when it is discharged or cancelled.

Cash and cash equivalents
Cash or cash equivalents comprise cash balances and deposits which can be withdrawn on demand (up to three months from the date of their deposit). A bank overdraft which is repayable on demand and forms an integral part of the Group's cash management, is included as a component of cash and cash equivalents for the purpose of the cash flow statement only.

The accounting treatment of finance income and expenses is described in Note 3O below.

Available-for-sale financial assets
The Group's investments in shares, certain equity securities and a venture capital fund are classified as available-for-sale financial assets. Subsequent to initial recognition, these investments are measured at fair value, and changes therein, other than accrual of interest, deduction, impairment losses (see Note 3K1) and exchange gains and losses on available-for-sale monetary items (see Note 3B), are recognised directly in equity. When the investment is derecognised, the cumulative gain or loss in equity is transferred to profit or loss.

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

Index-linked financial instruments
The Group has balances of Index-linked financial instruments. In the opinion of the Group's Management, relaying on the position paper published by the Israel Accounting Standards Board ("IASB"), there are several possible options for the accounting treatment of Index-linked financial instruments. In preparing the financial statements, the Group adopted an accounting treatment whereby the carrying value of the financial instrument and the payments deriving therefrom are revalued in each period according to the actual rate of the rise in the Index. The subject of the measurement of Index-linked financial instruments according to IFRSs is under review, and as part of that review, the professional committee of the IASB approached the accounting treatment of Index-linked liabilities and assets under the International Reporting Standards.

In view of the aforesaid, it might be determined that the above-mentioned accounting treatment is not possible under the provisions of the International Reporting Standards, and that a different treatment – whereby the expectations of inflation should be taken into account when measuring the financial instrument – would be more appropriate (on this matter, see the provisions of AG7 and AG8 of IFRS 39). If this is indeed the decision, the Group will be required to examine the implication, including transition provisions, if determined, on its financial statements as published and will be published until the decision is made according to International standards.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

C. Financial Instruments (contd.)

(2) Derivative financial instruments

The Group holds derivative financial instruments to hedge its foreign currency and Index risks exposure. Embedded derivatives are separated from the host contract and accounted for separately if: (a) the economic characteristics and the risks of the host contract and the embedded derivative are not closely related; (b) a separate instrument with the same terms as the embedded instrument would meet the definition of a derivative, and (c) the combined instrument is not measured at fair value through profit or loss.

Derivatives are recognised initially at fair value: the attributable transaction costs are recognised in profit or loss when incurred. Subsequent to their initial recognition, derivative financial instruments are measured at fair value, and changes therein are recognised through profit or loss.

Economic hedging

Hedge accounting is not applied to derivative instruments that economically hedge monetary assets and liabilities. Changes in the fair value of such derivatives are recognised in profit or loss.

Separable embedded derivatives

Changes in the fair value of separable embedded derivatives are charged immediately in profit or loss.

(3) Share capital – Ordinary shares

Incremental costs directly attributable to the issue of ordinary shares and share options, are recognised as a deduction from equity.

D. Property, plant and equipment

(1) Recognition and measurement

Items of property, plant and equipment are measured at cost less accumulated depreciation and losses from impairment. Certain items of property, plant and equipment that were revalued to fair value on the date of transition to IFRSs, are measured on the basis of their deemed cost, which is the revalued amount at the transition date (January 1, 2005), in accordance with the Group's assessments based on an external appraisal.

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of the materials, direct labour and financing costs, as well as any other costs directly attributable to bringing the asset to a working condition for its intended use by Management, and the costs of dismantling and removing the items and restoring the site on which they are located in cases where the Group has an obligation to vacate and restore the site. Purchased software that is an integral to the functionality of the related asset, is recognised as part of the cost of that asset.

Where significant parts of the property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of the property, plant and equipment.

For asset dismantling and removal costs, the Group chose a relief under IFRS1, whereby:

(a) the liability for dismantling and removal at the date of transition to IFRSs is measured in accordance with IAS 37;

(b) the amount that would have been included in the cost of the asset on the date when the liability was first created, is measured by discounting the liability at the same date, according to the historical discount rates; and additionally

(c) the accumulated depreciation is calculated on the same amount at the date of transition to IFRSs.

(2) Subsequent costs

The cost of replacing part of an item of property, plant and equipment item is recognised parting the carrying amount of the item if it is probable that the future economic benefit embodied in the item will flow to the Group and that the cost of the item can be reliably measured. The costs of day to day servicing are recognised in profit and loss as incurred.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

D. Property, plant and equipment (contd.)

(3) Capitalisation of borrowing costs

Costs of non-specific borrowing are capitalised as qualifying assets as defined in IAS 23 – Borrowing Costs, during the period required for completion and construction through the date on which they are ready for their intended use. Non-specific borrowing costs are capitalised for investment in qualifying assets, using a rate which is the weighted average of the rates of cost for those borrowing sources. Other borrowing costs are recognised in profit or loss as incurred.

(4) Depreciation

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

Improvements made to leased premises are depreciated over the term of the lease, which includes any option for the extension of the lease held by the Group, which it intends to exercise.

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

	Years	Main depreciation %
Digital switching equipment	4-20	10
Transmission and power equipment	5-10	20
Network equipment	5-20	5
Terminal equipment (cellular)	2-3	33
Subscriber equipment and public telephones	5	20
Vehicles	7	15
Internet equipment	4-7	20
Office equipment	5-15	10
Electronic equipment, computers and internal communication systems	3-7	33
Cellular infrastructure equipment	5-10	10
Digital satellite decoders	4-8	17
Broadcasting and reception equipment (satellite)	7	15
Buildings	25	4

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

E. Assets classified as held for sale

Non-current assets which are expected to be realised by way of sale rather than ongoing use, are classified as assets held for sale. These assets are presented according to the lower of book value and fair value, less selling costs. Losses from impairment in value at the time of initial classification of an asset held for sale, and subsequent gains or losses resulting from remeasurement, are recognised in profit or loss. Gains are recognised up to the cumulative amount of loss from impairment in value recorded in the past.

F. Broadcasting rights

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

Costs of purchased broadcasting rights for screening films and television programmes include the amounts paid to suppliers of rights, plus the direct costs incurred for adaptation of the films and other programs for screening in Israel. The broadcasting rights are depreciated in accordance with the terms of the agreement for their purchase, on the basis of actual screenings out of the total number of screenings permitted under the agreement (where the undepreciated portion at the end of the term of the agreement is depreciated in full upon its termination), or according to the term of the rights agreement.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

G. Intangible assets

(1) Goodwill

Goodwill is created as a result of the acquisition of subsidiaries and associates.

Acquisitions prior to January 1, 2005

As part of the transition to reporting in accordance with IFRSs, the Group chose to account for only those business combinations which occurred after January 1, 2005 in accordance with IFRS 3. Regarding acquisitions prior to January 1, 2005, the goodwill reflects the amount recognised by the Group according to Israeli GAAP. For these acquisitions, the accounting treatment was not adjusted to IFRS 3 in preparing the opening balance sheet of the Group.

Acquisitions subsequent to January 1, 2005

For acquisitions subsequent to January 1, 2005, the goodwill reflects the excess cost of the acquisition over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquiree.

Subsequent measurement

Goodwill is measured at cost less accumulated impairment losses. In respect of equity accounted investees, the carrying amount of the goodwill is included in the carrying amount of the investment. For assessment of impairment in value, see K(2) below.

(2) Software development costs

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

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

(3) Subscriber acquisition

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

(4) Software

The Group's assets include computer systems consisting of hardware and software. Software that is an integral part of the hardware, which cannot function without the programs installed on it, is classified as property, plant and equipment. However, the licenses for the software, which are a separate item and add functionality to the hardware, are classified (mostly) as intangible assets. The depreciation in respect of software is recognised in profit or loss by the straight-line method, over the estimated useful life of the asset.

(5) Frequency usage rights

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

(6) Other intangible assets

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

G. Intangible assets (contd.)

(7) Subsequent expenses

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the asset to which it relates. All other expenditure, including expenditure relating to amortised goodwill and brands, is recognised in profit and loss as incurred.

(8) Amortisation

Amortisation, except for goodwill, is recognised in profit or loss on a straight-line basis over the estimated useful life of the intangible assets, from the date on which the assets are available for use.

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

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

H. Leased properties

Leases in which the Group assumes most of the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased properties are measured at the lower of the fair value and the present value of the minimum lease payments. Subsequent to the initial recognition, the asset is treated according to the accounting policy applicable to that asset.

Other leases (including leases from the Administration), are classified as operating leases, where the leased properties are not recognized on the balance sheet of the Group.

The Group applies IFRIC 4 – Determining Whether an Arrangement Contains a Lease, which defines criteria for determining, at the commencement of the arrangement, whether a right to use the property constitutes a lease arrangement. In addition, it defines when thereafter the arrangement should be reviewed. The Group applied the relief laid down in IFRS1, whereby the examination of whether an arrangement contains a lease was made on the basis of the facts and circumstances prevailing on January 1, 2005 (the date of transition to IFRSs).

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

In accordance with IFRIC 4, as mentioned above, transactions for acquiring an indefeasible right of use (“IRU”) of undersea cable capacities are accounted for as receipt of service transactions. The prepaid expense is amortised on a straight-line basis over the shorter of the term stated in the agreement and the estimated useful life of those capacities (mainly 15 years).

J. Inventory

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

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

K. Impairment

(1) Financial assets

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

An impairment loss in respect of a financial asset measured at amortised cost, is calculated as the difference between its carrying amount and the present value of the estimated future cash flows, discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its fair value.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics. In addition, the financial statements include specific provisions and specific Group provisions for doubtful debts, which properly reflect, according to Management's assessment, the loss inherent in debts whose collection is in doubt.

All the impairment losses recognised in profit or loss. Any cumulative loss in respect of an available-for-sale financial asset, which was formerly charged to capital, is transferred to profit and loss when the asset value became impaired.

An impairment loss is reversed if the reversal can be related objectively to an event that occurred after the impairment loss was recognised. For financial assets measured at amortised cost and available-for-sale financial assets that are debt securities, the reversal is recognised in profit or loss. For available-for-sale financial assets that are equity securities, the reversal is recognised directly in equity.

(2) Non-financial assets

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

An impairment loss is recognised whenever the carrying amount of the asset or its cash-generating unit, exceeds its estimated recoverable amount. A cash-generating unit is the smallest identified group of assets that generates cash flows, irrespective of assets in other groups.

Impairment losses are recognised in profit or loss. Impairment losses which were recognised for cash-generating units are allocated first to reduce the carrying amount of any goodwill attributed to those units, and then to reduce the carrying amount of the other assets in the unit on a pro rata basis.

The recoverable amount of an asset or cash-generating unit is the greater of the value in use and the net selling price (fair value less selling costs). In assessing value in use, the Group capitalises the estimated future cash flows at a pre-tax discount rate, which reflects the market assessments of the time value of the money and the specific risks related to the asset.

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

L. Employee benefits

(1) Post-employment benefits

The Group has a number of post-employment benefit plans. The plans are usually financed by contributions to insurance companies, and are classified as defined contribution plans and as defined benefit plans.

a. Defined contribution plans

The Group's obligation to make contributions to a defined contribution plan, are recognised as an expense in profit or loss on the date on which the obligation to contribute is assumed. (See Note 16D below.)

b. Defined benefit plans

The Group's net obligation in respect of a defined benefit plan for post-retirement benefits is calculated separately for each plan by estimating the future amount of the benefit payable to the employee in return for his service in the current and in prior periods. That benefit is stated at present value less the fair value of the plan's assets and less the cost of past service not yet recognised. The discount rate is the yield at the reporting date on government bonds whose currency and maturity dates are similar to the terms of the Group's obligation. The calculations are made by a qualified actuary using the projected unit credit method. (See Note 16E below.)

Where the benefits of a plan are improved, the portion of the increased benefits relating to past service of employees is recognised in profit or loss on a straight-line basis over the average period until the benefits mature. If the benefits mature immediately, the expense is recognised immediately in profit or loss.

The Group charges immediately, directly to reserves, all the actuarial gains and losses derived from a defined benefit plan.

(2) Other long-term employee benefits

The Group's net obligation in respect of long-term employee benefits, which are not post-employment benefit plans, is the amount of future benefit payable to employees in return for their service in the current and prior periods. The amount of these benefits is discounted to its present value, net of the fair value of the assets related to the obligation. The discount rate is determined according to the yield at the reporting date on corporate bonds in a currency and with a maturity date similar to the terms of the Group's obligation. The calculation is performed using the projected credit unit method. Actuarial gains and losses are recognised in profit or loss in the period in which they arise. (See Note 16F below.)

(3) Severance pay and voluntary retirement benefits

Employee severance pay is recognised as an expense when the Group is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan to terminate employment before the normal retirement date. Employee benefits upon voluntary retirement are recognised when the Group proposes a plan encouraging employees to retire voluntarily, the plan is expected to be accepted, and the number of those who will benefit from the plan can be estimated reliably. (See Note 16G and H below.)

(4) Short-term benefits

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

L. Employee benefits (contd.)

(5) Share-based payment transactions

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

The fair value of the options granted to employees by the State in the period when the State was the controlling shareholder of the Company, was recorded as an expense at the time the employees were entitled to the options.

M. Provisions

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

(1) Contingent liabilities

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

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

a. More likely than not – more than 50% probability.
b. Possible – probability more than unlikely and less than 50%
c. Unlikely – probability of 10% or less.

For claims which are more likely than not, the financial statements include provisions which in the opinion of the Group's managements, based, *inter alia*, on the opinions of its legal advisers retained in respect of those claims, are appropriate to the circumstances of each case.

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

(2) Reorganisation

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

(3) Onerous contracts

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

(4) Site dismantling and clearing costs

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

M. Provisions (contd.)

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

N. Revenue

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

(1) Equipment sales
Revenue from sales of equipment is recorded at the time of shipment to the customer, upon transfer of the significant risks and rewards related to ownership of the equipment sold.

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

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

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

(5) Gross or net-based income reporting
When the Group acts in the capacity of an agent or broker without bearing the risks and rewards deriving from the transaction, its income stated net. Conversely, where the Group acts as a main supplier and bears the risks and rewards deriving from the transaction, its income is stated gross.

(6) Lease of satellite decoders
A subsidiary collects deposits for digital satellite decoders held by its customers, in an amount which does not exceed the cost of the decoders. At the end of the agreement the customers are entitled to the remaining portion of the deposit in accordance with their agreement. Revenues from deduction of the deposits are recorded in profit or loss, in accordance with the terms of the agreement with the customers.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

O. Finance income and expenses

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

Financing expenses comprise interest expense on borrowings, debentures issued, commissions paid, changes in the time value in respect of provisions, foreign currency losses, changes in the fair value of financial assets stated at fair value through profit or loss, losses from impairment of financial assets (except for a provision for doubtful debts, which is stated in operating and general expenses), and losses from hedging instruments recognised in profit or loss. All borrowing costs are charged to profit or loss using the effective interest rate.

P. Income tax expense

Income tax expense comprises current and deferred taxes and is recognised in profit or loss except to the extent that it relates to a transaction or event recognised directly in equity, in which case it charged to equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Recognition of deferred taxes is by the equity method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for tax purposes. The Group does not recognise deferred taxes for the following temporary differences: initial recognition of goodwill, initial recognition of assets and liabilities in a transaction which is not a business combination and which does not affect accounting profit or taxable profit, losses carried forward which are nor expected to be utilised in the foreseeable future, and differences arising from investment in subsidiaries if they are not expected to be reversed in the foreseeable future. The deferred taxes are measured using the tax rates expected to be applicable to the temporary differences on the date of their realisation, based on the laws enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised if it is probable that future taxable profits will be available against which the deductible temporary differences can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced if the related tax benefit is not expected to be realised.

Q. Earnings per share

The Group presents basic and diluted earnings per share (EPS) data in respect of its ordinary shares. The basic earning per share is calculated by dividing the profit or loss attributable to the ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. The diluted earning per share is determined by adjusting the loss or gain attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise convertible notes, share options and share options granted to employees.

R. Segment reporting

A segment is a distinguishable component of the Group that is engaged in providing related services (business segment), and which is subject to risks and rewards that differ from those of the other segments. The Group's primary format for segment reporting is based on business segments. The business segments are determined by the Group's Management according to the internal reporting structure.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

S. Dividend declared subsequent to the balance sheet date

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

T. Classified amounts

The financial statements include reclassification of certain amounts of the comparative figures of for the relevant sections.

U. New standards and interpretations not yet adopted

A number of new standards, amendments to existing standards and interpretations, were not yet effective on December 31, 2007, and therefore have not been applied in the preparation of these consolidated financial statements.

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

(2) Amended IAS 23 – Borrowing Costs. The amendment revokes the option to recognise all borrowing costs immediately to profit or loss if specific borrowing costs were incurred from the acquisition, erection or production of a recognised asset. The amendment requires that such costs be capitalised as part of the total cost of the asset. The other borrowing costs will be recognised in profit or loss as incurred. The standard will come into force on January 1, 2009, and is not expected to impact the Group's financial statements.

(3) Amended IAS 1 – Presentation of Financial Statements, presents the term "comprehensive income" (i.e. changes in equity during the period, except for changes deriving from transactions with shareholders by virtue of their being shareholders). The provisions for application of the amended standard include a specimen statement of comprehensive income in one statement or two. The standard also prohibits the presentation of components or comprehensive income in the statement of changes in equity. IAS 1 will apply to the Group's 2009 financial statements, and is not expected to impact them except regarding presentation.

(4) IAS 27 (2008) – Consolidated and Separate Financial Statements, reflects changes in the accounting treatment of the rights of non-controlling (minority) shareholders, and deals mainly with the accounting treatment of changes in ownership rights in subsidiaries after the acquisition of control, the accounting treatment upon loss of control in subsidiaries, and the allocation of profit or loss to those with and without controlling rights in a subsidiary. IAS 27 will apply to the Group's 2010 financial statements. The Group's Management is considering the impact of the standard on the financial statements, including the possibility of early application.

(5) IFRS 3 (2008) – Business Combinations, also deals with business combinations made by contract only; the definition of a business combination focuses on attaining control; including contingent consideration; the acquirer can choose to measure the rights which do not grant control at their fair value on the date of acquisition or according to its relative part in the fair value of the identifiable assets and the identifiable liabilities of the acquiree; where acquisition is achieved by means of step acquisition, the identifiable assets and liabilities of the acquiree are recognised at their fair value when control is achieved. IFRS 3 (2008) will apply to the Group's 2010 financial statements.. The Group is considering the effects of the standard on the financial statements, including the possibility of early application.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

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

(6) IFRS 2 – Share-Based Payment – Vesting Conditions and Cancellations, clarifies the vesting conditions to be reflected in the fair value at the grant date, and explains the accounting treatment of instruments that have no vesting period, and forfeitures. IFRS 2 will apply to the Group's 2009 financial statements , and at this stage, Management does not expect it to impact the Group's financial statements.

(7) IFRIC 11 – Group and Treasury Share Transactions. The interpretation deals with share-based transactions related to the Company's equity instruments. IFRIC 11 will apply for annual periods commencing March 1, 2007 or thereafter. The adoption of IFRIC 11 is not expected to influence the financial statements of the Group.

(8) IFRIC 12 – Segment Reporting Arrangements, is an interpretation dealing with the accounting treatment of operators from the private sector which provide public infrastructure assets and services. IFRIC 12 creates a distinction between two types of arrangements for service concessions: in one, the operator receives a financial asset, an unconditional contractual right to receive cash or other financial asset from the government in exchange for the construction or upgrading of a public asset; in the other, the operator receives an intangible asset, a right to collect payment for the use of the public asset it is constructing or upgrading. The right to collect payment from users is not an unconditional right to receive cash, since the amounts depend on how much use the public will use the service. The interpretation will apply to annual periods commencing on January 1, 2008, or thereafter, and early adoption is permitted. The adoption of IFRIC 12 is not likely to impact the Group's financial statements.

(9) IFRIC 13 – Customer Loyalty Programmes. The interpretation addresses the accounting of companies that grant benefits as part of customer loyalty programmes (such as "points" or "frequent flyer" programs) when goods or services are purchased. IFRIC 13 explains how companies should treat an obligation to supply goods or services in the future free of charge or at a discount (benefits) to customers who are expected to utilise the benefits. The interpretation will apply to annual periods commencing July 1, 2008 or thereafter. The adoption of IFRIC 13 is not expected to impact the Group's financial statements.

(10) IFRIC 14 – The Limit on a Defined Benefit Asset, is the interpretation relating to IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction. The interpretation clarifies three subjects:
(a) when the reductions in future funding or returns are considered "available" in the context of Section 58 of IAS19;
(b) how minimum funding requirements affect the availability of future reductions in funding;
(c) when minimum funding requirements might generate a liability.
The Interpretation will apply to annual periods commencing January 1, 2008 or thereafter. The adoption of IFRIC 14 is not expected to impact the Group's financial statements.

NOTE 4 – DETERMINING FAIR VALUE

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

A. Property, plant and equipment

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

NOTE 4 – DETERMINING FAIR VALUE (CONTD.)

B. Investments in shares and debentures

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

C. Customers and other trade receivables

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

D. Derivatives

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

E. Non-derivative financial liabilities

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

F. Share-based payments

The fair value of stock options for employees is measured using the Black and Scholes model. The assumptions of the model include the share price at the date of measurement, the exercise price of the instrument, expected volatility (based on the weighted average of historical volatility, adjusted for changes expected from information available to the public), the weighted average of the projected useful life of the instruments (based on past experience and the general behaviour of the option-holders), expected dividends, and the risk-free interest rate (based on government bonds). Conditions of service and performance which are not market conditions, are not taken into account in determining the fair value. Conditions which are not vesting conditions are taken into account in calculating the fair value. See also Note 26.

NOTE 5 – CASH AND CASH EQUIVALENTS

	December 31 2007	December 31 2006
	NIS millions	NIS millions
Bank balances	**55**	66
Demand deposits	**1,148**	2,566
Cash and cash equivalents	**1,203**	2,632

The effective interest rate on the demand deposits in 2007 was 3.3% - 5.0% (2006 – 4.8% - 5.3%). For deposits, the average maturity period was 6-8 days (2006 – 3-7 days).

NOTE 6 – INVESTMENTS AND LOANS, INCLUDING DERIVATIVES

A. Segmentation by investment classification

	December 31 2007	December 31 2006
	NIS millions	NIS millions
Current investments		
Financial assets measured at fair value through profit and loss[1]	**294**	894
Structured instruments[2]	**-**	61
Financial assets available for sale	**47**	-
Derivatives	**45**	3
Other investments	**3**	3
	389	961
Non-current investments		
Bank deposit for providing loans to employees[3]	**149**	185
Financial assets available for sale	**68**	121
Loans and long-term debit balances	**-**	36
Derivatives	**16**	-
	233	342
	622	1,303

(1) **Sensitivity analysis – negotiable financial assets price risk**

All of the Group's investments in securities are listed for trading on the stock exchange.

A rise of 1% in the market value of the investments at the reporting date would increase the profit and the equity by NIS 2 million after tax (2006 – an increase of NIS 6 million). A similar change downwards would decrease the profit and the equity by the same amounts.

(2) The carrying value in 2006 of embedded instruments includes debentures. The instruments are dollar-linked and bear LIBOR for six months and three months plus a margin of 3.4% and 1.65% respectively.

(3) The deposit serves as a security for providing bank loans to Company employees. The deposit is unlinked, and the effective interest rate of the deposit at December 31, 2007 is 2.8% (2006 – 2.93%). The Company is liable for the loans to the employees. The deposit is stated at its present value, taking into account loan repayment schedule, based on a weighted average discount rate of 5.15% (2006 – 5.56%). Deferred salary expenses are added to the deposit amount.

NOTE 6 – INVESTMENTS AND LOANS, INCLUDING DERIVATIVES (CONTD.)

B. Segmentation by types of securities

	December 31, 2007			December 31, 2006		
	Marketable	Others	Total	Marketable	Others	Total
	Equity value	Equity value	Equity value	Equity value	Equity value	Equity value
		NIS millions			NIS millions	
Government bonds –						
Index-linked	**86**	**-**	**86**	189	-	189
Unlinked	**71**	**-**	**71**	201	-	201
Dollar-linked	**-***	**-**	**-***	-*	-	-*
Corporate debentures	**74**	**-**	**74**	329	-	329
Foreign securities	**12**	**-**	**12**	55	-	55
Short-term loan	**8**	**-**	**8**	88	-	88
Investments in shares and options	**31**	**68**	**99**	29	75	104
Participation in trust funds	**15**	**-**	**15**	8	-	8
Investments in debentures convertible to shares	**1**	**-**	**1**	2	-	2
Structured instruments	**-**	**-**	**-**	-	61	61
Bank deposit for providing loans to employees	**-**	**149**	**149**	-	185	185
Investment in hedge fund	**-**	**43**	**43**	-	39	39
Loans and long-term debit balances	**-**	**-**	**-**	-	36	36
Derivatives	**-**	**61**	**61**	-	3	3
Other investments	**-**	**3**	**3**	-	3	3
	298	**324**	**622**	901	402	1,303

* Less than NIS 500,000.

C. Linkage basis and interest terms – non-current investments*

	December 31, 2007				
	Interest %	Unlinked	Index-linked	Linked to foreign currency	Total
		NIS millions	NIS millions	NIS millions	NIS millions
Deposit in bank for providing loans for employees	2.8%	**149**	**-**	**-**	**149**
Derivatives	Interest-free	**-**	**16**	**-**	**16**
		149	**16**	**-**	**165**

	December 31, 2006				
	Interest %	Unlinked	CPI-linked	Linked to foreign currency	Total
		NIS millions	NIS millions	NIS millions	NIS millions
Deposit in bank for providing loans for employees	2.93%	185	-	-	185
Capital notes	5.85%	-	16	-	16
Loan	6.25%	-	20	-	20
Financial asset available for sale	Interest-free	-	-	39	39
		185	36	39	260

* Not including non-negotiable shares.

NOTE 7 – TRADE AND OTHER RECEIVABLES

	December 31 2007	December 31 2006
	NIS millions	NIS millions
Trade receivables		
Trade receivables that are related parties and interested parties	**113**	98
Outstanding debts	**893**	778*
Credit vouchers and checks receivable	**460**	455
Income receivable	**361**	291*
Current maturities of long-term trade receivables(2)	**576**	443
	2,403	2,065
Receivables		
Prepaid expenses	**80**	94
Other receivables	**167**	157
	247	251
Long-term trade receivables(1)(2)	**535**	435*
Other long-term receivables(1)	**-**	28
	535	463
	3,185	2,779

Trade and other receivables denominated in a currency which is not the functional currency include NIS 84 million denominated in US dollars (2006 – NIS 60 million), and NIS 391,000 denominated in euro (2006 – NIS 7 million).

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

(2) **Sensitivity analysis – Interest risk**
An increase of 10% in nominal shekel interest would reduce the fair value by approximately NIS 8 million. A similar change in the opposite direction would increase the fair value by the same amount.

* See Note 3T

Following is the trade receivables aging at the reporting date

	December 31 2007	December 31 2006
	NIS millions	NIS millions
Not in arrears	**2,566**	2,189
One year's arrears	**385**	358
Arrears between one and two years	**128**	118
Arrears of over two years	**187**	174
	3,266	2,839
Less the provision for doubtful debts	**328**	339*
	2,938	2,500

NOTE 7 – TRADE AND OTHER RECEIVABLES (CONTD.)

Movement in provision for doubtful debts during the year

	December 31 2007	December 31 2006
	NIS millions	NIS millions
Balance at January 1	**339**	385
Change during the year, net	**(11)**	(46)
Balance at December 31	**328**	339*

* See Note 3T.

NOTE 8 – INCOME TAX

A. General

	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Current tax expenses			
In respect of the current period	**365**	397	308
Adjustments in respect of prior years	**(5)**	5	(29)
	360	402	279
Deferred tax expense			
Reduction in the tax rate	**-**	-	83
Creation and reversal of temporary differences	**312**	91	195
Changes in the value of temporary differences not recognised	**-**	(5)	(25)
	312	86	253
Income tax expense from ongoing activities	**672**	488	532

B. Reconciliation of effective tax rate

	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Net profit	**1,361**	750	620
Income tax	**672**	488	532
Profit before tax	**2,033**	1,238	1,152
Statutory tax rate	**29%**	31%	34%
Income tax at the local tax rate applicable to the Group	**590**	384	392
Differences in the tax rate	**34**	8	83
Differences in definition of capital and assets	**(39)**	(6)	(60)
Expenses not recognised for tax purposes	**52**	15	48
Recognition of losses for tax purposes not recognised in the past	**-**	-	5
Deferred taxes in respect of temporary differences not recognised in the past	**-**	(5)	(25)
Losses generated in the period, for which a deferred tax asset was not recognised	**28**	88	129
Agreed tax assessments	**-**	-	(8)
Losses of a partnership	**-**	1	(4)
Change in temporary provisions not recognised	**(1)**	(4)	(12)
Taxes in respect of prior years	**(5)**	5	(29)
Others	**13**	2	13
	672	488	532

NOTE 8 – INCOME TAX (CONTD.)

C. Income tax attributable directly to equity

	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Available-for-sale financial assets	**4**	(6)	(104)
Actuarial gains and losses	**14**	3	(15)
Expenses recognised directly in equity	**18**	(3)	(119)
Total tax recognised directly in equity	**(4)**	2	41

D. Deferred tax assets that were not recognised

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

Deferred tax assets not recognised

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

	2007	2006
	NIS millions	NIS millions
Deductible temporary differences	**3**	18
Losses for tax purposes	**96**	225
	99	243

Under existing tax laws, there is no time limit on utilising tax losses or on utilising deductible temporary differences. Deferred tax assets were not recognised in respect of these items since it is not anticipated that there will be taxable income against which the tax benefits can be utilised. The balance of unrecognised deferred tax assets in respect of losses for tax purposes is approximately NIS 902 million.

NOTE 8 – INCOME TAX (CONTD.)

E. Recognised tax assets and deferred tax liabilities

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

	Assets		Liabilities		Net	
	2007	2006	2007	2006	2007	2006
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Property, plant and equipment	**58**	57	**116**	70	**(58)**	(13)
Doubtful debts	**50**	51	**-**	-	**50**	51
Intangible assets	**-**	-	**13**	10	**(13)**	(10)
Monetary assets measured at fair value through profit and loss	**3**	4	**-**	2	**3**	2
Available-for-sale financial assets	**3**	3	**2**	1	**1**	2
Derivatives	**-**	-	**-**	-*	**-**	-*
Employee benefit plan	**418**	547	**-**	-	**418**	547
Share-based payments	**136**	136	**-**	-	**136**	136
Provisions	**51**	5	**-**	-	**51**	5
Other assets	**2**	11	**-**	-	**2**	11
Deferred expenses in connection with agreed assessments	**4**	9	**-**	-	**4**	9
Losses from partnerships	**-**	3	**-**	-	**-**	3
Tax losses carried forward	**84**	251	**-**	-	**84**	251
	809	1,077	**131**	83	**678**	994

* Less than NIS 500,000.

NOTE 8 – INCOME TAX (CONTD.)

F. Changes in temporary differences during the year

	Balance at January 1, 2006	Charged to profit and loss	Charged to equity	Balance at December 31, 2006	Charged to profit and loss	Charged to equity	Balance at December 31, 2007
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Property, plant and equipment	87	(100)	-	(13)	**(45)**	**-**	**(58)**
Doubtful debts	65	(14)	-	51	**(1)**	**-**	**50**
Intangible assets	(5)	(5)	-	(10)	**(3)**	**-**	**(13)**
Financial assets measured at fair value through profit and loss	(12)	14	-	2	**1**	**-**	**3**
Financial assets available for sale	4	(4)	2	2	**-**	**(1)**	**1**
Derivatives	-*	-*	-	-*	**-***	**-**	**-***
Employee benefits	480	67	-	547	**(126)**	**(3)**	**418**
Share-based payments	64	72	-*	136	**-**	**-**	**136**
Provisions	6	(1)	-	5	**46**	**-**	**51**
Deferred expenses in connection with other items	10	1	-	11	**(9)**	**-**	**2**
Agreed assessments	14	(5)	-	9	**(5)**	**-**	**4**
Losses from partnerships	-	3	-	3	**(3)**	**-**	**-**
Losses carried forward for tax purposes	365	(114)	-	251	**(167)**	**-**	**84**
	1,078	(86)	2	994	**(312)**	**(4)**	**678**

* Less than NIS 500,000.

NOTE 8 – INCOME TAX (CONTD.)

G. Amendments to the Income Tax Ordinance

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

Current taxes and deferred tax balances at December 31, 2006 and at December 31, 2007 are calculated at the new tax rates as provided in Amendment 147. The effect of the change on the consolidated financial statements at the beginning of 2005 is an increase in the income tax expense in the income statement and a decrease in the deferred taxes included in the balance sheet in the amount of NIS 83 million consolidated.

H. Adjustments Law

Under the Income Tax (Adjustments for inflation) Law, 5745-1985 ("the Adjustments Law"), taxable results are measured on a real basis, taking into account the rate of change in the Index. The Group is assessed on the basis of this law.

On February 26, 2008 the Knesset enacted the Income Tax Law (Adjustments for Inflation) (Amendment No. 20) (Restriction of Effective Period) – 2008 (hereinafter – the Amendment). In accordance with the Amendment, the effective period of the Adjustments Law will cease at the end of the 2007 tax year and as from the 2008 tax year the provisions of the law shall no longer apply, other than the transitional provisions intended to prevent distortions in the tax calculations.

In accordance with the Amendment, as from the 2008 tax year, income for tax purposes will no longer be adjusted to a real (net of inflation) measurement basis. Furthermore, the depreciation of inflation immune assets and carried forward tax losses will no longer be linked to the CPI, so that these amounts will be adjusted until the end of the 2007 tax year after which they will cease to be linked to the CPI.
,

In 2007, with annual inflation of 3.4%, the effects of the Adjustments Law, mainly an addition due to inflation and a deduction due to depreciation, led to a decrease of approximately NIS 39 million in the tax expenses of the Company.

I. Final tax assessments

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

(2) In December 2007, an inactive company wholly owned by Pelephone received best-judgment tax assessments for the years 2003-2005. The amount of the assessments is NIS 31 million. Pelephone has filed an objection to these assessments.

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

NOTE 9 – PROPERTY, PLANT AND EQUIPMENT

A. Composition and movement

	Land and buildings	Switching, transmission and power equipment	Network equipment	Subscriber equipment	Motor Vehicles	Office equipment and computers	Total
				NIS millions			
Cost or deemed cost							
Balance at January 1, 2006	2,041	3,949	12,152	2,836	149	1,223	22,350
Additions	25	350	104	320	1	108	908
Disposals (d below)	(116)	(357)	(36)	(141)	(39)	(105)	(794)
Balance at December 31, 2006	1,950	3,942	12,220	3,015	111	1,226	22,464
Balance at January 1, 2007	1,950	3,942	12,220	3,015	111	1,226	22,464
Additions	**79**	**477**	**108**	**325**	**1**	**112**	**1,102**
Disposals (d below)	**(85)**	**(268)**	**(45)**	**(57)**	**(32)**	**(53)**	**(540)**
Transfer to assets held for sale	**(54)**	**-**	**-**	**-**	**-**	**-**	**(54)**
Balance at December 31, 2007	**1,890**	**4,151**	**12,283**	**3,283**	**80**	**1,285**	**22,972**
Depreciation and losses from impairment							
Balance at January 1, 2006	1,404	1,362	9,484	1,869	115	869	15,103
Depreciation for the year	104	693	277	373	14	130	1,591
Disposals (D below)	(83)	(354)	(36)	(111)	(35)	(103)	(722)
Balance at December 31, 2006	1,425	1,701	9,725	2,131	94	896	15,972
Balance at January 1, 2007	1,425	1,701	9,725	2,131	94	896	15,972
Depreciation for the year	**98**	**621**	**261**	**359**	**6**	**137**	**1,482**
Disposals (D below)	**(73)**	**(266)**	**(45)**	**(43)**	**(29)**	**(50)**	**(506)**
Transfer to assets held for sale	**(40)**	**-**	**-**	**-**	**-**	**-**	**(40)**
Balance at December 31, 2007	**1,410**	**2,056**	**9,941**	**2,447**	**71**	**983**	**16,908**
Carrying value							
At January 1, 2006	637	2,587	2,668	967	34	354	7,247
At December 31, 2006	525	2,241	2,495	884	17	330	6,492
At December 31, 2007	**480**	**2,095**	**2,342**	**836**	**9**	**302**	**6,064**

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

A. Composition and movement (contd.)

a. Determination of fair value as deemed cost – Certain items of property, plant and equipment from the switching, transmission and power group of equipment, principally switching equipment, which were revalued to fair value on the date of transition to the IFRSs, were measured on the basis of their deemed cost, which was determined according to their fair value on the transition date (January 1, 2005), as assessed by the Group based on valuation an external appraiser. The assessments were attached to the financial statements of the Group at December 31, 2006.

b. Residual value – The residual value of the Group's copper cables as assessed at the end of the reporting year. The residual value is approximately NIS 591 million and NIS 598 million at December 31, 2007 and December 31, 2006 respectively.

c. Cost of dismantling and removal of assets – The cost of items of property, plant and equipment includes dismantling and removal costs, as well as other restoration costs to which the Group has an obligation. These costs are depreciated according to the expected useful life of the sites. During 2007, the Group capitalised costs of approximately NIS 4 million for dismantling and removal of assets (2006 – NIS 1 million).

d. Property, plant and equipment in the Group is removed at the year end upon reaching full depreciation, except for land, buildings and vehicles, which are removed on their sale. In 2007, the Group removed fully depreciated property at a cost of approximately NIS 385 million (2006 – NIS 565 million).

e. The cost includes approximately NIS2 million in the Group, representing real financing expenses which were capitalised in the reporting period in respect of loans and credit in the construction period and calculated at a real average interest rate of approximately 6.78% per year (prior year – 4.3%).

f. At December 31, 2007, Pelephone has a commitment to purchase terminal equipment during 2008, for a total amount of NIS 242 million.

g. In November 2007, the general meting of Pelephone adopted the resolution of Pelephone's board of directors concerning the erection of a HSPA/UMTS network for one billion shekels. The new network is scheduled to start operation at the beginning of 2009. The investment in the network will be spread over four years (mainly in 2008).

h. At the balance sheet date, there are agreements to purchase property, plant and equipment totalling approximately NIS 348 million consolidated, which includes sub-sections f. above.

i. Concerning liens, see Note 19.

j. The useful life of the property, plant and equipment was reviewed by the Depreciation Committee of the Group companies, in order to estimate the useful life of their equipment.

The main findings of the review are as follows:

(1) In infrastructure and communications equipment a change was made in the estimate, as a result of which the depreciation expense decreased in 2007 by approximately NIS 7 million, in 2008 it will decrease by approximately NIS 24 million, and in 2009 it will decrease by approximately NIS 7 million.

(2) In Pelephone's network equipment (see g. above), a change was made in the estimate, as a result of which the depreciation expense in 2007 increased by approximately NIS 5 million, in 2008 it will increase by approximately NIS 10 million, and in 2009 it will increase by approximately NIS 2 million.

NOTE 10 – INTANGIBLE ASSETS

	Goodwill	Computer software and licenses and discounted development costs	Subscriber acquisition, net	Right of use in frequencies	Others	Total
	NIS millions					
Cost						
Balance at January 1, 2006	1,793	1,174	226	220	50	3,463
Acquisitions as part of business combinations	*-	-	-	-	-	*-
Developed by the Group or purchased separately	-	147	49	-	*-	196
Deductions (1)	-	(74)	-	-	-	(74)
Balance at December 31, 2006	1,793	1,247	275	220	50	3,585
Balance at January 1, 2007	1,793	1,247	275	220	50	3,585
Acquisitions as part of business combinations	**6**	**-**	**-**	**-**	**-**	**6**
Developed or purchased separately by the Group	**-**	**141**	**84**	**-**	**11**	**236**
Disposals(1)	**-**	**(28)**	**(47)**	**-**	**-**	**(75)**
Balance at December 31, 2007	**1,799**	**1,360**	**312**	**220**	**61**	**3,752**
Amortisation and losses from impairment						
Balance at January 1, 2006	-	648	181	-	22	851
Amortisation for the year	-	200	45	-	3	248
Loss from impairment	6	-	-	-	-	6
Deductions (1)	-	(74)	-	-	-	(74)
Balance at December 31, 2006	6	774	226	-	25	1,031
Balance at January 1, 2007	6	774	226	-	25	1,031
Amortisation for the year	**-**	**203**	**59**	**-**	**8**	**270**
Disposals(1)	**-**	**(28)**	**(47)**	**-**	**-**	**(75)**
Balance at December 31, 2007	**6**	**949**	**238**	**-**	**33**	**1,226**
Carrying value						
At January 1, 2006	1,793	526	45	220	28	2,612
At December 31, 2006	1,787	473	49	220	25	2,554
At December 31, 2007	**1,793**	**411**	**74**	**220**	**28**	**2,526**

* Less than NIS 500,000.

(1) Fully depreciated assets.

NOTE 10 – INTANGIBLE ASSETS (CONTD.)

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

	2007	2006
	NIS millions	NIS millions
Pelephone Communications Ltd.[(1)]	**1,027**	1,027
D.B.S. Satellite Services (1998) Ltd.[(2)]	**760**	760
Others	**6**	-*
	1,793	1,787

* Less than NIS 500,000.

(1) The value of the holding in Pelephone was calculated by the Discount Cash Flow (DCF) method, and was based on the following assumptions:
A detailed projected was prepared for 5-year profit, which is a reasonable assessment range for which a detailed cash flow can be prepared.

- The cash flow forecast, based on the Pelephone's strategic plan to set up a third generation network (3.75) in HSPA/UMTS technology which is scheduled to start operation at the beginning of 2009. The new network will mean that Pelephone will operate in GSM technology, which will help it to achieve a higher market positioning, broaden the range of handsets it sells, and lead to overall improvement in its customer mix and ARPU. In addition, it will increase the company's revenue from roaming services. On the expense side, it will increase fees for transmission, frequencies and engineering, as well as marketing expenses for penetration of the new handsets.
- The income forecast was constructed on the basis of a forecast for the number of subscribers and average revenue per user (ARPU) according to the structure of revenues from departments plus revenues from sales of handsets. The subscriber forecast is based on a cellular company market model, taking into account market saturation, population growth, and assuming an increase of 1% in Pelephone's market share in the forecast periods.
- The assumptions for call time and call prices lead to erosion of approximately 1.5% in ARPU in 2008, and growth thereafter as a result of the effects of the strategic plan, at a cumulative rate of approximately 4% from 2007.
- The operating, sales and marketing expenses were adjusted for the company's volume of operations, with adjustment for operation of the HSPA network. Tax was deducted from the profit at the statutory tax rate.
- Investments were assessed according to Pelephone's investment plan, which consists mainly of investment of approximately one billion shekels in an HSPA network over four years, mainly in 2008, investment in IT and other ongoing and projected investments, as well as investment in subscriber acquisition.
- The capitalisation rate taken, 9.75% (nominal), was calculated by the WACC model and based on a capital price of 11.9% and a debt price of approximately 6.6%.
- Beyond the fifth year, growth of approximately 1.25% was assumed, taking into account that in the years of the forecast, Pelephone has not exhausted the advantages from transition to the HSPA network, population growth, the stabilization of the market among the cellular companies, and the competition possible future and alternatives.

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

- An increase of one half of one percent in the capitalisation rate reduces the value by approximately 6%.
- A decrease of one percent in ARPU in the first year, decreases the value by 4%.

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

- A detailed projected cash flow was prepared for 10 years. Beyond the tenth year, growth of approximately 1.75% was assumed, taking into account the growth in population, the balance between DBS and the cable companies which merged into one company (HOT), as well as competition and possible future alternatives.

NOTE 10 – INTANGIBLE ASSETS (CONTD.)

(2) (contd.).

- The income forecast was prepared on the basis of projected number of subscribers and average revenue per user (ARPU) which provides the revenue from the services. The subscriber forecast is based on the business plan of DBS for the coming year and on continued growth based on the growth forecasts for households in Israel, the customer churn rate based on past experience, global trends, and a forecast of the stabilization of competition and lower churn rates, where it was assumed that the market share of DBS would increase over the years at the expense of HOT, to about 39% (compared with 37% today).
- The ARPU forecast is based on a price rise derived, *inter alia*, from DBS's strategy of selling YesMax sets and HDTV converters (which have a high ARPU) and added value added services, while taking into consideration competition and the weight of the expense in the total household expense.
- Operating, selling and marketing expenses were adjusted to the projected volume of activity, assuming content expenses (the main expense) declining gradually to approximately 30% of income (excluding internet).
- DBS has considerable losses for tax purposes. Accordingly, tax was not taken in the forecast period. After the forecast period, tax was taken at 25%, in respect of the part of the profit exceeding the cumulative loss at that date.
- Investments are mainly in installations, and in decoders which are a function of new subscribers, gross, and the accepted level of decoder replacement, based on past data. In addition, engineering investments for preserving what is and developing new areas.
- The capitalisation rate taken, 13.4%, took into account DBS's dependence on external financing, limitations and dependence on changes in regulation, and the equity structure of DBS.
- The calculated value was attributed initially to the new shareholder loans (which were provided after July 2002) of about NIS 1.125 billion, since under the agreement they will be paid before the old loans. The Company's part in the loans is approximately 85%. The balance was attributed to repayment of the shareholder loans, in which the Company's part is approximately 51%.

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

- An increase of one half of one percent in the capitalisation rate taken reduces the value by 7%.
- A decrease of one percent in the ARPU in the first year reduces the value by 3%.

The aforementioned valuations were made by an external appraiser. As a result of these value assessments, the Group was not required to make deductions for impairment of these goodwill balances.

NOTE 11 – DEFERRED AND OTHER EXPENSES

	2007	2006
	NIS millions	NIS millions
Land lease rights[(1)]	**185**	221
Long-term prepaid expenses in respect of use of capacities[(2)]	**177**	147
Long-term prepaid expenses in respect of lease agreement	**5**	6
	367	374

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

(2) See Note 3I

NOTE 12 – ASSOCIATES ACCOUNTED BY THE EQUITY METHOD

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

	Rate of ownership	Current assets	Non-current assets	Total assets	Current liabilities	Non-current liabilities	Total liabilities	Income	Profit/loss
		NIS millions							
2007									
Walla! Communications Ltd.	34.41%	**134**	**22**	**156**	**55**	**3**	**58**	**99**	**15**
2006									
Walla! Communications Ltd.	44.04%	67	25	92	27	4	31	101	25

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

B. The investment in an associate company comprises the investment of a consolidated subsidiary in Walla! Communications ("Walla") (an associate), an Israeli company whose shares are listed on the stock exchange in Tel Aviv, which provides internet services and operates internet portals, in Bezecom Ltd. and B-Zone partnership.

Composition of the investment

	December 31 2007	December 31 2006
	NIS millions	NIS millions
Cost of shares[1]	**80**	80
Exercisable option warrants	**-**	-*
Share in equity reserve in respect of financial assets classified as available for sale	**1**	1
Share in accumulated losses, net	**(24)**	(29)
	57	52
Index-linked interest-free loans[2]	**1**	1
	58	53
Reductions for impairment[1]	**(21)**	(21)
	37	32

* Less than NIS 500,000.

(1) The balance at December 31, 2007 and 2006 includes goodwill, the undepreciated cost of which at those dates amounts to NIS 46 million and NIS 46 million, respectively, and the depreciated cost at the same dates amounts to NIS 5 million and NIS 7 million respectively.

(2) During 2007 and 2006, Bezeq International exercised, as did others, option warrants of Walla (series 3). In all, Bezeq International exercised 508,879 and 2,564,764 option warrants (series 3) in 2007 and 2006 respectively, in consideration of NIS 916,000 and NIS 4.617 million respectively, which were offset against the balance of the shareholder loans which Bezeq International provided to Walla. Following the exercise of the options warrants, Bezeq International recognised a surplus cost of NIS 80,000 and NIS 2.313 million in 2007 and 2006, respectively. In accordance with the provisions of IFRS 3, the cost of the purchase was attributed to the fair value of intangible assets, based on the Purchase Price Allocation (PPA) prepared by an external appraiser.
At December 31, 2007, Bezeq International holds 34.41% of the rights in Walla (at full dilution – 33.66%). See also D below.

(3) The market value of Bezeq International's holding in Walla shares at December 31, 2007 is NIS 83.3 million (2006 – NIS 122.6 million in shares and NIS 3.2 million in options).

C. Movement in investments is as follows:

	2007	2006
	NIS millions	NIS millions
Balance at the beginning of the year	**32**	20
Movement during the year:		
Investment in shares	**1**	5
Group's equity in profits	**5**	12
Loans and capital notes	**(1)**	(5)
Balance at the end of the year	**37**	32

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

D. Stock options plan for Walla employees

On January 15, 2008, Walla published an immediate report on a resolution of its board of directors to grant options to the employees of Walla in a remuneration plan. The remuneration plan is expected to consist of approximately 1.8 million options, comprising 3.71% of the equity of Wall at full dilution, convertible to approximately 1.8 million ordinary shares of Walla. In addition, the board of directors of Walla is entitled to cancel 0.4 million options granted to the CEO of Walla in the past, and to grant them anew in accordance with the new plan.
Implementation of the remuneration plan as described above is expected to reduce the Group's holding in Walla to 32.41% at full dilution.

NOTE 13 – LOANS AND BORROWINGS

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

A. Composition

	December 31, 2007	December 31, 2006
	NIS millions	NIS millions
Current liabilities to banks		
Short-term borrowings	**81**	118
Current maturities of debentures	**841**	1,993
Current maturities of bank loans	**991**	1,526
	1,913	3,637
Non-current liabilities to banks and others		
Debentures	**4,420**	3,170
Bank loans	**307**	481
Loans from institutional entities	**136**	169
	4,863	3,820
	6,776	7,457
Loans provided by the minority in a consolidated company	**375**	564

NOTE 13 – LOANS AND BORROWINGS (CONTD.)

B. Terms and debt repayment table

	Currency	Nominal interest rate %	Redemption year	December 31, 2007 Par value	December 31, 2007 Carrying value	December 31, 2006 Par value	December 31, 2006 Carrying value
				NIS millions			
Short-term borrowings	Shekel	Prime + (1.1-1.5)	2008	**81**	**81**	118	118
Loans from banks and others:							
Index-linked*	Shekel	3.9-11.0	2008-2015	**532**	**588**	1,486	1,528
Unlinked[1]	Shekel	PRIME + (1.15-1.112)	2008-2013	**846**	**846**	648	648
					1,515		2,294
Debentures issued to the public:							
Index-linked series 4 and 5[3]	Shekel	4.8-5.3	2008-2016	**2,707**	**2,959**	1,637	1,704
In foreign currency[4]	euro	6.5	2007	**-**	**-**	1,630	1,629
					2,959		3,333
Debentures issued to financial and other institutions:							
Index-linked**	Shekel	4.40-7.9	2008-2017	**2,160**	**2,271**	1,726	1,799
Linked to the euro	Shekel	LIBOR + 0.8	2008	**22**	**31**	22	31
					2,302		1,830
Total interest-bearing liabilities					**6,776**		7,457
Loans provided by the minority in a subsidiary (see E below)	Shekel (Index-linked)	0-11	2017	**1,012**	**375**	1,012	564

* For long-term loans of DBS from institutional bodies, the balance of which at December 31, 2007 is approximately NIS 136 million, see B(2) below.
** For an issue of DBS in July 2007, see B(5) below, and for debentures of Pelephone, see B(6) below.

NOTE 13 – LOANS AND BORROWINGS (CONTD.)

B. Terms and debt repayment table (contd.)

(1) DBS's bank loans of approximately NIS 846 million are repaid according to a repayment schedule over a period of 8 years commencing December 31, 2005. Under the loan agreements, DBS can change the loan tracks every year or two years, commencing December 31, 2005. The next date for selecting a loan track is December 31, 2008.

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

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

These loans are Index-linked and bear 11% interest. The loans are repayable together with the interest and linkage differentials on December 31, 2013, but may be repaid earlier, subject to repayment of part of the bank loans under the terms laid down in the loan agreements.

The Company undertook, in connection with the aforementioned loans, that if by December 31, 2013, the loans were not repaid (all or part thereof) or upon fulfilment of certain other conditions, the lenders could demand that it repay the lower of the balance of the loans (principal, interest and linkage) and an amount computed according to a formula which was determined, which takes into account the value of DBS at that date. In view of the Company's undertaking, on June 22, 2005 the Company received a letter from the then Director General of the Ministry of Communications, giving notice of the decision of the Ministry to call in a guarantee in the amount of NIS 10 million out of the bank guarantee the Company had provided in accordance with the provisions of its general license. According to the Director General's notice, the decision to call in the guarantee was made in view of the fact that the Company had made a commitment to the institutional entities in a manner which contravenes the directive of the Minister of Communications. The Company's position is that there are no legal or other grounds for forfeiture of the guarantee. An appeal against the decision was submitted to the then Minister of Communications, due to which the forfeiture was stayed until receipt of the ruling of the Supreme Court In September 2007 on the petitions filed by the Company. In February 2008, a hearing of the Company's appeal was held before the Minister of Communications, and the Company believes that the guarantee will be forfeited. The financial statements include a provision which the Company's Management deems appropriate. See also Note 33(3).

(b) In December 2006, DBS signed an agreement with another institutional entity for receipt of a loan of NIS 50 million. The aforementioned loan is linked to the Index and bears interest at an annual rate of 8%. DBS was granted an option for an additional loan in the same amount. DBS exercised the option in June 2007. Following the issue of the debentures (described in section (5) below), the loan agreement was amended and the parties agreed that DBS would repay the principal – NIS 100 million, upon receipt of the funds raised in the issue, since the institutional investor purchased debentures in the framework of the issue. The loan was repaid during the reporting period as described above.

(c) The balance of the loans from institutional entities at December 31, 2007 includes accrued interest of NIS 31 million (2006 – NIS 17 million).

(3) The balance of the par value of the debentures is NIS 3,586,967,000, of which NIS 2,706,867,000 par value was issued to the public.

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

NOTE 13 – LOANS AND BORROWINGS (CONTD.)

B. Terms and debt repayment table (contd.)

(3) (contd.)

b. The balance of the par value of the debentures (series 5) is 2,386,967,000 of NIS 1 par value each, of which 1,506,867,000 debentures were issued to the public and to institutional investors, and the balance of 880,100,000 to Bezeq Zahav Holdings Ltd. (wholly controlled by the Company). The debentures are payable in 6 equal annual instalments in each of the years 2011-2016. The interest rate for these debentures is 5.3% p.a.

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

(4) The balance of the par value of the debentures held by the public on December 31, 2006 was 293,000,000 euro. These debentures were repaid in August 2007.

(5) On July 31, 2007, in a private placement. DBS issued approximately NIS 620 million par value of debentures (series A) to institutional investors, to be registered in a continuous institutional system on the Tel Aviv stock exchange. For the issuance, the debentures were rated by Maalot Securities Rating Co. Ltd. ("the Rating Company") at BBB-/stable. The net proceeds from the issuance amounted to approximately NIS 614 million.

The debentures are repayable in 8 annual payments of principal and interest of July 5th of each of the years 2010 – 2017, where the payments of the principal in each of the years 2010 – 2013 will be at 8% of the par value of the debentures and the payments of the principal in each of the years 2014 – 2017 will be at 17% of the par value of the debentures. The debentures are linked to the Index commencing June 2007, and bear annual linked interest at 7.9% (subject to various possible adjustments pursuant to the terms of the debentures), which will be paid in half-yearly instalments in January and July of each of the years 2009 – 2017.

DBS did not undertake to list the debentures for trading on the stock exchange; however, if they are listed, the annual interest paid on them from that date will be reduced to 7.4%. Conversely, if the debentures are not listed by July 31, 2008, the annual interest rate paid on them will increase to 8.4% as long as they are not listed (and in the event of later listing, the interest rate from that date will be reduced to 7.4% as aforesaid).
If the rating of the debentures is lowered by two rating levels without the debentures having been listed, then the annual interest rate will be increased to 8% until the original rating is restored or until the debentures are listed (in which case, the above-mentioned lowering of the interest rate will apply additionally). Furthermore, if DBS does not comply with the terms set out in the financing agreement between it and the banks, and as a condition for the banks waiving such violation, DBS undertook to pay the banks, in respect of the bank credit, an additional margin on the bank interest, and if at that time the debentures are not listed for trading, then as long as the banks are paid such an additional margin and the debentures are not listed, DBS will pay the debenture- holders additional annual interest at the same rate.

(6) Pelephone had four series of debentures issued in a private placement to institutional investors. The debentures, which were issued at par value, are linked to the Index, bear annual interest of 4.4% - 5.2%, and are repayable in 20 equal semi-annual payments. The interest is paid on the unpaid balance of the principal. The balance of the debentures at December 31, 2007, is approximately NIS 895 million.

C. Charges and collateral

(1) The private debentures of the Company, whose carrying value at December 31, 2007 is approximately NIS 750 million, are secured by a symbolic charge. In addition, the Company created a negative pledge in favour of the holders of those debentures.

NOTE 13 – LOANS AND BORROWINGS (CONTD.)

C. Charges and collateral (contd.)

(1) (contd.)

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

In addition, some of the lenders, from whom the balance of the debentures at December 31, 2007 is approximately NIS 159 million, may call for immediate payment of the debentures if the State's holdings in the share capital of the Company falls below 26% (a condition that was met commencing October 11, 2005). For this reason, the balance in the financial statements is stated as a short-term liability.

The Company's position is that at the reporting date, it is in compliance with all the aforementioned terms, except for the holdings of the State.

(2) a. The bank loans and debentures ("credit providers") of Pelephone, the carrying amount of which at December 31, 2007 is NIS 1.347 million, are secured by an irrevocable liability of Pelephone in favour of the credit providers, not to encumber its assets without their consent, i.e. a negative pledge.

The liability includes, *inter alia*:

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

(2) Compliance with the following financial stipulations:
a. An undertaking that Pelephone's debt will not exceed three times its shareholders' equity and an undertaking that as long as that ratio exceeds 2.5, dividends will not be distributed and management fees will not be paid to the shareholders.
b. Pelephone undertook that the amount of its debts will not exceed NIS 3.8 billion (linked to the known Index in January 2002).
c. An undertaking towards a certain bank that its total debt to it will not exceed 40% of its total debts to all the financial entities.

At the date of the financial statements, Pelephone is in compliance with its undertakings and the financial stipulations with which it undertook to comply for the banks. Non-compliance with these undertakings would cause the loans received by Pelephone from the banks to be immediately repayable.

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

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

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

NOTE 13 – LOANS AND BORROWINGS (CONTD.)

C. Charges and collateral (contd.)

(3) During 2005, the banks completed the transfer of the entire credit line to which DBS was entitled under the financing agreements.

The terms of long-term loans which DBS received from banks, the balance of which at December 31, 2007, is NIS 974 million (which includes short-term borrowings of approximately NIS 81 million and shekel loans at variable interest of approximately NIS 846 million), impose restrictions with regard to the lien or sale of certain assets,, a restriction on receipt of credit from other banks (without the prior approval of the lending bank), a restriction on distribution of a dividend, a restriction with regard to repayment of shareholder loans, and restrictions on transactions with interested parties, a restriction on changes in the holdings of shareholders, restrictions relating to providing DBS with various licenses granted to it, restrictions relating to the purchase of securities by DBS and the establishment of a subsidiary, restrictions relating to the issuance of shares or other securities of DBS.

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

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

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

On July 22, 2007, DBS and the banks signed an eighth addendum ("the Addendum") to the financing agreement, which determines the following matters:

a. The terms laid down in the financing agreement were updated.
b. A reserve was created from the proceeds of an issuance of debentures by DBS in July 2007 as mentioned in section B(5) above. Under the Addendum, the issue of the debentures will be used by DBS for partial repayment of the bank credit, for repayment of the loan DBS took from an institutional entity in 2006 (including a bridge loan provided by that entity to DBS in June 2007), in the amount of NIS 100 million, and for DBS's current operations.

At December 31, 2007, DBS is not in compliance with the financial criteria set for it. Subsequent to the balance sheet date, DBS received relief in connection with those criteria at December 31, 2007, whereby at the date of approval of the financial statements, DBS is in compliance with the terns laid down in the financing agreement.

Since DBS prepares its financial statements in accordance with IFRSs, which require review of DBS's compliance with the terms at the date of the financial statements, the loans at December 31, 2007 are classified under short-term liabilities.

DBS requested the banks that they update the stipulations for 2008 in order that they correspond to DBS's budget. On March 6, 2008, DBS received the banks' consent to amend the aforementioned stipulations.

NOTE 13 – LOANS AND BORROWINGS (CONTD.)

C. Charges and collateral (contd.)

(3) (contd.)

According to the assessments of DBS's management, the financing resources available to it will be sufficient for its operational requirements for the coming year, based on the cash flow projections approved by DBS's board of directors and if additional resources are needed for those requirements in the coming year, DBS will adapt its activities so that additional resources will not be required beyond those at its disposal.

To secure these liabilities and guarantees, DBS registered a charge on all its assets, including shareholders' equity and goodwill.

(4) The debentures issued by DBS as described above in Section B(5), are secured by a senior floating charge on all the assets of DBS (except for those excluded pursuant to the Communications Law) in an unlimited amount, as well as a senior fixed charge of unlimited amount on the rights and assets of DBS which it encumbered in favour of banks (except for those excluded pursuant to the Communications Law). These securities are first rank and *pari passu* to the floating charges and fixed charge created by DBS in favour of the banks to secure the bank credit.

In October 2007, Maalot announced that the debentures had been placed on the Watch list due to the disruptions in DBS's broadcasts, since, it said, they led to a higher level of expenses than expected, to a deviation from the business plan of DBS and to the filing of a number of legal claims against it. In February 2008, Maalot announced that the debentures had been removed from the Watch list and affirmed the BBB-/stable rating, *inter alia* since DBS had succeeded in preserving its subscriber base and in meeting the subscriber target set prior to the disruption event.

On October 21, 2007, DBS received a letter from the trustee of the debentures, noting that following the disruptions in broadcasts and the subsequent publicity about them, including about the decreasing number of DBS's subscribers and the compensation that DBS granted its subscribers, and requesting various documents and approvals from DBS in order to ascertain whether those events and their long-term implications could have an adverse effect of DBS's undertakings to the debenture-holders. Following the enquiry from the trustee, a meeting and discussion on the matter was held between the trustee and DBS and as a result of the aforementioned Maalot notification that DBS had been taken off the Watch list the trustee notified DBS of the return to the regular reporting format required by the deed of trust.

(5) For the matter of a charge provided by the shareholders of DBS, see Note 19H below.

D. Debenture issue expenses

The expenses for issuing the debentures amounted to approximately NIS 11 million for 2007 (2006 – NIS 22 million), and are presented after deduction of accumulated amortisation of approximately NIS 4 million (2006 – NIS 14 million).

E. Loans provided by the minority in a consolidated company

Loans provided by the shareholders of DBS were included in the DBS financial statements according to their fair value when received. The fair value of the loans was determined according to the present value of the cash flows anticipated in respect of loan repayment, taking into account the dates on which the shareholders would first be able to demand repayment of the loans (in accordance with the restrictions to which the shareholders consented in agreements with the banks and financial institutions), and the interest rates applicable to loans carrying a similar risk on the dates of receipt of the loans. The interest rate taken into account as aforesaid, which constitutes the effective interest rate in respect of the loans, is 12%.

NOTE 13 – LOANS AND BORROWINGS (CONTD.)

E. Loans provided by the minority in a consolidated company (contd.)

When a change occurs in the terms of the loans which gives rise to a difference of more than 10% in the discounted cash flows, the difference between the cash flows expected before the change when they are discounted at the interest rate on the date of provision of the loan, and their discounted value at the interest rate on the date of the change, is recognized in finance income. The difference between the present value of the new cash flows when discounted at the interest rate on the date of the change, and the old cash flows when discounted at the interest rate on the date of the change, is charged to a capital fund under equity.

During 2007, as part of the rating process of the debentures with the Rating Company, it was agreed to postpone the dates on which the shareholders would first be able to demand repayment of the loans.

The interest rate on the date of the change was determined in accordance with a professional opinion received by the Company from an external consultant, stating that the interest rate for capitalisation of the interest-free shareholder loans is 15.63%, and the interest rate for capitalisation of the shareholder loans bearing 5.5% interest is 15.58%. In accordance with these rates, the difference between the cash flows anticipated before the change when discounted at the interest rate on the date of providing the loan 12% and their discounted value at the interest rate on the date of the change 15.63% or 15.58%, as the case may be, which amounted to approximately NIS 213 million, was charged to finance income in the financial statements of DBS, and approximately NIA 96 million in the consolidated statement. Income of NIS 96 million in the consolidated statement was attributed to minority rights, and did not impact the share of the equity holders of the Company.

The difference between the present value of the anticipated cash flows prior to the new repayment dates and the present value of the cash flows that were anticipated according to the repayment dates before the change when discounted at the interest rate on the date of the change 15.63% or 15.58%, which amounted to NIS 348 million, was charged to a capital reserve in the financial statements of DBS, of which approximately NIS 160 million was recognised as the minority interest in the consolidated statement. These differences, which relate to loans provided by the minority shareholders in DBS, are expected to impact the finance expense in the consolidated statement in the future, and conversely, to increase the loss that will be attributed to the minority in DBS.

NOTE 14 – TRADE AND OTHER PAYABLES, INCLUDING DERIVATIVES

	December 31, 2007 NIS millions	December 31, 2006 NIS millions
Trade payables		
Outstanding debts	**1,407**	1,221
Notes payable	**56**	84
Trade payables who are related parties and interested parties	**70**	88
Total trade payables	**1,533**	1,393
Other payables, including derivatives		
Government of Israel in respect of royalties	**54**	65
Liabilities to employees and other liabilities for salary and wages	**271**	298
Institutions	**148**	105
Liabilities to related parties and interested parties	**48**	49
Accrued interest	**120**	136
Derivatives	**12**	28
Payables and other credit balances	**92**	122
Total other payables, including derivatives	**745**	803
	2,278	2,196

Amounts payable denominated in a currency other than the functional currency include approximately NIS 313 million in respect of suppliers denominated in US dollars (2006 – NIS 381 million), and approximately NIS 8 million in respect of suppliers denominated in euro (2006 – NIS 20 million).

NOTE 15 – PROVISIONS

	Legal claims and other disputes NIS millions	Employee claims NIS millions	Dismantling and clearing of sites NIS millions	Onerous contracts NIS millions	Warranty and others NIS millions	Total NIS millions
Balance at January 1, 2007	173	105	44	8	11	341
Provisions created during the period	**50**	**60**	**4**	**12**	**4**	**130**
Provisions used during the period	**(19)**	**-**	**(2)**	**(1)**	**(2)**	**(24)**
Provisions cancelled during the period	**(2)**	**-**	**-**	**-**	**-**	**(2)**
Effect of the elapse of time in respect of capitalisation	**4**	**-**	**-***	**-***	**-**	**4**
Balance at December 31, 2007	**206**	**165**	**46**	**19**	**13**	**449**
Current	**206**	**165**	**-**	**8**	**13**	**392**
Non-current	**-**	**-**	**46**	**11**	**-**	**57**

* Less than NIS 500,000.

NOTE 15 – PROVISIONS (CONTD.)

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

Dismantling and clearing of sites
The provision is in respect of an obligation of some of the Group's companies to clear sites they lease.

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

NOTE 16 – EMPLOYEE BENEFITS

A. Composition

	December 31, 2007	December 31, 2006
	NIS millions	NIS millions
Present value of unfunded obligations	**287**	245
Present value of funded obligations	**161**	196
Total present value of liabilities	**448**	441
Fair value of plan assets	**(104)**	(130)
	344	311
Cost of past service – benefit not yet vested	**(49)**	(73)
Recognised liability in respect of a defined benefit plan	**295**	238
Liability for vacation	**84**	96
Liability for sick leave	**70**	65
Liability for voluntary early retirement	**517***	880
Total employee benefits	**966**	1,279
Stated in the balance sheet as follows:		
Short-term	**705**	906
Long-term	**261**	373
	966	1,279

* Less advance payments transferred to an insurance company (Harel).

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

A. Composition (contd.)

	For the year ended December 31	
	2007	2006
	NIS millions	NIS millions
Movement in a liability in respect of a defined benefit plan		
Liability in respect of a defined benefit plan at January 1	**441**	314
Benefits paid according to the plans	**(81)**	(21)
Costs of current service and interest (see below)	**128**	46
Cost of past service – benefit not yet vested	**-**	73
Cost of past service – benefit vested	**-**	32
Cutbacks	**(21)**	-
Exchange rate differences in respect of a foreign currency plan	**(4)**	-
Actuarial gains charged to equity (see below)	**(15)**	(3)
Liability in respect of defined benefit plans at December 31	**448**	441
Movement in the plan's assets		
Fair value of the plan's assets at January 1	**130**	114
Amounts deposited in the plan	**32**	21
Benefits paid	**(62)**	(9)
Expected return on the plan's assets	**5**	4
Actuarial gains (losses) charged to equity (see below)	**(1)**	-*
Fair value of the plan's assets at December 31	**104**	130
Movement in the cost of past service – unvested benefit		
Cost of past service – unvested benefit January 1	**73**	-
Cutbacks	**(21)**	-
Amortisation of cost of past service	**(3)**	-
Cost of past service – unvested benefit	**-**	73
Cost of past service – unvested benefit at December 31	**49**	73
Expense charged to profit and loss		
Costs of current service	**107**	34
Interest on the obligation	**21**	12
Return expected on the plan's assets	**(5)**	(4)
Exchange rate differences in respect of a foreign currency plan	**(4)**	-
Amortisation of cost of past service	**3**	-
Cost of past service – benefit vested	**-**	32
	122	74
The expense was included in the following items in the income statement		
Salary expenses	**68**	66
Other operating expenses	**42**	-
Financing expenses	**12**	8
	122	74
Actual return on the plan's assets	**6**	3
Actuarial gains and losses charged directly to equity		
Amount accrued at January 1	**12**	15
Amounts recognised during the period	**(14)**	(3)
Amount accrued at December 31	**(2)**	12

* Less than NIS 500,000.

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

B. Actuarial assumptions

The principle actuarial assumptions at the date of the report:

(1) Mortality rates are based on the rates published in Insurance Circular 3-1-2007 of the Ministry of Finance, except for early retirement, which was calculated according to the agreement with Harel, and including future improvements in the mortality rate.

(2) Turnover rates were determined on the basis of the past experience of the Company and the subsidiaries, distinguishing between employees entitled to supplementary compensation and those who are not, depending on the number of years of employment in addition to the above distinction made. In the Company – the turnover rate is determined, additionally, with a distinction made between permanent employees (between 3.5% in the first year to 0.5% over 10 years), personal contract employees (5.5% per year), senior employees (20% per year), and temporary employees (between 34% in the first year and 25% over 7 years).
Bezeq International – The turnover rate includes a distinction made between headquarters' employees with compensation (between 2.2% for the first year up to 4% over 11 years), headquarters' employees without compensation (between 17.6% for the first year to 2% from the seventh year onwards), non-headquarters' employees with compensation (3.3% in the first year to 4% over 11 years), headquarters employees without compensation (48.1% in the first year to 3% over 6 years). Pelephone – The turnover rate includes a distinction made between senior employees with compensation (8% per year), senior employees without compensation (12% for the first year and 2.5% over 11 years), non-senior employees with compensation (5% for the first year and 25% from the second year), and non-senior employees without compensation (45% for the first year and 7% from the third year). DBS – The turnover rate includes a distinction between employees with compensation (between 20.66% in the first year to 2% in the fifth year and over) and employees without compensation (between 27% in the first year and 2% in the fifth year and over).

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

	December 31, 2007	December 31, 2006
	Discounted rate	Discounted rate
Compensation	**3.4%**	3.7%
Sick leave	**3.6%**	3.6%
Vacation	**3.4%**	3.6%
Retirement benefit – holiday gift*	**5.3%**	5.2%
Retirement benefit – clubs and activities	**3.6%**	3.6%
Early notice to senior employees	**3.3%**	3.6%

* At a discount rate based on American corporate debentures.

(4) Assumptions regarding salary increments were made on the basis of the Company's experience and Management's assessments, distinguishing between groups of employees as explained in sub-section 2 above over the period of their service to retirement.
The Company – For permanent employees, the average salary increment is 6% for young employees, with a linear decrease to 1.75% per year up to age 60. For temporary workers, salary increments average 0.45% at every age. For senior employees, an average increment of 6% per year.
Bezeq International – For headquarters' employees, salary costs of 7% per year to age 34 and from that age, a linear decrease of 1% until stabilisation at an increment of 1% per year from age 40. For workers who are not headquarters' employees, the rate of the increment is 1%.
Pelephone – For senior employees at age 21, salary costs of 4% increases linearly to 14% at age 28, and from that age onwards, decreases linearly to 2.5% at age 39. For non-senior employees from age 21 to age 28 a salary increment of 16%, and from that age a linear decrease to 2.5% at age 39.
DBS – For all employees, the salary increment rate is 5% per year throughout the period of service.

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

B. Actuarial assumptions (contd.)

(5) The forecasted growth rate of the assets accumulated in all the companies in the Group, except those Company employees who do not have senior status, is 3% per year – a rate reflecting an expected return value of 4% and a deduction of 1% management fees, while in the Company, for employees who are not senior, the growth rate in accumulated assets is only 2%. This rate reflects the fact that most of the funds are in old pension funds in which the yield rate is fixed.

(6) An obligation in respect of voluntary early retirement includes an obligation for pension and grants. The obligation for pension is calculated according to the terms of the agreement of December 5, 2006 (see section H) and in accordance with the terms with Harel (see section G). The obligation is influenced by changes in the interest rate of the debentures up to the date of purchase of the policies and their payment to Harel.

C.

	December 31, 2007	December 31, 2006	December 31, 2005
	NIS millions	NIS millions	NIS millions
Present value of the defined benefit plan obligation	**448**	441	314
Fair value of plan assets	**(104)**	(130)	(114)
Deficit in the plan	**344**	311	200
Adjustments for liabilities arising from past experience	**15**	4	
Adjustments for assets arising from past experience	**1**	(4)	

In 2008, the Group expects to pay NIS 20.6 million as a contribution to a defined benefit plan.

D. Defined contribution plans

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

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

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

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

E. Defined benefit plan

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

(2) The collective agreement dated December 5, 2006 (see Section H(1) below), provides, among others, that employees who transferred from the civil service to the Company, who end their employment due to retirement after December 31, 2013, are entitled to a supplement to close the gap between the two Civil Service Law tracks and the regulations governing Makefet. As a result of this clause in the agreement, the benefit to these employees is enhanced. The Company includes in its financial statements the liability net of the cost of prior service not yet vested. This benefit will be spread on a straight line basis over a period of 18.75 years (the average period to vesting of the benefit).

(3) Through December 2005, liability in respect of early notice for senior employees was not included in the financial statements. In September 2006, the Company's Management decided that this benefit should be paid upon cessation of the employer employee relationship. Accordingly, the liability is included in the financial statements in accordance with the employment agreement and an actuarial calculation. The increase in the benefit in respect of this change is recorded as cost of prior service vested immediately, and is therefore recognised immediately in profit and loss.

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

F. Other long-term employee benefits

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

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

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

G. Benefits in respect of dismissal and early retirement

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

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

On April 17, 2005, a special collective agreement was signed between the Company and the employees' representatives and the Histadrut, enabling early retirement of employees through a substitute for Makefet Fund. On June 28, 2005, an agreement between the Company and Harel Insurance Co, Ltd. ("Harel") was completed and signed. The agreement regulates pension payments in respect of early retirement, as well as old age and survivor pension payment differences arising from legislative amendments to the Israel Economic Recovery Plan (Legislative amendments for attaining budget targets and the economic policy for the 2003 and 2004 financial years) Law, 5763-2003, for employees who retired commencing at the end of 2003 and until the beginning of 2004, and/or who will retire from the Company in accordance with the special collective agreement for retirement signed in September 2000, as amended on March 18, 2004 ("the Retirement Agreement").

Following execution of the agreement with Harel, the aforementioned special collective agreement between the Company, the employees' representatives and the Histadrut was revised and amended on the same date (June 28, 2005). On February 14, 2008, an amendment to the June 2005 agreement was signed by the Company and Harel, which contains the following main points:

(1) the June 2005 agreement will also apply to Company employees who retire from their employment in the Company by December 31, 2013 in the early pension track in accordance with the option granted to the Company in the special collective agreement of December 5, 2006, if and insofar as the Company chooses to exercise that option;

(2) reduction of the contribution paid by the Company to Harel in respect of each retiree who is insured in accordance with the June 2005 agreement, where a policy had not yet been issued by Harel in respect of him on the date of the signature of the amendment to the June 2005 agreement.

H. Other

(1) On December 5, 2006, the Board of Directors of the Company approved a new collective agreement between the Company and the employees' organisation and the New General Workers' Histadrut. The agreement regulates the labour relations in the Company following the transfer of control in the Company from the State of Israel, and delineates a new organisational structure for the Company. Below are the main points of the agreement:

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

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

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

H. Other (contd.)

(1) (contd.)

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

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

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

f. In addition, the Company will pay the employees a special bonus for the period through December 31, 2006, in a total amount of NIS 44 million. Commencing in 2007, the bonus system which had been customary in the Company (as a State-controlled company) would be changed in the manner detailed in the agreement.

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

An amendment to the new collective agreement is being discussed by the Company and the employees' representatives, mainly concerning the organisational structure being brought forward (with minor changes) and concerning earlier retirement ages and a change in the mix of retirees. The financial statements include a revised provision for retirement in accordance with the amendment being formulated.

NOTE 16 – EMPLOYEE BENEFITS (CONTD.)

H. Other (contd.)

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

NOTE 17 – CONTINGENT LIABILITIES

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

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

In the opinion of the managements of the Group's companies, the additional exposure at December 31, 2007 due to claims filed against the companies in the Group on various matters and in which the likelihood of realisation is possible, amounts to approximately NIS 18.5 billion, of which approximately NIS 3.4 billion relates to salary claims filed by groups of employees or individual claims with wide ramifications. The above amounts are before the addition of interest. For the matter of a claim dismissed subsequent to the balance sheet date, see Section A(34) below.
Concerning applications for certification as class actions regarding which the Group has exposure beyond the aforesaid (since the claims do not state a specific amount), see claims in sections A(4), (5), (7) and (20) below.

Below are details of the status of the significant contingent liabilities of the Group at December 31, 2007.

A. Claims

(1) In September 2004, a claim and an application for certification as a class action were filed in the Jerusalem District Court against the Company and several other defendants (including Telrad and Tadiran) and against the State of Israel – Ministry of Communications as a formal defendant. The claim alleges that public switching cartels gave rise to unnecessary expenditure for the Company and an unjustified increase in its tariffs, in a cumulative amount of approximately NIS 1,750 million. In this matter, the Antitrust Court approved issue of an agreed order whereby the Company will pay NIS 2 million to the State Treasury without admitting violation of the provisions of the Antitrust Law, and the Antitrust Authority will refrain from instituting proceedings in connection with the matter.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims

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

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

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(2) (contd.)
The maximum total exposure in respect of the above claims is approximately NIS 3.4 billion.

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

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

(4) In September 2000, three plaintiffs filed a claim in the Tel Aviv District Court, together with an application for certification as a class action, against the Company, Bezeq International and the other international call operators, concerning the charge of VAT on international calls originating from abroad. The plaintiffs estimated the total value of the claim in millions of shekels per year. The application for certification was dismissed, and the plaintiffs filed an appeal against the decision. On April 10, 2007, a decision was given validating the procedural arrangement whereby the Company and Bezeq International would be struck out of the claim (after they undertook to transfer any amount paid to them, if paid, by the Customs and VAT Division in connection with the claim, as directed by the Court).

(5) a. In March 2003, a claim was filed in the Tel Aviv District Court (in 2007, the case was transferred to the new Central District Court) against the Company, the Broadcasting Authority and the State of Israel, by various plaintiffs from Moshav Porath in the Sharon region, including the estates of deceased persons, for compensation due to physical harm allegedly caused by prohibited radiation from the Hillel broadcasting station. The amount of the claim stated by the plaintiffs is "more than NIS 15 million", and the same claim notes that the plaintiffs will also petition to split the reliefs so that they will reserve the right to sue later for other financial damages which are not bodily harm, such as damage to crops and loss of value of land.

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

b. In June 2004, another claim was filed in the Tel Aviv District Court (in 2007, the case was transferred to the new Central District Court) by 25 plaintiffs from Moshav Porath and Moshav Ein Vered, including 11 heirs to the estates of deceased persons, against the Company, the Broadcasting Authority and the State of Israel, for compensation in respect of bodily harm. The claim alleges violation of legislated duties, and/or acts of omission by the defendants in connection with the operation of the Hillel station. The amount of compensation claimed is not estimated (although the claim is in the jurisdiction of the District Court, i.e. more than NIS 2.5 million), and the compensation is based on financial and non-financial damages items which are listed in respect of each plaintiff, together with punitive compensation.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(5) (contd.)

c. In May 2005, the Company received a claim for NIS 46 million in damages, which was filed in the Tel Aviv District Court (in 2007, the case was transferred to the new Central District Court) by 14 plaintiffs who were and/or are residents of the moshavim Porath, Ein Vered, Ein Sarid and community of Kadima, against the Company, the Broadcasting Authority and the State of Israel. The claim alleges the violation of legislated duties in connection with the Hillel station, which resulted in bodily harm to the plaintiffs due to prohibited radiation.

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

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

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

(6) In January 2002 a claim for payment of monetary compensation of approximately NIS 57 million and for writs of mandamus were filed in the Tel Aviv District Court (in 2007, the case was transferred to the new Central District Court), by an international communications operator against the Company and Bezeq International. The claim is for damages allegedly sustained by that operator due to acts of commission and omission in connection with customer allocation to the international call operators. Alternatively, the plaintiff alleges that it is entitled to reimbursement of access fees which it paid to the Company.

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

(8) On December 25, 2005, a claim was filed against the Company in the Tel Aviv District Court, together with an application for certification as a class action, under the Consumer Protection Law, 5741-1981, alleging that the Company unlawfully collects payment for surfing the internet with WOW's high-speed internet service, even though is technically unable to provide the service in certain areas at the promised speed. The plaintiffs estimate the amount of the class action at approximately NIS 100 million for all subscribers. On March 6, 2008, the application of one of the two plaintiffs for certification of the claim as a class action, was allowed for a group of subscribers defined in the court's decision. The Company, together with the external attorneys who are handling the case, are discussing the significance of the decision, as well as the possibility of appealing it.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(9) In May 2006, a claim was filed in the Tel Aviv District Court together with an application for certification as a class action under the Consumer Protection Law and the Class Action Law, alleging deception in advertising in the matter of a charge for calls from a Bezeq line to a cellular line. According to the plaintiff, the Company deceived the public in its advertisements, which stated that the price of such a call would be "approximately 44 agorot per minute", whereas the exact price per call minute was 44.57 agorot, nor did it disclose that the charge for interconnect was made according to segments of 12 seconds, which means that the actual average charge was 49 agorot per minute. The plaintiff estimates the amount of the claim at approximately NIS 68.5 million (the amount of the individual's claim is NIS 11).

(10) Various municipalities and local councils submitted demands for retroactive payments of municipal property taxes for the increased area of buildings and a change of the classification for municipal tax purposes. The demands together total approximately NIS 102 million.

(11) In May 2006, a claim was filed in the Tel Aviv District Court together with an application for certification as a class action, against HOT and against the Company. According to the plaintiff, on May 17, 2006, a fault occurred in his telephone line in the HOT network and it is possible that Company employees played some part in the malfunction. The plaintiff alleges that as a result of the malfunction, he incurred financial loss, harm to his goodwill, and distress. The amount of the claim is estimated by the plaintiff at approximately NIS 100 million (the amount of the personal individual's claim is assessed at NIS 1,000).

It is noted that on December 24, 2007, the Company received a ruling of the Antitrust Commissioner stating that the Company abused its status in the market, in contravention of Section 29A of the Antitrust Law, in that it did not respond, as required and promptly, to actions taken in a labour dispute. The ruling also states that pursuant to Section 43(e) of the Antitrust Law, the ruling would serve as *prima facie* evidence of its contents in any legal proceeding. On this matter, see also Section C(1) below.

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

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

(14) In August 2006, a claim was filed in the District Court against Pelephone, Cellcom and Partner, together with an application for certification as a class action ("the First Claim"). The amount of the action (consolidated against the three companies) is NIS 100 million. The claim relates to the time of termination of cellular system calls with the fixed line and it is claimed that regarding the aforementioned calls, where the cellular customer initiates the end of the call there is an excess charge until the time the call is actually ended. In November 2006, a claim and application for certification as a class action were filed in the Tel Aviv District Court against the Company, Pelephone, HOT, Cellcom and Partner, amounting to approximately NIS 159 million, of which NIS 53 million against the Company, together with Pelephone and HOT ("the Second Claim"). In the second claim, the plaintiffs allege that when terminating a call made from a cellular line to a fixed line, if the call is ended by the fixed line call recipient (and not by the cellular line call initiator), the Company and HOT delay sending the disconnection signal for about 60 seconds. As a result, they incur a loss which is reflected in air-time costs and interconnect fees.
In a procedural arrangement reached between the parties, it was determined that the First Claim would be conducted against Pelephone and against Cellcom and Partner, and the Second Claim would be conducted against the Company and HOT.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(15) The Company has received a demand for the forfeiture of a guarantee in the amount of approximately USD 6.5 million related to a project (HBTL) in a basic telephony tender in 1995 in India, in which the Company participated, together with others. An appeal against an order given at the request of the project, preventing forfeiture of the guarantees, is being heard in the Appeals department of the High Court in Delhi. The Company has applied to the court in Delhi for release of the bank guarantees it provided. The court has not yet heard the application.

(16) In May 2007, the Company received a claim, together with an application for its certification as a class action, that was filed with the Tel Aviv District Court 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 or are serving in the Company during the relevant period, as well as Ap.Sb.Ar. Holdings Ltd., which holds 30% of the Company's shares.

The claim alleges that the Company's financial statements for the years 2004 and 2005 contained false and misleading material information, including with regard to the annual profit, the property, plant and equipment and the shareholders' equity, in light of a retroactive deduction of 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 claim is NIS 194, and the total amount of the claim for the group is NIS 56.5 million.

(17) In August 2007, the Company received a claim together with an application for certification as a class action, which was filed against the Company in the Tel Aviv District Court by a plaintiff alleging to be a customer of the Company, who signed a contract with the subsidiary DBS for receipt of high-speed internet infrastructure services (ADSL). The plaintiff is seeking reimbursement of all the fixed monthly payments he made for maintaining a landline for which he no longer has any use. He contends that these payments were collected unlawfully since from the technological aspect, high-speed internet can be provided without the landline being used. According to the plaintiff, all the customers of the Company and/or of DBS who subscribed to the Company's high-speed internet service during the past two years and who requested that the Company's landline be disconnected and/or who ceased to use it but continued making the fixed monthly payments for it, have the right of such a claim. The plaintiff is seeking certification of the claim as a class action in the name of the customers referred to above, and he estimates the amount of the class action at approximately NIS 108 million.

(18) In September 2007, a claim was filed against the Company in the Tel Aviv District Court, with an application for certification as a class action, concerning the collection of VAT on arrearage interest and on charging collection expenses and commissions. The amount of the class action is estimated at approximately NIS 114 million.

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

In June 2007, a hearing was held at which the Court proposed that Bezeq International publish an apology and make some kind of contribution to the community. In June 2007, Bezeq International notified the Court that there was no justification for such apology or contribution, since there was no deception and/or misleading advertising. Bezeq International also noted that in view of its respect for the Court, it would make a donation to the public, which should not be bound up with the class action. In August 2007, the Supreme Court ruled that the parties should state whether they see any need for a frontal hearing, and later the same month Bezeq International delivered a notice saying that an additional frontal hearing was necessary in the presence of the parties, in order to present the facts relevant to the proceeding and to clarify that in view of the evidence, there is no justification for certification of the claim as a class action.

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(22) In September 2001, a claim was filed in the Ram Allah District Court by the General Public Palestinian Communications Company ("Patel"), against Pelephone and another company.

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

The process of transferring the claim through the Attorney General ceased and the alternative service of process by registered mail was returned through the Ministry of Justice. It should also be noted that Pelephone does not recognize the jurisdiction of the court in Ramallah.

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

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

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

The claim relates to amounts collected by Pelephone and another cellular company for interconnect fees on incoming calls, from May 10, 1996 to October 2, 2000. The applicants, through their lawyers, base their claim on the allegation that every cellular operator is a monopoly in the incoming call service to its network. Pelephone and the other cellular operator abused their monopoly status in that they set high and unfair prices for the incoming call service to their networks. The correct and fair tariff for the incoming call service is 25 agorot per minute, and not as collected in the past by Pelephone and the other cellular company or as set today in the Telecommunications (Payments for interconnect) Regulations, 5760-2000.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

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

(25) In July 2006, a claim and an application for its certification as a class action were filed in the District Court against Pelephone, in the amount of approximately NIS 251 million. The claim relates to the interpretation of an agreement which the plaintiff signed with Pelephone for reimbursement of payments he was charged by Cellcom when he switched from Cellcom to Pelephone. According to the plaintiff, Pelephone should have paid NIS 3,000 in respect of those payments, even though he did not comply with the terms of the agreement. Pelephone is conducting procedural discussions with the plaintiff, in view of new applications he filed for amendment of the application for the class action. Pelephone will respond appropriately when these discussions are completed.

(26) In February 2007, Pelephone received an application for certification of a class action filed against it in the Tel Aviv District Court. The claim concerns an allegation of misleading the defendant's subscribers who reside in Eilat, who were charged VAT on cellular communication service. According to the claim, this charge contravenes the law in that Eilat is a free trade zone and therefore lawfully exempt from payment of VAT. The amount of the claim is NIS 33 million. It is noted that other class actions were filed against Partner and Cellcom for the same cause and in similar amounts. The claim was dismissed in 2007 without an order to pay costs.

(27) In February 2007, a claim and an application for its certification as a class action were filed in the Tel Aviv District Court against Pelephone, Cellcom and Partner, in a total amount of NIS 449 million. The amount attributed to Pelephone is NIS 167 million. The plaintiffs are suing for restitution of excess amounts which they allege were collected from the subscribers of the defendants, claiming that the defendants charged their subscribers for a service which was provided and/or received while they were abroad, according to an increased charge (time) segment than the defendants were ostensibly permitted to charge, thereby seemingly violating the license, which prohibits them from charging their customers according to time units of one minute for roaming services.

(28) In June 2007, a financial claim and application for its certification as a class action were filed in the Tel Aviv District Court against Pelephone. The aggregate amount of the claim is approximately NIS 239 million, and it relates to a group of customers from the Russian sector of the population and the tariff tracks that were offered to them.
According to the plaintiffs, Pelephone deceived the subscribers of the "New Immigrants Plan" into believing that they would be charged on the basis of 12-second units, while in practice, they were debited on the basis of one-minute units.
It is also alleged that in order to perpetuate the deception, Pelephone did not provide the subscribers with the price list for the plan, as required under its license.

(29) In November 2007, a claim was filed against Pelephone in the Tel Aviv District Court together with an application for its certification as a class action. The amount of the class action is approximately NIS 368 million.
The application is based on the allegation that Pelephone did not fulfil its obligation to ascertain that the content services provided by external providers are provided only to those of its customers who request them. According to the plaintiffs, Pelephone violated Section 58.6 of its cellular operator license and therefore also Section 11(a) of the Telecommunications Law, and is therefore in beach of a legislated duty towards its customers.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(30) In June 2006, an application was filed in the Tel Aviv District Court for approval of a claim as a class action against DBS and against the cable companies, in connection with the broadcasting of commercials during the 2006 World Cup Games. According to the applicants, the broadcasting of commercials, which they allege were integrated into the first three days of broadcasts of the World Cup channel as part of the games and the World Cup studio, was against the law, contrary to the contract between DBS and its customers, and contrary to the terms laid down in the decision of the Council to approve the broadcasting of the 2006 World Cup Games. The applicants estimated the amount of the claim at NIS 106 million for all the members of the group (based on 200,000 World Cup subscribers of the cable companies and DBS together, calculated at NIS 530 per subscriber who purchased the World Cup package).

(31) 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 obligation, 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.

(32) During October 2007, two applications for certification of claims as class actions were filed in the District Court against DBS, in the matter of broadcast interference. The plaintiffs allege that because in September 2007 DBS subscribers were subjected to daily disruptions and long breaks in television broadcasts which severely disrupted the picture and sound, and that the DBS service centre malfunctioned and neither service nor assistance were available. The plaintiffs are seeking restitution, compensation or credit in the full amount of the monthly subscriber fees paid to DBS for September 2007, for all those who were subscribers at that time.
The plaintiffs estimate the loss for one claim at NIS 103 million and for the other at NIS 66 million.
On January 16, 2008, the applicants filed a notice in the court, stating that the actions would be conducted in only one claim. The date for filing DBS's response to the application for certification was set for March 31, 2008.

(33) In July 2007, a statement of defence was filed on behalf of an entity that had been sued by DBS, and concurrently it filed a counter-claim against DBS and another company for approximately NIS 43 million. In the statements of defence and counter-claim, it was alleged that the liability for the failures in the decoders supplied to DBS is not that of the entity but devolves on DBS and/or another company since the entity alleged, *inter alia*, the decoders were not properly characterised by the defendants and were not tested as required, and in at least some of the cases were not properly installed in the DBS subscribers' homes. In view of these allegations, the counter-plaintiff alleged various losses related to repair of the decoders even beyond the contractual warranty period, in the supply of spare parts, in providing manpower services and in various payments it made to the other company. Alternatively, the counter-plaintiff is suing for lost expenses and loss of profits, which it allegedly incurred. On November 1, 2007, an application was filed on behalf of DBS for amendment of the statement of defence and the statement of counter-claim filed by the aforementioned entity, since they were not in compliance with the Civil Procedures Regulations. Concurrently, an application was filed on behalf of DBS for postponement of the date for filing its statement of reply and statement of defence in the counter-claim, until a decision is handed down in the application for an order as aforesaid. No decisions have been received on these applications.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

A. Claims (contd.)

(34) In November 2006, the claim and application for certification as a class action were filed in the Jerusalem District Court for the sum of approximately NIS 10.6 billion, against the Company, HOT, Pelephone, Cellcom and Partner, concerning the failure to implement number portability. According to the plaintiffs, each of the 10.6 million subscribers of the aforementioned companies incurred a loss of NIS 1,000. Accordingly, the exposure of the Company (since it has approximately 2.9 million subscribers), is NIS 2.9 billion, while that of Pelephone (which has approximately 2.6 million subscribers) is NIS 2.366 billion. On March 5, 2008, the court approved the withdrawal of the applicants from the application for certification of the claim as a class action, and instructed that the application be struck out, and in accordance with the consent among the parties, it dismissed the personal claim of the applicants.

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

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

Claims in respect of which the exposure cannot be calculated

(1) In January 2004, a claim was filed in the Tel Aviv Regional Labour Court against the Company and against the Makefet Fund, by employees who retired under a retirement agreement signed in November 1997. The plaintiffs allege that they chose the Pension Track B after having been promised an increment pursuant to the "Yellow Note" agreement, and that this promise was not kept. The claim was originally filed by 66 retirees and today, the number of plaintiffs is approximately 320.

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

(3) In December 2007, a claim and an application for its certification as a class action were filed against Pelephone in the Tel Aviv District Court, in the amount of approximately NIS 37 million. The principal allegation in the claim is that Pelephone decided unilaterally, commencing June 2007, to add all its telephone lines which pay only for call minutes without a commitment, to a plan called the "Basic Diminishing Tariff", and to charge those who subscribe to it a monthly fee of NIS 12.90.

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

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

On March 8, 2006, DBS filed an application for removal of the claim as a class action. On April 11, 2006, the applicant filed its response, in which dismissal of the application was allowed without any decision having been given.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

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

Claims in respect of which the exposure cannot yet be assessed

(1) In December 2007, a claim was filed in the Tel Aviv District Court against Pelephone, Cellcom and Partner, together with an application for certification as a class action, in the amount of NIS 1 billion. The claim relates to radiation injury from cellular antennae which were ostensibly erected unlawfully. Pelephone is studying the claim.

(2) In January 2008, a claim was filed in the Tel Aviv District Court against Pelephone and another company, for physical injury due to exposure to radiation during the plaintiff's work with fire extinguishing systems in the relay stations of the Company. Pelephone is studying the claim.

(3) A number of proceedings have been served on Pelephone, in which local councils are seeking to add Pelephone as a party to various appeals filed in the Appeals Committee against dismissal of impairment of value claims under Section 197 of the Planning and Construction Law, due to the erection of communications installations. Pelephone studies each application on its merits, and decides on its course of action accordingly.

(4) On March 10, 2008, the Company received a counter-claim which was filed in the Tel Aviv District Court by HOT Telecom Limited Partnership against the Company and the subsidiary Bezeq International. The counter-claim was filed together with a statement of defence of HOT Telecom in the claim field against it by Bezeq International (in which Bezeq International alleged discrimination in contravention of HOT Telecom's license). In the counter-claim, HOT is suing for monetary losses it allegedly incurred in respect of Bezeq International's marketing of fixed-line telephony in PRI channels; deliberate disruptions in interconnect between the Company's network and the HOT network; the Company's failure to provide naked ADSL service by Bezeq; receipt of confidential information about HOT's customers by unlawful means by Bezeq International. The stated amount of the counter-claim for fee purposes is NIS 30 million.

C. Other contingencies

(1) On May 2006, investigators from the Antitrust Authority appeared in the Company's offices and presented an order of the Magistrate's Court permitting them to search the Company's offices and seize any document or object required for the investigation. According to the order, the cause of its grant was suspicion of abuse of status by a monopoly according to Section 29A of the Antitrust Law and Section 47(a)(4a) of the Antitrust Law, 5748-1988 ("the Law"), and/or unreasonable refusal to provide an asset or service which is provided in monopoly, according to Section 29 of the Law. During the search, the investigators collected various documents, including computerised material, and a number of employees were called for questioning at the Antitrust Authority offices. The Company cooperated fully with the Authority investigators.

The Antitrust Commission announced that it had completed its investigation.

On December 24, 2007, the Company received a ruling from the Antitrust Commissioner, as authorised under Section 43(a)(5) of the Law, given after having considered the Company's arguments and finding them insufficient to prevent the ruling from being given. The ruling states that the Company abused its status in the market, contrary to Section 29A of the Law, in that it did not respond to steps taken during a labour dispute by its employees, in connection with the activities of other communications operators, and in that it was not prepared, according to the ruling, to apply immediately to the Labour Court in the matter of the disconnection between its network and the HOT network. It is noted that the Company filed its application for an injunction in the Labour Court towards midday on May 18, 2006, the day after the malfunction commenced in the HOT network (during the afternoon of May 17, 2006).

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (contd.)

(1) (contd.)

The ruling also stated that pursuant to Section 43(e) of the Law, this ruling would serve as prima facie evidence of its contents in any legal proceeding, and that pursuant to Section 43(f) of the Law, the exercise of the Commissioner's authority according to Section 43, or its non-exercise, is no impediment to bringing suit against a person who committed an offence against the Law.
The Company intends to file an appeal against the Commissioner's ruling.

It is noted that in May 2006, a claim and application for certification as a class action were filed against the Company and against HOT, in the matter of a malfunction in the telephone line in the HOT network on May 17, 2006. On this matter, see Section A(12) above.

(2) a. The Company received a letter on March 15, 2007, from a shareholder of the Company pursuant to Section 194 of the Companies Law, in which the Company is required to institute legal proceedings against the former CEO of the Company and the former VP Marketing of the Company, on the matter of the debts of a consolidated company, DBS, to the Company, and to take action for the collection of the debts of DBS to the Company. The Board of Directors of the Company rejected this demand out of hand, since, among other reasons, the debts were generated as a result of lawful activities of DBS as a marketer for the Company, and the Company is acting to collect the debts, and has even reached a payment arrangement with DBS and DBS is repaying its debts regularly in accordance with the arrangement. The author of the letter (the shareholder) was notified of the decision. Subsequently, the shareholder decided to sue the Board of Directors of the Company for retroactively approving transactions which were mentioned in his first letter. The Board of Directors rejected this letter also.

b. On September 20, 2007, another letter was received from the same shareholder pursuant to Section 194 of the Companies Law, in which he demanded that the Company institute legal proceedings against members of the Board of Directors of the Company who, according to the shareholder, approved the injection of Company monies into DBS, contrary to the decisions of Ministers of Communications, thereby incurring losses of NIS 10 million for the Company (the amount which the Ministry of Communications announced at the time it would render forfeit from the Company's guarantee). The Board of Directors of the Company discussed this letter and decided to reject it. It is noted that the petitions of the Company and DBS against the Minister of Communications in the matter of the Company's injections of funds to DBS, were dismissed *in limine* in September 2007. The Company also filed an appeal in respect of the intention to forfeit the guarantee. The appeal was discussed with the Minister of Communications, and the Company believes that the guarantee will be forfeited. The financial statements include a provision which the Company's Management considers appropriate.

(3) In May 2007, the Company received a letter pursuant to Section 194 of the Companies Law, which was sent by a claimant who said she is a shareholder of the Company from the public. According to the letter, following the findings of the external examiner appointed by the Company to examine the manner in which various decisions are made and the way the Company is run, which indicate 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 was requested to institute legal proceedings against the Board of Directors and the Company's other officers who were responsible for those shortcomings and failures. The Company's Board of Directors rejected the demand outright, and informed the claimant to that effect.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (contd.)

(4) In August 2005 a claim was filed against the Government of Israel, the National Council, the Ministry of the Interior, the head of the Noise and Radiation Abatement Division (at the Ministry for Protection of the Environment), the cellular companies, including Pelephone, and a company named Elidav – Building & Investments Ltd. (the owner of a house in Ramat Hasharon on the roof of which cellular antennae were installed). The claim concerns the liability for claims under Section 197 of the Planning and Construction Law for the issue of building permits for cellular antennae. The central allegation in the claim, as far as the cellular companies are concerned, is that in the proceedings for approval of National Outline Plan 36A, the cellular companies undertook to indemnify the local committees in respect of compensation those committees would be ordered to pay in claims under the aforementioned Section 197, and that the National Outline Plan was approved on the basis of that undertaking. According to the plaintiffs, the undertaking is tantamount to "a contract in favour of a third party" in their favour and in favour of the other local committees.
The plaintiffs also allege that the Government and the National Council were negligent in that they did not anchor that undertaking in the National Outline Plan, and once it transpired – after approval of the Plan – that the cellular companies were unwilling to indemnify the local committees, the Government and the National Council should have cancelled or suspended the Plan and should also have cancelled the franchises of the cellular companies.

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

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

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

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

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (contd.)

(6) (contd.)

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

After dismissal of its application, HOT filed a "revised" *ex parte* application ("the Second Application"), in which it reiterated its First Application, this time noting that its allegations were not based only on media reports, as it had alleged in the First Application, but on information provided by Israel Police. Simultaneously, HOT filed a statement of claim against DBS, which does not include an application for any financial relief, in which the court is requested to grant a number of declaratory reliefs, mandamuses and injunctions concerned with prohibiting DBS from making use of commercial secrets of HOT.

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

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

On July 12, 2005, HOT filed an application to split reliefs so as to enable it to file a financial claim against DBS in a separate claim. On September 18, 2005, DBS filed a response, requesting the dismissal of HOT's application. On September 5, 2006, the court issued a decision directing HOT to give notice of whether it intends to continue with its application to split reliefs. On September 26, 2006, HOT filed notice in court that it intends to continue with the application and that it requests that the court allow the application as is until the pre-trial date of the claim. On the same date, the court gave its decision allowing HOT's request to leave the application as is until the pre-trial date. The first pre-trial hearing was postponed to the beginning of March 2008.

On March 3, 2008, the legal representative of DBS appeared for the pre-trial hearing of the case, whereas the legal representative of HOT was absent. In its decision, the court ruled that HOT must show cause, within 14 days, why the action should not be dismissed or struck out for failure to appear, and alternatively, why court costs should not be ruled in DBS's favour and/or in favour of the State Treasury.

In addition, in November 2005, a claim was filed in the Tel Aviv District Court against Pelephone, for an order to provide a financial report, together with an application to split reliefs. The cause of claim revolved around allegations whereby, as it were, Pelephone had "ordered" business information about the Plaintiff's business and this was supplied by defendant no. 2 (Modi'in Ezrachi) by way of violating a number of provisions of law and as part of the Trojan horse affair.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (contd.)

(7) For the provision of their services, the Company and the subsidiary Pelephone operate installations which emit electromagnetic radiation. The operation of such installations is subject to the Non-ionizing Radiation Law, 5766-2006, the majority of whose provisions came into force on January 1, 2007 ("the Radiation Law"), and the Pharmacists (Radioactive elements and their products) Regulations, 5740-1980, which regulate the erection, operation and supervision of these installations, including a requirement for permits for that purpose. Erection and operation permits are granted by the Supervisor of Radiation at the Ministry for Protection of the Environment, and grant of an operator's license necessitates presentation of a permit under the Planning and Construction Law. The Company and Pelephone are at an advanced stage of preparation and adaptation of their installations for operation in accordance with the provisions of the relevant laws. The subject of electromagnetic radiation and its effects has not yet been thoroughly investigated in Israel or elsewhere. In the first half of 2007, the Company applied for operating permits from the Supervisor of Non-Ionizing Radiation at the Ministry for Protection of the Environment, and all in accordance with the Radiation Law which came into force at the beginning of 2007. As a result of this activity, the Company received operating permits for its communications installations, except for an isolated few for which a radiation permit remains in effect under the Pharmacists Regulations. The Company has applied for operating permits in respect of these few installations also. In January 2008, drafts of National Outline Plan 36A and National Outline Plan 36B were published, which regulate licensing proceedings, in accordance with the Planning and Construction Law, of small and large radiation-emitting installations. The Company is reviewing the significance of the amendments inserted into these drafts, their effects on its installations and possible ways of changing certain provisions.

The Company and Pelephone are using their best efforts to meet the requirements of the Radiation Law, including concerning the permits required. Nevertheless, the managements of the Company and Pelephone are unable to assess whether all the approvals will be received within the time prescribed in the Radiation Law, and what the implications of the aforementioned might be.

(8) In connection with the number portability plan of December 2, 2007, which enables customers to switch between various communications operators without changing their telephone number, the petitions filed in the Supreme Court by the cellular companies and by the Company, were withdrawn with the consent of the parties while reserving their rights, and the proceedings were terminated.

On May 24, 2007, the Company received a notice from the Director General at the Ministry of Communications, stating that he was considering imposing financial sanctions on the Company pursuant to Chapter G1 of the Communications Law, 5742-1982, in respect of violation, he alleged, of the duty to provide number portability commencing 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 of NIS 2,031,750.
b. For the period from May 25, 2007, to November 30, 2007 or until the date of remedy of the alleged violation (whichever is the earlier) by the Company – a rate of NIS 6,450 for each additional day of continued violation.
c. For the period from December 1, 2007 (which, according to the letter, is the reasonable date required for the relevant license-holders to remedy the alleged violation) to the date of remedy of the alleged violation – a financial sanction as set out in Sections 37B(b) and 37C(a) of the Communications Law after Amendment 36 (it is noted that under the provisions of those sections, the relevant sanction is seven times higher than the penalty prescribed in Section 61(a)(4) of the Penal Law (which is NIS 202,000), plus 0.25% of the Company's annual income, plus a financial sanction in the amount of one fiftieth of the aforementioned sanction, for each day on which the violation continues).

The Company, Pelephone and Bezeq International (which received similar notices) have responded to the notices of the Ministry of Communications.

NOTE 17 – CONTINGENT LIABILITIES (CONTD.)

C. Other contingencies (contd.)

(9) In November 2007, a claim and an application for its certification as a class action were filed against Pelephone in the Tel Aviv District Court, in the amount of NIS 12 billion.
The claim is without cause. Pelephone and its legal advisers believe that the claim will be struck from the calendar.

(10) On November 27, 2007 and on January 31, 2008, one of the DBS shareholders (through her lawyer) approached the Company and another DBS shareholder, demanding the appointment of an arbitrator and/or compensation in the amount of NIS 124 million for losses she had allegedly incurred as a result of the conduct of the Company and the other shareholder in DBS in all matters relating to the management of DBS and the use of DBS to promote objectives which are foreign to the shareholders agreement. The Company rejected the approaches, following which, on February 28, 2008, in connection with an application was filed in the Tel Aviv District Court for the appointment of an arbitrator.

(11) Concerning class actions filed against DBS in respect of broadcast disruptions, see Section A(32) above.

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

D. Claims in an associate

(1) In July 2007, a claim was filed in the Jerusalem District Court against an associate of Bezeq International, the Israeli Police, the State of Israel and 7 other defendants from the field of communications, in a total amount of more than NIS 65 million, for physical injury ostensibly sustained by the plaintiff following the publication of libel and slander concerning his involvement in securities crimes and conspiracy to commit murder. On October 22, 2007, the associate filed an application for extension of the date for filing a statement of defence.

In the opinion of the associate and its legal advisers, since the claim is not supported by concrete evidence and since the associate is not the principal defendant, the likelihood of the claim against the associate being allowed is remote, and therefore the associate has made no provision for it in its financial statements.

(2) On September 4, 2007, an application for certification as a class action was filed in the Tel Aviv District Court against 70 respondents, including operators of e-trade sites, among them an associate of Bezeq International and suppliers who offered products for sale through those sites. According to the applicants, the respondents operate ostensibly "fictitious offerors" who make "fictitious offers" in auctions conducted on the sites, in order to prevent participants in the auctions from winning them at prices which the respondents consider too low, and in so doing, they applicants allege, they are acting in breach of contract and deceitfully under the Consumer Protection Law. The reliefs applied for by the applicants include orders prohibiting the respondents from interfering in auctions and unquantifiable financial reliefs. On October 15, 2007, the Court gave an interlocutory order that includes the prohibition of the deletion and/or change of sale data.

In view of the preliminary stage of the proceeding, the likelihood of the application being certified as a class action cannot be assessed; however, in the opinion of the associate's legal advisers, the associate has reasonable defence arguments, both against the certification and against the claim itself.

NOTE 18 – COMMITMENTS

A. Engagements in lease agreements and rentals

Contractual rental payments during the next 5 years, are calculated according to the rent in effect at December 31, 2007 are as follows:

For the year ended December 31,	NIS millions
2008	**163**
2009	**182**
2010	**145**
2011	**83**
2012 onwards	**131**
	704

B. At December 31, 2007, DBS has agreements for the purchase of broadcasting rights. In the year ended December 31, the purchase of these rights amounted to approximately NIS 122 million.

C. (1) DBS entered into an agreement for leasing space segments of the Amos 1 satellite with Israel Aircraft Industries ("IAI") commencing April 14, 1999. The term of the lease will end on June 30, 2009 or at the end of the life of the satellite, whichever is the earlier.

(2) In addition, on May 16, 2001, DBS entered into an agreement with H.L.L. Spacecom Satellite Communications Ltd. ("HLL"). The term of the lease will end 12 years after the satellite is positioned in space or at the end of the life of the satellite, whichever is the earlier. The satellite was positioned in space in April 2004.

The projected annual lease fees in the coming years under those agreements are as follows:

	NIS millions
2008	**101**
2009	**100**

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

In addition, DBS and HLL are in dispute in respect of the amount of the annual payments, and DBS's entitlement to a certain discount on the lease fees.
In February 2008, a settlement agreement was signed between DBS and HLL for cessation of the arbitration proceeding between the parties concerning the amount of the monthly payment due to HLL for the lease of space segments in the Amos 2 satellite.

D. The Group has a number of operating lease agreements for periods of 3 to 4 years in respect of vehicles it uses. The contractual annual lease fees, calculated according to the fees in effect at December 31, 2007, are approximately NIS 215 million.

E. In accordance with the requirements of the license and the principles laid down by the Council for Cable and Satellite Broadcasts, in 2006, 2007 and 2008, DBS must invest in content broadcasts not less than 8% of its revenues from subscriber fees in local productions.

F. At December 31, 2007, DBS has agreements to buy purchased channels. In the year ended December 31, 2007, the expenses for consumption of purchased channels amounted to approximately NIS 227 million.

NOTE 18 – COMMITMENTS (CONTD.)

G. Right to purchase a usage right in frequencies

In 2001, the band of frequencies in which Pelephone was granted rights when it won a tender published by the Ministry of Communications (see Note 33(1)), which it would use in HSPA/UMTS technology for the new frequency range was made subject to terms which include, among others, payment of NIS 225 million (plus Accountant General's interest, except on the first, index-linked payment),and provision of a guarantee in the amount of USD 20 million to secure the terms of the license, which was amended in 2004 to USD10 million. The payment due upon winning the tender was supposed to have been made in six different instalments, spread over the period through 2006.

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

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

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

As part of its preparations for setting up a network in HSPA/UMTS technology (see also Note 9G above), Pelephone intends to exercise the right to purchase the frequencies.

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

I. For engagements for the purchase of property, plant and equipment, see Note 9H above.

NOTE 19 – SECURITIES, LIENS AND GUARANTEES

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

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

A. (contd.)

It is noted that since the then Minister of Communications made her decision to impose restrictions and conditions on the Company's injections to DBS, both DBS and the Company acted without relating to their legal position, with the purpose of complying with the conditions and restrictions imposed by the Minister of Communications and at the time also by the Antitrust Commissioner, as well as the legal action they had instituted both in the High Court of Justice (the petitions of the Company and DBS have since been dismissed) and in the Antitrust Court (in a proceeding which has already been terminated, since the term of the restriction imposed by it had elapsed).

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

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

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

E. In February 2002 and May 2005, at the demand of the Ministry of Communications, Bezeq International provided bank guarantees of approximately NIS 9.4 million and NIS 1.4 million respectively, for fulfilment of all the terms of the license to provide international telecommunication services. In December 2004, at the behest of the Ministry of Communications, Bezeq International provided a bank guarantee of approximately NIS 340,000 for fulfilment of the terms of a special license granted it for a marketing trial for the provisions of VOB services. At the balance sheet date, Bezeq International had provided additional bank guarantees in a total amount of approximately NIS 11 million.

F. Pelephone provided guarantees of approximately NIS 71 million in favour of third parties, of which approximately NIS 38 million in favour of the Ministry of Communications, in connection with a guarantee for fulfilment of the terms of its license.

G. To secure its liabilities, DBS provided documentary credit and guarantees amounting to approximately NIS 40 million (including a bank guarantee of NIS 36 million in favour of the State of Israel).

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

Except for one, the shareholders in DBS, have made a commitment to the banks not to oppose the sale or other realisation of their shares in DBS, which were mortgaged or for which a guarantee was provided (by the Company), in a way that will enable the banks to accomplish a friendly liquidation.

I. For securities, charges and stipulations given by the Company and subsidiaries in connection with loan covenants and borrowings, see Note 13.

NOTE 20 – SHAREHOLDERS' EQUITY

A. Share capital

	Registered		Issued and paid in	
	December 31, 2007	December 31, 2006	December 31, 2007	December 31, 2006
	No. of shares	No. of shares	No. of shares	No. of shares
Ordinary shares of NIS 1 par value	**2,749,000,000**	2,625,000,000	**2,605,045,611**	2,605,045,611

B. Following completion of the sale of 30% of the State's shares in the Company to Ap.Sb.Ar. (see also Note 1) on October 11, 2005, the State's holdings in the Company decreased to approximately 16%. Ap.Sb.Ar. has an option to purchase 10.66% from the State on terms that have been determined.

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

D. The Company also issued stock options to employees, managers and senior employees in the Group (see Note 26).

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

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

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

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

	For the year ended December 31	
	2007	2006
	NIS millions	NIS millions
In February 2007, a cash dividend was distributed (NIS 0.69 per share)[(1)]	**1,800**	-
In October 2007 a cash dividend was distributed (NIS 0.29 per share)	**760**	-
In April 2006 a cash dividend was distributed (NIS 0.46 per share)	**-**	1,200
In October 2006 a cash dividend was distributed (NIS 0.15 per share)	**-**	400
In November 2006 a dividend was declared (NIS 0.12 per share)[(2)]	**-**	300
	2,560	1,900

(1) On December 28, 2006, the general meeting of the shareholders of the Company approved the recommendation of the Board of Directors of the Company concerning distribution of a cash dividend of NIS 1,800,000,030 (comprising NIS 0.69 per share), as a distribution not in compliance with the earnings test. The distribution was subject to the approval of the court. On February 4, 2007, the court approved the distribution, and the distribution was made on February 26, 2007.

(2) The dividend was paid in January 2007.

E. On February 1, 2007, the general meeting of the Company approved an increase in the registered capital of the Company by 124,000,000 ordinary shares of NIS 1 par value each, which will be equal in all their rights to the ordinary shares of NIS 1 par value of the Company, so that together with the balance of the existing registered capital, the registered capital of the Company will be 2,749,000,000 ordinary shares of NIS 1 par value each.

NOTE 20 – SHAREHOLDERS' EQUITY (CONTD.)

F. On March 10, 2008, the Board of Directors of the Company resolved, and recommended to the general meeting of the shareholders of the Company, to distribute a cash dividend to the shareholders in the amount of NIS 679 million (representing NIS 0.26 per share).

NOTE 21 – REVENUE

	For the year ended December 31		
	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Fixed-line domestic communications			
Landline telephony	**3,798**	4,068	4,251
Internet – infrastructure	**711**	606	543
Transmission, data communication and others	**935**	895	862
	5,444	5,569	5,656
Cellular telephone			
Cellular and terminal equipment services	**3,669**	3,524	3,349
Sale of equipment to subscribers	**711**	617	723
	4,380	4,141	4,072
International communications, internet and network end point services	**1,226**	1,219	1,011
Multi-channel television	**1,331**	1,284	1,171
Others	**19**	19	15
	12,400	12,232	11,925

NOTE 22 – SALARIES

	For the year ended December 31		
	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Salaries and related expenses –			
Operating	**1,833**	1,784	1,809
General and administrative	**733**	727	649
Share-based payments	**-**	287	346
Total salaries and associated expenses	**2,566**	2,798	2,804
Less – Salaries attributed to investments in property, plant and equipment	**191**	212	218
	2,375	2,586	2,586

NOTE 23 – OPERATING AND GENERAL EXPENSES

	For the year ended December 31		
	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Cellular telephone expenses	**1,828**	1,854	1,816
General expenses	**1,187**	1,169	1,258
Materials and spare parts	**924**	923	931
Consumption of satellite services content	**426**	441	419
Building maintenance	**332**	348	367
Services and maintenance by sub-contractors	**381**	428	423
International communication expenses	**338**	384	277
Motor vehicle maintenance expenses	**183**	190	181
Royalties to the Government of Israel	**194**	180	257
Collection fees	**48**	50	49
	5,841	5,967	5,978

NOTE 24 – OTHER OPERATING EXPENSES (INCOME), NET

	For the year ended December 31		
	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Provision (cancellation of provision) in respect of severance pay in early retirement	**91**	309	(83)
Net capital gains mostly from realisation of real estate	**(105)**	(159)	(9)
Provision in respect of contingent liabilities	**80**	97	-
Provision in respect of impairment of long-term loans	**17**	-	-
Others	**(4)**	3	(8)
	79	250	(100)

NOTE 25 – FINANCING EXPENSES, NET[1]

	For the year ended December 31,		
	2007	**2006**	**2005**
	NIS millions	**NIS millions**	**NIS millions**
Interest income from bank deposits, investments and others	**116**	195	158
Net change in the fair value of financial assets measured at fair value through profit and loss (mainly for forward transactions)	**168**	-	-
Income in respect of borrowing grossed up in sales net of discount commission	**63**	49	44
Interest income and dividend from financial assets available for sale and from embedded derivatives	**6**	30	9
Net profit from the realisation of financial assets available for sale transferred from equity			
Income from financial liabilities provided by the minority in a subsidiary	**-**	5	104[2]
Net gain in respect of exchange rate differences	**96**	-	-
Other financing income	**-**	-	82
	38	77	36
	487	356	433
Interest expenses in respect of financial liabilities	**420**	477	494
Net loss in respect of linkage differentials	**193**	6	127
Net loss in respect of exchange rate differences	**114**	12	
Net change in the fair value of financial assets measured at fair value through profit and loss	**-**	103	128
Expenses in respect of capitalisation of loans to the minority in a subsidiary	**23**	50	**-**
Expenses in respect of available-for-sale financial assets	**10**	**-**	**-**
Other financing expenses	**36**	46	56
	796	694	805
Financing expenses, net	**309**	338	372
[1] Net of amounts capitalised in the amount of	**2**	1	8
Presented directly in equity			
Net change in fair value of financial assets classified as available for sale	**4**	(1)	1
Net change in the fair value of financial assets classified available for sale transferred to profit and loss	**-**	(5)	(105)

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

NOTE 26 – SHARE-BASED PAYMENTS

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

B. Following the agreement signed with the employees (see Note 16H) in the matter of an employee stock options plan comprising 3% of the issued and paid up capital of the Company, the Board of Directors of the Company approved the employee stock options plan on February 22, 2007. On March 25, 2007, approximately 78,092,000 options were allocated, and on January 2, 2008 an additional 59,000 options were allocated to two employee-directors. The expenses for this grant were recorded in 2006, since the promise was made to the employees that year, with the terms of the grant. The value of the grant was determined at February 22, 2007, which was the date of the grant.

C. On November 20, 2007, the Board of Directors of the Company resolved to adopt a new stock options plan for managers and senior employees in the Company and/or in controlled companies, which would allocate up to 65,000,000 non-negotiable option warrants, exercisable for up to 65,000,000 shares of the Company and constituting approximately 2.5% of the issued capital of the Company, and at full dilution – 2.36% of the share capital.

On December 25, 2007, the Company published an outline for the allocation of stock options from the plan, in accordance with the Securities (Details of an outline offer of securities to employees) Regulations, 5760-2000, which described, *inter alia*, the terms of the plan, and a private placement report in accordance with the Securities (Private placement of securities in a listed company) Regulations, 5760-2000.

The options plan and the allocation of all the options in accordance with it, were approved by the general meeting of the Company on January 31, 2008, in accordance with the Company's Articles of Association. Exercise of the options under the plan in contingent upon receipt of the necessary approvals as prescribed in the provisions of the Communications (Telecommunications and broadcasts) (Determination of an essential service provided by Bezeq, The Israel Telecommunication Corp. Ltd.) Order, 5757-1997 ("the Telecommunications Order") or upon finding another solution which enables the allocation of Company shares while complying with the provisions of the Telecommunications Order, and it could be that such exercise will necessitate amendment of the Telecommunications Order.

The option warrants will vest in three equal annual portions. The vesting dates of each portion will fall at the end of each of the first, second and third years after the date of the grant, respectively, and the expense for each portion will be spread according to its vesting period.

The exercise price of each option is NIS 5.50, which reflects a discount of approximately 16.8% on the closing price of the Company's share on the Tel Aviv Stock Exchange on January 31, 2008, the date of the approval by the general meeting.

The theoretical economic value of all the option warrants in the plan, based on a weighted Black and Scholes model, is approximately NIS 187 million, while the theoretical economic value of all the options approved and/or allocated (45,700,000 options), is approximately NIS 134 million, based, *inter alia*, on the share price on the date of grant (for options approved and/or allocated) and the share price close to the date of approval of the financial statements (for options not yet approved or allocated), a risk-free annual interest rate of 5.11% - 5.24%, the exercise price noted above, and an annual standard deviation of 22.35% - 24.20%, as well as the limitation described above pursuant to the Telecommunications Order. The Company has not yet decided on the exercise price of future option allocations, if any, under the plan. The date of the grant was set as the later of the date of the general meeting and the date of the notice to the employees.

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

NOTE 26 – SHARE-BASED PAYMENTS (CONTD.)

C. (contd.)

	Date of grant / Eligible employees	No. of instruments in thousands	Vesting terms	Contractual duration of the options
A.	Grant of options from the State to employees on October 11, 2005	122,698	Immediate (subject to lock-up – commencing at the end of two years, to three years – one third each year)	4 years
B.	Grant of options to employees on February 22, 2007[(1)]	78,151	Immediate (subject to lock-up for two years)	5 years
C	Approval and/or grant of options to managers, senior employees and officers by the date of approval of the financial statements	45,700	Three equal annual portions	8 years
	Total options for shares	246,549		

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

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

	No. of options (In thousands) 2007	No. of options (In thousands) 2006	No. of options (In thousands) 2005
Balance at January 1	**200,849**	122,698	122,698
Options granted during the period	**-**	78,151	-
Options for exercise at December 31	**200,849**	200,849	122,698

Subsequent to the balance sheet date, approximately 16,929,000 of the options granted by the State to employees on October 11, 2005, were exercised

The weighted average of the exercise price in 2007 and 2006 is NIS 2.852 per share and NIS 3.494 per share, respectively.

For the balance of the options issued at December 31, 2007, the exercise price is in the range of NIS 2.417 to NIS 3.013, and the weighted average of the remaining contractual life is 2.8 years.

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

Fair value of the options and the assumptions

	2007	2006	2005
Fair value at the time of grant	-	3.653	2.817
Share price	-	6.678	6.400
Exercise price	-	3.339	4.037
Anticipated volatility (weighted average)	-	21.00%	25.25%
Useful life of the option (projected weighted average)	-	3.00	3.39
Risk-free interest rate (based on government bonds)	-	3.20%	2.45%

NOTE 26 – SHARE-BASED PAYMENTS (CONTD.)

C. (contd.)

Salary expense

	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Share options granted in 2005	-	-	346
Share options granted in 2006	-	287	-
Total expenses charged to salary expenses	-	287	346

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

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

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

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

NOTE 27 – EARNINGS PER SHARE

Basic earnings per share

Calculation of the basic earnings per share at December 31, 2007 was based on the earnings relating to the ordinary shareholders, of NIS 1.363 million (2006 – NIS 809 million), and on a weighted average number of ordinary shares in circulation of 2,605,046,000 shares, as follows:

	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Profit attributable to the ordinary shareholders			
Profit attributable to the ordinary shares	**1,330**	809	666
Weighted average of the number of ordinary shares			
Weighted average of the number of ordinary shares	**2,605**	2,605	2,605

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NOTE 27 – EARNINGS PER SHARE (CONTD.)

Diluted earnings per share

Calculation of the diluted earnings per share at December 31, 2007 was based on the earnings relating to the ordinary shareholders, of NIS 1,330 million, and on a weighted average number of ordinary shares in circulation of 2,641 million shares, as follows:

	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Profit attributable to the ordinary shareholders (diluted)			
Profit attributable to the ordinary shares (basic and diluted)	**1,330**	809	666
Weighted average of the number of ordinary shares			
Weighted average of the number of ordinary shares (basic)	**2,065**	2,065	2,065
Effect of the options on the shares	**36**	-	-
Weighted average of the number of ordinary shares (diluted)	**2,641**	2,605	2,605

The average market value of the Company's shares, for calculating the diluting effect of the options on the shares, was based on the market prices in the period during which the options were in circulation.

NOTE 28 – SEGMENT REPORTING

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

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

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

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

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

The other companies in the Group are presented under the "Other" item.

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

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

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

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation

	Year ended December 31, 2007						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue							
Revenues from external sources	5,373	4,380	1,226	1,402	19	-	12,400
Inter-segment revenues	340	304	78	12	46	(780)	-
Total revenue	5,713	4,684	1,304	1,414	65	(780)	12,400
Segment results	1,279	804	203	50	-	-	2,336
Financing costs, net							(309)
Profit after financing expenses							2,027
Equity in profits of associates accounted by the equity method							6
Profit before income tax							2,033
Income tax							672
Net profit							1,361
Attributed to:							
Shareholders of the Company							1,330
Minority interest							31
Profit for the year							1,361

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2007						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Segment assets	7,769	4,290	628	1,097	59	229	14,072
Investments in associates accounted by the equity method							37
Unallocated assets							1,047
Total assets							15,156
Segment liabilities	1,944	798	321	589	37	229	3,918
Unallocated liabilities							7,066
Total liabilities							10,984
Capital expenses	520	440	69	299	3		
Depreciation	789	398	47	245	2		
Amortisation of intangible assets	136	81	25	26	2		

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2006						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Revenue							
Revenue from external sources	5,514*	4,141*	1,219*	1,339	19*	-	12,232
Inter-segment revenues	285*	337*	82*	23	37*	(764)	-
Total revenue	5,799	4,478	1,301*	1,362	56*	(764)	12,232
Segment results	746	692	119*	8	-*	-	1,565
Financing costs, net							(338)
Profit after financing expenses							1,227
Equity in profits of associates accounted by the equity method							11
Earnings before income tax							1,238
Income tax							488
Net profit							750
Attributed to:							
Shareholders of the Company							809
Minority interest in a consolidated company							(59)
Profit for the year							750

* See Note 3T.

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2006						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Segment assets	9,837*	3,717*	631*	1,008*	47*	214*	15,454
Investment in associates accounted by the equity method							32
Unallocated assets							2,059
Total assets							17,545
Segment liabilities	2,320	756	346*	584	33*	209	4,248
Unallocated liabilities							8,106
Total liabilities							12,354
Capital expenses	511	337	47*	208	2*		
Depreciation	875	407	38*	268	3*		
Amortisation of intangible assets	128	63	29*	25	3*		
Losses from impairment of intangible assets and property, plant and equipment	5	-	-	-	1		
Share-based payments	287	-	-	-	-		

* See Note 3T.

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2005						
	Domestic fixed–line communications	**Cellular telephone**	**International communications and internet services**	**Multi-channel television**	**Others**	**Adjustments**	**Consolidated**
	NIS millions	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**
Revenue							
Revenues from external sources	5,626*	4,072*	1,011*	1,201	15*	-	11,925
Inter-segment revenues	267*	356*	85*	21	40*	(769)	-
Total revenue	5,893	4,428	1,096*	1,222	55*	(769)	11,925
Segment results	919	585	110*	(78)	(9)*	-	1,527
Financing costs, net							(372)
Profit after financing expenses							1,155
Equity in losses of associates accounted by the equity method							(3)
Profit before income tax							1,152
Income tax							532
Net profit							620
Attributed to:							
Shareholders of the Company							666
Minority interest							(46)
Profit for the year							620

* See Note 3T.

NOTE 28 – SEGMENT REPORTING (CONTD.)

A. Segments of operation (contd.)

	Year ended December 31, 2005						
	Domestic fixed–line communications	Cellular telephone	International communications and internet services	Multi-channel television	Others	Adjustments	Consolidated
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Segment assets	9,639	3,930*	708*	1,096*	59*	198	15,630
Investment in associates accounted by the equity method							20
Unallocated assets							3,738
Total assets							19,388
Segment liabilities	2,325	741	312*	592	46*	187	4,203
Unallocated liabilities							9,130
Total liabilities							13,333
Capital expenses	764	504	49*	266	3*		
Depreciation	971	380	52*	258	5*		
Amortisation of intangible assets	131	58	24*	26	2*		
Share-based payments	346	-	-	-	-		

* See Note 3T.

NOTE 29 – TRANSACTIONS WITH INTERESTED PARTIES AND RELATED PARTIES

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

Among the entities for which the Company and its subsidiaries provide the Services, there are also interested parties in the Company, including Ap.Sb.Ar. which holds 30% of the Company's shares, the State of Israel, which holds approximately 16% of the Company's shares, and the Zeevi group, which holds 17.75% of the Company's shares through a receiver appointed for those shares on behalf of certain banks.

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

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

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

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

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

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

B. Most of the Companies in the Group are required to pay royalties to the Government of Israel. Commencing January 2001, the income base requiring the payment of royalties was broadened, concurrently with a gradual reduction in the rate of the royalties, until a uniform rate was arrived at for all communications operators. In August 2006, an amendment to the royalties regulations was published, which regulates the reduction of 0.5% per year in their rate for all the licensees required to pay them, commencing January 1, 2006, until a rate of 1% per year is reached in 2010. The Ministry of Communications also gave notice that it will work for amendment of the regulations so that the Company will be exempted retroactively, from January 2004, from the duty to pay royalties in respect of revenues from services which have been opened to competition. On December 31, 2007, the Ministers of Finance and Communications submitted a draft amendment of the regulations to the Knesset Finance Committee.

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

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

C. On May 8, 2005, a new commercial agreement was signed between the Company and the Ministry of Defence on behalf of the State of Israel, for the provision of communication services by the Company. The agreement was approved beforehand by the Audit Committee of the Board of Directors and by the Board of Directors on May 3, 2005, and required, since the Company was at that time under government control, the approval of the general meeting of the shareholders of the Company (by a special majority), as required by the Security (Transactions between a company and its controlling shareholder) Regulations, 5761-2001. Approval of the agreement was delayed at the request of the Ministry of Communications and the Antitrust Commissioner, to enable receipt of the Company's remarks on questions they had raised. On August 23, 2006, the Company received a copy of a letter from the Antitrust Authority to the legal representative of the Ministry of Defence and the IDF, in which the Authority gave notice that the agreement does not contravene the provisions of the Antitrust Law, 5748-1988, and that the Authority sees no justification, at the present time, for insisting on cancellation of the agreement. The Company forwarded a copy of the letter to the Ministry of Communications. Based on the contents of the letter, the agreement came into force and the parties operate in accordance with it. The financial statements include the income deriving from the new agreement. However, the Ministry of Communications believes that the agreement includes discounts which the Company is not authorised to grant, and that it was signed for too long a term. On March 27, 2007, the Ministry demanded (following an earlier request on December 4, 2006), that the agreement be amended so as not to violate the provisions of the law and of the Company's license. The Company has notified the Ministry of Defence of cancellation of the discount arrangements and is charging the IDF at the tariffs stated in the Agreement from July 2002, which precedes the current agreement, although the Ministry of Defence pays the Company according to the tariffs in the current agreement. At this stage the Company is unable to assess the developments and therefore the financial statements include the income from the Ministry of Defence according to the agreement dated May 8, 2005, which are lower than the tariffs in the prior agreement from 2002 and lower than the Company's regular tariffs (for the period from October 2005 to September 30, 2007).

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

Below are the main points of the settlement agreement:

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

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

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

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

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

D. On July 29, 2007, an agreement was signed (after being approved by the general meeting of the shareholders of the Company on March 23, 2006) with a corporation owned and controlled by the shareholders of Ap.Sb.Ar., whereby the Company will be granted regular management and consultation services, including by means of currently-serving and future directors of the Company and/or its subsidiaries, all for a consideration of USD 1.2 million per year. The term of the agreement is from October 11, 2005 (the date on which Ap.Sb.Ar. purchased 30% of the shares of the Company), and ends on December 31, 2008, unless one of the parties notifies the other of its wish to terminate the agreement by giving three months' notice.

E. Transaction with interested parties and related parties

	For the year ended December 31		
	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Sales of products and services			
To the State of Israel	**361**	368	424
Others	**-**	3	3
Expenses			
State of Israel –			
Royalties	**194**	181	257
Frequencies	**25**	29	31
Finance	**18**	59	40
Others (mainly purchase of satellite segments)	**141**	124	116

	Interest rate	For the year ended December 31		
		2007	2006	2005
		NIS millions	NIS millions	NIS millions
Balances with related parties – Loans and long-term debts of interested parties				
Loans and debts – Index-linked, without date to maturity	0%	**1**	1	6

For other balances with related parties, see relevant notes.

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

F. Benefits to directors and the CEO

	For the year ended December 31		
	2007	**2006**	**2005**
	NIS thousands	**NIS thousands**	**NIS thousands**
Total cost of salary of the CEO and the Chairman of the Board	**10,479***	13,386**	8,025***
Number of employees	**4**	2	3
Compensation for members of the Board of Directors who are not Company employees****	**372**	167	1,643
Number of directors receiving compensation	**4**	2	8
Remuneration of employee-directors*****	**996**	1,010	653
Number of directors receiving the remuneration	**2**	2	1
Management fees to a controlling company	**5,127**	5,000	1,250

* Including salary and bonuses to the serving CEO and former chairmen and to the CEO in respect of his term of office as former CEO of Bezeq International. The terms of employment of the current Chairman of the Board of Directors have not yet been agreed or approved by the relevant institutions of the Company. Nonetheless, the financial statements include a provision in the amount of approximately NIS 4.6 million based on an estimate of the cost of salary and future payments. The aforementioned cost does not include this provision, does not include salary and payments to the substitute CEO in the period from April 1, 2007 to June 26, 2007, and does not include special compensation for a former CEO of the Company, Mr. Amnon Dick, as described in Section G below.

** Includes a bonus in the amount of NIS 2.4 million to the retiring CEO. Following a request of the Securities Authority regarding senior officer bonuses, the aforementioned bonus to the CEO was cancelled. The Company decided that if this bonus is not returned to the Company it will follow legal procedures to collect the debt.

*** Includes salary and grants for the term of office of the outgoing CEO of the Company as CEO of Pelephone and also the salary and the months of notice of the CEO which preceded him, as well as salary and compensation to the Chairman of the Board of Directors who resigned during the period. The salary includes options distributed under the employee stock options plan by the State (pursuant to an outline dated November 15, 2005) to the CEO who preceded the retiring CEO and to the retiring Chairman of the Board of Directors in the period.

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

***** Salary paid to employee-directors for their work in the Company, and they receive no additional payment for their service as directors in the Company, in the matter of the options allocated to them in 2006 – see Note 26.

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

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

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

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

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

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

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

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

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

(4) On April 6, 2005, the general meeting of the shareholders approved an indemnification commitment in respect of a financial liability that would be imposed on officers of the Company and in respect of reasonable litigation expenses which they would incur, related directly or indirectly, to a proceeding for the sale of the State's holdings in the Company.

The indemnification commitment will be provided to officers who served and/or were appointed and/or will be appointed by the Company, commencing from the start of the Company's preparations for the sale proceeding and until the date of the closing of the sale proceeding.

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

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

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

a. For a period of seven years from the date of the closing of the transfer of the State's shares in the Company which are being sold pursuant to the decision of the Ministerial Committee for Privatisation Affairs on July 19, 2004 ("the Sale Closing Date").

b. The total amount of the insurance cover will not exceed USD 150 million, plus USD 30 million in respect of legal expenses in Israel only.

c. Limits of liability:

(1) Cover for the first 3 years at a limited liability of USD 150 million, plus USD 30 million in respect of legal expenses in Israel only.

(2) Cover for an additional 3 years at a limited liability of USD 75 million, plus USD 15 million in respect of legal expenses in Israel only.

(3) Cover for the seventh year at a limited liability of USD 25 million, plus USD 5 million in respect of legal expenses in Israel only.

It should be noted that there is one limited liability for each run-off policy.

d. The premium for the entire period of insurance – USD 3 million (in a one-time advance payment).

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

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

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

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

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

(8) On December 26, 2007, a special general meeting of the shareholders of the Company approved the purchase of an insurance policy for the officers of the Company for a period of one year commencing October 11, 2007, with a limit of liability of up to USD 150 million per claim and in total for the entire insurance year. In addition, up to USD 30 million per claim and in total for all claims for the period of insurance, in respect of legal expenses in Israel only. The limit of liability for subsidiaries is up to USD 50 million (as part of the aforementioned limit of liability). The annual premium is up to USD 510,000.

In addition, the same meeting on December 26, 2007, approved a "framework transaction" for the Company to engage, during the normal course of business, in future insurance policies (after expiry of the present policy described above), to cover the liability of directors and officers, as may be from time to time, including directors and officers who are or might be considered controlling shareholders in the Company, all the officers in the companies in which the Company holds 50% or more, officers representing the Company in companies where the Company holds 20% or more, and senior employees who are not officers with regard to managerial actions they carry out, and all by way of a "framework transaction" as defined in the Companies (Reliefs in transactions with interested parties) Regulations, 5760-2000, at an annual premium of up to USD 510,000, plus an amount comprising 20% of that premium in respect of the amount of insurance cover existing today.

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

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

G. On June 28, 2007, Ap.Sb.Ar., which holds 30% of the shares of the Company, notified the Company that it had signed an agreement with the former CEO of the Company, Mr.. Amnon Dick, whereby Ap.Sb.Ar. would pay him a special bonus of NIS 5.75 million, as a gesture in respect of his contribution to the Company. The bonus was recorded in the Company's books as a salary expense, and also in a capital fund from activities between a corporation and a controlling shareholder.

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

NOTE 30 – FINANCIAL INSTRUMENTS

General
In the normal course of business, the Group is exposed to credit, liquidity and market risks, as well as interest, currency and Index risks. The purpose of risk management in the Group is to monitor those risks constantly, and to hedge them in order to minimise the possible effects of the exposure on the basis of assessments and expectations for parameters that generate such effects. The Group's policy is to partially hedge exposure from fluctuations in foreign exchange rates, the Index, and interest rates.

Credit risk
Credit risk is the risk of financial loss if a customer or the other part to a financial instrument fails to meet its contractual obligations, and is derived mainly from debit balances of customers and other receivables and from investments in deposits and in securities.

Management has a credit policy in place and the exposure to credit risks is monitored on a regular basis. Cash and investments in deposits and securities are deposited in highly-rated banks. Credit assessments are made on material customer balances, and collateral is required for financial assets.

Trade and other receivables
The Group's Management regularly monitors customer debts, and the financial statements include provisions for doubtful debts which properly reflect, in Management's estimation, the loss inherent in debts whose collection is in question. In addition, the balances of the trade receivables are widely spread.

Investments
The Group has investments in marketable securities of the Government and of investment-grade companies, which are liquid and negotiable. Transactions involving derivatives are made with entities that have a high credit rating.

Guarantees
The Group's policy is to provide tender, performance and legal guarantees. In addition, the Company provides bank guarantees, where necessary, for banking obligations of subsidiaries. At December 31, 2007, the Group has the guarantees described in Note 19.

At the reporting date, there is no significant concentration of credit risks. The maximum exposure to credit risk is represented by the carrying value of each financial asset, including derivatives, in the balance sheet.

Liquidity risk
Liquidity risk is the risk that the Group will be unable to honour its financial obligations on time. The Group's policy for liquidity management is to ensure, as far as possible, that it will always have sufficient liquidity to honour those obligations, in normal conditions and in conditions of distress, without incurring undesirable losses. In addition, for the matter of the debentures held by a subsidiary, see Note 13(b)(3).

Market risks
Market risk is the risk that changes in market prices, such as foreign currency exchange rates, interest rates and the prices of securities, will influence the Group's income or the value of its holdings in financial instruments. The purpose of market risk management is to manage and oversee the exposure to market risks within accepted parameters, while maximising the return on the risk.
During the normal course of its business, the Group performs full or partial hedging and takes into account the effects of the exposure in its considerations for determining the type of loans it takes and in managing its investment portfolio.

NOTE 30 – FINANCIAL INSTRUMENTS (CONTD.)

Index risk

Changes in the rate of inflation affect the Group's profitability and its future cash flows, mainly due to its Index-linked liabilities. The Group has surplus liabilities over assets linked to the Index. In applying a policy of minimising the exposure, the Group makes forward transactions against the Index. The duration of the forward transactions is the same as or shorter than the duration of the hedged exposure. A considerable part of the cash balances is invested in deposits which are exposed to changes in their real value as a result of a change in the rate of the Index.

Foreign currency risk

The Group is exposed to foreign currency risks mainly due to payments for purchases of dollar-linked terminal equipment and property, plant and equipment linked o the dollar. In addition, it provides services for customers and receives services from suppliers worldwide for which it is paid and it pays in foreign currency, mainly the dollar. The Group has surplus liabilities over assets in foreign currency. In applying a policy of minimising the exposure, the Group makes forward transactions against the dollar. The duration of the forward transactions is the same as or shorter than the duration of the hedged exposure.

Exposure hedging

The Group has future currency contracts for hedging projected transactions. The hedging transactions made by the Group at December 31, 2007 do not meet the criteria for hedge accounting, and therefore any change in the fair value is recognised directly in profit or loss.

Interest risk

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

Exposure to credit risk

The carrying value of financial assets represents the maximum exposure to credit risk. The maximum exposure to credit risk as at the reporting date is:

	December 31, 2007	December 31, 2006
	NIS millions	NIS millions
	Carrying value	Carrying value
Cash and cash equivalents	**1,203**	2,632
Financial assets available for sale	**115**	121
Financial assets measured at fair value through profit and loss	**294**	894
Structured instruments	**-**	61
Trade and other receivables	**3,105**	2,685
Bank deposit for provision of loans to employees	**149**	185
Long-term loans and debit balances	**-**	36
Other investments	**3**	3
Derivatives	**61**	3

See Note 7 for the matter of maximum exposure to credit risk in respect of trade receivables.

NOTE 30 – FINANCIAL INSTRUMENTS (CONTD.)

Liquidity risk

Below are the contractual repayment dates of monetary liabilities, including interest payments:

	At December 31, 2007						
	Carrying value	Contractual cash flow	6 months or less	6-12 months	1-2 years	3-5 years	Over five years
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Financial liabilities that are not derivatives:							
Short-term borrowings	81	81	-	81	-	-	-
Bank loans(1)	1,298	1,579	120	102	174	1,037	146
Debentures issued to the public	2,959	3,551	461	-	446	1,445	1,199
Debentures issued to financial and other institutions (2)	2,302	2,920	348	117	489	1,007	959
Institutional loans	136	254	-	-	-	-	254
	6,776	8,385	929	300	1,109	3,489	2,558
(1) Derivative financial liabilities							
Forward contracts on currencies	11	11	11	-	-	-	-
Forward contracts on the Index	-*	1	-	1	-	-	-
	11	12	11	1	-	-	-
Loans provided by the minority in a subsidiary	375	1,384	-	-	-	-	1,384

* Less than NIS 500,000.

(1) Including loans of a subsidiary amounting to approximately NIS 846 million, stated in the financial statements as short term due to non-compliance with financial stipulations (see Note 13C(3)).
(2) Including approximately NIS 112 million of debentures of the Company presented in the financial statements as short term due to non-compliance with financial stipulations (see Note 13C(1)).

NOTE 30 – FINANCIAL INSTRUMENTS (CONTD.)

Liquidity risk (contd.)

	At December 31, 2006						
	Carrying value	Contractual cash flow	6 months or less	6-12 months	1-2 years	3-5 years	Over five years
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Financial liabilities that are not derivatives:							
Short-term borrowings	118	118	20	98	-	-	-
Bank loans(1)	2,007	2,459	258	220	374	1,065	542
Debentures issued to the public	3,333	3,799	83	1,736	390	1,157	433
Debentures issued to financial and other institutions (2)	1,830	2,193	144	135	465	934	515
Institutional loans	169	329	2	2	4	12	309
	7,457	8,898	507	2,191	1,233	3,168	1,799
(1) Derivative financial liabilities							
Forward contracts on currencies	41	38	5	1	-	32	-
Forward contracts on the Index	18	40	-	8	-	32	-
	59	78	5	9	-	64	-
Loans provided by the minority in a subsidiary	564	1,231	-	-	-	-	1,231

(1) Including loans of a subsidiary amounting to approximately NIS 1,296 million, stated in the financial statements as short term due to non-compliance with financial stipulations (see Note 13C(3)).
(2) Including approximately NIS 154 million of debentures of the Company presented in the financial statements as short term due to non-compliance with financial stipulations (see Note 13C(1)).

NOTE 30 – FINANCIAL INSTRUMENTS (CONTD.)

Currency risks

The Group's currency risk based on denominated values is as follows:

	December 31, 2007					
	Unlinked	Index-linked	In dollars or dollar-linked	In euro or euro-linked	Other foreign currency or linked to other foreign currency	Total financial balances
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Assets						
Cash and cash equivalents	1,115	-	83	4	1	1,203
Trade receivables	2,330	15	58	-*	-	2,403
Other receivables	166	-	1	-	-	166
Other investments including derivatives	116	192	35	56	1	400
Long-term trade and other receivables	487	24	25	-	-	536
Long-term investments and loans including derivatives	149	16	-	-	-	165
Total assets	4,362	247	202	60	2	4,873
Liabilities						
Loans and borrowings	927	955	-	31	-	1,913
Trade payables	1,212	-	313	8	-	1,533
Other current liabilities and provisions	937	244	12	1	-	1,194
Long-term liabilities to banks and debentures	-	4,733	-	-	-	4,733
Loans provided by the minority and others	-	511	-	-	-	511
Other long-term current liabilities and provisions	57	28	1	-	-	86
Total liabilities	3,133	6,471	326	40	-	9,970
Details of currency futures transactions						
Dollar/shekel forward transactions	(389)	-	389	-	-	-
Index-linked shekel / shekel forward transactions	(2,600)	2,600	-	-	-	-
	(2,989)	2,600	389	-	-	-

* Less than NIS 500,000.

NOTE 30 – FINANCIAL INSTRUMENTS (CONTD.)

Currency risks (contd.)

	December 31, 2006					
	Unlinked	Index-linked	In dollars or dollar-linked	In euro or euro-linked	Other foreign currency or linked to other foreign currency	Total financial balances
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Assets						
Cash and cash equivalents	2,579	-	48	4	-	2,632
Trade receivables	1,990	13	55	7	-	2,065
Other receivables	153	4	-	-	-	157
Other investments including derivatives	329	490	123	30	-	972
Long-term trade and other receivables	434	24	5	-	-	463
Long-term investments and loans including derivatives	260	36	8	38	-	342
Total assets	5,745	567	239	80	-	6,631
Liabilities						
Loans and borrowings	766	1,242	-	1,629	-	3,637
Trade payables	992	-	381	20	-	1,393
Proposed dividend	300	-	-	-	-	300
Other current liabilities and provisions	825	284	3	76	-	1,188
Long-term liabilities to banks and debentures	-	3,628	-	30	-	3,658
Loans provided by the minority and others	-	733	-	-	-	733
Other long-term current liabilities and provisions	52	19	-	-	-	71
Total liabilities	2,935	5,906	384	1,755	-	10,980
Details of currency futures transactions						
Euro/shekel forward transactions	(1,574)	-	-	1,574	-	-
Dollar/shekel forward transactions	(484)	-	484			
Index-linked shekel / shekel forward transactions	(350)	350	-	-	-	-
	(2,408)	350	484	1,574	-	-

NOTE 30 – FINANCIAL INSTRUMENTS (CONTD.)

Data in NIS for exchange rates and the Index:

	December 31	December 31	December 31	% of change December 31	% of change December 31
	2007	2006	2005	2007	2006
Consumer price index in points(*)	**120.9**	116.9	117.0	**3.40**	(0.09)
1 US dollar	**3.846**	4.225	4.603	**(8.97)**	(8.21)
1 euro	**5.659**	5.564	5.447	**1.71**	2.16

(*) Index for the month at average base of 100=1998.

Sensitivity analysis for changes in the Index and foreign currency

Strengthening of the NIS against the following currencies at December 31, would increase (decrease) the shareholders' equity and the profit or loss by the amounts shown below. The analysis is made on the assumption that all other variables, and in particular the interest rates, would remain fixed. The analysis for 2006 was made on the same basis.

	Equity NIS millions	Profit or loss NIS millions
December 31, 2007		
USD1 – 10% strengthening of the shekel vis-à-vis the dollar	17	17
Euro 1 – 5% strengthening of the shekel vis-à-vis the euro	1	(1)
Index – 5% strengthening beyond the inflation forecast (inflation forecast of 2% per year)	(2)	(2)
December 31, 2006		
USD1 – 10% strengthening of the shekel vis-à-vis the dollar	6	6
Euro 1 – 5% strengthening of the shekel vis-à-vis the euro	(3)	(4)
Index – 5% strengthening according to an inflation forecast of 2% per year	(3)	(3)

Weakening of the NIS against the above currencies at December 31, would have the same effect in the opposite direction and in the same amounts, assuming all other variables remain fixed.

Interest rate risks

The interest rate profile of the Group's interest-bearing financial instruments at the reporting date is as follows:

	Carrying value 2007 NIS millions	Carrying value 2006 NIS millions
Fixed-interest instruments		
Financial assets	**2,514**	3,783*
Financial liabilities	**(5,818)**	(6,660)
Loans provided by the minority in a subsidiary	**(375)**	(564)
Variable-interest instruments	**(3,679)**	(3,441)
Financial assets	**23**	103*
Financial liabilities	**(958)**	(797)
	(935)	(694)

* See Note 3T.

Sensitivity analysis of the fair value for instruments at fixed interest

The Group's assets and liabilities at fixed interest are not measured at fair value through profit and loss, nor does the Group earmark derivatives (interest swap contracts) as hedging instruments according to a hedge accounting model of fair value. Therefore, a change in interest rates at the reporting date will not affect profit and loss.

NOTE 30 – FINANCIAL INSTRUMENTS (CONTD.)

Sensitivity analysis of cash flows for instruments at variable interest

A rise of 100 base points in the interest rates at the reporting date would reduce the shareholders' equity and the profit or loss by approximately NIS 7 million (2006 – NIS 5 million). The analysis was made assuming all other variables, and in particular the foreign currency exchange rates, would remain fixed.

Fair value

The table below details the differences between the carrying value and the fair value of groups of financial instruments, where material differences exist. The carrying value of financial assets does not differ significantly from their fair value. The fair value of long-term loans provided by the minority in a subsidiary is similar to the carrying value in the books.

		December 31, 2007		December 31, 2006	
		Carrying value	Fair value	Carrying value	Fair value
	Note	NIS millions	NIS millions	NIS millions	NIS millions
Loan provided	6	-	-	22	25
Investment in capital notes	6	-	-	16	16
		-	-	38	41
Unrecognised profit			-		3
Short-term borrowing	13	**81**	**81**	118	118
Secured loans from banks and others	13				
Index-linked		**588**	**598**	1,528	1,451
Unlinked		**846**	**846**	648	648
Debentures issued to the public	13				
Index-linked		**2,959**	**3,046**	1,704	1,762
Denominated in euro		-	-	1,629	1,691
Debentures issued to financial institutions and others					
Index-linked	13	**2,271**	**2,354**	1,799	1,829
Euro-linked		**31**	**31**	31	33
		6,776	**6,956**	7,457	7,532
Unrecognised loss			**180**		75

Estimation of fair values

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

Interest rates applied in the determination of fair value

	2007	2006
	%	%
Long-term trade receivables	**7.2**	7.6
Loans and receivables	**-**	5.6
Loans	**5.5**	6.4
Debentures	**5.3**	4.4

NOTE 31 – DETAILS OF OTHER MOVEMENTS IN EQUITY

	Share capital	Share premium	Capital reserve in respect of activities between a corporation and a controlling shareholder	Capital reserve in respect of available-for-sale financial assets	Capital reserve in respect of employee options	Deficit	Total	Minority interest	Total equity
	NIS millions								
	Related to shareholders of the Company								
Balance at January 1, 2007	**6,309**	**1,623**	**384**	**1**	**287**	**(2,849)**	**5,755**	**(564)**	**5,191**
Total recognised income and expense	**-**	**-**	**-**	**3**	**-**	**1,341**	**1,344**	**31**	**1,375**
Dividends to equity holders	**-**	**-**	**-**	**-**	**-**	**(760)**	**(760)**	**-**	**(760)**
Dividends to equity holders – distribution that does not pass the earnings test	**(177)**	**(1,623)**	**-**	**-**	**-**	**-**	**(1,800)**	**-**	**(1,800)**
Change in the repayment date of a loan provided by the minority in a subsidiary	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**160**	**160**
Payments to a former senior officer	**-**	**-**	**6**	**-**	**-**	**-**	**6**	**-**	**6**
Balance at December 31, 2007	**6,132**	**-**	**390**	**4**	**287**	**(2,268)**	**4,545**	**(373)**	**4,172**

NOTE 31 – DETAILS OF OTHER MOVEMENTS IN EQUITY (CONTD.)

	Share capital	Share premium	Capital reserve in respect of activities between a corporation and a controlling shareholder	Capital reserve in respect of available-for -sale financial assets	Capital reserve in respect of employee options	Deficit	Total	Minority interest	Total equity
	NIS millions								
	Related to shareholders of the Company								
Balance at January 1, 2006	6,309	1,623	384	6	-	(1,762)	6,560	(505)	6,055
Total recognised income and expense	-	-	-	(5)	-	813	808	(59)	749
Dividends to equity holders of the Company	-					(1,900)	(1,900)	-	(1,900)
Share-based payments made by the Company	-	-	-	-	287	-	287	-	287
Balance at December 31, 2006	6,309	1,623	384	1	287	(2,849)	5,755	(564)	5,191

NOTE 31 – DETAILS OF OTHER MOVEMENTS IN EQUITY (CONTD.)

	Share capital	Share premium	Capital reserve in respect of activities between a corporation and a controlling shareholder	Capital reserve in respect of available-for-sale financial assets	Deficit	Total	Minority interest	Total equity
	NIS millions							
	Related to shareholders of the Company							
Balance at January 1, 2005	6,309	1,623	37	73	(2,417)	5,625	(467)	5,158
Total recognised income and expense	-	-	-	(67)	655	588	(46)	542
Payment from the State to employees in respect of privatisation of the Company	-	-	1	-	-	1	-	1
Share-based payments to Company employees from its equity holders	-	-	346	-	-	346	-	346
Minority interest in a benefit deriving from a change in the terms of equity holder loans	-	-	-	-	-	-	8	8
Balance at December 31, 2005	6,309	1,623	384	6	(1,762)	6,560	(505)	6,055

* Less than NIS 500,000

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NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY

Balance sheet

	2007	2006
	NIS millions	NIS millions
Assets		
Cash and cash equivalents	**451**	2,262
Other investments, including derivatives	**366**	957
Trade receivables	**1,059**	857
Other receivables	**181**	214
Inventory	**19**	13
Assets classified as held for sale	**17**	-
Total current assets	**2,093**	4,303
Trade and other payables	**51**	80
Investments and loans, including derivatives	**174**	276
Property, plant and equipment	**3,873**	4,245
Intangible assets	**176**	230
Deferred and other expenses	**185**	221
Investments in associates accounted by the cost method	**5,033**	5,973
Deferred tax assets	**643**	739
Total non-current assets	**10,135**	11,764
Total assets	**12,228**	16,067

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

Balance sheet (contd.)

	2007	2006
	NIS millions	NIS millions
Liabilities		
Loans and borrowings	**722**	1,877
Trade payables	**448**	394
Other payables, including derivatives	**490**	578
Current tax liabilities	**57**	78
Deferred income	**21**	27
Provisions	**287**	208
Employee benefits	**663**	863
Proposed dividend	**-**	300
Total current liabilities	**2,688**	4,325
Debentures	**3,974**	4,381
Other long-term liabilities	**7**	27
Employee benefits	**219**	336
Total non-current liabilities	**4,200**	4,744
Total liabilities	**6,888**	9,069
Equity		
Share capital	**6,132**	6,309
Share premium	**-**	1,623
Reserves	**680**	670
Capital deficit	**(1,472)**	(1,604)
Total equity	**5,340**	6,998
Total equity and liabilities	**12,228**	16,067

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

B. Statement of income

	For the year ended December 31		
	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Income	**5,713**	5,799	5,893
Costs and expenses			
Depreciation	**941**	1,026	1,109
Wages	**1,293**	1,557	1,571
General and operating expenses	**2,121**	2,233	2,391
Other expenses (income), net	**79**	229	(97)
	4,434	5,045	4,974
Operating profit	**1,279**	754	919
Financing expenses (income), net	**3**	(688)	36
Profit before income tax	**1,276**	1,442	883
Income tax	**394**	254	375
Profit for the year	**882**	1,188	508

Income segmentation

	For the year ended December 31		
	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Telephony	**3,905**	4,148	4,337
Internet	**712**	608	550
Transmission and data communication	**754**	711	691
Other services	**342**	332	315
	5,713	5,799	5,893

NOTE 32 – CONDENSED DATA FROM THE SEPARATE FINANCIAL STATEMENTS OF THE COMPANY (CONTD.)

C. Statement of recognised income and expense for the year ended December 31

	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Net change in fair value of available-for-sale financial assets	**5**	(1)	1
Net change in fair value of available-for-sale financial assets transferred to profit or loss	**-**	(5)	(105)
Defined benefit plan actuarial gains (losses)	**13**	(3)	(16)
Income tax on income and expense recognised directly in equity	**(4)**	2	41
Income and expenses recognised directly in equity	**14**	(7)	(79)
Profit for the year	**882**	1,188	508
Total recognised income and expense	**896**	1,181	429

D. Statement of cash flows

	For the year ended December 31		
	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Cash flows from operating activities			
Profit	**882**	1,188	508
Adjustments to profit	**595**	1,536*	2,011*
Net cash from operating activities	**1, 477**	2,724	2,519
Cash flows from (used for) investment activities	**362**	630	(1,371)
Cash flows used for financing activities	**(3,632)**	(2,776)*	(798)*
Net increase in cash and cash equivalents	**(1,793)**	578	350
Cash and cash equivalents at January 1	**2,262**	1,679	1,328
Effect of exchange rate fluctuations on cash balances	**(18)**	5	1
Cash and cash equivalents at December 31	**451**	2,262	1,679

* See Note 3T.

NOTE 33 – GROUP ENTITIES

	Country of registration	Rate of ownership For the year ended December 31, 2007	2006
Pelephone Communications Ltd. (1)	Israel	**100**	100
Bezeq International Ltd. (2)	Israel	**100**	100
D.B.S. Satellite Services (1998) Ltd. (3)	Israel	**49.8**	49.8
BezeqCall Communications Ltd. (2)	Israel	**-**	100
Bezeq On Line Ltd. (4)	Israel	**100**	100
Bezeq Zahav (Holdings) Ltd. (5)	Israel	**100**	100
Stage One (6)	Israel	**83**	83
GoldNet Communication Services – registered partnership (2)	Israel	**-**	100

(1) Pelephone Communications Ltd.

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

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

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

(2) Bezeq International Ltd.

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

Following an agreement signed on October 15, 2006 between BezeqCall and Tadiran Telecom Communication Services Israel – Limited Partnership ("Tadiran") for the acquisition of Tadiran's operation in consideration of approximately NIS 93 million, in April 2007, the agreement for acquisition of the partnership was cancelled, in view of the decision of the Antitrust Authority not to approve the transaction and following Tadiran's notice of its decision to cancel the agreement.

In addition, on April 30, 2006, the Company and M.L.M. Systems Ltd., which are partners in Goldnet Communications Services ("Goldnet"), a registered partnership which provides solutions for secure electronic data transfer between organisations, signed an agreement with the subsidiary Bezeq International. Under the agreement, Bezeq International acquired all the operations of Goldnet.

After compliance with all the preconditions set out in the acquisition agreement, during July 2006, Goldnet, which conducted its business under the trade name Bezeq Zahav, ceased to provide services and its operation was merged with Bezeq International.

NOTE 33 – GROUP ENTITIES (CONTD.)

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

D.B.S. Satellite Services (1998) Ltd. ("DBS") was incorporated in Israel on December 2, 1998. In January 1999, DBS received a license from the Ministry of Communications to transmit satellite television broadcasts in Israel ("the License"). The term of the License when granted to the consolidated company is through January 2014, and can be extended for a period of six additional years on certain terms. In its operations, DBS is subject to the Communications (Telecommunications and broadcasts) Law, 5742-1982 ("the Communications Law'), its concomitant regulations and rules, and the terms of its license.

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

On March 31, 2004, the then Minister of Communications signed an amendment to the Company's license, which includes a provision whereby the Company is obliged to maintain complete structural separation between it and its subsidiaries, including DBS. Business cooperation between the Company and the subsidiaries, including DBS, was also prohibited, unless, *inter alia*, the competitive status of DBS deteriorates materially.
Regarding the financial position of DBS, see below.

A. (1) Since commencing operations, DBS has accumulated considerable losses. DBS's losses in 2007 and 2006 amounted to approximately NIS 118 million and NIS 320 million, respectively. As a result of these losses, its capital deficit and its working capital deficit at December 31, 2007 amount to approximately NIS 2,629 million and NIS 1,327 million respectively.

The Company's investment in DBS (primarily in shareholder loans) at the balance sheet date amount to approximately NIS 1,562 million (without interest and linkage). The balance of the current debt of DBS to the Company and its consolidated companies amounts to approximately NIS 148 million, of which approximately NIS 112 million is to the Company. The Company and DBS put together an arrangement for collection of the balance of DBS's debt to the Company which was in arrears, approximately NIS 55.6 million. Under the arrangement, the debt is being paid in 60 equal monthly instalments plus interest at prime + 1.5%. At the balance sheet date, the balance of the debt covered by the arrangement is approximately NIS 42 million. The balance of the debt to the Company outside the above arrangement, is current debt for which the agreed terms of payment are the usual credit terms between the Company and its customers. At the date of approval of the financial statements, DBS is not in compliance with the terms of the arrangement and these credit terms. The Company, as well, as its consolidated companies, are acting to collect the debts of DBS which are in arrears.

During 2005, the banks completed the provision of the entire credit facility to which DBS was entitled under the financing agreements. See Note 13C(3).

(2) On July 31, 2007, in a private placement. DBS issued approximately NIS 620 million par value of debentures (Series A) to institutional investors, to be registered in a continuous institutional system on the Tel Aviv stock exchange. The net proceeds from the issuance amounted to approximately NIS 614 million. The terms of the debentures are explained above (see Note 13B and C above).

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

NOTE 33 – GROUP ENTITIES (CONTD.)

(3) DBS (contd.)

A. (3) (contd.)

During April and May 2005, the Company and DBS filed petitions in the High Court of Justice for an order *nisi* against the then Minister of Communications, according to which the aforementioned decisions of the Ministry of Communications are void *ab initio*. The petitions were heard on October 11, 2005 and in September 2007 the petitions were dismissed *in limine*.

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

(5) On December 20, 2007, the board of directors of DBS approved the budget for 2008. According to this budget, in 2008 DBS will require additional external financing. At the date of approval of the financial statements, DBS is working to obtain additional finance resources that will enable it to attain the budget targets for the coming year. If those resources cannot be found, DBS will operate in accordance with an alternative business plan which does not necessitate financial resources beyond those at its disposal. The Management of DBS estimates, based on the 2008 budget and on the alternative business plan, that it is more likely than not that the financial resources it requires in the coming year can be arranged.

B. On January 2, 2005, the Antitrust Commissioner gave his approval for the merger of DBS (increasing the Company's holding in DBS beyond 50%) on certain conditions. The merger was not accomplished within a year of the date of its approval, and required renewed consent. On August 2, 2006, the Company and DBS filed new merger notices to the Antitrust Commissioner on the matter of exercise of the options for DBS shares by the Company, which are expected to increase the Company's holdings in DBS from approximately 49.8% to approximately 58%. On December 31, 2006, the Antitrust Authority announced the Commissioner's opposition to the merger, and on February 18, 2007, it gave the reasons for the opposition. On May 15, 2007, the Company appealed the decision. The Antitrust Commissioner has filed his response to the appeal and the case is ongoing.

It is noted that even though the options held by the Company in DBS have not yet been exercised for the reasons stated above, the Company consolidates DBS fully into its financial statements.

Concerning the petition of the Company and DBS to the High Court of Justice against the Minister of Communications in the matter of restrictions imposed on the Company's investments in DBS, the petition was dismissed in September 2007.

(4) Bezeq On Line Ltd.

Bezeq On Line Ltd. ("Bezeq On Line") was established in December 2000 and commenced operation in 2001, providing call centre outsourcing services.

(5) Bezeq Zahav (Holdings) Ltd.

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

(6) Stage One Venture Capital Fund (Israel L.P.

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

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

1. Pelephone Communications Ltd.

A. Balance sheet

	December 31, 2007	December 31, 2006
	NIS millions	NIS millions
Current assets	**1,976**	1,405
Non-current assets	**2,363**	2,566
	4,339	3,971
Current liabilities	**1,106**	1,089
Long-term liabilities	**1,154**	1,384
Total liabilities	**2,260**	2,473
Shareholders' equity	**2,079**	1,498
	4,339	3,971

B. Income statement

	For the year ended December 31,		
	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Income from services and sales	**4,684**	4,478	4,428
Cost of services and sales	**3,347**	3,250	3,301
Gross profit	**1,337**	1,228	1,127
Sales and marketing expenses	**430**	417	428
General and administrative expenses	**102**	110	108
	532	527	536
Operating income	**805**	701	591
Financing expenses	**114**	107	200
Financing income	**(109)**	(89)	(76)
Financing costs, net	**5**	18	124
Share in losses of an affiliated partnership, net	**-**	-	8
Profit before income tax	**800**	683	459
Income tax	**215**	197	172
Profit for the year	**585**	486	287

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

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

A. Balance sheet

	December 31, 2007	December 31, 2006
	NIS millions	NIS millions
Current assets	**400**	338
Non-current assets	**706**	678*
	1,106	1,016
Current liabilities	**1,483**	1,889
Long-term liabilities	**2,252**	1,988*
Total liabilities	**3,735**	3,877
Equity deficit	**(2,629)**	(2,861)
	1,106	1,016

B. Income statement

	For the year ended December 31,		
	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Income	**1,415**	1,355	1,222
Cost of income	**1,117**	1,139	1,072
Gross profit	**298**	216	150
Sales and marketing expenses	**138**	123	142
General and administrative expenses	**104**	92*	72*
	242	215	214
Operating income (loss)	**56**	1	(64)
Financing expenses	**394**	328	281
Financing income	**(226)****	(9)	(2)
Financing costs, net	**168**	319	279
Loss before income tax	**(112)**	(318)	(343)
Income tax	**6**	2*	3*
Loss for the year	**(118)**	(320)	(346)

* See Note 3T.
** See Note 13E

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

3. Bezeq International Ltd.**

A. Balance sheet

	December 31, 2007	December 31, 2006
	NIS millions	NIS millions
Current assets	**431**	332
Non-current assets	**456**	341
	887	673
Current liabilities	**312**	307
Long-term liabilities	**26**	16
Total liabilities	**338**	323
Shareholders' equity	**549**	350
	887	673

B. Income statement

	For the year ended December 31,		
	2007	2006	2005
	NIS millions	NIS millions	NIS millions
Income	**1,304**	1,021	815
Cost of income	**859**	662	530
Gross profit	**445**	359	285
Sales and marketing expenses	**147**	148	136
General and administrative expenses	**94**	72	57
Other income (expenses), net	**-***	7	(1)
Operating income	**204**	132	93
Financing costs, net			
Financing expenses	**13**	20	15
Financing income	**(14)**	(13)	(6)
Financing incomes (expenses), net	**(1)**	7	9
Share in profits of an associate accounted by the equity method	**6**	11	5
Profit before income tax	**211**	136	89
Income tax	**58**	40	(15)
Net profit for the year	**153**	96	104

* Less than NIS 500,000.

** The above financial statements are presented in accordance with IFRSs only, Furthermore, commencing January 1, 2007, the financial statements include the operations of BezeqCall Communications Ltd.