"BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

FINANCIAL STATEMENTS

DECEMBER 31, 1999

Contents

March 28, 2000

Auditor's Report to the Shareholders of
“Bezeq” The Israel Telecommunication Corp. Limited

We have audited the accompanying balance sheets of “Bezeq” The Israel Telecommunication Corp. Limited (the Company) as at December 31, 1999 and December 31, 1998, and the consolidated balance sheets as at such dates and the related statements of income, shareholders’ equity and cash flows for each of the three years in period ended December 31, 1999. 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 certain subsidiaries, whose assets constitute approximately 3% and approximately 5% of the total consolidated assets as at December 31, 1999 and December 31, 1998, respectively, and whose revenues constitute approximately 7%, 8% and 14% of the total consolidated revenues for the years ended December 31, 1999, 1998 and 1997, respectively. The financial statements of those subsidiaries were audited by other auditors whose reports thereon were furnished to us. Our opinion, insofar as it relates to amounts emanating from the financial statements of such subsidiaries, is based solely on the said reports of the other auditors. Furthermore, the data included in the financial statements relating to the net asset value of the Company’s investments in affiliates and to its equity in their operating results is based on the financial statements of such affiliates, some of which were audited by other auditors.

We conducted our audits in accordance with generally accepted auditing standards, 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and on the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the Company and the consolidated financial position of the Company and its subsidiaries as at December 31, 1999 and December 31, 1998 and the results of their operations, the changes in the shareholders’ equity and their cash flows for each of for each of the three years in the period ended December 31, 1999, in conformity with generally accepted accounting principles. Furthermore, in our opinion, the financial statements referred to above are prepared in conformity with the Securities Regulations (Preparation of Annual Financial Statements), 1993.

As explained in Note 2, the abovementioned financial statements are stated in values adjusted for the changes in the general purchasing power of the Israeli currency, in accordance with opinions of the Institute of Certified Public Accountants in Israel.

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

1. The anticipated opening of the communications sector to competition, changes in the tariffs and their effect on the Company’s financial position and operating results, as described in Note 1.

2. A program for an additional reorganization, as described in Note 17D (2).

3. Claims made against the Company and against investee companies, as described in Note 21A.

Certified Public Accountants (Isr.)

Balance Sheets

In terms of shekels of December 1999

		Consolidated		Company	
		December 31, 1999	December 31, 1998	December 31, 1999	December 31, 1998
	Note	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Current assets					
Cash and cash equivalents	3	664,237	932,287	486,162	805,031
Short-term investments	4	301,140	385,825	294,457	158,014
Trade receivables	5	1,522,844	1,552,672	1,008,146	1,071,572
Other receivables and debit balances	6	482,522	439,239	388,048	411,233
Inventory		110,210	57,033*	–	–
		3,080,953	3,367,056	2,176,813	2,445,850
Materials and spare parts		231,248	234,848*	231,248	234,848
Investments and long-term receivables					
Deposits and debit balances	7	275,743	316,557	257,492	277,702
Investments in investee companies	8	75,498	36,546	1,479,571	1,540,981
		351,241	353,103	1,737,063	1,818,683
Fixed assets	9				
Cost		28,751,669	28,665,372	25,643,973	26,024,730
Less - accumulated depreciation		16,095,221	14,750,634	14,573,613	13,596,938
		12,656,448	13,914,738	11,070,360	12,427,792
Other assets					
Deferred charges and other assets	10	255,230	22,781	13,225	19,853
Deferred taxes	11	237,737	334,837*	248,816	348,177
		492,967	357,618	262,041	368,030
		16,812,857	18,227,363	15,477,525	17,295,203

		Consolidated		Company	
		December 31, 1999	December 31, 1998	December 31, 1999	December 31, 1998
	Note	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Current liabilities					
Short-term bank credit	12	271,006	–	–	–
Current maturities of:					
Debenture issued to the Government of Israel	13	470,954	941,316	470,954	941,316
Long-term bank loans	14	1,053,418	1,090,549	983,615	1,043,133
Other debentures	15	225,517	206,518	225,517	206,518
Trade payables	16	1,156,374	997,469	654,624	527,309
Dividend payable		301,565	–	301,565	–
Employee severance benefits	17	351,185	637,707	351,185	637,707
Other current liabilities	18	825,777	1,066,020	694,358	928,084
		4,655,796	4,939,579	3,681,818	4,284,067
Long-term liabilities					
Debenture issued to the Government of Israel	13	–	470,658	–	470,658
Long-term loans	14	3,236,604	3,619,892	2,862,097	3,332,147
Other debentures	15	1,253,620	1,213,815	1,253,620	1,213,815
Convertible debentures	19	–	419,470	–	419,470
Employee severance benefits	17	78,463	93,118	79,375	91,714
Deferred taxes	11	19,362	24,556*	–	–
Deferred revenues	20	78,780	85,121	110,383	122,178
		4,666,829	5,926,630	4,305,475	5,649,982
Convertible debentures	19	233,699	–	233,699	–
Contingent liabilities	21				
Shareholders' equity	22	7,256,533	7,361,154	7,256,533	7,361,154
		16,812,857	18,227,363	15,477,525	17,295,203

Israel (Izzy) Tapoohi	Iris Stark	Ilan Biran
Chairman of the Board	Member of the Board	CEO

Date of approval of the financial statements: March 23, 1999

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

Statement of Operations for the Year Ended December 31

In terms of shekels of December 1999

		Consolidated			Company		
	Note	1999 NIS thousands	1998 NIS thousands	1997 NIS thousands	1999 NIS thousands	1998 NIS thousands	1997 NIS thousands
Revenues from telecommunications services	23	9,143,350	9,514,025*	9,578,576*	7,458,820	7,680,869*	7,314,733*
Costs and expenses							
Operating and general expenses	24	5,111,469	4,988,371*	5,057,104*	3,927,405	3,939,791*	3,766,011*
Depreciation	9	2,720,919	2,509,146	2,500,971	2,293,311	2,127,913	2,160,359
Royalties to the Government of Israel		301,358	354,672	388,359	208,207	248,033	272,310
		8,133,746	7,852,189	7,946,434	6,428,923	6,315,737	6,198,680
Operating income		1,009,604	1,661,836	1,632,142	1,029,897	1,365,132	1,116,053
Financing expenses							
On debentures issued to the Government of Israel		56,060	101,695	209,022*	56,060	101,695	209,022*
Banks and others, net (including inflationary erosion in value)	25	304,012	354,119	421,533	308,627	375,907	420,074
		360,072	455,814	630,555	364,687	477,602	629,096
Earnings after financing expenses		649,532	1,206,022	1,001,587	665,210	887,530	486,957
Other income (expenses), net	26	(558,458)	42,762*	(1,262,726)*	(482,770)	51,419*	(1,249,069)*
Earnings (loss) before income tax		91,074	1,248,784	(261,139)	182,440	938,949	(762,112)
Tax benefit (income tax)	11	(62,796)	(491,230)	37,957	(70,379)	(374,297)	232,908
Earnings (loss) after income tax		28,278	757,554	(223,182)	112,061	564,652	(529,204)
Equity in earnings (losses) of investee companies	8	(21,5500)	6,468	(22,039)	(105,333)	199,370	283,983
Net earnings (loss)		6,728	764,022	(245,221)	6,728	764,022	(245,221)
Earnings per share							
Primary and diluted earnings (loss) per NIS 1 par value of common shares (in NIS)	27	0.02	1.00	(0.33)	0.02	1.00	(0.33)

* Reclassified

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

Statement of Changes in Shareholders' Equity

In terms of shekels of December 1999

	Share capital	Receipts from issue of option warrants	Capital reserve share premium (5)	Capital reserve in respect of transactions between the Company and a controlling shareholder	Retained earnings	Total
	NIS thousands					
Balance as at January 1, 1997	4,078,550	-	200,741	-	2,293,649	6,572,940
Changes in 1997 -						
Net loss	-	-	-	-	(245,221)	(245,221)
Final dividend for preceding year - net (1)	-	-	-	-	(81,456)	(81,456)
Compensation to the Company's employees from the State	-	-	-	5,555	-	5,555
Balance as at December 31, 1997	4,078,550	-	200,741	5,555	1,966,972	6,251,818
Changes in 1998 -						
Net earnings	-	-	-	-	764,022	764,022
Public issue	-	80,587	-	-	-	80,587
Issue to employees (2)	4,637	-	35,806	-	-	40,443
Offer to employees	-	-	-	3,482	-	3,482
Compensation to the Company's employees from the State	-	-	-	26,613	-	26,613
Exercise of warrants (3)	31,542	(80,587)	240,721	-	-	191,676
Conversion of convertible debentures(4)	237	-	2,276	-	-	2,513
Balance as at December 31, 1998	4,114,966	-	479,544	35,650	2,730,994	7,361,154
Changes in 1999						
Net earnings	-	-	-	-	6,728	6,728
Dividend for preceding year	-	-	-	-	(301,565)	(301,565)
Conversion of convertible debentures(6)	17,903	-	172,313	-	-	190,216
Balance as at December 31, 1999	4,132,869	-	651,857	35,650	2,436,157	7,256,533

(1) Including inflationary erosion of dividend, which was proposed in the previous year and paid in the current year.
(2) 4,215,844 ordinary shares of NIS 1 par value were issued to employees.
(3) Pursuant to a prospectus from February 27, 1998 the Company issued to the public 29,250,000 option warrants exercisable into Company shares (Series C). These options were converted into 29,250,000 ordinary shares with a par value of NIS 1 each.
(4) 2,336,657 par value convertible debentures were converted into 230,895 ordinary shares of a par value of NIS 1 each.
(5) After deduction of assigned issue expenses in the amount of NIS 3,924,000 in respect of 1998.
(6) 2,336,657 par value convertible debentures were converted into 230,895 ordinary shares with a par value of NIS 1 each.

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

Statement of Cash Flows for the Year Ended December 31

In terms of shekels of December 1999

	Consolidated			Company		
	1999	1998	1997	1999	1998	1997
	NIS thousands			NIS thousands		
Cash flows generated by operating activities						
Net earnings (loss)	6,728	764,022	(245,221)	6,728	764,022	(245,221)
Adjustments to reconcile net earnings (loss) to net cash flows generated by operating activities (see A below)	2,368,426	2,254,565	3,666,605	2,139,072	1,730,248	3,044,133
Net cash inflow generated by operating activities	2,375,154	3018,587	3,421,384	2,145,800	2,494,270	2,798,912
Cash flows generated by investing activities						
Acquisition of fixed and other assets	(1,417,578)	(1,862,647)	(2,065,689)	(920,584)	(1,236,799)	(1,630,413)
Proceeds from disposal of fixed assets	20,112	65,016	44,413	16,311	51,473	22,309
Investment in long-term deposits and investments	(15,820)	(100,035)*	(41,013)*	(4,989)	(65,370)*	(34,687)*
Proceeds from long-term deposits and investments	112,707	20,430*	296*	83,194	18,954*	-*
Decrease (increase) in short-term investments, net	85,002	(8,222)	(266,669)	(136,126)	(41,436)	(227)
Decrease (increase) in materials and spare parts	(80,034)	87,749*	90,538*	(80,033)	87,748	87,333
Disposal (investment) in investee companies	(60,502)	4	(4,618)	(43,923)	(3,364)	(97,319)
Investments in other assets	(290,430)	-	-	(130)	-	-
Net cash outflow generated by investment activities	(1,646,543)	(1,797,705)	(2,242,742)	(1,086,280)	(1,188,794)	(1,653,004)
Cash flows generated by financing activities						
Repayment of debentures issued to the Government of Israel	(938,612)	(928,504)	(927,702)	(938,612)	(928,504)	(927,702)
Issue of other debentures (net of issue expenses)	263,253	69,103	304,422	263,253	69,103	304,422
Repayment of other debentures	(206,575)	(240,792)	(229,785)	(206,575)	(240,792)	(229,785)
Receipt of long-term loans	720,809	725,248	712,526	559,319	610,702	579,332
Repayment of long-term loans	(1,106,542)	(1,270,100)	(738,248)	(1,055,774)	(1,185,110)	(713,721)
Receipt (repayment) of short-term bank credit	271,006	(18,823)	(20,147)	-	(7,785)	7,785
Dividend paid	-	-	(222,898)	-	-	(222,898)
Proceeds from issue of shares to employees (net of issue expenses)	-	26,502	-	-	26,502	-
Proceeds from issue of share options (net of issue expenses)	-	80,587	-	-	80,587	-
Proceeds from convertible debentures and options on them (net of issue Expenses)	-	407,719	-	-	407,719	-
Proceeds from exercise of options	-	191,676	-	-	191,676	-
Net cash inflow (outflow) generated by financing activities	(996,661)	(957,384)	(1,121,832)	(1,378,389)	(975,902)	(1,202,567)
Increase (decrease) in cash and cash equivalents	(268,050)	263,498	56,810	(318,869)	329,574	(56,659)
Cash and cash equivalents at beginning of year	932,287	668,789	611,979	805,031	475,457	532,116
Cash and cash equivalents at end of year	664,237	932,287	668,789	486,162	805,031	475,457

* Reclassified

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

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

In terms of shekels of December 1999

	Consolidated			Company		
	1999	1998	1997	1999	1998	1997
	NIS thousands			NIS thousands		
A - Adjustments to reconcile net earnings (loss) to net cash flows generated by operating activities						
Revenues and expenses not involving cash flows:						
Depreciation	2,720,919	2,509,146	2,500,971	2,293,311	2,127,913	2,160,359
Provision for decrease in value	106,380	14,623	-	106,380	14,623	-
Deferred taxes	79,290	164,068	(330,075)	72,884	172,998	(317,689)
Company's equity in losses (earnings) of Investee companies, net	21,550	(6,468)	22,039	105,333	(115,400)	(238,114)
Provision for decrease in value of affiliate	(14,919)	-	87,074	(14,919)	-	87,074
Increase (decrease) in employee severance benefits, net	(301,177)	(745,385)	1,053,583	(298,861)	(745,286)	1,052,449
Loss (gain) on disposal of fixed assets	(16,391)	(4,686)	604	(17,454)	(13,027)	6,619
Imputed salaries expense	-	44,036	5,555	-	44,036	5,555
Erosion (appreciation) of and interest on Long-term deposits and investments	16,933	(68,202)*	24,200*	16,933	(68,202)*	24,200*
Erosion (appreciation) of short-term Investments, net	(317)	5,272	(3,599)	(317)	5,272	(9,013)
Appreciation (erosion) of long-term Liabilities:						
Debenture issued to the Government of Israel	(2,408)	(21,916)	18,853	(2,408)	(21,916)	18,853
Other debentures	817	(5,961)	20,082	817	(5,961)	20,082
Long-term loans	(36,222)	246,755	72,898	(34,985)	233,955	69,396
Convertible debentures	140	(807)	-	140	(807)	-
Amortization and other adjustments	58,818	8,336	5,725	7,595	7,982	5,725
Changes in asset and liability items:						
Decrease (increase) in trade receivables	54,801	(51,630)	189,152	86,477	(60,970)	212,433
Decrease (increase) in other Receivables and debit balances	(105,595)	117,748	(64,764)	(25,266)	92,430	(60,345)
Increase (decrease) in inventory	(81,943)	(25,065)*	22,985*	-	-	-
Increase in trade payables	92,884	9,109	116,675	67,483	19,206	41,868
Increase (decrease) in other current liabilities	(218,793)	64,156	(114,358)	(212,276)	41,965	(111,379)
Increase in deferred revenues	(6,341)	1,436	39,005	(11,795)	1,437	76,060
	2,368,426	2,254,565	3,666,605	2,139,072	1,730,248	3,044,133
B – Non-cash transactions						
Acquisition of fixed assets, materials and spare parts on credit	324,161	258,361	298,571	263,327	203,377	227,788
Sale of fixed assets on credit	23,051	-	-	23,051	-	-
Proposed dividend	301,565	-	-	301,565	-	-
Transfer of fixed assets, net, after Deduction of provision for taxes in an affiliate	-	-	-	-	-	(6,739)

* Reclassified

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

NOTE 1 - GENERAL

A. "Bezeq" - The Israel Telecommunication Corp. Limited (hereinafter - the Company) is controlled by the State of Israel and therefore, is subject to the provisions of the Government Companies Law, 5735-1975. The Company operates under a general license awarded under the Telecommunications Law, 5742-1982, which authorizes it to engage in telecommunication business and provide telecommunication services. The Company's license, which was granted on March 1, 1994 (and amended on various dates), sets out the terms under which the Company shall operate, and provides, inter alia, that the Company shall continue to provide telephone and related services, and infrastructure services, and shall operate through subsidiaries which will engage in providing services in areas which were opened to competition. Under the license, the management of the subsidiaries is to be separate from the management of the Company. It was also determined that the provision of new services by the Company is contingent upon receipt of a license from the Ministry of Communications. Limits were also imposed on the extent of the Company's financial exposure with regard to projects undertaken outside Israel. The limits are U.S. $20 million in respect of a single project, and an overall amount of U.S. $100 million in respect of all projects. The Minister of Communications may permit the Company to exceed these limits for specified periods.

B. The Company's operations are supervised by the Government and most of the tariffs for its services are determined in accordance with Section 15 of the Telecommunications Law, 5742-1982, and are updated according to regulations

In October 1998, the committee for the arrangement of the Company's tariffs submitted its recommendations for a new tariff arrangement from January 1, 1999.

According to the announcement of the Director General of the Ministry of Communications in March 1999, the Ministers of Communications and Finance decided to adopt the recommendations of the committee for the arrangement of the Company's tariffs, with certain amendments. Below are the principal recommendations:

(1) The decrease in the average level of telecommunications tariffs during the new tariff arrangement period will be 6.03%, in view of the rise in the rate of inflation beyond that foreseen by the committee.

Taking into account that application of the new arrangement was postponed from January 1, 1999 to April 1, 1999, the reduction in tariffs for 1999 alone was an actual 8.04%, since the increase in usage fees took effect only on May 1, 1999 and not on April 1, 1999, the overall reduction on April 1, 1999 amounted to 7.7%, and the percentage which will be added on January 1, 2000 will be 1.72%.

(2) The efficiency factor of the Company's tariffs ("the efficiency factor") averaged 6% in 1999 and will average 7% in 2000. This factor will be updated in the three years 2001 to 2003 to between 3.5% - 8%, depending on the average rate of increase in Company aggregate outputs in the years 1999-2000.

(3) In order to enable the Company to compete in the Internet access market, the Company will be permitted to offer a reduced package for these services.

(4) The Ministries of Telecommunications and Finance will act to change the existing arrangement between the Broadcasting Authority and the Company so that within four years, the payments of the Broadcasting Authority will cover the costs of the services which the Broadcasting Authority will purchase from the Company, or an alternative arrangement.

Commencing April 1, 1999, the tariffs of the Company were updated in accordance with the regulations that were approved by the Finance Committee of the Knesset. Below are the principal updates:

NOTE 1 - GENERAL (contd.)

B. Contd.

- The price of call units was reduced by 21.34%.
- Usage fees per fixed line were raised by 16% (effective from May 1, 1999).
- The fee for the segment in land-to-mobile calls that passes through the Bezeq network was reduced by 63%.
- Interconnect fees for international operators were reduced by 65%.
- Data communication service tariffs, among them the Sifranet service, were raised by an average rate of 51.5%, and frame relay service by an average rate of 42%.

Under the regulations, starting from January 1, 2000 the efficiency factor will be 7%. The regulations do not include the examination and adaptation mechanism of the efficiency factor as appears in the notice of the Director General of the Ministry of Communications from March 1999.

The tariff update that was scheduled for January 1, 2000 was postponed, at the request of the Company and in coordination with the Ministry of Communications, to May 1, 2000. Pursuant to the decision of the Finance and Economics Committees of the Knesset from March 13, 2000, a change was made in the method of charging for calls, principally a change from charging by call unit to charging by time, as well as a reduction in the Company's tariffs by an average rate of 2.43%. The Company also decided to offer a number of tariff baskets to Internet users which will signify a reduction in tariffs.

C. As of April 1, 1997, the Company and its subsidiary, Bezeq International Ltd. are required to pay royalties to the Government of Israel at the rate of 5% of their revenues (until then the rate was 8%). Pelephone Communications Ltd. is required to pay royalties at the rate of 8% of its revenues.

D. In June 1995, the Director General of the Anti-Trust Authority declared the Company a monopoly in the following areas: basic telephone service, telecommunications infrastructure services, two-way unrestricted international telephone services, including international telephone service for incoming calls and relay transfer and transmission services for public broadcasting. In March 2000 application was made to the Director General of the Anti-Trust Authority for cancellation of the announcement of the Company as a monopoly in the area of basic telephone service. In its application, the Company requests the comments of the Director General to its claim that this area includes both fixed telephony and mobile telephony, and since the announcement the status of the Company therein has changed.

E. Below are the significant changes which have occurred in recent years with regard to the monopoly which the Company enjoyed in providing telecommunications services in Israel, pursuant to the 1992 amendment of Section 50 of the Telecommunications Law, 5742-1982:

(1) Cellular services

Cellular services are currently provided by three companies, of which one - Pelephone Communications Ltd. - is 50% owned by the Company.

The Ministry of Communications is considering making a change in the general license for cellular services, which was awarded to the companies. The proposed change would change the method of calculating incoming call tariffs, and if applied, is liable to have a materially adverse effect on the future operating expenses of a proportionally consolidated company, Pelephone Communications Ltd. The management of Pelephone Communications Ltd. opposes the proposed change and the issue is being discussed with the Ministry of Communications.

NOTE 1 - GENERAL (contd.)

E. Contd.

(2) International communication services

At the beginning of July 1997, two new companies began providing international communication services at tariffs that were significantly lower than those then in effect. The subsidiary company Bezeq International Ltd. also lowered its tariffs by more than 50%. Interconnect fees with operators around the world were also lowered considerably. The tariffs of the subsidiary are fixed at its discretion owing to the decline of its market share to below 60%. If its market share returns to more than 60%, the table of tariffs will be changed in accordance with rules set by the Ministry of Communications.

At the beginning of July 1997, new regulations were promulgated for the purpose of requiring all the companies operating international telecommunication services to pay the Company a fee for "interconnect services". In addition, the general license awarded to the international operators obligates them to pay a fee to the Company for "access services" until December 31, 2001 which will be linked to the U.S. dollar, the currency basket and to the CPI.

Pursuant to an amendment to the license of Bezeq International Ltd. relating to the process of allocating subscribers to the various operators, Bezeq International Ltd. and the Company filed petitions in the High Court of Justice. On September 26, 1999, a decision on the petitions was handed down, with the consent of the parties, whereby the allocation process would be carried out in two stages:

(a) In stage one - and not later than December 1, 1999 - all customers not yet lawfully allocated would be approached in a letter worded by the Ministry of Communications, in which they would be requested to select one of the international operators.

(b) In stage two - for a subscriber who had not given notice of his selection of an international communications operator, the dial codes 00 and 188 will be blocked, and he will have the option of using the individual dial codes of each operator (012, 013 and 014). Stage two was to be completed by May 1, 2000 at the latest.

The court also decided that customers, who were registered as subscribers by the other competing companies up to the time of the referendum, would be deemed to be the subscribers of those companies and need not be approached. On the other hand, customers who registered during the "Family and friends" campaign of Bezeq International Ltd. would not be deemed to be allocated to that company. Furthermore, the court ruled, "without giving a specific opinion", that the competing companies would retain the right to sue for damages allegedly incurred by them due to postponement of the date of allocation of customers to the international communications operators.

Following the decision, the general license of the international operators was amended in accordance with the above decision of the High Court of Justice.

Implementation of the allocation process as in the court ruling is liable to have a materially adverse effect on Bezeq International Ltd. and its operations. In 1999 Bezeq International recorded direct expenses of approximately NIS 76 million in respect of the allocation process. The company also incurred costs for the technical operation of the allocation. Pursuant to the amendment to the Company's license, the international operators must bear these costs, except for the cost of the initial allocation of the subscriber.

NOTE 1 - GENERAL (contd.)

E. Contd.

On November 4, 1999 the Minister of Communications signed an amendment to the license of Bezeq International Ltd., obligating the company to present a bank guarantee in the amount of 20 million dollars for fulfillment of all the terms of its license. In the opinion of the management of Bezeq International Ltd., based on the opinion of its legal advisers, it is not required to present such a guarantee. Up to the date of approval of the financial statements, no guarantee had been presented.

The Company, based on the assessment of Bezeq International Ltd., estimates that following the changes in the business environment in which Bezeq International Ltd. has been operating since the start of competition, additional changes are likely to occur in international communications, inter alia, in tariffs, market share and traffic ratio. This could lead to a material decrease in the financial results of the Group.

(3) Domestic communication services

An inter-ministerial committee established for the purpose of examining policy for the telecommunication industry and the opening of the industry to competition submitted its recommendations to the Minister of Finance and the Minister of Communications in December 1996. These included, inter alia, a recommendation for the amendment of Section 50 of the Telecommunications Law, 5742-1982, enabling the Minister of Communications to grant others a general license for the provision of telecommunication services in a nationwide telephone network.

The Government adopted the recommendations of the committee. The Ministers of Finance and Communications then appointed a team to formulate detailed recommendations (hereinafter - the Implementation Team). The Implementation Team submitted its recommendations to the Ministers on October 30, 1997, and in September 1998 submitted a series of revisions to those recommendations, clarifying several issues that had been inadequately explained and changing some other recommendations. The changes include:

(a) A licensee will be permitted to provide a certain service of his choice, fulfilling all the conditions and duties relating to the provision of that service, without being obligated to provide any other service except for auxiliary services. Accordingly, the licensee will be able to operate in one or more of the fields of infrastructure, transmission, data communications and voice telephony.

(b) The new operators will be permitted to provide their services all over the country, but will be required to provide them in a "broad region of demand". This region will be defined in the license of each operator, and will include twelve "natural regions". The broad region of demand of a cable television services licensee will be a group of concession regions that includes all the concession regions of that licensee. Definition of the natural regions is based on an administrative division of the country into 41 such "natural regions". The broad region of demand of the Company is the entire country.

The Ministry of Communications applied to the public in November 1998, requesting it to present a position on the terms of the general license for providing domestic telecommunications services, and the conditions and criteria for granting the license. The request incorporated a draft of a general license for a domestic operator and a draft license for the Company, which would replace its existing license. The Company submitted its response to the request.

In February 1999, Section 50 of the Telecommunications Law, 5742-1982 was repealed. The section granted the Company exclusivity in providing nationwide telecommunication services in a national network of telephones under the general license. The repeal took effect on June 1, 1999, but activities of new operators in domestic fixed-line communications will be permitted only from the date on which the Ministry of Communications awards them a general license.

NOTE 1 - GENERAL (contd.)

E. Contd.

On August 22, 1999, two government decisions were adopted concerning the acceleration and increase of competition in domestic communications during 1999, and in the area of mobile personal communications during 2000. In addition, as part of the steps for the acceleration of competition, the Ministry of Communications intends to publish tenders for awarding licenses for LMDS broadband wireless access.

In January 2000, under the Arrangement in the State Economy Law, a number of amendments were inserted into the Telecommunications Law, which the Ministry of Communications believed were necessary prior to opening the communications market to full competition.

The reduction in tariffs on April 1, 1999 has led to a significant downturn in the business results of the Company. This trend is expected to continue as a result of the reduction in tariffs which will take effect on May 1, 2000, the opening of fixed-line domestic communication services to full competition, and the increasing competition in the areas of cellular and international communications, which cannot be estimated a this stage.

F. On October 20, 1999, the Ministerial Committee for Privatization resolved to require the Government Companies Authority, in coordination with the relevant government ministries, to submit to the Ministerial Committee for Privatization a proposed resolution for the privatization of all of the State's holdings in the Company, together with a document setting out the considerations for determining the percentage of control core to be sold.

Following the above decision, on November 22, 1999 the Government Companies Authority submitted to the Company a proposal for privatization of the Company by way of a private placement. In accordance with to Section 59B(d) of the Government Companies Law, 5735-1975, the preliminary response of the Board of Directors of the Company was submitted to the Government Companies Authority.

The Company is unable to estimate if, when and how the all or some of the State's shares in the Company will be sold.

On May 12, 1999, the General Meeting of the Shareholders of the Company resolved to approve changes in the Company's bylaws, some of which would take effect immediately and some on the date on which the State's holdings in the issued and paid up capital of the Company would fall to 50% or less.

In the Company's opinion, the result of these provisions in the bylaws is that even after the State's holdings fall below 50%, the Government will continue to control it as long as the State holds 10% or more of the share capital of the Company, unless another person control the Company pursuant to approval under the Telecommunications Order.

NOTE 2 - SIGNIFICANT ACCOUNTING PRINCIPLES AND REPORTING POLICIES

A. DEFINITIONS

In these financial statements -

(1) Consolidated company - A company whose financial statements are fully consolidated, directly or indirectly, with the financial statements of the Company.

(2) Proportionately consolidated company - A company whose financial statements are proportionally consolidated, directly or indirectly, with the financial statements of the Company.

(3) Affiliate - A company, other than a subsidiary or a proportionately consolidated company and including a partnership, the Company's investment in which is stated, directly or indirectly on the equity basis.

(4) Investee company - A subsidiary, proportionately consolidated company or an affiliate.

(5) Related party - as defined in opinion No. 29 of the Institute of Certified Public Accountants in Israel (hereinafter - "ICPAI").

(6) Interested party - as defined in the Securities Law, Section 1 Paragraph (1)

(7) Controlling interest - as defined in the Securities Regulations (Presentation of transactions between a company and its controlling interests in the financial statements) 5756-1996.

(8) CPI - the Consumer Price Index published by the Central Bureau for Statistics.

B. FINANCIAL STATEMENTS ADJUSTED FOR THE EFFECT OF INFLATION

(1) The financial statements have been prepared on the basis of historical cost adjusted for the effect of the changes in the general purchasing power of the Israeli currency. (Financial statement data on the Company in nominal historical values appears in Note 32.)

(2) The adjusted value of non-monetary assets does not purport to reflect their market or economic value, but rather the balance of their historical cost adjusted for the effect of the changes in the general purchasing power of the shekel.

(3) The terms "cost" as used herein means "adjusted cost".

(4) All of the comparative figures (including those of monetary items), have also been adjusted to the CPI of the end of the current reporting period.

C. USE OF ESTIMATES

Preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and disclosure relating to contingent assets and liabilities, as well as amounts of revenues and expenses for the report period. Actual results may differ from these estimates.

D. The items of the financial statements have been classified and are presented in the order arising from the nature of the Company's business as a communications company.

NOTE 2 - SIGNIFICANT ACCOUNTING PRINCIPLES AND REPORTING POLICIES (Contd.)

E. PRINCIPLES OF ADJUSTMENT

(1) Balance sheet

Non-monetary items (mainly fixed assets, materials and spare parts, investments stated at cost) have been adjusted on the basis of the changes in the CPI from the index in respect of the month in which the item was acquired or arose, to the index in respect of balance sheet month.

Monetary assets are stated in the adjusted balance sheet at their historical value at balance sheet date.

The net asset value of the investments in investee companies is determined on the basis of the adjusted financial statements of such investees.

(2) Statement of operations

Statement of operation items were adjusted on the basis of changes in the CPI as follows:

(a) Income and expenses deriving from non-monetary items (such as depreciation, amortization, changes in materials and spare parts, prepaid expenses, deferred income, etc.) or from provisions included in the balance sheet (such as for vacation pay, employee vacation expense allowance, etc.), were adjusted on the basis of the same specific indices which were applied to the related balance sheet items.

(b) Other statement of operation items (such as sales, purchases, current production costs, etc.), other than the financing item, were adjusted on the basis of the changes in the CPI from the date of receipt of payment until the index in respect of balance sheet month.

(c) The Company's equity in operating results of investee companies was determined on the basis of the adjusted financial statements of those companies.

(d) The financing item reflects interest income and expenses in real terms, erosion of financial items during the year, earnings and losses from the disposal and revaluation of marketable securities, and earnings and losses from derivatives.

(e) Income tax:
Current income tax expense is comprised of advance payments made during the year plus amounts payable (or less amounts refundable) at balance sheet date. The advance payments were adjusted on the basis of the changes in the CPI from each date of payment until balance sheet date while the amounts payable or refundable at year end were not adjusted. Therefore, the current income tax expense includes also the erosion in the value of the advance payments, from payment date until the balance sheet date. See Notes 2N and 11D relating to deferred taxes.

(3) Statement of shareholders' equity

A dividend that was announced and actually paid in the report year was adjusted on the basis of the CPI at date of payment. A dividend that was declared/proposed in the report year but had not been distributed as at balance sheet date, was stated unadjusted.

NOTE 2 - SIGNIFICANT ACCOUNTING PRINCIPLES AND REPORTING POLICIES (contd.)

E. PRINCIPLES OF ADJUSTMENT (contd.)

(4) Adjustments on the basis of the foreign currency exchange rates and foreign companies

The net asset value of an affiliate that operates autonomously in a foreign country is determined on the basis of the financial statement of the affiliate, adjusted to the changes in the purchasing power of the currency in which they were prepared and translated into NIS according to the representative exchange rate as at balance sheet date.

F. CONSOLIDATION OF THE FINANCIAL STATEMENTS

(1) The consolidated financial statements include the financial statements of those companies over which the Company has control. Jointly controlled companies are consolidated by the proportionate consolidation method.

(2) A list of subsidiaries, affiliates, other companies and rates of holding is included in a schedule of the financial statements.

(3) For the purpose of the consolidation, the amounts appearing in the financial statements of the subsidiaries were taken after adjustments required by the application of the uniform accounting policies used by the Group.

(4) Intercompany balances and transactions between subsidiaries were eliminated upon consolidation.

(5) The excess of the net asset value upon acquisition over the cost of the investment (hereinafter - "negative goodwill") is attributed to fixed assets in accordance with Opinion No. 57 of the ICPAI and is amortized accordingly.

G. INVESTMENTS IN INVESTEE COMPANIES

(1) Investments in affiliates are accounted for by the equity method. In determining the equity of the investments in these companies, the amounts as they are included in the financial statements of the companies are taken into account after making certain adjustments necessitated by application of generally accepted accounting principles.

(2) On the financial statements of an affiliate that are adjusted according to changes in the foreign currency exchange rate - see Note 2E(4).

(3) One affiliate incurred losses in amounts exceeding its shareholders' equity. The Company recorded its share in the losses of the affiliate up to the amount of its investment in the affiliate, plus a loss likely to be incurred by the Company as a result of guarantees which it gave for that affiliate.

H. MARKETABLE SECURITIES

Current investments in marketable securities are carried at market value on the stock exchange as at the balance sheet date. The changes in the value of the securities are recognized on a current basis.

NOTE 2 - SIGNIFICANT ACCOUNTING PRINCIPLES AND REPORTING POLICIES (contd.)

I. PROVISION FOR DOUBTFUL DEBTS

In the opinion of management, the provisions for doubtful debts in the financial statements properly reflect the loss inherent in debts, the collection of which is considered doubtful. In determining the propriety of the provisions, management considered, among other things, the risk assessment as derived from the information in its possession concerning the financial situation of the debtors, the scope of their operations, and the period of arrears in clearing their debt. Doubtful debts which management believes cannot be collected are written off in the Company's books following a management decision. The financial statements also contain a general provision for doubtful debts.

J. INVENTORY

Inventory of equipment and user equipment are presented at the lower of cost or book value, which is determined mainly by the First In First Out method.

As part of its current operations, a proportionately consolidated company upgrades user equipment for its customers. As a result, inventory includes user equipment returned from customers, as well as spare parts that are used by the company for the repair of user equipment in the framework of the insurance it provides for its customers.

K. MATERIALS AND SPARE PARTS

Materials and spare parts are valued at the lower of cost (which is determined by the "moving-average" method) or market. Materials are intended primarily for use as components of fixed assets.

L. FIXED ASSETS

(1) Fixed assets are stated at cost.

(2) The cost of an asset under self-construction includes material, labor and sub-contracting costs but not exceeding their value to the business.

(3) Improvements and enhancements are added to the cost of assets, while maintenance and repairs are charged to expense as incurred.

(4) In the event of a decrease in the value of assets to the business, a provisions is recorded accordingly for decrease in value.

(5) Capitalization of credit costs - the Company is preparing to apply Accounting Standard No. 3.

(6) Depreciation is calculated by the straight-line method, based on the estimated useful lives of the assets.

NOTE 2 - SIGNIFICANT ACCOUNTING PRINCIPLES AND REPORTING POLICIES (contd.)

The annual depreciation rates are:

	% depreciation	Until 1999	As of 1999
Buildings	4	4	4
Digital switching equipment	10	8.3	10
Transformer and power equipment	10-20	20	20
Network equipment	4-12.5	4.33	5
Subscriber equipment and public telephones	14.3-20	20	20
Motor vehicles	15	15	15
Office equipment	10-20	20	20
Computers	10-33	20	33
Cellular telephone equipment	10-20	20	20

Improvements to leased premises are depreciated throughout the term of the lease (including the Company's option to extend the lease period), that does not exceed the economic life of the asset.

On a change in the depreciation rate, see Note 9D.

M. OTHER ASSETS

(1) Cost of issue of debentures and raising loans

These costs (treated as a non-monetary item) are amortized over the term of the debentures pro rata to the balance of the debentures in circulation.

(2) Cost of acquiring a subscriber

Since 1999, Pelephone Communications Ltd. has been capitalizing its net direct costs paid to a third party in respect of the sale of subscribers who signed an undertaking to remain customer of Pelephone (where violation of the undertaking leads to payment of a penalty by the customer and depreciation of the asset). These costs appear in the balance sheet under Other assets, and are amortized throughout the minimum period of the subscribers' undertaking, which is 36 months.

(3) Rights of representation of a communications corporation

The rights of representation of a communications corporation are depreciated for the period of financial benefit over 10 years.

N. DEFERRED TAXES

The companies in the Group allocate taxes for temporary differences. Temporary differences are differences between the value of assets and liabilities for tax purposes and their book value in the balance sheet. Such allocation of taxes is made for differences relating to assets whose consumption or depreciation is deductible for tax purposes. Deferred tax balances (asset or liability) are calculated according to the liability approach using the tax rates which will be in effect at the time of utilization of the deferred taxes, or upon realization of tax benefits, as they are known at the date of approval of the financial statements.

NOTE 2 - SIGNIFICANT ACCOUNTING PRINCIPLES AND REPORTING POLICIES (contd.)

The main factors for which deferred taxes were not calculated are these:

(1) The amounts of the adjustment for changes in the purchasing power of the shekel which relate mainly to buildings and private cars, in accordance with the principles stated by the ICPAI.

(2) Investments in investee companies, since the Company intends to hold these investments and not to realize them.

(3) A deferred tax asset in respect of timing differences where the likelihood of realizing the benefit is questionable.

O. REVENUE RECOGNITION

Income is recognized on the accrual basis.

P. DERIVATIVE FINANCIAL INSTRUMENTS

(1) Forward currency contracts intended to hedge foreign currency exposure of assets and liabilities are included in the Statement of Operations, concurrently with accounting reference to the hedged item.

(2) Derivative financial instruments not designated for hedging are presented in the balance sheet at their fair value. Changes in the fair value are attributed to the Statement of Operations in the period in which they occurred.

Q. BALANCES IN FOREIGN CURRENCY AND LINKED BALANCES

Assets (excluding securities) and liabilities in or linked to foreign currency are stated at the representative exchange rates published by Bank of Israel as at the balance sheet date.
Assets (excluding securities) and liabilities linked to the CPI are stated on the basis of the contractual linkage terms of each balance.

Following are details of the CPI and the U.S. dollar exchange rates:

	December 31, 1999	December 31, 1998	% of change 1999	% of change 1998	% of change 1997
CPI - in points	168.53	166.30	1.34	8.62	6.99
US dollar exchange rate $1 - in NIS	4.153	4.160	(0.17)	17.65	8.76

R. EARNINGS PER SHARE

Earnings per share are calculated in accordance with Opinion No. 55 of the ICPAI. In calculating the diluted earnings per share, account was taken of convertible securities issued by the Company which were not included in the calculation of the primary earnings per share if their conversion or exercise does not lead to an increase in earnings per share. Fully-diluted earnings per share are not presented as the effect of dilution is not significant.

NOTE 2 - SIGNIFICANT ACCOUNTING PRINCIPLES AND REPORTING POLICIES (contd.)

S. DEBENTURES CONVERTIBLE INTO SHARES

Debentures convertible into shares are classified according to likelihood of conversion, as determined in Opinion No. 53 of the ICPAI. Debentures that are not expected to be converted are included as liabilities at their liability value. Debentures that are expected to be converted are included between the item Long term liabilities and Shareholders' equity, at liability value or capital value, whichever is higher.

T. ISSUE TO EMPLOYEES

The benefit component in respect of an issue to employees (as well as in respect of the sales offer and employee compensation by the State) is charged as imputed salaries expense in the Statement of Operations and as an imputed addition to the Company's equity.

U. ADAPTATION TO THE YEAR 2000

Costs required for adapting and converting the Company's existing software so as to distinguish between years of the twentieth century and years of the twenty-first century (adaptation to the year 2000), were recorded as current expenses at the time they were incurred.

NOTE 3 - CASH AND CASH EQUIVALENTS

	Consolidated		Company	
	December 31, 1999	December 31, 1998	December 31, 1999	December 31, 1998
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Israeli currency	641,462	831,500	483,463	804,891
Foreign currency	22,775	100,787	2,669	140
	664,237	932,287	486,162	805,031

Cash equivalents include bank deposits with an original maturity not exceeding three months.

NOTE 4 - SHORT-TERM INVESTMENTS

	Consolidated		Company	
	December 31, 1999	December 31, 1998	December 31, 1999	December 31, 1998
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Marketable securities:				
Government debentures				
Linked to the CPI	56,584	57,489	56,584	57,489
Linked to the U.S. dollar exchange rate	8,604	9,802	8,604	9,802
Unlinked	35,834	31,332	35,834	31,332
Debentures convertible to shares	5,828	2,561	5,828	2,561
Other debentures	14,258	9,812	14,258	9,812
Mutual fund participation certificates	179,704	47,018	173,349	47,018
	300,812	158,014	294,457	158,014
Short-term bank deposits - in Shekels	328	227,811	-	-
	301,140	385,825	294,457	158,014

NOTE 5 - TRADE RECEIVABLES

	Consolidated		Company	
	December 31, 1999	December 31, 1998	December 31, 1999	December 31, 1998
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
In respect of domestic services:				
On open account	1,184,220	1,138,061	791,111	809,772
Income receivable	411,363	450,465	358,162	383,955
Credit cards and post-dated checks	103,404	102,414	86,159	96,443
Investee companies	712	925	2,419	2,371
In respect of international services	170,032	193,423	20,079	16,166
	1,869,731	1,885,288	1,257,930	1,308,707
Less provision for doubtful debts	346,887	332,616	249,784	237,135
	1,522,844	1,552,672	1,008,146	1,071,572

NOTE 6 - OTHER RECEIVABLES AND DEBIT BALANCES

	Consolidated		Company	
	December 31, 1999	December 31, 1998	December 31, 1999	December 31, 1998
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Deferred tax asset (see Note 11D)	234,152	221,536	214,377	187,900
Income tax refundable	185,768	112,128	139,804	122,490
Consolidated company	-	-	-	16,962
Prepaid expenses	21,540	21,248	6,202	6,632
Other receivables and debit balances	41,062	84,327	27,665	77,249
	482,522	439,239	388,048	411,233

NOTE 7 - DEPOSITS AND DEBIT BALANCES

	Consolidated		Company	
	December 31, 1999	December 31, 1998	December 31, 1999	December 31, 1998
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Bank deposit for the purpose of granting loans to employees (1)	257,492	255,413	257,492	255,413
Forward currency transactions	-	22,289	-	22,289
Earmarked deposits	-	22,936	-	-
Trade receivables (2)	18,251	15,919	-	-
	275,743	316,557	257,492	277,702

(1) The deposit is unlinked and bears interest, the rate of which at balance sheet date was approximately 5% (after deduction of commission). The Company is responsible for the loans to the employees. Withdrawal of the deposit is contingent upon repayment of the loans.

(2) Deferred interest income is the difference between the amount of the original debt and its present value on the date the income is recognized. Present value is calculated at effective interest linked to the CPI at a rate of about 6% per annum.

NOTE 8 - INVESTMENTS IN INVESTEE COMPANIES

A. COMPOSITION:

	December 31, 1999 NIS thousands	December 31, 1998 NIS thousands
Affiliated companies		
Shares -		
Cost	115,134	108,433
Post-acquisition losses	(49,957)	(28,407)
Provision for decrease in value	(43,480)	(87,074)
	21,697	(7,048)
Other investments -		
Long-term loans (1)	53,801	-
Total consolidated balance sheet (2)	75,498	(7,048)
Subsidiaries		
Shares -		
Cost	354,326	370,905
Post-acquisition earnings	53,258	155,697
	407,584	526,602
Proportionately Consolidated Company		
Shares -		
Cost	253,657	253,657
Post -acquisition earnings	705,890	687,234
Depreciation of surplus equity over cost attributed to fixed assets	36,942	36,942
	996,489	977,833
Total Company balance sheet (2)	1,479,571	1,497,387

(1) The loans are linked to the CPI, do not bear interest and have an undetermined maturity date.

(2) Stated as follows:

	Consolidated		Company	
	December 31, 1999 NIS thousands	December 31, 1998 NIS thousands	December 31, 1999 NIS thousands	December 31, 1998 NIS thousands
Investment in investee companies	75,498	36,546	1,479,571	1,540,981
Current liabilities (see Note 18)	-	(43,594)	-	(43,594)
	75,498	(7,048)	1,479,571	1,497,387

A list of the Group companies is presented in a schedule to the financial statements.

NOTE 8 - INVESTMENTS IN INVESTEE COMPANIES (contd.)

B. INVESTMENT MOVEMENT IN 1999 WAS AS FOLLOWS:

	Consolidated	Company
	NIS thousands	NIS thousands
Balance as at the beginning of the year	(7,048)	1,497,387
Movement during the year:		
Investment in shares	6,701	(9,878)
Equity in losses	(21,550)	(105,333)
Forfeiture of guarantees for an affiliated company (see E below)	28,675	28,675
Cancellation of provision for guarantee for an affiliated company (see E below)	14,919	14,919
Balance as at the end of the year	21,697	1,425,770

C. SUMMARY OF COMPANY EQUITY IN ASSETS, LIABILITIES, INCOME AND EXPENSES OF A PROPORTIONATELY CONSOLIDATED COMPANY AS INCLUDED IN THE CONSOLIDATED STATEMENTS

	December 31, 1999	December 31, 1998
	NIS thousands	NIS thousands
Current assets	416,046	345,378
Other assets	1,488,081	1,183,969
Current liabilities	595,941	291,445
Long-term liabilities	385,316	284,590

	For the year ended December 31		
	1999	1998	1997
	NIS thousands	NIS thousands	NIS thousands
Revenues	1,159,855	1,162,601*	1,013,280*
Costs and expenses	1,324,410	937,516*	1,033,972*

* Reclassified

D. BASIC TELECOMMUNICATION PROJECT IN INDIA

The Company submitted a bid, together with others, through a jointly owned company, in respect of tenders issued by the Indian Government for the setting up of a basic telecommunication system in India. The letter of intent and the draft concession agreements for development of the basic telephone system in four districts, which were awarded to the jointly owned company in which the Company has an interest, were transferred to the jointly owned company. The jointly owned company did not sign the letter of intent or the draft agreements since, inter alia, in its opinion, the draft agreements did not conform with the terms of the tender. When the jointly owned company submitted its bid for the tender, it provided the Indian Ministry of Communications with bank guarantees, of which Bezeq's share is RS (Indian rupees) 273 million (approximately NIS 27 million).

NOTE 8 - INVESTMENTS IN INVESTEE COMPANIES (contd.)

D. BASIC TELECOMMUNICATIONS PROJECT IN INDIA (contd.)

At the end of June 1996, the Indian Ministry of Communications sought to foreclose on the guarantees. On September 19, 1997 the court issued a permanent injunction which prevents the Indian Ministry of Communications from foreclosing on the guarantees. The Indian Ministry of Communications appealed against the injunction at the end of October 1997.

The Company's management and its legal advisors are at present unable to forecast the outcome of these legal proceedings and, therefore, no provision has been included in the financial statements in respect thereof.

E. CELLULAR COMMUNICATIONS PROJECT IN INDIA

The Company, through a company jointly owned with others, is engaged in constructing a cellular communications system in the State of Gujarat in India. The Company owns 16% of the jointly owned company. Until balance sheet date, the Company had invested approximately NIS 62 million in this company and had, together with the other joint owners, provided bank guarantees to secure the obligations of the jointly owned company. The Company's share of such guarantees is approximately RS 293 million (approximately NIS 29 million). Furthermore, the jointly owned company has undertaken towards an equipment vendor to comply with certain financial ratios, if it should require further credit. Pursuant to that undertaking, the Company could be required to invest an additional amount due to an obligation in favor of the equipment vendor.

At the beginning of 1997 the jointly owned company began providing communications services to subscribers. The jointly owned company has not completed raising the necessary financing for the continuation of its operations, and, therefore the license fee payments were not made on time.

In the opinion of the Company these events reflect a continuing process that increases the probability of a loss from the Company's investment in the jointly owned company to such a high level as to necessitate that the investment be written off and a provision be created for the said investment and guarantees.

Accordingly, following the resolution of the Board of Directors on February 23, 1998 to write off the investment balance and to create a provision for the full amount of the guarantees (including the obligations towards the equipment vendor as mentioned above), a provision of approximately NIS 43 million was made for the balance of the investment as at December 31, 1997 (after recording the Company's share in losses of the jointly-owned company in the amount of NIS 20 million, based upon unaudited financial statements prepared by the jointly owned company). An additional provision of approximately NIS 44 million was made in respect of the balance of guarantees given to or on behalf of the jointly owned company as at the same date.

Following the ruling of the Indian court in April and June 1999, the guarantees given by the Company were foreclosed in favor of the government of India, in the amount of $6.9 million (approximately NIS 29 million).

In August 1999 the government of India announced the transition to payment of license fees as a percentage of revenues rather than a fixed amount as it had been previously. The balance of the license fee up to July 31, 1999 must be paid, and therefore the shareholders were required to increase their investment in the company. In November 1999 the equipment vendor in whose favor the Company was guarantor, gave notice of cancellation of the Company's guarantee. Accordingly, the provision in the financial statements for the guarantee for the equipment vendor, in the amount of NIS 15 million, was canceled.

NOTE 8 - INVESTMENTS IN INVESTEE COMPANIES (contd.)

In December 1999 the Company increased the guarantee in favor of the government of India by another RS 70 million (approximately NIS 6.9 million), and in February 2000 increased its investment in the joint company by another $5.4 million (approximately NIS 22.4 million).

In the opinion of the Company's management, the change in the license fee payment policy makes the investment more economical. Nevertheless, since the joint company has not yet succeeded in making financing arrangements with financial institutions and has not issued audited financial statements, the probability of the investment producing a loss still exists.

F. PELEPHONE COMMUNICATIONS LTD. ("PELEPHONE")

In 1994 the Company was allotted shares which gave it 50% of the ownership and control of Pelephone, in exchange for the Company's rights to provide cellular services. In accordance with Government decisions of January 9, 1994 and August 10, 1994, the "market value" of the assets transferred, to be agreed upon between Motorola Israel Ltd. (50%-owner of Pelephone) and the Company, must be examined and will require the approval of the Government Companies Authority.

The Government Companies Authority appointed independent consultants to verify the aforementioned "market value". In the opinion of the consultants, the Company's share in Pelephone should be 60%.

The Company's Board of Directors has considered the reports findings, and has concluded, on the basis of explanations and clarifications obtained from the Company's management and the Company's legal advisors, that the transactions by which 50% of the ownership and control of Pelephone was allotted to the Company, was effected in a subjective, economically sound manner in accordance with the Government decisions referred to above. This position of the Board of Directors has been conveyed to the Government Companies Authority. As of the date of publication of these financial statements, the Government Companies Authority had not yet conveyed its position to the Company.

The Government Companies Authority and the Company have decided to review the validity and the legal and commercial implications of a letter of undertaking in respect of the agreement made between the Company and Motorola Israel Ltd., which the Company submitted to Motorola Israel Ltd. on October 10, 1994.

On November 5, 1997, a meeting to discuss the "market value" took place at the office of the Minister of Finance with the participation of representatives of his office and of the Ministries of Communications and Justice and of the Government Companies Authority. At the conclusion or the meeting the Minister of Finance said that the Government would make no claim against the Company in matters of this transaction and that the Legal Advisor of the Ministry of Finance, in coordination with the Ministry of Communications, would prepare a legal opinion concerning the possibility of the State realizing the Company's rights vis-a-vis Motorola, if such exist, either directly or by means of the Company, and that the Ministry of Justice would relate to the said legal opinion. As of the balance sheet date, such opinions have not yet been prepared.

Neither the Company's management nor its legal advisors can predict the outcome of the examination described above or the likely impact thereof on the Company.

NOTE 8 - INVESTMENTS IN INVESTEE COMPANIES (contd.)

G. D.B.S. SATELLITE SERVICES (1998) LTD.

Pursuant to the shareholders agreement signed by the Company in December 1998 with additional entrepreneurs, the Company is entitled to hold approximately 30% of the shares of D.B.S. Satellite Services (1998) Ltd. (hereinafter - DBS). In January 1999, DBS received a license from the Ministry of Communications for satellite television broadcasts, in exchange for payment of NIS 30 million and a guarantee in the amount of NIS 30 million (on the deed of guarantee signed by the Company, see Note 29C). DBS is an enterprise under development, and foresees considerable losses and negative cash flow from operations in the first years of its activities. A bank with which DBS entered into a long-term financing agreement has refused to grant further credit. DBS is negotiating with other banks for long-term credit lines to finance its ongoing activities.

According to a decision of the Ministerial Committee for Privatization, the maximum cumulative exposure of the Company in connection with this investment shall not exceed, at any time, the rate of the company's actual holding in DBS, multiplied by $ 216 million (approximately NIS 864 million).

NOTE 9 - FIXED ASSETS

A. COMPOSITION AND MOVEMENT

Consolidated

	Land & buildings	Switching, transmission and power equipment(1)	Network equipment	Subscriber equipment and public telephones	Motor Vehicles	Office equipment and computers	Total
	NIS thousands						
Cost -							
Balance as at January 1, 1999	2,047,446	14,235,777	10,436,707	773,636	360,529	811,277	28,665,372
Additions	76,670	976,614	229,609	140,491	42,783	192,190	1,658,357
Disposals (2)	(64,462)	(879,347)	(105,359)	(235,341)	(41,707)	(245,844)	(1,572,060)
Balance as at December 31, 1999	2,059,654	14,333,044	10,560,957	678,786	361,605	757,623	28,751,669
Accumulated depreciation							
Balance as at January 1, 1999	956,677	6,847,122	5,978,530	472,042	175,073	321,190	14,750,634
Provision for depreciation	95,081	1,670,484	606,757	145,576	47,282	155,739	2,720,919
Eliminations upon disposal (2)	(50,202)	(846,894)	(105,359)	(202,947)	(33,582)	(243,728)	(1,482,712)
Provision for impairment of asset value (see Note 9E)	-	-	-	-	-	106,380	106,380
Balance as at December 31, 1999	1,001,556	7,670,712	6,479,928	414,671	188,773	339,581	16,095,221
Net book value -							
As at December 31, 1999	1,058,098	6,662,332	4,081,029	264,115	172,832	418,042	12,656,448
As at December 31, 1998	1,090,769	7,388,655	4,458,177	301,594	185,456	490,087	13,914,738

NOTE 9 - FIXED ASSETS (contd.)

A. COMPOSITION AND MOVEMENT (contd.)

Company

	Land & buildings	Switching, transmission and power equipment(1)	Network equipment	Subscriber equipment and public telephones	Motor Vehicles	Office equipment and computers	Total
	NIS thousands						
Cost -							
Balance as at January 1, 1999	2,013,520	11,974,373	10,325,933	740,466	326,904	643,534	26,024,730
Additions	59,608	561,802	229,609	75,684	33,242	104,222	1,064,167
Disposals (2)	(64,436)	(799,891)	(105,359)	(193,790)	(39,379)	(242,069)	(1,444,924)
Balance as at December 31, 1999	2,008,692	11,736,284	10,450,183	622,360	320,767	505,687	25,643,973
Accumulated depreciation							
Balance as at January 1, 1999	945,542	5,813,073	5,939,696	469,282	165,949	263,396	13,596,938
Provision for depreciation	90,974	1,314,935	601,028	126,071	41,627	118,676	2,293,311
Eliminations upon disposal (2)	(50,184)	(799,690)	(105,359)	(193,136)	(32,578)	(242,069)	(1,423,016)
Provision for impairment of asset value (see Note 9E)	-	-	-	-	-	106,380	106,380
Balance as at December 31, 1999	986,332	6,328,318	6,435,365	402,217	174,998	246,383	14,573,613
Net book value -							
As at December 31, 1999	1,022,360	5,407,966	4,014,818	220,143	145,769	259,304	11,070,360
As at December 31, 1998	1,067,978	6,161,300	4,386,237	271,184	160,955	380,138	12,427,792

(1) Including NIS 7,116,000 (1998 - NIS 745,000) advances to vendors on account of telephone exchange equipment ordered.

(2) Fixed assets are written off the books at the end of the year in which they became fully depreciated, except for land, buildings and vehicles, which are written off the books when sold. In 1999 fully depreciated fixed assets of a cost of approximately NIS 1,337 million (1998 - NIS 1,332 million) were written off the books.

NOTE 9 - FIXED ASSETS (contd.)

B. Most of the real estate assets which were transferred to the Company pursuant to the agreement dated January 31,1984, are leased (rented) from the State of Israel, for various periods, as follows:

- Some of the assets are leased for a period of 49 years with an option for extension for an additional 49 years, in consideration of a token lease payment.
- Some of the assets are leased for periods of 2 years renewable for additional two-year periods, in consideration of a token lease payment.
- Some of the assets are leased under rent-control arrangements.

Up to the time of the preparation of the financial statements, only a small portion of the real estate assets has been registered in the Company's name at the Lands Registry Office. The Company carried out a land survey and measuring of the freehold and leasehold real estate as well as other real estate it rents or uses. It is also in the process of registering its real estate, and of signing agreements with Israel Lands Administration.

The Accountant General of the Ministry of Finance notified the Company that on January 31, 1998, the State intends to terminate the lease of those assets rented for renewable two-year periods. In addition, the Ministry of Finance will review the Company's actual usage of each of the properties and take appropriate action regarding the matter of making available alternative land and the payment of relocation expenses. In the opinion of Management and its legal advisors, this demand is not consistent with the asset transfer agreement. The Company negotiated with the Israel Lands Authority in order to reach an agreement whereby the Company will return to the Authority a portion of the assets and will receive other properties instead. At the date of the preparation of the financial statements, the Company continues to hold the said property. In Management's opinion, if it will be required to vacate the property without alternative land of equal value being made available, as well as the covering of the relocation costs, the Company will suffer significant damage, which cannot be precisely estimated.

On May 13, 1999, discussions were held at the Attorney General's office between representatives of the Company and Israel Lands Authority, in the presence of the Government Companies Authority's representatives. At the end of the discussions, the Attorney General decided that a public offering could not be performed before clarification of the factual basis and the issues in dispute, so that the dispute could be settled in the appropriate manner. The Attorney General also instructed the relevant government entities to prepare a detailed working paper defining which assets are under dispute, their value, and the use being made of them today. In addition, the Attorney General recommended that the parties negotiate in an attempt to settle the dispute or to limit its scope, as practically as possible. The negotiations between the Company and the Israel Lands Authority have not yet resulted in a resolution of the issues.

C. At the balance sheet date, commitments exist for the purchase of fixed assets (mainly switching equipment) in the amount of approximately NIS 335 million on a consolidated basis and approximately NIS 261 million for the Company. Furthermore, in December 1999 a proportionately consolidated company signed a letter of intent for the purchase of additional CDMA infrastructure equipment from Motorola in the amount of approximately NIS 244 million (presented at the Company's proportionate share).

NOTE 9 - FIXED ASSETS (contd.)

D. On May 12, 1999 the Board of Directors of the Company resolved to adopt the recommendations of management, which were based on the report of a firm of outside consultants concerning recommendations to change the depreciation policy and depreciation rates of the Company's assets.

The decision, effective from January 1, 1999, changed the depreciation rates of a number of fixed assets recorded in the Company's books. Among these items are the switching systems, for which the depreciation rate was raised to 10% per annum (instead of 8.33%), and the Company's network, for which the depreciation rate was raised to 5% per annum (instead of 4.33%). As a result of implementation of these recommendations, the Company's depreciation expenses increased for the year ended December 31, 1999 by approximately NIS 214 million.

In the Company's opinion, these changes will lead to increased depreciation expenses of the Company of approximately NIS 182 million, in respect of existing investments in the year 2000, and NIS 85 million, NIS 118 million and NIS 76 million in each of the subsequent years, respectively.

Following these changes the Company approached the Ministry of Communications, requesting approval for an increase of the Company's tariffs, which it believes is necessary as a result of the new depreciation policy. The final stance of the Ministry of Communications has not yet been received.

E. Following the breakdown of negotiations between the Company and a software supplier who undertook to develop a billing and collection system, and the Company's notice of foreclosure of a bank guarantee in the amount of approximately $20 million (NIS 80 million) given to it by the supplier, the parties took a number of legal steps, as described below:

(1) A claim by the Company for payment of approximately $ 18 million (NIS 76 million as at the date of filing the claim), as compensation in respect of breach of contract, and a counter-claim of the supplier in the amount of approximately $ 59 million (NIS 239 million as at the date of filing the claim).

(2) Application of the supplier for a temporary and permanent injunction against foreclosure of the bank guarantees by the Company. The application for a temporary injunction was dismissed by the District Court and an application was filed for permission to appeal in the Supreme Court.

(3) A claim by the supplier for enforcement of the contract between the parties. Application for a temporary injunction forbidding the Company to enter into a similar agreement with a third party - was dismissed.

It is not possible, at this stage, to estimate the outcome of these legal proceedings, but in the opinion of the legal advisers of the Company, it has good substantiation of its position. Furthermore, the Company is not able to estimate the full implications of the dispute on the process of building a software system, timetables for its completion and the losses that these are liable to cause the Company. However, the Company is of the opinion that delays in completing the system by the planned date, if any, could result in material losses.

As at the balance sheet date, the Company's investment in the billing and collection system project amounted to approximately NIS 118 million. A provision is made in the financial statements for decrease in the value of the investment in the amount of NIS 107 million In addition, an expense of NIS 20 million is recorded in respect of compensation for a sub-contractor due to cessation of the project.

NOTE 10 - DEFERRED AND OTHER EXPENSES

Consolidated

	Cost	Accumulated depreciation	Balance for depreciation December 31, 1999	Balance for depreciation December 31, 1998
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Representation rights in a communications corporation	3,550	976	2,574	2,928
Capitalized subscriber acquisition costs	290,300	50,869	239,431	-
	293,850	51,845	242,005	2,928
Expenses for issue of debentures and procurement of loans			13,225	19,853
			255,230	22,781

Company

	Balance for depreciation December 31, 1999	Balance for depreciation December 31, 1998
	NIS thousands	NIS thousands
Deferred expenses		
Expenses for issue of debentures and procurement of loans	13,225	19,853

NOTE 11 - TAXES ON INCOME

A. The Income Tax Law (Adjustments for inflation) - 5745-1985, effective since 1985, provides for a method of measuring operating results for tax purposes on a real (inflation adjusted) basis. The various adjustments required by the said law are intended to bring about taxation on the basis of real income. However, adjustment of the nominal historical profit in accordance with the terms of said law is not always identical with the inflation adjustments prescribed for financial reporting purposes by opinions of the Institute of ICPAI. As a result, differences arise between the inflation-adjusted profit in the financial statements and adjusted taxable income.

Regarding deferred taxes in respect of the aforesaid differences - see Notes 2N above and 11D below.

NOTE 11 - TAXES ON INCOME (contd.)

B. INCOME TAX IN THE STATEMENT OF OPERATIONS

Consolidated

	For the year ended December 31		
	1999	1998	1997
	NIS thousands	NIS thousands	NIS thousands
Current taxes	(6,466)	302,352	292,118
Deferred taxes	71,356	175,411	(330,075)
Taxes for prior years, net	(2,094)	13,467	-
	62,796	491,230	(37,957)

Company

	For the year ended December 31		
	1999	1998	1997
	NIS thousands	NIS thousands	NIS thousands
Current taxes	1,085	179,147	84,781
Deferred taxes	70,139	185,917	(317,689)
Taxes for prior years, net	(845)	9,233	-
	70,379	374,297	(232,908)

C. RECONCILIATION BETWEEN THE THEORETICAL TAX COMPUTED IN RESPECT OF THE PRE-TAX INFLATION ADJUSTED EARNINGS AND THE ACTUAL TAX EXPENSE

Consolidated

	For the year ended December 31		
	1999	1998	1997
	NIS thousands	NIS thousands	NIS thousands
Tax computed at the regular tax rates (*)	32,787	449,562	(94,010)
Increase (savings) in tax owed, due to:			
Inflationary erosion of advance tax payments	1,174	14,226	6,220
Exempt income and capital gains	(14,470)	(5,404)	(7,808)
Non-deductible expenses	12,127	14,077	13,838
Losses in respect of which a deferred tax asset was not created	30,983	1,056	42,919
Taxes for prior years, net	(2,094)	13,467	-
Other	2,289	4,246	884
	62,796	491,230	(37,957)
(*) Regular tax rates	36%	36%	36%

NOTE 11 - TAXES ON INCOME (contd.)

C. RECONCILIATION BETWEEN THE THEORETICAL TAX COMPUTED IN RESPECT OF THE PRE-TAX INFLATION ADJUSTED EARNINGS AND THE ACTUAL TAX EXPENSE (contd.)

Company

	For the year ended December 31		
	1999	1998	1997
	NIS thousands	NIS thousands	NIS thousands
Tax computed at the regular tax rates (*)	65,678	338,022	(274,360)
Increase (savings) in tax owed, due to:			
Inflationary erosion of advance tax payments	694	10,364	2,889
Exempt income and capital gains	(8,221)	(2,470)	(6,371)
Non-deductible expenses	9,360	14,700	11,632
Losses in respect of which a deferred tax asset was not created	-	-	31,348
Taxes for prior years, net	(845)	9,233	-
Other	3,713	4,448	1,954
	70,379	374,297	(232,908)
(*) Regular tax rates	36%	36%	36%

D. DEFERRED TAXES

	Consolidated		Company	
	December 31, 1999	December 31, 1998	December 31, 1999	December 31, 1998
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Movement -				
Balance at beginning of year	531,817	695,885	536,077	709,075
Charged to statement of operations for the year	(71,356)	(175,411)	(70,139)	(185,917)
Charged to investment in consolidated company	-	-	(2,745)	-
Charged to statement of operations for prior years	(7,934)	11,343	-	12,919
Balance as at end of year	452,527	531,817	463,193	536,077

NOTE 11 - TAXES ON INCOME (contd.)

D. DEFERRED TAXES (CONTD.)

	Consolidated		Company	
	December 31, 1999	December 31, 1998	December 31, 1999	December 31, 1998
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Composition of deferred taxes -				
Difference between the adjusted value of fixed assets and their value for tax purposes	(138,852)	(47,278)	(108,740)	(31,500)
Adjustment of materials and spare parts	(1,204)	(4,655)	(969)	(4,386)
Differences in the recognition of expenses relating to employee rights and doubtful debts	592,583	583,750	572,902	571,963
Total	452,527	531,817	463,193	536,077
Classified as follows:				
Among current assets:	234,152	221,536	214,377	187,900
Among other assets	237,737	334,837*	248,816	348,177
Among long-term liabilities	(19,362)	(24,556)*	-	-
Total	452,527	531,817	463,193	536,077

* Reclassified

The deferred taxes are computed based on the tax rate expected to be in effect at the time of their utilization (36%). Realization of the tax benefit is contingent upon the existence of adequate taxable income in the future. The said deferred tax asset is included in the financial statements since, according to the Company's business plans, its realization is anticipated.

Losses for tax purposes of subsidiaries which are carried forward to the coming years amounted to NIS 100,195,000 (1998 - NIS 31,334,000). The balance of the loss and deduction carry-forwards for which no deferred tax asset was included because of the uncertainty of their realization, is approximately NIS 100,195,000 (1998 - NIS 31,334,000).

The net book value of the buildings for tax purposes exceeds its net book value in the financial statements (Company) by NIS 64,652,000 (1998 - NIS 62,009,000; 1997 - NIS 58,725,000). No deferred tax asset in respect of these differences was included in the financial statements.

E. FINAL TAX ASSESSMENTS

The Company has received final tax assessments (as a result of the statue of limitations having elapsed) up to and including 1993. A proportionately consolidated company has received final tax assessments up to and including 1993. The other investee companies have not yet received final tax assessments since their inception.

The Company is currently undergoing an assessment review by the income tax authorities for the years 1994 - 1997 (inclusive). In December 1999, tax assessments were issued to the Company (not with agreement) by the Large Companies Tax Assessor, in respect of 1994 only. According to the assessment, the Company must pay additional taxes in the amount of approximately NIS 408 million for 1994, including interest and CPI-linkage. Most of the additional tax derives from a liability for capital gain from the sale of equipment to Pelephone Communications Ltd. in exchange for an allotment of 50% of

NOTE 11 - TAXES ON INCOME (contd.)

Pelephone's shares to the Company. The Company is disputing the assessment and intends to file an objection to the demand.

In the Company's opinion, based on its legal advisers who are handling the matter on its behalf, the Company has proper substantiation of its position against the main points of the assessment. At this point, the outcome of the objection cannot be estimated, and therefore, no provision is made in the financial statements in respect of the assessment.

F. VALUE ADDED TAX

The Company files a consolidated tax return with its subsidiaries for Value Added Tax purposes.

NOTE 12 - BANK CREDIT

	Interest rate p.a.	Consolidated		Company	
		December 31, 1999	December 31, 1998	December 31, 1999	December 31, 1998
	%	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Unlinked loans	10.95	271,006	-	-	-

NOTE 13 - DEBENTURE ISSUED TO THE GOVERNMENT OF ISRAEL (CONSOLIDATED AND COMPANY)

The debenture represents a portion of the consideration to the Government of Israel for assets transferred to the Company based on the agreement dated January 31, 1984. The principal of the debenture is linked to the Consumer Price Index and bears interest at an effective annual rate of 7.3%, payable quarterly. The debenture is repayable in equal quarterly installments of NIS 235,477,000 each, where the last payment will be made on April 1, 2000.

NOTE 14 - LONG-TERM LOANS

A. COMPOSITION

	Consolidated		Company	
	December 31, 1999	December 31, 1998	December 31, 1999	December 31, 1998
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Banks	4,188,482	4,599,174	3,747,197	4,264,013
Pension fund	111,337	122,374	111,337	122,374
Supplier credit	3,361	118	-	118
	4,303,180	4,721,666	3,858,534	4,386,505
Less -				
Current maturities from banks	1,053,418	1,090,549	983,615	1,043,133
Other current maturities	13,158	11,225	12,822	11,225
	3,236,604	3,619,892	2,862,097	3,332,147

B. LINKAGE TERMS AND INTEREST

	Interest rate	Consolidated		Company	
		December 31, 1999	December 31, 1998	December 31, 1999	December 31, 1998
	%	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Loans in foreign currency					
US dollar(*)	LIBOR + 0.25-0.7	2,972,362	3,184,862	2,868,536	3,047,850
Loans linked to the CPI	3.6 - 5.75	1,219,481	1,414,430	878,661	1,216,281
	6.1	111,337	122,374	111,337	122,374
		1,330,818	1,536,804	989,998	1,338,655
		4,303,180	4,721,666	3,858,534	4,386,505

(*) These loans bear interest at the rate of LIBOR plus a margin. The rate shown in the above table is a weighted average rate as at the balance sheet date.

C. REPAYMENT SCHEDULE

	Consolidated	Company
December 31	NIS thousands	NIS thousands
2001	805,706	704,276
2002	1,067,103	992,719
2003	492,085	434,433
2004	432,408	394,838
2005 and thereafter	439,302	335,831
	3,236,604	2,862,097

NOTE 14 - LONG-TERM LOANS (contd.)

D. SECURITY

(1) The long-term loan agreements of the Company, aggregating NIS 2,960,707, include certain conditions upon the occurrence of which the lender may demand early repayment of the loans, including:

- The intervention of an authority in the administration of Company matters.

- In respect of loans aggregating NIS 1,684,931,000 a decrease in the State's voting rights in the Company to 50% or less, or initiation of a process which is liable to lead to such a decrease, as well as occurrence of an event which allows other loans of the Company to be made available for early repayment.

- In respect of the remaining loan balance of NIS 1,275,776,000 a decrease in the State's voting rights in the Company to 26% or less, of which in respect of a balance of approximately NIS 524,946,000, upon occurrence of an event which also allows other loans of the Company to be made available for early repayment.

- Change of the nature of the Company's business without the agreement of the lenders, which would have a materially adverse effect on the Company's business, assets or financial position.

With respect to the possibility of the occurrence of the aforementioned conditions, including a decline in the rate of the State's voting rights and the possibility of the complete opening of the communications market to competition - see Note 1.

The Company has made a negative pledge in favor of the lenders.

(2) A proportionately consolidated company made a negative pledge and committed to maintain certain financial conditions in respect of loans it received from banks, whose balance as at the balance sheet date is NIS 433,728,000. As at the balance sheet date, this company is in compliance with the aforementioned conditions.

E. LOAN-PROCUREMENT EXPENSES

The deferred expenses in connection with the procurement of loans as at December 31, 1999 and as at December 31, 1998 amounted to NIS 12,878,000 and NIS 9,437,000 respectively. The expenses are stated net of accumulated amortization in the amount of NIS 6,184,000 and NIS 3,263,000 respectively.

NOTE 15 - OTHER DEBENTURES

A. COMPOSITION AND TERMS

	Interest Rates	Consolidated and Company December 31, 1999	December 31, 1998
	%	NIS thousands	NIS thousands
CPI-linked debentures issued to the public:			
Debentures Series 1 (1)	4.5	327,704	392,997
Debentures issued to financial institutions and others:			
CPI-linked	5.0	1,151,433	1,027,336
		1,479,137	1,420,333
Less - current maturities		225,517	206,518
		1,253,620	1,213,815

(1) The outstanding balance of the debentures is NIS 99,751,438 par value (1998 - NIS 119,701,727 par value).

B. REPAYMENT SCHEDULE

	NIS thousands
2001	224,379
2002	183,945
2003	194,183
2004	194,802
2005 and thereafter	456,311
	1,253,620

C. SECURITY

The debentures are not secured, except for a token lien; however, the Company has undertaken that so long as the debentures are outstanding it will refrain from encumbering its property with other liens.

Some of the lenders, the balance of whose loans as at December 31, 1998 amounts to approximately NIS 1,073,401,000, are entitled to demand the immediate repayment of the debentures if the State of Israel's holdings in the share capital of the Company falls below 26% (see Note 1).

D. ISSUE EXPENSES

The deferred expenses with respect to the issue of the debentures amounted to NIS 21,581,000, (1998 - 20,269,000) and are stated net of accumulated amortization of NIS 17,416,000 (1998 - NIS 16,318,000).

NOTE 16 - TRADE PAYABLES

	Consolidated		Company	
	December 31, 1999	December 31, 1998	December 31, 1999	December 31, 1998
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Suppliers of goods and services(*)	1,156,038	997,351	654,624	527,191
Current maturities of long-term supplier credit	336	118	-	118
	1,156,374	997,469	654,624	527,309
(*) Includes foreign currency balances	373,568	458,442	14,183	37,817
Includes consolidated companies	-	-	4,470	2,251
Includes a proportionately consolidated company	46,682	50,145	93,364	100,289

NOTE 17 - LIABILITY FOR EMPLOYEE SEVERANCE BENEFITS

A. COMPOSITION

	Consolidated		Company	
	December 31, 1999	December 31, 1998	December 31, 1999	December 31, 1998
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Provision for early retirement, net (see D below)	351,185	637,707	351,185	637,707
Compensation for unused sick leave (see E below)	79,375	91,714	79,375	91,714
	430,560	729,421	430,560	729,421
Provision for severance pay	11,447	10,525	-	-
Less – fundings	(12,359)	(9,121)	-	-
Total	(912)	1,404	-	-
	429,648	730,825	430,560	729,421
Stated as follows:				
Among current liabilities	351,185	637,707	351,185	637,707
Among long-term liabilities	78,463	93,118	79,375	91,714
	429,648	730,825	430,560	729,421

NOTE 17 - LIABILITY FOR EMPLOYEE SEVERANCE BENEFITS (contd.)

B. ELIGIBILITY OF EMPLOYEES UPON REACHING RETIREMENT AGE

(1) The liability of the Company and its investee companies for severance benefits to employees is fully covered by current payments to pension funds and insurance companies and the above provision. The fundings are not under the management or control of the companies and, therefore, are not reflected in the balance sheet.

(2) The pension rights of the Company's employees with respect to the period of their employment in government service, up to January 31, 1985, is covered by a pension fund ("Keren Makefet") which assumed the Government's liability in accordance with an agreement between the Government, the Company, the New General Federation of Labor (Histadrut) and the Fund.

C. EMPLOYEE RIGHTS BEFORE RETIREMENT AGE

The Company's liability to pay severance pay to employees leaving their employment under conditions entitling them to such benefits are covered, in respect of the period from February 1,1985, by current deposits in pension funds and with insurance companies, as stated in B, above. Severance pay in respect of the period of government service up to January 31,1985, is paid by the Company, and amounts accumulated with Keren Makefet, with respect to this period, are held in the Fund for use in connection with the employees' rights.

Employees who transferred to the Company from government service and who leave their service prior to reaching retirement age, are entitled, under certain conditions, at their election, to receive early retirement benefits in lieu of severance pay. The cost of the early retirement benefits, except for cases of sickness or disability up to retirement age, are to be borne by the Company. In light of past experience, most of the Company's employees leave their employment upon reaching retirement age and, accordingly, the chances of actualization of the liabilities referred to above, except for the plan for organizational change (see D below), are quite small and, therefore, no provision with respect thereto has been included in the financial statements.

D. PLAN FOR ORGANIZATIONAL CHANGE

(1) On November 23, 1997, a special collective labor agreement regarding employee separation and a special collective labor agreement regarding change in organizational structure were signed between the Company and the employees' representatives and the New General Federation of Labor (Histadrut).

The main provisions of the special collective labor agreement regarding employee separation include the following:

- Separation of approximately 1,800 employees.

- Separation of the employees will be effected in stages up to December 31, 1999.

- The total cost of implementing the agreement shall not be more than NIS 1.4 billion.

Within the framework of the plan for improvements and organizational changes in the Company, the implementation of this plan is continuing. The number of employees who retired within the framework of this plan has exceeded the Company's forecasts as they were when the plan was formulated, and has reached approximately 2,050 rather than1,800. An expense of NIS 110 million is included in the financial statements for adjustment of the cost for up-to-date retirement data.

NOTE 17 - LIABILITY FOR EMPLOYEE SEVERANCE BENEFITS (contd.)

D. PLAN FOR ORGANIZATIONAL CHANGE (contd.)

(2) Following adoption of the recommendations of the committee for arrangement of the Company's tariffs (see Note 1B) by the Ministers of Finance and Communications, the Board of Directors instructed the management of the Company to formulate a plan accordingly.

The Company's management presented a plan to the Board of Directors in March 2000, which is based on a material change in its organizational and functional concept, in a format similar to that already implemented in a number of similar companies in the communications world as they moved into functioning in a competitive environment. The Board of Directors requested further clarification before giving its approval. The plan indicates that the initial estimate made by the Company in 1999 in respect of the number of employees who would need to retire - is valid: it indicates the need for the retirement of 500-600 employees. The Company has included in the report a provision of approximately NIS 288 million, which is the estimated cost of that retirement, which comes by virtue of an agreement that is valid until June 30, 2000. The Company has approached the Companies Authority for its consent to extend the term of the agreement until March 31, 2001.

E. COMPENSATION FOR UNUTILIZED SICK LEAVE

The financial statements include a provision for compensation in respect of unutilized sick leave for all employees, in accordance with the conditions fixed in the employment agreement.

NOTE 18 - OTHER CURRENT LIABILITIES

	Consolidated		Company	
	December 31, 1999	December 31, 1998	December 31, 1999	December 31, 1998
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
The Government of Israel in respect of royalties, interest and fees	193,356	223,605	146,553	167,137
Employees and other salary-related liabilities (1)	178,712	295,322	156,834	263,763
Provision for vacation pay	94,987	107,920	87,700	103,075
Institutions	35,133	51,481	29,266	51,481
Accrued interest	80,158	97,903	77,247	93,873
Forward exchange contracts	19,992	-	19,620	-
Other accrued expenses	106,721	83,077	80,406	50,658
Current maturities in respect of deferred income	56,886	44,219	36,900	35,604
Liability in respect of investee company (Note 8)	-	43,594	-	43,594
Provision for claims in respect of salary and pension components	59,832	118,899	59,832	118,899
	825,777	1,066,020	694,358	928,084
(1) Includes current maturities of long-term loan from pension fund	12,822	11,107	12,822	11,107

NOTE 19 - CONVERTIBLE DEBENTURES

The debentures registered in name were issued pursuant to a prospectus from February 1998. The issued par value of the debentures as at the balance sheet date is NIS 313,500,000. The debentures are convertible into ordinary shares of a par value of NIS 1 so that each NIS 10.12 par value of debentures can be converted into one ordinary share of NIS 1 par value. The debentures bear real annual interest of 3.25% and guarantee an annual nominal yield of at least 12% in their first year of issue. The debentures will mature, if not converted into shares, on February 8, 2001. During the reporting period, 178,187,698 par value of debentures were converted and in exchange, 17,607,480 ordinary shares of a par value of NIS 1 were issued. Since then, during the period until the preparation of the financial statements, another 132,655,288 par value of debentures were converted and in exchange, 13,108,230 ordinary shares of a par value of NIS 1 were issued.

NOTE 20 - DEFERRED REVENUES

Deferred revenues is comprised mainly of compensation in respect of a purchase agreement with a proportionately consolidated company, and of advance payments on account of service to outside factors.

NOTE 21 - CONTINGENT LIABILITIES

A. CLAIMS

(1) Following the reduction in the Company's tariffs from April 1, 1992, an application was filed in the District Court in April 1992 for approval of a class action against the State of Israel and against the Company, alleging a lack of proper disclosure and the presentation of misleading information in the prospectus of May 23, 1991. The action alleged that the Company's public shareholders sustained damages estimated at approximately NIS 618 million. In May 1994 the District Court dismissed the application. In the appeal filed by the plaintiffs in the Supreme Court in June 1994, a deliberate arrangement was arrived at (and was validated as a decision in the appeal and in the application for permission to appeal). Under the arrangement, the appeal and the application for permission to appeal were canceled and it was agreed, inter alia, that the plaintiff may sue on its own behalf in the District Court for the same cause as that for which approval of the class action was sought, and that within 30 days of a decision being given in the District Court, the plaintiff would be entitled to file a renewed appeal against the decision of the District Court to reject the application for approval of the class action. The plaintiff has not yet filed such a claim on its own behalf. In the Company's opinion, relying on the legal counsel who is handling the case on its behalf, the prospects for the claim in the aforesaid proceedings cannot be estimated. No provision is included in the financial statements in respect of this claim.

NOTE 21 - CONTINGENT LIABILITIES (contd.)

A. CLAIMS (contd.)

(2) In August 1996 a claim and an application by way of motion for approval of the claim as a class action were filed against the Company in the District Court. The plaintiff alleges that the Company is misleading the public in that the prices of direct-dial international calls are calculated and collected on the basis of meter pulses rather than call time units as promised in its advertisements. The claimed damage relates to overcharging deriving from rounding-up of fractions of meter pulses to a whole meter pulse. The value of the claim as a class action is approximately NIS 124 million, and it refers to the seven years preceding the filing of the action. In February 1997 the court approved the action as a declaratory class action with regard to the deception only, and determined that the extent of the damage of the members of the group could not be fixed, whether as a whole or as individuals. If the class action is allowed and a declaration made that the advertising was misleading, a subscriber who believes that he sustained damages as a result of the deception will be able to file a personal claim against the Company, in which he will attempt to prove his losses. The plaintiff filed an appeal against the part of the court's decision that rejects the application to recognize the action as a monetary class action. The Company filed an cross-appeal of the decision to recognize the action a declaratory class action. In March 1998 the application of the plaintiff to conjoin Bezeq International Ltd. as an additional defendant in the class action was allowed. Bezeq International Ltd. filed an appeal against this decision in May 1998 in the Supreme Court. On the same occasion, Bezeq International Ltd. requested to be conjoined as an additional appellant in the Company's appeal. In the Company's opinion, relying on the legal counsel who is handling the claim on its behalf, the chances of the appeal and the cross-appeal cannot be estimated. No provision is included in the financial statements in respect of this claim.

(3) In June 1997 a group of approximately 130 employees filed a claim, through the Histadrut, in the Regional Labor Court, for declaratory relief in respect of the pension rights of those employees of the group who were transferred from the Ministry of Communications, serving as department heads and employed under personal contracts. According to the plaintiffs, they are entitled to pension terms identical to those of all Company employees to whom a collective agreement applies. In September 1997 the Attorney General gave notice of his presence in the proceeding. In May 1998 the Company filed an actuarial opinion in the Regional Labor Court, stating that the cost of the plaintiffs' demand would be approximately NIS 157 million. In November 1999 a decision was given rejecting almost all the causes of the action. This decision has been appealed. No provision appears in the financial statements in respect of this claim.

(4) In July 1997 a claim and an application by way of motion were filed against the Company and the subsidiary - Bezeq International Ltd. - to recognize an action as a class action under Section 46A of the Restraint of Trade Law. The plaintiff alleges that the tariffs for international telecommunication services in the period from May 10, 1996 to July 8, 1997 were inflated and unreasonable, while exploiting its status as a monopoly, against a background of lowering prices as the international calls market was opening up to competition. The amount of the action is estimated by the plaintiff at about NIS 903 million. The plaintiff declared before the court his willingness to reword his claim so that it would stand against the Company only up to the date on which Bezeq International Ltd. would give notice that it has taken upon itself responsibility for international calls. On October 19, 1998 the Attorney General conveyed his position to the court, stating that the action should not be recognized as a class action. On January 27, 1999 the Anti-Trust Commissioner applied to the court, requesting a hearing in which he would present evidence refuting the allegations of the Company and Bezeq International. On March 18, 1999 the Anti-Trust Commissioner applied to the court requesting to clarify that he does not dispute that the tariffs of Bezeq International Ltd. and the Company, at the times relevant to the action, were binding prices rather than maximum prices as alleged by the plaintiff, and that Bezeq International Ltd. and the Company could not have lawfully lowered the international call prices themselves without the approval of the competent authorities. On August 8, 1999, after submission of the summations of the parties, the District Court approved the claim as a class action. On September 20, 1999 the Company and Bezeq International Ltd. filed for permission to appeal this decision.

NOTE 21 - CONTINGENT LIABILITIES (contd.)

A. CLAIMS (contd.)

In the opinion of the Company and Bezeq International Ltd., relying on the legal counsels who are handling the claim on their behalf, it is not possible, at this stage, to estimate the outcome of the legal proceedings. No provision is made in the financial statements in respect of this claim.

(5) In September 1997 a claim was filed against the Company and the State in the Regional Labor Court. The claim was filed on behalf of 128 senior employees who are employed under personal contracts. The nature of the claim is the plaintiffs' allegation that starting from October 1, 1996, they are entitled to a wage increment of 33%, corresponding to the increment which was given at that time to Members of the Knesset and to senior civil servants whose salaries are linked to those of Members of the Knesset. The total amount of the claim in respect of salary differences is approximately NIS 11 million. Additional amounts are being claimed in respect of delay in payment. The Company alleged that it pays the salaries of the plaintiffs according to the directives of the Government Companies Authority. In the Company's opinion, relying on the legal counsel who is handling the claim on its behalf, it is not possible, at this stage, to estimate the outcome of this claim. No provision is made in the financial statements in respect of this claim.

It should be noted in this regard, that the Government Companies Authority applied to the Attorney General on November 4, 1996, requesting an opinion. According to the draft opinion that was prepared at the Ministry of Justice, no obligation exists to pay the aforementioned increment. The opinion was conveyed to the government companies, and their senior employees were given the opportunity to present their position to the Attorney General. In the hearing held on January 27, 1998, the State's representative announced that the Attorney General had made his decision, which was that the Companies Authority has no obligation to issue an instruction to raise the senior employees' salaries by 33%, and that the Companies Authority had exercised its discretion reasonably on this question in deciding not to respond to the claim.

(6) In November 1997 a claim was filed in the District Court, together with an application by way of motion to recognize a claim as a class action, against the Company, Bezeq International, the Chairman of the Board of Bezq International and the CEO of Bezeq International. The claim alleges, inter alia, that the Anti-Trust Commissioner determined that Bezeq International had unfairly exploited its status in the international calls market and had implemented a deliberate policy of misleading the public on the subject of overseas call tariffs and that it had refrained from clarifying to the public that only those who register as Bezeq International subscribers would enjoy the reduced tariffs, while those who did not so register would be charged at the old tariffs, which were higher than those published.

The claim further alleged that the Company is liable for the acts and omissions of Bezeq International in that Bezeq International is its agent or is offending together with it and/or by allowing the use of the goodwill of Bezeq and/or by violating the duty to supervise Bezeq International, and that the Chairman of the Board and the CEO of Bezeq International are personally liable as managers and/or officers in Bezeq International who, in the course of fulfilling their offices, personally instructed the creation of the misrepresentations, the concealing of information, the selective publication of information, etc.

The amount of the claim as a class action is estimated by the plaintiffs at approximately NIS 56 million. In November 1997 Bezeq International filed an application for dismissal of the claim on the basis of lack of local jurisdiction. In December 1997 the Company was stricken from the claim, while the plaintiffs filed a request to conjoin an additional plaintiff. In addition, the Court approved a procedural agreement whereby all proceedings in the case would be deferred until the decision of the District Court in Jerusalem in the objection filed by Bezeq International to the determination of the Anti-Trust Commissioner. The court has not yet decided on the question of whether to approve the claim as a class action. In the opinion of the consolidated company and its legal advisers, the chances of the claim and/or its possible effect on its business cannot be estimated at this stage. No provision is made in the financial statements in respect of this claim.

NOTE 21 - CONTINGENT LIABILITIES (contd.)

A. CLAIMS (contd.)

(7) In July 1998, the Central Administration Committee of the General Federation of Workers announced a labor dispute, mainly concerning definition of various payments to wage-earning workers and the determination of the value of various components in calculating pension-related wages. In July 1999 the Company reached an arrangement with the workers concerning the leisure component in the pension-related wage calculation. Under this arrangement, which was validated as a decision by the Regional Labor Court, the workers undertook to end the labor dispute immediately.

(8) A number of claims of former employees are pending against the Company, whose subject matter is mainly the inclusion of various wage components for calculating pensions. These issues are liable to have broad consequences. In the opinion of Company management, based on opinions of its legal advisers who are handling the claims on its behalf, it is not possible, at this stage, to estimate the outcome and possible implications for the Company of these claims. Accordingly, no provision is made in the financial statements in respect of these claims.

(9) In accordance with the notice of the Anti-Trust Commissioner dated November 10, 1997, at the end of June 1997 the Commissioner opened an investigation against the consolidated company, which focused on two main suspicions: exploitation of market status by setting "predatory prices", and exploitation of market status by misleading the public. The application of the Ministry of Communications referred to above was also added to the investigation material. On November 9, 1997 the Anti-Trust Commissioner determined that the consolidated company exploited its status in the market in contravention of Section 29A of the Restraint of Trade Law by adopting a policy of deception in connection with the prices it collects, and he decided that there was no incidence of "predatory prices" and that no action need be taken on that front. The Commissioner conveyed his decision to the State Comptroller, the Minister of Communications, the Attorney General, the director of the Government Companies Authority and the CEO of the Company, to allow them to examine, each according to his or her authority and discretion, whether its contents justifies or requires any action on his or her part, against the aforesaid background. On November 16, 1997 the director of the Government Companies Authority addressed the Attorney General, requesting that he notify her whether the determination constitutes suspicion of a shameful offense and whether there is any intention to act by serving indictments. She also addressed the Anti-Trust Commissioner, requesting that he notify her when he has formulated his position in the matter of criminal proceedings. In response, on December 22, 1997, the Commissioner informed her that at that stage, and based on the investigation material in his possession, he does not intend to initiate criminal proceedings against Bezeq International or against its officers. On December 23, 1997 the consolidated company filed an objection in the Anti-Trust Tribunal to the determination of the Commissioner in the matter of exploitation of market status by way of misleading the public.

In July 1998 the Anti-Trust Commissioner submitted his response to the objection, filed by Bezeq International Ltd. in the Anti-Trust Tribunal, to the determination of the Commissioner concerning exploitation of market status by way of misleading the public, in which he disputes the allegations raised by Bezeq International Ltd. concerning tariffs, including the contention that no fair hearing was held.

On September 8, 1998, Bezeq International Ltd. filed an application for dismissal of the response of the Commissioner in limine and cancellation of his determination. On February 3, 2000 the Anti-Trust Tribunal rejected the application of Bezeq International Ltd. On March 5, 2000 Bezeq International Ltd. filed a request for permission to appeal that decision in the Supreme Court. In the opinion of the consolidated company and its legal advisers, it is not possible, at this stage, to estimate the implications of the Commissioner's determination for the Company if the court or the tribunal does not void it. Accordingly, no provision is made in the financial statements for this matter.

NOTE 21 - CONTINGENT LIABILITIES (contd.)

A. CLAIMS (contd.)

(10) In December 1998 the Anti-Trust Commissioner published notice that the Investigations Department of the Anti-Trust Commission had completed an investigation it had carried out over the past year, of prima facie suspicions of cartels between Koor Industries, Telrad, Tadiran, the Company and BezeqCall Communications, in the supply of large switching exchanges and in network terminal point exchanges.

Below are the main points of the Commissioner's notice:

The investigation focused on two main issues: the public switching market, which includes the supply of digital exchange equipment and concomitant services by Tadiran and Telrad to the Company; and the network terminal point exchange market.

According to the Commissioner, the Authority investigators recommend that indictments be filed against some of those who were investigated concerning some of the suspicions that were investigated. The Legal Department at the Anti-Trust Commission will now examine the investigation material and the recommendations of the investigators, in order to determine whether offenses against the Anti-Trust Law were indeed perpetrated, and whether there is sufficient evidentiary basis for trial. This examination is expected to last several months.

The Commissioner added that the findings of the investigation paint a harsh picture of the manner in which the Company purchased exchanges from Koor, and of the manner in which the network terminal point market was operated until recently.

In the area of public switching, the Authority's investigation raises suspicions of collaboration between Telrad and Tadiran, vis-a-vis the Company. Among other things, there is prima facie suspicion that Telrad and Tadiran coordinated various aspects of the competition between them vis-a-vis the Company, in some cases with the knowledge of the Company and in other cases without its knowledge. The Authority also investigated suspicion of coordination between Telrad and Tadiran relating to telecommunications tenders in 1998 and relating to framework agreements with the Company in 1994 and 1996.

The second area of suspicion which was investigated in connection with large exchanges, concerns suspicion of cartelism between the Company and Koor, Telrad and Tadiran, which includes a commitment by the Company not to purchase exchanges from a third vendor; division of purchases between Telrad and Tadiran according to a predetermined key, i.e. the ostensible pre-arrangement of the competition between the companies vis-a-vis the Company; an undertaking by the Company not to purchase from the two companies by tender. It is suspected that some or all of these undertakings, in the relevant circumstances, constitute violation of the provisions of the Anti-Trust Law. From the findings of the investigation, it appears, ostensibly, that in fact the Company purchased exchanges from one vendor (Koor Industries) - at prices which were seemingly much higher than those the Company would have paid had it not bound itself and had the entire market not been blocked by the aforementioned arrangement to other equipment vendors.

The investigation of the Authority also revealed, ostensibly, that in some of these engagements the Company acted in clear contravention of the legal advice it received. In the opinion of the Authority investigators, this element of acting elusively constitutes not only proof that the relevant parties knew they were involved in an offense, but also defines aggravated circumstances for that offense.

NOTE 21 - CONTINGENT LIABILITIES (contd.)

A. CLAIMS (contd.)

The findings of the Authority's investigation in this area appear to indicate a series of cartels and attempted offenses in the field of network end points, between Bezeq Call Communications, Telrad and Tadiran. Among others, suspicions are raised of cartels or attempts at such arrangements - in providing maintenance service for private exchanges, in the prices of buying the service, in customer transfer arrangements and in price discrimination arrangements; in the field of providing maintenance services for private exchanges and network terminal point infrastructures, the composition and price of the service which will be offered to customers for the exchanges in their possession; in ongoing coordination between those entities or some of them; in tenders which were held by final customers for the purchase of network terminal point exchanges. It is suspected that said companies or some of them, in various instances, coordinated the prices of the proposals they would submit in the tenders of final customers. In addition, prima facie evidence was found of market division arrangements between the companies, as well as agreements concerning non-marketing of the product of an additional third vendor in the field of network terminal point exchanges.

The Anti-Trust Law, 5748-1988, forbids engagement as a party to a cartel which was not duly approved or which was not granted exemption or a temporary permit. Commission of such an act is a criminal offense and is also a tortious act and a possible basis for class action proceedings against a party to the arrangement. The findings of the Anti-Trust Authority's investigation have not been not conveyed to the Company and the Company is unable to assess their significance for it and for its officers, in the past and present, or what the decisions of the Anti-Trust Commissioner will be on the above matters, and their implications for the Company, including the ability of its shareholders or customers or any other third party to sue it, or its ability to sue others.

(11) In December 1998 a claim was filed against the Company, together with an application for recognition of the claim as a class action under the Consumer Protection Law, 5741-1981, the Anti-Trust Law, 5748-1988, and alternatively under Regulation 29 of the Civil Procedures Regulations. The claim concerns an advertising campaign of the Company which deals with the advantages of using a fixed-line telephone from the home compared with the use of a cellular telephone. The amount of the class action is estimated by the plaintiff at approximately NIS 57 million. The court partially accepted the application for approval of the class action. Approval of the action as a class action was limited to a declaratory class action by virtue of the Consumer Protection Law, 5741-1981 only, where the cause is "misleading advertising". The parties filed applications for permission to appeal this decision in the Supreme Court. On October 31, 1999, a statement of defense was filed in the class action. In the opinion of the Company, relying on the legal counsel who is handling the claim on its behalf, it is not possible, at this stage, to estimate the chances of the claim. No provision is made in the financial statements in respect of this claim.

(12) In December 1998, a claim was filed against the Company, Pelephone Communications Ltd. and against another cellular communications company, together with an application for recognition as a class action under the Consumer Protection Law, 5741-1981,and alternatively under Section 29 of the Civil Procedures Regulations. The claim concerns the collection of payment for airtime which is effected, according to the plaintiff, by the Company for the defendant cellular operators in respect of a call which originates in the network of the Company to one of the operators when the call is routed by means of a service of the operator, to voice mail or by "call forwarding" to the network of the Company. The amount of the class action is estimated by the plaintiff at approximately NIS 2 billion. In the opinion of the Company, based on the legal counsel who is handling the claim on its behalf, it is not possible, at this stage, to estimate the outcome of the claim. No provision is made in the financial statements in respect of this claim.

NOTE 21 - CONTINGENT LIABILITIES - (CONTD.)

A. Claims (contd.)

(13) In March 1999 a claim was filed against the Company by a group of employees who were employed as temporary workers by the Ministry of Communications and were transferred to the Company when it commenced operations. The plaintiffs are requesting that the Labor Court determine that they are entitled to all the benefits which were granted to permanent transferred employees, graduates of Bezeq College and Ministry of Communications pensioners. The Company has filed an application to dismiss the action in limine since it has exceeded the period of limitations.

The questions raised in this claim are liable to have a lateral effect on the Company. The Company is unable, at this stage, to estimate the outcome and the possible implications for the Company. Accordingly, no provision is made in the financial statements in respect of this claim.

(14) On February 15, 2000 a claim was filed against the Company in the District Court in Jerusalem in the amount of NIS 20 million. The plaintiff alleges in his claim that the Company breached its commitments and representations to him to purchase large quantities of equipment from him. The plaintiff further alleges that the procedure which was used for selecting the equipment which would be purchased by the Company was unlawfully managed, with infringement of the tenders laws and the rules of proper administration, with negligence and while exploiting the status of the Company as a monopoly or monopsony. No statement of defense has yet been filed. At this stage of the proceedings, the Company is unable, relying on the legal counsel which is handling the claim on its behalf, to estimate the outcome of the claim. Accordingly, no provision is made in the financial statements in respect of this claim.

(15) On February 23, 2000, two former employees of the Company filed a financial claim in the District Court in Jerusalem against the State of Israel and against the Company. An application was attached to the claim, requesting approval as a class action in the names of additional employees and pensioners of the Company. The amount of the personal claim of the two representative plaintiffs is approximately NIS 6,500. The amount of the claim of all the plaintiffs, for whom representation is requested, is not stated in the claim. The groups for whom approval of representation is applied for in the action comprise a total of 8,272 employees.

In their statement of claim, the plaintiffs allege, inter alia, that the defendants breached various commitments toward them which were included in the prospectus of the Company published in 1991, including commitments to allot Company shares, pay dividends and make preferential loans available to the plaintiffs. The plaintiffs allege that the allotment of shares to employees in accordance with the Company's prospectus that was published in 1998 constitutes only partial and inadequate fulfillment of those undertakings. (For example, they allege that the number of shares allotted was insufficient, that inadequate sums were paid in dividends, that no preferential loans were given, etc.) The plaintiffs further allege that the prospectus that was published in 1998 contained misleading details and representations, and material documents that ought to have been attached were not attached.

The Company has not yet filed a statement of defense, nor a response to the application for approval as a class action.

At this stage of the proceedings, the Company is unable to estimate the outcome of this legal proceeding, and accordingly, no provision is made in the financial statements in respect of this claim.

(16) A class action was filed against Pelephone Communications Ltd. in the District Court, by virtue of the Consumer Protection Law, 5741-1981 and the Anti-Trust Law 5748-1988. The basis for the claim is an allegation of exploitation of the Company's status as a monopoly and exploitation of distress and misleading consumers. If the action is recognized as a class action, the amount claimed is approximately NIS 16 billion.

NOTE 21 - CONTINGENT LIABILITIES - (contd.)

A. Claims (contd.)

The Company has filed an application for dismissal in limine, based on the belief that the claim is unfounded. The management of Pelephone Communications Ltd. estimates, based on the opinion of its in house and outside legal advisers, that the claim is unlikely to succeed. Accordingly, no provision is made in the financial statements in respect of this claim.

(17) A class action was filed against Pelephone Communications Ltd. for charging value added tax within the borders of the free trade zone in Eilat. The total for which approval is sought as part of the action is approximately NIS 34 million. At this stage, Pelephone Communications Ltd. and its legal advisers are unable to express any opinion in connection with this claim, since they are still studying the matter. Accordingly, no provision is made in the financial statements in respect of this claim.

(18) For the claim of the Ministry of Communications in India for forfeiture of guarantees, see Note 8D.

(19) For the claim of the Company from an equipment vendor and his counter-claim, see Note 9E.

(20) In the matter of the notice of the Accountant General at the Ministry of Finance on the subject of the end of the asset lease period for a two-year renewal period, see Note 9B.

(21) For the income tax assessment for 1994, see note 11E.

(22) For possible demand for early repayment of bank loans, se Note 14D1 and 15C.

(23) Miscellaneous claims - Various claims are pending against the Company in the normal course of business. It is the opinion of the Company's management that the risk inherent in each of these claims will not cause the Company material financial losses in excess of the provisions included in the financial statements.

The amounts of the claims referred to above are adjusted (without interest) in terms of shekels of December 31, 1999.

B. Forward Exchange Contracts

The Company has entered into forward exchange contracts as a hedge against exposure resulting from changes in the exchange rate of the US dollar in relation to changes in the CPI. As at December 31, 1999, the Company contracted to purchase approximately US $343 million (approximately NIS 1,425 million) for which it will pay approximately NIS 1,422 million linked to the CPI. The contracts mature on various dates, the last of which is December 2001. The Company also contracted to purchase approximately US $355 million (NIS 1,474 million) for which it will pay, per agreed interest rates, approximately NIS 1,504 million interest.

NOTE 21 - CONTINGENT LIABILITIES - (contd.)

C. Lease Commitments

For the year ended December 31	Consolidated NIS thousands	Company NIS thousands
2000	105,437	69,699
2001	110,463	66,517
2002	106,789	65,039
2003	99,393	59,515
2004	92,104	52,226
2005 and onwards	523,356	420,282
	1,037,542	733,278

D. Securities and Liens

For securities, liens and stipulations in connection with loan covenants given by the Company, see Note 14D and Note 15C.

NOTE 22 - SHARE CAPITAL

The general Meeting which convened on May 12, 1999 resolved to approve an increase in the authorized share capital of the Company from NIS 835,000,000 to NIS 910,000,000 by the creation of 75,000,000 ordinary shares of a par value of NIS 1 each, which would be equal in their rights to the existing ordinary shares of the Company. This was done for the purpose of issuing securities as part of a public offering according to a prospectus, pursuant to the decision of the Ministerial Committee for Privatization from August 4, 1998.

The above mentioned capital increase requires the approval of the Ministerial Committee for Privatization pursuant to Section 11 of the Government Companies Law, 5735-1975. Following the determination of the Attorney General that a public offering cannot be made due to the dispute in the matter of land assets (see Note 9B), the above resolution was not transferred to the Ministerial Committee for Privatization for approval.

The share capital consists of ordinary shares of a par value of NIS 1 each. The authorized share capital is 835,000,000 shares, the issued and paid up capital is 783,391,072 shares (1998 - 765,783,592 shares). All the shares are traded on the Tel Aviv Stock Exchange.

NOTE 23 - REVENUES FROM TELECOMMUNICATION SERVICES

Consolidated

	For the year ended December 31		
	1999	1998 *	1997 *
	NIS thousands	NIS thousands	NIS thousands
Revenues from telephone services -			
Domestic calls	2,750,493	3,305,647	3,331,673
Cellular telephone	2,837,589	2,677,852	2,362,425
Fixed fees	1,819,036	1,573,652	1,418,202
International communications	892,514	1,105,604	1,662,706
Installation and sale of equipment to subscribers	479,170	505,651	504,390
Other	141,440	76,389	47,153
	8,920,242	9,244,795	9,326,549
Other revenues	223,108	269,230	252,027
	9,143,350	9,514,025	9,578,576

Company

	For the year ended December 31		
	1999	1998 *	1997 *
	NIS thousands	NIS thousands	NIS thousands
Revenues from telephone services -			
Domestic calls	2,765,344	3,315,010	3,344,011
Cellular telephone	1,983,563	1,821,376	1,612,492
Fixed fees	1,669,119	1,405,872	1,257,113
International communications	444,369	540,088	541,104
Installation and sale of equipment to subscribers	235,377	261,013	264,810
Other	143,736	80,324	49,054
	7,241,508	7,423,683	7,068,584
Other revenues	217,312	257,186	246,149
	7,458,820	7,680,869	7,314,733

* Reclassified

NOTE 24 - OPERATING AND GENERAL EXPENSES

Consolidated

	For the year ended December 31		
	1999	1998 *	1997 *
	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses	1,671,130	1,878,920	1,806,479
Cellular telephone expenses	1,364,926	1,090,993	888,506
General expenses	716,230	529,904	499,431
Services and maintenance by sub-contractors	470,703	429,486	387,261
Building maintenance	396,693	379,547	415,592
Materials and spare parts	279,484	288,559	341,094
International communications expenses	264,601	456,213	765,514
Vehicle maintenance expenses	65,457	62,980	77,876
Collection fees	42,115	43,075	44,445
	5,271,339	5,159,677	5,226,198
Less - salaries charged to investment in fixed assets	159,870	171,306	169,094
	5,111,469	4,988,371	5,057,104

Company

	For the year ended December 31		
	1999	1998 *	1997 *
	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses	1,393,014	1,660,797	1,589,508
Cellular telephone expenses	1,497,174	1,300,636	1,101,943
General expenses	256,117	231,443	251,487
Services and maintenance by sub-contractors	415,237	386,408	335,138
Building maintenance	354,149	342,999	386,677
Materials and spare parts	51,433	59,597	138,948
International communications expenses	18,751	27,993	21,248
Vehicle maintenance expenses	59,936	58,763	69,074
Collection fees	41,464	42,461	41,082
	4,087,275	4,111,097	3,935,105
Less - salaries charged to investment in fixed assets	159,870	171,306	169,094
	3,927,405	3,939,791	3,766,011

* Reclassified

NOTE 25 - FINANCING EXPENSES TO BANKS AND OTHERS, NET

Consolidated -

	For the year ended December 31		
	1999	1998	1997
	NIS thousands	NIS thousands	NIS thousands
Expenses in respect of long-term liabilities (*)			
Debentures	82,668	69,876	57,116
Loans	212,984	520,876	373,930
	295,652	590,752	431,046
Income in respect of deposits and investments	(73,606)	(42,230)	(11,009)
Expenses (income) in respect of forward exchange contracts	111,182	(181,705)	(12,460)
Other expenses (income), net	(29,216)	(12,698)	13,956
	304,012	354,119	421,533
(*) Includes increase in value (net of erosion) of liabilities in foreign currency	(33,276)	265,994	59,755

Company -

	For the year ended December 31		
	1999	1998	1997
	NIS thousands	NIS thousands	NIS thousands
Expenses in respect of long-term liabilities (*)			
Debentures	82,668	69,876	85,470
Loans	193,815	495,804	354,636
	276,483	565,680	440,106
Income in respect of deposits and investments	(73,606)	(3,318)	(17,606)
Expenses (income) in respect of forward exchange contracts	111,182	(181,705)	(12,460)
Other expenses (income), net	(5,432)	(4,750)	10,034
	308,627	375,907	420,074
(*) Includes increase in value (net of erosion) of liabilities in foreign currency	(35,329)	242,466	51,737

NOTE 26 - OTHER INCOME (EXPENSES), NET

Consolidated -

	For the year ended December 31		
	1999	1998	1997
	NIS thousands	NIS thousands	NIS thousands
Provision for employee severance benefits upon early retirement (Note 17D)	(398,340)	202,317	(1,155,376)
Provision for billing system (Note 9E)	(126,772)	-	-
Provision for claims for salary and pension components (Note 21A(7))	-	(88,497)	-
Provision for unused sick leave (1)	9,767	(60,805)	-
Provision for decrease in value of fixed assets	-	(14,623)	-
Direct expenses for customer allocation process	(75,561)	-	-
Capital gains (losses), net	16,391	4,686*	(604)*
Loss from curtailment of operations of BezeqCall Ltd.	-	-	(21,690)
Write-off of investment in an affiliate (Note 8E)	-	-	(87,074)
Cancellation of provision for a guarantee for an affiliate (Note 8)	14,919	-	-
Others	1,138	(316)	2,018
	(558,458)	42,762	(1,262,726)

Company

	For the year ended December 31		
	1999	1998 *	1997 *
	NIS thousands	NIS thousands	NIS thousands
Provision for employee severance benefits upon early retirement (Note 17D)	(398,340)	202,317	(1,155,376)-
Provision for billing system (Note 9E)	(126,772)	-	-
Provision for claims for salary and pension components (Note 21A(7))	-	(88,497)	-
Provision for unused sick leave (1)	9,767	(60,805)	-
Provision for decrease in value of fixed assets	-	(14,623)	-
Capital gains (losses), net	17,454	13,027*	(6,619)*
Write-off of investment in an affiliate (Note 8E)	-	-	(87,074)
Cancellation of provision for a guarantee for an affiliate (Note 8)	14,919	-	-
Others	202	-	-
	(482,770)	51,419	(1,249,069)

* Reclassified

(1) Constitutes recording of a provision for unused sick leave in respect of employees who have not yet reached the age of 55 (which is the age at which redemption of unused sick pay is permitted). Up to the year of account, this provision was recorded only in respect of employees who had reached the age of 55.

NOTE 27 - EARNINGS PER SHARE (CONSOLIDATED AND COMPANY)

	For the year ended December 31		
	1999	1998	1997
	NIS thousands	NIS thousands	NIS thousands
Primary and diluted earnings (loss)	18,867	766,149	(245,221)
Weighted number of shares in primary earnings and diluted earnings	803,942	769,611	741,904

In order to determine the likelihood of the conversion of the convertible debentures to calculate earnings per share, the present value for 1999 was calculated assuming possible exercise of the convertible debentures at a post-tax shekel interest rate of 6.5%.

NOTE 27 - TRANSACTIONS WITH INTERESTED AND RELATED PARTIES (contd.)

D. TRANSACTIONS WITH SUBSIDIARIES AND A PROPORTIONATELY CONSOLIDATED COMPANY (Company Books)

	For the year ended December 31		
	1999	1998	1997
	NIS thousands	NIS thousands	NIS thousands
Revenues -			
Interconnect and access fees	419,337	478,567	454,014
Services, royalties and commissions	59,527	42,265	249,074
Rent and fixed fees for buildings and equipment	896	20,312	14,074
Interest	-	970	1,304
Management fees	-	5,652	12,584
Expenses -			
Purchase of services	672,516	691,112	625,751
Interest	14,630	-	-
Total earnings from fixed asset transactions	963	2,256	3,989
Total transaction turnover	1,590	4,776	13,772

Transactions with a proportionately consolidated company were presented in full (100%).
For balances with subsidiaries and a proportionately consolidated company, see related notes.

E. BENEFITS TO DIRECTORS AND THE CEO

	For the year ended December 31		
	1999	1998	1997
	NIS thousands	NIS thousands	NIS thousands
Total cost of compensation of the CEO and the Chairman of the Board of Directors	1,512	1,251	1,104
Number of employees	3	2	4
Balance of loans to the CEO and the Chairman of the Board of Directors	-	8	-
Compensation of members of the Board of Directors who are not Company employees*	1,243	1,294	825
Number of directors receiving compensation	13	14	15

* The compensation for directors in a proportionately consolidated company is presented at the proportional share of the Company (50%).

The Company holds an insurance policy for the officers of the Company and of the subsidiaries in which the Company holds 50% or more of the share capital. The maximum insurance is $150 million per event and per period, and an additional $30 million for legal expenses in Israel. In addition, the Company will indemnify officers in an amount not exceeding $50 million per officer for a financial obligation imposed upon them in any matter connected with the Company's prospectus from February 27, 1998 and which is not covered by the insurance policy.

NOTE 28 - BUSINESS SEGMENTS

The Company and the investee companies operate in various segments of the communications sector. The data concerning operations by segment are presented according to the segments of operation of those companies.

	For the year ended December 31, 1999					
	Fixed line domestic communications	Cellular telephone	International communications	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues						
Revenues from outside sources	7,127,974	1,159,855	698,553	156,968	-	9,143,350
Inter-segment revenues	330,846	327,969	9,417	27,482	(695,714)	-
Total revenues	7,458,820	1,487,824	707,970	184,450	(695,714)	9,143,350
Segment results	1,029,897	72,266	(59,773)	14,649	(47,435)	1,009,604
Financing expenses						(360,072)
Earnings after financing expenses						649,532
Other expenses, net						(558,458)
Earnings before income tax						91,074
Income tax						(62,796)
Earnings after income tax						28,278
Equity in earnings (losses) of affiliates	5,382			(26,932)		(21,550)
Net earnings						6,728
Identified assets	12,828,818	1,896,261	730,159	94,097	(60,378)	15,488,957
Investment by equity method	48,628	-	-	26,870	-	75,498
General assets						1,248,402
Total consolidated assets						16,812,857
Segment liabilities	1,433,503	520,425	385,098	52,863	(89,533)	2,302,356
General liabilities						7,020,269
Total consolidated liabilities						9,322,625
Capital investments	1,064,167	771,853	105,347	7,290		
Depreciation and deductions	2,293,311	427,362	48,174	3,714		

NOTE 28 - BUSINESS SEGMENTS (contd.)

	For the year ended December 31, 1998					
	Fixed line domestic communications	Cellular telephone	International communications	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenue						
Revenues from outside sources	7,255,317	1,162,601	931,483	164,624	-	9,514,025
Inter-segment revenues	425,552	346,949	39,347	15,614	(827,462)	-
Total revenues	7,680,869	1,509,550	970,830	180,238	(827,462)	9,514,025
Segment results	1,365,132	234,786	25,290	13,689	22,939	1,661,836
Financing expenses						(455,814)
Earnings after financing expenses						1,206,022
Other expenses, net						42,762
Earnings before income tax						1,248,784
Income tax						(491,230)
Earnings after income tax						757,554
Equity in earnings of affiliates	6,468					6,468
Net earnings						764,022
Identified assets	14,552,646	1,510,185	872,641	79,944	(62,826)	16,949,590
Investment by equity method	36,546	-	-	-	-	36,546
General assets						1,241,227
Total consolidated assets						18,227,363
Segment liabilities	1,506,726	242,599	421,796	41,827	(137,810)	2,075,138
General liabilities						8,791,071
Total consolidated liabilities						10,866,209
Capital investments	1,192,893	558,226	50,596	3,872		
Depreciation and deductions	2,127,913	337,617	40,952	2,992		

NOTE 28 - BUSINESS SEGMENTS (contd.)

	For the year ended December 31, 1997					
	Fixed line domestic communications	Cellular telephone	International communications	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues						
Revenues from outside sources	6,708,172	1,013,280	1,696,189	160,935	-	9,578,576
Inter-segment revenues	606,561	305,228	37,985	24,451	(974,225)	-
Total revenues	7,314,733	1,318,508	1,734,174	185,386	(974,225)	9,578,576
Segment results	1,116,053	256,049	258,320	(10,654)	12,374	1,632,142
Financing expenses						(630,555)
Earnings after financing expenses						1,001,587
Other expenses, net						(1,262,726)
Loss before income tax						(261,139)
Income tax						37,957
Loss after income tax						(223,182)
Equity in losses of affiliates	(22,039)					(22,039)
Net loss						(245,221)
Identified assets	15,238,083	1,276,586	1,029,574	79,767	(106,762)	17,517,248
Investment by equity method	30,082	-	-	-	-	30,082
General assets						1,313,621
Total consolidated assets						18,860,951
Segment liabilities	1,412,966	188,279	498,073	40,273	(152,482)	1,987,109
General liabilities						10,622,024
Total consolidated liabilities						12,609,133
Capital investments	1,642,506	324,020	97,488	3,004		
Depreciation and deductions	2,160,359	299,453	39,205	2,220		

NOTE 29 - TRANSACTIONS WITH INTERESTED AND RELATED PARTIES

A. The Company is a government company, which transacts a large volume of business, in the regular course of its operations, with government ministries and agencies and government companies. The business transacted is, primarily, the provision of telecommunications services and the execution of development work, as well as the receipt of various types of services. It is not practicable to determine the identity of the interested parties involved in such transactions nor to make a distinction in the recording thereof. The Securities Authority, pursuant to its authority under the Securities Regulations (Preparation of annual financial statements), 5753-1993, exempted the Company from detailing its transactions with interested parties, other than extraordinary transactions.

B. The Company provides services to the Israeli Defense and Security Forces in accordance with terms decided upon in prior years and which provided, inter alia, that the Ministry of Defense will fund the Company's infrastructure investments in consideration of discounts which the Company will grant in respect of current services.

Due to controversies that arose between the Company and the Ministry of Defense in connection with the terms of the services that the Company provides to the Israeli Defense Forces, a professional committee was established to examine the differences of opinion. In May 1996, the committee submitted recommendations for the resolution of the differences of opinion, of which the main recommendations are as follows:

(1) The balance of the accounting between the Company and the Ministry of Defense for the first half of 1996 amounts to approximately NIS 350 million as excess investments by the Ministry of Defense.

(2) For the purpose of completing the accounting mentioned in (1) above, the Company will grant a discount at the rate of 14% on its total services provided to the Israeli Defense Forces, for a period of ten years commencing on July 1, 1996.

(3) All prior obligations and controversies between the parties, as they appear in the claims and demands submitted by both parties, are canceled.

(4) Commencing July 1, 1996, the relationship between the Company and the Ministry of Defense shall be similar to that as between the Company and its other customers. The investments in communications infrastructure shall be made and financed by the Company and the Ministry of Defense will be charged based on the Company's tariffs, subject to that stated in (2) above.

The committee's recommendations require approval by the Minister of Defense and the Minister of Communications. The Company announced that notwithstanding the fact that it has reservations about the report and the results and in order to resolve the long outstanding disagreements, it accepts the recommendations of the committee. Since the recommendations were not adopted by the Ministers of Defense and Communications, the arrangements which were hitherto in effect between the Company and the Israeli Defense Forces, and which were the subject of the committee's discussions, continue to govern.

C. **GUARANTEES**

The Company has given guarantees to banks in connection with credit granted to subsidiary companies of up to NIS 70 million. As at balance sheet date, the balance of the guaranteed loans, as stated, amounted to approximately NIS 10 million.

The Company signed a deed of guarantee on behalf of an affiliate to a bank in the amount of NIS 10 million. The guarantee is valid until December 31, 2010. See Note 8F.

In connection with guarantees given by the Company in respect of its investments in India, see Notes 8D and 8E.

NOTE 30 - FINANCIAL INSTRUMENTS

A. FINANCIAL DERIVATIVES

The Group has an excess of liabilities over assets in or linked to foreign currency, in the amount of approximately NIS 3,209 million, of which the excess of current liabilities is approximately NIS 986 million. The excess of current liabilities is partially covered by forward exchange contracts, as described in Note 21B. The Group has revenues in foreign currency from international communications.

As at December 31, 1999, the excess of CPI-linked monetary liabilities over CPI-linked monetary assets amounted to approximately NIS 3,060 million, of which the excess of current liabilities is approximately NIS 793 million. As stated in Note 1B, most of the Company's tariffs are subject to government regulation and are revised from time to time in accordance with the increase in the CPI, net of an efficiency factor.

The Company has limited commitments in connection with financial derivatives, which are intended solely for purposes of hedging.

Regarding the Company's commitments to execute forward exchange contracts, at December 31,1999 - see Note 21B.

B. CREDIT RISKS

Most of the cash and cash equivalents, at December 31, 1999, as well as bank deposits, are deposited in large Israeli banks. The short-term investments represent, primarily, investments in government debentures and bank deposits, while a small part thereof is invested in debentures of companies traded on the Tel Aviv Stock Exchange in Israel. Accordingly, Management does not expect significant losses deriving from credit risks.

The Group's revenues derive from a large number of customers. Management reviews customer balances on a current basis, and the financial statements include provisions which, in Management's opinion, are adequate for doubtful debts. The exposure to credit risk in connection with customers is limited considering the large number of customers of the Company.

C. FAIR VALUE OF FINANCIAL INSTRUMENTS

The book value of the cash and cash equivalents, short-term investments, trade receivables, other current assets, most of the long-term liabilities, the payables and accrued expenses, are equal or are close to their fair values. The fair value of loans from banks is also close to their book value, since they bear interest at roughly the market rate.

Regarding several items, there is a difference between the amount recorded on the books and the estimated fair value thereof, as detailed below.

	December 31, 1999	
	Book value NIS thousands	**Fair value NIS thousands**
Debenture issued to the Government of Israel	470,954	472,256
Other debentures		
Issued to the public	327,704	311,572
Issued to others	1,151,433	1,038,299
Loans linked to CPI	1,219,481	1,148,362

The fair value of the debentures issued to the public is based on their market value. The fair value of the other liabilities presented above is based on the present value of the cash flows related thereto.

NOTE 31 - LINKAGE TERMS OF MONETARY BALANCES AS AT DECEMBER 31, 1999

Consolidated

	In foreign currency or linked thereto	CPI-linked	Unlinked	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Assets				
Cash and cash equivalents	22,775	-	641,462	664,237
Short-term investments	9,040	67,474	224,626	301,140
Trade receivables	163,138	3,447	1,356,259	1,522,844
Other receivables and debit balances	104	185,768	40,958	226,830
Long-term bank deposits and debit balances	-	11,841	263,902	275,743
	195,057	268,530	2,527,207	2,990,794
Liabilities				
Short-term credit from banks	-	-	271,006	271,006
Current maturities of long-term liabilities	749,173	529,762	-	1,278,935
Trade payables	373,568	-	782,806	1,156,374
Other current liabilities	58,501	60,976	649,414	768,891
Debenture issued to the Government of Israel	-	470,954	-	470,954
Long-term liabilities	2,223,189	1,013,415	-	3,236,604
Other long-term debentures	-	1,253,620	-	1,253,620
Dividend payable	-	-	301,565	301,565
Liabilities for employee severance benefits	-	-	429,648	429,648
	3,404,431	3,328,727	2,434,439	9,167,597

Company

	In foreign currency or linked thereto	CPI-linked	Unlinked	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Assets				
Cash and cash equivalents	2,699	-	483,463	486,162
Short-term investments	9,040	67,474	217,943	294,457
Trade receivables	5,032	-	1,003,114	1,008,146
Other receivables and debit balances	-	139,804	27,665	167,469
Long-term bank deposits and debit balances	-	-	257,492	257,492
	16,771	207,278	1,989,677	2,213,726
Liabilities				
Current maturities of long-term liabilities	731,522	477,610	-	1,209,132
Trade payables	14,183	-	640,441	654,624
Other current liabilities	57,082	60,976	539,400	657,458
Debenture issued to the Government of Israel	-	470,954	-	470,954
Long-term liabilities	2,137,014	725,083	-	2,862,097
Other long-term debentures	-	1,253,620	-	1,253,620
Dividend payable	-	-	301,565	301,565
Liabilities for employee severance benefits	-	-	430,560	430,560
	2,939,801	2,988,243	1,911,966	7,840,010

For details of forward exchange contracts for covering exposure to foreign currency, see Note 21B.

NOTE 31 (contd.) - LINKAGE TERMS OF MONETARY BALANCES AS AT DECEMBER 31, 1998

Consolidated

	In foreign currency or linked thereto	CPI-linked	Unlinked	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Assets				
Cash and cash equivalents	100,787	-	831,500	932,287
Short-term investments	10,406	149,788	225,631	385,825
Trade receivables	178,802	1,538	1,372,332	1,552,672
Other receivables and debit balances	68,109	112,128	16,218	196,455
Long-term bank deposits and debit balances	22,289	6,912	287,356	316,557
	380,393	270,366	2,733,037	3,383,796
Liabilities				
Short-term credit from banks				
Current maturities of long-term liabilities	736,579	1,501,804	-	2,238,383
Trade payables	458,442	-	539,027	997,469
Other current liabilities	84,942	93,691	843,168	1,021,801
Debenture issued to the Government of Israel	-	470,658	-	470,658
Long-term liabilities	2,448,165	1,171,727	-	3,619,892
Other long-term debentures	-	1,213,815	-	1,213,815
Convertible debentures	-	419,470	-	419,470
Liabilities for employee severance benefits	-	-	730,825	730,825
	3,728,128	4,871,165	2,113,020	10,712,313

Company

	In foreign currency or linked thereto	CPI-linked	Unlinked	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Assets				
Cash and cash equivalents	140	-	804,891	805,031
Short-term investments	10,406	65,568	82,040	158,014
Trade receivables	1,544	-	1,070,028	1,071,572
Other receivables and debit balances	67,860	122,490	26,351	216,701
Bank deposits and debit balances	22,289	-	255,413	277,702
	102,239	188,058	2,238,723	2,529,020
Liabilities				
Current maturities of long-term liabilities	704,961	1,486,006	-	2,190,967
Trade payables	37,817	-	489,492	527,309
Other current liabilities	80,942	92,724	718,814	892,480
Debenture issued to the Government of Israel	-	470,658	-	470,658
Long-term liabilities	2,342,771	989,376	-	3,332,147
Other long-term debentures	-	1,213,815	-	1,213,815
Convertible debentures	-	419,470	-	419,470
Liabilities for employee severance benefits	-	-	729,421	729,421
	3,166,491	4,672,049	1,937,727	9,776,267

For details of forward exchange contracts for covering exposure to foreign currency, see Note 21B.

NOTE 32 - CONDENSED FINANCIAL STATEMENTS OF THE COMPANY IN NOMINAL VALUES

A. BALANCE SHEETS

	December 31, 1999	December 31, 1998
	NIS thousands	NIS thousands
Assets		
Current assets	2,177,728	2,417,815
Materials and spare parts	228,557	219,717
Long-term bank deposits and debit balances	257,492	274,027
Investment in investee companies	1,277,590	1,240,913
Fixed assets	7,579,662	8,060,043
Other assets	401,369	390,742
	11,922,398	12,603,257
Liabilities		
Current	3,681,818	4,184,363
Long-term	4,299,349	5,569,020
	7,981,167	9,753,383
Convertible debentures	233,699	-
Shareholders' equity	3,707,532	2,849,874
	11,922,398	12,603,257

NOTE 32 - CONDENSED FINANCIAL STATEMENTS OF THE COMPANY IN NOMINAL VALUES (contd.)

B. STATEMENTS OF OPERATIONS

	For the year ended December 31		
	1999	1998	1997
	NIS thousands	NIS thousands	NIS thousands
Revenues from telecommunication services	7,369,982	7,276,454*	6,563,481
Costs and expenses			
Operating and general expenses	3,883,844	3,731,935*	3,383,168*
Depreciation	1,422,078	1,255,005	1,202,581
Royalties to the Government of Israel	205,769	236,244	245,845
	5,511,691	5,223,184	4,831,594
Operating income	1,858,291	2,053,270	1,731,887
Financing expenses			
Debenture issued to the Government of Israel	61,104	230,925	361,380
Banks and others, net	355,551	788,705	683,866
	416,655	1,019,630	1,045,246
Earnings after financing expenses	1,441,636	1,033,640	686,641
Other expenses, net	464,378	25,036*	1,147,427*
Earnings (loss) before income tax	977,258	1,008,604	(460,786)
Income tax (tax benefit)	44,455	(262,346)	220,392
Earnings (loss) after income tax	1,021,713	746,258	(240,394)
Company's equity in earnings (losses) of affiliated companies	(49,917)	252,054	300,849
Net earnings	971,796	998,312	60,455

* Reclassified

NOTE 32 - CONDENSED FINANCIAL STATEMENTS OF THE COMPANY IN NOMINAL HISTORICAL VALUES (contd.)

C. STATEMENT OF SHAREHOLDERS' EQUITY

	Share capital	Receipts from the issue of warrants	Capital reserves*	Accumulated deficit	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Balance as at January 1, 1997	732,087	-	2,741,260	(1,927,863)	1,545,484
Net earnings	-	-	-	60,455	60,455
Dividend**	-	-	-	(77,512)	(77,512)
Exercise of option warrants	-	-	5,000	-	5,000
Balance as at December 31, 1997	732,087	-	2,746,260	(1,944,920)	1,533,427
Net earnings	-	-	-	998,312	998,312
Issue to the public	-	73,257	-	-	73,257
Issue to employees	4,216	-	32,549	-	36,765
Offer to employees	-	-	3,166	-	3,166
Compensation to Company employees from the Government	-	-	24,710	-	24,710
Exercise of warrants	29,250	(73,257)	221,785	-	177,778
Conversion of convertible debentures	231	-	2,228	-	2,459
Balance as at December 31, 1998	765,784	-	3,030,698	(946,608)	2,849,874
Net earnings	-	-	-	971,796	971,796
Dividend for preceding year	-	-	-	(301,565)	(301,565)
Conversion of convertible debentures	17,607	-	169,820	-	187,427
Balance as at December 31, 1999	783,391	-	3,200,518	(276,377)	3,707,532

* After deduction of assigned issuance expenses in the amount of NIS 3,615,000 in respect of 1998.

** Out of earnings adjusted for changes in the general purchasing power of the shekel.

NOTE 33 - CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD.

1. BEZEQ INTERNATIONAL LTD.

A. Balance sheets

	December 31, 1999	December 31, 1998
	NIS thousands	NIS thousands
Current assets	413,169	602,128
Investments	-	22,936
Fixed assets	314,224	296,600
Other assets	12,258	2,929
	739,651	924,593
Current liabilities	385,098	438,758
Long-term liabilities	-	22,463
Quasi-capital receipt	158,474	158,474
Shareholders' equity	196,079	304,898
	739,651	924,593

B. Statements of Operations

	For the year ended December 31		
	1999	1998	1997
	NIS thousands	NIS thousands	NIS thousands
Revenues from international communications services	696,681	934,173	1,722,855
Operating expenses	594,726	795,289	1,344,806
Gross profit	101,955	138,884	378,049
Marketing expenses	111,422	61,506	62,129
General and administration expenses	50,306	46,331	53,823
Operating income (loss)	(59,773)	31,047	262,097
Financing income, net	36,075	37,072	18,738
Earnings (losses) after financing	(23,698)	68,119	280,835
Other income (expenses), net	(77,538)	(7,534)	3,701
Earnings (losses) before income tax	(101,236)	60,585	284,536
Income tax	9,003	26,660	103,006
Net earnings (losses)	(92,233)	33,925	181,530

NOTE 33 - CONDENSED FINANCIAL STATEMENTS OF BEZEQ INTERNATIONAL LTD. AND PELEPHONE COMMUNICATIONS LTD. (contd.)

2. PELEPHONE COMMUNICATIONS LTD.

A. Balance sheets

	December 31, 1999	December 31, 1998
	NIS thousands	NIS thousands
Current assets	930,749	696,979
Fixed assets	2,575,434	2,429,260
Long-term receivables	11,352	18,015
Reserve for compensation fund, net	3,482	-
Other assets, net	459,494	-
	3,980,511	3,144,254
Current liabilities	1,186,213	587,501
Provision for losses of investee company	3,978	-
Long-term liabilities	796,705	595,683
Shareholders' equity	1,993,615	1,961,070
	3,980,511	3,144,254

B. Statements of Operations

	For the year ended December 31		
	1999	1998	1997
	NIS thousands	NIS thousands	NIS thousands
Income from cellular services, sales and services	2,975,126	3,011,278	2,637,089
Cost of cellular services, sales and services	2,377,871	2,173,625	1,803,810
Gross profit	597,255	837,653	833,279
Sales and marketing expenses	280,398	230,465	198,379
General and administration expenses	183,677	161,577	138,929
	464,075	392,042	337,308
Income from ordinary operations	133,180	445,611	495,971
Financing expenses, net	65,745	29,541	35,168
Capital (gains) losses	(521)	5,156	593
Earnings before income tax	67,956	410,914	460,210
Income tax	31,433	158,973	171,145
Earnings after income tax	36,523	251,941	289,065
Equity in losses of investee companies	3,978	-	-
Net earnings	32,545	251,941	289,065

Schedule A - List of Investee Companies

	Percent of equity and control as at	
	December 31, 1999	December 31, 1998
	%	%
Subsidiaries		
Bezeq International Ltd.	100	100
BezeqCall Communications Ltd. (formerly Bezeq Bit 1995 Ltd.) (1)	100	100
BezeqCall Ltd. (1)	100	100
Bezeq Globe Ltd. (2)	100	100
Proportionately Consolidated Company	50	50
Pelephone Communications Ltd.		
Affiliated Companies		
The International Company for Underwater Cables Ltd. (3)	50	50
Goldnet Communications Services - registered partnership	38	38
Emitel Telecommunication Corp. Ltd. (Hungary) (4)	33	33
Israeli Autostrada for Information Ltd. (5)	33	33
Fascel Ltd. (India) (6)	16	16
D.B.S. Satellite Services (1998) Ltd. (7)	33	33
Infogate Online Ltd. (8)	29	-
Safe Com-Car Communication (hereinafter - Safe-Car)(9)	25.5	-
Walla! Communications Ltd.(10)	26	-
Other Companies		
Intelsat (The International Organization for International Communications)	1.06	1.06

(1) Commencing July 1, 1997, the operations of both companies were merged and BezeqCall Ltd. ceased its operations.
(2) The company ceased to operate on July 1, 1998.
(3) The company maintained an underwater cable which it laid. The Company's share of the cost and maintenance of the equipment is charged to fixed assets and maintenance expenses. In February 1997 use of the cable ceased. In January 1999 the Board of Directors adopted a resolution for voluntary liquidation as of March 31, 1999.
(4) Indirect holding.
(5) During 1997 the operations of Israeli Autostrada for Information Ltd. ceased and a decision was made for its voluntary liquidation.
(6) Right to appoint directors - 25% (see Note 8E).
(7) See Note 8G.
(8) The Company is developing and supplying data communication services in ASP concept, in which computers are linked in a broadband network to a central server from which various services are received.
(9) The company is an investee company of Pelephone Communications Ltd. Pelephone holds 51% of Safe-Car Co. The financial statements of Safe-Car were not consolidated since Pelephone Communications Ltd. does not have control or joint control, pursuant to the establishment agreement of Safe-Car, in which material decisions are adopted by a majority of 75%.
(10) On December 30, 1999, Bezeq International Ltd. gave notice of its wish to exercise the option to purchase 26% of the issued share capital of Walla! Communications Ltd. On January 3, 2000, the shares were transferred to the company in consideration of NIS 24.6 million.