May 22, 2003

Directors' Report on the State of the Company's Affairs for the three month period ended March 31, 2003

We hereby present the Directors' Report on the state of affairs of "Bezeq" - The Israel Telecommunication Corp. Limited (hereinafter: "the Company") and the consolidated Group companies (hereinafter collectively referred to as "the Group") for the three month period ended March 31, 2003 (hereinafter: "the Directors' Report"). The Report was prepared in accordance with the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

The Directors' Report contains a review of its subject matter, in condensed form, and was prepared on the assumption that the reader can also refer to the Directors' Report for the year ended December 31, 2002.

The financial data in the Directors' Report are presented in adjusted shekels of March 2003.

1. Business Environment

During the period of the Directors' Report and the period immediately subsequent thereto, a number of events and changes took place in the state of the Group's affairs and business environment, the most noteworthy of which are the following:

A. On March 31, 2003, the Committee for Regulating the Tariffs of the Company presented a report containing its recommendations. The recommendations and the Company's response to them, appear in Note 1(b)(1) to the financial statements. Implementation of the recommendations is expected to materially reduce the Company's revenues and have a materially adverse effect on the Company's business results.

B. On May 15, 2003, a settlement agreement was signed between the Company and the Government of Israel on behalf of the State of Israel and the Israel Lands Administration, regulating the dispute between them in the matter of the rights of the Company in various real estate properties which were transferred to the Company when it commenced operations in 1984 under an asset transfer agreement signed between the Company and the State. For a description of the main points of the agreement see Note 5 to the financial statements. The settlement agreement will take effect upon receipt of the approvals mentioned in Note 5. The Company's Management does not expect the aforesaid to have a material effect on the financial statements of the Company.

C. On April 30, 2003, the Knesset passed the first reading of the proposed Law for the Recovery of the Israeli Economy (Legislative amendments for attainment of the budget objectives and the economic policy for the financial years 2003 - 2004), 5763-2003. The proposed law includes, *inter alia*, amendments to the Telecommunications Law (Telecommunications and Broadcasts), 5742-1982 and to the Government Companies Law, 5735-1975, which could have a materially adverse effect on the activities of the Group. Among the amendments and further to the recommendations of the committee appointed by the Minister of Communications to make detailed recommendations regarding the rules and policy for opening domestic fixed-line communications to competition, the Knesset Economics Committee approved the grant of licenses to new domestic operators without imposing a universal obligation, starting in September 2004. This amendment, as well as the entire proposed law, has not yet passed its second and third reading by the Knesset.

2. Details concerning exposure to and management of market risks

A. The Company officer responsible for managing market risk is the Chief Financial Officer, Mr. Ron Eilon. For details of his qualifications and experience, see Regulation 26A in the periodic report for 2002.

B. Further to that described in the Directors' Report for the year 2002 and as a result of hedging transactions against market risks associated with exposure to fluctuations in exchange rates, the Group experienced no material interest expense or income during the period of account despite the material changes which occurred in the exchange rates of foreign currencies during the period.

C. The report in respect of linkage bases and positions in derivatives as at March 31, 2003, does not differ significantly from that reported as at December 31, 2002.

D. The Group's surplus monetary liabilities over monetary assets denominated in or linked to foreign currency as at March 31, 2003, amounted to approximately NIS 2.98 billion. As a result of forward currency transactions as at March 31, 2003, the net balance of foreign currency liabilities not hedged by such forward transactions amounts to approximately NIS 122 million.

The Group's surplus monetary liabilities over monetary assets that are linked to the CPI as at March 31, 2003, amounted to approximately NIS 1.5 billion.

3. Financial Position

A. The Group's assets as at March 31, 2003, amount to approximately NIS 16.3 billion, compared with NIS 18.1 billion on March 31, 2002. Of these, approximately NIS 9.9 billion (approximately 60.8%) are fixed assets, compared with approximately NIS 10.7 billion (approximately 58.8%) on March 31, 2002.

The decrease in total assets derived mainly from the decrease in the net book value of the fixed assets as a result of the difference between the depreciation expense and the investment made during the period of the report , from a decrease in investments and long-term debt and from a decrease in the balance of cash and cash equivalents, this decrease being partially offset by an increase in short-term investments.

B. The Group's shareholders' equity as at March 31, 2003, amounted to approximately NIS 6.65 billion, representing approximately 40.9% of the total balance sheet, compared with approximately NIS 7.82 billion on March 31, 2002, which represented approximately 43.1% of the total balance sheet. The decrease in shareholders' equity was caused mainly by the Group's net loss in 2002 and the distribution of a dividend during the period of the report.

C. Total Group debt to financial institutions and debenture holders as at March 31, 2003, amounted to approximately NIS 6.03 billion, compared with approximately NIS 6.54 billion on March 31, 2002.

D. Group balances in cash and short-term investments as at March 31, 2003 amounted to approximately NIS 2.1 billion, compared with NIS 2.07 billion on March 31, 2002.

4. Results of Operations

A. Principal results

Net earnings for the first three months of 2003 amounted to approximately NIS 69 million, compared with net earnings of approximately NIS 114 million during the corresponding period in the prior year.

Earnings per share in the first three months of 2003 were NIS 0.029 per NIS 1 par value, compared with earnings of NIS 0.047 per share during the corresponding period in the prior year.

B. Revenues

Group revenues in the first three months of 2003 amounted to approximately NIS 2.03 billion, compared with approximately NIS 2.08 billion during the corresponding period in the prior year. The decrease in revenues derives principally from the decrease in revenues from domestic fixed-line and cellular communications.

Revenues from domestic fixed-line communications decreased as a result of real tariff erosion due to accelerated inflation during the period, and as a result of a decrease in call traffic. Company revenues from cellular communications decreased due to the decrease in interconnect fees, transmission revenues and collection fees. The decrease in the Group's revenues was moderated by an increase in the Company's revenues from ADSL lines.

C. Operating and general expenses

The Group's operating and general expenses in the first three months of 2003 amounted to approximately NIS 1.15 billion, similar to the corresponding period in the prior year.

The operating and general expenses of the Group were influenced mainly by a decrease in general and building maintenance expenses which were offset mainly by an increase in expenses for materials and spare parts.

D. Depreciation

The Group's depreciation expenses are decreasing as a result of the cessation of the depreciation charge of Company fixed assets and a decrease in investments in new assets.

E. Royalty payments to the Government of Israel

The Group's royalties expenses in the first three months of 2003 amounted to approximately NIS 62 million, compared with approximately NIS 67 million during the corresponding period in the prior year. The source of the decrease is the decrease in the royalty rate applicable to the revenues of Pelephone and a decrease in the revenues of the Company.

F. Operating income

The Group's operating income in the first three months of 2003 amounted to approximately NIS 262 million, compared with approximately NIS 279 million during the corresponding period in the prior year, a decrease of approximately NIS 17 million. The decrease in operating income results from the changes described above in the revenue and expense items. These changes led to a decrease in the operating loss of Pelephone, to an increase in the operating income of Bezeq International and a decrease in the operating income of the Company.

G. Financing expenses

The Group's net financing expenses in the first three months of 2003 amounted to approximately NIS 33 million, compared with approximately NIS 45 million during the corresponding period in the prior year. The decrease is derived mainly from a rise in the interest income of the Company from its financial assets. In addition, financing expenses decreased due to a decrease in the total financial debt of the Group. The effect of the changes in foreign currency exchange rates was neutralized to a large extent by hedging transactions.

H. Company equity in losses of affiliates

The Company’s equity in losses of affiliates increased compared to the corresponding period last year, due to the increase in the Company's equity in the losses of D.B.S. Satellite Services.

5. Liquidity and sources of financing

Consolidated cash flows generated by operating activities in the first three months of 2003 amounted to approximately NIS 777 million, compared with approximately NIS 680 million during the corresponding period in the prior year. The increase in consolidated cash flows was due to an increase in the operating cash flows of the Company, Pelephone and Bezeq International.

Cash flows generated by operating activities are the principal source of financing the Group's investments, and these were applied during the report period, *inter alia*, for the investment of approximately NIS 399 million in the development of communications infrastructures, approximately NIS 52 million in investee companies and approximately NIS 26 million in long-term deposits and investments. During the quarter, the Group repaid approximately NIS 355 million of debt, of which approximately NIS 118 million was on account of long-term loans, approximately NIS 160 million on account of debentures and approximately NIS 77 million on account of short-term credit. In addition, the Company paid a dividend of approximately NIS 190 million. Conversely, the Group raised new debt in a total amount of approximately NIS 156 million in new long-term loans.

The average monthly short-term credit during the period was approximately NIS 494 million. The average monthly long-term liabilities during the period were approximately NIS 5,621 million.

Working capital as at March 31, 2003, was positive and amounted to approximately NIS 371 million, compared with positive working capital of approximately NIS 876 million on March 31, 2002. The decrease in the Group's working capital derived mainly from an increase in current maturities of debentures and an increase in short-term credit. The decrease was partially offset by the increase in trade receivables and debit balances.

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

Adv. Miriam (Miki) Mazar Chairperson of the Board	Ilan Biran CEO