"BEZEQ" THE ISRAEL TELECOMMUNICATION CORP. LIMITED

FINANCIAL STATEMENTS

DECEMBER 31, 2000

Contents

March 28, 2000

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

We have audited the attached balance sheets of "Bezeq" - The Israel Telecommunication Corp. Limited (hereinafter - the Company) as at December 31, 2000 and 1999 and the consolidated balance sheets as at such dates and the related statements of operations, shareholders' equity and cash flow for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Board of Directors and the management of the Company. Our responsibility is to give our opinion on these financial statements based on our audit.

We did not audit the financial statements of subsidiaries, whose assets constitute approximately 5% and approximately 5% of total consolidated assets as at December 31, 2000 and 1999, respectively, and whose revenues constitutes approximately 9%, approximately 7% and about 8% of total consolidated revenues for the years ended December 31, 2000, 1999 and 1998, respectively. The financial statements of those subsidiaries were audited by other auditors, whose reports 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 audit in accordance with generally accepted accounting 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 assurances 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 assessment of the accounting principles used and significant estimates made by the Board of Directors and the 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 aspects, the financial position of the Company and its subsidiaries as at December 31, 2000 and 1999 and the results of their operations, the changes in shareholders' equity and their cash flows for each of the three years in the period ended on December 31, 2000, conformity with generally accepted accounting principles. Furthermore, in our opinion, these 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 above mentioned financial statements are stated in values adjusted for the changes in the general purchasing power of the Israeli currency, in accordance with opinion 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 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.

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

(4) The financial condition of an affiliated company, the memorandum of terms signed by the affiliated company and banking corporations, the unsigned financing agreement between the affiliated company and the banking corporations, and the affiliated company's assessment as to the agreement signing process, as described in Note 8H.

Somekh Chaikin

Certified Public Accountants

Balance Sheets

In terms of shekels of December 2000

	Note	Consolidated December 31, 2000 NIS thousands	Consolidated December 31, 1999 NIS thousands	Company December 31, 2000 NIS thousands	Company December 31, 1999 NIS thousands
Current assets					
Cash and cash equivalents	3	1,532,882	664,237	1,521,842	486,162
Short-term investments	4	188,369	301,140	168,376	294,457
Trade receivables	5	1,372,781	1,522,844	728,350	1,008,146
Other receivables and debit balances	6	475,968	482,522	386,396	388,048
Inventory		134,425	110,210	-	-
		3,704,425	3,080,953	2,804,964	2,176,813
Materials and spare parts		185,184	231,248	185,184	231,248
Investments and long-term receivables					
Deposits and debit balances	7	289,495	275,743	244,011	257,492
Investments in investee companies	8	172,676	75,498	1,286,670	1,481,028
		462,171	351,241	1,530,681	1,738,520
Fixed assets	9				
Cost		29,041,943	28,751,669	25,298,162	25,643,973
Less - accumulated depreciation		17,434,738	16,095,221	15,475,710	14,573,613
		11,607,205	12,656,448	9,822,452	11,070,360
Other assets					
Deferred charges and other assets	10	378,089	257,508	15,285	13,225
Deferred taxes	11	633,347	237,737	633,049	248,816
		1,011,436	495,245	648,334	262,041
		16,970,421	16,815,135	14,991,615	15,478,982

		Consolidated		Company	
		December 31, 2000	December 31, 1999	December 31, 2000	December 31, 1999
	Note	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Current liabilities					
Short-term bank credit	12	735,142	271,006	-	-
Current maturities of:					
Debenture issued to the Government of Israel	13	-	470,954	-	470,954
Long-term bank loans	14	377,587	1,053,418	317,495	983,615
Other debentures	15	224,590	225,517	224,590	225,517
Trade payables	16	1,046,886	1,156,374	465,896	654,624
Dividend payable		-	301,565	-	301,565
Employee severance benefits	17	344,780	351,185	344,780	351,185
Other current liabilities	18	967,379	825,777	779,862	694,358
		3,696,364	4,655,796	2,132,623	3,681,818
Long-term liabilities					
Long-term loans	14	2,824,784	3,236,604	2,404,728	2,862,097
Other debentures	15	2,152,075	1,253,620	2,152,075	1,253,620
Employee severance benefits	17	1,251,591	78,463	1,247,318	79,375
Deferred taxes	11	14,432	20,183	-	-
Deferred revenues	19	69,801	78,780	93,497	110,383
		6,312,683	4,667,650	5,897,618	4,305,475
Convertible debentures	20	68,092	233,699	68,092	233,699
Contingent liabilities	21				
Shareholders' equity	22	6,893,282	7,257,990	6,893,282	7,257,990
		16,970,421	16,815,135	14,991,615	15,478,982

Ido Dissentshik
Chairman of the Board

Ilan Biran
CEO

Date of approval of the financial statements: March 15, 2001

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 2000

		Consolidated			Company		
	Note	2000 NIS thousands	1999 NIS thousands	1998 NIS thousands	2000 NIS thousands	1999 NIS thousands	1998 NIS thousands
Revenues from telecommunications services	23	8,402,239	9,154,721*	9,540,512 *	6,252,265	7,458,820	7,680,869 *
Costs and expenses							
Operating and general expenses	24	4,283,834	5,131,538 *	5,014,858 *	2,536,180	3,927,405	3,939,791 *
Depreciation	9	2,700,286	2,720,919	2,509,146	2,246,299	2,293,311	2,127,913
Royalties to the Government of Israel		314,557	301,358	354,672	200,875	208,207	248,033
		7,298,677	8,153,815	7,878,676	4,983,354	6,428,923	6,315,737
Operating income		1,103,562	1,000,906	1,661,836	1,268,911	1,029,897	1,365,132
Financing expenses, net	25	343,232	360,072	455,814	294,339	364,687	477,602
Earnings after financing expenses		760,330	640,834	1,206,022	974,572	665,210	887,530
Other income (expenses), net	26	(1,272,655)	(558,458)	*42,762	(1,232,857)	(482,770)	51,419 *
Earnings (loss) before income tax		(512,325)	82,376	1,248,784	(258,285)	182,440	938,949
Tax benefit (income tax)	11	153,323	(59,665)	(491,230)	138,792	(70,379)	(374,297)
Earnings (loss) after income tax		(359,002)	22,711	757,554	(119,493)	112,061	564,652
Equity in earnings (loss) of investee companies	8	(195,159)	(21,550)	6,468	(429,775)	(103,876)	199,370
Minority share in loss of consolidated company		4,893	-	-	-	-	-
Earnings (loss) before cumulative effect of change in accounting method		(549,268)	1,161	764,022	(549,268)	8,185	764,022
Cumulative effect as at beginning of year of the change in accounting method		-	7,024	-	-	-	-
Net earnings (loss)		(549,268)	8,185	764,022	(549,268)	8,185	764,022
Earnings (loss) per share							
Primary and diluted earnings (loss) per NIS 1 par value of common shares (in NIS)	27	(0.226)	0.008 **	0.332 **	(0.226)	0.008 **	0.332 **

* Reclassified

** Restated due to issue of bonus shares which occurred after the balance sheet date.

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

Statement of Changes in Shareholders' Equity

In terms of shekels of December 2000

	Share capital	Receipts from issue of option warrants	Capital reserve for distribution of bonus shares	Capital reserve share premium (4)	Capital reserve in respect of transactions between the Company and a controlling shareholder	Retained earnings	Total
	NIS thousands						
Balance as at January 1, 1998	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(1)	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 (2)	31,542	(80,587)	-	240,721	-	-	191,676
Conversion of convertible debentures(3)	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	-	-	-	-	-	8,185	8,185
Dividend for preceding year	-	-	-	-	-	(301,565)	(301,565)
Conversion of convertible debentures (5)	17,903	-	-	172,313	-	-	190,216
Balance as at December 31, 1999	4,132,869	-	-	651,857	35,650	2,437,614	7,257,990
Changes in 2000							
Erosion of dividend declared in a previous year and paid this year	-	-	-	-	-	(1,421)	(1,421)
Net loss	-	-	-	-	-	(549,268)	(549,268)
Tax benefit in respect of shares to employees	-	-	-	21,759	-	-	21,759
Conversion of convertible debentures(6)	14,654	-	-	149,568	-	-	164,222
Capitalization of undesignated earnings to a reserve fund for the distribution of bonus shares (7)	-	-	1,598,500	-	-	(1,598,500)	-
Balance as at December 31, 2000	4,147,523	-	1,598,500	823,184	35,650	288,425	6,893,282

(1) 4,215,844 ordinary shares of NIS 1 par value were issued to employees.
(2) 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.
(3) 2,336,657 par value convertible debentures were converted into 230,895 ordinary shares with a par value of NIS 1 each.
(4) After deduction of assigned issue expenses in the amount of NIS 3,977,000 in respect of 1998.
(5) 178,187,698 par value convertible debentures were converted into 17,607,480 ordinary shares with a par value of NIS 1 each.
(6) 147,652,429 par value convertible debentures were converted into 14,590,161 ordinary shares with a par value of NIS 1 each.
(7) See Note 22.

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 2000

	Consolidated			Company		
	2000	1999	1998	2000	1999	1998
	NIS thousands			NIS thousands		
Cash flows generated by operating activities						
Net earnings (loss)	(549,268)	8,185	764,022	(549,268)	8,185	764,022
Adjustments to reconcile net earnings (loss) to net cash flows generated by operating activities (see A below)	3,814,489	2,377,944	2,254,565	3,530,490	2,137,615	1,730,248
Net cash flow generated by operating activities	3,265,221	2,386,129	3,018,587	2,981,222	2,145,800	2,494,270
Cash flows generated by investing activities						
Acquisition of fixed assets	(1,725,641)	(1,417,578)	(1,862,647)	(1,104,237)	(920,584)	(1,236,799)
Proceeds from disposal of fixed assets	34,594	20,112	65,016	29,159	16,311	51,473
Proceeds from disposal of investment in investee company	171,120	-	4	171,120	-	-
Investment in long-term deposits and investments	(59,826)	(15,820)	(100,035)*	(25,489)	(4,989)	(65,370)*
Proceeds from long-term deposits and investments	60,019	112,707	20,430*	23,545	83,194	18,954*
Decrease (increase) in short-term investments, net	115,703	85,002	(8,222)	128,191	(136,126)	(41,436)
Decrease (increase) in materials and spare parts	57,959	(80,034)	87,749*	57,959	(80,033)	87,748
Investment in investee companies	(324,720)	(60,502)	-	(267,800)	(43,923)	(3,364)
Investments in other assets	(263,001)	(301,405)	-	-	(130)	-
Net cash flow used for investment activities	(1,933,793)	(1,657,518)	(1,797,705)	(987,552)	(1,086,280)	(1,188,794)
Cash flows generated by financing activities						
Repayment of debentures issued to the Government of Israel	(471,619)	(938,612)	(928,504)	(471,619)	(938,612)	(928,504)
Issue of other debentures (net of issue expenses)	1,093,841	263,253	69,103	1,093,841	263,253	69,103
Repayment of other debentures	(226,254)	(206,575)	(240,792)	(226,254)	(206,575)	(240,792)
Receipt of long-term loans	802,938	720,809	725,248	589,856	559,319	610,702
Repayment of long-term loans	(1,822,839)	(1,106,542)	(1,270,100)	(1,640,828)	(1,055,774)	(1,185,110)
Receipt (repayment) of short-term bank credit	464,136	271,006	(18,823)	-	-	(7,785)
Dividend paid	(302,986)	-	-	(302,986)	-	-
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 debenture and options on them (after deduction of issue expenses)	-	-	407,719	-	-	407,719
Proceeds from exercise of options	-	-	191,676	-	-	191,676
Net cash flow used for financing activities	(462,783)	(996,661)	(957,384)	(957,990)	(1,378,389)	(975,902)
Increase (decrease) in cash and cash equivalents	868,645	(268,050)	263,498	1,035,680	(318,869)	329,574
Cash and cash equivalents at beginning of year	664,237	932,287	668,789	486,162	805,031	475,457
Cash and cash equivalents at end of year	1,532,882	664,237	932,287	1,521,842	486,162	805,031

* 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 2000

	Consolidated			Company		
	2000	1999	1998	2000	1999	1998
	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	2,700,286	2,720,919	2,509,146	2,246,299	2,293,311	2,127,913
Provision for decrease in value of fixed assets	11,013	106,380	14,623	-	106,380	14,623
Deferred taxes	(308,193)	80,111	164,068	(286,943)	72,884	172,998
Company's equity in losses (earnings) of investee companies, net	195,159	21,550	(6,468)	429,775	103,876	(115,400)
Minority share in losses of a consolidated company	(4,893)	-	-	-	-	-
Provision for decrease in value of affiliate	-	(14,919)	-	-	(14,919)	-
Increase (decrease) in employee severance benefits, net	1,166,723	(301,177)	(745,385)	1,161,538	(298,861)	(745,286)
Gain on disposal of fixed assets	(1,341)	(16,391)	(4,686)	(2,657)	(17,454)	(13,027)
Gain on disposal of investment in investee company	(138,737)	-	-	(138,737)	-	-
Imputed salaries expense	-	-	44,036	-	-	44,036
Erosion (appreciation) of and interest on long-term deposits and investments	15,425	16,933	(68,202)*	15,425	16,933	(68,202)*
Erosion (appreciation) of short-term investments, net	(2,932)	(317)	5,272	(2,110)	(317)	5,272
Appreciation (erosion) of long-term liabilities:						
Debenture issued to the Government of Israel	665	(2,408)	(21,916)	665	(2,408)	(21,916)
Other debentures	26,939	817	(5,961)	26,939	817	(5,961)
Long-term loans	(73,788)	(36,222)	246,755	(71,854)	(34,985)	233,955
Convertible debentures	-	140	(807)	-	140	(807)
Amortization of deferred expenses and other adjustments	150,460	67,515	8,336	1,086	7,595	7,982
Changes in asset and liability items:						
Decrease (increase) in trade receivables	151,149	54,801	(51,630)	279,796	86,477	(60,970)
Decrease (increase) in other receivables and debit balances	(82,586)	(105,595)	117,748	(88,174)	(25,266)	92,430
Increase in inventory	(14,714)	(81,943)	(25,065)*	-	-	-
Increase (decrease) in trade payables	(86,695)	92,884	9,109	(107,085)	67,483	19,206
Increase (decrease) in other current liabilities	119,528	(218,793)	64,156	83,413	(212,276)	41,965
Increase (decrease) in deferred revenues	(8,979)	(6,341)	1,436	(16,886)	(11,795)	1,437
	3,814,489	2,377,944	2,254,565	3,530,490	2,137,615	1,730,248
B - Non-cash transactions						
Acquisition of fixed assets, materials and spare parts on credit	181,685	324,161	258,361	301,032	263,327	203,377
Sale of fixed assets on credit	8,858	23,051	-	8,858	23,051	-
Proposed dividend	-	301,565	-	-	301,565	-

* 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 which replaced an earlier license and was 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.

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.

The Company's tariffs are updated according to the recommendations of the committee for arrangement of the Company's tariffs, which were adopted by the Minister of Communications and Minister of Finance with certain amendments. Pursuant to the recommendations, the efficiency factor of the Company's tariffs ("the efficiency factor"), was determined to average 6% in 1999 and 7% in 2000. This factor will be updated in 2001 and subsequent years to 3.5% per year.

In accordance with the above recommendations, the Company's tariffs were lowered on April 1, 1999, May 1, 2000 and March 1, 2001.

In the update of May 2000, the Company's tariffs were lowered by an average of 2.43%, and several tariff baskets were offered, mainly for Internet users, which meant a significant reduction in tariffs. The tariff update was accompanied by a change in the manner of charging for calls, principally a change from charging by call unit to charging by duration (subject to a minimum tariff per call).

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, and an affiliated company – D.B.S. Satellite Services (1998) Ltd. at 5% (with a reduced rate of 1.5% in its first years of operation). The Ministry of Communications announced that it is considering making a change in the payment arrangements, whereby the basis of revenues for the matter of payment of royalties will be broadened and a gradual reduction of their rate will be introduced.

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 December 2000 the Anti-Trust Commissioner declared the Company a monopoly in the field of telecommunications infrastructure for providing high-speed Internet access services. The Company has submitted a petition to the Anti-Trust Court, seeking revocation of the declaration.

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

NOTE 1 - GENERAL (CONTD.)

E. Contd.

(1) Cellular services

Cellular services are currently provided by three companies (the Operators), of which one - Pelephone Communications Ltd. - is 50% owned by the Company. At the beginning of 2001, an operating license was awarded to an additional Operator, which had formerly operated in a format somewhat different from that of the other three companies.

According to a notice of the Company to the Operators, starting on March 1, 2000, the arrangement between them for billing was cancelled and a new arrangement was introduced, whereby the Company transfers to the Operators only the amounts it actually collects in respect of airtime, less a collection commission (in the previous arrangement, money was transferred on the basis of customer charges without deducting a collection commission). The Operators opposed the change, and one of them even filed a claim in the District Court, requesting that the Company be ordered to continue the previous arrangement. The Court dismissed the claim and approved the validity of the new arrangement as introduced by the Company. Nevertheless, the disputes between the Company and the Operators have not yet been settled.

As a result of the aforementioned change in the billing arrangements, since March 1, 2000 the cellular revenues and expenses of the Company do not include airtime. Airtime included in revenues and expenses from cellular in 2000 is approximately NIS 290 million (1999 – approximately NIS 1,500 million).

In September 2000 the Ministry of Communications promulgated regulations (effective from October 2, 2000) in connection with the tariffs of incoming calls to the cellular network, whereby the tariffs of the incoming calls to cellular telephones will be gradually reduced, from October 2000 to January 2003. The management of Pelephone Communications Ltd. ("Pelephone") estimates that the effect of the new regulations on its earnings will be material. Pelephone has appealed to the High Court of Justice for cancellation of the regulation.

(2) International communication services

At the beginning of July 1997, two new companies began providing international communication services, as a result of which, international call tariffs were lowered significantly, including those of the consolidated company Bezeq International Ltd.

At the beginning of July 1997, regulations were promulgated for the purpose of anchoring the duty of all the international operators 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 the CPI, and will be reduced by 30% each year.

Pursuant to an amendment to the license of Bezeq International Ltd. relating to the process of allocating subscribers to the various operators, the subscriber allocation process was carried out during the year.

During 2000, Bezeq International allocated NIS 28 million in direct expenses for the allocation process, and in 1999 – NIS 76 million. The Company also incurred costs relating to the technical operation of the allocation. In 2000, Bezeq International expanded its operations as an Internet provider. These activities, added to tariff erosion and a decline in market share, caused it considerable losses.

NOTE 1 - GENERAL (CONTD.)

E. (2) 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., and 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 may 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 Company.

(3) Domestic communication services

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 they are awarded a general license by the Ministry of Communications.

At the beginning of April 2000, the Attorney General decided on a dispute between the Ministries of Finance and Communications on the question of whether the Minister of Communications is authorized to award the cable services franchisees a license for providing fixed-line domestic communication services using the existing cable infrastructure, without a tender, and alternatively, without receipt of special consideration. The main point in the Attorney General's decision was that in the present legal situation the Minister of Communications may not grant licenses whose practical significance is the unlimited extension of the franchises, and that for implementation of a decision to change the policy of granting franchises to a policy of granting licenses, legislation would be required. It is noted that in an additional opinion, the Attorney General also rejected the possibility of granting a temporary license to the cable companies for providing high-speed Internet access services.

Following the Attorney General's decision, two proposals were submitted to the Knesset for amendment of the Telecommunications Law, both dealing with arrangements for opening the communications market to competition. These proposals include, inter alia, a proposal to enable operators to use some or all of the infrastructures of the Company (unbundling). The proposals are at various stages of legislation but have not yet taken shape as a law.

In October 20, 2000, the Ministry of Communications published tenders for the provision of domestic communication services via a wireless network to subscribers' homes (LMDS). In February 2001, the Ministry of Communications awarded a license to an additional company for operating fixed-line domestic communication services.

On November 6, 2000 the Ministry of Communications approved the service file for the provision of broadband communications services in ADSL technology by the Company. The Company has started to provide the service and is working to expand it.

As a result of the various changes in the communications market as described above, a significant decrease has occurred in the business results of the Group. This is expected to continue with the opening of fixed-line domestic communication services to full competition, and cannot be estimated at this stage.

NOTE 1 - GENERAL (CONTD.)

E. (3) Contd.

On August 27, 2000 the Ministerial Committee for Privatization decided that the State's holdings in the Company would be sold by way of a private sale, which would be accompanied by raising capital for the Company. The sale will include shares comprising at least 50.01% of the Company's share capital. The Companies Authority was authorized to carry out the actions required for implementation of the decision, including actions listed in the decision. It was further decided that the sale process would end, if possible, within 9 - 12 months from the date of the decision. The above decision of the Ministerial Committee was approved on September 6, 2000 by the Knesset Finance Committee. As at the date of this Report, the capital had not been raised for the Company.

The Company is unable to estimate whether, when and how the holdings, in whole or in part, of the State in the Company will be reduced.

NOTE 2 - SIGNIFICANT ACCOUNTING PRINCIPLES AND REPORTING POLICIES

A. DEFINITIONS

In these financial statements -

(1) Subsidiary - 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 necessarily reflect their market or economic value, but rather, their cost adjusted for the effect of the changes in the general purchasing power of the shekel.

(3) The terms "cost" as used in the adjusted reports means "adjusted cost".

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

B. FINANCIAL STATEMENTS ADJUSTED FOR THE EFFECT OF INFLATION (CONTD.)

(4) All 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 reclassified and are presented in the order arising from the nature of the Company's business as a communications company.

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 nominal value at that 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 as 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 or making payment, until the index in respect of balance sheet month.

(c) The Company's equity in operating results of investee companies was included 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 monetary 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 CPI at the time of making each payment, while the amounts payable (or refundable) were not adjusted. Therefore, the current income tax expense includes also the expenses deriving from erosion in the value of the advance tax payments, from the date of payment until the balance sheet date. See Notes 2N and 11D relating to deferred taxes.

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

E. PRINCIPLES OF ADJUSTMENT (contd.)

(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 announced/proposed in the report year but had not been distributed as at balance sheet date, was stated unadjusted.

(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.

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

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 derives 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 is presented at the lower of cost or value to the business. Cost is determined mainly by the moving average 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 customer, as well as spare parts which are used by the company for the repair of user equipment in the framework of the insurance it provides for its customers.

The cost of the inventory of a proportionally consolidated company was determined until December 31, 1999 by the First In First out method. Starting in 2000, the cost was determined by the moving average method. The cumulative effect as at the beginning of the year due to the change of accounting method, is not material.

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 materials, sub-contractors, wages and financing expenses in the construction period, 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 the statement of operations 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) Real financing expense for loans and credit used for financing the construction or purchase of fixed assets is attributed, starting on January 1, 2000, to the cost of those assets, in accordance with Accounting Standard No. 3 – Capitalization of Credit Costs. See Note 9A.

(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.)

L. FIXED ASSETS (CONTD.)

The annual depreciation rates are:

	% depreciation	Until 1999	As of 1999
Buildings	4	4	4
Digital switching equipment	10	8.3	10
Transmission 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), which does not exceed the economic life of the asset.

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

M. DEFERRED EXPENSES AND 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. The cost of acquiring a subscriber for Internet services at Bezeq International Ltd. is amortized over the term of the subscriber's commitment, which is more than one year.

(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.

(4) Rights in channels

Rights in channels are amortized over the periods of lease, which are 5 and 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.)

N. DEFERRED TAXES (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. CAPITALIZATION OF CREDIT COSTS

The Company capitalizes credit costs in accordance with Standard No. 3 – Capitalization of credit costs, published in July 1999 by the Institute for Accounting Standardization.

This standard requires the capitalization of specific credit costs and credit costs which are not specific to qualified assets. Non-specific credit costs are capitalized to the investment or part thereof which was not financed by specific credit, at a rate which is the weighted average of the cost in respect of those credit resources whose cost was not specifically capitalized.
The provisions of this standard have been applied since January 1, 2000, and accordingly, credit costs attributed to assets under construction are capitalized until the date on which all activities preparing it for its intended use have been completed. See Note 9A.

Q. 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.

R. FOREIGN CURRENCY AND LINKAGE

Assets (excluding securities) and liabilities in or linked to foreign currency are stated at the representative exchange rates published by the 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.

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

R. FOREIGN CURRENCY AND LINKAGE (CONTD.)

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

	December 31, 2000	December 31, 1999	% of change 2000	% of change 1999	% of change 1998
CPI – in points	106.6	106.6	0.00	1.34	8.62
US dollar exchange rate $1 – in NIS	4.041	4.153	(2.69)	(0.17)	17.65
Euro exchange rate 1 Euro - in NIS	3.763	4.175	(9.87)	-	-

S. RESTATEMENT

The Company retroactively adjusted its financial statements for the year ended December 31, 1999 by way of restatement, so as to retroactively reflect therein, amendment of the accounting treatment of the capitalization of the costs of subscriber acquisitions in Pelephone Communications Ltd. - a proportionally consolidated company. In the original financial statements until 1999, Pelephone Communications Ltd. charged the costs of subscriber acquisitions to the statement of operations. Commencing with the financial statements for the year ended December 31, 1999 subscriber acquisition costs, including those in respect of years up to 1999, appear in the balance sheet within Other Assets and are depreciated over 36 months. Amended reports for the year ended December 31, 1999 were published on August 15, 2000.

(1) Effect on the Consolidated Balance Sheet as at December 31, 1999

	As previously reported*	Effect of restatement	As reported in these financial statements
	NIS thousands	NIS thousands	NIS thousands
Deferred and other expenses	255,230	2,278	257,508
Long-term liabilities – deferred taxes	19,362	821	20,183
Shareholders' Equity	7,256,533	1,457	7,257,990

(2) Effect on net earnings

	For the year ended December 31, 1999
	NIS thousands
Net earnings as previously reported	6,728
Effect of restatement:	
Increase in operating and general expenses	(8,698)
Decrease in income taxes	3,131
Cumulative influence of the change in accounting method as at beginning of year, net	7,024
	8,185

* Refers to the financial statements for the year ended December 31, 1999, published on March 28, 2000, prior to adjustment of the financial statements by way of restatement.

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

S. RESTATEMENT (CONTD.)

(3) Cumulative effect of the change in the accounting method

	For the year ended December 31, 1999
	NIS thousands
Cumulative effect of the change in accounting method as at beginning of year, gross	10,975
Less: tax effect	3,951
Net	7,024

(4) Effect of net earnings per NIS 1 par value

	For the year ended December 31, 1999
	NIS thousands
Net earnings per NIS 1 par value of shares, as previously reported	0.020
Net earnings per NIS 1 par value of shares, as reported in these financial statements	0.025

(5) Effect on the Company Balance Sheet as at December 31, 1999

	As previously reported*	Influence of restatement	As reported in these financial statements
	NIS thousands	NIS thousands	NIS thousands
Investments in investee companies	1,479,571	1,457	1,481,028
Shareholders' Equity	7,256,533	1,457	7,257,990

(6) Effect on net earnings

	For the year ended December 31, 1999
	NIS thousands
Net earnings as previously reported	6,728
Effect of restatement:	
Decrease in the company's share in losses of investee companies	1,457
	8,185

* Refers to the financial statements for the year ended December 31, 1999, published on March 28, 2000, prior to adjustment of the financial statements by way of restatement.

T. EARNINGS PER SHARE

Earnings per share are calculated in accordance with Opinion No. 55 of the ICPAI. 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.)

U. 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 which are not expected to be converted are included as liabilities at their liability value. Debentures which are expected to be converted are included between the items Long term liabilities and Shareholders' equity, at liability value or capital value, whichever is the higher.

V. ISSUE TO EMPLOYEES

The benefit component in respect of an issue to employees (as well as in respect of the offer for sale 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.

NOTE 3 - CASH AND CASH EQUIVALENTS

	Consolidated		Company	
	December 31, 2000	December 31, 1999	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Israeli currency	810,969	641,462	802,487	483,463
Foreign currency	721,913	22,775	719,355	2,699
	1,532,882	664,237	1,521,842	486,162

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

NOTE 4 - SHORT-TERM INVESTMENTS

	Consolidated		Company	
	December 31, 2000	December 31, 1999	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Marketable securities:				
Government debentures				
Linked to the CPI	55,508	56,584	53,353	56,584
Linked to the U.S. dollar exchange rate	11,981	8,604	10,486	8,604
Unlinked	39,820	35,834	29,457	35,834
Debentures convertible to shares	5,164	5,828	4,853	5,828
Other debentures	25,021	14,258	24,294	14,258
Mutual fund participation certificates	25,216	179,704	21,933	173,349
	162,710	300,812	144,376	294,457
Short-term bank deposits				
Linked to the CPI	24,254	-	24,000	-
Unlinked	1,405	328	-	-
	188,369	301,140	168,376	294,457

NOTE 5 - TRADE RECEIVABLES

	Consolidated		Company	
	December 31, 2000	December 31, 1999	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
In respect of domestic services:				
On open account	1,155,031	1,184,220	615,617	791,111
Income receivable	278,352	411,363	218,716	358,162
Credit cards and checks payable	126,795	103,404	89,825	86,159
Investee companies	983	712	8,024	2,419
In respect of international services	164,042	170,032	16,673	20,079
	1,725,203	1,869,731	948,855	1,257,930
Less provision for doubtful debts	352,422	346,887	220,505	249,784
	1,372,781	1,522,844	728,350	1,008,146

NOTE 6 - OTHER RECEIVABLES AND DEBIT BALANCES

	Consolidated		Company	
	December 31, 2000	December 31, 1999	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Deferred tax asset (see Note 11D)	186,161	234,152	162,264	214,377
Income tax refundable	223,382	185,768	187,341	139,804
Prepaid expenses	20,165	21,540	5,271	6,202
Other receivables and debit balances	46,260	41,062	31,520	27,665
	475,968	482,522	386,396	388,048

NOTE 7 - INVESTMENTS, DEPOSITS AND DEBIT BALANCES

	Consolidated		Company	
	December 31, 2000	December 31, 1999	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Bank deposit for granting loans to Employees (1)	220,536	257,492	220,536	257,492
Investment in venture capital funds	19,083	-	19,083	-
Investment in a company that is not an investee company	4,392	-	4,392	-
Long term receivables(2)	45,484	18,251	-	-
	289,495	275,743	244,011	257,492

(1) The deposit is unlinked and the average weighted monthly interest rate is approximately 0.3%. The Company is responsible for the loans to the employees. Withdrawal of the deposit is contingent upon repayment of the loans.

(2) Long-term receivables is calculated less the income of deferred interest which comprises the difference between the amount of the original debt and its present value on the date of recognition of

the income. Present value is calculated at an effective interest rate of approximately 12% per annum.

NOTE 8 - INVESTMENTS IN INVESTEE COMPANIES

A. COMPOSITION:

	Consolidated		Company	
	December 31, 2000	December 31, 1999	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Affiliated companies				
Investment in shares -				
Cost	116,255	115,134	62,391	115,134
Post-acquisition losses	(209,343)	(49,957)	(194,037)	(49,957)
Provision for decrease in value	-	(43,480)	-	(43,480)
Amortization of surplus equity over cost attributed to goodwill	(3,168)	-	(563)	-
	(96,256)	21,697	(132,209)	21,697
Other investments -				
Long-term loans (1)	268,932	53,801	265,998	53,801
	172,676	75,498	133,789	75,498
Consolidated companies				
Shares -				
Cost			354,326	354,326
Post-acquisition earnings (losses)			(141,505)	53,258
			212,821	407,584
Proportionally consolidated company				
Shares -				
Cost			253,657	253,657
Post –acquisition earnings			649,461	707,347
Amortization of surplus equity over cost attributed to fixed assets			36,942	36,942
			940,060	997,946
			1,286,670	1,481,028

	Consolidated		Company	
	December 31, 2000	December 31, 1999	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Balance of surplus equity over cost not yet amortized, attributed to goodwill	35,484	5,919	4,767	5,919

(1) The loans are linked to the CPI, bear no interest and have no due date.
(2) The market value of an affiliated company traded on the stock exchange as at December 31, 2000 was NIS 25.3 million. The book value of the investment was approximately NIS 38 million.

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

NOTE 8 - INVESTMENTS IN INVESTEE COMPANIES (CONTD.)

B. INVESTMENT ACTIVITY IN 2000 WAS AS FOLLOWS (NOT INCLUDING LONG-TERM LOANS):

	Consolidated	Company
	NIS thousands	NIS thousands
Balance as at the beginning of the year	21,697	1,427,227
Movement during the year:		
Investment in shares	86,305	32,319
Realization of investment	(32,383)	(32,383)
Equity in losses	(195,159)	(429,775)
Forfeiture of guarantees for an affiliated company	23,284	23,284
Balance as at the end of the year	(96,256)	1,020,672

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

	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands
Current assets	559,389	416,046
Other assets	1,786,913	1,490,359
Current liabilities	1,040,039	595,941
Long-term liabilities	401,655	384,497

	For the year ended December 31		
	2000	1999	1998
	NIS thousands	NIS thousands	NIS thousands
Revenues	1,660,826	1,159,855	1,162,601 *
Costs and expenses	1,758,125	1,333,107	937,516 *

* 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 establishment 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 273 million Indian rupees (approximately NIS 24 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 preventing 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

On September 5, 2000 the Company signed an agreement for the sale and transfer of its holdings in the joint company in India (16% of the share capital). By December 31, 2000, the Company had received the full consideration for the sale of its holdings. The financial statements include a pre-tax capital gain of approximately NIS 139 million from this sale.

F. PELEPHONE COMMUNICATIONS LTD. ("PELEPHONE")

(1) 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 considered the reports findings, and concluded, on the basis of explanations and clarification 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 professional, economically-sound manner in accordance with the Government decisions referred to above. This position of the Board of Directors was conveyed to the Government Companies Authority. As of the date of publication of these financial statements, the Government Companies Authority has 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 connection with 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 of the meeting the Minister of Finance decided that the Government would make no claim against the Company in matters of this transaction and that the Legal Counsel 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, whether directly or through of the Company, and that the Ministry of Justice would relate to said legal opinion. As at 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.)

F. PELEPHONE COMMUNICATIONS LTD. ("PELEPHONE") (CONTD.)

(2) In September 2000 notice was received from Motorola Israel Ltd. ("Motorola"), informing the Company of negotiations between Motorola and a third party for the sale of its holdings in Pelephone. Under the Pelephone shareholders agreement, if one party to the agreement wishes to sell its shares in Pelephone, it must offer them to the other party, and the other party is entitled, inter alia, to propose an alternative offeree to buy the shares. On November 22, 2000, the Board of Directors of the Company selected an alternative offeree to buy the shares of the other shareholder, with which an option agreement would be signed.

On February 27, 2001, after approval of the Ministry of Communications and the Anti-Trust Commissioner, the transaction was closed. The main points of the transaction are these:

a. Motorola's shares in Pelephone were transferred to a corporation registered in the USA in consideration of 591 million dollars. The consideration was partially financed by a loan of 240 million dollars extended by the Company, for which it received convertible debentures for up to four years, for 80% of the shares of the alternative offeree.

b. The Company was given a call option to purchase the remaining 20% of the share capital of the alternative offeree together with conversion of the debentures to shares as aforesaid ("the Options).

c. The Company can exercise the Options within six months of the date of purchase of the shares ("the Short Option") or starting from the end of 24 months from the date of purchase of the shares until the elapse of four years from the date of the purchase ("the Long Option").

d. The exercise price of the Short Option is return of the nominal investment plus 8 million US dollars, and of the Long Option is the higher of return of the nominal investment or a valuation of the holdings of the alternative offeree in Pelephone at full dilution.

G. EMITEL TELECOMMUNICATION CORP. LTD.

In December 2000, Aphrodite B.V. ("Aphrodite"), which is indirectly held by the Company (66.7%), signed an agreement for the sale of all its holdings in Emitel. In consideration, Aphrodite will receive a sum calculated according to a stipulated formula and which will not be less than 46.5 million US dollars. Closing of the transaction is contingent upon receipt of approvals from the Hungarian Minister of Communications (granted in February 2001) and from the Hungarian Anti-Trust Authority, which has not yet been granted. The indirect investment in Emitel is recorded in the Company's books of account at equity value, and amounts to approximately NIS 41 million as at December 31, 2000. If the sale is executed, the Company can expect to include in its financial statements for 2001 a pre-tax capital gain of approximately NIS 84 million.

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

The Company holds 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. DBS foresees considerable losses and negative cash flow from operations in the first years of its activities. Its losses in 2000 amounted to NIS 544 million (adjusted), which has led to an increase in its working capital deficit to NIS 960, million (including NIS 493 million in short-term bank credit – see below). The sources of finance for DBS's operations are shareholders' loans and bank credit. On August 1, 2000, DBS signed a memorandum of terms with banks, which indicates the terms and stipulations likely to be included in a financing agreement between them and under which the banks will be willing to consider consenting in principle to participate in the financing of DBS's operations. The memorandum states, inter alia, preconditions for withdrawing funds from the credit line, including an undertaking by DBS to comply with cumulative milestones.

NOTE 8 - INVESTMENTS IN INVESTEE COMPANIES (CONTD.)

H. D.B.S. SATELLITE SERVICES (1998) LTD. (contd.)

The memorandum also states: "If the financing agreement is not signed by September 30, 2000, this memorandum shall not be valid." In the period from October 1, 2000 to the date of signing the financial statements, the signatory banks to the above memorandum made another NIS 156 million of credit available to DBS. DBS estimates that the delay in signing a financing agreement is technical, and does not harm its continued engagement with the banks in the manner defined in the memorandum.

The Company has presented the banks with a continuing guarantee for payment of the debts of DBS, up to 30% of the value of DBS as derives from disposal of the pledged shares of the other shareholders. If the Company participates in a sale as part of disposal of the pledged shares of the other shareholders, the amount of the guarantee will not exceed the consideration which the Company will receive from the sale of its shares in DBS. The deed of guarantee includes numerous restrictions on the Company in disposing of the shares it holds, and specifies infringing events which enable the banks to foreclose on the guarantee.

According to a decision of the Ministerial Committee for Privatization on January 21, 2001, the maximum cumulative exposure of the Company in connection with this investment shall at no time exceed the rate of the Company's actual holding in DBS, multiplied by $400 million (approximately NIS 1.6 billion). The Committee also approved an increase of the Company's holding in DBS to 50% of DBS's share capital, the approval being contingent upon amendment of the Telecommunications Regulations or the Telecommunications Law in the matter of limitations on a holding of the means of control in DBS by anyone who is a controlling interest in a broadcasting franchise. This term has not yet been met.

In July 2000, DBS completed the development stage and started to provide its customers with multi-channel satellite broadcasting services. The Company's investment in DBS as at the date of the balance sheet was approximately NIS 260 million. The Company's equity in the cumulative loss of DBS was approximately NIS 188 million, of which approximately NIS 164 million were recorded in the year ended December 31, 2000.

I. AGREEMENT FOR THE ESTABLISHMENT OF AN INVESTEE COMPANY

On March 16, 2000, a proportionally consolidated company signed an agreement for the establishment of GoNext Ltd. ("GoNext"). The main part of GoNext's activities focuses on setting up a mobile internet portal. The proportionally consolidated company holds 51% of the shares of GoNext. The consolidated financial statements include consolidation of the financial reports of GoNext, in which the proportionally consolidated company is the controlling interest.

NOTE 9 - FIXED ASSETS

A. COMPOSITION AND ACTIVITY

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, 2000	2,059,654	14,333,044	10,560,957	678,786	361,605	757,623	28,751,669
Additions	44,003	992,167	248,496	112,931	38,844	265,769	1,702,210
Disposals (2)	(13,520)	(922,155)	(40,713)	(218,716)	(76,996)	(139,836)	(1,411,936)
Balance as at December 31, 2000	2,090,137	14,403,056	10,768,740	573,001	323,453	883,556	29,041,943
Accumulated depreciation							
Balance as at January 1, 2000	1,001,556	7,670,712	6,479,928	414,671	188,773	339,581	16,095,221
Depreciation allocation	89,758	1,635,586	614,848	128,720	51,079	180,295	2,700,286
Elimination upon disposals (2)	(11,304)	(916,412)	(32,261)	(201,981)	(70,058)	(139,766)	(1,371,782)
Provision for decrease of value (3)	-		-	-	-	11,013	11,013
Balance as at December 31, 2000	1,080,010	8,389,886	7,062,515	341,410	169,794	391,123	17,434,738
Depreciated value -							
As at December 31, 2000	1,010,127	6,013,170	3,706,225	231,591	153,659	492,433	11,607,205
As at December 31, 1999	1,058,098	6,662,332	4,081,029	264,115	172,832	418,042	12,656,448

NOTE 9 - FIXED ASSETS (CONTD.)

A. COMPOSITION AND ACTIVITY (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, 2000	2,008,692	11,736,284	10,450,183	622,360	320,767	505,687	25,643,973
Additions	32,891	532,724	193,604	102,177	29,038	120,266	1,010,700
Disposals (2)	(10,881)	(910,383)	(35,713)	(185,758)	(73,083)	(140,693)	(1,356,511)
Balance as at December 31, 2000	2,030,702	11,358,625	10,608,074	538,779	276,722	485,260	25,298,162
Accumulated depreciation							
Balance as at January 1, 2000	986,332	6,328,318	6,435,365	402,217	174,998	246,383	14,573,613
Depreciation allocation	84,556	1,276,551	607,722	111,628	44,465	121,377	2,246,299
Elimination upon disposals (2)	(10,590)	(906,968)	(34,109)	(185,059)	(67,689)	(139,787)	(1,344,202)
Balance as at December 31, 2000	1,060,298	6,697,901	7,008,978	328,786	151,774	227,973	15,475,710
Depreciated cost -							
As at December 31, 2000	970,404	4,660,724	3,599,096	209,993	124,948	257,287	9,822,452
As at December 31, 1999	1,022,360	5,407,966	4,014,818	220,143	145,769	259,304	11,070,360

(1) Including NIS 2,305,000 (1999 - NIS 7,116,000) advance payments to suppliers 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 2000, fully depreciated fixed assets of a cost of approximately NIS 1,276 million (1999 - NIS 1,337 million) were written off the books.

(3) A consolidated company made a provision for a decrease in value of computer equipment and software based on a valuation made by professional consultants.

(4) The cost includes the amount of NIS 15,475,000 in the Company and NIS 30,723,000 consolidated, which constitutes real financing expenses in respect of loans and credit during the establishment period calculated at a real interest rate of approximately 7.4% per annum.

NOTE 9 - FIXED ASSETS (CONTD.)

B. Most of the real estate assets used by the Company were transferred to it by the State under an agreement dated January 31, 1984 and for the consideration stipulated therein. Some of these assets are leased for 49 years with an option for an extension for another 49 years, and some are rented for renewable periods of two years each.

As at the time of the preparation of the financial statements, the Company's rights in a considerable part of its real estate assets are not registered at the Lands Registry Office.

The Accountant General of the Ministry of Finance notified the Company on January 31, 1998 that the State intends to terminate the lease of those assets rented for the renewable two-year periods, and that the Ministry of Finance will examine the use actually made by the Company of each specific asset and will take appropriate action with respect to making alternative land available and the payment of the relocation expenses. The Company's management opposed implementation of such demand. In May 1999, representatives of the Company and the Israel Lands Administration held a meeting in the presence of representatives of the Government Companies Authority at the office of the Attorney General. In summing up the meeting, the Attorney General decided that the Company could not carry out a public offering of its shares before clarification of the factual basis and the questions in dispute, so that the discussions could be held on the best way for settling the dispute. Further to the decision of the Ministerial Committee for Privatization of August 27, 2000 concerning the privatization of the Company, the Attorney General confirmed, in February 2001, the description of the land dispute which was then set forth in an immediate report issued by the Company. The description includes the positions of the parties in their own words, to which was attached a list of the properties which are the subject of the dispute. The main points of the Company's position are, *inter alia*, that it is entitled to receive rights of ownership or "quasi-ownership" in those assets which are rented for renewable two-year periods. With regard to the leased part of the assets, the Company also believes that it is entitled to ownership rights or rights of lease for the maximum period that the State could offer. The State does not agree to these claims of the Company, and asserts, *inter alia*, that it is authorized, with notice to the Company, to terminate the renewable rental, and in any case not to renew it. In the opinion of the State, the Company's refusal to accede to the demands of the State has harmed and continues to harm the State's ability to make financially sound and efficient use of the land, and as an example the State mentions the value of two assets which, according to its preliminary estimates, are worth (together) approximately $440 million. On the leased assets, the State's position is that the Company's rights therein are rights of lease as stipulated in the agreements signed by the parties on this matter. It s noted that the parties negotiated in the past in an attempt to settle the various disputes on this matter, but were unsuccessful in reaching in a settlement. At present, the intention is to bring the dispute to court for settlement.

C. As at the balance sheet date, commitments exist for the purchase of fixed assets (mainly switching equipment) in the amount of approximately NIS 439 million on a consolidated basis and approximately NIS 315 million for the Company.

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.

Pursuant to the decision, starting from January 1, 1999, the depreciation rates of a number of fixed assets recorded in the Company's books was changed. Among these items are the switching systems, for which the depreciation rate was raised to 10% (instead of 8.33%), and the Company's network, for which the depreciation rate was raised to 5% (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.

E. Following cancellation of the agreement of the Company with a software supplier who undertook to develop a billing system and the Company's notice of foreclosure of bank guarantees given to it by the supplier, the parties took a number of legal steps.

NOTE 9 - FIXED ASSETS (CONTD.)

E. CONTD.

As a result, the financial statements as at December 31, 1999 recorded a provision of approximately NIS 107 million for decrease in value of the investment, and an expense of approximately NIS 20 million in respect of compensation which as paid to a sub-contractor in the project due to termination of the project.

On September 21, 2000 the Company signed a settlement agreement with the software supplier, whereby the software supplier paid the Company approximately NIS 3.7 million in addition to the amounts of the guarantees foreclosed by the Company, $19.8 million. The parties waived all their claims without admitting any liability. The financial statements include revenues of approximately NIS 100 million in respect of the amounts received.

NOTE 10 - DEFERRED AND OTHER EXPENSES

Consolidated

			Balance for depreciation	
	Cost	Accumulated depreciation	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Capitalized subscriber acquisition costs	559,111	207,758	351,353	241,709
Rights in channels	5,169	830	4,339	-
Representation rights in a communications corporation	3,550	1,331	2,219	2,574
	567,830	209,919	357,911	244,283
Expenses for issue of debentures and raising loans			15,285	13,225
Minority rights of proportionately consolidated company			4,893	-
			378,089	257,508

Company

	Balance for depreciation	
	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands
Deferred expenses		
Expenses for issue of debentures and raising loans	15,285	13,225

NOTE 11 - TAXES ON INCOME

A. GENERAL

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

The asset component demanded by the Company as an expense for tax purposes, is allocated directly to shareholders' equity.

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

B. INCOME TAX (TAX BENEFIT) INCLUDED IN THE STATEMENT OF OPERATIONS

Consolidated

	For the year ended December 31		
	2000	1999	1998
	NIS thousands	NIS thousands	NIS thousands
Current taxes	175,821	(9,597)	302,352
Deferred taxes	(322,824)	71,356	175,411
Taxes for prior years, net	(6,320)	(2,094)	13,467
	(153,323)	59,665	491,230

Company

	For the year ended December 31		
	2000	1999	1998
	NIS thousands	NIS thousands	NIS thousands
Current taxes	169,252	1,085	179,147
Deferred taxes	(301,574)	70,139	185,917
Taxes for prior years, net	(6,470)	(845)	9,233
	(138,792)	70,379	374,297

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

Consolidated

	For the year ended December 31		
	2000	**1999**	**1998**
	NIS thousands	**NIS thousands**	**NIS thousands**
Tax computed at the regular tax rates (*)	(184,437)	29,656	449,562
Increase (savings) in tax liability due to:			
Inflationary erosion of advance tax payments	(67)	1,174	14,226
Exempt income and capital gains	(48,012)	(14,470)	(5,404)
Non-deductible expenses	13,008	12,127	14,077
Losses in respect of which a deferred tax asset was not created	59,108	30,983	1,056
Timing differentials for which no tax assets were created	11,678	(1,107)	(1,261)
Taxes for prior years, net	(6,320)	(2,094)	13,467
Other	1,719	3,396	5,507
	(153,323)	59,665	491,230
(*) Regular tax rates	36	36	36

Company

	For the year ended December 31		
	2000	**1999**	**1998**
	NIS thousands	**NIS thousands**	**NIS thousands**
Tax computed at the regular tax rates (*)	(92,983)	65,678	338,022
Increase (savings) in tax liability due to:			
Inflationary erosion of advance tax payments	(65)	694	10,364
Exempt income and capital gains	(47,993)	(8,221)	(2,470)
Non-deductible expenses	9,589	9,360	14,700
Taxes for prior years, net	(6,470)	(845)	9,233
Other	(870)	3,713	4,448
	(138,792)	70,379	374,297
(*) Regular tax rates	36	36	36

NOTE 11 - TAXES ON INCOME (CONTD.)

D. DEFERRED TAXES

	Consolidated		Company	
	December 31, 2000	December 31, 1999	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Activity -				
Balance at beginning of year	451,706	531,817	463,193	536,077
Charged to statement of operations for the year	322,824	(72,177)	301,574	(70,139)
Charged to investment in consolidated company	-	-	-	(2,745)
Charged to income tax refund for prior years	45,177	-	45,177	-
Charged to statement of operations for prior years	(14,631)	(7,934)	(14,631)	-
Balance as at end of year	805,076	451,706	795,313	463,193
Composition of deferred taxes -				
Difference between the adjusted value of fixed assets and their value for income tax purposes	(203,993)	(138,852)	(168,429)	(108,740)
Adjustment of materials and spare parts	(179)	(2,025)	(72)	(969)
Deferred tax due to losses	140,908	-	-	-
Differences in the recognition of expenses relating to employee Rights, doubtful debts and other	868,340	592,583	963,814	572,902
Total	805,076	451,706	795,313	463,193
Classified as follows:				
As part of current assets	186,161	234,152	162,264	214,377
As part of other assets	633,347	237,737	633,049	248,816
As part of long-term liabilities	(14,432)	(20,183)	-	-
Total	805,076	451,706	795,313	463,193

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 approximately NIS 662,929,000 (1999 - NIS 100,195,000). 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 244,991,000 (1999 - NIS 100,195,000).

The net book value of the buildings for tax purposes exceeds its net book value in the financial statements (Company) by NIS 65,619,000 (1999 - NIS 64,652,000; 1998 - NIS 62,009,000). No deferred tax asset in respect of these differences was included in the financial statements.

NOTE 11 - TAXES ON INCOME (CONTD.)

E. FINAL TAX ASSESSMENTS

(1) The Company has received final tax assessments (prescribed) up to and including the year 1993. A proportionally consolidated company has received final tax assessments up to and including 1994, and a final tax assessment (prescribed) has been agreed up to 1996. The other principal investee companies have not received tax assessments since the dates of their establishment.

(2) In December 1999, tax assessments were issued to the Company (outside the agreement) by the large companies tax assessor, in respect of 1994. According to that assessment, the Company must pay additional taxes in the amount of approximately NIS 425 million, including interest and CPI-linkage. Most of the additional tax liability derives from a capital gain from the sale of equipment to Pelephone Communications Ltd. in exchange for an allotment of 50% of Pelephone's shares to the Company. The Company is disputing the assessment and has filed an objection to the demand.

In August 2000 the Company and the tax assessor reached an agreement relating to some of the issues which arose in the audits for 1995-1998, while for the other issues a disputed assessment was issued, to which the Company objected in January 2001. It was also agreed that further to the Company's application and the consent of the Income Tax Authority of August 7, 2000 to increase the depreciation rates which the Company can legitimately claim in respect of subscriber equipment for the years 1995-1998, the tax assessor will examine the amended reports filed by the Company and will reduce the Company's tax liability according to his findings. In the amended reports the Company claims additional depreciation amounts which far exceed the additional tax liabilities in the aforementioned assessments. The agreement is subject to the approval of the tax assessor.

The above proceedings, including the assessment for 1994 and the objection thereto, are still in progress. In the Company's opinion, based on that of its legal advisors who are handling the matter, the Company has good arguments against most of the assessment. At this stage, it is not possible to estimate the outcome of the proceedings. No provision was made in the financial statements in respect of the tax assessments.

(3) In September 2000, Bezeq Call Ltd. (an inactive company) received an assessment according to best judgment for the year 1997, in which its taxable income was increased to approximately NIS 30 million as a result of determination by the tax assessor of the consideration from the sale of Bezeq Call's business to Bezeq Call Communications Ltd. The Company has filed an objection to the assessment, in which it absolutely rejects the determination. It is not possible, at this stage, to estimate the final outcome of these proceedings. No provision was made in the financial statements in respect of this 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	Consolidated		Company	
		December 31, 2000	December 31, 1999	December 31, 2000	December 31, 1999
	%	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Unlinked loans	8.25 - 8.60	716,136	271,006	-	-
Dollar-linked loans	6.7	19,006	-	-	-
		735,142	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 was made on April 1, 2000.

NOTE 14 - LONG-TERM LOANS

A. COMPOSITION

	Consolidated		Company	
	December 31, 2000	December 31, 1999	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Banks	3,109,381	4,188,482	2,638,529	3,747,197
Pension fund	98,607	111,337	98,607	111,337
Others	7,711	-	-	-
Supplier credit	2,257	3,361	-	-
	3,217,956	4,303,180	2,737,136	3,858,534
Less -				
Current maturities from banks	377,587	1,053,418	317,495	983,615
Other current maturities	15,585	13,158	14,913	12,822
	2,824,784	3,236,604	2,404,728	2,862,097

NOTE 14 - LONG-TERM LOANS (CONTD.)

B. LINKAGE TERMS AND INTEREST

		Consolidated		Company	
	Interest rate	December 31, 2000	December 31, 1999	December 31, 2000	December 31, 1999
	%	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Loans in foreign currency US dollar(*)	LIBOR + 0.35-0.5	2,011,373	2,972,362	2,011,373	2,868,536
Loans linked to the CPI	3.6 - 8.2	1,070,265	1,219,481	627,156	878,661
	6.1	98,607	111,337	98,607	111,337
		1,168,872	1,330,818	725,763	989,998
Unlinked loans	9.45	37,711	-	-	-
		3,217,956	4,303,180	2,737,136	3,858,534

(*) 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

December 31	Consolidated NIS thousands	Company NIS thousands
2002	1,172,758	978,088
2003	485,388	427,887
2004	445,474	388,255
2005	563,737	517,704
2006 and thereafter	157,427	92,794
	2,824,784	2,404,728

D. SECURITY

(1) The long-term loan agreements of the Company, aggregating NIS 1,707,156,000 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 the Company's affairs.

- In respect of loans aggregating NIS 606,150,000, 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 1,101,006,000 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 303,075,000, upon occurrence of an event which also allows other loans of the Company to be made available for early repayment.

NOTE 14 - LONG-TERM LOANS (CONTD.)

D. SECURITY (CONTD.)

- 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 proportionally 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 437,005,000. 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, 2000 and as at December 31, 1999 amounted to NIS 14,318,000 and NIS 12,878,000 respectively. The expenses are stated net of accumulated amortization in the amount of NIS 9,529,000 and NIS 6,183,000 respectively.

NOTE 15 - OTHER DEBENTURES

A. COMPOSITION AND TERMS

		Consolidated and Company	
	Interest Rates	December 31, 2000	December 31, 1999
	%	NIS thousands	NIS thousands
CPI-linked debentures issued to the public:			
Debentures Series 1 (1)	4.5	262,409	327,704
Debentures issued to the public:			
Linked to the euro (2)	6.5	1,121,869	-
Debentures issued to financial institutions and others:			
CPI-linked	5.1	992,387	1,151,433
		2,376,665	1,479,137
Less - current maturities		224,590	225,517
		2,152,075	1,253,620

(1) The outstanding balance of the debentures is NIS 79,801,157 par value (1999 - NIS 99,751,438 par value).
(2) The outstanding balance of the debenture is 300,000,000 euro par value.

NOTE 15 - OTHER DEBENTURES (CONTD.)

B. REPAYMENT SCHEDULE

	NIS thousands
2002	184,117
2003	194,366
2004	194,985
2005	130,038
2006 and thereafter	1,448,569
	2,152,075

C. SECURITY

The debentures are not secured, except for a nominal 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, 2000 amounts to approximately NIS 925,439,000, are entitled to demand the immediate repayment of the debentures if the State's holdings in the share capital of the Company falls below 26% (see Note 1).

The Company has made a negative pledge in favor of the holders of the euro-linked debentures issued to the public.

D. ISSUE EXPENSES

The deferred expenses with respect to the issue of the debentures amounted to NIS 29,265,000 (1999 – NIS 21,581,000), and are stated net of amortization of NIS 18,769,000 (1999 - NIS 17,416,000).

NOTE 16 - TRADE PAYABLES

	Consolidated		Company	
	December 31, 2000	December 31, 1999	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Suppliers of goods and services(*)	1,046,214	1,156,038	465,896	654,624
Current maturities of long-term supplier credit	672	336	-	-
	1,046,886	1,156,374	465,896	654,624
(*) Including foreign currency balances	423,116	373,568	15,804	14,183
Including subsidiaries	-	-	1,994	4,470
Including a proportionally consolidated company	16,041	46,682	32,082	93,364

NOTE 17 - LIABILITY FOR EMPLOYEE SEVERANCE BENEFITS

A. COMPOSITION

	Consolidated		Company	
	December 31, 2000	December 31, 1999	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Provision for early retirement (see D below)	1,544,375	351,185	1,544,375	351,185
Compensation for unutilized sick leave (see E below)	47,723	79,375	47,723	79,375
	1,592,098	430,560	1,592,098	430,560
Provision for severance pay	17,023	11,447	-	-
Less - reserve in compensation fund	(12,750)	(12,359)	-	-
	4,273	(912)	-	-
	1,596,371	429,648	1,592,098	430,560
Stated as follows:				
Among current liabilities	344,780	351,185	344,780	351,185
Among long-term liabilities	1,251,591	78,463	1,247,318	79,375
	1,596,371	429,648	1,592,098	430,560

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 liabilities. The accumulated amounts 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. The costs of retirement of such employees is included in the provision to early retirement plans, as described below.

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

D. EARLY RETIREMENT PLANS

(1) Under a special collective agreement for retirement, signed on November 23, 1997 between the Company and the workers' representatives, 2,050 employees retired from the Company up to December 31, 1999.

(2) As part of the plan for organizational change in the Company, which was approved by the Board of Directors in March 2000, between December 31, 1999 and December 31, 2000, 353 employees retired from the Company, and another 177 are scheduled to retire by March 31, 2001. These financial statements include a provision of approximately NIS 75 million for adjustment of the expected cost of the retirement plan to up-to-date retirement data.

(3) In the wake of privatization of the Company and the opening of the market to competition, additional workforce changes will become necessary at the Company; accordingly, the Company reached agreement with the workers' representatives in September 2000, to extend the early retirement collective agreement from 1997. The new arrangement states that from April 1, 2001 to December 31, 2006 (with an option to extend the final retirement date for certain employees to December 31, 2008), another 1,770 employees will take early retirement. Furthermore, pursuant to the agreement, the Company's management will be able to dismiss employees under a compensation arrangement over and above the number stated in the agreement.

The financial statements include an expense of approximately NIS 1,371 million in respect of the expected cost of implementation of this plan. The Company's management estimates that the possibility of additional employees retiring under a compensation arrangement is slight, and accordingly, no provision was made therefore in the financial statements.

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, 2000	December 31, 1999	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
The Government of Israel in respect of royalties, interest and fees	194,341	193,356	146,307	146,553
Wages and salaries (1)	199,376	178,712	156,413	156,834
Provision for vacation pay	91,508	94,987	83,458	87,700
Government agencies	72,724	35,133	58,614	29,266
Accrued interest	103,583	80,158	100,312	77,247
Forward exchange contracts	34,351	19,992	34,351	19,620
Other accrued expenses	116,906	106,721	64,122	80,406
Current maturities in respect of prepaid income	44,758	56,886	26,453	36,900
Provision for claims in respect of Salary and pension components	109,832	59,832	109,832	59,832
	967,379	825,777	779,862	694,358
(1) Includes current maturities of a long-term loan from a pension fund	14,913	12,822	14,913	12,822

NOTE 19 - DEFERRED REVENUES

Deferred revenues consists mainly of receipts in respect of making infrastructures available for the use of outside entities and from compensation in respect of a purchase agreement with a proportionally consolidated company.

NOTE 20 - CONVERTIBLE DEBENTURES

The debentures registered in name were issued pursuant to a prospectus from February 1998. The issued par value of the debentures 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. In addition, under the same prospectus, options were issued which can be exercised for a convertible debenture, where the par value of the debentures converted from the options is NIS 74,992,200. The debentures will mature, if not converted into shares, on February 28, 2001. During the reporting period, 147,652,429 par value of debentures were converted and in exchange, 14,590,161 ordinary shares of a par value of NIS 1 were issued. From then, to the last date for conversion, another 59,754,681 par value of debentures were converted and in exchange, 5,904,613 ordinary shares of a par value of NIS 1 were issued. The balance of the debentures, 560,735 par value, have matured.

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 certification of a class action against the State of Israel and against the Company, alleging the lack of required disclosure and inclusion 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 rejected 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 stricken 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 in his own name. 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 such 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 held that the extent of the damage of the members of the group should 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 managers 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 1998 the Attorney General gave notice of his involvement 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. Negotiations are in progress between the Company and the workers' representatives, with the aim of reaching an arrangement which will end the dispute. A provision is made in the financial statements based on an arrangement proposed by the Company's management.

(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 Anti-Trust 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 the Company's and Bezeq International's 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 approximately NIS 900 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 30, 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 chances 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. Differences are also claimed in respect of holding back of wages for these amounts. 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 prospects for this claim. No provision is made in the financial statements in respect of this claim.

The opinion of the Attorney General was filed in the case, and supports the position of the Government Companies Authority that no obligation exists to pay senior employees the wage increment. 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 Government 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 accede 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 such claim as a class action, against the Company, Bezeq International, the Chairman of the Board of Bezeq 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 its reduced tariffs. The amount of the class action is estimated by the plaintiffs at approximately NIS 50 million. In December 1997, the Company was stricken from the claim.

Bezeq International and its legal advisers are unable, at this stage, to estimate the chances of the claim and/or its possible effect on the business of Bezeq International, and therefore no provision is made in the financial statements in respect of this claim.

(7) 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 questions are liable to have a broad impact. In the opinion of the Company's 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 of the claims for the Company. Accordingly, no provision is made in the financial statements in respect of these claims.

(8) Prior to the opening of the market to competition, the subsidiary Bezeq International Ltd. lowered its tariffs to several destinations for registered subscribers. Following that action, the Anti-Trust Commissioner started an investigation which determined, on November 1997, that the subsidiary had unfairly exploited its status by adopting a misleading policy in connection with the tariffs it collects. The Commissioner determined however, that this is not an instance of predatory pricing. On December 22, 1997, following an approach by the Ministry of Communications, the Commissioner announced that at that stage, and based upon the investigation material, he does not intend to initiate criminal proceedings against the subsidiary or its officers. On December 23, 1997 the subsidiary filed an objection to the Commissioner's determination in the Anti-Trust Tribunal, with regard to exploitation of market status by misleading the public. On July 20,

NOTE 21 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS (contd.)

2000, the Tribunal allowed the subsidiary's application to terminate the objection without possibility of renewal.

(9) 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 switchboards and exchanges for network end points.

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 accompanying services by Tadiran and Telrad to the Company; and the network end point exchanges.

According to the Commissioner, the Authority investigators recommend that indictments be obtained against some of those who were investigated concerning some of the suspicions which 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 end points 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 equipment in tenders. It is suspected that these undertakings, or some of them, 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 restricted by the aforementioned arrangement from 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, the element of secrecy constitutes not only proof that the relevant parties knew they were involved in an offense, but also indicates aggravated circumstances for this 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 restrictive business arrangements and attempted offenses in the field of network end point equipment, between Bezeq Call Communications, Telrad and Tadiran. Among others, suspicions are raised of restrictive business arrangements 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 end 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 end 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 end point exchanges.

The Anti-Trust Law, 5748-1988, forbids engagement as a party to a restrictive business arrangement 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.

In November 2000, a communication was received from a Company shareholder, demanding that the Company take legal action against the vendors and stating that in his opinion, the Company had incurred losses of approximately NIS 400 million as a result of the restrictive business arrangement. The shareholder reserves the right to file a derivative claim pursuant to Section 194 of the Companies Law. The Company responded to the communication that it is following the developments in the matter, and that it had requested the investigation material from the Anti-Trust Commission, and that it would formulate its position based on the decision of the Anti-Trust Commission and its findings, if any.

(10) In March 1999 a claim was filed against the Company by a group of employees who were employed as temporary workers at 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. In the hearing of the Company's application to dismiss the action *in limine*, the parties reached an agreement regarding partial dismissal and a narrowing of the claim in respect of some of its components, following which, exposure decreased in respect of the claim.

The questions raised in this claim are liable to have a broad impact on the Company. However, in view of the above agreements, exposure has been materially reduced. 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.

(11) 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 violated its undertakings 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. 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 chances of the claim. Accordingly, no provision is made in the financial statements in respect of this claim.

NOTE 21 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS (contd.)

(12) On February 23, 2000, two former employees of the Company filed a monetary 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 violated various undertakings toward them which were included in the prospectus of the Company published in 1991, including undertakings 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 which 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 which was published in 1998 contained misleading details and representations, and material documents which should 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. The Company and the State have filed, separately, preliminary applications for dismissal of the claim *in limine* for no case to answer and expiry under the statute of limitations.

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

(13) In October 1999, 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 Pelephone's status as a monopoly and exploitation of distress and misleading consumers. If the action shall be recognized as a class action, the amount claimed is estimated at approximately NIS 12.3 billion.

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

(14) In March 2000, 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 34.5 million. In the opinion of Pelephone's management, based on the opinion of its legal advisers and on an outside opinion, the claim is unlikely to succeed. Accordingly, no provision is made in the financial statements in respect of this claim.

(15) In July 2000 a class action and application for approval as a class action were filed against the Company. According to the plaintiffs, the Company collected money unlawfully from its subscribers for certain services which it provides. The claim is for approximately NIS 903 million. In the opinion of the Company's legal advisors, the Company has good arguments against the application and against the claim; nevertheless, the Company is unable to estimate the chances that the application for approval will be allowed. No provision is made for this claim in the financial statements.

NOTE 21 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS (contd.)

(16) In April 2000, a company which provides cable television broadcasts filed a claim against the Company in which it petitions for a permanent mandamus for enforcement of an agreement to upgrade its cable network and alternatively, to enable it to carry out the works itself or through a contractor, alleging that as a result of work disruptions by the Company's employees, the upgrade works were interrupted, which constitutes breach of contract. In the opinion of the Company's legal advisors, the Company has good arguments against the application for the permanent mandamus.

(17) On August 10, 2000, the Company received a letter from a representative of the Anti-Trust Commissioner, stating that according to information which had reached the Commissioner, there was prima facie evidence that the Company was taking actions, in connection with its preparations for providing ADSL services, which are liable to constitute violations of provisions in the Anti-Trust Law, 5748-1988 ("the Law"). The alleged actions relate to agreements between the Company and its dealers (agents) for ADSL services. Accordingly, the Company is required to give its preliminary response to the allegations, and to submit to the Commissioner various information and documents. From the Company's initial investigation it transpires that the above-mentioned suspected violation of the Law, taking into consideration that it relates to a trial and to agreements with dealers who are actually agents, is exaggerated and unjustified. The Company submitted its comments on the allegations, as well as information and documents as requested, and later received, on November 16, 2000, a letter from the representative of the Anti-Trust Commissioner, stating that in their opinion, even after consideration of the Company's response, the suspicion of violation of the Law still exists, and that the Company is required to cancel all the agreements with the dealers and notify them accordingly. The Company is firm in its position that the suspicion is unjustified. Nevertheless, the Company is examining ways to handle the matter, *inter alia,* in view of the final approval of the ADSL service file, which could make the agreements with the dealers irrelevant.

(18) In August 2000, a class action together with an application for approval as a class action, was filed against the Company in the amount of approximately NIS 60 million, including VAT. The plaintiff alleges that the Company unlawfully collected payment differentials from its subscribers, for the fixed fee for use of the telephone line. The requested reliefs are two – declaratory, whereby the Court is requested to declare that the Company collected the payment differentials unlawfully, and "operative – financial", for reimbursement of said amounts. The Company rejects the plaintiff's allegations and alleges that its method of charging meets the criteria of the law, reasonableness and justice. In the Company's opinion, relying on its legal advisors, the chances of the claim's success cannot be estimated a this stage. No provision was made in the financial statements in respect of this claim.

(19) In September 2000, a declaratory claim was filed against the Company in the Jerusalem Labor Court, by 2,423 pensioners of the Company, former employees, who were transferred from the Ministry of Communications to the Company upon its establishment. The plaintiffs are requesting from the Labor Court declaratory relief which will determine that the payments they received for grossing up of tax, clothing allowance and incentive pay are normal pay for work which should be seen as part of their regular wage for calculating their pension and the payments made to them upon retirement. The plaintiffs are also seeking declaratory relief which will determine that their last determining salary for the pension should be calculated according to the last salary which was paid to each of them for the last month of work, and not according to the average rank which each of them held. The Company has filed a preliminary application for dismissal of the claim in limine, to which the plaintiffs have not yet responded. In the opinion of the Company, relying on the opinion of its legal counsel, the chances of the claim cannot be estimated at this stage. No provision was made in the financial statements in respect of this claim.

NOTE 21 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS (contd.)

(20) In September 2000, a class action and an application for approval as a class action were filed against the Company in an amount which is estimated at approximately NIS 103 million. According to the plaintiff, the Company unlawfully collected from its subscribers "collection expenses" for Company bills which were not promptly paid, before it had started any collection actions in connection with the plaintiff. The reliefs requested by the plaintiff are mainly two: declarative: – in which the Court is requested to declare that the collection of "collection expenses" by the Company in the instances described in the claim was unlawful, and that the Company may not continue to collect such expenses in the future, and "operative – financial", for reimbursement of said amounts. In January 2001 the Company filed its response to the application for approval of the class action, in which it alleges that the claim does not meet the criteria of the law and states that it rejects the plaintiff's interpretation of the regulations governing collection of bills, claiming to have acted lawfully. The plaintiff has filed his reply to the Company's response and date has been set for hearing the application. The legal advisors of the Company are unable, at this stage, to estimate the chances of the claim. No provision was made in the financial statements in respect of this claim.

(21) In September 2000 a class action and application for approval as a class action was filed against the Company in an amount estimated at more than NIS 750 million. According to the plaintiffs, the Company unlawfully collected from its subscribers a fixed payment for the lease of telephones which the Company made available to them, so they allege, after the telephones were supplied to subscribers without a specific lease agreement being made, without disclosure and proper publication of the fact that the telephones were given in a "lease" agreement unlimited in time, and also concerns the amount of the "lease fee" demanded and the duration of collection of the "lease fee" even after the date of which the Company's subscribers had paid the "lease fees" in an amount equal to the full revalued value of the telephones supplied. The plaintiffs further allege that the Company collected "lease fees" unlawfully in that it did not give its subscribers the choice of whether to "lease" or purchase the telephones and in that it did not inform them of the option to cease payment of the fixed lease fee in exchange for a lump-sum payment which of itself, according to the plaintiffs, is unlawful. The relief requested by the plaintiffs is mainly financial, for reimbursement of the aforesaid amounts. The legal advisors of the Company are unable, at this stage, to estimate the chances of the claim. No provision was made in the financial statements in respect of this claim.

In addition, on November 21, 2000 the Company received a class action and application for approval as a class action in an amount estimated at approximately NIS 240 million. This action makes similar allegations to those of the action described above from September 2000. The Company is studying the claim and is unable, at this stage, to assess its chances.

The plaintiffs have filed a request for consolidation of the two actions described above.

(22) In September 2000 a class action and application for approval as a class action were filed against the Company, Bezeq International Ltd. and the other international communications operators. The amount of the claim, according to the action, cannot be calculated accurately, and is estimated to be in excess of the competence of the Magistrate's Court, which is currently one million shekels.

According to the plaintiffs, starting on October 20, 1998, the Company unlawfully collected 17% VAT for part of collect calls received by its subscribers in Israel originating outside Israel, in contravention of the VAT law and its regulations and in violation of a legislated duty in a manner which breaches existing agreements, acting in bad faith in the fulfillment of such contracts and with negligent conduct. The plaintiffs further allege against the international operators and the collection of VAT in respect of calls which were made abroad to Israel using phone cards. The plaintiffs estimate the total loss incurred by the plaintiffs, as a group, due to the unlawful collection of VAT for all calls made from abroad to Israel in the relevant period (since October 20, 1998) at millions of shekels per year.

NOTE 21 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS (contd.)

The reliefs requested by the plaintiffs are mainly two – declaratory, in which the court is requested to declare that each of the defendants violated its obligations under the agreement between it and each member of the group of plaintiffs, and financial, for restitution of said amounts, compensation for the loss incurred by the members of the group in the aforesaid amounts. The legal advisors of the Company are unable, at this stage, to estimate the chances of the claim. No provision was made in the financial statements in respect of this claim.

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

In the opinion of the management of Pelephone, based on the opinions of its outside legal advisors, Pelephone has a genuine defense against the claim, the amount of which is also deemed to be highly exaggerated.

On March 11 ,2001 Pelephone filed a defense and a counter-claim relating to the State's claim for payment of royalties for the above period. In the counter-claim, Pelephone claims reimbursement of NIS 66 million in respect of an advance payment it made to the State as a goodwill gesture for reaching a settlement in 1996, a payment which was contingent upon the State not suing Pelephone for royalties.

The claim includes sums in respect of the period January – October 1994, for which the Company also received a demand to pay royalties, even though in the Company's opinion the royalties for that period were already paid by the Company as part of a settlement arrangement with the State in November 1995.

(24) In February 2001 a class action and application for approval as a class action were filed against the Company, as well as an application for a temporary injunction. The amount of the claim is not stated, but according to the action, the accumulated loss for the entire group in whose name the plaintiff has filed suit, is estimated at "millions of shekels".

According to the plaintiff, the "Light Net" track, which is one of the tracks in the alternative basket of payments introduced on May 1, 2000, is actually a "default" from the aspect of the customer, since it is an offer which contains nothing but a benefit to the customer.

The plaintiff alleges that since May 1, 2000, when the new tariffs took effect, until the end of June, the Company charged subscribers who did not select one of the Internet tracks, for calls to the Internet according to the Light Net track as if it were the "regular" tariff for connecting to the Internet. Therefore, according to the plaintiff, from July 1, 2000 and onwards the Company should have continued to apply the Light Net tariff to all subscribers who did not choose another track. The plaintiff alleges that the charge in the months May – June 2000 constitutes deception, as well as representation of the Company, on the basis of which the subscriber altered his or her situation for the worse, and therefore, according to the plaintiff, the Company is bound by the alleged representation. In this, according to the plaintiff, the Company violated the provisions of Section 2(a) of the Consumer Protection Law.

The Company is studying the claim and is unable, at this stage, to estimate its chances.

NOTE 21 - CONTINGENT LIABILITIES (CONTD.)

A. CLAIMS (contd.)

(25) A claim and application for recognition as a class action which were filed against the Company in the matter of the Company's advertising campaign about the advantages of using a fixed-line telephone rather than a cellular telephone (which was estimated by the plaintiff in the amount of approximately NIS 57 million), ended in an arrangement (at nominal cost to the Company) between the parties which was confirmed by the Supreme Court, which stipulated, *inter alia*, that the Company's advertising campaign did not mislead the public. As part of the arrangement, the Company acceded, for its part, to devote part of its sponsorships for humanistic purposes.

In addition, the claim and application for recognition as a class action which were filed against the Company, a proportionally consolidated company and another cellular communications company, concerning the collection of payment for airtime for voice mail services or "call forwarding" services" to the Company's network (estimated by the plaintiff at approximately NIS 2 billion), was dismissed.

(26) In March 2001, a petition was filed in the Supreme Court against the Minister of Communications, the Company and the three cellular operators, in which the petitioner is requesting, *inter alia*, that the Court order the Minister of Communications and the Company to provide a blocking service for every Company telephone-line subscriber against outgoing calls to the area codes of the mobile telephones as a positive default. The Court has transferred the petition for the response of the respondents. The Company is studying the petition and is unable, at this stage, to estimate its chances and implications.

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

(28) In the matter of the notice of the Accountant General at the Ministry of Finance on the subject of the end of the period of two-year renewable rental of assets, see Note 9B.

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

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

(31) 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 beyond the amounts included in the financial statements.

The amounts of the claims referred to above are adjusted (without interest) in terms of shekels of December 31, 2000.

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, 2000, the Company contracted to purchase approximately US $302 million (approximately NIS 1,222 million) for which it will pay approximately NIS 1,249 million linked to the CPI, and approximately 40 million euros (approximately NIS 152 million), for which it will pay approximately NIS 144 million linked to the CPI. The contracts mature on various dates, the last of which is May 2002. The Company also contracted to purchase approximately US $205 million (approximately NIS 828 million), for which it will pay approximately NIS 844 million at predetermined rates, and approximately 70 million euros (NIS 263 million), for which it will pay approximately NIS 258 million at predetermined rates, and approximately NIS 187 million for which it will pay approximately NIS 189 million.

NOTE 21 - CONTINGENT LIABILITIES (CONTD.)

C. Lease Contract Commitments

For the year ended December 31	Consolidated NIS thousands	Company NIS thousands
2001	113,833	77,441
2002	119,445	73,838
2003	108,344	64,922
2004	95,496	54,636
2005	91,314	50,820
2006 onwards	460,284	384,187
	988,716	705,844

D. COMMITMENT OF A SUBSIDIARY FOR THE CREATION OF A JOINT VENTURE

The subsidiary Bezeq International Ltd. entered into an agreement of principles on January 30, 2001 with TyCom Networks Ltd. ("TyCom"), one of the world's leading international providers, for communications systems and services, including capacity and sub-marine optical fibers.

The agreement of principles addresses the establishment of a joint venture for laying and operating a system of undersea optical fibers in the eastern Mediterranean Basin as part of TyCom's global network ("TGN"), at a total cost of approximately 390 million dollars. The investment of Bezeq International in the project will be approximately 20%. Bezeq International has an option to increase its investment, on certain terms, to 33% of the joint venture.

According to the agreement of principles, the parties are to take steps toward the signing of a detailed agreement within 60 days of the date of signature of the agreement of principles.

E. Securities and Liens

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

For guarantees given by the Company for its investments in D.B.S. Satellite Services (1998) Ltd., see Note 8H.

NOTE 22 - SHARE CAPITAL

The share capital consists of ordinary shares of a par value of NIS 1 each. The registered capital – 835,000,000 shares. The issued and paid up capital – 797,981,233 shares (1999 – 783,391,072 shares). All the shares are listed on the Tel Aviv Stock Exchange.

The General Meeting which convened on November 22, 2000 resolved to approve the recommendation of the Board of Directors of the Company to increase the registered capital of the Company by approximately NIS 1.6 billion of ordinary shares and to distribute bonus shares in the amount of approximately 1.6 billion shares, so that in respect of each shares of a par value of NIS 1, two bonus shares of a par value of NIS 1 each will be distributed. For this purpose, it was resolved to capitalize undesignated earnings to a reserve fund which will be earmarked for the distribution of bonus shares, and to authorize the Board of Directors to issue those bonus shares. In January 2001, approval was received from the Ministerial Committee for Privatization for the increase of the registered capital for allotment of the bonus shares. The increase in the registered capital and the allotment of the bonus shares as aforesaid, were implemented in February 2001.

NOTE 23 - REVENUES FROM TELECOMMUNICATION SERVICES

Consolidated

	For the year ended December 31		
	2000	1999 *	1998 *
	NIS thousands	NIS thousands	NIS thousands
Revenues from telephone services -			
Domestic fixed-line communications	2,525,700	2,750,493	3,305,647
Cellular telephone (1)	2,145,539	2,837,589	2,677,852
Fixed fees	1,988,651	1,819,036	1,573,652
International communications and Internet services	846,370	903,885	1,132,091
Installation and sale of equipment to subscribers	496,269	479,170	505,651
Other	140,389	141,440	76,389
	8,142,918	8,931,613	9,271,282
Other revenues	259,321	223,108	269,230
	8,402,239	9,154,721	9,540,512

Company

	For the year ended December 31		
	2000	1999 *	1998 *
	NIS thousands	NIS thousands	NIS thousands
Revenues from telephone services -			
Domestic fixed-line communications	2,546,617	2,765,344	3,315,010
Cellular telephone (1)	842,491	1,983,563	1,821,376
Fixed fees	1,882,363	1,669,119	1,405,872
International communications and Internet services	388,467	444,369	540,088
Installation and sale of equipment to subscribers	211,283	235,377	261,013
Other	144,122	143,736	80,324
	6,015,343	7,241,508	7,423,683
Other revenues	236,922	217,312	257,186
	6,252,265	7,458,820	7,680,869

(1) See Note 1E(1).

* Reclassified.

NOTE 24 - OPERATING AND GENERAL EXPENSES

Consolidated

	For the year ended December 31		
	2000	1999 *	1998 *
	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses	1,676,182	1,671,130	1,878,920
Cellular telephone expenses (1)	509,729	1,364,926	1,090,993
General expenses	680,319	730,017	556,391
Services and maintenance by sub-contractors	398,104	470,703	429,486
Building maintenance	388,660	396,693	379,547
Materials and spare parts	418,101	285,766	288,559
International communications expenses	251,065	264,601	456,213
Vehicle maintenance expenses	72,599	65,457	62,980
Collection fees	39,008	42,115	43,075
	4,433,767	5,291,408	5,186,164
Less - salaries charged to investment in fixed assets	149,933	159,870	171,306
	4,283,834	5,131,538	5,014,858

Company

	For the year ended December 31		
	2000	1999	1998 *
	NIS thousands	NIS thousands	NIS thousands
Salaries and related expenses	1,312,659	1,393,014	1,660,797
Cellular telephone expenses (1)	302,838	1,497,174	1,300,636
General expenses	233,649	256,117	231,443
Services and maintenance by sub-contractors	340,715	415,237	386,408
Building maintenance	343,891	354,149	342,999
Materials and spare parts	39,021	51,433	59,597
International communications expenses	12,145	18,751	27,993
Vehicle maintenance expenses	62,412	59,936	58,763
Collection fees	38,783	41,464	42,461
	2,686,113	4,087,275	4,111,097
Less - salaries charged to investment in fixed assets	149,933	159,870	171,306
	2,536,180	3,927,405	3,939,791

(1) See Note 1E(1)

* Reclassified

NOTE 25 - FINANCING EXPENSES TO BANKS AND OTHERS, NET

Consolidated -

	For the year ended December 31		
	2000	1999	1998
	NIS thousands	NIS thousands	NIS thousands
Financing expenses for a debenture issued to the State of Israel	4,881	56,060	101,695
Expenses in respect of long-term liabilities (*)			
Debentures	118,766	82,668	69,876
Loans	172,416	212,984	520,876
	296,063	351,712	692,447
Income in respect of deposits and investments	(66,000)	(73,606)	(42,230)
Expenses (income) in respect of forward exchange contracts	102,223	111,182	(181,705)
Short-term bank credit	35,769	14,972	-
Other income, net	(24,823)	(44,188)	(12,698)
	343,232	360,072	455,814
(*) Includes increase in value (net of erosion) Of liabilities in foreign currency	(50,006)	(33,276)	265,994

Company -

	For the year ended December 31		
	2000	1999	1998
	NIS thousands	NIS thousands	NIS thousands
Financing expenses for a debenture issued to the State of Israel	4,881	56,060	101,695
Expenses in respect of long-term liabilities (*)			
Debentures	118,766	82,668	69,876
Loans	153,543	193,815	495,804
	277,190	332,543	667,375
Income in respect of deposits and investments	(66,000)	(73,606)	(3,318)
Expenses (income) in respect of forward exchange contracts	102,223	111,182	(181,705)
Other income, net	(19,074)	(5,432)	(4,750)
	294,339	364,687	477,602
(*) Includes increase in value (net of erosion) of liabilities in foreign currency	(47,006)	(35,329)	242,466

NOTE 26 - OTHER INCOME (EXPENSES), NET

Consolidated -

	For the year ended December 31		
	2000	1999	1998
	NIS thousands	NIS thousands	NIS thousands
Provision for employee severance benefits upon early retirement (Note 17D)	(1,446,463)	(398,340)	202,317
Compensation (provision) for the billing system (Note 9E)	99,131	(126,772)	-
Provision for claims for salary and pension components	(50,000)	-	(88,497)
Provision for unutilized sick leave (1)	-	9,767	(60,805)
Provision for decrease in value of fixed assets	(11,013)	-	(14,623)
Direct expenses for the customer allocation process	(27,690)	(75,561)	-
Capital gains (losses), net	1,341	16,391	4,686*
Capital gain from sale of an affiliate (Note 8E)	138,737	-	-
Cancellation of provision for a guarantee for an affiliate	23,306	14,919	-
Others	(4)	1,138	(316)
	(1,272,655)	(558,458)	42,762

Company

	For the year ended December 31		
	2000	1999	1998
	NIS thousands	NIS thousands	NIS thousands
Provision for employee severance benefits upon early retirement (Note 17D)	(1,446,463)	(398,340)	202,317
Compensation (provision) for the billing system (Note 9E)	99,131	(126,772)	-
Provision for claims for salary and pension components	(50,000)	-	(88,497)
Provision for unutilized sick leave (1)	-	9,767	(60,805)
Provision for decrease in value of fixed assets	-	-	(14,623)
Capital gains, net	2,657	17,454	13,027*
Capital gain from sale of an affiliate (Note 8E)	138,737	-	
Cancellation of provision for a guarantee for an affiliate	23,306	14,919	-
Others	(225)	202	-
	(1,232,857)	(482,770)	51,419

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

* Reclassified

NOTE 27 - EARNINGS PER SHARE (CONSOLIDATED AND COMPANY)

	For the year ended December 31		
	2000	1999	1998
	NIS thousands	NIS thousands	NIS thousands
Primary and diluted earnings (loss)	(544,327)	20,324	766,149
Weighted number of shares in primary earnings and diluted earnings (1)	2,411,826	2,411,826	2,308,833

In order to determine the likelihood of conversion of the convertible debentures and calculate earnings per share, the present value for 2000 was calculated assuming possible exercise of the convertible debentures at a shekel interest rate after tax of 7%.

(1) Calculation of earnings per share takes into account the bonus share component, as explained in Note 22.

NOTE 28 - BUSINESS SECTORS

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 operations segments of those companies.

For the year ended December 31, 2000

	Fixed-line domestic communications	**Cellular telephone**	**International communications**	**Others**	**Adjustments**	**Consolidated**
	NIS thousands	**NIS thousands**	**NIS thousands**	**NIS thousands**	**NIS thousands**	**NIS thousands**
Revenues						
Revenue from outside sources	5,911,946	1,667,822	667,254	155,217	-	8,402,239
Inter-segment revenues	340,319	53,246	4,434	30,837	(428,836)	-
Total revenues	6,252,265	1,721,068	671,688	186,054	(428,836)	8,402,239
Segment results	1,268,911	(28,912)	(148,886)	12,286	163	1,103,562
Financing expenses						343,232
Earnings after financing expenses						760,330
Other expenses, net						(1,272,655)
Loss before income tax						(512,325)
Tax benefit						153,323
Loss after income tax						(359,002)
Equity in earnings (losses) of affiliates	(12,096)			(183,063)		(195,159)
Minority equity in losses of a subsidiary						4,893
Net loss						(549,268)
Identified assets	12,299,132	2,294,075	635,023	89,166	(55,438)	15,261,958
Investment by equity method	100,467			72,209		172,676
General assets						1,535,787
Total consolidated assets						16,970,421
Segment liabilities	2,451,910	924,727	501,089	49,389	(53,598)	3,873,517
General liabilities						6,135,530
Total consolidated liabilities						10,009,047
Capital investments	1,010,700	816,349	129,857	8,157		
Depreciation and						

amortization	2,246,299	529,967	74,407	4,445

NOTE 28 - BUSINESS SECTORS (CONTD.)

	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						
Revenue 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	63,568	(59,773)	14,649	(47,435)	1,000,906
Financing expenses						(360,072)
Earnings after financing expenses						640,834
Other expenses, net						(558,458)
Earnings before income tax						82,376
Income tax						(59,665)
Earnings after income tax						22,711
Equity in earnings (losses) of affiliates	5,382			(26,932)		(21,550)
Earnings before cumulative influence of the change in accounting method						1,161
Cumulative effect as at beginning of year of change in accounting method, net		7,024				7,024
Net earnings						8,185
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						1,250,680
Total consolidated assets						16,815,135
Segment liabilities	1,433,503	520,425	385,098	52,863	(89,533)	2,302,356
General liabilities						7,021,090
Total consolidated liabilities						9,323,446
Capital investments	1,064,167	771,853	105,347	7,290		
Depreciation and amortization	2,293,311	436,060	48,174	3,714		

NOTE 28 - BUSINESS SECTORS (CONTD.)

	For the year ended December 31, 1998					
	Fixed-line domestic communication	Cellular telephone	International communication	Others	Adjustments	Consolidated
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Revenues						
Revenue 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	76,944	(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 amortization	2,127,913	337,617	40,952	2,992		

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, (the exemption for the year 2000 is dated February 4, 2001) 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 which arose between the Company and the Ministry of Defense in connection with the terms of the services which 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, 1997.

(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.

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.

The Company and the Ministry of Defense are negotiating a revised arrangement of their commercial relations.

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 53 million.

The Company signed a deed of guarantee in connection with the debts of an affiliate to a bank in the amount of NIS 10 million. The guarantee is valid until December 31, 2010.

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

In connection with an additional guarantee in respect of the Company's investments in D.B.S. Satellite Services (1998) Ltd., see Note 8H.

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

D. TRANSACTIONS WITH INVESTEE COMPANIES (Company)

	For the year ended December 31		
	2000	1999	1998
	NIS thousands	NIS thousands	NIS thousands
Revenues -			
Interconnect and access fees	297,711	419,337	478,567
Services, royalties and commissions	190,732	59,527	42,265
Rent and usage of buildings and equipment	9,782	896	20,312
Interest	-	-	970
Management fees	-	-	5,652
Expenses -			
Purchase of services	142,865	672,516	691,112
Interest	-	14,630	-
Total earnings (losses) from fixed asset transactions	(444)	963	2,256
Total transaction turnover	568	1,590	4,776

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

E. BENEFITS FOR DIRECTORS AND THE CEO

	For the year ended December 31		
	2000	1999	1998
	NIS thousands	NIS thousands	NIS thousands
Total cost of compensation of the CEO and the Chairman of the Board	1,172	1,512	1,251
Number of employees	2	3	2
Balance of loans to the CEO and the Chairman of the Board	-	-	8
Compensation of members of the Board of Directors who are not Company employees*	1,382	1,243	1,294
Number of directors receiving compensation	17	13	14

* The compensation for directors in a proportionally 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 up to 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 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 2,750,091,000, of which the excess of current liabilities is approximately NIS 231,614,000. 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, 2000, the excess of CPI-linked monetary liabilities over CPI-linked monetary assets amounted to approximately NIS 2,159,335,000, of which the excess of current liabilities is approximately NIS 211,771,000. 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 financial derivatives, which are intended solely for purposes of hedging.

Regarding the Company's commitments to execute forward exchange contracts, at December 31,2000 - see Note 21B.

B. CREDIT RISKS

Most of the cash and cash equivalents, at December 31, 2000, 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 is invested in debentures of companies trading on the 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, customers, 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, 2000	
	Book value NIS thousands	**Fair value NIS thousands**
Debentures:		
Issued to the public	1,384,278	1,321,329
Issued to others	992,387	744,886
CPI-linked loans	1,168,872	1,128,036

The fair value of the debentures issued to the public is based on their market price. 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, 2000

Consolidated

	In foreign currency or linked thereto	CPI-linked	Unlinked	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Assets				
Cash and cash equivalents	721,913	-	810,969	1,532,882
Short-term investments	12,187	89,491	86,691	188,369
Trade receivables	144,142	4,533	1,224,106	1,372,781
Other receivables and debit balances	18,629	222,823	28,190	269,642
Long-term deposits and other debit balances	-	9,859	256,161	266,020
	896,871	326,706	2,406,117	3,629,694
Liabilities				
Short-term bank credit	19,006	-	716,136	735,142
Current maturities of long-term liabilities	151,537	450,640	-	602,177
Trade payables	423,116	-	623,770	1,046,886
Other current liabilities	71,598	77,978	773,045	922,621
Long-term loans	1,859,836	927,237	37,711	2,824,784
Other long-term debentures	1,121,869	1,030,206	-	2,152,075
Liabilities for employee severance benefits	-	-	1,596,371	1,596,371
	3,646,962	2,486,061	3,747,033	9,880,056

Company

	In foreign currency or linked thereto	CPI-linked	Unlinked	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Assets				
Cash and cash equivalents	719,355	-	802,487	1,521,842
Short-term investments	10,692	87,336	70,348	168,376
Trade receivables	1,773	-	726,577	728,350
Other receivables and debit balances	18,629	186,782	13,450	218,861
Long-term bank deposits and debit balances	-	-	220,536	220,536
	750,449	274,118	1,833,398	2,857,965
Liabilities				
Current maturities of long-term liabilities	151,537	390,548	-	542,085
Trade payables	15,804	-	450,092	465,896
Other current liabilities	71,598	77,978	603,833	753,409
Long-term loans	1,859,836	544,892	-	2,404,728
Other long-term debentures	1,121,869	1,030,206	-	2,152,075
Liabilities for employee severance benefits	-	-	1,592,098	1,592,098
	3,220,644	2,043,624	2,646,023	7,910,291

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

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 other debit balances	-	11,841	263,902	275,743
	195,057	268,530	2,527,207	2,990,794
Liabilities				
Short-term bank credit	-	-	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 loans	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 other 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 loans	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 32 - CONDENSED FINANCIAL STATEMENTS OF THE COMPANY IN NOMINAL VALUES

A. BALANCE SHEETS

	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands
Assets		
Current assets	2,804,982	2,177,728
Materials and spare parts	184,983	228,557
Long-term deposits and debit balances	244,027	257,492
Investment in investee companies	1,143,339	1,278,945
Fixed assets	7,097,316	7,579,662
Other assets	864,730	401,369
	12,339,377	11,923,753
Liabilities		
Current	2,132,623	3,681,818
Long-term	5,893,028	4,299,349
	8,025,651	7,981,167
Convertible debentures	68,092	233,699
Shareholders' equity	4,245,634	3,708,887
	12,339,377	11,923,753

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

B. STATEMENTS OF OPERATIONS

	For the year ended December 31		
	2000	1999	1998
	NIS thousands	NIS thousands	NIS thousands
Revenues from telecommunication services	6,237,202	7,369,982	7,276,454*
Costs and expenses			
Operating and general expenses	2,531,190	3,883,844	3,731,935*
Depreciation	1,482,947	1,422,078	1,255,005
Royalties to the Government of Israel	204,058	205,769	236,244
	4,218,195	5,511,691	5,223,184
Operating income	2,019,007	1,858,291	2,053,270
Financing expenses, net	289,522	416,655	1,019,630
Earnings after financing expenses	1,729,485	1,441,636	1,033,640
Other expenses, net	1,227,500	464,378	25,036*
Earnings before taxes on income	501,985	977,258	1,008,604
Tax benefit (income tax)	213,762	44,455	(262,346)
Earnings after income tax	715,747	1,021,713	746,258
Company's equity in earnings (losses) of investee companies	(364,188)	(48,562)	252,054
Net earnings	351,559	973,151	998,312

* Reclassified

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

C. STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

	Share capital	Receipts from the issue of option warrants	Capital reserves(*)	Accumulated deficit	Total
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Balance as at January 1, 1998	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	-	-	-	973,151	973,151
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	(275,022)	3,708,887
Net earnings	-	-	-	351,559	351,559
Tax benefit for shares to employees	-	-	21,841	-	21,841
Capitalization of undesignated earnings to a reserve fund for the distribution of bonus shares	-	-	1,600,000	(1,600,000)	-
Conversion of convertible debentures	14,590	-	148,757	-	163,347
Balance as at December 31, 2000	797,981	-	4,971,116	(1,523,463)	4,245,634

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

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

1. BEZEQ INTERNATIONAL LTD.

A. Balance sheets

	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands
Current assets	266,781	413,169
Investments	38,167	-
Fixed assets	359,684	314,224
Other assets	18,200	12,258
	682,832	739,651
Current liabilities	499,398	385,098
Long-term liabilities	32,740	-
Quasi-capital receipt	158,474	158,474
Shareholders' equity (deficit)	(7,780)	196,079
	682,832	739,651

B. Statements of Operations

	For the year ended December 31		
	2000	1999	1998
	NIS thousands	NIS thousands	NIS thousands
Revenues from international telecommunications services	671,688	719,423*	982,491*
Operating expenses	559,901	594,726	795,289
Gross profit	111,787	124,697	187,202
Marketing expenses	165,388	111,422	61,506
General and administration expenses	95,285	73,048*	94,649*
	260,673	184,470	156,155
Operating income (loss)	(148,886)	(59,773)	31,047
Financing income (expenses), net	(3,179)	36,075	37,072
Earnings (loss) after financing	(152,065)	(23,698)	68,119
Other expenses, net	(39,716)	(77,538)	(7,534)
Earnings (loss) before income tax	(191,781)	(101,236)	60,585
Tax benefit (income tax)	(1,620)	9,003	(26,660)
Earnings (loss) after income tax	(193,401)	(92,233)	33,925
Company's equity in losses of investee company	(10,458)	-	-
Net earnings (loss)	(203,859)	(92,233)	33,925

*Reclassified

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

2. PELEPHONE COMMUNICATIONS LTD. (CONSOLIDATED)

A. Balance sheets

	December 31, 2000	December 31, 1999
	NIS thousands	NIS thousands
Current assets	1,129,961	930,749
Long-term receivables	71,255	11,352
Investment in an investee company	1,440	-
Reserve for compensation fund, net	-	3,482
Fixed assets	2,862,967	2,575,434
Other assets, net	679,422	464,048
	4,745,045	3,985,065
Current liabilities	2,083,658	1,186,213
Provision for losses of investee company	-	3,978
Long-term liabilities	793,541	798,345
Shareholders' equity	1,867,846	1,996,529
	4,745,045	3,985,065

B. Statements of Operations

	For the year ended December 31		
	Consolidated	Company	
	2000	1999	1998
	NIS thousands	NIS thousands	NIS thousands
Revenues from cellular services, sales and services	3,442,135	2,975,126	3,011,278
Cost of cellular services, sales and services	2,876,330	2,390,434	2,173,625
Gross profit	565,805	584,692	837,653
Sales and marketing expenses	448,385	285,229	229,918
General and administration expenses	200,125	183,677	160,951
	648,510	468,906	390,869
Operating Income (loss)	(82,705)	115,786	446,784
Financing expenses, net	(98,001)	(65,745)	(29,586)
Other income (expenses), net	1,715	521	(5,156)
Earnings (loss) before income tax	(178,991)	50,562	412,042
Tax benefit (income tax)	51,441	(25,171)	(158,973)
Earnings (loss) after income tax	(127,550)	25,391	253,069
Minority interest in losses of a subsidiary	9,790	-	-
Company's equity in losses of investee companies	(10,923)	(3,978)	(1,128)
Earnings (loss) before cumulative effect of change in accounting method	(128,683)	21,413	251,941
Cumulative effect as at beginning of year of change in accounting method	-	14,047	-
Net earnings (loss)	(128,683)	35,460	251,941

	Percent of control and ownership as at	
	December 31, 2000	December 31, 1999
	%	%
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
Bezeq On Line Ltd. (3)	100	–
Proportionally Consolidated Company		
Pelephone Communications Ltd.	50	50
GoNext Ltd. (4)	25.5	–
Affiliated Companies		
The International Company for Underwater Cables Ltd. (5)	50	50
Goldnet Communications Services – registered partnership (6)	49	38
Emitel Telecommunication Corp. Ltd. (Hungary) (7)	33	33
Fascel Ltd. (India) (8)	–	16
D.B.S. Satellite Services (1998) Ltd. (9)	30	33
Infogate Online Ltd. (10)	29	29
Safe Com-Car Communication (hereinafter - Safe-Car)(11)	–	25.5
Walla! Communications Ltd.(12)	38.5	26
Eden Telecom Ltd. (11)	23	–

(1) Commencing July 1, 1997, the operations of both companies were merged and BezeqCall Ltd. ceased operations.

(2) The company ceased to operate on July 1, 1998. In 2000 the company decided on voluntary liquidation. The liquidation is subject to approval of the Ministerial Committee for Privatization.

(3) The company was founded in December 2000 and began operations in 2001.

(4) See Note 8I.

(5) 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 resolved upon voluntary liquidation as of March 31, 1999.

(6) Under the agreement between the partners, the Company increased its investment in the partnership to 49% during the year. In addition, under the agreement, the Company has an option to increase its share in the partnership by another 5%. Furthermore, the Company has an option to increase its shares in the partnership up to an additional 20%, while the other partners have an option to obligate the Company to increase its share as aforesaid. The option is valid until March 31, 2003.

(7) Indirect holding.

(8) See Note 8E.

(9) See Note 8H

(10) The Company is developing and supplying data communication services under the ASP concept, in which computers are linked in a broadband network to a central server from which various services are received.

(11) In October 2000 an agreement was signed between Pelephone Communications Ltd. and the other shareholders in Safe-Car Communication Ltd. ("Safe-Car"), and Eden Telecom Ltd. ("Eden") and its shareholders, whereby the operations of Safe-Car were merged with the operations of Eden by a transfer of net assets from Safe-Car to Eden. After the merger, Pelephone holds 22.95% of Eden. The main business of Eden is the locating of vehicles, similar to the business of Safe-Car.

Until October 2000, Pelephone held 51% of Safe-Car. The financial statements of Safe-Car were not consolidated since Pelephone was not the controlling interest or joint controlling interest, pursuant to the establishment agreement of the company, which stipulates that material resolutions require a 75% majority.

(12) On December 26, 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. ("Walla"). On January 3, 2000 the shares were transferred to the company in consideration of NIS 24.6 million. During 2000, Bezeq International increased its holding in Walla! So that at the balance sheet date, it holds 38.5% of the issued and paid up capital of Walla.

On December 31, 2000, Walla entered into an agreement with I.O.L. On line (2000) Ltd. ("IOL"), which stipulates that the shareholders of IOL will transfer all their shares to Walla in consideration of shares which will be allotted to them in Walla. After the said exchange of shares, Walla will transfer all its assets and liabilities to a company in its ownership and control ("the Merged Company") and will be wound up without liquidation. The agreement is subject to certain approvals.

On December 31, 2000, Bezeq International and Ha'aretz Newspaper Publishers Ltd. (which is the controlling interest in IOL) entered into an agreement which regulates the relations between them as shareholders in the Merged Company.

Furthermore, the agreement stipulates that the parties will act for the raising of ten million dollars in capital by the Merged Company by way of an issue of rights ("the Issue"). Each of the parties undertook to exercise all the rights offered to it in the Issue, if it is indeed made. In addition, it was agreed that if in the Issue, the Merged Company raises less than ten million dollars, Bezeq International undertakes to act for another issue of rights, on similar terms, and to exercise in the additional issue all of the rights offered to it up to an investment ceiling of 6 million dollars. The shareholders agreement will take effect on the date on which the merger transaction is closed.