

November 9, 2014

# Quarterly report for the period ended September 30, 2014

- Update to Chapter A (Description of Company Operations) of the Periodic Report for 2013
- Directors report on the state of the Company's affairs for the period ended September 30, 2014
- Interim Financial Statements as at September 30, 2014



# **Update to Chapter A (Description of Company Operations) of the Periodic Report for 2013**



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

**Update to Chapter A (Description of Company Operations) <sup>1</sup>  
to the Periodic Report for 2013 ("Periodic Report")  
of "Bezeq" - The Israel Telecommunication Corporation Ltd. ("the Company")**

**1. Description of the general development of Bezeq Group's business**

**Section 1.1 - Bezeq Group activities and business development**

**Section 1.1.2 - Mergers and acquisitions - Merger of the Company and DBS, Section 1.6.2(D) - Limitations concerning the control of DBS, and Section 1.6.5(B) - Approvals and limitations as part of the transaction to acquire control of the Company**

On March 26, 2014, the Company received the decision of the Antitrust Authority stipulating that when the conditions listed in the decision are met, the limitations that were imposed on Eurocom Group with respect to its holdings in DBS will be cancelled and the merger between the Company and DBS will be permitted (in this section - "the Merger").

Hereunder are the key conditions for approval of the merger:

- The Company and any person associated with it (in this section - "Bezeq") will not impose any restriction on the use of fixed-line Internet infrastructure services stemming from the customer's cumulative surfing volume, and it may not restrict or block the possibility available to a customer to make use of any service or application provided on the Internet.<sup>2</sup>
- Bezeq will deduct amounts for providing multi-channel TV services from the payments of ISPs for connecting them to the Bezeq network.
- Bezeq will sell and provide Internet infrastructure services and TV services under equal conditions for all Bezeq customers (the sale of Internet infrastructure services as part of a bundle will not, in itself, be considered a sale under non-equal conditions).<sup>3</sup>
- Bezeq and DBS will cancel any exclusivity arrangements pertaining to productions that are not original productions and they shall not be party to any such exclusivity arrangements (except in relation to a third party which, on the date of the decision, has a broadcasting license). Furthermore, for two years from the approval date of the merger, Bezeq will not prevent any entity (excluding an entity that has a broadcasting license on the date of the decision) from acquiring rights in original productions (this does not apply to new productions).

The full text of the Antitrust Authority's decision appears in an Immediate Report of the Company dated March 26, 2014, presented here by way of reference.

Through the Board of Directors sub-committee which was set up to handle the issue, and with the help of external consultants selected by the committee, the Company is making progress in its review of the feasibility of the merger and the options available to it in light of the Commissioner's aforementioned decision and its conditions, including the purchase of DBS's shares that are held by Eurocom, as well as other options. As part of this review, the Company is conducting a due diligence of DBS with the help of external consultants.

At this point in time, as part of the review of the options available to the Company, the parties are discussing the possible acquisition of DBS shares that are held by Eurocom. There is no certainty that a transaction with Eurocom will actually be finalized, and even if it does, what the outline of the transaction and its conditions will be. If and insofar as subsequent to the completion of the review of feasibility of the merger and the options available to the Company, and completion of the negotiations with Eurocom, a decision is made to enter into a transaction to acquire Eurocom's DBS shares, such an acquisition may entail a significant financial expense for the Company, insofar as the transaction is paid for in cash.

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<sup>1</sup> The update is further to Regulation 39A of the Securities Regulations (Periodic and Immediate Reports), 1970, and includes material changes or innovations that have occurred in the corporation in any matter which must be described in the periodic report. The update relates to the Company's periodic report for the year 2013 and refers to the section numbers in Chapter A (Description of Company Operations) in the said periodic report.

<sup>2</sup> It is noted that as part of the approval of the merger between Partner Communications Ltd. and Hot Mobile Ltd. from May 22, 2014, a similar condition was determined which will apply to Hot Telecom Limited Partnership.

<sup>3</sup> It is noted that as part of the approval of the merger between Partner Communications Ltd. and Hot Mobile Ltd. from May 22, 2014, a similar condition was determined which will apply to Hot Telecom Limited Partnership.

The foregoing with respect to the potential ramifications of a possible transaction for the acquisition of DBS's shares that are held by Eurocom is forward-looking information. It should be emphasized that, as noted, at this point in time, the Company is reviewing the feasibility of the merger and the options open to it, and there is no certainty that the transaction will actually materialize and in what format, and/or that the relevant approvals required by law for execution of the transaction will be obtained.

### **Section 1.2 - Segments of operation**

On May 20, 2014, a transaction was completed between the subsidiary Walla! Communications Ltd. ("Walla") and Axel Springer Digital Classifieds Holding GmbH, a foreign media company incorporated in Germany, for the sale of all the share capital of Coral Tell Ltd. ("Coral Tell"), a private company fully controlled by the Company (indirectly, through Walla), which operates the Yad2 website. The full consideration in the amount of NIS 805 million was received upon completion of the transaction and Walla no longer holds any share capital in Coral Tell. The sale agreement signed by the parties on May 5, 2014 includes an undertaking by Walla and the Company not to engage in the areas of operation of Coral Tell for 24 months.. In view of the foregoing, the Company recorded pre-tax profit of NIS 582 million in its financial statements for the second quarter of 2014.

### **Section 1.3.3 - Dividend distribution**

For information about a dividend distribution in respect of profits from the second half of 2013 and in respect of profits from the first half of 2014, see Note 7 to the Company's Financial Statements for the period ended September 30, 2014.

**Section 1.4 - Financial information about Bezeq Group's segments of operation****Section 1.4.4 - Main results and operational data****A. Bezeq Fixed Line (the Company's operations as a domestic carrier)**

	Q3 2014	Q2 2014	Q1 2014	Q4 2013	Q3 2013	Q2 2013	Q1 2013
Revenues (NIS million)	1,081	1,073	1,077	1,101	1,127	1,121	1,129
Operating profit (NIS million)	498	471	504	459	494	510	535
Depreciation and amortization (NIS million)	178	172	168	174	174	168	167
EBITDA (Earnings before interest, taxes, depreciation and amortization) (NIS million)(1)	676	643	672	633	668	678	702
Net profit (NIS million)	324	314	332	312	360	351	348
Cash flow from operating activities (NIS million)	599	545	616	526	631	556	561
Payments for investments in property, plant & equipment and intangible assets (NIS million)	210	207	210	222	198	186	183
Proceeds from the sale of property, plant & equipment and intangible assets (NIS million)	69	42	28	90	48	124	42
Free cash flow (NIS million) (2)	458	380	434	394	481	494	420
Number of active subscriber lines at the end of the period (in thousands)(3)	2,205	2,205	2,214	2,216	2,223	2,224	2,242
Average monthly revenue per line (NIS) (ARPL)(4)	63	63	64	70	73	75	75
Number of outgoing minutes (in million)	1,588	1,522	1,608	1,742	1,712	1,805	1,788
Number of incoming minutes (in million)	1,501	1,428	1,467	1,541	1,521	1,550	1,503
Number of Internet subscribers at the end of the period (in thousands)	1,335	1,308	1,289	1,263	1,230	1,202	1,185
Average monthly revenue per Internet subscriber (NIS)	85	84	82	82	86	85	83
Average broadband speed per Internet subscriber (Mbps) (5)	24.0	21.9	20.0	18.1	17.3	15.2	10.4
Churn rate (6)	2.7%	2.8%	3.0%	3.1%	2.8%	3.5%	3.7%

- (1) EBITDA is a financial index that is not based on generally accepted accounting principles. The Company presents this index as an additional index for assessing its business results since this index is generally accepted in the Company's area of operations and adjusts for differences in the capital structure, various taxation issues and methods, and the depreciation period for fixed and intangible assets. This index is not a substitute for indices which are based on GAAP and it is not used as a sole index for estimating the results of the Company's activities or cash flows. Additionally, the index presented in this report is unlikely to be calculated in the same way as corresponding indices in other companies.
- (2) Free cash flow is a financial index which is not based on GAAP. Free cash flow is defined as cash from operating activities less cash for the purchase/sale of property, plant and equipment, and intangible assets, net. The Company presents free cash flow as an additional index for assessing its business results and cash flows because the Company believes that free cash flow is an important liquidity index that reflects cash resulting from ongoing operations after cash investments in infrastructure and other fixed and intangible assets.
- (3) Inactive subscribers are subscribers whose Bezeq lines have been physically disconnected (except for a subscriber during (roughly) the first three months of the collection process).
- (4) Excluding revenues from transmission services and data communications, Internet services, services to communications operators and contractor and other works. Calculated according to average lines for the period.
- (5) For plans with a range of speeds, the maximum plan speeds are taken into account.
- (6) The number of telephony subscribers who left Bezeq Fixed Line during the period divided by the average number of registered telephony subscribers in the period.

B. Pelephone

	Q3 2014	Q2 2014	Q1 2014	Q4 2013	Q3 2013	Q2 2013	Q1 2013
Revenue from services (NIS million)	610	622	637	688	710	696	714
Revenues from sale of terminal equipment (NIS million)	214	221	280	295	237	219	250
Total revenue (NIS million)	824	843	917	983	947	915	964
Operating profit (NIS million)	122	127	126	76	172	186	174
Depreciation and amortization (NIS million)	108	105	106	113	111	113	121
EBITDA (Earnings before interest, taxes, depreciation and amortization) (NIS million)(1)	231	232	232	188*	283	299	295
Net profit (NIS million)	100	106	108	67*	140	161	153
Cash flow from operating activities (NIS million)	286	420	349	327	442	468	354
Payments for investments in property, plant and equipment and intangible assets (NIS million)	83	85	73	77	88	84	66
Free cash flow (NIS million) (1)	203	335	276	250	354	384	288
Number of subscribers at end of the period (thousands) (2)	2,600	2,610	2,631	2,642	2,683	2,702	2,741
Average monthly revenue per subscriber (NIS) (ARPU) (3)	78	79	80	86	88	85	86
Churn rate (4)	7.3%	6.5%	7.5%	8.3%	6.2%	6.9%	7.2%

\* After adjustment for non-recurring expenses resulting from the implementation of the collective labor agreement detailed in Section 3.9.2 of the Description of Company Operations in the 2013 reports, which also includes increased severance pay as specified in Section 3.9.6 of the same report, Pelephone's EBITDA and net profit in Q4 2013 amounted to NIS 249 million and NIS 109 million respectively.

- (1) Regarding the definition of EBITDA and free cash flows, see comments (1) and (2) in the Bezeq Fixed Line table.
- (2) Subscriber data include Pelephone subscribers (without subscribers from other operators hosted on the Pelephone network) and does not include subscribers connected to Pelephone services for six months or more but who are inactive. An inactive subscriber is one who in the past six months has not received at least one call, has not made at least one call/ sent one SMS, has not had any web browsing activity or who has not paid for Pelephone services. It is noted that a customer may have more than one subscriber number ("line").
- (3) Average monthly revenue per subscriber. The index is calculated by dividing the average total monthly revenues from cellular services, from Pelephone subscribers and other telecom operators, including revenues from cellular operators who use Pelephone's network, repair services and warranty in the period, by the average number of active subscribers in the same period.
- (4) The churn rate is calculated at the ratio of subscribers who disconnected from the company's services and subscribers who became inactive during the period, to the average number of active subscribers during the period.

C. Bezeq International

	Q3 2014	Q2 2014	Q1 2014	Q4 2013	Q3 2013	Q2 2013	Q1 2013
Revenues (NIS million)	385	366	355	368	360	359	346
Operating profit (NIS million)	59	58	58	56	55	60	56
Depreciation and amortization (NIS million)	32	33	32	33	33	33	31
EBITDA (Earnings before interest, taxes, depreciation and amortization) (NIS million)(1)	92	90	90	89	88	93	87
Net profit (NIS million)	42	41	42	38	39	44	37
Cash flow from operating activities (NIS million)	71	95	74	77	71	81	58
Payments for investments in property, plant and equipment and intangible assets (NIS million) (2)	27	23	31	18	21	27	31
Free cash flow (NIS million) (1)	44	72	43	59	50	54	28
Churn rate (3)	4.5%	3.7%	4.0%	4.6%	4.7%	4.5%	4.2%

(1) Regarding the definition of EBITDA and cash flows, see notes (1) and (2) in the Bezeq Fixed Line table.

(2) The item also includes investments in long-term assets.

(3) The number of Internet subscribers who left Bezeq International during the period, divided by the average number of registered Internet subscribers in the period.

D. DBS

	Q3 2014	Q2 2014	Q1 2014	Q4 2013	Q3 2013	Q2 2013	Q1 2013
Revenues (NIS million)	432	428	424	417	410	404	404
Operating profit (NIS million)	76	67	73	61	72	68	67
Depreciation and amortization (NIS million)	75	74	70	71	66	64	62
EBITDA (Earnings before interest, taxes, depreciation and amortization) (NIS million)(1)	151	141	143	131	138	132	130
Net profit (loss) (NIS million)	(86)	(115)	(34)	(83)	(136)	(101)	(61)
Cash flow from operating activities (NIS million)	101	106	113	133	126	110	122
Payments for investments in property, plant and equipment and intangible assets (NIS million)	64	68	78	83	67	84	90
Free cash flow (NIS million) (1)	38	38	35	50	59	26	32
Number of subscribers (at the end of the period, in thousands) (2)	623	613	607	601	593	583	578
Average monthly revenues per subscriber (ARPU) (NIS)(3)	233	234	234	233	233	232	233
Churn rate (4)	3.2%	3.1%	3.6%	3.0%	3.4%	3.2%	3.8%

(1) Regarding the definition of EBITDA and cash flows, see notes (1) and (2) in the Bezeq Fixed Line table.

(2) Subscriber – one household or one small business customer. In the event of a business customer with many reception points or a large number of decoders (such as a hotel, kibbutz or gym), the number of subscribers is calculated by dividing the total payment received from the business customer by the average revenue from a small business customer.

(3) Monthly ARPU is calculated by dividing total DBS revenues (from content and equipment, premium channels, advanced products, and other services) by average number of customers.

(4) Number of DBS subscribers who left DBS during the period, divided by the average number of DBS registered subscribers in the period.

### **Section 1.5 - Forecast in relation to the Group**

Following completion of the transaction to sell all the share capital of Coral Tell, which operates Yad2 (see update to Section 1.2), approval of the provision for the early retirement of employees (see update to Section 2.9.3), and the execution of an agreement by Pelephone to establish an LTE network, below is a revised forecast for the Bezeq Group for 2014, based on the information currently known to the Bezeq Group (there is no change compared with the revised forecast published in the Company's quarterly reports at March 31, 2014 and June 30, 2014):

- Net profit for shareholders is expected to be approximately NIS 2 billion.
- EBITDA<sup>4</sup> is expected to be approximately NIS 4.5 billion.
- The Group's free cash flow<sup>5</sup> is expected to be approximately NIS 2.5 billion.<sup>6</sup>

**The Company's forecasts in this section are forward-looking information, as defined in the Securities Law. The forecasts are based on the Company's estimates, assumptions and expectations, including -**

**the forecasts do not include the effect of provision for the early retirement of employees, insofar as this takes place (over and above any resolutions relating to retirement that have already been passed by the Company, as detailed in the update to Section 2.9.3), investments insofar as there are any for the purchase of frequencies for a 4G LTE network, and the impact of a possible merger with DBS.**

**The Group's forecasts are based, inter alia, on its estimates regarding the structure of competition in the telecommunications market and regulation in this sector, the economic situation and accordingly, the Group's ability to implement its plans in 2014. Actual results might differ significantly from these estimates, taking note of changes which may occur in the foregoing, in business conditions and the effects of regulatory decisions, technology changes, developments in the structure of the telecommunications market, etc. or insofar as one or more of the risk factors listed in Sections 2.21, 3.20, 4.17 and 5.21 in the chapter - Description of Company Operations in the 2013 reports, materializes.**

### **Section 1.6 - General environment and the influence of external factors on the Group's activity**

#### Hearing on the subject of call center response times

On August 18, 2014, the Ministry of Communications published hearings for holders of communications licenses, including holders of cable and satellite licenses, cellular and fixed line licenses, virtual operators and Internet providers on the subject of regulating the response of telephone service and support call centers that serve the license holders private and business customers. The main provisions in the proposed amendments define a maximum and average waiting time and how to measure it, the option to leave a phone number for a return call, operation of round-the-clock call centers for certain problems and a customer-service call center that operates 13 hours a day (for DBS - 15 hours a day); toll-free access to the service and support centers; the submittal and publication of reports and presentation of the service information on the websites of the license holders; setting a menu for a human response and automated response; an option to cancel the service by phone as well; calls on all call centers must be recorded; and a memorandum to amend the Communications Law, which prescribes compensation without the need to prove loss if the waiting time is longer than that prescribed, and compensation for a surcharge of up to 10 times the amount overcharged. Responses were submitted to the hearing opposing the proposed regulations. Insofar as the proposed regulations are approved, the costs of operating the call centers of the Group's companies are likely to increase.

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<sup>4</sup> For a definition of EBITDA, see note (1) to the table in the update to Section 1.4.4 A.

<sup>5</sup> For a definition of free cash flow, see note (2) to the table in the update to Section 1.4.4 A.

<sup>6</sup> It is stipulated that the net proceeds of the sale of Yad2 (net of tax) were presented as part of cash flow from investment activity, and the sale therefore has no effect on the forecast of free cash flow as defined in the Periodic Report (cash from operating activities less cash for the purchase/sale of property, plant and equipment, and intangible assets, net).



Hearing on the subject of guaranteeing continuity of operations of the communications companies in emergency situations

In June 2014, the Ministry of Communications published a hearing according to which it wishes to obligate various telecom operator licensees to meet minimum requirements to guarantee continuity of operations in emergency situations and in the event of a significant shut-down or malfunction of communications services. The provisions of the proposed amendment to the licenses prescribe that the license holders must present a plan of action that ensures operational continuity of certain procedures that are defined as critical and limit damage to the supply of critical communications services in emergency situations; provisions concerning the responsibility of management and the board of directors, emergency situation management and provisions concerning continuity, backup and survivability of the network and infrastructure.

On September 15, 2014, the Company submitted its comments to the hearing and stated that the Company works constantly to provide a high-quality, integrated response to the range of requirements, and that it has proven organized, on-going work interfaces with the relevant entities, whereas some of the requirements listed in the hearing documents are impossible to implement or do not form the most appropriate means of achieving the objective and reflect an extreme degree of intervention. Furthermore, compliance with the provisions of the amendment to be heard will require large-scale investments and on-going expenses that are beyond the realm of reasonable, including the allocation of resources and manpower on an unprecedented and unjustifiable scale.

**Section 1.6.1 - Emergence of communication groups in the Israeli market and transition to competition among the groups.**

Par. C - HOT Group

On May 22, 2014, the Antitrust Authority published a decision of the Antitrust Commissioner ("the Commissioner") giving conditional approval for the infrastructure sharing agreement with Partner Communications Ltd. ("Partner") (see update to Section 3.6.2.C below). This decision prescribes the following conditions that will apply to HOT Telecom Limited Partnership ("HOT Telecom"), a company wholly owned by HOT: (a) HOT Telecom will not place and will not enforce any restriction on the use of fixed-line Internet infrastructure services stemming from the customer's cumulative surfing volume. This includes that HOT Telecom may not set the price and quality of the fixed-line Internet infrastructure services according to the customer's cumulative surfing volume (this condition will remain in force until the earlier of (1) December 31, 2015, (2) 30 days after the Minister of Communications has laid out the conditions and tariffs for providing wholesale services on HOT Telecom's Internet infrastructures); (b) HOT Telecom will not restrict or block, directly or indirectly, the possibility available to customers to use any service or application provided on the Internet at any time, including by way of setting prices or the use of technology. (c) HOT Telecom's Internet infrastructure services will be sold and supplied on equal terms to all HOT Telecom customers, irrespective of whether or not they purchase additional communications services from HOT. On this, it was determined that the sale of discounted Internet infrastructure services as part of a service bundle will not, in itself, be deemed a breach of the conditions.

**Section 1.6.3 - Regulatory oversight and changes in the regulatory environment**

Par. A - Policy for regulating competition

Concerning a petition by the Company to HCJ in an application for relief to obtain information for its reference at a hearing on the subject of a wholesale market, in a HCJ hearing that took place on March 17, 2014, the parties agreed that they would conduct a thorough dialog and the Company would be allowed to hold a supplementary hearing to exhaust all its arguments. After reaching agreement, the Company withdrew its petition. Subsequently, a first session of the hearing took place at which the Company requested further clarifications. The Ministry sent the Company partial clarifications to which it responded and it is now waiting for additional clarifications.

Subsequently, on August 19, 2014, the Company received a secondary hearing on the provision of wholesale services and setting the rate for wholesale services on Bezeq's network ("the Secondary Hearing"). According to the secondary hearing, the Minister of Communications is considering regulating the maximum rates for the provision of wholesale services on the Company's network, as detailed in an immediate report published by the Company on August 19, 2014 which is included in this report by way of reference, and, among other things, the amendment reflects a significant decline in tariffs for data transfer services on the network core over the period 2014-2018.

Draft regulations were attached to the secondary hearing which anchor the wholesale services listed in the hearing, the duty of the infrastructure owners to provide the services, and the maximum price

proposed for each service on the Company's network. The secondary hearing also included other documents, including a draft portfolio for BSA service and wholesale telephony service.

The Company submitted its comments on the secondary hearing, claiming that the economic model and its implementation contained serious errors and was unreasonable, that the wholesale telephony service would be impossible to implement and that the provisions of the service portfolio are unreasonable and disproportionate.

Concerning a hearing on the subject of a service portfolio for the use of passive infrastructures according to which service providers will be allowed to use the physical infrastructure of the infrastructure owner, on May 1, 2014 the Company submitted its response to the hearing and expressed its objection to the scope and content of the services, and also noted that the defining of the portfolio was beyond the scope of the Ministry's powers and that it constitutes an infringement of the Company's rights.

Concerning a hearing that is under way as part of the Ministry of Communications discussions on the subject of the SLU (Sub Loop Unbundling) service portfolio, whereby service providers will be allowed to use the copper cable infrastructure of infrastructure owners, on July 3, 2014 the Company submitted its comments on the service portfolio which was published by the Ministry of Communications.

On October 6, 2014, the Ministry published a secondary hearing relating to two service portfolios - the use of passive infrastructures and SLU, for response by November 23, 2014. The hearing documents once again included draft regulations which anchor the aforementioned wholesale services, the maximum price proposed for each service on the Company's network and the duty of the infrastructure owners to provide them. The draft regulations further prescribe an obligation to provide access services to passive infrastructure (not dark fiber) for another domestic carrier license holder (Hot), including a domestic carrier licensee (IBC), and it also imposed this obligation on Partner Fixed-line Communication Solutions and Cellcom Fixed Line.

As emerges from the foregoing, the hearing on the wholesale market is well under way and the Company has significant comments on the Ministry of Communications' hearing documents, which, in the Company's opinion, include erroneous facts, assumptions and conclusions regarding the price and scope of the wholesale services. In view of the foregoing, and in view of the positions of other relevant entities that are expected to be submitted during the course of the hearing, there is still a great deal of uncertainty as to the final manner of regulation that will apply to the wholesale market. Consequently, at the date of publication of this quarterly report, there is no change in the Company's estimates detailed in this section in the chapter - "Description of Company Operations" in the 2013 financial reports.

#### **Par. G - Enforcement and financial sanctions**

On July 24, 2014, an amendment to the Consumer Protection Law was published (effective from January 1, 2015, subject to the promulgation of regulations by that date). The amendment allows administrative enforcement action to be taken against one who is in breach of the provisions of the Consumer Protection Law, including - the imposition of progressive financial sanctions on those involved in a breach (including an on-going and recurring breach) of the provisions of the law, the issuing of an administrative warning to the offender, and an undertaking by the offending party to refrain from the breach. Likewise, the amendment also promulgates supervisory powers, including conferring powers on the Director of Consumer Protection to investigate, appoint inspectors and issue administrative orders. Additionally, a section of the law that prohibits exploiting the consumer's distress was replaced with a prohibition on exerting unfair influence, and several presumptions were prescribed that are deemed to be the exertion of unfair influence on the consumer.

#### **Par. H – Market Concentration Law**

Sub-par. 2 - Special provisions concerning directors in a third tier company during the transition period - on June 11, 2014, Regulations to Promote Competition and Reduce Concentration (Relief with Regard to the Number of External Directors), 2014, were published. Accordingly, where the director of a company who is appointed according to the proposal of a representative labor union as per a collective labor agreement serves in another tier company, the number of external directors in the tier company required under the Market Concentration Law who meet the provisions of the law may be reduced, provided that the external directors account for at least one third of the Board members. This provision is relevant for the Company (Bezeq) in which one serving director was appointed according to the proposal of the representative union. In accordance with the provisions of the aforementioned Market Concentration Law and regulations, on September 3, 2014, the general meeting of Company shareholders elected an additional external director for the Board of Directors,

and on September 9, 2014, another director terminated his office, so that the Company is in compliance with the conditions of the Market Concentration Law in this regard.

Par. I - Ministry of Communications policy concerning Wi-Fi

Pursuant to a secondary hearing on this subject, on August 6, 2014, the Ministry of Communications published its decision to abolish the existing policy and to prescribe in an order, that the establishment and operation of access points (as they are defined in the order) are exempt from licensing and general permit requirements. It was also decided to allow license holders to use WLAN technology, to set up and operate access points based on the conditions of the exemption order, provided that a general license holder who utilizes an access point as part of its public telecommunications network does not collect payment from subscribers for providing Internet access services when the said services are provided through an access point, and it may not lower the use allocation in the Internet access service to which the subscriber is entitled for the relative part that is provided via the access point. Consequently, with the entering into force of the exemption order, if a general license holder applies to the Ministry for an extension of its public telecommunications network through the use of access points, the application will be reviewed subject to that mentioned in the decision document and the law, and its license will be amended accordingly

## **2. Domestic fixed-line communications; "Bezeq" - The Israel Telecommunication Corporation Ltd. ("the Company")**

### **Section 2.9.3 - Early retirement plans**

On May 15, 2014, the Board of Directors approved a budget of NIS 116.5 million for the early retirement of 101 employees on the early retirement track in accordance with the conditions of the collective labor agreement from December 2006, as amended in December 2010. The Board also approved the early retirement of additional employees on the enlarged severance pay track, based on the Company's requirements. In view of the foregoing, the Company recorded a provision for the above in the amount of NIS 116.5 million in its financial statements for Q2 2014. On this, see also Note 6 to the Company's Financials for the period ended on September 30, 2014.

### **Section 2.9.6 - Officers and senior management in the Company**

After changes in the composition of the Board of Directors (see update to Section 1.6.3(H) - on the date of publication of this report, the Company has 11 directors, of whom four are external directors, one is an employee-director and two are independent directors (who are not external directors) pursuant to Section 249B of the Companies Law

Concerning the Company's compensation policy – on March 19, 2014, a general meeting of the Company's shareholders approved the compensation policy as detailed in the 2013 reports.

### **Section 2.11 – Working capital**

At September 30, 2014, the Company has a working capital deficit in the amount of NIS 88 million (this figure refers to the Company's separate financial statements. In the Company's consolidated financial statements at September 30, 2014, there is working capital surplus in the amount of NIS 1,530 million). On November 9, 2014, the Company's directors determined that despite its deficit in working capital, it does not have a liquidity problem. See Section 1.3 of the Directors' Report.

### **Section 2.13 - Financing**

On May 29, 2014, the Company published a shelf prospectus for the issue of shares, debentures, convertible bonds, stock options, options for debentures and commercial papers, of a scope and under conditions to be determined in accordance with shelf proposal reports, if and insofar as the Company should publish them in the future. On this, see the Company's Immediate Report dated May 29, 2014, included here by way of reference.

#### **Section 2.13.4 – Credit received during the Reporting Period, and Section 2.13.1 - Average and effective interest rates on loans**

On August 18, 2014, the Company completed a private placement for classified investors by way of an expansion of existing Debentures (Series 6) and (Series 7) which the Company issued according to a shelf prospectus dated June 1, 2011 and an amendment thereto on June 22, 2011. For additional information on this subject, see Section 5.1 of the Directors Report, and Note 11.1 to the Company's financial statements for the period ended September 30, 2014.

Following is an up-to date table of the distribution of long-term loans (including current maturities), including information about the aforementioned private placement:

Loan term	Source of financing	Amount (NIS million)	Currency or linkage	Type of interest and change mechanism	Average interest rate	Effective interest rate	Interest range in 2014
<b>Long-term loans</b>	Banks	1,931	Unlinked NIS	Variable, based on prime rate*	1.72%	1.73%	1.72%-2.47%
	Banks	2,068	Unlinked NIS	Fixed	5.67%	5.69%	5.00%-6.85%
	Non-bank sources	734	Unlinked NIS	Variable, based on annual STL rate**	1.68%	1.74%	1.67%-2.25%
	Non-bank sources	1,729	Unlinked NIS	Fixed	5.92%	6.10%	5.70%-6.65%
	Non-bank sources***	3,609	CPI-linked NIS	Fixed	2.78%	2.83%	2.53%-5.95%

\* Prime interest rate as at October 2014 – 1.75%.

\*\* STL yield per year (815) – 0.268% (average of the last five trading days of August 2014) for the interest period that ended on September 1, 2014.

\*\*\* Not including Debentures (Series 5) held by a wholly-owned subsidiary.

### **Section 2.13.6 - Credit rating**

On May 13, 2014, Standard & Poor's Maalot Ltd. published affirmation of a rating of iIAA/Stable for the Company and Telephone (unchanged from the previous rating). The rating report can be seen in an Immediate Report (Amendment) issued by the Company on May 15, 2014, cited here by way of reference.

In connection with a private placement made by the Company in August 2014 (see update to Section 2.13.4) - on August 13, 2014, Standard & Poor's Maalot Ltd. affirmed the iIAA rating for an issue of the Company's debentures up to an amount of NIS 1 billion. Likewise, on the same day, Midroog Ltd. announced a rating of Aa2 outlook stable for Debentures Series 6 and 7 which the Company intends to issue in the amount of up to NIS 1 billion by means of an expansion of the series, and for Debentures (Series 5-8) of the Company. On this, see two immediate reports published by the Company on August 13, 2014, which are included in this report by way of reference.

### **Section 2.16.1 - Control of Company tariffs**

Sub-par. B - A temporary order dated June 1, 2014, stipulated that the tariffs would not be updated on June 2, 2014, and that the postponement will be taken into consideration in the next update

### **Section 2.16.8 – Antitrust Laws**

Subsection G - From talks held in recent months between the Company and the Antitrust Authority, it emerges that, based on the determination under consideration, the Antitrust Authority is of the opinion that the Company's actions constitute abuse of its position as owner of a monopoly in contravention of Sections 29A(a), 29A(b)(1) and 29A(b)(3) of the Law, but the determination under consideration does not necessarily classify these actions as a Price / Margin Squeeze. The Company objects and is of the opinion that the Authority has expanded its initial claim.

### **Section 2.17.4 - Early retirement agreements**

On April 24, 2014, the Company and Menorah Mivtachim Insurance Ltd. signed an agreement regulating pension payments for the early retirement of Company employees and payment of the remainder old-age and survivors' pensions to employees who retire from the Company under the special collective retirement agreement. The agreement period is until the end of 2016 and it includes a mechanism for Company participation in future yields/losses in the pension portfolio for the retirees which will be managed by Menorah.

### **Section 2.18 – Legal proceedings**

In the matter of sub-paragraph B concerning a claim filed by the Company against Makefet Pension Fund in connection with the calculation of early retirement costs for employees who were transferred to the Company from the Ministry of Communications - on September 22, 2014 the claim was dismissed.

In the matter of sub-paragraph D concerning an action and application for its certification as a class action, in which it was alleged that the Company unlawfully collected amounts from its subscribers upon disconnection due to failure to make payments - on May 18, 2014 the Company received a court ruling certifying the action as a class action in one of the causes (insofar as it pertains to collection of the fixed payment after discontinuation of the service) and rejecting the application insofar as it pertains to the other causes (disconnection of the additional line, collection of a renewal fee when the line is reconnected or collection of the fixed payment for the line for the period until the discontinuation of the service). Taking note of the above, and given that other causes of the applicants were neglected prior to the issue of the said ruling, and according to information in the Company's possession, the financial implications of the ruling are insignificant to the Company's business.

In the matter of subsection F concerning two applications (that were consolidated) to certify two derivative actions against officers in the Company (past and present) in which it was argued, inter alia, that the Company's officers resolved to distribute dividends and take loans that the Company implemented during the period relevant to the two applications, in breach of their duty towards the Company, in a conflict of interests and harming the good of the Company - on September 17, 2014 the Tel Aviv District Court (Economic Department) issued a judgment dismissing the two applications. Based on the judgment, the court decided to dismiss the two applications after finding that it had not been proved that the Respondents (the officers) made their decisions in bad faith, or that they deviated from the prerogative given to them, or that they had harmed the good of the Company. Concerning an action together with an application for its certification as a class action against Coral-Tell - as part of agreement for the sale of Walla's holdings in Coral Tell (see update to Section 1.2), Walla undertook to indemnify the buyer for loss that may be incurred as a result of this move up to the amount of the purchase, subject to the conditions and limitations specified in the agreement. On October 7, 2014, the parties filed an agreed application to withdraw from the application for certification of the class action.

In June 2014, a claim was filed in the Haifa District Court together with a motion for its certification as a class action. The Plaintiff, who is a customer of the Company's internet infrastructure, alleges that the Company does not permit existing customers to connect to the Company's infrastructure at the prices offered to new customers for the same service. The Plaintiff estimates the total amount of the claim at NIS 144 million (based on personal loss of NIS 10 per month, calculated according to the difference between the price for an existing customer and the price for a new customer, multiplied by 1.2 million existing customers in one year).

## **3. Mobile radio-telephone (cellular telephony) - Pelephone Communications Ltd. ("Pelephone")**

### **Section 3.1.5A - Establishment of cellular networks using advanced technologies**

- A. In July 2014, the Ministry of Communications published a tender for the allocation of 4G frequencies. The following may participate in the tender: infrastructure-owning cellular operators, virtual operators, and entities that are not currently cellular operators, all subject to the threshold conditions determined in the tender. According to the tender, eight bands in the 1800 MHz spectrum will be allocated, where each band is 5 MHz and the total bandwidth is 38-40 MHz (depending on who wins the tender), and the minimum price for each 1 MHz is NIS 2 million. The tender includes a limitation on the bandwidth allocation taking into account the existing inventory of frequencies in the 1800 MHz spectrum for each operator. The tender includes provisions concerning requirements for the cover and quality of the network to operate on 4G (LTE), and this within the context of amended cellular licenses, which are more stringent than the current cover and quality requirements. Pelephone intends to participate in the tender.
- B. In July 2014, Pelephone received a letter from the Ministry of Communications whereby until the frequencies tender takes place, the Ministry had decided to allow all existing cellular operators who wish to perform an immediate technology upgrade of their systems, to begin using frequency bandwidth of 5 MHz in the 1800 MHz spectrum on LTE technology now. Given that Pelephone does not have an allocation of frequencies on the 1800 MHz spectrum, the Ministry

of Communications made a temporary allocation of 5 MHz frequency bandwidth to be used for operating the LTE technology.

The temporary allocation of frequencies will be cancelled if Pelephone does not win the frequency tender mentioned in par. A above. Insofar as Pelephone wins the tender, the temporary allocation will be revoked when the frequencies are allocated following the tender, or when the specific frequency in the temporary allocation is allocated to another operator, whichever is earlier.

On August 3, 2014, Pelephone received the go-ahead from the Ministry of Communications allowing it to supply 4G services using LTE technology, by means of a temporary allocation of 5 MHz bandwidth on the 1800 MHz spectrum. During the third quarter of 2014, Pelephone launched the service gradually in those areas with LTE infrastructure, thus enabling the hundreds of thousands of compatible handsets that operate on the Pelephone network to benefit from advanced data services in those locations. Further deployment of the network is currently underway. On this, see also the Company's Immediate Report dated August 3, 2014, included here by way of reference.

Notably, during the third quarter of 2014, Partner and Cellcom also announced the launching of a 4G network on bandwidth of 5 MHz in the 1800 MHz spectrum.

### **Section 3.6.2 C - Infrastructure sharing**

In May 2014, the Ministry of Communications ("the Ministry") published a document on "Policy for sharing broadband access networks that belong to general license-holders for providing cellular (mobile radio telephone) services" ("the Policy Document").

Following are the main points of the policy document:<sup>7</sup>

1. The Ministry encourages and will continue to encourage passive sharing of network sites and masts only, as well as the active sharing of antennae only, among all operators.
2. In general, the Ministry believes that active sharing on a multi-operator core network (MOCN) format (sharing of antennae, frequencies and radio equipment) is preferable to active sharing on a multi-operator radio access network (MORAN) format (sharing of antennae and radio equipment without the sharing of frequencies), in view of the need to streamline the frequency spectrum. Nevertheless, the Ministry does not rule out the possibility that under special circumstances, it might deem it appropriate to approve an agreement under a MORAN format.
3. In general, the Ministry of Communications will allow the sharing of transmission from cell sites to the centralized radio-based stations in a bandwidth-sharing configuration. However, under exceptional conditions, and at the Ministry's discretion, it might allow sharing of transmission from the cell sites to the centralized radio-based stations in other cases as well.
4. When examining individual network-sharing agreements, the Ministry will take into account the considerations specified in the Policy Document that pertain to four key aspects: the existing level of competition and the potential for harm to the competition, the existing and expected inventory of frequencies and how efficiently they are being used, survivability and redundancy of the networks from the national perspective, and ensuring the level of telecommunications services over time.
5. Based on the foregoing, the Ministry outlined principle guidelines that will be used to examine each individual network-sharing agreement submitted for its approval. The guidelines also stipulate that sharing under a MOCN format will not be allowed for two cellular operators with fully deployed 3G cellular network, but that it will be considered in relation to a new operator with a partially deployed 3G cellular network, together with an established operator with a fully deployed 3G cellular network, and that the Ministry will allow sharing based on an MOCN format, provided that at least 3 independent wireless access networks are being operated in every region in Israel. Other conditions are also prescribed.
6. The Ministry does not intend to allow any sharing of radio (cellular) infrastructure, including shared transmission to radio base stations between Bezeq Group and HOT Group, which are the only owners of fixed-line infrastructure in Israel.

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<sup>7</sup> The policy document appears on the Ministry of Communications website:  
[http://www.moc.gov.il/sip\\_storage/FILES/0/3550.pdf](http://www.moc.gov.il/sip_storage/FILES/0/3550.pdf).

7. The Minister of Communications will consider revoking all or some of the network sharing approvals, depending on the circumstances, if it emerges that harm has been caused to the level of competition, the level of coverage or the level of service to customers.

According to the document outline, the network sharing agreement that Pelephone signed with Cellcom and Golan in December 2013, does not comply with the threshold conditions in the Policy Document.

As a consequence, on May 25, 2014, Cellcom announced that it had signed an agreement with Golan granting it the right to use the 4G network that it intends to establish. This agreement is in addition to an agreement for the right to use the 2G and 3G networks that Cellcom and Golan signed in December 2013. These agreements are subject to the approvals of the Ministry of Communications and the Antitrust Commissioner. Cellcom's announcement also noted that it is continuing its efforts to implement network sharing, including the sharing of the passive elements on the network sites.

Additionally, in September 2014, Pelephone entered into a cooperation agreement with Cellcom for maintenance of the passive components of cellular sites, including uniting the passive components and reducing costs by means of a joint supplier (contractor). The supplier, who will be chosen by tender, will sign separate agreements with Pelephone and Cellcom for a period of at least 5 years. The agreement is subject to regulatory approvals.

On May 22, 2014, Partner and HOT announced that the Commissioner had resolved to approve the network sharing agreement between them subject to conditions. In its report, Partner noted that it estimates that in principle, the network sharing agreement signed by the companies was consistent with the principles of the policy document and that they are in the process of obtaining the relevant approvals for implementing the network sharing agreement.

The infrastructure sharing model has the potential to reduce the costs of establishing the network and its on-going operation. Consequently, insofar as Pelephone does not receive permission to operate under any network sharing model, the costs of Pelephone's network (with respect to establishment of the networks, acquiring the frequencies and the on-going operation of the network) are likely to be higher than those of its main competitors.

Pelephone's estimates, as described above in this section, are forward-looking information. At this stage, there is no certainty as to the extent to which the policy document will in future impact Pelephone's ability to operate under an infrastructure sharing model or the format of its operations based on such a model, nor is there any certainty as to the extent to which approval or lack thereof for Pelephone's operations based on an infrastructure sharing model will affect the costs of its network.

#### **Section 3.6.2 D - MVNO - Mobile Virtual Network Operator**

In June 2014, the Ministry of Communications published a hearing on the determination, that in hosting agreements drawn up between cellular operators and MVNOs, the cellular operators will not demand hosting tariffs that are higher than the lowest tariff given to business customers in cellular agreements. Pelephone submitted its objection to this directive.

#### **Section 3.7.1 - Infrastructures**

In April 2014, Pelephone signed an agreement with L.M. Ericsson Israel Ltd. ("Ericsson") to upgrade the network center to support LTE, purchase and install radio equipment and to make additional adjustments to the network to support LTE. The equipment to be supplied to Pelephone will also support Advanced 4.5G LTE technology.

In connection with the anticipated costs of setting up the LTE network – the cost of establishing and expanding the network (payments to Ericsson and additional costs relating to the setting up and expansion of the network) over the period 2014-2017 is expected to reach NIS 500 million, excluding the cost of purchasing the frequencies. Implementation of the full cost of the setting up and expansion of the network is subject to Pelephone winning the frequencies tender. See the update to Section 3.1.5A on the frequencies tender.

Pelephone's above-mentioned estimates concerning the costs of setting up the LTE network and payment period are forward-looking information, based on Pelephone's forecasts and assessments, in part, in connection with the speed of expansion of the network. It should be clarified that, as noted above, these costs do not take into account the costs of purchasing frequencies and they therefore do not reflect the full cost of setting up and expanding the network.

### **Section 3.9 – Human capital**

On November 6, 2014, the New General Labor Federation informed Pelephone that it would declare a labor dispute in accordance with the Settlement of Labor Disputes Law, 1957, commencing November 21, 2014 and thereafter ("the Announcement"). According to the Announcement the first issue under dispute is the Company's demand to dismiss 200 employees immediately, which is incorrect. This is also true of the other issues in the announcement (restructuring and work load in Pelephone's business division). At this stage, the Company and/or Pelephone are unable to estimate the ramifications of this Announcement.

#### **Section 3.15.2 - Pelephone's cellular license**

##### **Add sub-par. C - Hearing on required cover and quality obligation**

In July 2014, the Ministry of Communications published a hearing directed to general license holders that offer cellular services, including Pelephone ("the Operators"). The hearing discusses an amendment to the Operators licenses which will tighten the cover and quality requirements for public telecommunications systems that they operate using 2G and 3G technology with nationwide deployment and in the Administered Territories ("the Hearing"). Pelephone submitted its comments and reservations to the hearing in September 2014. Insofar as the cover and quality required from the systems is tightened, as specified in the hearing, Pelephone and the other operators are likely to face significant costs.

##### **Add sub-par. D - Hearing on functional continuity in emergency situations**

In June 2014, the Ministry of Communications published a hearing about technical parameters, procedures and routine operations that the Ministry intends to demand of communications providers in Israel to guarantee functional continuity (on-going rendering of services) in emergency situations ("the Hearing"). Pelephone submitted its comments and reservations to the hearing in September 2014. On this, see also the update to Section 1.6.

#### **Section 3.15.3 – Site construction licensing**

As part of the "pergola reform" [reform of planning and building regulations] - Amendment 101 to the Planning and Building Law, 1965, on August 1, 2014, the Planning and Building (Works and Buildings that are Exempt from a Permit) Regulations, 2014, entered into force. Regulation 34 prescribes that the addition of an antenna to an existing, lawful broadcasting facility is exempt from a permit, subject to meeting a combination of conditions and exclusions, including that it is consistent with the plans and the applicable spatial instructions, to be determined by the local planning committees.

On September 15, 2014, a hearing was held on petitions filed in the High Court of Justice and all the parties' arguments were heard. In this context, HCJ recommended that the parties attempt to achieve an arrangement that will balance the conflicting interests and move the process of promulgating the regulations forward in the spirit of the draft regulations from March 2010. HCJ further instructed the state to submit an updated notice within 120 days which will include, among other things, the Minister of the Interior's current position, the current position of the Minister of Communications with respect to both the draft regulations and the existing regulations, the current position of the Antitrust Commissioner and an update on the discussions in the Knesset Economic Affairs Committee. The parties were also granted permission to respond to the state's position within 30 days of receiving it. HCJ also instructed the parties to advise, no later than January 20, 2015, as to whether they have reached agreement and it was determined that after receiving notice from all the parties, HCJ will make a decision on how handling of the cases will continue.

#### **Section 3.17.1 – Legal proceedings**

In sub-paragraph A in the matter of an action together with an application for its recognition as a class action for the restitution of amounts that the Plaintiff alleges were over-collected - in August 2014, the court dismissed the Plaintiff's application for recognition of its claim as a class action

In sub-paragraph B in the matter of a claim and application for its certification as a class action which was filed against Pelephone and three other cellular operators on grounds pertaining to the non-ionizing radiation values of cellular handsets - in July 2014, a judgment was given certifying a compromise arrangement which includes verifying and ascertaining certain matters relating to the claim as well as the sale of earphones to customers at a reduced price for a certain period. In October 2014, an appeal was filed on the judgment. The Plaintiffs are appealing, inter alia, that an investigator was not appointed for the process of approving the amounts of the compromise between



the parties (for the radiation tests that were agreed upon), that the instructions of the Head of Radiation Safety were not enforced as part of the compromise settlement in connection with tests of mobile devices after repair and/or damage and/or upgrade, and they are also appealing the amount of compensation and lawyers' fees awarded to the Plaintiffs. It should be noted that the appeal does not reject the basis of the compromise settlement, but includes a request to reinforce implementation of the arrangement with respect to operation of the tests, and under these circumstances Pelephone does not face any significant exposure.

In sub-paragraph C in the matter of an action together with an application for its recognition as a class action in which it is alleged that Pelephone must refrain from collecting VAT from customers that use its services while they are outside Israel - in August 2014, the court dismissed the application for certification. In October 2014, the judgment was appealed.

In sub-paragraph G in the matter of an action together with an application for its certification as a class action alleging that Pelephone makes false representations to the public, according to which it provides a surfing experience on its network at extremely high speeds whereas in practice the surfing speed on its cellular network is lower than specified - in July 2014 a ruling was given in the case confirming a settlement between Pelephone and the applicants at a cost of NIS 4.5 million to Pelephone.

#### **4. Bezeq International – Communications, Internet and NEP Services - Bezeq International Ltd. ("Bezeq International")**

##### **Section 4.2 – Products and Services**

In July 2014, Bezeq International launched activity in the small business and self-employed sector offering the "Bigger" service - a new digital platform for managing the business's marketing and advertising.

##### **Section 4.8 – Human resources**

In March 2014, Bezeq International received notice from the New Labor Federation ("the Histadrut") that more than one third of Bezeq International's employees had chosen to sign up as members of the Histadrut, and that it therefore constitutes a representative workers union of Bezeq International's employees. After inspecting the enrollment forms that it received, Bezeq International informed the Histadrut that it is inclined to recognize it as the representative workers union of Bezeq International. The parties have begun to negotiate a collective labor agreement.

Commencing May 15, 2014, Moti Elmaliach is the CEO of Bezeq International. This follows the announcement by the previous CEO of Bezeq International, Yitzhak Benbenisti, that he would be stepping down.

##### **Section 4.13.2 - Licenses**

On June 30, 2014, Bezeq International's special license to provide internet access services (ISP) was extended to April 30, 2019.

On July 9, 2014, the Minister of Communications granted Bezeq International the powers pertaining to land that are listed in Chapter 6 of the Communications Law, including access to land for the purpose of laying and maintaining a network.

##### **Section 4.13.4 - Key regulatory developments**

Subsection E - Amendment to the Communications Law in relation to filtering of offensive content - on August 6, 2014, the Ministry of Communications published a hearing on the subject of amending the Internet license of Bezeq International (corresponding with the bill discussed by the Economic Affairs Committee). The main points of the amendment are an expansion of the existing obligation under the provisions of the Communications Law to inform customers and offer them an opportunity to protect themselves against offensive Internet content by means of basic filtering software that is provided free of charge. In the context of the hearing, the Ministry seeks, among other things, to obligate Bezeq International to offer its customers more advanced filtering software free of charge, allowing them to choose between an applicative filter (which must be compatible with all devices) and the use of a network filter. Some of these solutions are not applicative at the present time.

Secondary hearing on new regulations in the international communications market - on October 5, 2014, the Ministry of Communications published a secondary hearing (subsequent to the hearing

published on October 16, 2013 which is described in Sections 4.1.1., 4.13.4 and 1.6.2 of the 2013 Periodic Report) on the subject of new regulations in the international telecommunications market in which it requested the public's opinion in connection with procedures/method of using international telephony services in the wake of the proposed regulations (dialing codes, etc.).

In the matter of hearings on the subject of call center response times and guaranteed functional continuity, see the update to Section 1.6.

## **5. Multi-channel television - DBS Satellite Services (1998) Ltd. ("DBS")**

### **Section 5.4 – New products**

In March 2014, DBS launched the YesGo Service.

#### **Section 5.15.3 - Institutional financing**

In April 2014, DBS issued additional debentures (Series 1) and (Series 2) by way of an expansion of the series, in the total amount of NIS 300 million.

In October 2014, DBS issued additional Debentures (Series 2), by way of an expansion of the series, in the total amount of NIS 30 million.

#### **Section 5.15.4 - S&P Maalot ratings for DBS and its debentures**

On April 1, 2014, S&P Maalot issued an (iIA-) rating for additional debentures of up to NIS 250 million par value to be issued by DBS through a new issuance of debentures or an expansion of an existing series.

On April 30, 2014 S&P Maalot upgraded DBS to a rating of iIA (stable) and upgraded the debentures of DBS to a rating of (iIA), and placed DBS on a rating watch list with positive outlook.

On September 30, 2014, S&P Maalot issued an (iIA) rating for additional debentures of up to NIS 250 million par value to be issued by DBS through a new issuance of debentures or the expansion of an existing series.

#### **Section 5.17.5 – Terminal Equipment**

In October 2014, the Knesset Economic Affairs Committee approved the Energy Sources (Maximum electrical output in active stand-by mode of a digital channel converter for TV broadcast reception) Regulations, 2011. The committee determined that the regulations will apply to all digital converters, also including converters for the reception of DTT broadcasts and converters for the reception of Internet-TV broadcasts. Several changes were made to the regulations compared with the original version. As far as DBS is aware, the regulations are due to enter into force from 60 days after their date of publication in the Official Gazette and they will apply to any new converter that is imported to or produced in Israel. DBS believes that the regulations are not expected to restrict its import of the types of decoders used by its subscribers.

#### **Section 5.17.6 - Requirement to transmit channels**

On July 20, 2014, HCJ dismissed DBS's petition without an order for costs.

#### **Section 5.17.9 - Ownership of broadcast channels**

In April 2014, DBS began to broadcast local news, in accordance with the Communications (Telecommunications and Broadcasts) Law (Amendment no. 59 and Temporary Provision), 2014 and a decision of the Council dated March 2014.

#### **Section 5.17.13 - Regulation of the transmission of video content via media infrastructures**

In February 2014, the Minister of Communications appointed a committee to review the regulation of commercial broadcasts, whose task is to review and compile recommendations, in part, in connection with the principles and standards that will apply to all companies involved in the distribution of audio-visual content. The committee was also asked to make recommendations as to the possible inclusion of advertising in the broadcasts of DBS and HOT. The committee was asked to formulate its recommendations by August 2014. Pursuant to a request from the committee, in April 2014, DBS submitted its position on the aforementioned subjects.

In August 2014, the Committee submitted to the Minister of Communications its recommendations within the context of the interim report it published. Among its recommendations, the Committee

recommended that a license will not be required to provide audio-visual services over the Internet; that the regulations that apply to the new providers will be imposed on them gradually, based on qualifying tests to be defined and the number of subscribers; and that a national communications authority will be established to serve as a central regulator which will incorporate the Ministry of Communications, the Second Authority and the Council. It was also noted that the committee's final recommendations will be submitted in November 2014. In September 2014, DBS submitted its response, in which it argued that licensing requirements should also apply to new suppliers, that the regulations should apply equally to owners of broadcasting licenses and to new providers, and that insofar as the regulations are applied gradually, the time period and date on which they become applicable should be specified (not only quantitatively).

#### **Section 5.19.1 - Legal proceedings**

Sub-par. B - On May 22, 2014, a hearing took place on the motion to certify during which the applicants, at the court's recommendation, asked to abandon the request for certification. The court instructed that the abandonment affidavits be filed by May 29, 2014, and that after they have been received, the court will strike out the application for certification. On May 29, 2014, a ruling was given in which the court approved the application for abandonment and struck out the request for certification.

Sub-par. C - On June 9, 2014, the parties filed an agreed application to withdraw from the application for certification. On September 19, 2014, a judgment was given in which context the court certified the application to withdraw.

On June 10, 2014, a claim, together with an application for its certification as a class action, was filed in the Tel Aviv District Court alleging that residents of apartment buildings (customers and non-customers of DBS) had been charged for the use of electricity by satellite dishes and/or amplifiers and/or devices used by DBS that are positioned on the apartment buildings. The applicant petitioned the court, in part, with a request to obligate DBS to reimburse the group's members for the charge for use of the electricity, as noted above, and set the total amount of the claim at NIS 126 million.

On June 15, 2016, two representatives of apartment buildings in Haifa filed a claim against DBS, together with an application for its certification as a class action, on the same subject. The applicants in this motion set the amount of the claim at NIS 125 million, of which NIS 80 million is for financial and non-financial losses that were allegedly caused for the use of electricity by DBS's systems, and an amount of NIS 44.6 million for the cost of a mandamus to obligate DBS to install electricity meters for measuring the electricity consumption of DBS's systems. On September 10, 2014, the court instructed that hearing of the action should be moved to the Tel Aviv District Court before which a previous class action on the same matter is pending.

On September 1, 2014, a claim and application for its certification as a class action was filed against DBS in the Tel Aviv District Court, the subject of which is the sending of electronic advertisements by DBS to its customers, allegedly in contravention of Section 30A of the Communications Law, a breach of DBS's license and breach of the agreement between DBS and its customers. The Plaintiffs asked the court for relief for the inconvenience caused to the customers of DBS, harassment, loss of time, etc. which the Plaintiffs estimate to be in the amount of NIS 402 million; and relief the amount of which will be determined at the court's discretion, for enrichment of DBS as a result of sending these messages.

November 9, 2014

Date

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Bezeq The Israel Telecommunication Corporation Ltd.

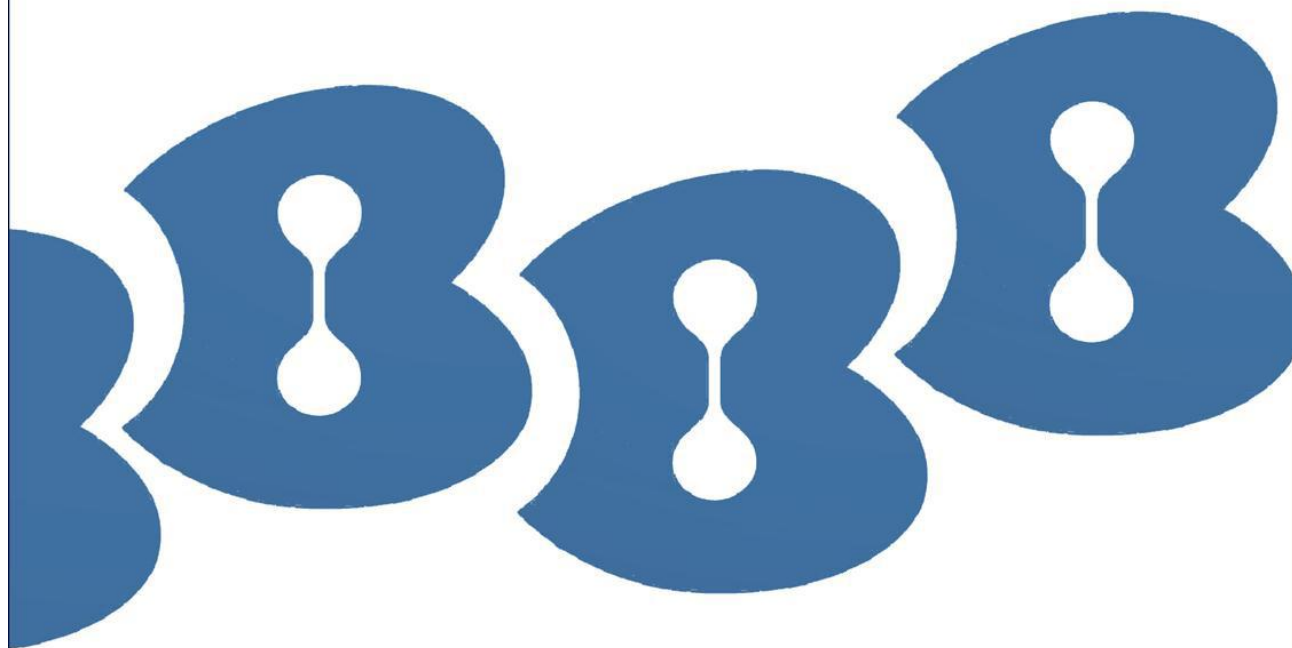
Names and titles of signatories:

Shaul Elovitch, Chairman of the Board of Directors

Stella Handler, CEO

**Bezeq - The Israel Telecommunications  
Corporation Ltd.**

**Board of Directors' Report on the Company's  
Business for the Nine and Three Months Ended  
September 30, 2014**



We hereby present the Board of Directors' report on the state of affairs of "Bezeq" - The Israel Telecommunication Corporation Ltd. ("the Company") and the consolidated Group companies (the Company and the consolidated companies, jointly - "the Group"), for the nine months ended September 30, 2014 ("the Period") and the three months then ended ("the Quarter").

The Board of Directors' report includes a condensed review of its subject-matter, and was prepared assuming the Board of Directors' report of December 31, 2013 is also available to the reader.

In its financial statements, the Group reports on four main operating segments:

1. **Domestic Fixed-Line Communications**
2. **Cellular Communications**
3. **International Communications, Internet and NEP Services**
4. **Multi-Channel Television (presented using the equity method)**

It is noted that the Company's financial statements include an "Others" segment, which comprises mainly online content, commerce and classified advertisement services (through Walla, Walla Shops, Yad2 and other websites) and contracted call center services (through "Bezeq Online"). The "Others" segment is immaterial at the Group level.

On May 20, 2014, the Company completed the sale of the entire share capital of Coral-Tell Ltd., which operates the 'Yad-2' website.

	<b>1-9.2014</b>	<b>1-9.2013</b>	<b>Increase (decrease)</b>		<b>7-9.2014</b>	<b>7-9.2013</b>	<b>Increase (decrease)</b>	
	<b>NIS</b>	<b>NIS</b>	<b>NIS</b>	<b>%</b>	<b>NIS</b>	<b>NIS</b>	<b>NIS</b>	<b>%</b>
	<b>millions</b>	<b>millions</b>	<b>millions</b>		<b>millions</b>	<b>millions</b>	<b>millions</b>	
Profit	1,695	1,419	276	19.5	428	449	(21)	(4.7)
EBITDA	3,553	3,209	344	10.7	998	1,050	(52)	(5.0)
(operating profit before depreciation and amortization)								

Results in the Period, as compared to the same period last year, were mainly affected by the sale of all holdings in the shares of Coral-Tell Ltd., and a provision for termination of employment by way of early retirement, as detailed in Note 10 to the financial statements.

Results in the Quarter, as compared to the same quarter last year, were mainly affected by a decrease in the Group's revenues, partially offset by lower operating expenses and by the Group's share in the losses of investees.

# 1. The Board of Directors' explanations on the state of the Company's affairs, the results of its operations, equity, cash flows, and additional matters

## 1.1 Financial position

	30.9.2014	30.9.2013	Increase (decrease)		
	NIS millions	NIS millions	NIS millions	%	Explanation
Cash and current investments	4,094	1,256	2,838	–	The increase was seen across all Group segments, but mainly in Domestic Fixed-Line Communications operations. For more information, see Section 1.3 - <i>Cash Flows</i> , below.
Current and non-current trade and other receivables	3,078	3,832	(754)	(19.7)	This decrease was mainly attributable to a decrease in trade receivables in the Cellular Communications segment, as a result of a decrease in revenues from handsets sold in 36 installments, and a decrease in service revenues.
Other current assets	116	205	(89)	(43.4)	This decrease was attributable to a decrease in assets held for sale in the Domestic Fixed-Line Communications segment and a decrease in inventory in the Cellular Communications and the Domestic Fixed-Line Communications segments.
Intangible assets	1,810	2,105	(295)	(14.0)	The decrease was mainly attributable to the deconsolidation of Coral-Tell Ltd. (see Note 4.2 to the financial statements). Other Group segments also saw a decrease in this item.
Other non-current assets	7,441	7,391	50	0.7	The increase was mainly attributable to growth in property, plant and equipment balances in the Domestic Fixed-Line Communications segment.
<b>Total assets</b>	<b>16,539</b>	<b>14,789</b>	<b>1,750</b>	<b>11.8</b>	
Debt to financial institutions and debenture holders	10,363	9,838	525	5.3	The increase was attributable to a debentures issue in the Domestic Fixed-Line Communications segment, by way of an expansion of existing debenture series. The increase was partially offset by repayment of loans and debentures, mainly in the Domestic Fixed-Line Communications and the Cellular Communications segments.
Other liabilities	4,152	2,901	1,251	43.1	The increase was attributable to the dividend payable balance of NIS 1,267 million on earnings from the first half of 2014.
<b>Total liabilities</b>	<b>14,515</b>	<b>12,739</b>	<b>1,776</b>	<b>13.9</b>	
<b>Total equity</b>	<b>2,024</b>	<b>2,050</b>	<b>(26)</b>	<b>(1.3)</b>	The decrease in equity was attributable to timing differences between the accrual of earnings in the Company, and their payment as dividends (see Note 7 to the financial statements). Equity comprises 12.2% of the balance sheet total, as compared to 13.9% of the balance sheet total on September 30, 2013.

## 1.2 Results of operations

### 1.2.1 Highlights

	1-9.2014	1-9.2013	Increase (decrease)		7-9.2014	7-9.2013	Increase (decrease)	
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%
Revenues	6,793	7,154	(361)	(5.0)	2,232	2,398	(166)	(6.9)
Depreciation and amortization	960	983	(23)	(2.3)	327	329	(2)	(0.6)
Labor costs	1,328	1,431	(103)	(7.2)	437	464	(27)	(5.8)
General and operating expenses	2,513	2,610	(97)	(3.7)	822	890	(68)	(7.6)
Other operating income, net	601	96	505	-	25	6	19	-
Operating profit	2,593	2,226	367	16.5	671	721	(50)	(6.9)
Finance expenses, net	113	96	17	17.7	39	45	(6)	(13.3)
Share in losses of investees	132	195	(63)	(32.3)	34	88	(54)	(61.4)
Income tax	653	516	137	26.6	170	139	31	22.3
Profit for the period	1,695	1,419	276	19.5	428	449	(21)	(4.7)

Explanation
The decrease was mainly attributable to lower service revenues in the Cellular Communications segment and fixed-line telephone revenues in the Domestic Fixed-Line Communications segment.
The decrease was mainly attributable to the Cellular Communications segment.
The decrease was mainly attributable to the Domestic Fixed-Line Communications segment, and the Cellular Communications segment, mainly due to downsizing and a decrease in share-based payments.
The decrease was attributable to the Domestic Fixed-Line Communications and the Cellular Communications segments, as detailed below.
The increase in income in the Period was attributable to the sale of all of Walla! Communications Ltd.'s holdings in the shares of Coral-Tell Ltd., for a pre-tax profit of NIS 582 million. This increase was partially offset by recognition of expenses from the termination of employment by way of early retirement in the Domestic Fixed-Line Communications Segment. The increase in income in the Quarter was mainly attributable to capital gains in the Domestic Fixed-Line Communications segment.
The increase in net finance expenses in the Period was attributable to a decrease in net finance income from the Cellular Communications segment.
This decrease was attributable to a reduction in the losses posted by the Multichannel Television segment.
The increase in the Period was mainly attributable to an increase in the Group's pre-tax profit. The increase in the Quarter was attributable to the Domestic Fixed-Line Communications segment.

1.2.2 Operating segments

A Revenue and operating profit data, presented by the Group's operating segments.

	1-9.2014		1-9.2013		7-9.2014		7-9.2013	
	NIS millions	% of total revenues	NIS millions	% of total revenues	NIS millions	% of total revenues	NIS millions	% of total revenues
<b>Revenues by operating segment</b>								
Domestic Fixed-Line Communications	3,231	47.6	3,377	47.2	1,081	48.4	1,127	47.0
Cellular Communications	2,584	38.0	2,826	39.5	824	36.9	947	39.5
International Communications, Internet and NEP Services	1,105	16.3	1,064	14.9	385	17.2	360	15.0
Multi-Channel Television	1,284	18.9	1,218	17.0	432	19.4	410	17.1
Other and offsets*	(1,411)	(20.8)	(1,331)	(18.6)	(490)	(22.0)	(446)	(18.6)
<b>Total</b>	<b>6,793</b>	<b>100.0</b>	<b>7,154</b>	<b>100.0</b>	<b>2,232</b>	<b>100.0</b>	<b>2,398</b>	<b>100.0</b>

	1-9.2014		1-9.2013		7-9.2014		7-9.2013	
	NIS millions	% of segment revenues	NIS millions	% of segment revenues	NIS millions	% of segment revenues	NIS millions	% of segment revenues
<b>Operating profit by segment</b>								
Domestic Fixed-Line Communications	1,473	45.6	1,539	45.6	498	46.1	494	43.8
Cellular Communications	375	14.5	532	18.8	122	14.8	172	18.2
International Communications, Internet and NEP Services	175	15.8	171	16.1	59	15.3	55	15.3
Multi-Channel Television	215	16.7	207	17.0	76	17.6	72	17.6
Other and offsets*	355**	-	(223)	-	(84)	-	(72)	-
<b>Consolidated operating profit/ % of Group revenues</b>	<b>2,593</b>	<b>38.2</b>	<b>2,226</b>	<b>31.1</b>	<b>671</b>	<b>30.1</b>	<b>721</b>	<b>30.1</b>

(\*) Offsets are mainly attributable to the Multi-Channel Television segment, an associate company.

(\*\*) Includes NIS 582 million in gains on the sale of Coral-Tell Ltd. shares.



## 1.2.2. Operating segments

## B Domestic Fixed-Line Communications Segment

	1-9.2014	1-9.2013	Increase (decrease)		7-9.2014	7-9.2013	Increase (decrease)	
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%
Fixed-line telephony	1,259	1,503	(244)	(16.2)	418	490	(72)	(14.7)
Internet - infrastructure	1,030	963	67	7.0	353	332	21	6.3
Transmission, data communications and others	942	911	31	3.4	310	305	5	1.6
Total revenues	3,231	3,377	(146)	(4.3)	1,081	1,127	(46)	(4.1)
Depreciation and amortization	518	509	9	1.8	178	174	4	2.3
Labor costs	678	755	(77)	(10.2)	227	243	(16)	(6.6)
General and operating expenses	581	672	(91)	(13.5)	203	224	(21)	(9.4)
Other operating income, net	19	98	(79)	(80.6)	25	8	17	-
Operating profit	1,473	1,539	(66)	(4.3)	498	494	4	0.8
Finance expenses, net	159	162	(3)	(1.9)	56	57	(1)	(1.8)

Explanation
This decrease was mainly attributable to a decrease in ARPU, mainly due to the reduction in call termination rates to fixed-line networks starting December 1, 2013.
The increase was mainly attributable to growth in the number of internet subscribers. The increase was partially offset by a decrease in revenues from home router sales following the transition from a sales-based to a rental-based model.
The increase was mainly attributable to transmission services.
The decrease was mainly attributable to a reduction in the workforce and share-based payments, and partially offset by higher wages.
This decrease was mainly attributable to a reduction in call completion fees and a reduction in terminal equipment costs following a transition from selling home network routers, to rental.
The decrease in net income in the Period was attributable to a NIS 133 million expense recognized on the termination of employment by way of early retirement (see Note 6 to the financial statements), and a decrease in profit from copper sales. This decrease in income was partially offset by an increase in capital gains on real estate property sales in the Period and Quarter.
The decrease was mainly attributable to expenses recognized in the corresponding period and quarter last year on the revaluation of a liability to distribute dividends not meeting the profit test, which expired in the corresponding period last year. The decrease was further attributable to lower interest costs following loan repayments. The decrease in net finance expenses was mostly offset by a reduction in finance income on shareholder loans given to D.B.S. (following a more modest increase in the CPI, as compared to the same period and quarter last year); a reduction in interest income on loans given to investees, following a reduction in the volume of these loans; and interest income on current investments.

1.2.2. Operating segments

b. **Domestic Fixed-Line Communications Segment (contd.)**

	1-9.2014	1-9.2013	Increase (decrease)		7-9.2014	7-9.2013	Increase (decrease)	
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%
Income tax	344	318	26	8.2	118	77	41	53.2
Segment profit	970	1,059	(89)	(8.4)	324	360	(36)	(10.0)

Explanation
In the Period and Quarter, income tax accounted for 26.2% and 26.7%, respectively, of profit after net finance expenses, as compared to 23.1% and 17.6%, respectively, in the same periods last year. This increase was attributable to an increase in the corporate income tax rate in 2014, and to tax-deductible expenses recognized in the corresponding quarter last year on employee options.

1.2.2 Operating segments**C Cellular Communications segment**

	1-9.2014	1-9.2013	Increase (decrease)		7-9.2014	7-9.2013	Increase (decrease)	
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%
Services	<b>1,869</b>	2,120	(251)	(11.8)	<b>610</b>	710	(100)	(14.1)
Terminal equipment sales	<b>715</b>	706	9	1.3	<b>214</b>	237	(23)	(9.7)
Total revenues	<b>2,584</b>	2,826	(242)	(8.6)	<b>824</b>	947	(123)	(13.0)
Depreciation and amortization expenses	<b>319</b>	345	(26)	(7.5)	<b>108</b>	111	(3)	(2.7)
Salary expenses	<b>312</b>	334	(22)	(6.6)	<b>100</b>	111	(11)	(9.9)
General and operating expenses	<b>1,578</b>	1,615	(37)	(2.3)	<b>494</b>	553	(59)	(10.7)
Operating profit	<b>375</b>	532	(157)	(29.5)	<b>122</b>	172	(50)	(29.1)
Finance income, net	<b>49</b>	76	(27)	(35.5)	<b>14</b>	17	(3)	(17.6)
Income tax	<b>110</b>	154	(44)	(28.6)	<b>36</b>	49	(13)	(26.5)
Segment profit	<b>314</b>	454	(140)	(30.8)	<b>100</b>	140	(40)	(28.6)

Explanation
The decrease was due to market competition driving down rates and migration of existing customers to cheaper bundles at current market prices, both of which served to lower ARPU. Revenues were also down due to a decrease in the number of subscribers.
The increase in the present Period was mainly attributable to increased sales volumes for DATA products such as tablets and laptop computers, partially offset by a change in the sales mix and an increase in accessories sales. The decrease in the Quarter was mainly attributable to lower sales volumes.
The decrease was mainly attributable to assets whose amortization period has ended, and from cessation of discounting subscriber acquisition costs starting 2012.
The decrease was mainly attributable to a reduction in the workforce and an increase in the value of executive options in the corresponding period and quarter of last year. The present Period also saw a decrease in incentives and bonuses.
General and operating expenses were down mainly due to a decrease in the cost of terminal equipment sales, which was mostly due to cost reductions caused by changes to the sales mix and in the Quarter - also due to lower sales volumes (in the Period - the decrease was partially offset by higher sales volumes). General and operating expenses were also down to a reduction in call completion fees following a reduction in call termination rates to domestic fixed-line communication operators, and lower advertising expenses. This reduction in expenses was partially offset by an increase in distribution fee costs, following an increase in the number of subscribers migrating to this segment; a one-time reduction in net collection costs recorded in the same quarter last year; and an increase in site rental fees in the present Period (following a one-time decrease of NIS 30 million recorded in the same period last year after adjusting a liability estimate).
The decrease in net finance income was mainly attributable to a decrease in credit on installment-based terminal equipment sales, increased costs on currency exchange rate differences following gains made by the USD, and in the present Period - also due to adjustment of a one-time liability which lowered finance expenses in the same period last year. The decrease was partially offset by a decrease in interest expenses following a reduction in the average debt.
The decrease was attributable to the reduction in income before taxes.

1.2.2 Operating segments**D International Communications, Internet and NEP Services**

	1-9.2014	1-9.2013	Increase (decrease)		7-9.2014	7-9.2013	Increase (decrease)	
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%
Revenues	<b>1,105</b>	1,064	41	3.9	<b>385</b>	360	25	6.9
Depreciation and amortization expenses	<b>97</b>	97	-	-	<b>32</b>	33	(1)	(3.0)
Salary expenses	<b>222</b>	213	9	4.2	<b>75</b>	70	5	7.1
Operating, general and other expenses	<b>611</b>	583	28	4.8	<b>219</b>	202	17	8.4
Operating profit	<b>175</b>	171	4	2.3	<b>59</b>	55	4	7.3
Finance expenses, net	<b>7</b>	10	(3)	(30)	<b>2</b>	4	(2)	(50)
Share in the earnings of associates	<b>1</b>	1	-	-	<b>-</b>	1	(1)	(100)
Income tax	<b>45</b>	42	3	7.1	<b>15</b>	13	2	15.4
Segment profit	<b>124</b>	120	4	3.3	<b>42</b>	39	3	7.7

Explanation
The increase was attributable to revenues from enterprise communication solutions (ICT) and data service solutions, and higher internet revenues due to growth in the number of subscribers. This increase was partially offset by a decrease in revenues from outgoing calls, stemming mainly from cellular market migration to plans offering unlimited international calls.
This increase was mainly attributable to an increase in the number of employees providing outsourced services in ICT operations.
This increase was mainly attributable to an increase in ICT and data service expenses, partially offset by a decrease in expenses for outgoing calls, along with the above revenues.

1.2.2 Operating segments**E Multi-Channel Television**

	1-9.2014	1-9.2013	Increase (decrease)		7-9.2014	7-9.2013	Increase (decrease)	
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%
Revenues	<b>1,284</b>	1,218	66	5.4	<b>432</b>	410	22	5.4
Cost of revenues	<b>820</b>	777	43	5.5	<b>276</b>	258	18	7.0
Sales, marketing, general and administrative expenses	<b>249</b>	234	15	6.4	<b>80</b>	80	-	-
Operating profit	<b>215</b>	207	8	3.9	<b>76</b>	72	4	5.6
Finance expenses, net	<b>449</b>	504	(55)	(10.9)	<b>162</b>	208	(46)	(22.1)
Income tax	<b>1</b>	1	-	-	-	-	-	-
Segment loss	<b>(235)</b>	(298)	63	(21.1)	<b>(86)</b>	(136)	50	(36.8)

Explanation
This increase was mainly attributable to an increase in the average number of subscribers.
This increase was mainly attributable to increased depreciation expenses, utilized broadcasting rights, and content costs.
The increase was mainly attributable to increased salary costs and depreciation expenses, partially offset by lower advertising expenses.
The decrease was mainly attributable to linkage differences on debentures and on shareholder loans, due to the more moderate increase in the CPI in the present Period and quarter, as compared to last year, and due to changes in the fair value of forward transactions following gains by the USD.

### 1.3 Cash Flow

	1-9.2014	1-9.2013	Change		7-9.2014	7-9.2013	Change	
	NIS millions	NIS millions	NIS millions	%	NIS millions	NIS millions	NIS millions	%
Net cash from operating activities	3,057	3,217	(160)	(5.0)	950	1,143	(193)	(16.9)
Net cash from (used in) investing activities	(1,579)	(528)	(1,051)	-	(1,022)	246	(1,268)	-
Net cash from (used in) financing activities	(489)	(2,855)	2,366	(82.9)	998	(1,633)	2,631	-
Increase in cash	989	(166)	1,155		926	(244)	1,170	-

Explanation
Net cash from operating activities was down due to a decrease in net profit after profit adjustments (in the present Period mainly due to adjustment of net gains on the sale of Coral-Tell Ltd. shares), partially offset in the present Period by a decrease in working capital.
Net cash used in investing activities was up due to a net increase in the purchase of held-for-trade financial assets in the Domestic Fixed-Line Communications segment, partially offset in the present Period by net proceeds on the sale of holdings in the shares of Coral-Tell Ltd.
Net cash used in financing activities was down due to a decrease in dividend payments as compared to the same periods last year, following the final payment of the dividend not meeting the profit test, and due to timing differences on current dividend payments. Furthermore, additional debt was raised in the present Quarter through a debenture issue in the Domestic Fixed-Line Communications segment.

#### Average volume in the reporting Period:

Long-term liabilities (including current maturities) to financial institutions and debenture holders: NIS 9,720 million.

Supplier credit: NIS 636 million.

Short-term credit to customers: NIS 2,424 million. Long-term credit to customers: NIS 593 million.

### **1.3. Cash Flow (contd.)**

As of September 30, 2014, the Group had a working capital surplus of NIS 1,530 million, as compared to a surplus of NIS 1,090 million on September 30, 2013.

This increase was attributable to an increase in cash and current investments, mostly offset by dividend payable balances as of the financial position statement date, an increase in current debts to debenture holders in the Domestic Fixed-Line Communications segment, and lower trade receivables balances in the Cellular Communications segment.

According to its separate financial statements, the Company had a working capital deficit of NIS 88 million as of September 30, 2014, as compared to a working capital deficit of NIS 162 million on September 30, 2013.

The Company's Board of Directors has reviewed the Company's resources and cash requirements at present and in the foreseeable future, has reviewed the Company's investment needs, and has examined the sources of financing and finance-raising options available to the Company. Based on its review of all the above, the Board of Directors determined that, despite the Company's working capital deficit (according to its separate financial statements), the Company does not face any liquidity problems. The Company can meet its cash requirements at present and in the foreseeable future, both through its existing cash balances, by generating cash from operating activities, by collecting dividends from subsidiaries, and by raising debt from banking and non-banking sources, should the Company so wish.

The above information includes forward-looking information, based on the Company's assessments concerning its liquidity. Actual data may differ materially from these assessments if there is a change in any of the factors taken into account in making them.

## **2. Market Risk - Exposure and Management**

The linkage bases report as of September 30, 2014, is not materially different from the report as of December 31, 2013, except for a NIS 438 million increase in CPI-linked liabilities following expansion of Debentures (Series 6) (see Section 5 below). This increase was partially offset by repayment of debentures in the Domestic Fixed-Line Communications and the Cellular Communications segments.

## **3. Aspects of Corporate Governance**

### **Disclosure concerning the financial statements' approval process**

#### **3.1 Committee**

The Company's Financial Statements Review Committee is a separate committee which does not serve as the Audit Committee. The Committee comprises 4 members, as follows: Yitzhak Idelman, chairman (external director); Mordechai Keret (external director); Tali Simone (external director); and Dr. Yehoshua Rosenzweig (independent director). All Committee members have accounting and financial expertise. All Committee members have submitted a statement prior to their appointment. For more information concerning the directors serving on the Committee, see Chapter D of the Company's Periodic Report for 2013.

#### **3.2 Financial Statements Approval Process**

- A. The Financial Statements Review Committee discussed and finalized its recommendations to the Company's Board of Directors in its meetings of November 2, 2014, and November 6, 2014.

The Committee's meeting of November 2, 2014, was attended by all Committee members and by the Chairman of the Board, Mr. Shaul Elovitch; Company CEO, Ms. Stella Handler; Deputy CEO and CFO, Mr. David Mizrahi; Company Comptroller, Mr. Danny Oz; the Internal Auditor, Mr. Lior Segal; the Legal Counsel, Mr. Amir Nachlieli; Mr. Rami Nomkin - director; the external auditors; and other Company officers. The Committee's meeting of November 6, 2014, was attended, in addition to the above, by the Company secretary, Mrs. Linor Yochelman.

- B. The Committee reviewed, inter alia, the assessments and estimates made in connection with the financial statements; internal controls over financial reporting; full and proper disclosure in the financial statements; and the accounting policies adopted on material matters.
- C. The Committee submitted its recommendations to the Company's Board of Directors in writing on November 6, 2014.

The Board of Directors discussed the Financial Statements Review Committee's recommendations and the financial statements on November 9, 2014.
- D. The Company's Board of Directors believes that the Financial Statements Review Committee's recommendations were submitted a reasonable time (three days) prior to the Board meeting, even taking into account the scope and complexity of these recommendations.
- E. The Company's Board of Directors adopted the Financial Statements Review Committee's recommendations and resolved to approve the Company's financial statements for the third quarter of 2014.

#### **4. Disclosure Concerning the Company's Financial Reporting**

Due to the material nature of legal actions brought against the Group, which cannot yet be assessed or for which the Group cannot yet estimate its exposure, the auditors drew attention to these actions in their opinion concerning the financial statements.

#### **5. Details of debt certificate series**

- 5.1 On August 18, 2014, the Company completed a private issue to classified investors, effected by way of expanding existing Debentures (Series 6) and Debentures (Series 7) issued by the Company under a shelf prospectus dated June 1, 2011, and an amendment to the said prospectus dated June 22, 2011:

Debentures (Series 6) - an issue of NIS 881,096,000 par value, in consideration for NIS 1,029 million.

Debentures (Series 7) - an issue of NIS 118,904,000 par value, in consideration for NIS 119 million.

The terms of the debentures issued as aforesaid are identical to the terms of the debentures already in circulation from those series.

(See Note 11.1 to the financial statements).

5.2 Debentures (Series 5)

On June 1, 2014, the Company repaid NIS 397,827,674 par value in debentures.

As of September 30, 2014, the par value, revalued to the reporting date, was NIS 987,184,379. The fair value on the stock exchange was 1,058,143,317.

- 5.3 On May 13, 2014, Standard & Poor's Maalot Ltd. ("Maalot") affirmed its iIAA/Stable rating for the Company's Debentures (Series 5-8). On August 13, 2014, Maalot approved an iIAA/Stable rating for up to NIS 1 billion par value debentures to be issued by the Company as an expansion of Series 6 and 7. Furthermore, on August 13, 2014, Midroog approved an Aa2 rating, with a stable outlook, for up to NIS 1 billion par value debentures to be issued by the Company as an expansion of Series 6 and 7, as well as for the Company's Debentures (Series 5-8).

For current and historical ratings data for the debentures, see the Company's (amended) immediate report of May 15, 2014 (ref. no. 2014-01-064836) and August 13, 2014 (ref. no. 2014-01-133185) (Maalot), and its immediate report of August 13, 2014 (ref. no. 2014-01-133236) (Midroog Ltd.). The rating reports are included in this Board of Directors' Report by way of reference.



**6. Miscellaneous**

For information concerning the liabilities balances of the reporting corporation and those companies consolidated in its financial statements as of September 30, 2014, see the Company's reporting form on the MAGNA system, dated November 10, 2014.

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

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Shaul Elovitch  
Chairman of the Board

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Stella Handler  
CEO

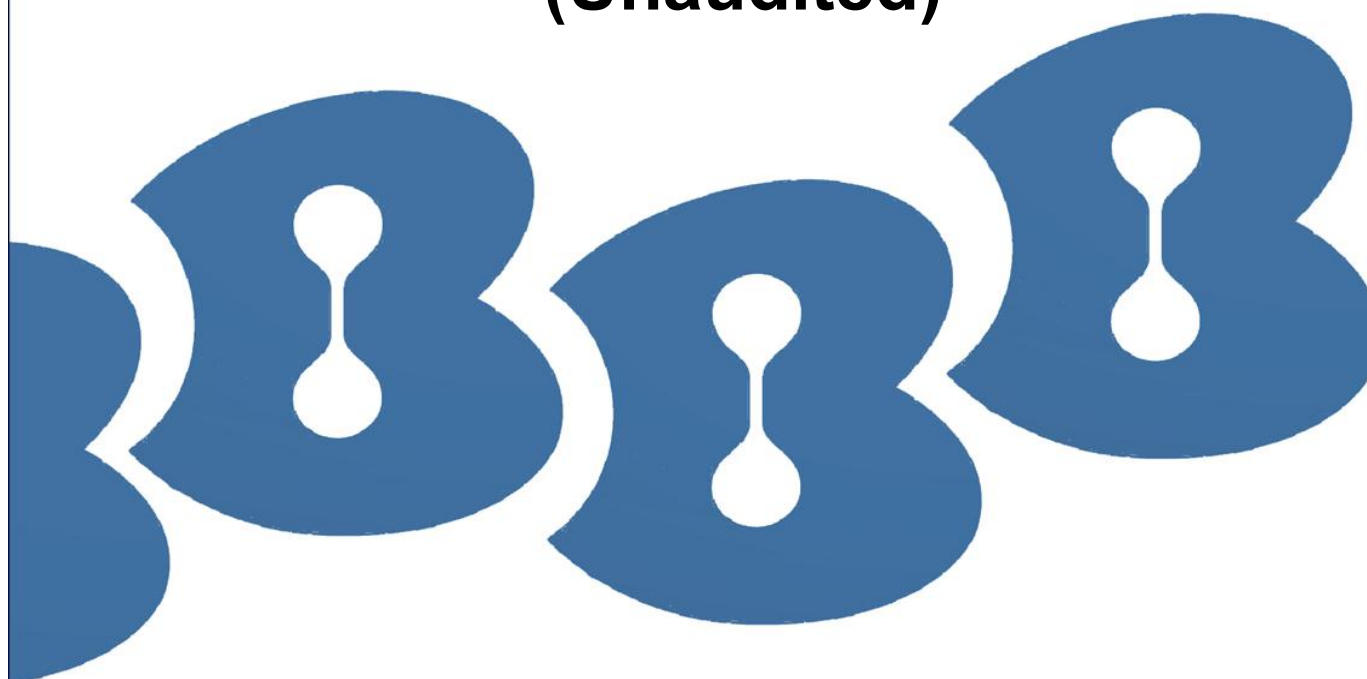
Signed: November 9, 2014

# **Bezeq The Israel Telecommunication Corporation Limited**

## **Condensed Consolidated Interim Financial Statements**

**September 30, 2014**

**(Unaudited)**



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

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**Somekh Chaikin**  
8 Hartum Street, Har Hotzvim  
PO Box 212, Jerusalem 91001  
Israel

Telephone 972 2 531 2000  
Fax 972 2 531 2044  
Internet [www.kpmg.co.il](http://www.kpmg.co.il)

## **Review Report to the Shareholders of**

### **“Bezeq” -The Israel Telecommunication Corporation Ltd.**

#### **Introduction**

We have reviewed the accompanying financial information of “Bezeq” -The Israel Telecommunication Corporation Ltd. and its subsidiaries (hereinafter – “the Group”) comprising of the condensed consolidated interim statement of financial position as of September 30, 2014 and the related condensed consolidated interim statements of income, comprehensive income, changes in equity and cash flows for the nine and three month periods then ended. The Board of Directors and Management are responsible for the preparation and presentation of interim financial information for these interim periods in accordance with IAS 34 “Interim Financial Reporting”, and are also responsible for the preparation of financial information for these interim periods in accordance with Section D of the Securities Regulations (Periodic and Immediate Reports), 1970. Our responsibility is to express a conclusion on interim financial information for these interim periods based on our review.

We did not review the condensed interim financial information of a certain consolidated subsidiary whose assets constitute 0.9% of the total consolidated assets as of September 30 2014, and whose revenues constitute 1.3% and 0.5% of the total consolidated revenues for the nine and three month periods then ended, respectively. The condensed interim financial information of that company was reviewed by other auditors whose review report thereon was furnished to us, and our conclusion, insofar as it relates to amounts emanating from the financial information of that company, is based solely on the said review report of the other auditors.

#### **Scope of Review**

We conducted our review in accordance with Standard on Review Engagements 1, “Review of Interim Financial Information Performed by the Independent Auditor of the Entity” of the Institute of Certified Public Accountants in Israel. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards in Israel and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

#### **Conclusion**

Based on our review and the review report of other auditors, nothing has come to our attention that causes us to believe that the accompanying financial information was not prepared, in all material respects, in accordance with IAS 34.

In addition to that mentioned in the previous paragraph, based on our review and the review report of other auditors, nothing has come to our attention that causes us to believe that the accompanying interim financial information does not comply, in all material respects, with the disclosure requirements of Section D of the Securities Regulations (Periodic and Immediate Reports), 1970.

Without qualifying our abovementioned conclusion, we draw attention to lawsuits filed against the Group which cannot yet be assessed or the exposure in respect thereof cannot yet be estimated, as set forth in Note 5.

Somekh Chaikin

Certified Public Accountants (Isr.)

November 9, 2014

**Condensed Consolidated Interim Statements of Financial Position**

	September 30, 2014	September 30, 2013	December 31, 2013
	(Unaudited)	(Unaudited)	(Audited)
<b>Assets</b>	<b>NIS million</b>	<b>NIS million</b>	<b>NIS million</b>
Cash and cash equivalents	1,599	300	610
Investments, including derivatives	2,495	956	1,132
Trade receivables	2,225	2,791	2,651
Other receivables	286	340	344
Inventory	83	122	117
Assets classified as held for sale	33	83	66
<b>Total current assets</b>	<b>6,721</b>	<b>4,592</b>	<b>4,920</b>
Trade and other receivables	567	701	652
Property, plant and equipment	6,052	5,948	5,973
Intangible assets	1,810	2,105	2,060
Deferred expenses and others	255	260	261
Investments in equity-accounted investees (mainly loans)	1,043	1,000	1,015
Investments	85	90	81
Deferred tax assets	6	93	60
<b>Total non-current assets</b>	<b>9,818</b>	<b>10,197</b>	<b>10,102</b>
<b>Total assets</b>	<b>16,539</b>	<b>14,789</b>	<b>15,022</b>

**Condensed Consolidated Interim Statements of Financial Position (Contd.)**

	September 30, 2014	September 30, 2013	December 31, 2013
	(Unaudited)	(Unaudited)	(Audited)
<b>Liabilities and equity</b>	<b>NIS million</b>	<b>NIS million</b>	<b>NIS million</b>
Debentures, loans and borrowings	1,491	1,067	1,136
Trade payables	572	629	719
Other payables, including derivatives	787	794	707
Current tax liabilities	592	640	523
Provisions	124	124	125
Employee benefits	358	248	257
Dividend payable (Note 7.2)	1,267	-	-
<b>Total current liabilities</b>	<b>5,191</b>	<b>3,502</b>	<b>3,467</b>
Loans and debentures	8,872	8,771	8,691
Employee benefits	231	258	234
Provisions	69	67	68
Deferred tax liabilities	16	63	55
Other liabilities, including derivatives	136	78	84
<b>Total non-current liabilities</b>	<b>9,324</b>	<b>9,237</b>	<b>9,132</b>
<b>Total liabilities</b>	<b>14,515</b>	<b>12,739</b>	<b>12,599</b>
<b>Total equity</b>	<b>2,024</b>	<b>2,050</b>	<b>2,423</b>
<b>Total liabilities and equity</b>	<b>16,539</b>	<b>14,789</b>	<b>15,022</b>

**Shaul Elovitch**  
Chairman of the Board of  
Directors

**Stella Handler**  
CEO

**David (Dudu) Mizrahi**  
Deputy CEO and CFO

Date of approval of the financial statements: November 9, 2014

The attached notes are an integral part of these condensed consolidated interim financial statements.

**Condensed Consolidated Interim Statements of Income**

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
<b>Revenues (Note 8)</b>	<b>6,793</b>	<b>7,154</b>	<b>2,232</b>	<b>2,398</b>	<b>9,563</b>
Costs of activity					
Depreciation and amortization	960	983	327	329	1,311
Salaries	1,328	1,431	437	464	1,872
General and operating expenses (Note 9)	2,513	2,610	822	890	3,576
Other operating income, net (Note 10)	(601)	(96)	(25)	(6)	(15)
	<b>4,200</b>	<b>4,928</b>	<b>1,561</b>	<b>1,677</b>	<b>6,744</b>
<b>Operating profit</b>	<b>2,593</b>	<b>2,226</b>	<b>671</b>	<b>721</b>	<b>2,819</b>
<b>Financing expenses (income)</b>					
Financing expenses	365	447	125	163	573
Financing income	(252)	(351)	(86)	(118)	(428)
Financing expenses, net	113	96	39	45	145
<b>Profit after financing expenses, net</b>	<b>2,480</b>	<b>2,130</b>	<b>632</b>	<b>676</b>	<b>2,674</b>
<b>Share in losses of equity-accounted investees</b>	<b>(132)</b>	<b>(195)</b>	<b>(34)</b>	<b>(88)</b>	<b>(252)</b>
<b>Profit before income tax</b>	<b>2,348</b>	<b>1,935</b>	<b>598</b>	<b>588</b>	<b>2,422</b>
<b>Income tax</b>	<b>653</b>	<b>516</b>	<b>170</b>	<b>139</b>	<b>651</b>
<b>Profit for the period</b>	<b>1,695</b>	<b>1,419</b>	<b>428</b>	<b>449</b>	<b>1,771</b>
<b>Earnings per share (NIS)</b>					
Basic and diluted earnings per share	0.62	0.52	0.16	0.16	0.65

The attached notes are an integral part of these condensed consolidated interim financial statements.

**Condensed Consolidated Interim Statements of Comprehensive Income**

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Profit for the period	1,695	1,419	428	449	1,771
<b>Items of other comprehensive income not transferred to profit and loss</b>					
Actuarial gains, net of tax	-	-	-	-	22
<b>Items of other comprehensive loss (net of tax) to be transferred to profit and loss subsequent to initial recognition in comprehensive income</b>	<b>(33)</b>	<b>(19)</b>	<b>(24)</b>	<b>(9)</b>	<b>(16)</b>
<b>Total comprehensive income for the period</b>	<b>1,662</b>	<b>1,400</b>	<b>404</b>	<b>440</b>	<b>1,777</b>

The attached notes are an integral part of these condensed consolidated interim financial statements.



**Condensed Consolidated Interim Statements of Changes in Equity**

	Share capital	Share premium	Capital reserve for employee options	Capital reserve for transactions between a corporation and a controlling shareholder	Other reserves	Deficit	Total
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
<b>Nine months ended September 30, 2014 (Unaudited):</b>							
Balance as at January 1, 2014	3,842	143	242	390	(67)	(2,127)	2,423
Profit for the period	-	-	-	-	-	1,695	1,695
Other comprehensive loss for the period, net of tax	-	-	-	-	(33)	-	(33)
Total comprehensive income for the period	-	-	-	-	(33)	1,695	1,662
<b>Transactions with owners recognized directly in equity</b>							
Dividends to Company shareholders (see Note 7.2)	-	-	-	-	-	(2,069)	(2,069)
Share-based payments	-	-	(1)	-	-	-	(1)
Exercise of options for shares	9	79	(79)	-	-	-	9
Balance as at September 30, 2014	3,851	222	162	390	(100)	(2,501)	2,024
<b>Nine months ended September 30, 2013 (Unaudited):</b>							
Balance as at January 1, 2013	3,837	100	256	390	(38)	(2,090)	2,455
Profit for the period	-	-	-	-	-	1,419	1,419
Other comprehensive loss for the period, net of tax	-	-	-	-	(19)	-	(19)
Total comprehensive income for the period	-	-	-	-	(19)	1,419	1,400
<b>Transactions with owners recognized directly in equity</b>							
Dividend to Company shareholders	-	-	-	-	-	(1,830)	(1,830)
Share-based payments	-	-	23	-	-	-	23
Exercise of options for shares	2	18	(18)	-	-	-	2
Balance as at September 30, 2013	3,839	118	261	390	(57)	(2,501)	2,050

The attached notes are an integral part of these condensed consolidated interim financial statements.

## Condensed Consolidated Interim Statements of Changes in Equity (Contd.)

	Share capital	Share premium	Capital reserve for employee options	Capital reserve for transactions between a corporation and a controlling shareholder	Other reserves	Deficit	Total
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
<b>Three months ended September 30, 2014 (Unaudited)</b>							
Balance as at July 1, 2014	3,848	198	186	390	(76)	(1,662)	2,884
Profit for the period	-	-	-	-	-	428	428
Other comprehensive loss for the period, net of tax	-	-	-	-	(24)	-	(24)
Total comprehensive income for the period	-	-	-	-	(24)	428	404
<b>Transactions with owners recognized directly in equity</b>							
Dividend to Company shareholders (Note 7.2)	-	-	-	-	-	(1,267)	(1,267)
Exercise of options for shares	3	24	(24)	-	-	-	3
Balance as at September 30, 2014	3,851	222	162	390	(100)	(2,501)	2,024
<b>Three months ended September 30, 2013 (Unaudited)</b>							
Balance as at July 1, 2013	3,838	102	270	390	(48)	(1,981)	2,571
Profit for the period	-	-	-	-	-	449	449
Other comprehensive loss for the period, net of tax	-	-	-	-	(9)	-	(9)
Total comprehensive income for the period	-	-	-	-	(9)	449	440
<b>Transactions with owners recognized directly in equity</b>							
Dividend to Company shareholders	-	-	-	-	-	(969)	(969)
Share-based payments	-	-	7	-	-	-	7
Exercise of options for shares	1	16	(16)	-	-	-	1
Balance as at September 30, 2013	3,839	118	261	390	(57)	(2,501)	2,050
<b>Year ended December 31, 2013 (Audited)</b>							
Balance as at January 1, 2013	3,837	100	256	390	(38)	(2,090)	2,455
Profit in 2013	-	-	-	-	-	1,771	1,771
Other comprehensive income for the year, net of tax	-	-	-	-	(16)	22	6
Total comprehensive income for 2013	-	-	-	-	(16)	1,793	1,777
<b>Transactions with owners recognized directly in equity</b>							
Dividend to Company shareholders	-	-	-	-	-	(1,830)	(1,830)
Share-based payments	-	-	29	-	-	-	29
Exercise of options for shares	5	43	(43)	-	-	-	5
Increase in the rate of holding in a subsidiary	-	-	-	-	(13)	-	(13)
Balance as at December 31, 2013	3,842	143	242	390	(67)	(2,127)	2,423

The attached notes are an integral part of these condensed consolidated interim financial statements.

**Condensed Consolidated Interim Statements of Cash Flows**

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
<b>Cash flows from operating activities</b>					
Profit for the period	1,695	1,419	428	449	1,771
Adjustments:					
Depreciation and amortization	960	983	327	329	1,311
Profit from the sale of Coral Tell Ltd. shares (see Note 4.2)	(582)	-	-	-	-
Share in losses of equity-accounted investees	132	195	34	88	252
Financing expenses, net	174	211	52	82	278
Capital gain, net	(149)	(124)	(28)	(16)	(159)
Share-based payments	(1)	23	-	7	29
Income tax expenses	653	516	170	139	651
Miscellaneous	(7)	(7)	-	3	(22)
Change in inventory	43	(3)	9	19	9
Change in trade and other receivables	529	469	142	201	646
Change in trade and other payables	(118)	(62)	(11)	19	27
Change in provisions	(1)	(30)	(9)	1	(29)
Change in employee benefits	98	(5)	(19)	(23)	2
Change in other liabilities	1	-	-	-	11
Net income tax paid	(370)	(368)	(145)	(155)	(625)
<b>Net cash from operating activities</b>	<b>3,057</b>	<b>3,217</b>	<b>950</b>	<b>1,143</b>	<b>4,152</b>
<b>Cash flow used for investing activities</b>					
Net consideration for the sale of Coral Tell Ltd. shares	596	-	-	-	-
Investment in intangible assets and deferred expenses	(140)	(143)	(50)	(50)	(186)
Proceeds from the sale of property, plant and equipment	147	219	72	53	312
Acquisition of financial assets held for trading and others	(1,497)	(1,308)	(811)	(171)	(1,570)
Proceeds from the sale of financial assets held for trading and others	137	1,445	43	679	1,528
Purchase of property, plant and equipment	(820)	(767)	(272)	(270)	(1,042)
Proceeds from disposal of long-term investments	(8)	6	(7)	-	9
Miscellaneous	6	20	3	5	32
<b>Net cash from (used in) investment activities</b>	<b>(1,579)</b>	<b>(528)</b>	<b>(1,022)</b>	<b>246</b>	<b>(917)</b>

**Condensed Consolidated Interim Statements of Cash Flows (Contd.)**

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
<b>Cash flows used in financing activities</b>					
Issue of debentures and receipt of loans	1,146	869	1,146	-	1,364
Repayment of debentures and loans	(588)	(622)	(126)	(135)	(1,120)
Dividends paid	(802)	(2,830)	-	(1,469)	(2,830)
Interest paid	(244)	(272)	(25)	(33)	(453)
Increase in the rate of holding in a subsidiary	-	-	-	-	(50)
Miscellaneous	(1)	-	3	4	(2)
<b>Net cash from (used in) financing activities</b>	<b>(489)</b>	<b>(2,855)</b>	<b>998</b>	<b>(1,633)</b>	<b>(3,091)</b>
<b>Increase (decrease) in cash and cash equivalents, net</b>	<b>989</b>	<b>(166)</b>	<b>926</b>	<b>(244)</b>	<b>144</b>
Cash and cash equivalents at beginning of period	610	466	673	544	466
<b>Cash and cash equivalents at end of period</b>	<b>1,599</b>	<b>300</b>	<b>1,599</b>	<b>300</b>	<b>610</b>

The attached notes are an integral part of these condensed consolidated interim financial statements.

## Notes to the Financial Statements

### 1. Reporting Entity

Bezeq – The Israel Telecommunication Corporation Limited (“the Company”) is a company registered in Israel whose shares are traded on the Tel Aviv Stock Exchange. The consolidated financial statements of the Company include those of the Company and its subsidiaries (together referred to as “the Group”), as well as the Group’s interests in associates. The Group is a principal provider of communication services in Israel (see also Note 12 – Segment Reporting).

### 2. Basis of Preparation

2.1 The condensed interim consolidated financial statements have been prepared in accordance with IAS 34 – Interim Financial Reporting, and Chapter D of the Securities Regulations (Periodic and Immediate Reports), 1970.

2.2 The condensed consolidated interim financial statements do not contain all the information required in full annual financial statements, and should be reviewed in the context of the annual financial statements of the Company and its subsidiaries as at December 31, 2013 and the year then ended, and their accompanying notes (“the Annual Financial Statements”). The notes to the interim financial statements include only the material changes that have occurred from the date of the most recent Annual Financial Statements until the date of these consolidated interim financial statements.

2.3 The condensed consolidated interim financial statements were approved by the Board of Directors on November 9, 2014.

#### 2.4 Use of estimates and judgment

The preparation of the condensed consolidated interim financial statements in conformity with IFRS requires management to make judgments and use estimates, assessments and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

The judgments made by management, when applying the Group’s accounting policies and the key assumptions used in assessments that involve uncertainty, are consistent with those applied in the Annual Financial Statements.

### 3. Reporting Principles and Accounting Policy

3.1 The Group’s accounting policy applied in these condensed consolidated interim financial statements is consistent with the policy applied in the Annual Financial Statements, except as described in section 3.2 below.

3.2 As from January 1, 2014, the Group applies the amendment to IAS 32, “Financial Instruments: Presentation”, which refers to offsetting financial assets and financial liabilities. Application of the amendment to IAS 32 did not have a material effect on the Group’s financial statements.

#### 3.3 New standards and interpretations not yet adopted

##### 3.3.1 IFRS 15, “Revenues from Contracts with Customers”, issued in May 2014 (“IFRS 15”)

IFRS 15 replaces current guidelines for revenue recognition and presents a new model for recognition of revenues from contracts with customers. The model includes five steps for analyzing transactions to determine the timing and amount of revenue recognition. IFRS 15 also establishes new and more extensive disclosure requirements. IFRS 15 will be effective for annual periods starting from January 1, 2017. Early adoption is permitted. IFRS 15 includes various alternatives for the transition guidelines, so that companies may choose one alternative upon initial application. The Group is examining the effects of adopting IFRS 15 on the financial statements.

## 3.3.2 IFRS 9 (2014), "Financial Instruments", issued in July 2014 ("IFRS 9")

IFRS 9 replaces the requirements included in IAS 39 regarding classification and measurement of financial assets and financial liabilities, hedge accounting, and impairment of financial instruments. IFRS 9 is effective for annual periods beginning on January 1, 2018. Early adoption is permitted, subject to the conditions set out in the Standard. The Standard is to be applied retrospectively other than in a number of exceptions as indicated in the transitional provisions included in the Standard. The Group is examining the effects of adopting IFRS 9 on the financial statements.

## 4. Group Entities

A detailed description of the Group entities appears in Note 10 to the Annual Financial Statements. Below is a description of the material changes that occurred in connection with the Group entities since publication of the Annual Financial Statements.

### 4.1. DBS Satellite Services (1998) Ltd. (an equity-accounted associate) ("DBS")

4.1.1 The Group attaches the condensed interim financial statements of DBS to these condensed consolidated interim financial statements.

4.1.2 Further to Note 10.1.2 to the Annual Financial Statements regarding publication of the terms for the Antitrust Commissioner's approval of the merger between the Company and DBS, on March 26, 2014, the Antitrust Commissioner informed the Company that on fulfillment of certain conditions, the restrictions imposed on Eurocom Group for its continued holding of DBS will be lifted and the Company will be permitted to merge with DBS ("the Merger").

The Company appointed a subcommittee of the Board of Directors to advance, with the support of external consultants chosen by the committee, a review of the feasibility of the merger and available options in view of the above decision and its conditions, including the acquisition of DBS shares that are held by Eurocom and other options. As part of these assessments, the Company is performing due diligence for DBS with the assistance of external consultants.

As of this date, as part of the review of the options available to the Company, the parties are discussing the possible acquisition of DBS shares that are held by Eurocom.

4.1.3 Summary of the statement of DBS's financial position and statement of income (without adjustment for ownership rates held by the Group)

Selected data from the statement of financial position

	September 30, 2014	September 30, 2013	December 31, 2013
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Current assets	394	174	291
Non-current assets	1,358	1,305	1,326
<b>Total assets</b>	<b>1,752</b>	<b>1,479</b>	<b>1,617</b>
Current liabilities	964	907	970
Non-current liabilities	5,366	4,831	4,990
<b>Total liabilities</b>	<b>6,330</b>	<b>5,738</b>	<b>5,960</b>
Capital deficit	(4,578)	(4,259)	(4,343)
<b>Total liabilities and equity</b>	<b>1,752</b>	<b>1,479</b>	<b>1,617</b>
<b>Carrying amount of investment</b>	<b>1,012</b>	<b>984</b>	<b>979</b>

## Selected data from the statement of income

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues	1,284	1,218	432	410	1,635
Total loss for the year	(235)	(298)	(86)	(136)	(381)
Company's share in total loss as stated in the statement of income	(128)	(196)	(34)	(88)	(250)

4.1.4 Financial position of DBS

- A. Since starting its operations, DBS has accumulated considerable losses. The loss of DBS in 2013 amounted to NIS 381 million and the losses in the nine month period ended September 30, 2014 amounted to NIS 235 million. As a result of these losses, as of September 30, 2014, DBS had an equity deficit and a working capital deficit of NIS 4,578 million and NIS 571 million, respectively.
- B. As of September 30, 2014, DBS complied with the financial covenants established under its financing and debenture agreements. As of September 30, 2014, DBS complied with the debt/EBITDA ratio covenant established in Deed of Trust B (the debt/EBITDA ratio of DBS as of September 30, 2014, was 2.8). Furthermore, DBS complied with the debt/EBITDA ratio covenant specified by the 2012 Debentures (as of September 30, 2014, the debt/EBITDA ratio of DBS was 2.6), and the debt/(E-C) ratio covenant specified by the 2012 Debentures (as of September 30, 2014, the debt/(E-C) ratio was 6.4).
- C. On April 1, 2014, S&P Maalot announced a rating of -ilA for additional debentures to be issued by DBS up to a total par value of NIS 250 million by a new debenture issue or expansion of an existing series.

In April 2014, DBS issued additional debentures (Series A) by way of expanding the series by a total of NIS 253 million, and issued additional debentures (Series B) by way of expanding the series by a total of NIS 47 million.

On April 30, 2014, S&P Maalot upgraded its rating for DBS and its debentures to ilA (stable), and placed the rating on the Credit Watch list with a positive outlook.

In addition, on September 30, 2014, S&P Maalot announced a rating of ilA for additional debentures to be issued by DBS up to a total par value of NIS 250 million by a new debenture issue or expansion of an existing series.

On October 7, 2014, DBS issued additional debentures (Series B) by expanding the series, amounting to NIS 30 million.

For information about the terms of the debentures, see note 10.1.6 to the Annual Financial Statements.

- D. The management of DBS estimates that the financing resources available to DBS, which include the working capital deficit and the potential amount of finances raised, will be sufficient for the operations of DBS for the coming year, based on the cash flow forecast approved by DBS's board of directors. If additional resources are required to meet its operating requirements for the

coming year, DBS will adjust its operations to preclude the need for additional resources beyond those currently at its disposal.

#### **4.2. Coral Tell Ltd. (a previously consolidated company)**

On May 20, 2014, the sale of the entire share capital of Coral Tell Ltd. was completed for NIS 805 million. Coral Tell Ltd. is wholly-owned by the Company indirectly through Walla! Communications Ltd. ("Walla"), which operates Yad2. The sale agreement included an undertaking by Walla and the Company to refrain from engaging in Coral Tel's fields of activity for 24 months. The pre-tax profit arising from the sale amounted to NIS 582 million, and the profit net of tax amounted to NIS 437 million.

Following the sale, intangible assets and goodwill amounting to NIS 187 million were derecognized.

### **5. Contingent liabilities**

During the normal course of business, legal claims were filed against Group companies or there are pending claims (in this section: "Legal Claims").

In the opinion of the managements of the Group companies, based, inter alia, on legal opinions as to the likelihood of success of the legal claims, the financial statements include appropriate provisions of NIS 111 million, where provisions are required to cover the exposure arising from such legal claims.

In the opinion of the managements of the Group companies, the additional exposure (beyond these provisions) as at September 30, 2014 for claims filed against Group companies on various matters and which are unlikely to be realized, amounted to NIS 3.1 billion. There is also an additional exposure of NIS 762 million for claims, the chances of which cannot yet be assessed.

In addition, motions for certification of class actions have been filed against the Group companies and associates, for which the Group has additional exposure beyond the aforesaid, since the exact amount of the claim is not stated in the claim.

This amount and all the amounts of the additional exposure in this note are linked to the CPI and are stated net of interest. For updates subsequent to the reporting date, see section 5.2 below.



5.1 Following is a detailed description of the Group's contingent liabilities as at September 30, 2014, classified into groups with similar characteristics:

Claims group	Nature of claims	Provision Balance	Additional exposure	Exposure for claims that cannot yet be assessed
		NIS million		
Claims of employees and former employees of Group companies	Mainly collective and individual claims filed by employees and former employees of the Company in respect of recognition of various salary components as components for calculation of payments to Company employees, some of which have wide ramifications in the Company.	64	77	1
Customer claims	Mainly motions for certification of class actions concerning contentions of unlawful collection of payment and impairment of the service provided by the Group companies.	21	2,798	735
Supplier and communication provider claims	Claims filed by suppliers of goods and/or services to Group companies or by communications providers that the Group companies supply goods and/or services to or receive goods and/or services from. These claims are usually for compensation for alleged damage as a result of the supply of the service and/or the product.	-	128	2
Claims for punitive damages, real estate and infrastructure	Claims for alleged physical damage or damage to property caused by Group companies (including in relation to environmental quality and radiation) and regarding real estate and infrastructure. The additional amount of exposure for punitive damages does not include claims for which the insurance coverage is not disputed.	1	48	24
Claims by enterprises and companies	Claims alleging liability of the Group companies in respect of their activities and/or the investments made in various projects.	11	48	-
Claims by the State and authorities	Various claims by the State of Israel, government institutions and authorities ("the Authorities"). These are mainly procedures related to regulations relevant to the Group companies and financial disputes concerning monies paid by the Group companies to the authorities (including property taxes) or by the authorities to the Group companies.	14	49	-
<b>Total legal claims against the Company and subsidiaries</b>		<b>111</b>	<b>3,148</b>	<b>762</b>
<b>Contingent liabilities for legal claims against associates</b>		<b>8</b>	<b>552</b>	<b>273</b>

5.2 Subsequent to the reporting date, claims amounting to NIS 158 million were filed against the Group companies. At the approval date of the financial statements, the exposure for these claims cannot yet be assessed. In addition, a claim against an associate company with exposure of NIS 53 million came to an end.

## 6. Employee benefits

- 6.1** Further to Note 14.5 to the Annual Financial Statements, on May 15, 2014, the Company's Board of Directors approved a provision of NIS 116.5 million for the voluntary redundancy of 101 employee, in accordance with the terms of the collective agreement of December 2006, as amended in December 2010. The Board of Directors also approved the voluntary redundancy of additional employees in an increased compensation track, in accordance with the Company's requirements. In view of the above, the Company included a provision of NIS 116.5 million in its financial statements for the second quarter of 2014. Total expenses for voluntary redundancy in the nine months ended September 30, 2014 amounted to NIS 133 million (including additional adjustments for a change in the number and mix of retiring employees).
- 6.2** Further to Note 14.9 to the Annual Financial Statements regarding the Company's claim against Keren Makefet Pension and Provident Center - Cooperative Society Ltd. (Under Special Management) for compensation in respect of the calculation of voluntary retirement costs of NIS 280 million for employees who were transferred to the Company from the Ministry of Communications, in September 2014, the Company received a ruling from the District Labor Court in Tel Aviv dismissing the claim.

## 7. Capital

- 7.1** Below are details of the Company's equity:

Registered			Issued and paid up		
September 30, 2014	September 30, 2013	December 31, 2013	September 30, 2014	September 30, 2013	December 31, 2013
(Unaudited)	(Unaudited)	(Audited)	(Unaudited)	(Unaudited)	(Audited)
Number of shares	Number of shares	Number of shares	Number of shares	Number of shares	Number of shares
2,825,000,000	2,825,000,000	2,825,000,000	2,738,776,941	2,727,545,950	2,730,129,689

- 7.2** On March 27, 2014, the general meeting of the Company's shareholders approved the recommendation of the Company's Board of Directors of March 5, 2014 to distribute a cash dividend to the shareholders of the Company in the amount of NIS 802 million (representing NIS 0.2935753 per share on the ex-date). The dividend was paid in cash on April 23, 2014.

In addition, on September 3, 2014, the general meeting of the Company's shareholders approved the recommendation of the Company's Board of Directors of August 6, 2014 to distribute a cash dividend to the shareholders of the Company in the amount of NIS 1,267 million (representing NIS 0.4626823 per share on the ex-date). The dividend was paid in cash on October 2, 2014.

- 7.3** The balance of the distributable profits as at the reporting date (subject to fulfillment of the distribution tests) amounts to NIS 428 million (surpluses accumulated in the last two years after deducting prior distributions).

## 8. Revenues

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
<b>Domestic fixed-line communication</b>					
Fixed-line telephony	1,234	1,444	410	465	1,908
Internet - infrastructure	1,029	963	352	332	1,283
Transmission and data communication	606	603	198	209	794
Other services	167	162	55	51	220
	3,036	3,172	1,015	1,057	4,205
<b>Cellular telephony</b>					
Cellular services and terminal equipment	1,828	2,072	596	695	2,744
Sale of terminal equipment	715	706	215	237	1,000
	2,543	2,778	811	932	3,744
<b>International communications, internet and NEP services</b>					
	1,048	1,022	359	346	1,367
<b>Other</b>					
	166	182	47	63	247
	6,793	7,154	2,232	2,398	9,563

## 9. General and Operating Expenses

	Nine months ended September 30		Three months ended September 30		For the year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Terminal equipment and materials	674	769	200	264	1,071
Interconnectivity and payments to domestic and international operators	633	684	219	232	905
Maintenance of buildings and sites	475	456	163	168	607
Marketing and general	421	392	140	126	563
Services and maintenance by sub-contractors	113	107	35	33	162
Vehicle maintenance	115	113	38	38	152
Content services	45	50	15	16	65
Collection fees	37	39	12	13	51
	2,513	2,610	822	890	3,576

**10. Other Operating Income, Net**

	Nine months ended September 30		Three months ended September 30		For the year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Profit from the sale of Coral Tell Ltd. shares (see Note 4.2)	(582)	-	-	-	-
Capital gain from sale of property, plant and equipment (mainly real estate)	(141)	(91)	(27)	(17)	(119)
Profit from copper sales	(8)	(33)	(1)	1	(40)
Provision for severance pay in voluntary redundancy	133	37	8	2	90
Expenses for collective agreement at Pelephone	-	-	-	-	61
Others	(3)	(9)	(5)	8	(7)
	(601)	(96)	(25)	(6)	(15)

**11. Financial instruments****11.1. Issuance of debentures**

On August 18, 2014, the Company completed a private issuance to classified investors by expanding Series 6 debentures and Series 7 debentures, issued in the Company's shelf prospectus of June 1, 2011 and amended on June 22, 2011.

- A. Series 6 debentures - issuance of 881,096,000 par value for NIS 1,029 million.
- B. Series 7 debentures - issuance of 118,904,000 par value for NIS 119 million.

The conditions for these debentures are the same as the conditions for debentures of the same series in circulation. For the conditions of Series 6 and Series 7 debentures, see Note 11 "Debentures, Loans and Borrowings" to the Annual Financial Statements.

## 11.2. Fair value

### 11.2.1 Financial instruments at fair value for disclosure purposes only

The carrying amounts of certain financial assets and liabilities, including cash and cash equivalents, trade receivables, other receivables, short-term investments, deposits, derivatives, some of the loans and credit, trade payables, other payables and declared dividend are the same or proximate to their fair value. The table below shows the differences between the carrying amount and the fair value of financial liabilities.

The methods used to estimate the fair values of financial instruments are described in Note 28.7 to the Annual Financial Statements.

	September 30, 2014		September 30, 2013		December 31, 2013	
	Carrying amount (including accrued interest)	Fair value	Carrying amount (including accrued interest)	Fair value	Carrying amount (including accrued interest)	Fair value
	(Unaudited)		(Unaudited)		(Audited)	
	NIS million		NIS million		NIS million	
Bank loans (unlinked)	2,121	2,287	2,399	2,510	2,086	2,203
Debentures issued to the public (CPI-linked)	3,858	4,509	2,665	2,859	3,132	3,347
Debentures issued to the public (unlinked)	1,354	1,459	1,354	1,476	1,335	1,449
Debentures issued to financial institutions (unlinked)	410	469	410	448	403	444
	7,743	8,724	6,828	7,293	6,956	7,443

### 11.2.2 Fair value hierarchy

The table below presents an analysis of the financial instruments measured at fair value, with details of the evaluation method. The methods used to estimate the fair values of financial instruments are described in Note 28.7 to the Annual Financial Statements.

	September 30, 2014	September 30, 2013	December 31, 2013
	NIS million	NIS million	NIS million
Level 1- investment in exchange-traded funds and financial funds	2,392	941	1,099
Level 2-: forward contracts	(76)	(14)	(25)
Level 3- investment in non-marketable shares	9	4	12
	2,325	931	1,086

## 12. Segment Reporting

### 12.1. Operating segments

Nine months ended September 30, 2014 (Unaudited):							
	Domestic fixed-line communication	Cellular communications	International communications and internet services	Multi- channel television	Other	Adjustment s	Consolidat ed
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	3,033	2,541	1,045	1,284	164	(1,284)	6,783
Inter-segment revenues	198	43	60	-	9	(300)	10
Total revenues	3,231	2,584	1,105	1,284	173	(1,584)	6,793
Depreciation and amortization	518	319	97	218	19	(211)	960
Segment results – operating profit	1,473	375	175	215	632*	(277)	2,593
Financing expenses	355	12	14	475	1	(492)	365
Financing income	(196)	(61)	(7)	(26)	(5)	43	(252)
Total financing expenses (income), net	159	(49)	7	449	(4)	(449)	113
Segment profit (loss) after financing expenses, net	1,314	424	168	(234)	636	172	2,480
Share in profits (losses) of associates	-	-	1	-	(3)	(130)	(132)
Segment profit (loss) before income tax	1,314	424	169	(234)	633	42	2,348
Income tax	344	110	45	1	156	(3)	653
Segment results – net profit (loss)	970	314	124	(235)	477	45	1,695

\* Including income from the sale of Coral Tell Ltd. shares amounting to NIS 582 million. See Note 4.2.

Nine months ended September 30, 2013 (Unaudited):							
	Domestic fixed-line communication	Cellular communications	International communications and internet services	Multi- channel television	Other	Adjustment s	Consolidat ed
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	3,166	2,775	1,020	1,217	181	(1,217)	7,142
Inter-segment revenues	211	51	44	1	14	(309)	12
Total revenues	3,377	2,826	1,064	1,218	195	(1,526)	7,154
Depreciation and amortization	509	345	97	192	23	(183)	983
Segment results – operating profit	1,539	532	171	207	(6)	(217)	2,226
Financing expenses	414	39	17	509	6	(538)	447
Financing income	(252)	(115)	(7)	(5)	(1)	29	(351)
Total financing expenses (income), net	162	(76)	10	504	5	(509)	96
Segment profit (loss) after financing expenses, net	1,377	608	161	(297)	(11)	292	2,130
Share in profits (losses) of associates	-	-	1	-	-	(196)	(195)
Segment profit (loss) before income tax	1,377	608	162	(297)	(11)	96	1,935
Income tax	318	154	42	1	2	(1)	516
Segment results – net profit (loss)	1,059	454	120	(298)	(13)	97	1,419

## 12.1 Operating segments (contd.)

Three months ended September 30, 2014 (Unaudited):							
	Domestic fixed-line communication	Cellular communication	International communications and internet services	Multi- channel television	Other	Adjustment s	Consolidat ed
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	1,016	811	361	432	45	(433)	2,232
Inter-segment revenues	65	13	24	-	2	(104)	-
Total revenues	1,081	824	385	432	47	(537)	2,232
Depreciation and amortization	178	108	32	75	5	(71)	327
Segment results – operating profit	498	122	59	76	(6)	(78)	671
Financing expenses	125	3	5	182	-	(190)	125
Financing income	(69)	(17)	(3)	(20)	(5)	28	(86)
Total financing expenses (income), net	56	(14)	2	162	(5)	(162)	39
Segment profit (loss) after financing expenses, net	442	136	57	(86)	(1)	84	632
Share in losses of associates	-	-	-	-	-	(34)	(34)
Segment profit (loss) before income tax	442	136	57	(86)	(1)	50	598
Income tax	118	36	15	-	2	(1)	170
Segment results – net profit (loss)	324	100	42	(86)	(3)	51	428

Three months ended September 30, 2013 (Unaudited):							
	Domestic fixed-line communication	Cellular communication	International communications and internet services	Multi- channel television	Other	Adjustment s	Consolidat ed
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	1,054	931	345	410	65	(411)	2,394
Inter-segment revenues	73	16	15	-	4	(104)	4
Total revenues	1,127	947	360	410	69	(515)	2,398
Depreciation and amortization	174	111	33	66	8	(63)	329
Segment results – operating profit	494	172	55	72	4	(76)	721
Financing expenses	150	13	6	208	2	(216)	163
Financing income	(93)	(30)	(2)	-	-	7	(118)
Total financing expenses (income), net	57	(17)	4	208	2	(209)	45
Segment profit (loss) after financing expenses, net	437	189	51	(136)	2	133	676
Share in losses of associates	-	-	1	-	-	(89)	(88)
Segment profit (loss) before income tax	437	189	52	(136)	2	44	588
Income tax	77	49	13	-	-	-	139
Segment results – net profit (loss)	360	140	39	(136)	2	44	449

## 12.1 Operating segments (contd.)

Year ended December 31, 2013 (Audited)							
	Domestic fixed-line communication	Cellular communication	International communication and internet services	Multi- channel television	Other	Adjustments	Consolidated
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	4,198	3,741	1,365	1,633	241	(1,633)	9,545
Inter-segment revenues	280	68	68	2	21	(421)	18
Total revenues	4,478	3,809	1,433	1,635	262	(2,054)	9,563
Depreciation and amortization	683	458	130	263	31	(254)	1,311
Segment results – operating profit	1,998	608	227	268	(4)	(278)	2,819
Financing expenses	534	46	23	654	6	(690)	573
Financing income	(317)	(137)	(9)	(7)	-	42	(428)
Total financing expenses (income), net	217	(91)	14	647	6	(648)	145
Segment profit (loss) after financing expenses, net	1,781	699	213	(379)	(10)	370	2,674
Share in profits (losses) of associates	-	-	1	-	-	(253)	(252)
Segment profit (loss) before income tax	1,781	699	214	(379)	(10)	117	2,422
Income tax	410	178	56	2	5	-	651
Segment results – net profit (loss)	1,371	521	158	(381)	(15)	117	1,771

## 12.2. Adjustments of profit and loss for reporting segments

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Operating profit for reporting segments	2,238	2,449	755	793	3,101
Cancellation of expenses for a segment classified as an associate	(215)	(207)	(76)	(72)	(268)
Financing expenses, net	(113)	(96)	(39)	(45)	(145)
Share in losses of associates	(132)	(195)	(34)	(88)	(252)
Other adjustments	570*	(16)	(8)	-	(14)
	2,348	1,935	598	588	2,422

\* Including income from the sale of Coral Tell Ltd. shares amounting to NIS 582 million



### 13. Condensed Financial Statements of Telephone Communications Ltd. and Bezeq International Ltd.

#### 13.1. Telephone Communications Ltd.

Selected data from the statement of financial position:

	September 30, 2014	September 30, 2013	December 31, 2013
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Current assets	1,790	1,983	2,073
Non-current assets	1,927	2,115	2,053
	3,717	4,098	4,126
Current liabilities	840	883	1,037
Long-term liabilities	90	400	205
<b>Total liabilities</b>	<b>930</b>	<b>1,283</b>	<b>1,242</b>
Equity	2,787	2,815	2,884
	3,717	4,098	4,126

Selected data from the statement of income:

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from services	1,869	2,120	610	710	2,808
Revenues from sales of terminal equipment	715	706	214	237	1,001
<b>Total revenues from services and sales</b>	<b>2,584</b>	<b>2,826</b>	<b>824</b>	<b>947</b>	<b>3,809</b>
Cost of services and sales	1,894	1,978	601	675	2,711
<b>Gross profit</b>	<b>690</b>	<b>848</b>	<b>223</b>	<b>272</b>	<b>1,098</b>
Selling and marketing expenses	235	230	76	69	320
General and administrative expenses	80	86	25	31	109
Other operating expenses	-	-	-	-	61
	315	316	101	100	490
<b>Operating profit</b>	<b>375</b>	<b>532</b>	<b>122</b>	<b>172</b>	<b>608</b>
Financing expenses	12	39	3	13	46
Financing income	(61)	(115)	(17)	(30)	(137)
<b>Financing income, net</b>	<b>(49)</b>	<b>(76)</b>	<b>(14)</b>	<b>(17)</b>	<b>(91)</b>
<b>Profit before income tax</b>	<b>424</b>	<b>608</b>	<b>136</b>	<b>189</b>	<b>699</b>
Income tax	110	154	36	49	178
<b>Profit for the period</b>	<b>314</b>	<b>454</b>	<b>100</b>	<b>140</b>	<b>521</b>

**13.2. Bezeq International Ltd.**

Selected data from the statement of financial position:

	September 30, 2014	September 30, 2013	December 31, 2013
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Current assets	533	478	494
Non-current assets	739	773	763
	1,272	1,251	1,257
Current liabilities	376	311	311
Long-term liabilities	114	163	129
<b>Total liabilities</b>	<b>490</b>	<b>474</b>	<b>440</b>
Equity	782	777	817
	1,272	1,251	1,257

Selected data from the statement of income:

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from services	1,105	1,064	385	360	1,433
Operating expenses	692	649	246	223	879
Gross profit	413	415	139	137	554
Selling and marketing expenses	154	151	54	49	205
General and administrative expenses	84	93	26	33	119
Other expenses, net	-	-	-	-	3
	238	244	80	82	327
Operating profit	175	171	59	55	227
Financing expenses	14	17	5	6	23
Financing income	(7)	(7)	(3)	(2)	(9)
Financing expenses, net	7	10	2	4	14
Share in profits of equity-accounted associates	1	1	-	1	1
Profit before income tax	169	162	57	52	214
Income tax	45	42	15	13	56
Profit for the period	124	120	42	39	158

# **D.B.S. Satellite Services (1998) Ltd.**

## **Condensed Interim Financial Statements as of September 30, 2014**



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



**Condensed Interim Financial Statements as of September 30, 2014**

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**Somekh Chaikin**

KPMG Millennium Tower  
17 Ha'arbah St. PO Box 609, Tel Aviv 61006  
Israel

Telephone 972 3 684 8000

Fax 972 3 684 8444

Website: [www.kpmg.co.il](http://www.kpmg.co.il)

**Auditors' Review Report to the Shareholders of  
D.B.S. Satellite Services (1998) Ltd.***Introduction*

We have reviewed the accompanying financial information from D.B.S. Satellite Services (1998) Ltd. ("the Company), including the condensed interim statement of financial position as of September 30, 2014, and the condensed interim statements of income, comprehensive income, changes in equity, and cash flows for the nine and three month periods then ended. The Board of Directors and Management are responsible for preparing and presenting the financial information for these periods in accordance with IAS 34 - Interim Financial Reporting. They are also responsible for preparing the financial information for these interim periods in accordance with Chapter D of the Securities Regulations (Periodic and Immediate Reports), 1970. Our responsibility is to express an opinion concerning the financial information for these interim periods based on our review.

*Scope*

We conducted our review in accordance with Review Standard 1 - *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* established by the Institute of Certified Public Accountants in Israel. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards in Israel and consequently does not enable us to be assured that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

*Conclusion*

Based on our review, nothing has come to our attention that causes us to believe that this financial information is not prepared, in all material respects, in accordance with IAS 34.

Additionally, based on our review, nothing has come to our attention that causes us to believe that this financial information does not conform, in all material respects, to the disclosure provisions set forth in Chapter D of the Securities Regulations (Periodic and Immediate Reports), 1970.

Without qualifying our conclusion, we draw attention to Note 4, concerning the Company's financial position.

Somekh Chaikin  
CPAs

November 4, 2014

**Condensed Interim Financial Statements as of September 30, 2014****Condensed Interim Statements of Financial Position as of**

	September 30, 2014	September 30, 2013	December 31, 2013
	(unaudited)	(unaudited)	(audited)
	NIS Thousands	NIS Thousands	NIS Thousands
<b>Assets</b>			
Cash and cash equivalents	207,462	9,300	125,263
Trade receivables	168,522	161,751	164,277
Other receivables	17,782	3,057	1,615
<b>Total current assets</b>	<b>393,766</b>	<b>174,108</b>	<b>291,155</b>
Broadcasting rights - net of exercised rights	431,946	407,040	416,598
Property, plant and equipment, net	785,910	772,790	775,131
Intangible assets, net	140,173	124,986	133,728
<b>Total non-current assets</b>	<b>1,358,029</b>	<b>1,304,816</b>	<b>1,325,457</b>
<b>Total assets</b>	<b>1,751,795</b>	<b>1,478,924</b>	<b>1,616,612</b>

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



**Condensed Interim Financial Statements as of September 30, 2014****Condensed Interim Statements of Financial Position as of**

	September 30, 2014	September 30, 2013	December 31, 2013
	(unaudited)	(unaudited)	(audited)
	NIS Thousands	NIS Thousands	NIS Thousands
<b>Liabilities</b>			
Credit from banks	20,391	36,090	35,785
Current maturities on debentures	355,550	258,903	292,168
Trade payables	428,871	445,611	467,929
Other payables	150,462	154,629	161,318
Provisions	9,019	11,724	12,360
<b>Total current liabilities</b>	<b>964,293</b>	<b>906,957</b>	<b>969,560</b>
Debentures and bank loans	1,406,010	1,321,318	1,387,616
Loans from shareholders	3,933,610	3,462,314	3,571,900
Other long-term liabilities	20,512	43,448	24,931
Employee benefits	5,420	4,278	5,779
<b>Total non-current liabilities</b>	<b>5,365,552</b>	<b>4,831,358</b>	<b>4,990,226</b>
<b>Total liabilities</b>	<b>6,329,845</b>	<b>5,738,315</b>	<b>5,959,786</b>
<b>Equity deficit</b>			
Share capital	29	29	29
Share premium	85,557	85,557	85,557
Options	48,219	48,219	48,219
Capital reserves	1,537,271	1,537,271	1,537,271
Capital reserve for share-based payments	10,280	10,280	10,280
Retained losses	(6,259,406)	(5,940,747)	(6,024,530)
<b>Total equity deficit</b>	<b>(4,578,050)</b>	<b>(4,259,391)</b>	<b>(4,343,174)</b>
<b>Total liabilities and equity</b>	<b>1,751,795</b>	<b>1,478,924</b>	<b>1,616,612</b>

**David Efrati**  
Authorized to sign as Chairman  
of the Board  
(See Note 9)

**Ron Eilon**  
CEO

**Micky Neiman**  
CFO

Financial statements approval date: November 4, 2014

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



**Condensed Interim Financial Statements as of September 30, 2014****Condensed Interim Statements of Income**

	For the nine months ended		For the three months ended		For the year ended
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013	December 31, 2013
	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(audited)
	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands
<b>Revenues</b>	<b>1,283,621</b>	1,217,645	<b>432,264</b>	410,264	1,635,216
Cost of revenues	<b>820,062</b>	776,770	<b>276,057</b>	257,775	1,051,618
<b>Gross profit</b>	<b>463,559</b>	440,875	<b>156,207</b>	152,489	583,598
Sales and marketing expenses	<b>113,590</b>	116,544	<b>33,806</b>	41,196	153,712
General and administrative expenses	<b>134,561</b>	116,910	<b>46,705</b>	38,885	162,372
<b>Operating profit</b>	<b>215,408</b>	207,421	<b>75,696</b>	72,408	267,514
Finance expenses	<b>113,788</b>	132,444	<b>45,276</b>	56,079	167,677
Finance income	<b>(25,920)</b>	(4,712)	<b>(19,841)</b>	-	(6,979)
Finance expenses for shareholder loans, net	<b>361,710</b>	376,572	<b>135,800</b>	152,047	486,158
Finance expenses, net	<b>449,578</b>	504,304	<b>161,235</b>	208,126	646,856
<b>Loss before income tax</b>	<b>(234,170)</b>	(296,883)	<b>(85,539)</b>	(135,718)	(379,342)
Income tax	<b>706</b>	840	<b>237</b>	366	1,352
<b>Loss for the period</b>	<b>(234,876)</b>	(297,723)	<b>(85,776)</b>	(136,084)	(380,694)
<b>Basic and diluted loss per share (NIS)</b>	<b>7,856</b>	9,959	<b>2,869</b>	4,552	12,734

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





**Condensed Interim Financial Statements as of September 30, 2014****Condensed Interim Statements of Comprehensive Income**

	For the nine months ended		For the three months ended		For the year ended
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013	December 31, 2013
	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(audited)
	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands
<b>Loss for the period</b>	<b>(234,876)</b>	<b>(297,723)</b>	<b>(85,776)</b>	<b>(136,084)</b>	<b>(380,694)</b>
<b>Items of other comprehensive income that will not be transferred to profit or loss</b>					
Actuarial gains (losses) on a defined benefit plan	-	166	-	-	(646)
Total other comprehensive income (loss) for the period that will not be transferred to profit or loss	-	166	-	-	(646)
<b>Total comprehensive loss for the period</b>	<b>(234,876)</b>	<b>(297,557)</b>	<b>(85,776)</b>	<b>(136,084)</b>	<b>(381,340)</b>

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



**Condensed Interim Financial Statements as of September 30, 2014****Condensed Interim Statements of Changes in Equity**

	Share capital	Share premium	Options	Capital reserve	Capital reserve for share-based payments	Retained losses	Total
	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands
<b>For the nine months ended September 30, 2014 (unaudited)</b>							
Balance as of January 1, 2014 (audited)	29	85,557	48,219	1,537,271	10,280	(6,024,530)	(4,343,174)
<b>Total comprehensive loss for the period</b>							
Loss for the period	-	-	-	-	-	(234,876)	(234,876)
Other comprehensive income for the period	-	-	-	-	-	-	-
<b>Total comprehensive loss for the period</b>	-	-	-	-	-	(234,876)	(234,876)
<b>Balance as of September 30, 2014 (unaudited)</b>	<b>29</b>	<b>85,557</b>	<b>48,219</b>	<b>1,537,271</b>	<b>10,280</b>	<b>(6,259,406)</b>	<b>(4,578,050)</b>
<b>For the nine months ended September 30, 2013 (unaudited)</b>							
Balance as of January 1, 2013 (audited)	29	85,557	48,219	1,537,271	10,280	(5,643,190)	(3,961,834)
<b>Total comprehensive loss for the period</b>							
Loss for the period	-	-	-	-	-	(297,723)	(297,723)
Other comprehensive income for the period	-	-	-	-	-	166	166
<b>Total comprehensive loss for the period</b>	-	-	-	-	-	(297,557)	(297,557)
<b>Balance as of September 30, 2013 (unaudited)</b>	<b>29</b>	<b>85,557</b>	<b>48,219</b>	<b>1,537,271</b>	<b>10,280</b>	<b>(5,940,747)</b>	<b>(4,259,391)</b>

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



**Condensed Interim Financial Statements as of September 30, 2014****Condensed Interim Statements of Changes in Equity**

	Share capital	Share premium	Options	Capital reserve	Capital reserve for share-based payments	Retained losses	Total
	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands
<b>For the three months ended September 30, 2014 (unaudited)</b>							
<b>Balance as of July 1, 2014 (unaudited)</b>	<b>29</b>	<b>85,557</b>	<b>48,219</b>	<b>1,537,271</b>	<b>10,280</b>	<b>(6,173,630)</b>	<b>(4,492,274)</b>
<b>Total comprehensive loss for the period</b>							
Loss for the period	-	-	-	-	-	(85,776)	(85,776)
Other comprehensive loss for the period	-	-	-	-	-	-	-
<b>Total comprehensive loss for the period</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(85,776)</b>	<b>(85,776)</b>
<b>Balance as of September 30, 2014 (unaudited)</b>	<b>29</b>	<b>85,557</b>	<b>48,219</b>	<b>1,537,271</b>	<b>10,280</b>	<b>(6,259,406)</b>	<b>(4,578,050)</b>
<b>For the three months ended September 30, 2013 (unaudited)</b>							
<b>Balance as of July 1, 2013 (unaudited)</b>	<b>29</b>	<b>85,557</b>	<b>48,219</b>	<b>1,537,271</b>	<b>10,280</b>	<b>(5,804,663)</b>	<b>(4,123,307)</b>
<b>Total comprehensive loss for the period</b>							
Loss for the period	-	-	-	-	-	(136,084)	(136,084)
Other comprehensive loss for the period	-	-	-	-	-	-	-
<b>Total comprehensive loss for the period</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(136,084)</b>	<b>(136,084)</b>
<b>Balance as of September 30, 2013 (unaudited)</b>	<b>29</b>	<b>85,557</b>	<b>48,219</b>	<b>1,537,271</b>	<b>10,280</b>	<b>(5,940,747)</b>	<b>(4,259,391)</b>

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



**Condensed Interim Financial Statements as of September 30, 2014****Condensed Interim Statements of Changes in Equity (Contd.)**

	Share capital	Share premium	Options	Capital reserve	Capital reserve for share-based payments	Retained losses	Total
	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands
<b>For the year ended December 31, 2013 (audited)</b>							
<b>Balance as of January 1, 2013 (audited)</b>	29	85,557	48,219	1,537,271	10,280	(5,643,190)	(3,961,834)
<b>Total comprehensive loss for the year</b>							
Loss for the year	-	-	-	-	-	(380,694)	(380,694)
Other comprehensive loss for the year	-	-	-	-	-	(646)	(646)
<b>Total comprehensive loss for the year</b>	-	-	-	-	-	(381,340)	(381,340)
<b>Balance as of December 31, 2013 (audited)</b>	29	85,557	48,219	1,537,271	10,280	(6,024,530)	(4,343,174)

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



**Condensed Interim Financial Statements as of September 30, 2014****Condensed Interim Statements of Cash Flows**

	For the nine months ended		For the three months ended		For the year ended
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013	December 31, 2013
	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(audited)
	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands
<b>Cash flows from operating activities</b>					
Loss for the period	(234,876)	(297,723)	(85,776)	(136,084)	(380,694)
Adjustments:					
Depreciation and amortization	218,408	192,064	74,848	66,006	262,735
Finance expenses, net	455,622	491,042	169,813	197,567	633,376
Losses (gains) from sale of property, plant and equipment	606	557	272	(167)	320
Income tax expenses	706	840	237	366	1,352
Change in trade receivables	(4,245)	1,292	(2,006)	(938)	(1,234)
Change in other receivables	(16,167)	(1,383)	(12,552)	1,688	59
Change in broadcasting rights	(15,349)	(29,691)	(4,653)	(10,750)	(39,249)
Change in trade and other payables	(83,781)	2,977	(38,473)	9,177	16,076
Change in employee benefits	(359)	(1,393)	(70)	(539)	(704)
	555,441	656,305	187,416	262,410	872,731
Income taxes paid	(838)	(974)	(293)	(500)	(1,550)
<b>Net cash from operating activities</b>	<b>319,727</b>	<b>357,608</b>	<b>101,347</b>	<b>125,826</b>	<b>490,487</b>
<b>Cash flows from investing activities</b>					
Proceeds from the sale of property, plant and equipment	194	329	79	212	474
Purchase of property, plant and equipment	(175,248)	(191,058)	(53,421)	(46,951)	(260,110)
Payments for software and licenses	(34,207)	(50,114)	(10,205)	(19,847)	(63,638)
<b>Net cash used in investing activities</b>	<b>(209,261)</b>	<b>(240,843)</b>	<b>(63,547)</b>	<b>(66,586)</b>	<b>(323,274)</b>

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



**Condensed Interim Financial Statements as of September 30, 2014****Condensed Interim Statements of Cash Flows (Contd.)**

	For the nine months ended		For the three months ended		For the year ended
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013	December 31, 2013
	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(audited)
	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands	NIS Thousands
<b>Cash flows from financing activities</b>					
Repayment of debenture principal	(214,314)	(90,432)	(182,240)	(58,737)	(223,355)
Short-term bank credit and loans, net	(12,392)	(33,232)	1,616	33,621	(33,537)
Payment for finance lease liabilities	(2,839)	(1,653)	(624)	(912)	(2,766)
Interest paid	(97,620)	(81,297)	(35,567)	(23,912)	(121,352)
Debenture issuance, net	298,898	99,149	-	-	339,060
<b>Net cash used in financing activities</b>	<b>(28,267)</b>	<b>(107,465)</b>	<b>(216,815)</b>	<b>(49,940)</b>	<b>(41,950)</b>
<b>Operating activities</b>					
Increase (decrease) in cash and cash equivalents	82,199	9,300	(179,015)	9,300	125,263
Cash and cash equivalents at the beginning of the year	125,263	-	386,477	-	-
<b>Cash and cash equivalents at the end of the year</b>	<b>207,462</b>	<b>9,300</b>	<b>207,462</b>	<b>9,300</b>	<b>125,263</b>

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



## Notes to the Condensed Interim Financial Statements

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### NOTE 1 - THE REPORTING ENTITY

D.B.S. Satellite Services (1998) Ltd. ("the Company") was incorporated in Israel in 1998 and has its main offices in 6 HaYozma Street, Kfar Saba.

The Company holds a Ministry of Communications license for satellite television broadcasts ("the License"). The License is valid until January 2017, and may be extended for additional six-year periods, subject to certain conditions. The Company's operations are subject, inter alia, to the Communications (Telecommunications and Broadcasts) Law, 1982 ("the Communications Law") and the regulations and rules enacted thereunder, and to the terms of the License.

Bezeq - The Israel Telecommunication Corporation Ltd. ("Bezeq") holds 49.78% of the Company's issued capital, and options for an additional 8.6% of the Company's issued capital, which Bezeq may exercise subject to Bezeq and the Company meeting the terms of the merger specified by the Antitrust Authority. The Company's remaining shares are held by Eurocom DBS Ltd. Voting rights granted by these shares are held by a trustee, under an irrevocable letter of appointment and authorization, and pursuant to the Antitrust Commissioner's decision stating, inter alia, that he must use the shares as an owner.

On March 26, 2014, Bezeq received the Antitrust Authority's decision, whereby, subject to certain conditions, the restrictions imposed on the Eurocom Group concerning its continued holding of the Company would be repealed, and the merger between the Company and Bezeq will be permitted.

### NOTE 2 - BASIS OF PREPARATION

#### A. Statement of Compliance

The condensed interim financial statements were prepared in accordance with IAS 34 - Interim Financial Reporting, and does not include all the information required to be presented in the full annual financial statements. These condensed statements should be read in conjunction with the financial statements for the year ended December 31, 2013 ("the Annual Statements"). In addition, these statements were prepared in accordance with Chapter D of the Securities Regulations (Periodic and Immediate Reports), 1970.

The condensed interim financial statements were approved by the Board of Directors on November 4, 2014.

#### B. Use of estimates and judgment

In preparing these condensed financial statements according to IFRS, Management is required to exercise judgment and use assessments, estimates, and assumptions which affect the application of accounting policies and the reported amounts of assets and liabilities, revenues and expenses. It is clarified that actual results may differ from these estimates.

Management's judgment in applying the Company's accounting policies and the key assumptions used in assessments involving uncertainty, are consistent with those applied in preparing the annual financial statements.



**Notes to the Condensed Interim Financial Statements****NOTE 3 - PRINCIPAL ACCOUNTING POLICIES**

Principal accounting policies were applied in these interim financial statements in a manner that is consistent with their application in the Annual Statements for the year ended December 31, 2013, except for the following:

**First-time application of new standards**

Starting January 1, 2014, the Company applies IAS 32 – “Financial Instruments: Presentation”, concerning the offsetting of financial assets and liabilities. Application of the amended standard did not materially affect the Company’s financial statements.

**New standards and interpretations not yet adopted**

Integrated amendments to IAS 16 – “Property, Plant and Equipment”, and IAS 38 – “Intangible Assets”, published in May 2014 (“the Amendment”).

The Amendment clarifies acceptable methods of depreciation and amortization. Application of the Amendments is mandatory starting with the financial statements for annual periods starting on or after January 1, 2016, on a prospective basis. Early adoption of the Amendment is possible, subject to disclosure requirements. The Company will study the effects of the Standard’s adoption on its financial statements.

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

IFRS 15 – “Revenue from Contracts with Customers”, published in May 2014 (“the Standard”).

The Standard supersedes existing guidelines concerning the recognition of revenue, and presents a new model for recognizing revenue from contracts with customers. The model includes a five-step approach to analyzing transactions, in order to determine when revenue is to be recognized, and to what amount. The Standard also establishes new and broader disclosure requirements as compared to the current guidelines. The Standard is to be applied for annual periods starting from January 1, 2017, and earlier adoption is permitted. The Standard includes various alternative transitional provisions, so that companies may choose one of the specified alternatives upon first-time application. The Company is examining the effects of the Standard’s adoption on its financial statements.

IFRS 9 (2014) – “Financial Instruments”, published in July 2014 (“the Standard”).

The Standard supersedes the requirements of IAS 39 concerning the classification and measurement of financial assets and financial liabilities, hedge accounting, and the measurement of impairment on financial instruments. The Standard is to be applied to annual periods starting January 1, 2018. Earlier application is permitted subject to certain conditions set forth in the Standard. The Standard will be applied retrospectively, except for certain allowances, as set forth in the Standard’s transitional provisions. The Company is examining the effects of the Standard’s adoption on its financial statements.





**Notes to the Condensed Interim Financial Statements****NOTE 4 - THE COMPANY'S FINANCIAL POSITION**

- A.** Since the beginning of its operations, the Company has accumulated considerable losses. The Company's loss in 2013 amounted to NIS 381 million, and its loss in the nine months ended September 30, 2014, amounted to NIS 235 million. As a result of these losses, as of September 30, 2014, the Company had an equity deficit and a working capital deficit of NIS 4,578 million and NIS 571 million, respectively.
- B.**
1. As of September 30, 2014, the Company complied with the financial covenants established under its financing and debenture agreements. As of September 30, 2014, the Company complied with the debt/EBITDA ratio covenant established in Deed of Trust B (the Company's debt/EBITDA ratio as of September 30, 2014, was 2.8). Furthermore, the Company complied with the debt/EBITDA ratio covenant specified by the 2012 Debentures (as of September 30, 2014, the Company's debt/EBITDA ratio was 2.6), and the debt/(E-C) ratio covenant specified by the 2012 Debentures (as of September 30, 2014, the debt/(E-C) ratio was 6.4).
  2. For information concerning additional debt raising in and subsequent to the reporting period, see Notes 7 and 8 below.
  3. For information concerning the upgrade of the Company's rating in the reporting period, see Note 7 below.
  4. Management estimates that the financing resources available to the Company, which include, inter alia, the working capital deficit and potential capital raising, will be sufficient for the Company's operating needs in the coming year, based on the forecasted cash flows approved by the Company's Board of Directors. Should additional resources be required to meet the Company's operating needs in the coming year, the Company will adjust its operations so as not to require additional resources beyond those currently at its disposal.

**NOTE 5 - CONTINGENT LIABILITIES****Legal actions**

Various legal actions have been filed or are pending against the Company (in this section: "Legal Actions").

Based, inter alia, on the opinion of its legal counsel concerning the chances for success of these Legal Actions, Management believes that adequate provisions have been included in the financial statements, where such provisions are required, to cover the Company's exposure from the said Legal Actions.

As of September 30, 2014, the Company's exposure to Legal Actions brought against the Company on various matters, totalled NIS 829,283 thousand, of which NIS 273,376 thousand were from actions whose chances cannot be estimated at this time. These amounts and all claimed amounts presented in this Note do not include linkage and interest.

Below are details of material claims pending against the Company as of September 30, 2014, classified into groups with similar characteristics.



## Notes to the Condensed Interim Financial Statements

## NOTE 5 - CONTINGENT LIABILITIES (CONTD.)

A. Employee claims

In the normal course of business, collective and individual Legal Actions have been filed against the Company by its employees and former employees. These claims primarily concern allegations of non-payment of salary components and delay in salary payments. As of September 30, 2014, these claims totaled NIS 82,422 thousand. Based, among other things, on the opinion of its legal counsel concerning the chances of success of these claims, Management believes that adequate provisions have been included in the financial statements, to the amount of NIS 1,919 thousand, where provisions are required to cover the Company's exposure to such claims.

B. Customer claims

In the normal course of business, Legal Actions have been filed against the Company by its customers. These are mainly applications for approval as class actions (and subsequent actions) which usually concern claims of unlawful charges and complaints concerning services provided by the Company. As of September 30, 2014, these claims totaled NIS 746,861 thousand. Based, among other things, on the opinion of its legal counsel concerning the chances of success of these claims, Management believes that adequate provisions have been included in the financial statements, to the amount of NIS 6,416 thousand, where provisions are required to cover the Company's exposure to such claims.

## NOTE 6 - FINANCIAL INSTRUMENTS

## Fair value

A. Fair value vs. carrying amount

The carrying amount of certain financial assets and financial liabilities including cash and cash equivalents, trade receivables, other receivables, deposits, derivatives, bank credit, long and short-term loans and credit, trade payables, other payables, matches or is near their fair value. The fair value of other financial assets and financial liabilities and their respective carrying amounts presented in the statement of financial position, are as follows:

	As of September 30, 2014	
	Carrying amount	Fair value
	NIS Thousands	
Debentures, including accrued interest and bank loans	1,803,952	1,984,253

	As of September 30, 2013	
	Carrying amount	Fair value
	NIS Thousands	
Debentures, including accrued interest	1,618,161	1,812,659

	December 31, 2013	
	Carrying amount	Fair value
	NIS Thousands	
Debentures, including accrued interest	1,712,923	1,933,242



**Notes to the Condensed Interim Financial Statements****NOTE 6 - FINANCIAL INSTRUMENTS (CONTD.)****B. Fair value hierarchy**

The fair value of financial instruments measured at fair value is assessed according to the fair value level in the hierarchy.

The various levels are defined as follows:

- Level 1: Quoted (non-adjusted) prices on an active market for identical instruments.
- Level 2: Directly or indirectly observed data, not included in Level 1 as aforesaid.
- Level 3: Data not based on observed market data.

**C. Data concerning Level 2 fair value measurement**

As of September 30, 2014, the Company made a number of forward transactions to reduce its exposure to changes in the USD exchange rate. The fair value of these forward transactions was determined by using market-observed data. The net fair value of these forward transactions as of September 30, 2014 (asset) totaled NIS 11.3 million.

The net fair value of forward transactions as of September 30, 2013 (liability) totaled NIS 4.7 million, and as of December 31, 2013 (liability) - NIS 6.9 million.

**NOTE 7 - EVENTS IN THE REPORTING PERIOD**

- A. On April 1, 2014, S&P Maalot set an -iIA rating for additional debentures to be issued by the Company up to a total par value amount of NIS 250 million. This issue will be through a new debenture issuance or as an expansion of an existing series.
- B. In April 2014, the Company carried out an additional issuance of Debentures (Series A), effected as an expansion of the existing series by a total of NIS 253 million, and an additional issuance of Debentures (Series B), effected as an expansion of the series by a total of NIS 47 million. For information concerning the terms of these debentures, see Note 14 to the financial statements for December 31, 2013.
- C. On April 30, 2014, S&P Maalot upgraded its rating for the Company and the Company's debentures to iIA (stable), and put this rating on its watch list with a positive outlook.
- D. On September 30, 2014, S&P Maalot set an iIA rating for additional debentures to be issued by the Company up to a total par value of NIS 250 million. This issue will be through a new debenture issue or as an expansion of an existing series.

**NOTE 8 - EVENTS SUBSEQUENT TO THE REPORTING PERIOD**

On October 7, 2014, the Company made an additional issuance of NIS 30 million of Debentures (Series B), effected as an expansion of the existing series. For information concerning the terms and conditions of these debentures, see Note 14 to the financial statements as of December 31, 2013.

**NOTE 9 - APPOINTMENT OF A CHAIRMAN FOR THE FINANCIAL STATEMENTS APPROVAL MEETING**

On the financial statements approval date, the Company's Board of Directors does not have an incumbent Chairperson. Consequently, on November 4, 2014, the Company's Board of Directors authorized David Efrati, a board director in the Company, to chair the Board of Directors meeting in which



**Notes to the Condensed Interim Financial Statements**

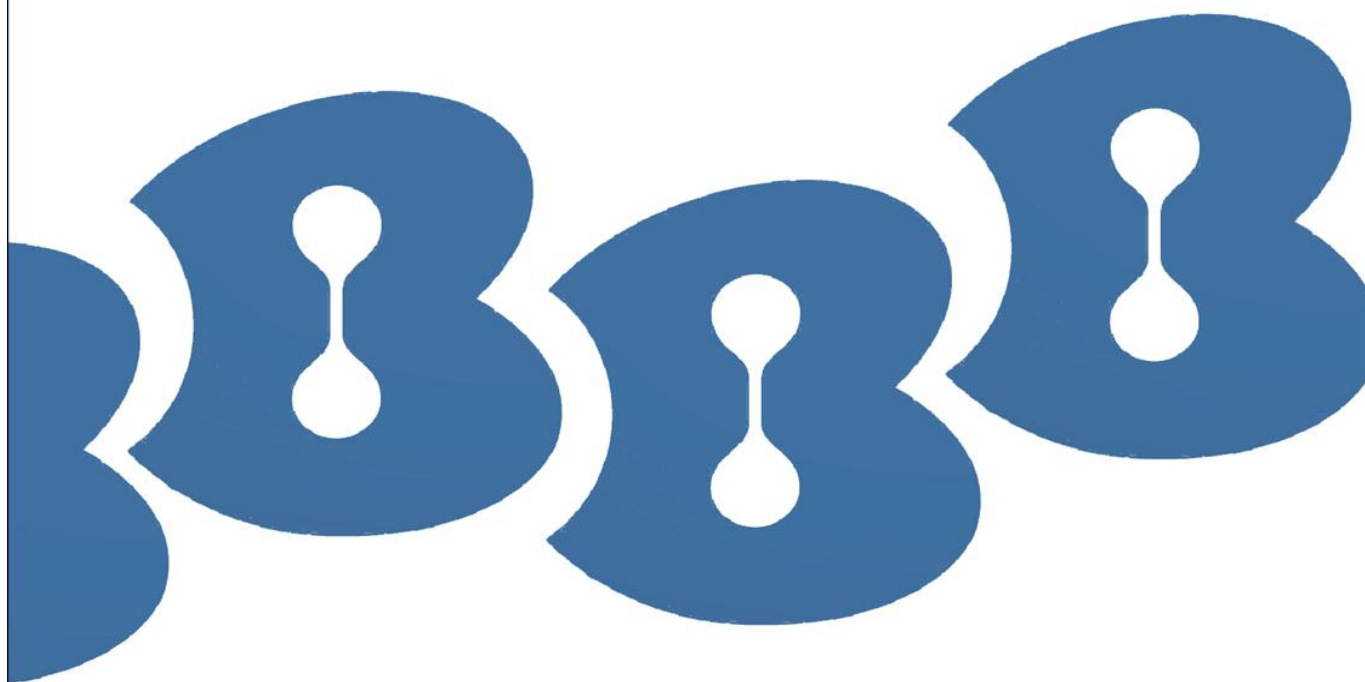
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the financial statements will be approved, and to sign the Company's financial statements for September 30, 2014.



# **Bezeq The Israel Telecommunication Corporation Ltd.**

## **Condensed Separate Interim Financial Information as at September 30, 2014 (Unaudited)**



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

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**Somekh Chaikin**  
8 Hartum Street, Har Hotzvim  
PO Box 212, Jerusalem 91001  
Israel

Telephone 972 2 531 2000  
Fax 972 2 531 2044  
Internet [www.kpmg.co.il](http://www.kpmg.co.il)

To:  
The Shareholders of "Bezeq"- The Israel Telecommunication Corporation Ltd.

**Subject: Special auditors' report on separate interim financial information according to Regulation 38D of the Securities Regulations (Periodic and Immediate Reports) – 1970**

*Introduction*

We have reviewed the separate interim financial information presented in accordance with Regulation 38D of the Securities Regulations (Periodic and Immediate Reports) – 1970 of "Bezeq"- The Israel Telecommunication Corporation Ltd. (hereinafter – "the Company") as of September 30, 2014 and for the nine and three month periods then ended. The separate interim financial information is the responsibility of the Company's Board of Directors and of its Management. Our responsibility is to express a conclusion on the separate interim financial information based on our review.

We did not review the separate interim financial information of an investee company the investment in which amounted to NIS 581 million as of September 30, 2014, and the profit from this investee company amounted to NIS 423 million and NIS 0.3 million for the nine and three month periods then ended, respectively. The financial statements of that company were reviewed by other auditors whose review report thereon was furnished to us, and our conclusion, insofar as it relates to amounts emanating from the financial statements of that company, is based solely on the said review report of the other auditors.

*Scope of Review*

We conducted our review in accordance with Standard on Review Engagements 1, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" of the Institute of Certified Public Accountants in Israel. A review of separate interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards in Israel and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

*Conclusion*

Based on our review and the review report of other auditors, nothing has come to our attention that causes us to believe that the accompanying separate interim financial information was not prepared, in all material respects, in accordance with Regulation 38D of the Securities Regulations (Periodic and Immediate Reports) – 1970.

Without qualifying our abovementioned conclusion, we draw attention to lawsuits filed against the Company which cannot yet be assessed or the exposure in respect thereof cannot yet be estimated, as set forth in Note 4.

Somekh Chaikin  
Certified Public Accountants (Isr.)

November 9, 2014

**Condensed Separate Interim Financial Information as at September 30, 2014 (unaudited)**

**Condensed Interim Information of Financial Position**

	September 30, 2014	September 30, 2013	December 31, 2013
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
<b>Assets</b>			
Cash and cash equivalents	968	85	237
Investments, including derivatives	2,442	944	1,129
Trade receivables	714	761	738
Other receivables	184	194	166
Dividend receivable	295	-	-
Inventory	6	15	7
Loans provided to investees	262	405	498
Assets classified as held for sale	33	83	66
<b>Total current assets</b>	<b>4,904</b>	<b>2,487</b>	<b>2,841</b>
Investments	74	75	67
Trade and other receivables	29	72	61
Property, plant and equipment	4,574	4,377	4,426
Intangible assets	302	338	334
Investment in investees	6,202	5,813	5,890
Loans granted to investees	304	744	555
Deferred tax assets	12	82	50
<b>Total non-current assets</b>	<b>11,497</b>	<b>11,501</b>	<b>11,383</b>
<b>Total assets</b>	<b>16,401</b>	<b>13,988</b>	<b>14,224</b>



**Condensed Interim Information of Financial Position (contd.)**

	September 30, 2014 (Unaudited) NIS million	September 30, 2013 (Unaudited) NIS million	December 31, 2013 (Audited) NIS million
<b>Liabilities</b>			
Debentures, loans and borrowings	1,568	1,061	1,127
Loan from a subsidiary	434	-	-
Trade payables	100	86	129
Other payables, including derivatives	623	543	484
Current tax liabilities	581	638	522
Provisions (Note 4)	99	107	109
Employee benefits	320	214	222
Dividend payable	1,267	-	-
<b>Total current liabilities</b>	<b>4,992</b>	<b>2,649</b>	<b>2,593</b>
Debentures and loans	9,053	8,995	8,926
Employee benefits	198	219	201
Other liabilities, including derivatives	134	75	81
<b>Total non-current liabilities</b>	<b>9,385</b>	<b>9,289</b>	<b>9,208</b>
<b>Total liabilities</b>	<b>14,377</b>	<b>11,938</b>	<b>11,801</b>
<b>Equity</b>			
Share capital	3,851	3,839	3,842
Share premium	222	118	143
Reserves	452	594	565
Deficit Balance	(2,501)	(2,501)	(2,127)
<b>Total equity attributable to equity holders of the Company</b>	<b>2,024</b>	<b>2,050</b>	<b>2,423</b>
<b>Total liabilities and equity</b>	<b>16,401</b>	<b>13,988</b>	<b>14,224</b>

**Shaul Elovitch**  
Chairman of the Board of Directors

**Stella Handler**  
CEO

**David (Dudu) Mizrahi**  
Deputy CEO and CFO

Date of approval of the financial statements: November 9, 2014

The attached notes are an integral part of these condensed separate interim financial information.

**Condensed Separate Interim Financial Information as at September 30, 2014 (unaudited)**

**Condensed Interim Information of Income**

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
<b>Revenues (Note 2)</b>	<b>3,231</b>	<b>3,377</b>	<b>1,081</b>	<b>1,127</b>	<b>4,478</b>
<b>Cost of Activities</b>					
Depreciation and amortization	518	509	178	174	683
Salaries	678	755	227	243	980
Operating and general expenses (Note 3)	581	672	203	224	895
Other operating income, net	(19)	(98)	(25)	(8)	(78)
	<b>1,758</b>	<b>1,838</b>	<b>583</b>	<b>633</b>	<b>2,480</b>
<b>Operating profit</b>	<b>1,473</b>	<b>1,539</b>	<b>498</b>	<b>494</b>	<b>1,998</b>
<b>Finance expenses (income)</b>					
Finance expenses	355	414	125	150	534
Finance income	(196)	(252)	(69)	(93)	(317)
Finance expenses, net	159	162	56	57	217
<b>Profit after financing expenses, net</b>	<b>1,314</b>	<b>1,377</b>	<b>442</b>	<b>437</b>	<b>1,781</b>
<b>Share in earnings of investees, net</b>	<b>725</b>	<b>360</b>	<b>104</b>	<b>89</b>	<b>400</b>
<b>Profit before income tax</b>	<b>2,039</b>	<b>1,737</b>	<b>546</b>	<b>526</b>	<b>2,181</b>
<b>Income tax</b>	<b>344</b>	<b>318</b>	<b>118</b>	<b>77</b>	<b>410</b>
<b>Profit for the period</b>	<b>1,695</b>	<b>1,419</b>	<b>428</b>	<b>449</b>	<b>1,771</b>

**Condensed Interim Information of Comprehensive Income**

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Profit for the period	1,695	1,419	428	449	1,771
Actuarial gains, net of tax	-	-	-	-	17
Other items of other comprehensive loss for the period, net of tax	(33)	(19)	(24)	(9)	(11)
<b>Total comprehensive income for the period</b>	<b>1,662</b>	<b>1,400</b>	<b>404</b>	<b>440</b>	<b>1,777</b>

The attached notes are an integral part of these condensed separate interim financial information.

**Condensed Interim Information of Cash Flows**

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
<b>Cash flows from operating activities</b>					
Profit for the period	1,695	1,419	428	449	1,771
Adjustments:					
Depreciation and amortization	518	509	178	174	683
Share in earnings of investees, net	(725)	(360)	(104)	(89)	(400)
Financing expenses, net	168	201	63	65	267
Capital gain, net	(148)	(127)	(28)	(15)	(161)
Share-based payment transactions	(1)	23	-	7	29
Income tax expenses	344	318	118	77	410
Sundries	-	(7)	-	3	(7)
Change in inventory	1	(3)	(1)	4	6
Change in trade and other receivables	59	(9)	12	25	25
Change in trade and other payables	28	(7)	44	39	40
Change in provisions	(11)	(31)	(8)	2	(29)
Change in employee benefits	96	(3)	(17)	(18)	3
Net cash from (used in) operating activities due to transactions with investees	(2)	(30)	4	(17)	(35)
Net income tax paid	(262)	(145)	(90)	(75)	(328)
<b>Net cash from operating activities</b>	<b>1,760</b>	<b>1,748</b>	<b>599</b>	<b>631</b>	<b>2,274</b>
<b>Cash flows from investing activities</b>					
Investment in intangible assets	(59)	(63)	(20)	(22)	(86)
Proceeds from the sale of property, plant and equipment	139	214	69	48	304
Acquisition of financial assets held for trading and others	(1,430)	(1,256)	(810)	(165)	(1,486)
Proceeds from the sale of financial assets held for trading and others	125	1,396	31	637	1,441
Purchase of property, plant and equipment	(568)	(504)	(190)	(176)	(703)
Sundries	(4)	14	(6)	1	23
Net cash from investment activities due to transactions with investees	598	977	9	468	1,080
<b>Net cash from (used in) investment activities</b>	<b>(1,199)</b>	<b>778</b>	<b>(917)</b>	<b>791</b>	<b>573</b>

The attached notes are an integral part of these condensed separate interim financial information.

**Condensed Interim Income of Cash Flows (contd.)**

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
<b>Cash flow from financing activities</b>					
Issuance of debentures and receipt of loans	1,146	869	1,146	-	1,360
Repayment of debentures and loans	(373)	(444)	(50)	(50)	(928)
Dividend paid	(802)	(2,830)	-	(1,469)	(2,830)
Interest paid	(234)	(253)	(21)	(25)	(433)
Sundries	(1)	(4)	4	1	-
Loan received from a subsidiary	434	-	-	-	-
<b>Net cash from (used for) financing activities</b>	<b>170</b>	<b>(2,662)</b>	<b>1,079</b>	<b>(1,543)</b>	<b>(2,831)</b>
Increase (decrease) in cash and cash equivalents	731	(136)	761	(121)	16
Cash and cash equivalents at beginning of period	237	221	207	206	221
<b>Cash and cash equivalents at the end of the period</b>	<b>968</b>	<b>85</b>	<b>968</b>	<b>85</b>	<b>237</b>

The attached notes are an integral part of these condensed separate interim financial information.

## Notes to the Condensed Separate Interim Financial Information

**1. Manner of preparing financial information****1.1. Definitions**

"The Company" - Bezeq The Israel Telecommunication Corporation Limited.

"Investee", "the Group", "Subsidiary": as these terms are defined in the Company's consolidated financial statements for 2013.

**1.2. Main principles used for preparing financial information**

The condensed separate interim financial information is presented in accordance with Regulation 38(D) ("the Regulation") and the Tenth Addendum of the Securities Regulations (Periodic and Immediate Reports), 1970 ("the Tenth Addendum") with respect to the separate interim financial information of the corporation. They should be read in conjunction with the separate financial information at and for the year ended December 31, 2013 and in conjunction with the condensed interim consolidated financial statements as at September 30, 2014 ("the Consolidated Financial Statements").

The accounting policies used in these condensed separate interim financial information are in accordance with the accounting policies set out in the separate financial information as of and for the year ended December 31, 2013.

**2. Revenues**

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Fixed-line telephony	1,259	1,503	418	490	1,971
Internet - infrastructure	1,030	963	353	332	1,287
Transmission and data communication	765	740	251	252	990
Other services	177	171	59	53	230
	3,231	3,377	1,081	1,127	4,478

**3. Operating and General Expenses**

	Nine months ended September 30		Three months ended September 30		Year ended December 31
	2014	2013	2014	2013	2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million	NIS million	NIS million
Maintenance of buildings and sites	165	175	57	61	233
Interconnectivity and payments to communications operators	123	170	42	55	220
Marketing and general	140	132	53	47	186
Terminal equipment and materials	33	72	11	22	90
Services and maintenance by sub-contractors	45	47	14	15	64
Vehicle maintenance	56	57	20	18	76
Collection commissions	19	19	6	6	26
	581	672	203	224	895

**4. Contingent Liabilities**

During the normal course of business, legal claims were filed against the Company or there are various pending claims (in this section: "Legal Claims").

In the opinion of the Company's management, based, inter alia, on legal opinions as to the likelihood of success of these litigations, the financial statements include appropriate provisions in the amount of NIS 99 million, where provisions are required to cover the exposure arising from such litigation.

In the opinion of the Company's management, the additional exposure (exceeding the foregoing provisions), as of September 30, 2014 due to legal claims filed against the Company on various matters, which are unlikely to be realized, amounts to a total of NIS 1.2 billion. Of this amount, NIS 374 million is for a claim filed against the Company and other associates without specifying the portion of the amount claimed from each of the plaintiffs. In addition, there is further exposure in the amount of NIS 187 million for claims, the success of which cannot be assessed at this stage. All the foregoing amounts are linked to the consumer price index and are before the addition of interest.

Furthermore, other claims have been filed against the Company as class actions with respect to which the Company has additional exposure beyond the aforesaid amounts, which cannot be quantified as the exact amounts of the claims are not stated in the claims.

For further information concerning contingent liabilities see Note 5 to the Consolidated Financial Statements, Contingent Claims.

**5. Material agreements and transactions with Investees during and subsequent to the reporting period**

- 5.1 In May 2014 Pelephone Communications Ltd. paid the Company a cash dividend in the amount of NIS 206 million, which it had announced in February 2014. In addition, in October 2014, Pelephone paid the Company a cash dividend in the amount of NIS 213 million, which it had announced in July 2014.
- 5.2 In May 2014 Bezeq International Ltd. paid the Company a cash dividend in the amount of NIS 77 million, which it had announced in February 2014. In addition, in October 2014, Bezeq International paid the Company a cash dividend in the amount of NIS 82 million, which it had announced in July 2014.
- 5.3 On May 21, 2014, Walla! Communications Ltd. ("Walla") paid the balance of the loans it received from the Company, in the amount of NIS 58 million. In addition, Walla provided the Company with a loan in the amount of NIS 434 million, bearing annual interest of 4.31%, which is repayable in December 2014.