STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:
B Communications Ltd.

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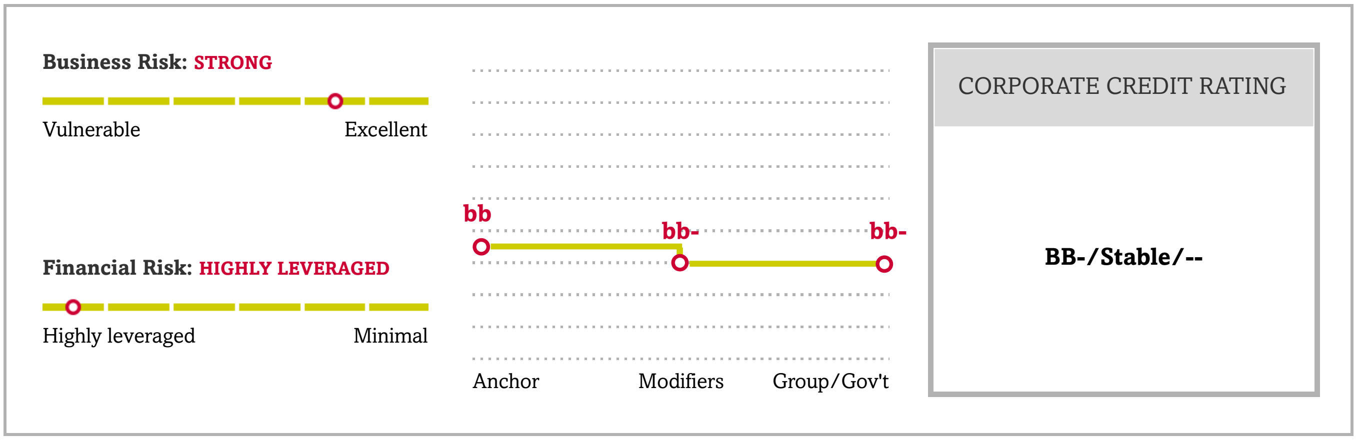

Rationale

Business Risk: Strong	Financial Risk: Highly leveraged
• Bcom's "strong" business risk profile reflects our view of Bezeq's position as the No. 1 telecommunication company in Israel. • Bezeq's leading positions in fixed and mobile telecommunications in Israel. • Higher-than-average profitability with EBITDA margins well over 40%. • Well invested networks and ability to offer network based converged services. • Highly competitive wireless market. • Single country operations.	• High debt burden at Bcom's level. • Highly leveraged debt to dividends of over 6.0x and Standard & Poor's-adjusted debt to EBITDA of about 5.0x. • Loan-to-value ratio of about 45%-50%. • Dividend coverage higher than 1.5x.

Outlook: Stable

The stable outlook reflects Standard & Poor's Ratings Services' expectation that Bezeq will maintain a relatively stable operating performance over the next few years, and continue to distribute 100% of its net income as dividends, while reducing its debt from discretionary cash flows. The outlook also reflects our anticipation that Bcom--which holds a 31% stake in Bezeq and is the ultimate controller--will maintain an "adequate" liquidity position.

Upside scenario

We see limited potential to raise the rating over the next 12 months because we expect debt to dividends to remain higher than 5x and dividend interest cover to remain at around 2x. We could consider a positive rating action if the company substantially reduces its debt.

Downside scenario

We could lower the rating if we see Bezeq's competitive position weakening; for example, if we witness a meaningful decline in its fixed-line market share and declining profitability. We could also consider a negative rating action if the company's liquidity position deteriorates because of a substantial decrease in dividends from Bezeq below New Israeli Shekel (NIS) 1.5 billion or if Bcom distributes meaningful dividends, higher than our expectations, to its shareholders. A decline in dividend interest coverage toward 1.5x could also trigger a downgrade.

Standard & Poor's Base-Case Scenario

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Assumptions

- Full consolidation of DBS Satellite's (YES) financial performances.
- Revenue increase of 5%-7% resulting from DBS purchase(omitting this factor, revenue decline of 5%-7%) in 2015, moderate increase in 2016, and narrow decline in 2017, incorporates the market intensified competition, the implementation of the wholesale market and the consolidation of DBS's financial performances starting 2015;
- Adjusted EBITDA margin will remain above 40% as decline in mobile margins is offset by an increase in broadband operations;
- Capital expenditure (capex) to sales of 16%-18% in 2015 due to investments in long-term evolution and fiber to the home (FTTH) and fiber to the building (FTTB) development. Capex to remain similar in 2016; and
- Dividend payment from Bcom to its shareholders of total NIS120 million-NIS150 million in 2015-2017.

Key Metrics

	2014A	2015E	2016E
Debt to EBITDA* (x)	4.8	4.9-5.2	4.9-5.2
Dividend coverage§ (x)	2.8	1.7-2.0	1.7-2.0
Total coverage§ (x)	2.8	1.2-1.5	1.2-1.5

A--Actual. E--Estimate; §As adjusted by Standard & Poor's.

*Debt includes consolidated debt of both Bezeq and Bcom.

§Total coverage also includes assumed dividend payments.

Business Risk: Strong

Bcom's "strong" business risk profile reflects our view of Bezeq's position as the No. 1 telecommunication company in Israel. Bezeq benefits from a leading brand name and market position in most segments, demonstrated by its market share of 65% in fixed-voice, 65% in broadband, 26% in mobile, and 42% in pay-TV. In comparison with key peers, Bezeq benefits from relatively moderate competition in the local fixed-line segment, which helps it maintain a very high share of the fixed landline and broadband markets. Bezeq further benefits from a well-invested network, enabling it to offer high-quality network-based services across all telecommunications segments. We consider this to be a key competitive advantage that should help Bezeq sustain meaningful market shares in the future. The recently approved merger with YES should assist Bezeq in offering network-based, fully converged services, and offer content across different platforms. In addition, Bezeq's higher-than-average profitability supports its business risk profile. The company's EBITDA margins are well over 40% and we expect them to maintain this level as it is expected to benefit from further cost reduction over the medium term with the removal of the structural separation.

We analyse Bcom using our standard corporate rating methodology because its only holding is a controlling stake in Bezeq (which gives it control of the board of directors), and because it has very limited flexibility to sell shares due to regulatory restrictions. Bezeq pays 100% of its net income to shareholders as ordinary dividends. Bcom's only access to Bezeq's cash flows is through these dividends and therefore we also look at supplementary financial ratios related to dividends from Bezeq.

The business risk profile is constrained by operations in the highly competitive Israeli telecommunications market, where competition in the wireless market is fierce, notably relative to the limited size of the market, leading to high churn and very low average revenue per user. The business risk profile is further constrained by low geographic diversification as Bezeq operates in a single country. We assume that implementing a wholesale broadband market will cause, in the long run, only a limited decline in revenue, because we anticipate that pricing pressures will be largely offset by increased traffic.

Financial Risk: Highly leveraged

We assess Bcom's financial risk profile as "highly leveraged" due to the meaningful debt burden at the level of Bcom, leading to a high ratio of debt to dividends of over 6x and relatively high loan-to-value ratio of about 50%. On an adjusted basis this reflects debt to EBITDA of about 5.0x and adjusted total debt to EBITDA (including debt of parent company, Internet Gold Golden Lines Ltd. [IGLD]), of slightly more than 6.0x. The financial risk also reflects Bcom's limited stake in Bezeq and sole reliance on dividends for its debt service.

We currently forecast that dividends from Bezeq will amount to about NIS450 million-NIS500 million in 2015, leading to a dividend coverage ratio of 1.8x-2.0x and total coverage of 1.2x-1.4x. We expect profitability at Bezeq will be negatively influenced by the mobile and fixed-line operations in 2016. However, we anticipate that the impact on the net income will be more than offset by the benefits of cost-cutting measures, following the removal of structural separation limitations currently imposed on Bezeq, and some tax benefits from the merger with YES.

Liquidity: Adequate

We assess Bcom's liquidity as "adequate," under our criteria. Our forecast of ongoing dividend payments from Bezeq, substantial cash balances, and limited debt maturities over the next two years, underpin our assessment. We anticipate that liquidity sources will exceed liquidity uses by about 3.0x over the next 12 months. We do not assess the company's liquidity as strong because its only source for debt payments is its dividend from Bezeq. Therefore, Bcom depends heavily on Bezeq's adequate standing in the capital market and its refinancing abilities.

Principal Liquidity Sources	Principal Liquidity Uses
• Available cash balances of about NIS550 million; • Restricted cash in lockbox of about NIS270 million; and • Subsidiary dividends of about NIS480 million.	• Debt (interest and principal) payments of about NIS446 million over the next 12 months; • OPEX needs of about NIS5 million; and • Potential dividends to shareholders, which would be paid from cash outside the lockbox.

Ratings Score Snapshot

Corporate Credit Rating

BB-/Stable/--

Business risk: Strong

- **Country risk:** Intermediate
- **Industry risk:** Intermediate
- **Competitive position:** Strong

Financial risk: Highly leveraged

- **Cash flow/Leverage:** Highly leveraged

Anchor: bb

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Negative (-1 notch)

Stand-alone credit profile : bb-

Recovery Analysis

Key Analytical Factors

- The issue rating on the senior secured bonds is 'BB-' with a recovery rating of '3' (upper-end of the range). Our recovery rating reflects our view of the comprehensive, but weak, security package, which includes first-ranking pledges over a 30% stake in Bezeq.
- We view the security as weak, given that it is in equity, with a volatile valuation and a less-than-liquid stock, given the need for prior approval and supervision from the Israeli Ministry of Communications. That said, we note that Bezeq is the largest telecommunications provider in Israel, and value would likely remain in the equity at the point of default.
- The documentation contains a lockbox mechanism, which, in our view, provides lenders with additional protection against 100% of dividends from Bezeq being upstreamed above Bcom. The documentation mandates that at least six months' debt service cover and 50% of the residual dividends will be stored in escrow for the benefit of noteholders (and the unsecured noteholders remaining at Bcom). Additional restrictions include incurring additional debt subject to a net leverage covenant.
- Our hypothetical default scenario assumes that Bezeq will underperform, particularly in its fixed-line operations, leading
- to significantly reduced or no dividend inflows to Bcom and a default in 2020.

Simulated Default Assumptions	Simplified Waterfall
• Year of default: 2020 • Jurisdiction: Israel	• Gross enterprise value at default: NIS2.2 billion • Administrative costs: NIS190 million • Net value available to creditors: NIS2.0 billion • Secured debt claims: NIS2.9 billion* • --Recovery expectation: 50%-70% (upper-end of the range) *All debt amounts include six months' prepetition interest.

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Revised Revolver Usage Assumptions For Recovery Analysis In Corporate Ratings, Nov. 20, 2014
- Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt, Aug. 10, 2009
- Jurisdiction-Specific Adjustments To Recovery And Issue Ratings, June 20, 2008

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	Significant	Aggressive	**Highly leveraged**
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	**bb**
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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