

March 16, 2016

Bezeq The Israel Telecommunication Corporation Ltd.

Periodic Report for the Year 2015

Chapter A - Description of Company Operations

Chapter B - Directors' Report on the State of the Company's Affairs

Chapter C - Financial Statements

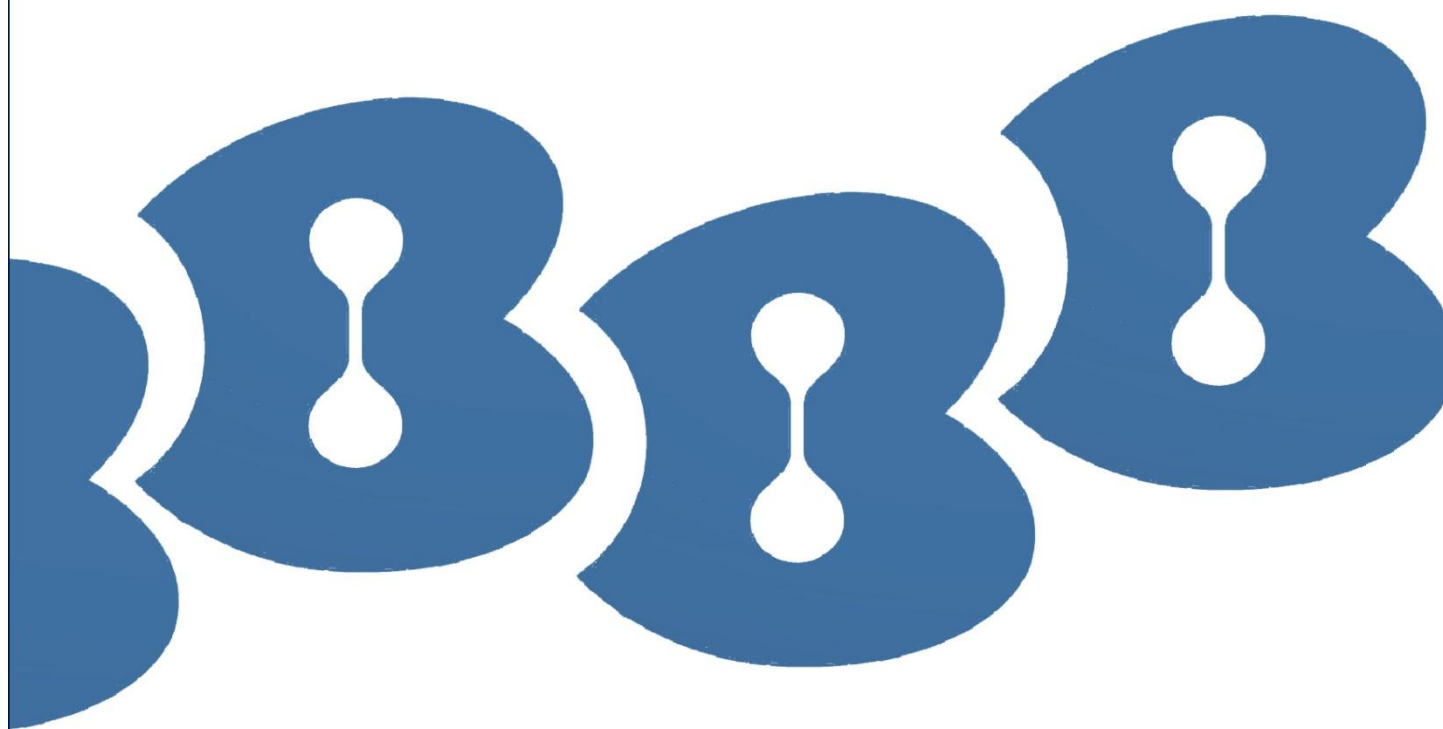
Chapter D - Additional Information about the Company and Corporate Governance Questionnaire

Chapter E - Report Concerning Effectiveness of the Internal Control (SOX outline)



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.

Chapter A (Description of Company Operations) of the 2015 Periodic Report



1.	General development of the Group's business.....	A-7
1.1	Group activities and business development	A-7
1.2	Segments of operation	A-10
1.3	Investments in the Company's capital and transactions in its shares	A-10
1.4	Dividend Distribution	A-11
1.5	Financial information about the Group's segments of operation	A-12
1.6	Projection regarding the Group	A-20
1.7	General environment and influence of external factors on the Group's activities	A-20
2.	Bezeq – Domestic fixed-line communications	A-38
2.1	General Information on the Operating Segment	A-38
2.2	Products and Services	A-42
2.3	Breakdown of product and service revenues	A-44
2.4	Trade receivables.....	A-44
2.5	Marketing, distribution and service	A-44
2.6	Competition	A-45
2.7	Property, plant and equipment.....	A-49
2.8	Intangible assets	A-53
2.9	Human Resources	A-53
2.10	Equipment and suppliers.....	A-56
2.11	Working Capital	A-57
2.12	Investments	A-57
2.13	Financing.....	A-57
2.14	Taxation.....	A-60
2.15	Environmental risks and means for their management	A-61
2.16	Restrictions and control of the Company's operations.....	A-61
2.17	Substantial agreements	A-70
2.18	Legal proceedings	A-73
2.19	Business Goals and Strategies	A-78
2.20	Risk Factors	A-79
3.	Pelephone – Mobile radio-telephone (cellular telephony)	A-84
3.1	General information about the segment of operation	A-84
3.2	Services and Products	A-87
3.3	Revenue from products and services	A-88
3.4	Trade receivables.....	A-88
3.5	Marketing, distribution and service	A-88
3.6	Competition	A-88
3.7	Property, plant and equipment.....	A-92
3.8	Intangible assets	A-93
3.9	Human resources.....	A-94
3.10	Trade payables.....	A-96
3.11	Working capital.....	A-96
3.12	Financing.....	A-97
3.13	Taxation.....	A-97
3.14	Environmental risks and means for their management	A-98
3.15	Restrictions on and control of Pelephone's operations.....	A-99
3.16	Material agreements	A-105
3.17	Legal proceedings	A-106

3.18	Business Goals and Strategy	A-108
3.19	Anticipated developments in the coming year	A-108
3.20	Risk Factors	A-108
4.	Bezeq International – International telecommunications, Internet and NEP services	A-112
4.1	General	A-112
4.2	Products and Services	A-113
4.3	Revenues	A-114
4.4	Trade receivables	A-114
4.5	Marketing, distribution and service	A-114
4.6	Competition	A-115
4.7	Property, plant and equipment, intangible assets and facilities	A-116
4.8	Human Capital	A-117
4.9	Trade payables	A-118
4.10	Working capital	A-118
4.11	Financing	A-119
4.12	Taxation	A-119
4.13	Restrictions and supervision of Bezeq International's operations	A-119
4.14	Joint venture agreements	A-120
4.15	Legal proceedings	A-121
4.16	Goals, business strategy and expected development	A-122
4.17	Risk Factors	A-122
5.	DBS – Multi-channel television	A-124
5.1	General information about the segment of operation	A-124
5.2	Products and Services	A-127
5.3	Revenue of products and services	A-128
5.4	New products	A-128
5.5	Trade receivables	A-128
5.6	Marketing and Distribution	A-128
5.7	Competition	A-129
5.8	Production capacity	A-130
5.9	Property, plant and equipment	A-130
5.10	Intangible assets	A-132
5.11	Broadcasting rights	A-132
5.12	Human Capital	A-133
5.13	Trade payables	A-134
5.14	Working capital	A-134
5.15	Financing	A-134
5.16	Taxation	A-136
5.17	Restrictions on and supervision of the company	A-137
5.18	Material agreements	A-141
5.19	Legal proceedings	A-143
5.20	Goals and Business Strategy	A-145
5.21	Risk Factors	A-145

List of terms

A. Names of laws appearing in the report

Consumer Protection Law	–	Consumer Protection Law, 1981
Antitrust Law	–	Antitrust Law, 1988
Arrangements Law	–	Economic Policy for 2013-2014 (Legislative Amendments) Law, 2013
Companies Law	–	Companies Law, 1999
Non-Ionizing Radiation Law	–	Non-Ionizing Radiation law, 2006
Market Concentration Law	–	Law to Promote Competition and Reduce Concentration, 2013
Second Authority Law	–	Second Authority for Television and Radio Law, 1990
Planning and Construction Law	–	Planning and Construction Law, 1965
Communications Law	–	Communications (Telecommunications and Broadcasts) Law, 1982
Securities Law	–	Securities Law, 1968
Communications Rules	–	Communications (Broadcasting Licensee) Rules, 1987
The Telegraph Ordinance	–	Wireless Telegraph Ordinance [New Version], 1972
The Communications Order	–	Communications (Telecommunications and Broadcasts) (Determination of an Essential Service Provided by Bezeq Israel Communications Corp.) Order, 1997
Frequency Regulations for Access Installations	–	Communications (Telecommunications and Broadcasts) (Frequencies for Wireless Access Installations) Regulations, 2002
Royalties Regulations	-	Communications (Telecommunications and Broadcasts) (Royalties) Regulations, 2001
Prospectus Details Regulations	-	The Securities (Details of a Prospectus, Draft Prospectus - Structure and Form) (Amendment) Regulations, 1969
Interconnect Regulations	-	Communications (Telecommunications and Broadcasts) (Payments for Interconnect) Regulations, 2000
Satellite Broadcasting License Regulations	-	Communications (Telecommunications and Broadcasts) (Proceedings and Conditions for Grant of a Satellite Broadcasts License), 1998

B. Other principal technological terms appearing in the report¹

Bezeq On Line	-	Bezeq On Line Ltd.
Bezeq International	-	Bezeq International Ltd.
Bezeq Zahav Holdings	-	Bezeq Zahav (Holdings) Ltd.
BIP		BIP Communication Solutions (limited partnership) controlled by Bezeq International
B Communications	-	B Communications Ltd. (formerly – 012 Smile Communications Ltd.)
Golan Telecom	-	Golan Telecom Ltd.
2015 Financials	-	The consolidated financial statements of the Company for the year ended December 31, 2015

¹ Please note that the definitions are for reader convenience only, and are not necessarily identical to the definitions in the Communications Law or its Regulations.

Chapter A (Description of Company Operations) of the Periodic Report for 2015

interconnect fees	- Interconnect fees (also called "call completion fees") are paid by one carrier to another for interconnection (see definition below)
DBS	- D.B.S. Satellite Services (1998) Ltd.
HOT	- HOT Communications Systems Ltd. and corporations in its control which operate in broadcasting (multi-channel television)
HOT Telecom	- HOT Telecom Limited Partnership
Hot Mobile	- Hot Mobile Ltd. (formerly Mirs Communications Ltd.) and corporations under its control
HOT-Net	- HOT-Net Internet Services Ltd.
the Stock Exchange	- The Tel Aviv Stock Exchange Ltd.
The Council	- The Cable and Satellite Broadcasting Council
Walla	- Walla! Communications Ltd. and corporations under its control
Hayek Commission	- Committee headed by Mr. Amir Hayek for reviewing the structure and updating of Bezeq tariffs and for setting wholesale service tariffs in fixed-line communications
Eurocom DBS	- Eurocom D.B.S. Ltd.
Public switching	- In the context of a communications network - a telephony system supporting the connection of installations for passing calls between various end units
Mbps	- Megabits per second; a unit of measure for the speed of data transfer
Domestic Carrier	- An entity providing fixed-line domestic telephony services under a general or special domestic carrier license
PVR set top boxes	- Digital set top boxes enabling viewing of satellite broadcasts, with recording ability on a hard disk (Personal Video Recorder) and enabling other advanced services, including HDPVR set top boxes
HDPVR set top boxes	- PVR set top boxes that also enable receipt of HD broadcasts
Roaming	- Roaming services allow a customer of one communications network to receive services from another communications network which is not his home network, based on roaming agreements between the home network and the host network
NEP	- Network End Point – an interface to which a public telecommunications network and terminal equipment or a private network is connected. NEP services include the supply and maintenance of equipment and services on the customer's premises
Access point	- A telecommunications device that operates in the frequencies stipulated in the relevant Wireless Telegraph Ordinance, which enables wireless communications between a user that has a wireless interface operating in those frequencies and the data-communications network, including the Internet.
Cellcom	- Cellcom Israel Ltd. and corporations under its control
Pelephone	- Pelephone Communications Ltd.
Channel or linear channel	- Content that is broadcast on a specific broadcasting channel, and must be watched at the particular time it is offered.
Partner	- Partner Communications Ltd. and corporations under its control
Interconnect	- Interconnect enables telecommunications messages to be transferred between subscribers of various license-holders or services to be provided by one license-holder to the subscribers of another license-holder; interconnect is made possible by means of a connection between a public telecommunications network of one license-holder (e.g. the Company) and a public network of another license-holder

	(e.g. a cellular operator). See also the definition of "interconnect fees".
Cellular	- Mobile radio-telephone; cellular telephony
Consolidated business license	- A general license which is one of the following or a license that combines several of them: (1) Special general license; (2) General mobile radio telephone license on another network; (3) General license for providing international telecommunications services; (4) NEP license; (5) Special license for the provision of internet services.
Domestic carrier license	- General license or special general license for providing fixed-line domestic telecommunications services
NEP license	- Special license for providing internet services.
Cellular license	- General license for providing mobile radio-telephone services by the cellular method
Broadcasting license	- License for satellite television broadcasts
Rami Levy	- Rami Levy Cellular Communications Ltd.
Transmission services	- Transmission of electromagnetic signals or series of bits between the telecommunications facilities of a license-holder (excluding terminal equipment)
Data communication services	- Network services for transferring data from point to point, transferring data between computers and between different communications networks, communications network connection services for the Internet, and remote access services for businesses
The Report Period	- The twelve months ended December 31, 2015
012 Smile	- 012 Smile Telecom Ltd. and corporations under its control
Bitstream Access (BSA)	- Managed broadband access that enables service providers to connect to the network of the infrastructure's owner and offer broadband services to subscribers. The connection to the network of the infrastructure's owner may be countrywide (single-point connection to the core of the network of the infrastructure's owner, and services offered to subscribers nationwide), or regional (multipoint connections to the network of the infrastructure's owner and provision of services to subscribers in those regions).
CDMA	- Code Division Multiple Access – Access technology for cellular communications networks based on separation of subscribers by encoding
xDSL	- Digital Subscriber Line Technology that uses the copper wires of telephone lines to transfer data (the Internet) at high speeds by using frequencies higher than the audible frequency and therefore enabling simultaneous call and data transfer
DTT	- Digital Terrestrial Television – Wireless digital broadcast of television channels by means of terrestrial transmission stations
GSM	- Global System for Mobile Communications – International standard for cellular communications networks ("2nd Generation")
HD	- High Definition TV - High resolution (separate) TV broadcasts
HSPA	- High Speed Packet Access - cellular technology succeeding the UMTS standard, enabling data transfer at high speeds ("3.5 Generation")

IP	- Internet Protocol. The protocol enables unity between voice, data and video services using the same network
IPVPN	- Virtual Private Network based on IP and located on the public network, through which it is possible to (a) enable end users to connect to the organizational network by remote access, and (b) connect between the organization's branches (intranet)
ISP	- Internet Service Provider – Holder of a special license for providing Internet access services. The Internet access provider is the entity enabling the end user to connect to TCP/IP protocol that links him and the global Internet
LTE	- Long Term Evolution- a standard for wireless communication of high-speed data for mobile phones
Multicast	- An application that streams content to a large number of end users over a small number of broadband links for each network element in the core, and replicates it to end-user sites.
MVNO	- Mobile Virtual Network Operator – A virtual cellular operator that uses the existing communications infrastructures of the cellular carriers without need for its own infrastructures
NDSL	- A subscriber's line that provides only high-speed access by means of ISPs
NGN	- Next Generation Network – The Company's new communications network, based on IP architecture
SLU	- Sub-loop Unbundling
UMTS	- Universal Mobile Telecommunications System - international standard for cellular communications developed from the GSM standard ("3G")
VoB	- Voice over Broadband – Telephony and associated services in IP technology using fixed-line broadband access services
VoC	- Voice over Cellular Broadband – Telephony services over a cellular data communications channel ("Mobile VoB Services")
VOD	- Video on Demand – Television services per customer demand
VoIP	- Voice over Internet Protocol – Technology enabling the transfer of voice messages (provision of telephony services) by means of IP protocol
Wi-Fi	- Wireless Fidelity – Wireless access to the Internet within a local space

Chapter A – Description of Company Operations

Bezeq – The Israel Telecommunication Corporation Limited ("the Company" or "Bezeq"), together with its subsidiaries, whether wholly or partly owned, whose financial statements are consolidated with those of the Company, will henceforth be called in this Periodic Report "the Group" or "Bezeq Group".

1. General development of the Group's business

1.1 Group activities and business development

1.1.1 General

At the date of this periodic report, Bezeq Group is a main provider of communications services in Israel. Bezeq Group implements and provides a broad range of telecommunications operations and services, including domestic fixed-line, cellular and international communication services, multi-channel satellite television broadcasts, internet infrastructure and access services, customer call centers, maintenance and development of communications infrastructures, provision of communications services to other communications providers, television and radio broadcasts, and supply and maintenance of equipment on customer premises (network end point – NEP – services).

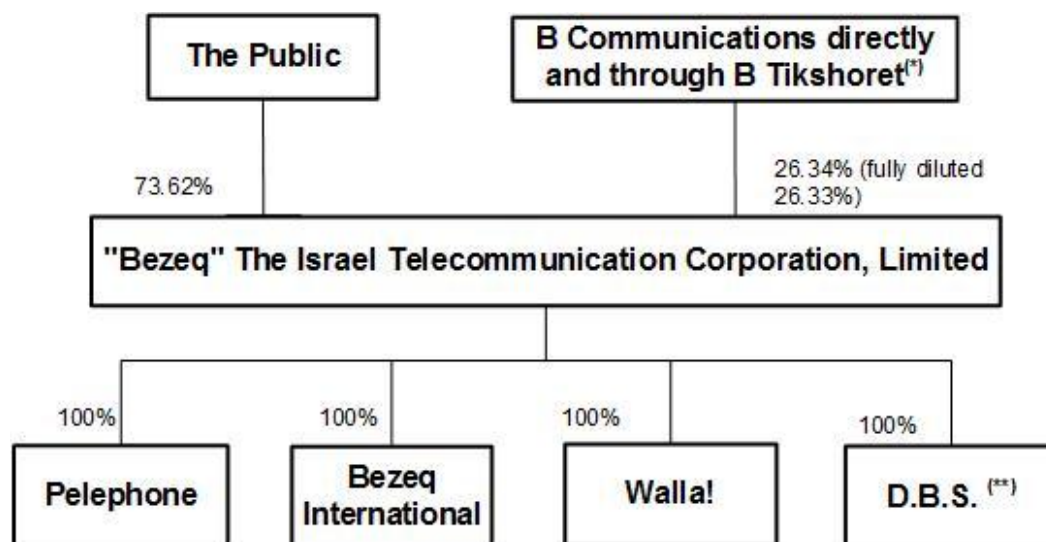
The Company was established in 1980 as a government company to which the activities carried out until then at the Ministry of Communications were transferred, and it was privatized over a period of years. The Company became a public company in 1990 and its shares are traded on the Tel Aviv Stock Exchange.

Since April 14, 2010, the controlling shareholder of the Company is B Communications, directly and through its wholly-controlled (indirectly) company B Tikshoret (SP2) Ltd. ("B Tikshoret"). (Concerning regulatory permits that were given in connection with the transaction to acquire control see Section 1.7.6).²

For information about restrictions that may apply to B Communications commencing December 2019 under the Market Concentration Law, in connection with control in the Company, if at that time B Communications is a second tier company according to this law, and restrictions that apply to the Company in this context as a third-tier company, see Sections 1.7.3(H).

² To the best of the Company's knowledge, B Tikshoret is a private company registered in Israel, wholly owned and controlled by B Tikshoret (SP1) Ltd., which is wholly owned and controlled by B Communications. B Communications is an Israeli public company whose shares are traded by way of double listing on the Stock Exchange and on the Nasdaq. The controlling shareholder in B Communications is Internet Gold – Golden Lines Ltd., and the controlling shareholder in Internet Gold – Golden Lines Ltd. is Eurocom Communications Ltd. ("Eurocom Communications"), which is controlled by Eurocom Holdings (1979) Ltd., in which the controlling shareholders are Mr. Shaul Elovitch and his brother Yosef Elovitch. 691,338,246 of the Company's shares are held by B Tikshoret in trust by Mishmeret Trust Company Ltd, as trustee for B Tikshoret 2 as the owner, on the one hand, and for the holders of bonds (USD Series A144) that were issued by B Communications as well as various hedge funds with which B Communications entered into agreements in connection with the aforementioned bonds – as collateral for the aforementioned issuance, on the other. Moreover, 22,831,314 additional Company shares, held by B Tikshoret, are pledged as collateral in favor of the aforementioned bond holders and hedge funds. In addition to the foregoing, 14,204,153 Company shares are owned directly by B Communications.

Diagram of the Company's holding structure, and the Company's holdings in the subsidiaries and main affiliates, at the date of approval of the report (March 16, 2016):



- (*) In addition to the above-mentioned holdings, 1,000,000 shares are held jointly by the Chairman of the Board of Directors, Mr. Shaul Elovitch and his brother Mr. Yosef Elovitch, the controlling shareholders (indirectly) of the Company, 72,360 shares are held by Ms. Iris Elovitch the wife of the controlling shareholder Shaul Elovitch, and 11,556 shares are held by Ms. Orna Elovitch Peled, a director of the Company and wife of Mr. Or Elovitch, a Company director and son of Shaul Elovitch, the controlling shareholder, indirectly, of the Company. These shares total approximately 0.03% of all the Company's issued capital.
- (**) After exercising stock options on March 25, 2015, which awarded the Company a right to 8.6% of the shares of DBS, and after completion of the transaction to acquire the outstanding shares of DBS, on June 24, 2015. See also Section 1.1.2.

In addition, the Company holds 100% of the issued capital of Bezeq On-Line, which operates customer call centers of a scope that is not material to the Company, and 100% of the issued capital of Bezeq Zahav Holdings whose entire operation is the holding of Debentures Series 5 of the Company.

1.1.2 Mergers and acquisitions

Merger of the Company and DBS

Until March 25, 2015, the Company held 49.78% of the shares of DBS and it also owned stock options which entitled it to 8.6% of the shares of DBS and which the Company has not yet exercised. In view of a decision of the Supreme Court in 2009 not to approve the merger of the Company and DBS, the Company ended its control in DBS and from August 21, 2009, it therefore discontinued consolidation of its financial statements with those of DBS, and from that date the investment in DBS shares was presented according to the equity method. The balance of DBS shares are held by Eurocom D.B.S.³

On March 26, 2014, the Company received the decision of the Antitrust Authority which stipulates that when the conditions listed in the decision are met, limitations that were imposed on Eurocom Group (holding by a trustee and the obligation to sell) 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").

³ A company controlled (indirectly) by Messrs. Shaul and Yosef Elovitch, controlling shareholders of the Company.

Hereunder are the key conditions for approval of the merger (in this section - “the Merger Terms”):⁴

- A. 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.
- B. Bezeq will deduct amounts for providing multi-channel TV services from the payments of ISPs for connecting them to the Bezeq network.
- C. 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).
- D. 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.

A sub-committee of the Board of Directors that was set up to deal with the topic, and the Audit Committee and Board of Directors as well as a General Meeting of the shareholders (on February 10, 2015 and March 23, 2015, respectively), approved the transaction between the Company and Eurocom DBS to acquire all the holdings of Eurocom DBS in DBS, which at that date constituted 50.22% of the issued share capital of DBS (41.62% fully diluted) as well as all the shareholders’ loans that Eurocom provided to DBS (NIS 1,538 million as at December 31, 2014) (“the Purchase Transaction”). It was also decided that prior to the Purchase Transaction, the Company and DBS will accept the merger conditions and the Company will also exercise the option conferred upon it for no payment for an allocation of shares in DBS at a rate of 8.6% of the issued share capital of DBS.

On March 25, 2015, the Company exercised the option for an allocation of shares in DBS at a rate of 8.6% of the issued share capital of DBS, so that from that date, the Company holds 58.4% of DBS shares. Subsequently, the Company received notice from the Antitrust Authority of cancellation of the limitations that were imposed on Eurocom Group with respect to its holdings in DBS.

On June 23, 2015, approval was received from the Minister of Communications to transfer the means of control in DBS in such a manner that the Company will control DBS and will hold the entire issued and paid-up capital of DBS. Subsequently, on June 24, 2015, the Purchase Transaction was completed. On this occasion, the Company transferred to Eurocom DBS the cash consideration for the transaction in the amount of NIS 680 million, Eurocom DBS transferred to the Company all its shares and rights to shares in DBS and assigned to the Company its entire rights in the shareholders’ loans that it had provided to DBS. Upon completion of the transaction, DBS became a wholly owned subsidiary (100%) of the Company.

Notably, under the terms of the Purchase Transaction, in addition to the cash payment of NIS 680 million, Eurocom D.B.S. will be entitled to two additional contingent payments, as follows: one additional payment of up to NIS 200 million will be paid in accordance with the tax synergy (see also Section 2.14); and an additional payment of NIS 170 million will be paid according to the business results of DBS in the next three years.

For additional information on the foregoing in this section, see the amended Transaction Report, included here by way of reference and also Note 11.2 to the 2015 Financials.

⁴ It is noted that conditions similar to those listed in Sections A, B, and D were imposed on Hot Telecom Limited Partnership as part of merger approvals by the Antitrust Authority.

1.2 Segments of operation

The Group has four main segments of operation which correspond with the corporate division among the Group companies and report as business segments in the Company's consolidated financial statements (see also Note 27 to the 2015 Financials):

1.2.1 The Company – Fixed-line domestic communications

This segment consists primarily of the Company's operation as a Domestic Carrier, including telephony services, Internet infrastructure and access services (and including wholesale BSA service), transmission and data communications services. The Company's activities in the domestic fixed-line segment are described in Section 2 of this report.

1.2.2 Telephone – Cellular communications

Cellular communications, marketing of terminal equipment, installation, operation and maintenance of cellular communication equipment and systems. Telephone's operations are described in Section 3 of this report.

1.2.3 Bezeq International – international communications, Internet and NEP services

Internet access services (ISP), international communication services and NEP services. Bezeq International's operations are described in Section 4 of this report.

1.2.4 DBS – Multi-channel television

Multi-channel digital satellite television broadcasting services for subscribers (DBS) and the provision of value added services for subscribers. DBS's operations are described in Section 5 of this report.

It is noted that in addition, the Company's consolidated financial statements include an "Others" segment, which covers mainly Internet-related content and trading, (through Walla!, WallaShops, and other websites), and customer call center services (through Bezeq Online). The "Others" segment is not material at the Group level.

On May 20, 2014, a transaction was completed between 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, by Walla), which operates the Yad2 website, in consideration of NIS 805 million. 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 2014 financial statements.

1.3 Investments in the Company's capital and transactions in its shares

1.3.1 On February 2, 2016, the Company received notice from B Communications whereby on that date it completed the sale of 115,500,000 ordinary NIS 1 par value shares of the Company (which on that date constituted 4.18% of the Company's issued and paid-up share capital) at a price of 850 agorot per share (in this section: "the Shares").

1.3.2 B Communications informed the Company that the sale took place in accordance with the provisions of Section 3(a3) of the Communications Order, by way of an agreement to sell the shares through a "distribution agent"⁵ (as this term is defined in the Communications Order), which entered into agreement with third parties to sell them the shares in off-the-floor transactions. B Communications also reported that in connection with this sale, the shares were released from a pledge that had been imposed on them in favor of debenture holders (USD Series A144) that were issued by B Communications as well as various hedge funds with which B Communications entered into agreements in connection with the aforementioned debentures.

⁵ Section 3(a3)(3) of the Communications Order refers to: "A sale or private placement to one or more distribution agents (as they are defined in the Communications Order), provided that the purchase is not made for themselves or for entities in their control or entities that control them, and that they undertook not to sell means of control at such rate, as a result of which one or more of the buyers will hold a percentage that must be approved under the Communications Order, unless the buyer has a permit to do so under the Order ...".

- 1.3.3** After completing the sale process, B Communications and B Communications together hold 26.34% of the Company's issued and paid-up share capital.

On this, see also Section **1.7.6C**.

1.4 Dividend Distribution

1.4.1 Dividend policy

On August 4, 2009, the Board of Directors of the Company resolved to adopt a dividend distribution policy under which the Company would distribute to its shareholders, on a semi-annual basis, a dividend of 100% of the semi-annual profits (after tax) ("Profit for the period attributable to the Company's owners") according to the consolidated financial statements of the Company. Implementation of the dividend distribution policy is subject to the provisions of any law, including the distribution tests laid down in the Companies Law, and to the Board's assessment as to the Company's ability to meet its existing and foreseeable obligations, and all with due attention to the Company's projected cash flow, activities and liabilities, its cash balances, its plans and its situation from time to time, and subject to the approval of the general meeting of the shareholders of the Company for each specific distribution, as provided in the Company's Articles of Association. At the publication date of the report, this policy is in force.

1.4.2 Dividend distribution

For information about dividends distributed by the Company in 2014-2015, and Board of Directors recommendations to the General Meeting about a dividend distribution on March 16, 2016, see Note 19.2 to the 2015 Financials.

Outstanding, distributable profits at the report date - NIS 788 million⁶ (surpluses accumulated over the last two years, after subtracting previous distributions).

⁶ Including revaluation gains in the amount of NIS 12 million for an increase in the control of DBS. Pursuant to a Board of Directors' resolution dated February 10, 2015, these revaluation gains will be excluded from the dividend distribution policy and will not be distributed as a dividend.

1.5 Financial information about the Group's segments of operation

All the data in this Section 1.5 are in NIS million.

1.5.1 2015

	Domestic fixed-line communications	Cellular communications	International communications, Internet services and NEP	Multi-channel television	Others	Adjustments to consolidated ⁽²⁾	Consolidated
Total revenues:							
From externals	4,122	2,831	1,485	1,774	197	(440)	9,969
From other segments of operation in the corporation	285	59	93	-	24	(445)	16
Total revenues	4,407	2,890	1,578	1,774	221	(885)	9,985
Total costs attributable to:							
Variable costs attributable to segment of operation ⁽¹⁾	522	1,469	837	606	174		
Fixed costs attributable to segment of operation ⁽¹⁾	1,737	1,264	501	918	63		
Total costs	2,259	2,733	1,338	1,524	237	(676)	7,415
Costs that do not constitute revenue in another segment of operation	2,181	2,540	1,177	1,507	230	(233)	7,402
Costs that constitute revenue in other segments of operation	78	193	161	17	7	(443)	13
Total costs	2,259	2,733	1,338	1,524	237	(676)	7,415
Profit from ordinary operations attributable to owners of the Company	2,148	157	240	220	(15)	(180)	2,570
Profit from operating activities attributable to non-controlling interests	-	-	-	30	-	(30)	-
Total assets attributable to operations at December 31, 2015	7,311	3,269	1,170	1,667	676	2,586	16,679
Total liabilities attributable to segment of operation at December 31, 2015	12,117	513	343	6,685	104	(5,494)	14,268

(1) The Group companies that are companies providing services (as opposed to manufacturing companies), do not manage a dedicated pricing system, which differentiates between fixed and variable costs. The above distinction was made for the purposes of this report only. Variable costs are costs for which the companies have flexible management and control in the short-term and which directly affect output, compared with fixed expenses, which are not flexible in the short term and do not directly affect output. (On this, regarding the definition of fixed and variable costs, "short-term" means a period of up to one year).

(2) Details of adjustments to consolidated – transactions between segments of operation and transactions in multi-channel television in the first quarter (before increase in control and consolidation of DBS).

Chapter A (Description of Company Operations) of the Periodic Report for 2015

1.5.2 2014:

	Domestic fixed-line communications	Cellular communications	International communications, Internet services and NEP	Multi-channel television	Others	Adjustments to consolidated ⁽²⁾	Consolidated
Total revenues:							
From externals	4,045	3,361	1,419	1,724	209	(1,724)	9,034
From other segments of operation in the corporation	272	58	85	-	17	(411)	21
Total revenues	4,317	3,419	1,504	1,724	226	(2,135)	9,055
Total costs attributable to:							
Variable costs attributable to segment of operation(1)	622	1,636	775	602	(472) 3		
Fixed costs attributable to segment of operation(1)	1,715	1,334	497	849	69		
Total costs	2,337	2,970	1,272	1,451	(403)	(1,798)	5,829
Costs that do not constitute revenue in another segment of operation	2,257	2,792	1,121	1,436	(411)	(1,372)	5,823
Costs that constitute revenue in other segments of operation	80	178	151	15	8	(426)	6
Total costs	2,337	2,970	1,272	1,451	(403)	(1,798)	5,829
Profit from ordinary operations attributable to owners of the Company	1,980	449	232	135	629	(199)	3,226
Profit from operating activities attributable to non-controlling interests	-	-	-	138	-	(138)	-
Total assets attributable to operations at December 31, 2014	8,483	3,541	1,217	1,820	703	(451)	15,313
Total liabilities attributable to segment of operation at December 31, 2014	12,369	696	392	6,484	107	(7,176)	12,872

- (1) The Group companies that are companies providing services (as opposed to manufacturing companies), do not manage a dedicated pricing system, which differentiates between fixed and variable costs. The above distinction was made for the purposes of this report only. Variable costs are costs for which the companies have flexible management and control in the short-term and which directly affect output, compared with fixed expenses, which are not flexible in the short term and do not directly affect output. (On this, regarding the definition of fixed and variable costs, "short-term" means a period of up to one year).
- (2) Details of adjustments to consolidated – transactions between segments of operation and transactions in multi-channel television.
- (3) Including profit from the sale of Coral-Tell Ltd. shares (See Section 1.2).

Chapter A (Description of Company Operations) of the Periodic Report for 2015

1.5.3 2013:

	Domestic fixed-line communications	Cellular communications	International communications, Internet services and NEP	Multi-channel television	Others	Adjustments to consolidated ⁽²⁾	Consolidated
Total revenues:							
From externals	4,198	3,741	1,365	1,633	241	(1,633)	9,545
From other segments of operation in the corporation	280	68	68	2	21	(421)	18
Total revenues	4,478	3,809	1,433	1,635	262	(2,054)	9,563
Total costs attributable to:							
Variable costs attributable to segment of operation(1)	725	1,901	945	585	141		
Fixed costs attributable to segment of operation(1)	1,755	1,300	261	783	123		
Total costs	2,480	3,201	1,206	1,368	266	(1,777)	6,744
Costs that do not constitute revenue in another segment of operation	2,403	2,995	1,071	1,357	258	(1,347)	6,737
Costs that constitute revenue in other segments of operation	77	206	135	11	8	(430)	7
Total costs	2,480	3,201	1,206	1,368	266	(1,777)	6,744
Profit from ordinary operations attributable to owners of the Company	1,998	608	227	133	(4)	(143)	2,819
Profit from operating activities attributable to non-controlling interests	-	-	-	135	-	(135)	-
Total assets attributable to operations at December 31, 2013	7,767	4,126	1,257	1,617	333	(78)	15,022
Total liabilities attributable to segment of operation at December 31, 2013	11,234	1,242	440	5,960	249	(6,526)	12,599

(1) The Group companies that are companies providing services (as opposed to manufacturing companies), do not manage a dedicated pricing system, which differentiates between fixed and variable costs. The above distinction was made for the purposes of this report only. Variable costs are costs for which the companies have flexible management and control in the short-term and which directly affect output, compared with fixed expenses, which are not flexible in the short term and do not directly affect output. (On this, regarding the definition of fixed and variable costs, “short-term” means a period of up to one year).

(2) Details of adjustments to consolidated – transactions between segments of operation and transactions in multi-channel television.

For explanations about the development of the financial information presented in Sections 1.5.1-1.5.3, see Section 1 of the Directors Report on the State of the Company's Affairs (“the Directors Report”).

Chapter A (Description of Company Operations) of the Periodic Report for 2015

1.5.4 Main results and operational data

Condensed data showing the results of each of the Company's main segments of operation in 2014 and 2015:

A. Bezeq Fixed Line (the Company's operations as a domestic carrier)

	2015	2014	Q4 2015	Q3 2015	Q2 2015	Q1 2015	Q4 2014	Q3 2014	Q2 2014	Q1 2014
Revenues (NIS million)	4,407	4,317	1,088	1,101	1,105	1,113	1,086	1,081	1,073	1,077
Operating profit (NIS million)	2,148	1,980	427	512	662	547	507	498	471	504
Depreciation and amortization (NIS million)	725	688	185	184	180	176	170	178	172	168
EBITDA (Earnings before depreciation and amortization) (NIS million)(1)	2,873	2,668	612	696	842	723	677	676	643	672
Net profit (NIS million) (8)	1,324	1,102	340	256	382	346	293	263	251	295
Cash flow from current operations (NIS million)	2,358	2,259	668	686	456	548	499	599	545	616
Payments for investments in property, plant & equipment and intangible assets (NIS million)	849	822	197	230	191	231	195	210	207	210
Proceeds from the sale of property, plant & equipment and intangible assets (NIS million)	146	221	33	21	80	12	82	69	42	28
Free cash flow (NIS million) (2)	1,655	1,658	504	477	345	329	386	458	380	434
Number of active subscriber lines at the end of the period (in thousands)(3)	2,181	2,205	2,181	2,193	2,204	2,208	2,205	2,205	2,205	2,214
Average monthly revenue per line (NIS) (ARPL)(4)	60	63	60	60	60	61	62	63	63	64
Number of outgoing minutes (in millions)	5,607	6,200	1,379	1,373	1,396	1,459	1,482	1,588	1,522	1,608
Number of incoming minutes (in millions)	5,628	5,829	1,403	1,410	1,386	1,429	1,440	1,498	1,424	1,467
Number of active subscriber lines at the end of the period (in thousands)(7)	1,479	1,364	1,479	1,448	1,418	1,390	1,364	1,335	1,308	1,289
Number of active subscriber lines at the end of the period (in thousands) - wholesale(7)	244	-	244	177	78	11	-	-	-	-
Average monthly revenue per Internet subscriber (NIS) - retail	88	84	89	88	88	87	85	85	84	82
Average bundle speed per Internet subscriber (Mbps)(5)	37.8	32.5	37.8	36.7	34.9	33.2	32.5	24.0	21.9	20.0
Churn rate (6)	10.1%	11.1%	2.7%	2.6%	2.4%	2.4%	2.5%	2.8%	2.8%	3.0%

- (1) EBITDA (Earnings before depreciation and amortization) 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 which counteracts aspects arising from the modified capital structure, various taxation aspects 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.

Chapter A (Description of Company Operations) of the Periodic Report for 2015

- (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 communication, internet services, services to communications operators and contractor and other works. Calculated according to average lines for the period.
- (5) For bundles with a range of speeds, the maximum speed per bundle is 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.
- (7) Number of active Internet lines including retail and wholesale lines. Retail - internet lines provided directly by the Company. Wholesale - Internet lines provided through a wholesale service to other communications providers.
- (8) Commencing in Q2 2015, the Company revised the internal management reporting structure in connection with financing income for shareholders loans that were provided to DBS and it no longer presents the financing income for shareholders loans as part of financing income for the fixed line domestic carrier segment. Comparison figures were restated so as to reflect the change in reporting structure. In this matter see Note 27.2 to the 2015 Financials.

Chapter A (Description of Company Operations) of the Periodic Report for 2015

B. Pelephone

	2015	2014	Q4 2015	Q3 2015	Q2 2015	Q1 2015	Q4 2014	Q3 2014	Q2 2014	Q1 2014
Revenue from services (NIS million)	1,999	2,453	477	521	502	499	584	610	622	637
Revenues from sale of terminal equipment (NIS million)	891	966	236	208	219	228	251	214	221	280
Total revenue (NIS million)	2,890	3,419	713	729	721	727	835	824	843	917
Operating profit (NIS million)	157	449	11	61	53	32	74	122	127	126
Depreciation and amortization (NIS million)	419	430	100	109	106	104	111	108	105	106
EBITDA (Earnings before depreciation and amortization) (NIS million)(1)	576	879	111	170	159	136	184	231	232	232
Net profit (NIS million)	151	373	11	55	49	36	59	100	106	108
Cash flow from current operations (NIS million)	730	1,213	14	163	202	351	158	286	420	349
Payments for investments in property, plant and equipment and intangible assets (NIS million)	426	321	65	90	199	72	80	83	85	73
Free cash flow (NIS million) (1)	304	892	(51)	73	3	279	78	203	335	276
Number of subscribers at end of the period (thousands) (2)	2,651	2,586	2,651	2,569	2,566	2,565	2,586	2,600	2,610	2,631
Average monthly revenue per subscriber (NIS) (ARPU) (3)	64	78	60	68	65	65	75	78	79	80
Churn rate (4)	25.8%	28.0%	6.7%	6.4%	6.1%	6.5%	6.6%	7.3%	6.5%	7.6%

- (1) Regarding the definition of EBITDA (earnings before depreciation and amortization) 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 one call / sent one SMS, performed no surfing activity on his phone or 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 extended 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.

Chapter A (Description of Company Operations) of the Periodic Report for 2015

C. Bezeq International

	2015	2014	Q4 2015	Q3 2015	Q2 2015	Q1 2015	Q4 2014	Q3 2014	Q2 2014	Q1 2014
Revenues (NIS million)	1,578	1,504	405	389	391	393	399	385	365	355
Operating profit (NIS million)	240	232	58	59	62	61	57	59	58	58
Depreciation and amortization (NIS million)	132	130	35	33	32	32	34	32	32	32
EBITDA (Earnings before depreciation and amortization) (NIS million)(1)	372	362	93	92	94	93	91	91	90	90
Net profit (NIS million)	172	165	42	41	45	44	40	42	41	42
Cash flow from current operations (NIS million)	301	312	96	69	74	62	72	71	95	74
Payments for investments in property, plant and equipment and intangible assets (NIS million) (2)	128	108	21	28	26	53	27	27	23	31
Free cash flow (NIS million) (1)	173	204	75	41	48	9	45	44	72	43
Churn rate (3)	17.3%	17.0%	4.6%	4.4%	4.2%	4.1%	4.7%	4.5%	3.7%	4.0%

(1) Regarding the definition of EBITDA (earnings before depreciation and amortization) and cash flows, see comments (1) and (2) in the Bezeq Fixed Line table.

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

Chapter A (Description of Company Operations) of the Periodic Report for 2015

D. DBS

	2015	2014	Q4 2015	Q3 2015	Q2 2015	Q1 2015	Q4 2014	Q3 2014	Q2 2014	Q1 2014
Revenues (NIS million)	1,774	1,724	449	446	439	440	440	432	428	424
Operating profit (NIS million)	250	273	47	74	70	59	57	76	67	73
Depreciation and amortization (NIS million)	322	297	88	78	80	76	78	75	74	70
EBITDA (Earnings before depreciation and amortization) (NIS million)(1)	572	570	135	152	150	135	135	151	141	143
Net profit (loss) (NIS million)	(354)	(322)	(110)	(75)	(166)	(3)	(87)	(86)	(115)	(34)
Cash flow from current operations (NIS million)	505	442	105	145	106	149	122	101	106	113
Payments for investments in property, plant and equipment and intangible assets (NIS million)	265	305	43	75	82	65	95	64	68	78
Free cash flow (NIS million) (1)	240	137	62	70	24	84	27	37	38	35
Number of subscribers (at the end of the period, in thousands) (2)	635	630	635	637	636	632	630	622	611	605
Average monthly revenues per subscriber (ARPU) (NIS)(3)	233	234	235	233	231	232	234	234	234	234
Churn rate (4)	13.9%	12.8%	3.5%	3.9%	3.1%	3.4%	2.9%	3.2%	3.1%	3.6%

- (1) Regarding the definition of EBITDA (earnings before depreciation and amortization) and cash flows, see comments (1) and (2) in the Bezeq Fixed Line table.
- (2) Subscriber - a single household or small business customer. In the case of a business customer with multiple reception points or a large number of set top boxes (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. The number of subscribers was corrected retrospectively due to an insignificant change in the counting of subscribers among large customers.
- (3) Monthly ARPU is calculated by dividing total DBS revenues (from content and equipment, premium channels, advanced products, and other services) by the average number of customers. The average monthly revenue was corrected retrospectively due to an insignificant change in the counting of subscribers among large customers.
- (4) Number of DBS subscribers who left DBS during the period, divided by the average number of DBS registered subscribers in the period.

1.6 Projection regarding the Group

Based on the information which is currently known to Bezeq Group, the forecast for 2016 is as follows:

- Net profit attributable to shareholders is expected to be approximately NIS 1.4 billion.
- EBITDA⁷ is expected to be approximately NIS 4.2 billion.
- The Group's free cash flow⁸ is expected to be approximately NIS 2 billion.

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 that the forecasts do not include the effects, insofar as there are any, of provision for voluntary redundancy of employees and/or the signing of collective agreements, the Company exercising its rights in the Sakia property (see Section 2.7.4A), and elimination of structural separation in the Group (see Sections 1.7.2 and 1.7.3. 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 2016. 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 2.20, 3.20, 4.17 and 5.21 materialize.

1.7 General environment and influence of external factors on the Group's activities

The communications industry around the world and in Israel is characterized by rapid development and frequent changes in technologies, the business structure of the industry and applicable regulation. Below is a description of the main trends and central characteristics of the communications industry in recent years, which have significantly affected the operations of the Group as a whole.

Recently, the competition in the communications industry has intensified, particularly in cellular telephony (which intensified with the entry of the operators HOT Mobile and Golan Telecom⁹), with packages consisting of several services and packages at a fixed price with unlimited use being offered. This stronger competition has brought down prices, increased customer churn, led to a decline in the sale of cellular terminal equipment, and higher desertion rates, which in turn has affected the Group's results. Implementation of the wholesale market (see Section 1.7.3) also increased competition in the Internet service packages and later other wholesale services. To reduce the impact on performance, the Group's companies are introducing streamlining and other measures to improve the services they provide and differentiate themselves from their competitors.

1.7.1 Emergence of communication groups in the Israeli market and transition to competition among the groups.

Whereas in the past competition in the communications market was mainly among independent communications service providers in each segment separately, more recently the trend has been to compete among communication groups operating in different segments of this market¹⁰, as detailed in the following table and its notes:

Group Activity	Bezeq	Cellcom (a)	Partner (b)	Hot (c)
Cellular telephony	Pelephone	Cellcom	Partner	Hot Mobile
Fixed-line telephony	Bezeq Bezeq International	Cellcom Netvision	Partner 012 Smile	HOT Telecom

⁷ For a definition of EBITDA, see note (1) to the table in Section 1.5.4.A.

⁸ For a definition of free cash flow, see note (2) to the table in Section 1.5.4.A.

⁹ It is noted that in the report period, Golan Telecom wishes to merge with Cellcom. In this matter, see also Section 3.1.8.B

¹⁰ In this matter, a group is characterized by proximity arising from the identity of shareholders, even though in some of the groups there is corporate, accounting or marketing segregation between the entities which belong to the Group.

Internet services (fixed-line / cellular)	Bezeq Pelephone Bezeq International	Cellcom Netvision	Partner 012 Smile	HOT Telecom HOT-Net
International calls	Bezeq International	Netvision	012 Smile	Hot Mobile
Multi-channel television	DBS	Cellcom	-	HOT Broadcasts

- A. **Cellcom Group** – To the best of the Company's knowledge, Cellcom Group provides communication services through Cellcom, a public company, and Netvision, a wholly owned subsidiary of Cellcom. These companies provide cellular telephony services (including cellular Internet), fixed-line telephony on its own infrastructure, transmission and data communication services for business customers through Cellcom's own transmission network, ISP services, end-to-end ISP service packages and wholesale service-based Internet infrastructure; international telecommunication services, and fixed-line telephony services using VoB technology. In December 2014, Cellcom launched OTT television services that include mainly VOD services, several linear channels, and integration of Idan+ channels.
- B. **Partner Group** - To the best of the Company's knowledge, Partner Group provides communication services through Partner, a public company, and 012 Smile, a wholly owned subsidiary of Partner, and its subsidiary 012 Telecom. Partner Group provides cellular telephony services (including cellular Internet); transmission and data-communication services; ISP services; end-to-end ISP service packages, wholesale service-based Internet infrastructure; and fixed-line telephony services using VoB technology.
- C. **HOT Group** - To the best of the Company's knowledge, HOT Group (controlled by Mr. Patrick Drahi) owns a nationwide cable infrastructure and provides multi-channel television services through HOT; cellular telephony services through HOT Mobile (a wholly owned subsidiary of HOT); fixed-line telephony services; Internet infrastructure, and transmission and data communications through HOT Telecom; and ISP services through HOT-Net, subject to structural separation restrictions between HOT-Net, HOT and HOT Telecom, and restrictions on marketing joint service bundles that include HOT-Net's Internet access (among the restrictions are an obligation to market bundles that correspond with competing ISPs and an obligation to sell the ISP services separately under the same terms as they are sold when part of the bundle (unbundling)).

Likewise, restrictions were imposed separating the structure of HOT Mobile from that of HOT Telecom and HOT Broadcasting, including full segregation of management, as well as the separation of assets and employees. HOT Mobile was prohibited from transferring commercial information (including about customers) to HOT Telecom and HOT Broadcasting, or from receiving such information. However, HOT Mobile was permitted to offer and market HOT Telecom or HOT Broadcasting services in a joint service bundle and transfer the information required for this purpose.

In April 2015, a network sharing agreement was signed between Partner and HOT Mobile. Further to such approval, Partner and HOT Mobile set up a joint company that received a special license to provide cellular radio infrastructure services to a cellular operator. The Antitrust Commission's approval was granted with conditions stipulating that HOT Telecom will refrain from limiting or blocking the option given to customers to use any service or application provided on the Internet at any time, directly or indirectly, including by setting rates or through technology, and that HOT Telecom's Internet infrastructure services will be sold and supplied under equal terms to all its customers, whether they purchase additional communication services from HOT or not. In this regard, it was stipulated that the sale of Internet infrastructure services at a discount as part of a service bundle will not in itself be considered a violation of the terms.

It is noted that competitors that are not part of the above communications group (such as Golan Telecom, MVNO cellular operators, international operators and ISPs, including service providers in the wholesale market) also operate in the market.

Recently the use of "service bundles" (packages including various combinations of several different communication services) has increased. Communications groups market, or are likely to market in the future, "joint" service bundles consisting of different communication services of the companies in each group. As a rule, the marketing of the joint bundle enables the communications group to offer its customers tariffs that are more attractive than purchasing each service separately (in some cases with "cross-subsidization" among the bundle's components), and a total solution that does away with the need to be subscribed to a number of different providers. These trends are strengthening with implementation of wholesale BSA services (see Section 1.7.3.A) that allow operators that do not own infrastructure and operators are not part of a communications group to offer a full end-to-end service package (including infrastructure) to their customers.

Unlike the other groups, Bezeq Group is subject, at the date of this report, to the stricter restrictions described below.

The convergence trend has strengthened due to the Minister of Communication's decision of November 17, 2014 regarding regulation of a unified general license with which it is possible to provide all services provided under specialist domestic carrier, mobile virtual network operator (MVNO), international service, ISP service and NEP service licenses. According to the decision, communications groups with more than one of the licenses - MVNO, international services, special general domestic carrier, or a unified license may apply and coordinate entering into a single license for the group, unless the Ministry approves deviation from this principle. Unified licenses have been granted to an increasing number of operators, including 013 Netvision, Xfone, Golan Telecom, Cellcom Fixed Line Communication, Partner Fixed-Line Communication Solutions, etc.

For the hearing regarding regulation of the provision of international services by domestic fixed-line and mobile carrier license holders, see Section 1.7.2.

1.7.2 Activities of Bezeq Group as a communications group and the structural separation restriction

At the date of this report, the Group is subject to a number of regulatory restrictions relating to the formation of joint ventures among the Group's companies.

A. Structural separation

The domestic carrier license stipulates that the Company must maintain structural separation between itself and its subsidiaries¹¹. This includes complete separation of the companies' managements.

The structural separation restrictions put the Group in an inferior competitive position, which is worsening over time with mergers of other communications groups, which are not subject to such far-reaching restrictions, and with the option for the operators to provide end-to-end services using wholesale services, mainly BSA, and give rise to high management overhead.

For information on the development of a competition policy document, including cancellation of structural separation and the conditions for doing so, and the amendments to the Communications Law on this matter, expanding the Minister of Communication's authority on structural separation, see Section 1.7.3.A. If the provisions of the policy document relating to structural separation are implemented, the rules that apply to the Group on this subject will change significantly, as set out in the same section.

On October 16, 2013 and October 5, 2014, the Minister of Communications published a hearing document regarding new regulation in the international communication services market. According to the proposed regulation, any domestic fixed-line carrier or cellular operator will be able to provide international communication services as part of the service packages offered to subscribers, under the terms of the hearing document. The proposed regulation also includes the provision of international data communication and transmission services by domestic fixed-line carriers and cellular

¹¹ Pelephone, Bezeq International (including Goldnet Partnership which was merged into it), DBS and Bezeq Online.

operators. The Company sent its response to the hearing supporting the move under different terms. However, on February 1, 2015, the Ministry published a secondary hearing regarding special regulation for Bezeq Group and HOT Group for the interim period until cancellation of the structural separation obligation in these groups, according to which the Company and HOT will only be able to provide these services through other operators. The Company objected to the proposed change. For the hearing on Bezeq International, see Section 4.13.4.

B. Easing of structural separation – Limited approval for marketing joint bundles

The structural separation restrictions prevented the Company from marketing joint service bundles. Following the decline of the Company's market share to below 85%¹², in May 2010 the Company was permitted to offer private subscribers joint service bundles with the subsidiaries, and in July 2012 to offer joint service bundles to business subscribers, subject to approvals by the Ministry of Communications and other conditions laid down in the Domestic Carrier license, including these:

1. The bundles must be able to be unbundled, meaning that a service included in them will be offered separately and on the same terms.
2. At the time of submitting a request for approval of a bundle, there is a group of services in similar format being marketed to a subscriber as a package by a license-holder who is not a subsidiary of the Company, or there is a group that includes license-holders who provide a private subscriber with all the services included in the joint service bundle.

Joint service bundles marketed by the subsidiaries including the services of the Company, are also subject, according to their licenses, to similar restrictions, including unbundling (except for a bundle marketed by a subsidiary that contains only the Company's Internet infrastructure service). Additionally, pursuant to the Ministry's clarification regarding joint packages in the business sector, the Ministry does not view the amendment to the licenses as a change in the previously existing practice, with respect to the ability of ISPs which belong to the Group and others outside the Group to offer business customers the ISP component as well as the Company's infrastructure which is purchased as an input, without this being considered a "joint bundle".

These restrictions, and in particular the unbundling obligation, which severely limits the Group's ability to offer discounts on the components of the bundle, puts the Group in a competitively inferior position as compared to the competing communication groups which are not subject to similar restriction in marketing joint bundles (other than a restriction on marketing a joint bundle of HOT-Net and other companies in HOT Group, as noted in Section 1.7.1). The Company's restriction is more significantly manifested with implementation of the wholesale BSA services and the option for ISPs to provide end-to-end services to customers at reduced prices compared with the bundles that the Company can market, which can be unbundled.

There is a dispute between the Company, Cellcom and Partner regarding the terms of the agreement for packages marketed by the Company, the Company's Internet infrastructure services together with ISP services. In this matter, Cellcom and Partner lodged complaints with the Ministry of Communications and the Antitrust Authority. The Company has sent its response.

Concerning restrictions on collaboration with DBS for the sale of joint service bundles under DBS's licenses, also see Section 5.17.11.

C. Other restrictions on offering benefits to Group companies and joint ventures among them

¹² The permit to market joint bundles was granted (by way of amendment of the Domestic Carrier license) pursuant to the policy paper published by the Minister of Communications in 2004, which stated that after the Company's market share in a particular segment (private or business) falls below 85%, it will be allowed to market joint service bundles with the subsidiaries in the same segment. The Company's market share in the private sector (calculated according to the method determined by the Ministry of Communications for this matter) fell below 85% in 2008 and in the business sector in September 2009.

Other restrictions on cooperative ventures between the Company and Group companies stem from various orders applicable to them, both under antitrust laws and conditions laid down by the Antitrust Commissioner in approvals of mergers between the Company and Group companies, which prohibit discrimination in favor of Group companies when providing certain services (see Section 2.16.8), and by power of the orders of the Company's license, which oblige it to provide its services equally to all. For further restrictions also see Section 5.17.11.

- D. For the terms of the merger with DBS, see Section 1.1.2. With regard to cancellation of the structural separation in the multi-channel television segment, also see Section 1.7.3.A.
- E. Lifting of the restrictions on structural separation and waiving the restrictions applicable to cooperative ventures between the Group's companies as set out above, if lifted, may form various opportunities for the Group to utilize synergies or the facilitate utilization of such synergies.

1.7.3 Regulatory oversight and changes in the regulatory environment - Wholesale market

Communications in Israel in general and the activities of the Company in particular, are subject to extensive regulation and close supervision. The main body overseeing the Company's activities is the Ministry of Communications. The regulation in the Israeli communication market is characterized by frequent changes, mainly taking various measures to strengthen competition in the industry and protect the consumer.

Considering the diversity of the Group's communication operations, regulatory developments could, in certain cases, have different effects on different areas of operation in the Group, meaning that changes in regulation that adversely affect one area, could have a positive effect on another area. In certain cases, opposing effects on the areas of operation might be offset one against the other at the Group level.

The main development in the reporting period, which affects a material part of the Group's activity, is commencement of implementation of the wholesale market, following establishment of the format for the services and the wholesale service tariffs, as follows:

A. Background - Competition expansion policy - Wholesale market

On May 2, 2012, the policy document concerning expansion of competition in the fixed-line communications segment – wholesale market was published, according to which the Minister of Communications ("the Minister") adopted the main recommendations of the Hayek Committee in the manner specified in that document which was included in the Company's immediate report dated May 2, 2012, cited here by way of reference ("Policy document on increased competition"). Following are the key points in the document:

1. Owners of country-wide fixed-line access infrastructures, who provide retail services, including the Company, will be obligated to sell wholesale services to holders of telecommunication licenses on a non-discriminatory basis and with no discounts for size. In this regard, a procedure was established whereby an agreement for these services will be negotiated and as soon as such agreement is signed, the infrastructure owner will publish a shelf offering for sale of the services based on the agreement and which also includes additional services as the Ministry determines from time to time ("the Shelf Offering"). In certain circumstances, the Minister has the power to stipulate conditions or prices for the services. The owners of the infrastructure must submit to the relevant license holders the distribution of the existing infrastructures with the exclusions to be defined. Upon publication of the Shelf Offering, companies with an interest in the infrastructure owner may also purchase wholesale services from it, without discrimination. The Company will be able to provide wholesale telephony services to its subsidiaries that are not supplied over a broadband network, provided that these services are also available to everyone without discrimination.
2. Within nine months of publication of the Shelf Offering, the Minister will order elimination of the structural separation between the infrastructure provider who published the aforementioned offering and the international call providers and

ISPs, changing it to accounting separation (unless the Minister believes that this will adversely affect competition or the public interest), so that the Company will be able to offer subsidized plans. Furthermore, insofar as the wholesale market develops and the degree of competition based on joint service bundles that combine fixed-line and mobile services in the private sector (according to indices or conditions stipulated by the Minister) allows this, the Minister will consider an easing or cancellation of the structural separation between an infrastructure provider and a cellular operator who has an interest in the said provider.

3. The Minister will review the subject of the unbundling of broadcast services included in the joint bundles, which also include Bezeq services (fixed or mobile) or broadband access services. The structural separation between the infrastructure providers and multi-channel TV sector will be eliminated by granting suppliers without nation-wide fixed-line infrastructure a reasonable possibility to provide a basic Internet-based TV service package.
 4. If no wholesale market develops in the correct manner (based on indices to be defined for this purpose) within 24 months of the publication of the policy document (namely, May 2014), the Minister will take action to implement structural separation between the infrastructure and the services provided by general domestic carrier license holders. On an amendment to the Communications Law on this subject, see below in this section.
 5. Within six months of publication of the Shelf Offering, the Minister will take action to change the method of oversight of the Company's prices so that prices will be controlled by the setting of a maximum price.
 6. Within nine months, the Ministry of Communications will formulate regulations aimed at increasing the investment in and upgrading fixed-line communications infrastructure in Israel. It is noted that this date has passed.
- B. Amendment to the Arrangements Law, from July 2013 - the amendment expands the powers of the Minister of Communications with the purpose of overseeing competition in the era of a wholesale market (according to the explanations given). This includes that the Minister of Communications was empowered (by the Minister of Finance) to determine payments for a license holder to use Bezeq installations operated by another license holder, to establish maximum or minimum tariffs for a license holder's services, and this, in part, based on cost plus a reasonable profit or on a benchmark point derived from parameters prescribed in the law. The Minister may also request a report on the tariffs before the services commence, instruct a tariff that a license holder may ask for a service, and instruct a license holder to take action to prevent immediate infringement of competition. The amendment also defines provisions regarding a basic broadcasting package, its content and the payment for the package.

As stipulated in the explanations to the bill, according to the competition policy document, the current structural separation is expected to be phased out gradually. However, the Minister's authority to order separate companies was expanded so as to apply also vertically between services rendered to subscribers and services rendered to license holders, and it is expected to be exercised if the wholesale market fails to develop at all or if problems arise in its development, in part due to price discrimination, high entry barriers, etc.

- C. List of wholesale services and hearing regarding wholesale service files and their prices:
1. On January 15, 2014, the Company received a decision from the Ministry of Communications concerning a list of the services that the license holders will be obligated to offer as a wholesale service to the service providers, as follows: Bitstream access (for a countrywide, regional or local connection); Sub Loop Unbundling (at this stage only on the Company's network); use and access to the Company's physical infrastructure; and wholesale telephony services.
 2. On November 17, 2014, the Company received the Minister of Communications' decision (explanations to the decision were sent on November 27, 2014) on

regulation of the wholesale services - format for provision of wholesale services and setting of rates for these services in the Company's network.

The Minister of Communications resolved to adopt the recommendations of the Ministry's professional echelons to amend the license of infrastructure owners (the Company and HOT Telecom) and to detail the service file covered by the license - managed broadband access (including multicast) and wholesale telephony services. As noted in the service file, the services must be provided within three to six month from the date of the decision.

The regulations that were included in the Minister's decision define the obligation to provide the services, including accompanying services and the maximum tariffs for such wholesale services to be provided by the Company (so far, no the tariffs have been prescribed for HOT Telecom's services).

In accordance with the Minister's decision, the tariffs are as follows:

	2015	2016	2017	2018	Unit
Access services - excluding telephony	32.56	32.70	32.87	33.21	NIS per line per month
Access services - including telephony	39.43	38.53	38.80	39.13	NIS per line per month
Sub loop unbundling services	19.34	20.04	20.74	21.47	NIS per line per month
Data transfer services in the core network	30.36	24.11	18.73	14.18	NIS per MB per month
Data transfer services in the multicast configuration ¹³	15,517	12,267	9,456	7,236	NIS per MB per month
Creating a phone call	0.01	0.01	0.01	0.01	NIS per minute
Internet access services ¹⁴	398	398	400	400	NIS per Km per month
First dark fiber on a line	484	484	487	485	NIS per Km per month
Additional dark fiber on a line (up to a total of 4 fibers)	2.18	2.14	2.11	1.99	NIS per Km per month
Technician visit to customer's home	158	158	158	158	NIS per visit

The tariffs are as at the end of 2014 based on the CPI published in November 2014 and updated once a year.

Implementation of a wholesale market, petition to the Supreme Court and wholesale telephony

On December 29, 2014, the Company petitioned the Supreme Court to repeal the decision and as a result, to cancel the amendment of the Company's license, cancel the regulations prescribing the obligation to provide the services and the maximum tariffs for the wholesale services, and to schedule an urgent hearing of the petition.

In the petition, the Company argued that parts of the decision were made without authority or in deviation of authority, parts are extremely unreasonable and parts are impossible to implement. The Company also argues that the decision-making process was improper, the Minister did not have the necessary basis for the decision, the decision was made before the petitioner was fully heard, and on certain issues, without being heard at all.

The Ministry of Communications held discussions with the Company and the relevant operators with respect to operating the service and on February 16, 2015, issued various appendices to the BSA wholesale service file, changing it,

¹³ The price for reaching customers connected to a maximum of 1000 MSAG boxes. The prices for a higher number of MSAG boxes are stipulated in the regulations.

¹⁴ Including access to pits, boxes and poles.

and in the Company's opinion, these were issued without any authority and in a procedure that deviates from proper practice and reason.

As of February 17, 2015, the Company provides wholesale services. As set out in the service file, until May 16, 2015, customers were transferred from retail subscribers to wholesale subscribers in a non-automated procedure (a manual procedure requiring involvement of the Company's staff). As from May 17, 2015, the transfer is automated and does not require human involvement.

Also, on March 25, 2015, the Supreme Court ruled that it would hold a round table with the Company and the State to examine - in a type of late hearing - the Company's arguments (professional or technical in nature, including technical issues which the Company claims are not applicable), and this in order to clarify topics, if possible, and make the necessary amendments, while a notice from the Company and the State will be submitted within 60 days.

On May 7, 2015, the Minister of Communications, the Minister of Finance and the Ministry of Communications submitted an update notice to the Supreme Court for the foregoing petition of the Company, according to which, after holding meetings with the Company following the Supreme Court ruling, the Ministry of Communications reached the conclusion that technically wholesale telephone services can be implemented by the Company and if the Company had made prior preparations, there would have been no technical obstacle to opening the wholesale market in this segment on the scheduled date, May 17, 2015. With regard to the economic aspect, the update notice states that the Ministry of Communications concluded that the Company's arguments that the tariffs are unreasonable are unacceptable. However, after reexamining the Company's claims, it ascertained that certain changes should be made regarding the demand for data consumption and the quality requirements of the service defined in the service file (which, in the Ministry's opinion, do not affect the tariffs), including the Ministry's intention to publish a market-wide hearing and not to enforce the service quality requirements at this stage. A professional opinion of the engineering and economics professionals at the Ministry was attached to the update notice.

On May 25, 2015, the Company submitted an update notice on its behalf in the proceedings. In the update notice, the Company rejected the State's update notice and noted that contrary to the State's conclusions (1) the different solutions proposed by the Ministry for provision of telephony services in the wholesale market are technologically inapplicable. (2) The tariffs prescribed by the Ministry of Communications for provision of the wholesale market services are unreasonable. The Company also argued that the Ministry of Communications has not completed the meetings to examine the Company's claims, as requested by the Supreme Court, and has held onto its decisions, so they remained unreasonable. An engineering opinion by an external expert and an economic opinion of an internal economist (together with an external comparative study indicating that the wholesale price in European countries on which the Ministry relied is more than double the price prescribed by the Ministry in Israel) were attached to the Company's update notice.

On October 8, 2015, the Ministry of Communications filed a notice to the Court, according to which, without derogating from its position to date, it believes that due to the importance it places on the ability of the service providers to offer services to their subscribers immediately, including telephony services, and in order not to allow continued delay in provision of this service, it is formulating a hearing which it intends to publish as soon as possible, with respect to compelling the Company to provide telephony services to the service providers for resale and to establish the maximum tariffs for provision of this service. In the notice, the Ministry notes that it is a different wholesale service which also the Company believes does not require any preparations or changes in its engineering systems. Therefore, it may be offered immediately and is offered as a temporary solution for a limited period of a year.

On October 11, 2015, a hearing of the petition was held in which, due, among other things, to the Ministry's notice regarding publication of a new hearing, the Court dismissed the petition insofar as it relates to wholesale telephony services and ruled that update notices would be submitted on the subject of tariffs, which is still pending.

On December 10, 2015, the Ministry of Communications published a hearing regarding "the supply of telephony services for resale on Bezeq's network". A draft amendment to the Company's general license ("the License") adding telephony services in a resale format was attached to the hearing document. The full document was attached to the Company's immediate report of December 12, 2015, Reference No. 2015-01-178008, which is included in this report by way of reference.

The service allows a general unified license holder that is entitled to provide domestic fixed-line services, to purchase telephony services from the Company, to allow outgoing and incoming calls, and provision of accompanying and added value services by the Company wherever possible without the service provider being able to distinguish that it is receiving services through Bezeq, other than with respect to technical support. In this regard, the service provider will be able to build packages to be sold to its subscribers in any manner.

At the hearing, it was stated that the Ministry is considering allowing Bezeq to offer the service as a temporary interim solution for a limited period of a year from adoption of the decision at the hearing, after which the Company will provide wholesale telephony services, and also that the temporary arrangement will apply as long as the Company is obligated to provide telephony as a product that can be unbundled, and it will also be canceled (and the Company will be compelled to provide wholesale telephony) if maximum tariffs for the Company's retail services are prescribed in place of the tariffs set out in the payment regulations. It was also stated at the hearing that the service will be provided immediately after establishment of the operating arrangement with the service providers, since provision of the service does not require any preparations or changes in the Company's engineering systems, but only in its IT systems.

The following tariffs were presented at the hearing:

Package	Wholesale payment (derived from the retail price less VAT)
Speak 100	NIS 23.03
Speak 300	NIS 28.15
Speak 600	NIS 35.85
Speak 750	NIS 38.41
Speak 1000	NIS 46.10

- Interconnection - the above payment includes payments for interconnection for calls to Bezeq subscribers and in addition, the service provider will pay an interconnection fee for outgoing calls from its network for every subscriber of another operator other than the Company's subscribers. The service provider will also be eligible to payment for every incoming call.
- Excess minute price - NIS 0.0923 per call minute.
- Payment for additional services - the payment prescribed in bundles is decreased by 40%.

On January 10, 2016, the Company submitted its response to the hearing, according to which it is impossible to determine that after a certain period (or upon establishment of maximum tariffs or cancellation of the unbundling obligation) the service format anchored in the service file will apply automatically, since the format is impossible to implement and postponing it will not lead to a solution. The only way that enables Bezeq to provide the service in the service file format entails switch replacement and compelling the Company to perform a complex, disproportionate unauthorized and unjustified procedure. Moreover, a wholesale telephony service in the service file format is essentially unnecessary and unjustified (as testified by the various arguments for the service, each of

which was concealed and another raised in its place) and all its aspects deviate from the global trend. With regard to the price of the service, it is clarified that it is inappropriate to reduce it by 40%, since it is a resale service with almost no costs to the telecommunication providers or saving for Bezeq and that the standard discount rate worldwide is between 10% and 20% maximum. It is further clarified that the "Kav Kal" (light line) is irrelevant and cannot be included in the resale arrangement and that interconnection fees will only be paid for outgoing services to another network and will be received for incoming calls from another network not belonging to the Company. It was further clarified that they are aimed at improving the cooperation between the Company and the service providers.

On January 11, 2016, the State submitted an update notice to the Court, which does not contain anything materially new compared with the previous update notice, and stipulates that the Ministry intends to review making fundamental changes in two issues raised by Bezeq (the issue of data consumption demand forecasts and the service quality requirements defined in the BSA and telephony service file). In view of the contents of the notice, the State requested dismissal of the petition and charging the Company for the expenses.

On February 7, 2016, the Company submitted a revised notice on its behalf, according to which the tariffs of the wholesale services set out by the Ministry of Communications are extremely unreasonable and lack jurisdiction. The Company petitioned the Court to issue a conditional order, as set out in the petition. Due to the contents of the revised documents, the Court scheduled a hearing for the file.

Imposition of fines

In the initial wholesale BSA service implementation period, the Ministry of Communications held supervisory proceedings against the Company claiming that the Company breached some of its provisions set out mainly in the service attachments issued as described above on the eve of the reform, February 16, 2015. On May 11, 2015, the Company received the Ministry of Communication's notice of its intention to impose fines regarding implementation of the broadband reform ("the Notice"), claiming that according to the supervision report attached to the notice, the Ministry discovered that the Company fails to comply with the provisions set out in the service file as required and that this conduct of the Company is a breach under item (5) in part D of the addendum to the Communications (Telecommunications and Broadcasts) Law, 1982. Therefore, the Ministry intends to impose a fine of NIS 11,343,800, which is the maximum amount possible under the law (see the Company's immediate report dated May 11, 2015, Reference No. 2015-01-017277, which is included in this report by way of reference). The Company rejected the notice and sent its counterclaims, including its rejection of the groundless statements and declarations in the notice regarding the failings of the reform and the impairment to competition. The Company presented the Ministry's unreasonable behavior and the update of the service file without jurisdiction, ignoring the complexity of the non-automated procedures and the time allocated to them.

Subsequently, on December 16, 2015, the Company received a demand for payment of a fine of NIS 8.5 million. On January 31, 2016, the Company filed an administrative petition against imposition of this fine.

Use of terminal equipment in the wholesale market

On December 30, 2015, the Ministry published an administrative instruction regarding the use of wholesale terminal equipment (following a hearing published on the subject on June 1, 2015 and a draft agreed arrangement sent for a response on August 31, 2015), according to which until February 17, 2016, a service or infrastructure provider who borrows or leases terminal equipment for a subscriber and that subscriber switches to receive service from another service provider under the BSA service file, will not prevent the abandoning subscriber from making regular and proper use of the terminal equipment, will under no circumstances limit and will allow the abandoning subscriber to make such use of the terminal equipment in its possession ("Transition Period") and as from February 18, 2016, will not prevent or limit and will allow such use for 21 business days from the switch notice. The

payment will be made by abandoning the subscriber in the same way as when subscribed to the abandoned service provider. In its decision, the Ministry also determined that under Section 51C(b) of the Communications Law regarding terminal equipment sold to an abandoning subscriber, the service or infrastructure provider will not bring about restriction of the use thereof by the abandoning subscriber.

3. Passive wholesale services (physical infrastructures and SLU):

On January 27, 2015, the Company received the Ministry of Communications ruling regarding regulation of the wholesale services - service files, access to physical infrastructures and service loop unbundling (SLU) prescribing that the Company must start providing these services from August 1, 2015.

The Director General of the Ministry of Communications noted in his decision that while the obligation of the infrastructure owners to provide wholesale services to the service providers was already prescribed, a ruling regarding the duty of reciprocation (between the infrastructure owners) is an initial decision, and since the Authority is committed to exercising restraint in making decisions regarding all those matters for which action is not especially pressing or urgent, it is fitting for this matter to be concluded by the next government.

The Minister of Communications' decision of November 17, 2014 set out the passive service tariffs, while the volume and content of the services have yet to be determined. As described in Subsection 2 above, the Company petitioned the Supreme Court, in part to cancel the tariffs.

The Company allows use of its physical infrastructures - access to passive infrastructure (pits, tubes, communication cabinets, over ground network, etc.), available-for-transfer communication cables or use of available dark fibers out of the Company's available optic cables, while in order to connect the service provider's infrastructure to the Company's infrastructure, the service provider must set up a passive infrastructure (pit, cross-connect cabinet, connection box, etc.) near the Company's passive infrastructure facility. A dispute erupted between the Company and one of the service providers regarding the option of using the physical infrastructures as part of this service for cellular subscribers. Measures are also being taken to test the SLU service with Cellcom, and the Company conducts meetings and tours with interested service providers for provision of the services.

With respect to the SLU service - according to the administrative instruction, the Company provided Cellcom and Partner (under secure conditions) with information regarding the geographic location of certain of its facilities and sites. The instruction will apply with regard to this type of information delivery to every unified general domestic carrier license holder wishing to receive it from the Company as part of preparations to implement the wholesale SLU service

4. Hearing regarding establishment of a format for reviewing a margin squeeze by the fixed-line broadband network owners:

On November 17, 2014, the Company received a Ministry of Communications hearing aimed at establishing policy and means of control to prevent a margin squeeze - a situation where the infrastructure owners reduce their retail prices and minimize the margin between their retail prices and wholesale price of the infrastructure input purchased by the service providers to a level that erodes the margin of the service providers to the point of being economically unfeasible to continue their operations.

According to the hearing, the infrastructure owners will be required to send every marketing offer to the Ministry of Communications for review and the Ministry will inform them within 14 days whether they are prohibited from marketing the package for concern of a margin squeeze. The Company sent its response to the hearing document. This review mechanism and the derived restriction on determining retail service tariffs, if implemented, may impair the Company's ability to market offerings of its wholesale services.

With respect to the effect of implementation of the wholesale market, as at the end of 2015, the number of wholesale Internet lines on the Company's network was 244,000. Implementation of wholesale telephony services for resale according to the outline of the hearing may increase the churn rate of the Company's BSA service subscribers and implementation of the transition to using the Company's physical infrastructures may lead to increased competition in the data communication segment by launching of services that compete with those of the Company using these infrastructures.

D. Cancellation of structural separation

In the Company's opinion, the Ministry of Communication must cancel the structural separation applicable to it, because the conditions set out in the competition expansion policy document were met, in part following the launch on February 17, 2015 of a broadband wholesale market, in which a variety of service providers operate providing end-to-end broadband services on the Company's infrastructure, there is intense competition in the cellular service segment and there are companies providing television services over the Internet.

The information in this paragraph includes forward-looking information, as defined in the Securities Law, based on the Company's assessments regarding regulation of the wholesale market and the possibility of canceling the structural separation and the price control. Actual results may differ significantly from the foregoing if any of the Company's above assessments do not materialize.

1.7.4 Regulatory oversight and changes in the regulatory environment - Additional topics

A. Royalties

The Communications Law states that a holder of a license for providing telecommunication services shall pay royalties to the State out of its revenues from providing the services named in the Regulations. The Royalties Regulations obligate the various license holders (including Bezeq, Pelephone, Bezeq International, DBS and B.I.P.) to pay royalties on certain revenues, as specified in the Regulations. Over the last few years, the rate of the royalties has been gradually reduced, and in accordance with the amendment to the Royalties Regulations relevant to the Group's companies dated August 1, 2012, commencing in 2013, 0% royalties apply to all license holders.

B. Change in interconnect tariffs

The Group's telecom companies (Bezeq, Pelephone and Bezeq International) pay interconnect fees to other carriers for calls that are terminated on the networks of those carriers, and some of them (Bezeq and Pelephone), receive interconnect fees for calls that are terminated on their networks and from international communications operators for outgoing calls on their networks.

The interconnect fees are determined by the regulator in the interconnection regulations, while in 2011 the tariff to cellular operators was decreased substantially and in 2012 the tariff paid to domestic carriers was reduced significantly. The changes in the interconnect tariffs have an offsetting effect at the Group's level, in view of the decrease in the expenses of the Company and its subsidiaries.

C. Restriction of the exit penalty a license-holder can collect from a subscriber

Pursuant to several amendments to the Communications Law, most of which entered into force in 2011, the following restrictions apply to the Group's companies with respect to the collection of disconnect fees when certain subscribers cancel an agreement

1. Holders of domestic carrier licenses, ITS licenses and broadcasting licenses (including the Company, Bezeq International, DBS and B.I.P.) - may not collect disconnect fees from subscribers who cancel agreements if their average monthly bill is less than NIS 5,000. Additionally, license holders may not withhold a benefit from a subscriber that would have been given had the agreement not been

terminated¹⁵, and they may not demand immediate repayment of any outstanding payments for terminal equipment if the agreement is canceled. The Company believes that these legislative amendments have led to an increase in the churn rate.

2. Cellular operators (including Pelephone) - the licensee may not collect disconnect fees from customers who hold up to 100 phone lines and who entered into an agreement with the license holder. Furthermore, from January 1, 2013, the cellular operators may not condition a contract for cellular services on an agreement to purchase, rent or lease terminal equipment ("unlocking").

For a description of other regulatory developments in the reporting period and of the main restrictions applicable to the areas of operation of the Group, see Sections 2.16, 3.15, 4.13 and 5.17.

D. No discrimination in the offering of benefits and special tariffs

1. On October 31, 2013, the Director General of the Ministry of Communications sent a clarifying document to the cellular operators on the applicability of certain clauses in their licenses that address equality and discrimination, including the offense to discriminate against subscribers belonging to the same group of subscribers by offering special benefits and tariff plans.
2. In its position paper submitted to the Tel Aviv District Court in January 2014, as part of a number of class actions that were consolidated against several communications operators, the Ministry of Communications stated that the licenses of the ISPs do not permit them to offer their customers "individualized tariff plans", tailored to the needs of individual customers and their ability to "haggle", and that they must offer a standard price for each service package (subject to certain exceptions).
3. On April 30 2015, the Ministry of Communications clarified its opinion with respect to "individualized tariff plans", "packages" or "service bundles" marketed to new subscribers that a new subscriber is someone who at the time of the inquiry to the license holder did not have an agreement with the license holder. Therefore, license holders may not demand a "waiting period" from anyone wishing to re-contract with them and they must allow anyone to join any plan under the terms offered to new subscribers.
4. In addition, according to the clarification, under the provisions of the license, all subscribers have the option of switching between the different plans offered at the time of the request, without discrimination, including plans marketed to new subscribers. However, this clarification does not derogate from the license holders' right to determine switching terms.

E. Consumer legislation

Changes in consumer legislation affect the operations of the Group's companies on a regular basis. Various amendments have been made in recent years to the Consumer Protection Law and regulations, inter alia, concerning the canceling of transactions even after service has begun, disconnecting from on-going services, and the need for the customer to give his express consent to continue transactions after the end of the specified period. Provisions concerning a refund of charges collected from the subscribers which are not in accordance with an agreement plus fixed handing charges are prescribed by law, as well as a maximum waiting time for a human response, and extension of the visiting times of technicians at the subscribers' homes. Likewise, a variety of bills have been tabled in the Knesset introducing further amendments in the Consumer Protection Law which may, inter alia, affect the terms of the agreement, and the conduct of the Group's companies towards their subscribers.

¹⁵ With regard to the operators' claims in the hearing conducted by the Ministry of Communications in respect of this provision, that the discounts or benefits, which are prescribed in the conditions that the subscribers are required to comply with, do not violate the provisions, the Ministry decided that in any case it will examine whether the conditions are real and relevant also when the subscriber remains as the operators' subscriber.

F. Enforcement and financial sanctions

Over the last few years, the Communications Law, the Antitrust Law, the Securities Law and the Consumer Protection Law were amended, giving the regulators powers of enforcement and the ability to impose graded monetary penalties for violation of these laws or regulations and their provisions. Likewise, the Law to Increase the Enforcement of Labor Laws was legislated. This legislation is expected to affect the way in which the Group's companies manage their affairs, in part with respect to the imposition of sanctions, their ability to protect themselves, etc.

Recently, the Ministry of Communication makes wide use of its authority to supervise and provide notices of its intention to impose fines on the Company on ongoing regulatory matters and issues related to implementation of the wholesale market. The Company sent the Ministry its response to the supervision documents and notices regarding such imposition of fines. In some cases, the Ministry rejected the Company's position and imposed fines. For fines regarding implementation of the wholesale market, see Section 1.7.3.

G. Hearings relative to the amendment of licenses and additional legislation

1. Hearing about call center waiting times

On August 18, 2014, the Ministry of Communications published hearings to the communication license holders, including holders of cable and satellite licenses, telecommunications, fixed communications, virtual operators and ISPs, relative to the response times of call and support centers that serve private and business subscribers of the license holders. The main provisions in the proposed amendments determine a maximum average waiting time and its measurement; the possibility to leave a telephone number to receive a return call; operation of specific malfunctions centers throughout all hours of the day and a customer service call center for 13 hours (in DBS, 15 hours a day); access to service centers via toll-free numbers; submission and publication of reports and service data on the website of the license holders; definition of a menu for human and automated responses; possibility to cancel a service by phone; recording of calls in all call centers; and a memorandum for the amendment of the Communications Law that determines a compensation without proof of damage in the event the response time in the call centers is higher than defined, and compensation for overcharge for an amount up to 10 times the amount overcharged. Responses to the hearing opposing the arrangements proposed were submitted. If the proposed arrangement is approved, an increase in the operation costs of the call centers of the Group's companies is expected.

2. Amendment of licenses relative to ensure operational continuity of communication companies in emergencies

On March 1, 2015, the licenses of communication operators were amended, including the licenses of Bezeq, Pelephone and B.I.P. In accordance with the amendment, the license holders must comply with minimum requirements to ensure operational continuity in emergencies. Operational continuity includes a business continuity plan and a plan for the recovery of the network from a disaster. In this respect, the license holders must implement a work plan that includes a risk assessment, as well as service and recovery objectives. Furthermore, the amendment to the licenses includes provisions relative to the management's and Board of Directors' responsibility, emergency management, preparation of personnel for each area of operation to enable operational continuity, as well as provisions relative to security of information systems, back up and survivability of the network and the infrastructure (including electricity and energy), agreements with vendors and subcontractors, and more.

H. The Concentration Law

The Business Concentration Law was published in December 2013. The following is a summary of the main provisions of the law relevant to the Company:

1. Restriction on the control of companies in a pyramid structure

The law prohibits a tier company (publicly traded or bond issuing companies that are a reporting entity), which is a second-tier company (a tier company whose controlling shareholder is not a tier company), from controlling another tier company. In relation to existing companies, transition provisions were prescribed whereby a second-tier company may continue to control another tier company in which it held control when the law was published, for a period of six years from the publication of the law (until December 10, 2019). Mechanisms were also prescribed allowing certain arrangements to be made to acquire shares and make early redemption of bonds offered to the public, in order to comply with the provisions of the law.

For the purpose of the law, the Company is considered a third-tier company, and accordingly, insofar as by the end of the 6-year transition period B Communications remains a tier company, it will not be allowed to control the Company from that date.

2. Special provisions concerning directors in a third tier company during the transition period

At the end of six months from the publication date of the law (June 2014) (subject to provisions of applicability that provide an additional three months for convening the meeting to appoint directors) the special provisions concerning the composition and appointment of Board of Directors apply to third-tier companies (including the Company). These provisions include: a majority of the Board members must be independent directors, the external directors will be appointed by a majority of Company's minority shareholders (who are not its controlling shareholders) and they will number half of the members of the Board less one, unless stipulated otherwise in statutorily authorized regulations.

On June 11, 2014, the Regulations to Promote Competition and Reduce Concentration (Relief with Regard to the Number of External Directors), 2014, were published, according to which, 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, as at the report date, one director serves who was appointed according to the proposal of the representative union. The Company complies with the terms of the Concentration Law in this matter.

3. Restrictions on providing credit to business groups

Powers were granted to the Minister of Finance and the Governor of the Bank of Israel to enact regulations and provisions limiting the cumulative credit that financial institutions in Israel may give to a corporation or business group (a group of companies under joint control and their controlling shareholder). It was determined that preliminary provisions by virtue of these powers will be prescribed within a year of the publication of the law.

4. Market concentration considerations in the allocation of rights - restrictions on the allocation of rights in critical infrastructures to a "highly concentrated entity"

The law prescribes a special, restrictive procedure that the regulator must apply prior to the allocation of rights (such as a license, franchise, contractual agreement with the state to operate a critical infrastructure and in certain circumstances also to extend existing licenses) in those areas that are defined as a "critical infrastructure" to entities that are defined as a "highly concentrated entity". For this purpose, a list of areas was defined that will be deemed "areas of critical infrastructure", including operations for which certain communications licenses will be required (domestic carriers, excluding a specialist domestic carrier (such as VoB operators) and cellular operators), broadcasting licenses, and other areas. On December 11, 2014, the Antitrust Authority published the list of concentrated entities according to the law. The Company, its investees and companies controlled by its controlling shareholder are

included in the list and considered "concentrated entities". The procedure prescribed in the law in relation to the allocation of a right to a concentrated entity will also apply to approval given for transferring the means of control in state-owned companies or companies that were previously government companies (the Company included) at the rates defined in the law, to a concentrated entity.

The provisions of this chapter entered into force in December 2014, although with respect to extending the validity of existing licenses, the provisions will apply from December 2017.

At this stage, the Company is unable to estimate the full impact of the law on the Bezeq Group, in part in view of the fact that its repercussions are dependent on policy that has yet to be formulated by the relevant authorities in relation to the issues prescribed in the law. Nevertheless, the law may adversely affect the Group's ability to enter new areas of activity as well as its current operations.

I. Ministry of Communications policy concerning Wi-Fi

On August 6, 2014, the Ministry of Communications published its decision (accompanied by a decree), according to which the establishment and operation of access points (as defined in the decree) are exempt from a license and general permit. It was further decided to permit the license holder to use WLAN technology, deploy and operate an access point in accordance with the exemption, provided the license holder that uses the access point as part of its public network does not collect payment from a subscriber for accessing services provided, where the aforementioned services are provided via the access point, and will not decrease the quota of Internet access services at the disposal of the subscriber for the relative portion of the service provided via said access point. Accordingly, upon entering the exemption into effect, a request from a general license holder to the Ministry of Communications to extend its public telecommunications network using access points will be evaluated subject to the provisions of the decision document and the law, and its license will be amended accordingly.

1.7.5 **Restrictions on creating charges on the assets of Group companies**

For convenience, below are referrals to sections in the 2015 Periodic Report that relate to the restrictions applicable to Group companies in placing charges on their assets, and the main restrictions:

- A. Regulatory restrictions – the Communication Law, the Communication Order (which applies to the Company), and some of the communications licenses of Group companies, contain restrictions on the grant of rights to a third party on assets used to provide the essential service or on the assets of the license¹⁶, as the case may be, including the need to obtain regulatory approval to create charges on these assets. In some cases, such as Pelephone's cellular operator's license, and Bezeq International's unified license, there are exceptions permitting the creation of charges in favor of banks without the need to obtain the regulator's approval in advance, provided that the charge agreement includes instructions to ensure that the services rendered according to the license will not be affected if the bank exercises the charge. In addition, under the provisions of the law and the communications licenses, the license and the resulting rights are not transferable and they cannot be pledged or confiscated (with certain exceptions). See also Sections 2.16.3G, 3.15.2A and 5.17.9.
- B. Contractual Restrictions - the Company has made undertakings towards certain financing entities that it will not pledge its assets without simultaneously creating a charge of the same class, rank and amount (negative charge) in favor of those financing entities, subject to specific exceptions. See also Note 12 to the 2015 financial statements. DBS created a current charge on all its assets and a fixed charge on several of its assets, whose conditions include, inter alia, restrictions on the creation of additional charges without obtaining the consent of the holder of the charge.

¹⁶ The assets required to secure the provision of service by the license holder.

1.7.6 Approvals and restrictions as part of the 2010 acquisition of control.

In the framework of the transaction to acquire the control of the Company by B Communications, which was completed in April 2010, several approvals were granted to the Company, as follows.

- A. Ministry of Communication approval for the transaction. The approvals were made contingent upon certain conditions, namely: a determination that transactions between the Eurocom Group¹⁷ and Pelephone would be considered an exceptional transaction under Section 270(4) to the Companies Law, and in addition to the approval proceeding at Pelephone, would also require an approval proceeding in the Company (a similar provision was determined relative to the purchase of satellite end equipment by DBS, of the Eurocom Group); the Eurocom Group would not transfer to Pelephone any information relating to the provision of products and services to its competitors; an employee of Eurocom Cellular Communications Ltd., would not serve as a director in Pelephone and vice versa. In addition, provisions in respect of the trust on DBS shared were also determined (see Subsection 'b' below).
- B. Approval of the transaction by the Antitrust Commissioner. The approvals were made contingent upon certain conditions, namely: prohibition to the Eurocom Group¹⁸ to be involved in the determination of commercial conditions that the cellular company that acquired from Eurocom Cellular Communications Ltd. terminal equipment offers to the consumer in Israel, except for the participation in the financing of sales of the cellular company. Another condition that imposed restrictions on Eurocom Group regarding its holdings in DBS was canceled by the Antitrust Authority, since the other conditions that allow the Company and DBS to merge were met. Subsequently, the Company purchased the remaining DBS shares. In this matter, see also Section 1.1.2.
- C. Approval of the Prime Minister and the Minister of Communications in accordance with the provisions the Communications Law and of the Communications Order, including approval of corporations from the B Communications Group and the controlling individuals in it to control Bezeq (the Control Permit). The Control Permit is contingent, inter alia, upon the percentage of B Communications' holding in the Company not falling below 30% ("the Minimum Percentage"), subject to a number of exceptions stated in the Communications Order.

On February 1, 2016, a notice was delivered to the Company from B Communications stating that according to the provisions of the law and the Control Permit, B Communications is entitled to fall below the minimum rate, subject to certain terms¹⁹, provided that B Communications Group continues to control the Company and its rate of holding in it does not fall below 25%. With regard to the sale of part of B Communications shares executed following this notice, see Section 1.3.

¹⁷ For this matter, Eurocom Group means all the corporations controlled, directly or indirectly, by Eurocom Holdings (1979) Ltd. and/or Eurocom Media-Net Holdings Ltd., excluding the Company, Pelephone, Bezeq International and B.E.P Communications Solutions LP, as well as employees of Bezeq and the above companies who are not employees in other companies in the Group.

¹⁸ For this matter, Eurocom Group means all the corporations controlled, directly or indirectly, by Eurocom Holdings (1979) Ltd. and/or Eurocom Media-Net Holdings Ltd., as well as any person related to those companies and excluding the Company and companies in which the Company holds more than 50% of the shares.

¹⁹ Section 3(A3) of the Communications Order allows decreasing the holdings of the controlling shareholder to below the minimum holding rate in one of the following ways, if after the decrease, it remains the controlling shareholder of the Company: A. A public placement or allocation under a prospectus on the TASE or a sale during trade on the TASE; B. A sale or private placement to one or more institutional investors (as defined in the Communications Order), which make investments for customers, provided that as a result of the purchase or placement the institutional investor does not hold, solely or with others, means of control in a percentage that requires approval under the Communications Order; C. A sale or private placement to one or more distributors (as defined in the Communications Order), provided that the purchase is not made for themselves or for their investees or entities controlling them, and they undertake not to sell means of control in a percentage that result in one or more buyer holding a percentage that requires approval under the Communications Order, unless the buyer has approval under the Order.

1.7.7 Level of economic activity in Israel

The activities of the Group are influenced by the level of economic activity in Israel, and accordingly, a change for the better or worse in that level can be expected to affect the Group's business.

2. Bezeq – Domestic fixed-line communications

2.1 General Information on the Operating Segment

2.1.1 Segment of operation and changes occurring in it

The Company holds a general license for providing domestic fixed-line communication services and provides a range of such services as described in Section 2.2, mainly these: domestic fixed-line telephony (fixed-line telephony), Internet access infrastructure services, transmission and data communication services, and wholesale services. In respect of the wholesale market, including regulation of service files, service prices, and the hearing relative to the plan for the prevention of a "margin squeeze", see Section 1.7.3.

2.1.2 Legislative restrictions and standards and special constraints

A. Communications laws and the Company's Domestic Carrier License

The Company's operations are subject to government regulations and extensive oversight, stemming from its position as a general license holder under the Communications Law, which is subject to the provisions of that Law, of the subsequent instructions, regulations, orders and rules, the provisions of the Domestic Carrier License, as well as other laws. In this respect and for the restrictions on the Company's activity, inter alia, in respect of price setting, structural separation, permits for new services and service bundles, see Sections 1.7.2 and 2.16. For details about the regulations in the wholesale market, see Section 1.7.3A.

In addition, the Company was declared a provider of essential telecommunication services under the Communications Order. Pursuant to that declaration, the Company is obliged to provide a number of basic services under the Domestic Carrier License, and may not terminate them or narrow them without approval. The order also stipulates restrictions on the transfer and acquisition of means of control in the Company, and certain restrictions on the activities of the Company. For details, see Section 2.16.3.

B. Antitrust laws

The Company was declared a monopoly in the main areas of its activities, and is also subject to supervision and to restrictions under the Antitrust Law (see Section 2.16.8).

C. Environmental laws and planning and construction laws

Some of the activities of the Company involve the use of wireless frequencies and the use of facilities that emit electromagnetic radiation, which are subject, respectively, to the Telegraph Ordinance (see Section 2.16.9), the Non-Ionizing Radiation Law (see Section 2.15), and to UBP 36 and UBP 56 (see Section 2.16.10).

2.1.3 Changes in the scope of operation in the segment and its profitability, market developments and customer characteristics

For the main data about the scope of operation in domestic fixed-line communications and its profitability in 2014 and 2015, see Section 1.5.4. The following is a description of the main changes in the scope of operation in the segment in the reporting period²⁰:

In the reporting period, the Company started providing wholesale services to service providers, while as at the end of 2015, the number of wholesale Internet lines on the Company's network was 244,000. In this regard, it is noted that these lines also includes lines which were not originally on the Company's network (new or from a competitor's network). The Company believes that 11% of the fixed-line Internet subscribers in Israel are part of the wholesale BSA services. For the hearing on provision of wholesale telephony services in a resale format and wholesale services using passive infrastructures, see Section 1.7.3.

A. Fixed-line telephony - in recent years has been characterized by a decline in demand and in prices. The decline in demand is reflected in the decline in the rate of

²⁰ For detailed data and definitions of subscriber and average income, see the notes to the table in Section 0A.

ownership of fixed telephone lines and in a gradual erosion of the number of calls originating in fixed-line networks. The Company believes that this trend stems primarily from the rise in the number of cellular subscribers and the volume of use of cellular telephones in the comprehensive call-minute packages the cellular companies have marketed extensively over the last years (the Company estimates that 80% of all calls originate in the cellular network), and from an increase in VoIP calls (see Section 2.1.4). In 2015, the number of Company lines declined by about 0.1% (compared with a decline of 0.5% in the number of lines in 2014), inter alia, due to the reduction in the cellular prices. Likewise, the number of call minutes (incoming and outgoing) declined by 7% on the Company's fixed telephone lines compared with 2014. The average monthly revenue per phone line declined by approximately 5%. With regard to the hearing on the wholesale telephony service in a resale format, see Section 1.7.3.

- B. Internet access - in the Internet segment, a growth has been recorded in recent years in terms of number of subscribers. In 2015, there was a 4% increase in the number of fixed-line Internet subscribers in Israel. Furthermore, the Internet segment is characterized by a rise in surfing speeds and by the adoption of advanced services and value-added applications. In 2015, against the background of introduction of the wholesale Internet services, an increase of 8% in the number of the Company's Internet subscribers (retail and wholesale) was recorded compared with 2014. Average monthly revenue per Internet subscriber (retail) rose by 5% compared with 2014. In the reporting period, the Company started providing wholesale BSA services and as at the end of 2015, the number of wholesale Internet lines on the Company's network was 244,000, which constitutes approximately 17% of the all the Company's subscribers. In this regard, it is noted that these lines also includes lines which were not originally on the Company's network (new or from a competitor's network).

With respect to establishment of a competing fixed-line network on the Company's infrastructure, on the electricity grid, see Section 2.6.5B.

- C. Transmission and data-communication services

The transmission and data communications segment for business customers and communications providers is characterized by a rapid increase in the customers' broadband consumption, but in general by lower prices per given volume of traffic. This stems both from development of the technology allowing greater bandwidth at lower prices than in the past, and from competition in this area (see Section 2.6.4).

- D. Use of physical infrastructures - with regard to this wholesale service, see Section 1.7.3.
- E. Service bundles

On the increase in consumption of service bundles and large-scale bundles, see Section 1.7.1.

2.1.4 Technological developments that may have a significant effect on the area of operations

- A. In recent years, a trend has established in the telecommunications market with the transition to technologies based on IP protocol, which promotes technology convergence between the different communication systems, and with the penetration of integrated products that enable various communication solutions in a single device (for example, cellular and Wi-Fi services). The availability of IP-based technologies and the continuing increase in bandwidth consumption provide customers, including business customers, a broader range of applications and services on IP-based infrastructures, such as telephony services, video transfer services, television, and network services with enterprise applications on the Internet infrastructure (ERP, CRM, etc.). These developments are leading to an increase in the demand for bandwidth by the Company's Internet infrastructure, transmission and data communication services. Conversely, these developments that enable IP-based telephony services are one of the factors that have led to the decline in the consumption of the Group's fixed-line telephony services (in respect of the competition in telephony by providing services over the Company's Voice over Broadband (VoB) infrastructure, see Section 2.6.1). On January 12, 2015, the Ministry of

Communications conducted a tender of frequencies for LTE networks, following which the capacity of cellular networks increased due to the rise in the popularity of 4G services. The increase in the capacity of cellular networks along with technological improvements, including future implementation of LTE networks, allow cellular operators to compete with the Company's telephony and Internet services, and to market larger bandwidths to their customers at lower prices. In the past year the trend of growing numbers of cellular Internet users has continued (see Section 2.6.3). As at the date of the report, the Company estimates the increase in the number of customers using cellular Internet network has not materially affected the volume of its Internet operations. Nevertheless, the potential of growth of the cellular networks at the expense of the Company's market share is a real one. The Company estimates that the transition of cellular companies to 4G in 2015 still does not materially change the interchangeability of cellular services compared with fixed services in the Internet segment.

- B. In respect of the decision about the exemption of a license to establish and operate a Wi-Fi access point, see Section 1.7.3I). The provision of cellular telephony services over the Wi-Fi network may assist in diverting loads to this network from the cellular network.
- C. Technological developments and falling prices of the equipment could enable other operators to provide services similar to those provided by the Company at much lower costs.

2.1.5 Critical success factors in the segment of operations and changes occurring in it

- A. The ability to offer reliable communications systems at a competitive price based on a cost structure suited to the frequent changes in the Company's business environment.
- B. Regulatory decisions and the ability to cope with them.
- C. The ability to maintain innovation and technological leadership and to translate them into advanced and reliable applications of value to the customer at short response times, and marketing primacy.
- D. Preservation of brand values and their adaptation to the conditions of the changing competitive environment, including the wholesale market.
- E. Effectiveness of the sales and services groups.
- F. Managing an intelligent price policy, subject to regulatory restrictions, including restrictions and changes following implementation of the wholesale market.

2.1.6 Main entry and exit barriers of the segment of operation, and changes occurring in them

Operating in the domestic fixed-line communications segment requires receipt of the appropriate Domestic Carrier licenses.

Traditionally, the main entry barrier to this segment stemmed from the need for heavy investment in technological infrastructure and in surrounding systems until obtaining economies of scale, and from high costs involving the establishment of marketing, sales, collection and customer support systems and the building of a brand. In recent years, these traditional carriers to the Company's segments of operation have lessened considerably as a result of the following factors: technological improvements, lower infrastructure and equipment prices, easing of regulation granted to new competitors, the mandatory obligation to allow the use of the Company's (and HOT's) infrastructures and services in the wholesale market, and the ability to use existing set-ups, including the Company's network, by competing communications carriers or those destined to compete with the Company.

The regulation of competition in VoB-based telephony, which enables telephony services to be provided on a broadband infrastructure of another operator, without the need for an independent line telephony infrastructure, and competition based on dividing the network into sections and wholesale sale of services (see Section 1.7.3A), more significantly reduces the size of investment required from those competing with the Company, thereby making entry barriers to the segment lower.

The main exit barriers stem from the commitment of the Company laid down in its license to provide its services to a defined quality and universally (to the entire public in Israel), its subordination to the provisions of the Communications Order, the regulations accompanying the Communications Law, and the provisions by power of Section 13A of the Communications law relating to emergency operation, its commitment to those of its employees who are employed under collective agreements, long-term agreements with communication operators, the large investments requiring time before seeing a return, and the commitment to the repayment of long-term loans taken to finance the investments. Some of these exit barriers are unique to the Company and not relevant to other operators active in the segment.

2.1.7 Substitutes for and changes in products in the sector

Cellular communication services are a substitute product for the Company's services, both in telephony and in Internet (see Sections 2.6.1 and 2.6.3).

IP technology such as VoB (see Section 2.6.1) is also a substitute for the Company's services. In Internet services, transmission and data communications, technological developments (e.g., 4G in cellular, infrastructure based on optical fibers, including over the electricity grid and advanced cable Internet protocols), enable the provision of new services at high speeds and competitive prices.

2.1.8 Competition structure and changes occurring in it

Domestic fixed-line telephony is regulated and controlled by the Ministry of Communications, inter alia by means of granting licenses to entities operating in the segment.

Fixed-line telephony is characterized by a lively competitive dynamic. The Company's competitors are HOT Telecom (which, pursuant to a decision by the Minister of Communications dated November 17, 2014, received an extension for the mandatory implementation of universal services in full deployment), VoB service providers that have operated for several years under license with no obligation to provide universal service, and without their own independent access infrastructure, and they are entities related to providers of Internet access services (ISP) and international communication services. Some of them compete with the Company as part of telecommunications groups (see Sections 1.7.1 and 1.7.4), and the Company believes that the cellular companies are also its competitors in the telephony segment (see Section 2.6.1). Following the decision and implementation of the wholesale telephony service in a resale format, service provided with a unified license that were permitted to provide domestic carrier services without any infrastructure at all will compete with the Company through basic telephony services that are identical to the Company's services, to BSA service subscribers.

The Internet segment is characterized by high rates of penetration, which are attributed to the deployment of a national access infrastructure. The Company's main competitor in this area is HOT, and the Company is also exposed to competition from the cellular companies (see Section 2.1.4). Upon implementation of a wholesale market, ISPs and unified general license holders compete with the Company, among other things, in providing packages of services, including broadband services, using the Company's infrastructures, at wholesale tariffs and following the decision in the hearing regarding wholesale telephony services for resale, unified license holders authorized to provide domestic carrier services will also be able to include telephony services in their packages (see Section 1.7.3).

HOT competes with the Company as an infrastructure owner compelled to provide wholesale services (although as at the report period, the services have not yet been provided by HOT).

In the transmission and data-communications segment, the Company competes mainly with HOT Telecom, Cellcom and Partner, which operate as communication groups and provide a full communications solution to customers.

Competition in the industry depends on a number of factors, such as regulatory decisions, possible changes in the terms of the licenses of the Company and the subsidiaries, and in the terms of the licenses of their competitors, mergers and joint ventures between companies that compete with the Group companies, the possible repercussions of the Concentration Law, further development of the wholesale market, the lack of symmetry

between the Company and the competitors' ability to provide a comprehensive service, the new services that the Company will be permitted to provide, the tariff policy, the extent of flexibility allowed to the Company when offering service bundles, including with subsidiaries, and technological developments.

For a description of the development of competition, see Section 1.7 and 2.6.

2.2 Products and Services

2.2.1 General

The Company provides a wide range of communication services for its business and private customers, as described below.

2.2.2 Telephony

The Company's telephony services include mainly the basic telephony services on the domestic telephone line, and associated services such as voice mail, caller ID, music on-hold, and Bphone (a service that enables to make telephone calls via the IP network as fixed-line calls).

The Company also provides its customers with a national numbering services for businesses (1-800, 1-700), for full or partial payment for the calls by the business.

The Company operates a unified telephone directory²¹ on a code (1344) determined by the Ministry of Communications for fixed-line and cellular telephony operators, as well as a unified website which is free of charge, in addition to the Company's 144 service. The Knesset approved the first reading of a bill under which, inter alia, information services provided under a Ministry of Communications license, will obligate the operators to transfer their databases to such a licensee for reasonable payment, and cancel allocation of the number 144 to the Company.

For the hearing on the wholesale telephony service in a resale format, see Section 1.7.3.

2.2.3 Internet access infrastructure services

The Company provides broadband Internet access infrastructure services in xDSL technology.

For details about changes in the number of the Company's Internet subscribers and average monthly revenue per Internet subscriber, see Section 0 For details about the Company's market share in this segment, see Section 2.6.3.

Internet service has become one of the main occupations of the Company and a central channel for its investments in technology, marketing, advertising and customer acquisition and upgrades. The average surfing speed of the Company's Internet subscribers at the end of 2015 was 37.8 Mbps, compared with an average of 32.5 Mbps at the end of 2014. Over the past year, the minimum speed of the package provided for new customers is 5 Mbps.

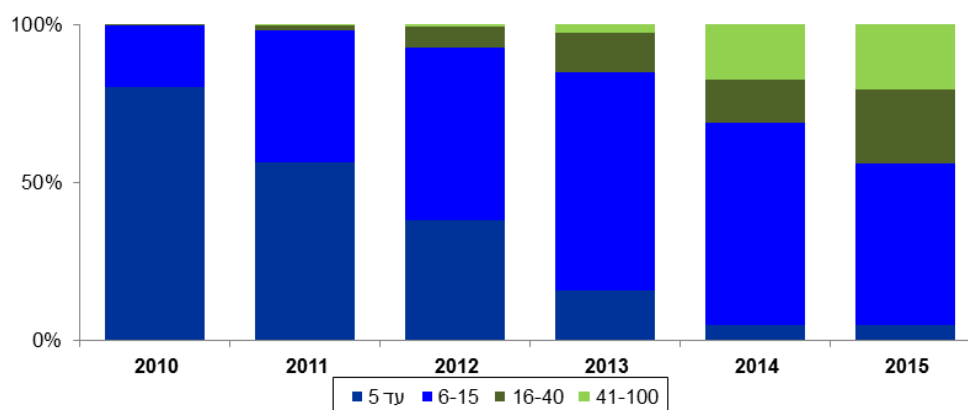
xDSL service is provided also on subscriber lines with no telephony and at no additional cost. It should be noted that, according to the decision of the Ministry of Communications (in respect of the cancellation of NDSL services), the Company is not entitled to apply differential xDSL pricing between subscribers who use the service together with telephony service and subscribers who only use the xDSL service. For the decision about wholesale BSA services, see Section 1.7.3.

Likewise, the company provides Free WiFi service, which enables the Company's customers to share part of their wireless bandwidth in return for browsing outside of their homes as well.

For the wholesale BSA services, see Section 1.7.3.

²¹ A "unified" directory service is an information service containing data on the subscribers of all the operators. Fixed-line and cellular telephony operators are obliged, under the terms of their licenses, to provide unified information services. The operation is exempt from the need for approval of a cartel for a period of three years starting November 5, 2014.

Graph – Changes in the surfing speeds of the Company's Internet subscribers 2010-2015
(in Mbps at the end of each year):



2.2.4 Transmission and data-communication services

Data communication services are network services for transferring data from point to point, transferring data between computers and between various communications networks, services connecting communications networks to the Internet, and remote access services.

The Company offers transmission services, including high rates, to communication operators and their business customers over a variety of interfaces (see Section 2.6.4).

2.2.5 Other services

A. Additional services to communication operators

The Company provides services to other communications operators, including cellular operators, international call operators, HOT, NEP operators, ISPs, domestic carriers, and Palestinian communications providers.

Among the services provided by the Company are infrastructure services, infrastructure upgrades, connection to the Company's network, transmission services, billing services, leasing of space, services in leased premises.

For details about wholesale services for communication operators, see Section 1.7.3A.

B. Broadcasting services

The Company operates and maintains radio transmitters which are operated, inter alia, by Israel Broadcasting Corporation, Israel Army Radio (Galei Zahal), and the broadcasts of a number of regional radio stations. It also operates the DTT transmitters for the Second Authority. The Company is responsible only for operating and maintaining the transmitters, and not for the content of the broadcasts. In this matter, see also Section 2.15.

C. Contract works

The Company carries out set-up and operation works of networks or subnetworks for various customers (e.g., the Ministry of Defense, HOT, radio and television broadcasting companies, cellular operators, international call operators, local authorities, municipalities, and government bodies).

The Company has agreements with HOT Telecom for providing installation, maintenance and hosting of networks using the Company's infrastructures, from the exit point of the operation of the license-holders to the delivery point at the entrance to the homes of the subscribers (the connection and maintenance from these points to the subscribers' homes themselves are not the responsibility of the Company).

- D. IP Centrex – IP Centrex service is a private and virtual exchange service in a public network.
- E. Data Center – A service enabling a backup and survivability solution for the customer.
- F. 144 Internet site (B144) – A search engine for finding the telephone numbers of businesses and private persons, including a classified search.
- G. Bcloud service - Enables Company Internet customers to store data and digital media in a virtual cloud.
- H. Bhome service - A "smart home" service that allows the Company's Internet subscribers to be updated of everything happening at home in real time via smartphone, cameras and sensors installed at home.

2.3 Breakdown of product and service revenues

The following table shows the distribution of the Company's revenues by main products and services in its segment of operation, 2013-2015 (in NIS millions):

	2015	2014	2013
Revenues from fixed-line telephony	1,586	1,668	1,971
Percentage out of total Company revenues in the segment	35.99%	38.64%	44.02%
Revenues from Internet infrastructure services	1,542	1,394	1,287
Percentage out of total Company revenues in the segment	34.99%	32.30%	28.74%
Revenues from transmission and data communication services	1,058	1,022	990
Percentage out of total Company revenues in the segment	24.01%	23.67%	22.10%
Revenues from other services	221	233	230
Percentage out of total Company revenues in the segment	5.01%	5.39%	5.14%
Total revenues from the domestic fixed-line communication services segment	4,407	4,317	4,478

2.4 Trade receivables

The Company is not dependent on a single customer, and there is no customer that accounts for 10% or more of the Company's total revenue.

The Company's revenues are distributed into two main customer types – private (57%), and business (43%). The distribution is by revenues, as shown in the following table:

	2015	2014	2013
Revenue from private customers	2,507	2,498	2,605
Revenue from business customers	1,900	1,819	1,873
Total revenue	4,407	4,317	4,478

2.5 Marketing, distribution and service

The Company has marketing, sales and service systems for its business and private customers, which include customer managers for the business sector, combined sales and service centers (including Moked 199) around the country, technical support centers for private and business customers, 10 points of sale and service (Bezeqstores) at various locations, as well as a virtual online shop.

The Company markets its services mainly through advertising in the mass media, telephone sales centers, customer managers and an array of independent dealers which are mainly ISPs, sales centers operated by outsourcing, and ISPs which, upon establishment of the wholesale market, mainly market end-to-end service packages based on the Company's wholesale BSA services. Furthermore, the Company has independent, advanced and innovative service and sales channels

on its website (adapted to surfing from mobile phones), a dedicated application ("My Bezeq"), and also Interactive Voice Response (IVR).

2.6 Competition

The following is a description of the development of competition in the domestic fixed-line communications segment.

2.6.1 Wholesale market (see Section 1.7.3)

Communication operators that compete with the Company can buy services from the Company at controlled prices, including infrastructure segments, and thus compete with the Company mainly by selling complete service packages to the customers, based on wholesale BSA services. Furthermore, if a similar control structure to that described in the hearing about the "Prevention of Margin Squeeze" (see Section 1.7.3) is implemented, the Company will be damaged in its ability to compete with its wholesale activity, both in quotations to customers and in time to market (TTM).

To the best of the Company's knowledge, HOT does not yet provide wholesale services in the absence of a price determined by the regulator. On January 14, 2016, the Ministry of Communications published a hearing to determine the maximum tariffs for wholesale services on HOT's network.

2.6.2 Telephony

The Company believes that at the end of 2015, its market share in the fixed-line telephony market was approximately 56% of the private sector and 74% of the business sector, without change compared to 2014²².

The competition in the fixed-line communications segment is lively:

A. Competition from other Domestic Carrier license-holders

The Company and HOT Telecom both own nationally-deployed fixed telephony infrastructures and they are in lively competition, which is manifested, inter alia, by HOT combining Internet infrastructure, telephony and cable television, and possibly cellular services as well, mainly to households (for the marketing of service bundles of the Bezeq Group, see Section 1.7.2). In addition, HOT markets telephony services to business customers.

The Company also has competition from license-holders for domestic fixed-line communication services, including VoB (see Section 2.1.8). Competition in this segment may increase as the rate of penetration of wholesale services BSA increases.

For the wholesale telephony service in a resale format, see Section 1.7.3.

B. Competition in telephony from the cellular companies

The penetration rate of cellular telephony in Israel is among the highest in the world (see Section 3.1.4). In the opinion of the Company, this penetration rate combined with low airtime rates on an international scale and large-scale bundles of minutes at fixed monthly prices have made the cellular telephone a product that largely substitutes for the landline telephone. The Company believes that a deepening of the substitution of fixed lines by mobile lines is one of the causes of the reduction in the average traffic per line, and of the growing removal rate of telephone lines (see Section 2.1.3).

In 2015, the trends that began in 2012 continued, marking a leap in competition in the cellular communications market in Israel. The activity of the new infrastructure operators, Golan and HOT Mobile, and to a lesser extent the activity of virtual cellular operators, continued the trend of erosion of prices and maintained the high level of mobility of customers between the companies. Notwithstanding, the continuation of these trends has

²² These market shares are in terms of lines, based on the Company's assessment.

a minor effect on the fixed-line operation compared with previous years, and in 2015 there is a decline in the downtrend of average movement per line and the rate of removal of fixed telephone lines. The migration of the cellular operators to 4G in 2015 did not change the interchangeability between cellular phones and fixed-line phones.

Partner and Cellcom also provide fixed-domestic fixed-line services through corporations they own, and they sell service bundles that combine fixed-line and cellular telephony and Internet services.

C. Regulation of VoC services

On November 21, 2012, the Ministry gave its decision on the hearing according to which VOB or VOC telephony services are telephony services which use IP technology over another entity's Internet services, irrespective of whether this network is mobile or fixed, and it is therefore a single fixed service, the provision of which will be regulated in a general Domestic Carrier License or special license, as applicable, pursuant to the amendment to the general or special Domestic Carrier licenses that currently provide VOB services.

In respect of the evaluation of the possibility to grant a license also to holders of cellular operator licenses to use Wi-Fi access points as part of their network to provide services, see Section 1.7.3I).

2.6.3 Internet infrastructure segment

The Company believes that at the end of 2015, its market share in the Internet infrastructure market was approximately 68% (compared with 66% at the end of 2014)²³.

The competition in this field is also lively:

- A. Competition from HOT Group – HOT's Internet infrastructure is deployed nationwide, in which a range of communication services and interactive applications can be provided. Today, this network is the main alternative to the competition with the Company's infrastructures in the private sector. The upgrading of the infrastructure and the service bundles marketed by the HOT Group (see Section 1.7.1C), and the Ministry of Communication's decision regarding the cancellation of NDSL services, increased the level of competition. HOT was compelled to provide wholesale services, including BSA services, but to the best of the Company's knowledge, it does not yet actually provide them (in this regard, see Section 2.6.1).
- B. Competition from ISPs and telecommunication companies - operating the wholesale market enables ISPs and telecommunication companies (holders of a single license) to offer customers service bundles that also include Internet infrastructure based on the Company's infrastructures and services (in exchange for controlled tariffs to be paid by the telecommunication providers to the Company). Furthermore, if and insofar as the mechanism for preventing a 'margin squeeze' is implemented, similar to the one described in the hearing of the Ministry of Communications, the Company's ability to market offerings of its wholesale services - in terms of both prices and TTM - will also suffer. The Ministry claims that the Company's ability to provide wholesale telephony services is important for expansion of competition in the broadband segment. The Company disagrees with this position. See Section 1.7.3) - Wholesale market.
- C. Competition from cellular operators – The cellular companies have deepened their Internet activities on the cellular range both in the private sector and in the business sector. Unlike the fixed-line communications segment (where the provision of access infrastructure services – by HOT, is separate from provision of Internet access services – by the ISP), the cellular Internet service is provided as one unit. Surfing services are provided both from the cellular handset and through a cellular modem that connects laptop and desktop computers in combination with Internet access services. On January 12, 2015, the Ministry

²³ The Company's assessment of its market share in Internet infrastructure services at the end of 2015 is based on the number of its subscribers and the number of HOT subscribers at the same date published by HOT. The data for the Company's market share at the end of 2014 is based on the number of Company subscribers and the number of HOT subscribers at that date, based on the data published by HOT in its 2014 annual financial statements.

of Communications conducted a tender of frequencies for LTE networks, following which the capacity of cellular networks increased due to the rise in the popularity of 4G services. Notwithstanding, the Company believes that the migration of the cellular operators to 4G in 2015 did not change the interchangeability between cellular Internet and fixed-line Internet.

- D. In respect of competition from IBC - IBC is deploying a fiber-optic infrastructure for the provision of Internet services over the electrical grid (see Section 2.6.5B), and has begun operating commercially in several cities, while declaring its intention to begin operating in additional cities in 2015. According to media reports, as at the publication date, volume of subscribers enlisted by IBC is immaterial.

2.6.4 Transmission and data communications

In addition to the Company, other companies operating in this field are Cellcom, Partner, HOT, and Internet companies that also use leased infrastructures.

To the best of the Company's knowledge, Cellcom has deployed and set up a transmission network which it uses both for its own needs (instead of transmission provided for it in the past by the Company) and for competition with the Company in the transmission and data communications market. Partner also provides transmission and data communication services combined with telephony and Internet to business customers.

For detail of operations and potential competition, see also Section 2.6.5B (IBC) and Section 1.7.31.7.3C (wholesale market - physical infrastructures).

2.6.5 Additional factors that could influence competition

A. Narrowing of transition barriers among companies

The transition to receive services from a service provider on the basis of the wholesale services (e.g. BSA services) is characterized by minimal transition barriers.

B. Other potentially competing infrastructures

In addition to HOT's cable and optical fiber network and the optical fiber infrastructures of Cellcom and Partner, there are a number of infrastructures in Israel today with the potential to serve as communications infrastructures, which are based on optical fibers and are mostly owned by government companies and bodies. Among these are Israel Electric Corporation ("IEC"), Israel Railways, Mekorot (water grid), Oil Infrastructures, and the Cross Israel Highway company. Some municipalities are also trying to create an alternative to pipes or fibers being laid by deploying their own infrastructures.

The state managed a procedure for selecting an investor for a communications enterprise in cooperation with IEC. As a result, in August 2013, IBC Israel Broadband Company (2013) Ltd. ("IBC") (60% of which is owned by a group of investors headed by the ViaEurope Group and 40% is owned by IEC), was granted a general license for the provision of communication infrastructure services (for example, data communications, digital transmission and VPN) over fiber optics. In accordance with the license, IBC will enter into an agreement with IEC to obtain the right to use its fiber-optics network and will become the network's operator. In addition, IBC is entitled to use the communication facilities of another operator. Pursuant to the provisions of the license, IBC was obligated to make a gradual universal deployment over a period of 20 years.

Furthermore, on the same date, IBC received a special license for the provision of domestic fixed data-communication services, according to which it is entitled to provide IPVPN services and broadband data-communication lines for a period of five years (with the option to request an extension). A special license does not obligate to provide universal services to all people in Israel.

The Company estimates that the significant reliefs granted to IBC in respect of the obligation to provide universal service (the option to make a gradual universal deployment over a long period of time), the granting of a special license for the provision of data-communication services without providing universal service, and the possibility to allow IBC to receive wholesale infrastructure services, if any, from the Company may adversely affect the Company's operations and its results.

The Company's foregoing estimate is forward-looking information as defined in the Securities Law. This estimate may not materialize, in part depending on the manner and scope of activities and schedules for IBC's operation, and in case of changes in the structure of the competition in the communications market.

2.6.6 Company's preparation and ways of coping with the intensifying competition

The Company deals with competition in domestic fixed-line telecommunication services in several ways:

- A. The Company launches new communication services, value added applications and product packages, and services, in order to broaden the scope of use of subscriber lines, to respond to customer needs and to strengthen its image of technological innovation. The Company invests in enhancement and modernization of its infrastructure so as to enable it to provide advanced services and products for its subscribers. In 2010, upon receipt of the requisite permit, the Company started marketing joint products packages in the private sector and in May 2012 in the business sector (see Section 1.7.2B), while broadening the supply of the services it offers and offering packages that correspond to some of those offered by its competitors.
- B. The Company is working on the penetration of a high-speed Internet infrastructure service and on increasing the number of its customers for the service. NGN enables customer upgrades to higher speeds, and the creation of added value for the customer by means of broader consumption of content, leisure and entertainment applications (see also Sections 2.2.3 and 2.7.2).
- C. The Company works constantly to improve the quality of its services and to maintain its customers, as well as to simplify and automate processes, and to adapt its operations to the structure of competition in its segment.
- D. The Company has simplified its tariff structure and offers its customers alternative payment packages (see Section 2.16.1), tracks and campaigns.
- E. The Company offers packages that can be unbundled and combines the Company's services with those of Bezeq International.
- F. The Company uses consumption-adapted packages and tracks to promote subscription to the telephony service.
- G. The Company makes adjustments on the expenses side for the purpose of focusing investments on fixed assets in growth activities and in projects for cutting operating costs. Nevertheless, the Company's ability to make adjustments in its expenses in the short and medium term is limited due to the structure of its costs, which are mainly rigid in the short and medium term (in particular depreciation expenses and expenses related to wages and wages incidentals, as well as operating costs such as infrastructure maintenance and building leasing and upkeep).

2.6.7 Positive and negative factors that affect the competitive status of the Company

A. Positive factors

- 1. Nationally deployed, quality infrastructure through which a range of services are provided.
- 2. Presence in most businesses and households.
- 3. Strong and familiar brand.
- 4. Technological innovation.
- 5. Strong capital structure and positive cash flows.
- 6. Broad service infrastructure and varied customer interfaces.
- 7. Professional, experienced and skilled human resources.

B. Negative factors

The Company believes that various restrictions imposed upon it by existing regulation, impede its ability to compete in its areas of operation. The main restrictions in this context are the following:

1. See Section 1.7.3 - Wholesale market - operation of the wholesale market at supervised prices, arrangements subject to the intervention of the regulator, potential selective enforcement by the Ministry of Communications in respect of the operation of the wholesale market, implementation of a control mechanism over the Company's wholesale services offering. Notwithstanding, the possibility to cancel the structural separation following operation of the wholesale market may also positively affect the competitive position of the Company.

2. Absence of tariff flexibility

The Company is limited in its ability to grant discounts on its main services and to offer differential tariffs. In this matter, see also Section 2.16.1.

With regard to prevention of a "margin squeeze" in the wholesale market, see Section 1.7.3.

3. Structural separation

For information about the obligation for a structural separation applicable to the Company, see Section 1.7.2.A. For information about the wholesale market, including cancellation of the structural separation and the conditions for doing so, see Section 1.7.3.

4. Obligation to provide universal service

The Company operates under an obligation to provide service to the entire public in Israel (universal service). Due to this obligation, the Company could be required to provide services also in circumstances that are not financially viable (subject to the possibility of obtaining an exemption in extraordinary circumstances; notwithstanding, in accordance with the document from the Minister of Communications dated November 17, 2014 on this matter, the circumstances for providing an exemption are virtually nonexistent). This obligation is not imposed on the holders of special Domestic Carrier licenses, which can offer their services to the most profitable of the Company's customers (mainly business customers), which are a material source of the Company's income. Furthermore, HOT, which is obligated to provide universal services, received in the aforementioned document from the Minister of Communications a postponement for the obligation to make a full deployment (see Section 2.1.8).

5. Restrictions in marketing joint service bundles of the Company and other Group companies

See Sections 1.7.2B and 1.7.3.

6. Characteristics of fixed-line telephony terminal equipment

Fixed-line terminal equipment is technologically less advanced than the cellular terminal equipment, and the supply of advanced services that can be consumed with it is limited.

2.7 Property, plant and equipment

2.7.1 General

The Company's property, plant and equipment consists mainly of domestic communications infrastructure, real estate assets (land and buildings), computer systems, vehicles, and office equipment.

2.7.2 Infrastructure and domestic fixed-line communications equipment

The Company has a Next-Generation Network (NGN) based on a core IP network and deployment and deployment of an optical fiber network to street cabinets (a network topology known as Fiber to the Curb, FTTC), and also based on an access network (a system that connects NEPs on the subscriber's premises to the network and engineering systems). The connection from the home to the access network is based on copper cables and the connection from the access systems to the backbone is based mainly on optic cables. Terminal equipment (equipment installed on the subscriber's premises, e.g. the actual telephone, private exchanges, fax machines, modems, routers, etc.) through which the subscriber receives the service.

In this network, using VDSL2²⁴ technology, bandwidth of up to 100 Mbps download speed can be provided, as well as innovative added value services. Other advantages of the new technology are simplification of the network structure and better management ability. For information about the number of subscribers connected to the NGN, changes in the volume of customers that consume NGN services and average bandwidths in 2013 and 2014, see Section 2.2.3.

As at the end of 2015, the Company has completed deployment of the network.

The Company is extending its infrastructure, including distribution of fiber optics so as to further enlarge bandwidth for its customers. On August 29, 2012, the Board of Directors resolved to approve extension of the Company's optical fiber deployment so that the fibers will be as close as possible to the customer's premises (FTTH/FTTB), as a basis for future provision of more advanced and broader-band communication services than those currently provided, in part on the basis of new technologies using the copper cables on the customer's premises. In this regard, a detailed design of the project, procurement and fiber-optics deployment are being carried out. The project is modular, and the Company reviews the project's scope and outline on a regular basis, as well as the need for adjustments, inter alia, in view of the advancement of relevant technologies and the development of customer needs.

As at the end of 2015, the Company has deployed optic cables to 1.3 million homes and businesses.

At the beginning of 2016, the Company started testing the G. fast technology and optic technologies in the field, which allow ultra high-speed surfing of hundreds of megabits and even 1 gigabit, with the aim of reviewing the technological and economic aspects of operating the network.

2.7.3 Computerization

The computer system in the Company supports four main areas: Marketing and Customers Management, engineering infrastructures of the telecommunications infrastructure, Company resources management, and company-wide systems.

The Company's computer system is large and complex, and supports critical work processes and handles very large volumes of data. This system consists of a large number of systems, some of which are information systems which started being developed many years ago, while others are modern and were developed and applied recently. Most of the systems operate in open computer environments.

2.7.4 Real Estate

A. General

The Company's real estate assets derive from two sources: Assets transferred to the Company by the State in 1984 under the Asset Transfer Agreement (see Section 2.17.2A), and assets in which the rights were purchased or received by the Company after that date, including assets that it leases from third parties.

²⁴ Very High Bit Rate Digital Subscriber Line – Digital Subscriber Line (DSL) at very high speed. One of the fastest technologies available for data transfer on high bandwidth in standard telephone lines.

Chapter A (Description of Company Operations) of the Periodic Report for 2015

The real estate assets are used by the Company for communications activities (exchanges, control rooms, broadcasting sites, etc.) and for other activities (offices, storage areas, etc.). Some of them are undeveloped or partially developed, and can be used for other purposes.

The following is a list of the Company's assets in accordance with the material rights on the asset. Furthermore, the Company has an interest (transition rights, etc.) in other real estate (such as for the erection of offices and for laying cables):

Right	Number of Assets	Area of the Plot (thousand sq. m.)	Built Area (thousand sq. m.)	Notes
Ownership, lease or right of lease	340	920	170	Of this, 330 assets cover an area of 890 thousand sq. m., and 140 thousand sq. m. built up are assets for communication needs, and the remainder for administration needs. 30 are jointly owned with the Ministry of Communications and/or the Israel Postal Co. Ltd., with whom an agreement was signed for defining and regulating the rights of the parties in these properties (see Section 2.17.2C). The parties operate as required by the orders of the agreement, and inter alia, to separate joint debits and systems.
Possession (authorized/possession rights by law)	40	2.5	0.8	Assets in Israeli settlements in the Administrated Territories, all for communication needs. There is no written regulation of the contractual rights for these properties, but in the Company's opinion this does not create material exposure.
Lease	330	30	70	310 assets, out of which 11 thousand sq. m. built up are for communication needs and the remainder for administration needs. Out of which, approximately 4 thousand sq.m. built up are sublet.
Miscellaneous rights in 'residential rooms'	1,050	10	18	These are rooms for cables and installations for residential communications. For most of the assets there is no arrangements for rights in writing (for example, the ILA, settlement entities, the entrepreneurs of the projects in which the properties are located, and house committees).
Right to receive areas for warehouses and offices	An asset in Sakia (near the Mesubim junction)	70 net	-	See below.

Further to the Company's negotiations with the planning authorities to exercise its rights under the authorization agreement between the Company and ILA for an area of 11.5 hectares signed in April 2013, in April 2015, the district committee filed and published for objections a detailed outline plan for the property, setting out the purpose, use, building rights and building provisions for zoning of the land in the plan. On October 26, 2015, the district committee approved validation of the outline plan. Subsequently, the Company is expected to sign a lease agreement with respect to the property. The Company is reviewing the different options available for exercising its rights in the property, including the option of selling it or part thereof, some of which may lead to recording of material gain in a volume that, according to the Company's initial estimation and prior to performing relevant tests, could reach hundreds of millions of shekels.

The information presented in this section includes forward-looking information, as defined in the Securities Law, 1968, based, in part on the Company's assessments with respect to the options available to it for selling the property, costs, expenses and taxes with respect to the sale of the property, the Company's requirements and the situation of the Israeli real estate market. If any of these assessments fail to materialize, the forward-looking information may not materialize.

B. Registration

At the date of publication of this Periodic Report, the Company's rights in a considerable number of its real estate assets are not registered in the Lands Registry, and therefore they correspond to contractual rights. The Company is in the process of registering in its name those properties which can be registered in the Lands Registry.

C. Real estate settlement agreement

On March 10, 2004, a settlement agreement between the Company, the Administration and the State ("the Settlement Agreement") was validated as a court decision. The agreement concerns most of the real estate assets transferred to the Company under the asset transfer agreement signed for commencement of the Company's business activity. The Settlement Agreement stated that the assets remaining in the Company's possession have the status of capitalized lease, and subject to the execution of individual lease contracts, the Company will be entitled to make any transaction in the properties and to enhance them. The Agreement sets out a mechanism for payment to the Administration for enhancement actions in the properties (if undertaken), beyond the rights according to plans approved by 1993 as set out in the Agreement, at the rate of 51% of the increase in value of the property following the enhancement (and less part of amounts paid for a betterment levy, if paid). The Settlement Agreement also states that 17 assets must be returned to the State, through the Administration, on various dates (up to 2010), and on the terms laid down in the Settlement Agreement.

As at the date of publication of this periodic report, the Company returned to 15 properties to the ILA. Two additional properties will be returned after the Company receives substitute properties, as provided in the Settlement Agreement.

D. Sale of real estate

Following a new review by the Company's Management regarding the sale of the Company's real estate, the Board of Directors approved further sales of assets which are inactive and/or which can be relatively easily vacated without incurring significant expenses, in accordance with a list presented to it from time to time. The transition to the NGN allows the Company to increase the efficiency of the network and to sell some of the real estate assets that will be vacated as a result of the transition. During 2015, the Company sold 16 such properties, on a total area of 30,000 sq.m. of land and 36,000 sq.m. built up, for a total sum of approximately NIS 273 million.

According to Company estimates, the sale of real estate assets that are inactive or that can easily be vacated without incurring significant expenses and for which the Company has no use after they are vacated, including real estate assets that may be vacated and will become redundant following the transition to the NGN network, if such assets are sold, and the sale of assets in the sale and leaseback method, may generate capital gains for the Company which may, in aggregate over the coming years, reach significant amounts estimated at hundreds of millions of shekels (before tax). It should be emphasized that this estimate also relates to real estate assets where no concrete decision has yet been made to sell them, and there is no certainty regarding the timing of their sale (if any); the estimate is based on appraisals prepared for some of the assets, some of which are not final or current, as well as to internal estimates prepared by the Company (including with respect to assets that were not appraised at all); likewise, the sale of some of the assets may involve difficulties, including if there is no demand or there are various planning restrictions, and at this stage the Company is unable to foresee what consideration will be received when any of these real estate assets are actually sold or when they will be sold.

In view of the foregoing, it should be emphasized that the Company's above estimates are forward-looking information, as defined in the Securities Law. These estimates are based, in part, on the Company's estimates with respect to the value of the real estate assets that it owns regarding their carrying value, subject to the foregoing regarding the fact that the Company has no appraisals for some of the assets, or the appraisals in the Company's possession are outdated and the valuations are therefore based on the Company's internal estimates; and regarding the Company's inability to predict the consideration that may actually be paid for any assets sold (if and when they are sold); and on the Company's estimates regarding the volume of real estate assets that may be vacated and become obsolete in coming years, making it possible to sell them based on Company policy, subject to the foregoing concerning the fact that no concrete decision has yet been made to sell the assets that were taken into account in estimating the above amount, the list of relevant assets may change from time to time and the timing of their sale (if a decision is made to sell them) is uncertain. Consequently, the Company's estimates concerning capital gains (in aggregate and before tax) that may be generated in coming years from the disposal of real estate assets as noted above, may not materialize or may materialize in a materially different way from that foreseen, including should any of the Company's assumptions and estimates listed above in this section fail to materialize or if they materialize only partially.

2.8 Intangible assets

2.8.1 The Company's Domestic Carrier license

The Company operates under its Domestic Carrier license, which forms the basis for its activities in domestic fixed-line communications (for a description of the main points of the license, see Section 2.16.2).

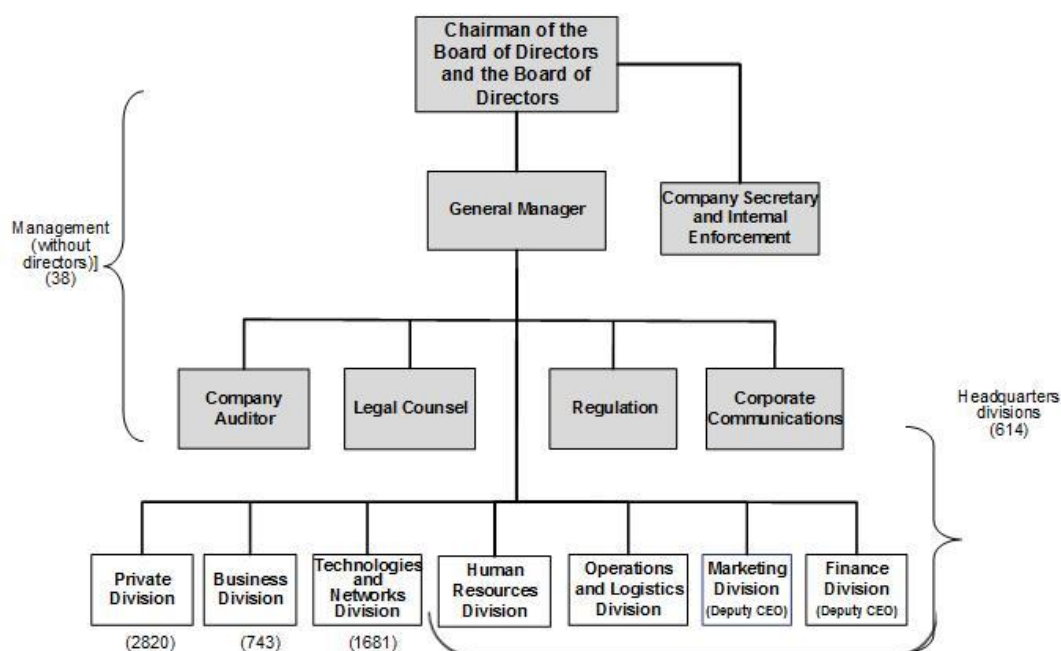
2.8.2 Trademarks

The Company uses trademarks that characterize its services and products. At the date of publication of this Periodic Report, there are about 190 trademarks registered or in the process of being registered in the Company's name with the Registrar of Trademarks. The main trademarks of the Company are "Bezeq" – the name of the Company, and "B" – the Company's logo. The investment in advertising the trademarks is intended to raise the level of exposure and awareness of the public to the trademarks and to build differentiation and uniqueness for the Company, which will influence the customers' purchasing considerations and preference.

2.9 Human Resources

2.9.1 Organizational structure and headcount according to the organizational structure

The following chart shows the general organizational structure of the Company as at December 31, 2015:



On September 4, 2007, the Board of Directors of the Company resolved, pursuant to Section 50(a) of the Companies Law and Sections 119 and 121.1 of the Company's Articles of Association, that the authority of the CEO in all matters relating to companies held directly or indirectly by the Company (Pelephone, Bezeq International, DBS, Walla, Bezeq on Line and Bezeq Zahav Holdings), would be transferred to the Board of Directors, and the Board adopted resolutions accordingly. As a result, on matters relating to the subsidiaries the Deputy CEO and CFO report to the Board of Directors, while on the Company's activities as Domestic Carrier they report to the CEO of the Company.

2.9.2 Number of Company employees and employment frameworks

The number of Company employees as at December 31, 2015 was 5986 (compared with 5,964 employees at the end of 2014). 90% of the Company's employees are employed under a collective agreement (out of which 58% are permanent employees and the remainder are nonpermanent employees). The remainder of the Company's employees (10%) are employed under personal agreements, not under collective agreements.

For details about the special collective agreement of December 2006 and its amendment, see Section 2.9.4.

2.9.3 Early-retirement plans

During the course of 2015, 55 tenured employees retired from the Company, based on the early retirement plan (some in the framework of a sub-budget from 2014). The Board also approved the termination of employment of additional employees in an increased severance pay track, in accordance with the Company's needs.

On December 22, 2015, the Company's Board approved a budget of NIS 103 million for 2016 for the early retirement of 78 employees in an early retirement track and severance pay track, in accordance with the conditions of the collective agreement of December 2006 and amendment of December 2010. The Board also approved an additional budget of NIS 12.5 million for 2015 (above a budget of NIS 30 million approved for early retirement in 2015).

On this matter, also see Note 15 to the 2015 financial statements.

2.9.4 Characteristics of employment agreements in the Company

Labor relations in the Company are regulated in collective agreements between the Company, the representatives of Company employees and the New General Federation of Workers ("Histadrut"), and in personal agreements. Company employees are also subject to expansion orders to certain general collective agreements such as cost-of-living increment agreements.

In December 2006, a special collective agreement was signed between the Company, the employee union and the Histadrut, regulating labor relations in the Company following transfer of control in the Company from the State to Ap.Sb.Ar. Holdings Ltd. and set a new organizational structure for the Company (see Section 2.9.1).

Under the agreement, all the agreements, arrangements and traditional behavior in the Company prior to execution of the agreement, including the mechanism for linkage of wages to the public sector, would continue to apply only to the veteran permanent employees of the Company to which the agreement would apply, subject to changes inserted specifically in the agreement. The hiring of existing and future temporary workers would be on the basis of monthly/hourly wage agreements based on a wage model according to occupation, with high managerial flexibility. The agreement sets out restrictions on certain kinds of future organizational changes, and a mechanism of notification, negotiation and arbitration with the union in the event of organizational changes. The agreement also states that the Company can, at its discretion, terminate the employment of 245 permanent employees in each of the years 2009-2013.

Under the agreement, during the term of the agreement, two employee-directors²⁵ will serve on the Board of Directors of the Company, who would be proposed by the union (subject to their approval by the Board of Directors and their election by the general meeting). The employee-directors are not entitled to payment for their service as directors, and will not participate in Board discussions of the terms of employment of senior employees.

On December 19, 2010, an amendment was made to the collective agreement, dating it to December 31, 2015 (with an option for extension to December 31, 2017), mainly to extend the retirement arrangements under the collective agreement until December 31, 2016. Under these retirement arrangements, the Company may, at its discretion, terminate the employment of up to 245 permanent employees in each of the years, cumulative, from 2010 until 2016.²⁶ The agreement also defines the "New Permanent Employee", the terms of whose employment differ from those of a veteran permanent employee of the Company (under the collective agreement): his wage model is according to the Company's wage policy and market wages; at the end of his employment in the Company he is entitled to increased severance pay only (depending on the number of years of employment).

On August 30, 2015, the Company's Board of Directors adopted another amendment to the collective agreement, mainly extension and revision of the collective agreement and retirement arrangements until December 31, 2021, and their amendment. As part of the retirement arrangements, the Company will be entitled, at its discretion, to terminate the employment of 203 permanent employees (including new permanent employees) each year. The estimated cost of the agreement, including wage improvements and excluding employee retirement, which is subject to the Company's discretion, is NIS 280 million throughout the agreement period (of which NIS 30 million are contingent to the Company's expenses).

For details of other material agreements concerning labor relations, see Section 2.17.4.

2.9.5 Employee reward plans

For details about options plans for employees, see Note 25 to the 2015 financial statements.

2.9.6 Officers and senior management in the Company

On the date of publication of this periodic 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 to the Companies Law. In addition, senior management has 11 members.

²⁵ At the beginning of 2016, the workers union announced that it agrees that so long as up to 15 directors service on the Board of Directors, one representative among the employees will serve on the Board and if the number of directors exceeds 15, an additional representative among the employees will serve on the board.

²⁶ The Company may complete the retirement process also in 2017, if it is not completed during the above period.

The members of the senior management are employed under personal agreements which include, inter alia, pension coverage, payment of bonuses based on targets, and advance notice months before retirement. The Company also allots options for Company shares to the members of senior management, at its discretion (see Note 25 to the 2015 financial statements).

In 2013, the compensation policy for Company officers was approved ("the Compensation Policy"). The Compensation Policy (including its amendments approved later on) includes reference to the following parameters for evaluating the compensation terms: The fixed salary component (base salary (linked) of the CEO and Vice Presidents of significant subsidiaries, which will not exceed NIS 2.5 million per year; the base salary of Deputy CEOs in the range of NIS 85,000 to NIS 100,000 per month, and of Vice Presidents in the range of NIS 40,000 to NIS 85,000 per month)²⁷; additional accepted conditions; severance pay; retirement conditions and retention grants; insurance and indemnity; a variable component - a performance-dependent bonus for a total budget equivalent to 1% of the group's EBIDTA; a capital component based on financial bonuses derived from the increase in the value of the share (Phantom stock); and the option of providing a special bonus to officers under specific conditions.

For details, see the Company's immediate reports of July 29, 2013 (convening an extraordinary general meeting), March 3, 2014 (amended report convening an extraordinary general meeting), and February 5, 2015 (amended immediate report convening an extraordinary general meeting), included in this report by way of reference.

On March 6, 2016 and March 8, 2016, the Compensation Committee and Board of Directors, respectively, approved a new compensation policy, including various amendments to the Compensation Policy as follows: Inclusion of the CEO of DBS under the policy, adding fixed targets and considerations for the Company CEO, increasing the maximum bonus subject to discretion, a special grant and retention grant and the option of granting additional benefits and fringe benefits at a rate of up to 10% of the monthly cost of the fixed component, and addition of the option to grant letters of exemption to officers (will not apply with regard to transactions of interested parties). The approval of the new compensation policy is subject to approval of the general meeting of the Company's shareholders convened for May 3, 2016. In this regard, also see the Company's immediate report of March 17, 2016 (report convening an extraordinary general meeting), which is included in this report by way of reference.

For additional information pertaining to the compensation of officers, see Section 2 to the Board of Directors' Report, Section 7 to Chapter D to this periodic report, and Note 28.6 to the 2015 financial statements.

2.10 Equipment and suppliers

2.10.1 Equipment

The main equipment used by the Company includes exchanges, communication cabinets (MSAGs), copper cables, optical cables, transmission equipment, data communication systems and equipment, servers, Internet modems and routers. The Company purchases most of the equipment needed for its communications infrastructure from Israeli companies affiliated with international communications equipment manufacturers. Hardware and software are purchased from a number of main suppliers.

2.10.2 Percentage of purchases from main suppliers and form of agreement with them

With respect to Section 23 of the First Annex to the Securities (Details of a Prospectus and Draft Prospectus - Structure and Form) Regulations, the Company considers a "main supplier" to be a supplier that accounts for more than 5% of the volume of the Company's annual purchases, or that accounts for more than 10% of the volume of all the Company's purchases in a particular operating segment.

In 2015, the Company had no main supplier, as defined above.

²⁷ Following completion of approval of the new compensation policy, as set out below, the range is expected to change to NIS 90,000 to NIS 100,000 and NIS 40,000 to NIS 90,000, respectively.

2.10.3 Dependence on suppliers

Most of the equipment purchased for data communication, switching, transmission and radio systems are unique, and over its years of operation the possibility of obtaining support other than through the manufacturer, is limited.

In the Company's opinion, in view of the importance of having the manufacturer's support for specific equipment used, the Company may be dependent on the following suppliers:

Supplier Name	Area of Expertise
Alcatel, represented in Israel by Alcatel Telecom Ltd.	Metro transmission and access systems to the NGN
Juniper Networks	Metro transmission
Dialogic Networks (Israel) Ltd.	Transfer exchanges for connecting operators to the Company's switching network
Comverse Ltd.	Switching networks for end customers in the NGN
Adtran Holdings Ltd.	Access systems to the NGN
EMC	Hardware and backup, restoration and survivability solutions for systems and infrastructures
VMware	Infrastructure for most of the virtualization of the servers

Agreements with suppliers on which the Company may be dependent, as noted in this section, generally include a warranty period for a certain period of time and conditions specified in the agreements, followed by another period of maintenance or support. Where necessary, the Company may enter into an agreement with the supplier for the supply of support and/or maintenance services for a further period. These agreements usually contain various forms of relief for the Company should the supplier breach the agreement. Such agreements with suppliers are usually long term.

2.11 Working Capital

For details about the Company's working capital, see Section 1.4 to the Board of Directors' report.

2.12 Investments

For information on investments in investees, see Note 11 to the 2015 Financial Statements, and see also Sections 3 and 4 in Chapter D of this Periodic Report.

2.13 Financing

On May 29, 2011, the Company published a shelf prospectus for the issue of shares, bonds, convertible bonds, stock options, options for bonds 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. For details, see the Company's immediate report of May 29, 2014, which is included in this report by way of reference.

2.13.1 Average and effective interest rates on loans

At 31 December 2015, the Company is not financed by any short-term credit (less than one year). The following table shows the distribution of long-term loans (including current maturities):

Loan term	Source of financing	Amount (NIS millions)	Currency or linkage	Type of interest and change mechanism	Average interest rate	Effective interest rate	Interest range in 2015
Long-term loans	Banks	1,331	Unlinked NIS	Variable, based on prime rate*	1.64%	1.64%	1.27%-1.95%
	Banks	1,823	Unlinked NIS	Fixed	5.21%	5.27%	2.40%-6.85%
	Non-bank sources	734	Unlinked NIS	Variable, based on	1.56%	1.60%	1.47%-1.61%

Loan term	Source of financing	Amount (NIS millions)	Currency or linkage	Type of interest and change mechanism	Average interest rate	Effective interest rate	Interest range in 2015
				annual STL rate**			
	Non-bank sources	1,675	Unlinked NIS	Fixed	5.53%	5.61%	3.65%-6.65%
	Non-bank sources***	3,661	CPI-linked NIS	Fixed	2.63%	2.68%	2.20%-5.30%

* Prime interest rate as at March 2016 – 1.6%.

** STL yield per year (227) – 0.072% (average last 5 trading days of February 2016) for the interest period that began on March 1, 2016.

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

For additional details about the Company's loans, see Note 12 to the 2015 financial statements.

2.13.2 Restrictions on borrowings

A. Restrictions included in the Company's loans

See Note 12 to the 2015 financial statements. At the date of the financial statements and the date of publication of this periodic report, the Company is in compliance with all the restrictions applicable to it.

B. Bank of Israel restrictions on a single borrower and group of borrowers

Directives of the Supervisor of Banks include restrictions on liability of a single borrower and of a group of borrowers towards the banks. Concerning these directives, the Company could be seen as part of one "group of borrowers" with B Communications Group and its controlling shareholders. The directives of the Supervisor of Banks could from time to time affect the ability of banks to grant further credit to the Company. For details about the authorization to determine restrictions on borrowings for a business group in the Concentration Law, see Section 1.7.3H.

2.13.3 Reportable credit

As at December 31, 2015, the Company's reportable credit, in accordance with Legal Position 104-15 of the Securities Authority (Reportable Credit Event) ("Reportable Credit Guideline") is as follows: Two bank loans, Series 5 to Series 10 bonds of the Company, and commitments to extend credit to the Company in 2016-2017 by banks and various institutional entities, all as set out in Note 12 of the 2015 financial statements and Section 6 of the Board of Directors' report.

2.13.4 Credit received during the reporting period/commitments to extend credit

Receiving commitments to extend credit for 2016-2017

In 2015 and the beginning of 2016, the Company signed agreements with banks and institutional entities under which it received a commitment to extend credit for future financing of the Company in 2016-2017 as follows:

Credit extension date	Credit in NIS millions	Average lifecycle (years) and repayment dates	Total interest rate (fixed, NIS and unlinked)
June 2016	900	4.6 (Repayment in five equal annual installments from June 1, 2019 to June 1, 2023)	3.71%
December 2016	500	4.9 (Repayment in five equal annual installments from December 15, 2019 to December 15, 2023)	4.25%
June 2017	900	4.5 (Repayment as from June 2020 until June 2024)	4.25%

The terms of all these commitments and the loans granted under them include similar terms to those provided with respect to other loans taken by the Company defined in Note 12.6 of the 2015 financial statements, including: an undertaking not to create any other charges on the Company's assets (with certain restrictions), an undertaking that should it make a commitment to any entity in connection with financial covenants, the Company will undertake the same commitment also in connection with this credit (subject to certain exceptions), and standard terms for calling for immediate repayment (such as a violations, insolvency, liquidation or receivership, etc., and cross default, with certain restrictions), which will apply, with the necessary changes, also with respect to the credit extension undertaking periods. Some of the commitments to extend credit in 2017 also include the same terms as those given in the public debt raising of October 2015, as set out in Section 2.13.5.

For information regarding credit received during the reporting year by public debt raising, see Section 2.13.5.

2.13.5 Company bonds

For details about the bonds issued by the Company, see Note 12 to the 2015 financial statements and Section 6 to the Board of Directors' report.

On October 15, 2015, the Company completed the issue of bonds (Series 9 and 10) as per its shelf offering dated October 13, 2015, which was published under its shelf prospectus dated May 30, 2014. The total gross consideration received in this issue for the bonds allocated under the shelf offering amounts to NIS 788,451,000 as follows:

	Consideration (gross)	Annual interest and linkage	Repayment dates and interest payment (in both series)
Bonds (Series 9)	NIS 388,451,000	3.65% unlinked	Principal - 4 unequal payments: 10% on December 1, 2022 and 30% on each of the dates December 1, 2023, December 1, 2024, December 1, 2025 Interest - six-monthly payments on June 1 and December 1 of each year.
Bonds (Series 10)	NIS 400,000,000	2.2%, CPI-linked	

The Company also undertook the following with respect to both bond series:

- an undertaking not to create any other charges on its assets (negative charge) without creating an identical charge in favor of the bond holders, an undertaking that should it make a commitment to any entity in connection with financial covenants, the Company will undertake the same commitment also to the bond holders, and an undertaking to do everything under its control for the bonds to continue being rated until they are fully repaid, in the same way as described in Note 12.3 of the 2015 financial statements, all under the terms set out in the Deeds of Trust for the bonds.
- The accepted grounds for recalling the bonds for immediate repayment were added, including violations, insolvency, liquidation procedures, receivership, etc.; the right to demand immediate repayment if a third party lender demanded immediate repayment of the Company's debt to it (for an amount that exceeds NIS 150 million, if another negotiable bond series is recalled for immediate repayment, the amount is unlimited); if more than 50% of the Group's assets (consolidated) are sold in a manner that the communication segment ceases to be the Group's central operation; in case of changes in control whereby the current controlling shareholder ceases to be its controlling shareholder (other than transfer of control to a recipient that obtained approval for control of the Company according to the provisions of the Communications Law or a change of control under other circumstances prescribed), if a "going concern" caveat is recorded in the Company's financial statements for a period of two consecutive quarters; material impairment of the Company's business compared to its situation on the issue date; and real concern that the Company will not be able to repay the bonds on time (as set out in Section 351(a)(1) of the Securities Law), all under the terms set out in the Deeds of Trust of the bonds.

The bonds were rated by S&P Maalot with an iIAA rating and by Midroog with an Aa2.il rating under the raising of NIS 800 million (the same as the latest rating of the Company and its bonds).

For further information regarding these bonds, see the Company's shelf offering report of October 13, 2015 and the Company's immediate report of October 14, 2015 regarding the results of the issue, which are included in this report by way of reference, and Section 6 of the Board of Directors report and Note 12.3 of the 2015 financial statements.

With respect to the principal repayments of bonds (Series 5) and bonds (Series 8), see Section 6 of the Board of Directors report.

2.13.6 Credit rating

Company bonds are rated by S&P Maalot Ltd., with an il/AA/Stable rating, and by Midroog Ltd., with an Aa2 rating with a stable outlook.

For information regarding the Company's rating history in the last two years, see its immediate reports of May 15, 2014, August 13, 2014, April 21, 2015 and September 7, 2015 (S&P Maalot Ltd.) and August 13, 2014, December 28, 2014, March 5, 2015 and September 10, 2015 (Midroog Ltd.), which are included in this report by way of reference.

2.13.7 Company assessment for raising financing and possible sources in 2016

During 2016, the Company expects to repay approximately NIS 1,786 million on account of loan principal and interest (including bonds).

The Company expects to exercise undertakings to extend credit of NIS 1.4 billion received from various banks and institutional entities (see Section 2.13.4).

The Company raises capital from time to time to finance its cash flow. The financing options at the Company's disposal are to raise debt by means of new bank loans and/or by raising private or negotiable debt and to exercise undertakings for credit extension for 2016-2017, as set out in Section 2.13.4.

2.13.8 Pledges and guarantees

For information about pledges and guarantees of the Company, see Note 18 to the 2015 financial statements.

Guarantee for DBS bonds

In September 2015, the Company signed guarantee letters for compliance with DBS' undertakings to pay its full outstanding debt to the holders of bonds (Series B) and 2012 bonds of DBS (total of NIS 1.05 billion and NIS 307 million, respectively), against a decrease in the annual interest rate borne by the bonds (by 0.5% and 1%, respectively), and cancellation of collateral and certain provisions of the Deeds of Trust and bonds (including the undertakings for compliance of DBS with financial covenants and restriction on distribution of a dividend by DBS), all according to the terms of the Deeds of Trust of the bonds and the bond. According to the terms of the bonds, decreasing the interest and canceling collateral and certain provisions in the bonds are subject to the Company's Maalot rating not falling below (-AA) or a corresponding rating ("the Minimum Rating"), terms that were complied with as at the date of providing the collateral, and if in future the Company's rating falls below the Minimum Rating, the interest reduction will be canceled, the canceled collateral will be provided again, the canceled provision will reapply and the guarantee will expire.

On December 17, 2015, the Company granted DBS a loan of NIS 325 million for early repayment of 2012 bonds (according to DBS' right under the terms of the 2012 bonds). The early repayment was executed on December 20, 2015 and at that same time the Company's guarantee for the 2012 bonds expired.

With regard to the bonds (Series B) for which the Company's guarantee is still valid, also see Section 5.15.3.

2.14 Taxation

For information about taxation, see Note 6 to the 2015 financial statements.

Also, for information with respect to the taxation aspects for the Company agreement in the transaction with Eurocom DBS to purchase Eurocom DBS' entire holdings in DBS (see Section 1.1.2), including the tax assessments received by the Company, see the transaction report of March 12, 2015 (Reference No. 2015-01-050563) and immediate report dated January 31, 2016 (Reference No. 2015-01-020485), which are included in this report by way of reference.

2.15 Environmental risks and means for their management

2.15.1 General

Some of the Company's facilities, such as broadcasting facilities, wireless communications facilities or high-voltage facilities²⁸ are sources of electromagnetic radiation which are included in the definition of "Sources of Radiation" in the Non-Ionizing Radiation Law.

2.15.2 Non-Ionizing Radiation Law

The law regulates the handling of Sources of Radiation, their erection, operation and supervision. The law provides, inter alia, that the erection and operation of a Source of Radiation and the provision of a radiation measurement service require a permit; sets penal provisions and severe responsibility of a company, employees and officers; imposes recording and reporting obligations on a permit-holder, and grants supervisory powers mainly to the Supervisor of Non-ionizing Radiation at the Ministry of Environmental Protection ("the Supervisor"), including for the matter of the terms of the permit, cancellation of the permit and removal of a Source of Radiation.

The Company obtained operating permits from the Supervisor for the communication facilities and broadcasting sites it operates. The Company also took steps to obtain radiation permits for high-voltage facilities included in its assets, and as at the report date, such permits were received for 27 such high-voltage facilities. Two other facilities are in the process of obtaining a permit.

It is noted that the Commissioner requires building permits as a condition for the continued validity of the operating permits for communications facilities (including broadcasting facilities) he granted, as well as the fulfillment of additional conditions, inter alia, concerning wireless access installations which have category approval granted to the Company by the Supervisor. Also see section 2.16.10.

The law includes a punitive chapter under which, inter alia, the construction or operation of a source of radiation in contravention of the provisions of the permit and the construction or operation of a source of radiation without a permit, after having been warned in writing by the Commissioner, are strict liability offenses.

2.15.3 Permits

On the permits for broadcasting facilities required under the Planning and Construction Law, see Section 2.16.10.

2.15.4 Company policy for radiation risk management

The Company applies a work procedure for the erection, operation and measurement of sources of non-ionizing radiation, and an appropriate compliance procedure that was approved by its Board of Directors. The Company has assigned an officer to oversee implementation of the compliance procedure. Periodic reports on the status of Sources of Radiation are submitted to the CEO and to the Board of Directors.

2.16 Restrictions and control of the Company's operations

The Company is subject to systems of laws that regulate and limit its business activities. The main body overseeing the Company's activities as a communications company is the Ministry of Communication.

²⁸ The establishment of high-voltage facilities (transformers) in Company sites is aimed at providing energy for use by the Company's facilities. The establishment and operation of these facilities require an establishment permit, as well as an operation permit in accordance with the Non-Ionizing Radiation Law.

2.16.1 Control of Company tariffs

Arrangements in Sections 5 and 15 to 17 of the Communications Law and the terms of the Company's license, apply to the Company's tariffs.

- A. Pursuant to the Communications Law, the Minister of Communications is entitled to determine, with the approval of the Minister of Finance, payments, maximum payments or minimum payments for services from a license holder (see Section 1.7.3A). The payment can be determined based on (1) The cost, according to the calculation method instructed by the Minister plus a reasonable profit; or (2) Reference points deriving from: payment for services provided by the license holder; payment for comparative services; payments in other countries for such services. (See section 1.7.3A).

The Gronau Commission's report on the rules of competition in the communications industry, and a letter from the Minister of Communications dated August 13, 2008 adopting the report (with some changes) ("Gronau Report"), stipulated that as long as the Group's market share remains higher than 60%, control of the Company's prices will continue in the format of mandatory price fixing. The competition expansion policy document stipulated that within six months of publication of the Shelf Offering (for the sale of wholesale services), the Minister will take action to change the method of oversight of the Company's prices so that prices will be controlled by the setting of a maximum price (see Section 1.7.3A).

- B. Tariffs fixed in regulations - The tariffs for the Company's controlled services (telephony and others) which are stipulated in the regulations, were updated in accordance with a linkage formula less an efficiency factor consisting of linkage to the CPI plus an efficiency factor, as provided in the regulations, so that on average, the Company's controlled tariffs have eroded in real terms. It is noted that in the last three years, the tariffs pursuant to the regulations have not been updated and the date of the update has been postponed, and in accordance with the provisions of the regulations, the postponement will be taken into consideration in the next update.
- C. The Ministers of Communications and Finance are authorized (pursuant to Section 5 to the Law) to determine interconnect payments or for the use by a license holder of the telecommunication facilities of another license holder, and to provide instructions thereof (including relative to additional arrangements), inter alia, based on the aforementioned parameters.
- D. Alternative payment packages - If tariffs that are neither maximum nor minimum are determined for supervised services, the license holder is entitled to offer an alternative payments package for a bundle of telecommunication services at fixed payments as aforementioned, provided that the Ministers of Communications and Finance do not oppose the package or approved it on the dates determined by the law. The Gronau report states that an alternative payment package will be approved only if it is worthwhile for 30% or more of subscribers who consume the services offered in the package, and that the smaller the market share of the Group in fixed-line telephony is, the higher the maximum discount rate permitted in an alternative payment package will be.²⁹

If maximum or minimum payments are determined pursuant to Sections 5 or 15 the Law, for communication services provided to another license holder, the license holder is entitled to offer to any other license holder, indiscriminately, an alternative payments package for the bundle of services at maximum or minimum payments, and services as aforementioned together with services for which payment has not been determined pursuant to Sections 5 or 15 to the Law, provided the Ministers are not opposed or approved the package.

- E. The license holder is entitled to request a reasonable payment for a service for which a payment is not determined pursuant to Sections 5 or 15, or for which a maximum or minimum payment has been determined. The Minister is entitled to instruct the license

²⁹ A maximum discount rate of 25% when the Group's market share is between 75% and 85%, and 40% when the market share is between 60% and 75%.

holder to notify the Minister about the payment the license holder intends to request as aforementioned, and of any change in the payment prior to the provision of the service or change. If the Minister of Communications determines that the license holder intends to request a payment that is not reasonable, or a payment that raises suspicion of harming competition, the Minister is entitled to instruct (for a period not exceeding one year) as follows: to make the payment that will be requested by the license holder for the service or for another service, or to separate the payment for the service from the payment for the bundle of services. The Minister can evaluate whether the payment is not reasonable according to the parameters in Subsection A (2) above, and the Minister is entitled to assess the payment based on the provisions in Subsection A (1) above.

- F. For details about the hearing dated November 17, 2014 about the prevention of 'margin squeezes' while determining a minimum bar for the Company's retail prices, and submission of marketing offerings for the approval of the Ministry of Communications, for the hearing for wholesale telephony services in a resale format and wholesale service tariffs, see Section 1.7.3C.
- G. The control of the Company's tariffs has a number of implications – the Company's tariffs are subject to regulatory intervention (even if they are not determined in the regulations or in alternative payment packages), and from time to time, the Company is exposed to significant changes in its tariff structure and tariff levels. The review mechanism for the controlled tariffs, as defined in the authorizing legislation and the regulations, results in a real average erosion of the tariffs over the years. Control of the tariffs creates or could create difficulties for the Company in providing an appropriate and competitive response to changes in the market and in offers of competitive prices at short notice. Furthermore, the restrictions on granting discounts on tariffs limit the Company in participation in certain tenders.

2.16.2 The Company's Domestic Carrier license

The Company operates, inter alia, under the Domestic Carrier license³⁰. The following are main topics covered in the license are these:

- A. Scope of license, the services the Company must provide, and the duty of universal service

The Company is required to provide its services to all on equal terms for each type of service, irrespective of the location or unique cost. The license is unlimited in time; the Minister may modify or cancel the license or make it contingent; the license and any part of it cannot be transferred, no charge can be imposed on it, nor can it be subject to attachment. For details about the addition of wholesale services to the Company's license, see Sections 1.7.3 and 2.1.1.

- B. Principles of structural separation

For a general description of the structural separation applicable to the Company, see Section 1.7.2A.

- C. Tariffs

The Company provides a service or package of services for which no tariff is set under Section 15 of the Communications Law, at a reasonable price and offers them to all, without discrimination and at a uniform tariff. See also Section 2.16.1.

- D. Marketing joint service bundles

In respect of the amendment to the Domestic Carrier license in a way that enables the Company to request to market joint service bundles subject to restrictions, see Section 1.7.2B.

³⁰ A copy of the Domestic Carrier license appears on the Ministry of Communications website at www.moc.gov.il.

E. Operations of Company networks and service standards

The Company is required to maintain and operate the network and provide its services at all times, including at times of emergency, in an orderly and proper manner commensurate with the technical requirements and the nature of the service, and to work towards improving its services. The license includes an appendix, "Service Standards for the Subscriber", which is to be amended after the Company provides the Ministry with data. The Company submitted to the Ministry its proposal for amendment of the appendix, adapting it to the current state of affairs and the licenses of other operators, but the amendment has not yet been made. For details about the hearing about the response of the call centers, see Section 1.7.4G.

F. Interconnect and use

Provisions are stated for the duty of interconnect to another public switching network and the option of use by another license-holder; a duty to provide infrastructure services to another license-holder on reasonable and equal terms is also provided, as well as refraining from preferring a license-holder that is a company with an interest.

G. Security arrangements

Provisions have been made for the operation of the Company's network in times of emergency, including the obligation to operate it in a manner that prevents its collapse in emergencies.

The Company is required to provide telecommunication services and set up and maintain the terminal equipment infrastructure for the security forces in Israel and abroad, as provided in its agreements with the security forces. Furthermore, the Company provides special services to the security forces. The Company will take action to ensure that each hardware purchase and installation in its telecommunications installations, other than terminal equipment, will be made in full compliance with instructions given to the Company under Section 13 of the Communications Law.

The Company is required to appoint a security officer and to comply fully with the security instructions contained in the appendix to the license.

For the license amendment regarding service continuity in emergencies and during major malfunctions, see Section 1.7.4G.

H. Supervision and reporting

Extensive reporting duties to the Ministry of Communications are imposed on the Company. In addition, the Director General at the Ministry of Communications is granted the authority to enter facilities and offices used by the Company and to seize documents.

I. Miscellaneous

1. The Domestic Carrier license includes restrictions on the acquisition, maintenance and transfer of means of control pursuant to the Communications Order (see Section 2.16.3), as well as on cross-ownership, which are mainly a ban on cross-holding by entities in which those with an interest in a another material Domestic Carrier³¹ as noted in the license, and restrictions on a cross-holding by entities with Domestic Carrier licenses or general licenses in the same segment of operation.
2. The Company submitted to the Director General a bank guarantee in the amount of USD 10 million for securing fulfillment of the terms of the license and for indemnifying the State for any loss it incurs due to their violation by the Company.

³¹ A Domestic Carrier with a market share of 25% or more.

3. The Director General at the Ministry of Communications is authorized to impose a monetary sanction for violation of any of the terms of the license (on this matter, see also Section 1.7.4F).
4. During a calendar year, the Company may invest up to 25% of its annual income in activities not intended for providing its services (the incomes of the subsidiaries are not considered Company income for this purpose).

For details about the wholesale market and wholesale services, see Section 1.7.3A.

2.16.3 The Communications Order

The Company was declared a provider of telecommunication services under the Communications Order. By power of that declaration, the Company is required to provide certain types of services and may not cease them or narrow them. Among these services are basic telephone service, infrastructure service, transmission service and data communication service including interconnect, and other services listed in the schedule to the Order.

The main provisions of the Communications Order are these:

- A. Restrictions on the transfer and acquisition of means of control in a company, which include a ban on holding 5% or more of means of control of a certain kind without the prior written approval of the Prime Minister and the Minister of Communications ("the Ministers").
- B. Transfer or acquisition of control in a company requires the approval of the Ministers ("Control Permit"). The Control Permit will lay down the minimum holding percentage in each of the means of control in the Company by the holder of the Control Permit, where a transfer of shares or an issuance of shares by a company, as a result of which the percentage of the holding of the Control Permit holder will fall below the minimum percentage, is prohibited without the prior approval of the Ministers, subject to permitted exceptions (among them – an issuance to the public under a prospectus, or sale or private placement to institutional investors)³².
- C. Holdings not approved as aforesaid will be considered "exceptional holdings", and the Order states that exercise of a right by power of exceptional holdings will not be valid. The Order also contains provisions authorizing the Ministers and the company to apply to the courts with an application for the enforced sale of exceptional holdings.
- D. A duty to report to the Ministers upon demand is imposed on the Company, on any information on matters relating to provision of an essential service.
- E. At least 75% of the members of the Board of Directors of the Company must be Israeli citizens and residents who have security clearance and security compatibility as determined by the General Security Service. The Chairman of the Board, the external directors, the CEO, the Deputy CEO and other office-holders in the Company as listed in the Order, must be Israeli citizens and residents and have security clearance appropriate to their functions.
- F. "Israeli" requirements are laid down for the controlling shareholder in the Company: for an individual – he is an Israeli Entity (as defined in the Order); for a corporation – it is incorporated in Israel, the center of its business is in Israel, and an Israeli Entity holds at least 19% of the means of control in it.
- G. The approval of the Ministers is required for granting rights in certain assets of the Company (switches, cable network, transmission network and data bases and banks). In addition, grant of rights in means of control in subsidiaries of the Company, including allotment of more than 25% of the shares in the subsidiary, requires the approval of the Ministers.

³² For the minimum rate of holding of control of B Communications Group and falling below this rate, see Section 1.7.6C.

H. Certain actions of the Company require the approval of the Minister of Communications, among them voluntary liquidation, a settlement or arrangement between the Company and its creditors, a change or reorganization of the structure of the Company, a merger and split of the Company.

2.16.4 Royalties

For details about the duty to pay royalties applicable to license holders pursuant to the provisions of the Communications Law, see Section 1.7.4A.

2.16.5 Authority with respect to real estate

Pursuant to the provisions of Section 4(F) of the Communications Law, the Minister of Communications granted the Company certain powers in connection with real estate, as set out in Chapter F of the Law.

The law distinguishes between land owned by the State, the Development Authority, the Jewish National Fund, a local authority or a corporation lawfully established and owned by one of them, and a road ("Public Land"), and other land ("Private Land"). With regard to Public Land, the Company and any person authorized by it, can enter and perform work there, provided that approval for deployment of the network has been granted by the local Planning and Construction Committee.

Under the provisions of the Telecommunications (Installation, operation and maintenance) Regulations, 1985, if the Company is of the opinion that providing a telecommunications service to an applicant requires the installation of a telecommunications device for transmission or switching on the applicant's premises (or in shared premises or common property), the Company is permitted to request that the applicant, as a prerequisite for providing the requested service, allocate a suitable place on the premises for installation of the device, for the sole use of the Company, and it may use the device to provide service to other applicants also.

Deployment of a network on Private Land requires the consent of the landowner, the lessee in perpetuity or the protected tenant, as the case may be.

Pursuant to the provisions of the Planning and Construction (application for a permit, its terms and fees) Regulations, 2010, an applicant for a permit to erect a residential building has a duty to install infrastructures for telephone, radio, television and Internet services so that the customer can choose whichever provider it prefers. In commercial buildings, if preparations for communications are installed, an underground infrastructure must be laid. At the same time, the Company's license was amended (as were the licenses of HOT Telecom and DBS), so that if the Company uses the internal wiring for providing its services, it is obliged to provide maintenance services for that internal wiring (the portion of the access network installed in residences and in apartments, and which is aimed to be used by those residences only), installed by the permit's applicant, without this granting it any proprietary rights in the internal wiring.

On May 7, 2015, the Ministry of Communications published a hearing regarding wiring in residential buildings, in which he notified, with attention to the amendment of the Planning and Building Regulations of 2010 setting out that a building permit holder will install three leads (pipes) from the border of the property to the building communication cabinet, and for IBC's complaints regarding a lack of free leads, that he is considering determining that Bezeq Group and HOT will each use one lead between the property border and the building communication cabinet and floor communication cabinets and that they will vacate leads in existing buildings and make adaptations due to IBC's demands under certain circumstances. The Company submitted its position, which opposes such determinations, among other things, due to a lack of justice, proportionality and need. The Ministry is holding a "round table" with the Company, DBS, HOT and IBC to reach an arrangement regarding installation of infrastructure in new buildings.

2.16.6 Immunities and exceptions to liability

The Minister of Communications granted the Company certain immunities from liability for from damages listed in Chapter I of the Communications Law, in accordance with his authority to grant immunity to a general license-holder.

In addition, Section 13 of the law contains exceptions to criminal and civil liability for an act done in fulfillment of a directive to provide services to the security forces in that section.

2.16.7 Regulations and rules under the Communications Law

At the date of publication of this Periodic Report, regulations in three additional and important areas apply to the Company: (1) cessation, delay or restriction of telecommunications actions and services; (2) installation, operation and maintenance; (3) ways of overseeing the actions of the license-holder.

2.16.8 Antitrust laws

A. The Antitrust Commissioner (in this section – "the Commissioner") declared the Company a monopoly in the following areas:

1. Basic telephone services, provision of communications infrastructure services, and transfer and transmission of broadcasting services to the public³³.
2. Provision of high-speed access services through the access network to the subscriber³⁴.
3. Provision of high-speed access services for ISPs through a central public telecommunications network.

The Commissioner's declaration of the Company as a monopoly constitutes prima facie evidence of its content in any legal proceeding, including criminal proceedings.

- B. The Company has adopted an internal compliance procedure containing internal rules, guidelines and an internal reporting and control system, the purpose of which is to ensure that the activities of the Company and its employees are carried out in accordance with the provisions of the Antitrust Law.
- C. With regard to the merger between the Company and DBS, see Section 1.1.2.
- D. As part of the approval of the merger of the Company and Pelephone on August 26, 2004, restrictive terms were imposed, mainly prohibiting discrimination in favor of Pelephone in the supply of a product in which the Company is a monopoly, prohibiting the bundling of the supply of certain products by any of the companies when purchasing products or services from the other, and restrictions on certain joint activities. On October 10, 2010, these terms were amended, removing some of those relating to joint marketing.
- E. On September 12, 2010, the merger of Walla and the Company was approved following the Company's acquisition of Walla shares, on terms that restrict discrimination in favor of Walla vis-à-vis its competitors.
- F. On October 11, 2011, the Antitrust Authority informed the Company that the Commissioner was considering issuing a ruling in accordance with his powers under Section 43(A)(5) of the Antitrust Law, that the Company had abused its position in contravention of the provisions of Section 29A of the Antitrust Law. The notice stated that the Commissioner is considering stipulating that the Company refused to provide transmission services for the provision of telephony and Internet services to Cellcom and Partner. The Commissioner's notice further states that before making his decision, the Company is given the opportunity to present its case in writing. It should be noted that as of October 2010, in accordance with the decision of the Ministry of Communications, the Company provides infrastructure and transmission services to both Cellcom and Partner.
- G. On November 16, 2014, the Company received the decision of the Deputy Commissioner of the Antitrust Authority pursuant to Section 43(A)(5) of the Antitrust Law, to the effect that the Company had abused its position as a monopoly and

³³ Declaration on July 30, 1995.

³⁴ On November 10, 2004, the Commissioner split the declaration of December 11, 2000 on Internet access infrastructure into two separate declarations (Declarations 2 and 3).

determined unfair purchase and sale prices of a service in a monopoly, in contravention of the provisions of Section 29A to the Antitrust Law 1988, in that it determined prices for Internet and telephony services that were lower than the Internet infrastructure only, in a campaign in which it had offered new subscribers, for six months, a fixed telephone line plus 200 minutes of free calls to fixed-line destinations for NIS 19.90 a month. The Commissioner claimed that given that the Internet access infrastructure service is a critical input for the supply of Internet-based telephony services, then the price set by the Company places competitors who wish to offer this service at a disadvantage, as the price of the critical input for supply of the service (NIS 25 for an NDSL Internet line only) is higher than the price of the final service which the Company offered its customers.

On March 31, 2015, the Company filed an appeal against the Antitrust Tribunal's decision, together with an affidavit and the opinion of an expert economist, under which the Company requests the Court to order that the decision is null and void or alternatively to order its cancellation. In the appeal, the Company claimed that there was no "negative margin", that the decision ignored various tests for existence of a negative margin and margin squeezes, that under the circumstances of the matter there is no concern for harm to competition, that there was no actual harm to competition and that there was no breach of any sections of the Antitrust Law. The Company also pointed out a breach of administrative duties of the authority while forming the decision and its very publication, which must also lead to cancellation of the decision. On September 8, 2015, the Commissioner's response to the appeal was submitted, in which the Court was requested to dismiss the appeal and leave the decision intact.

2.16.9 The Telegraph Ordinance

The Telegraph Ordinance regulates the use of the electromagnetic spectrum, and applies, inter alia, to the Company's use of radio frequencies as part of its infrastructure. The set-up and operation of a system that uses radio frequencies is subject, under the Telegraph Ordinance, to grant of a license, and the use of radio frequencies is subject to the designation and allocation of a suitable frequency. The Telegraph Ordinance imposes license fees and fees for the designation and allocation of frequencies.

The Government deals with the shortage of radio frequencies for public use in Israel (among other reasons, due to the allocation of a large number of frequencies for security purposes), by limiting the number of licenses granted for the use of frequencies, and providing incentives for efficient use of frequencies.

2.16.10 Setting up communications facilities

A. General

The National Outline Plan for communications, NOP 36 (within the Green Line) and NOP 56 (in the Administered Territories), were designed to regulate the deployment and manner of set-up of communication facilities in a way that would ensure coverage for transmitting and receiving radio, television and wireless communications, while avoiding radiation hazards and minimizing the damage to the environment and the landscape, and also to simplify and increase the efficiency of the processes involved in setting up the facilities.

The classification of the facilities according to their technical variables and physical dimensions, which affect the determination of safety ranges for protection against the effects of radiation and the extent to which they protrude on the landscape, determine which facilities will be included in Part A of the Plan and which in Part B of the Plan.

The Company has erected and is erecting broadcasting facilities and wireless communication facilities for providing broadcasting services to the Company's customers, and uses such communication facilities, mainly for providing services to areas that are not connected to the fixed-line communications infrastructure (remote areas or new towns).

B. NOP 36A

1. Part A of NOP 36 deals with guidelines for erecting small and miniature broadcasting installations.
2. The Company has obtained building permits for most of the small broadcasting installations in accordance with NOP 36A. From time to time, a need arises to add broadcasting installations which require that building permits be obtained in accordance with NOP 36A.
3. Given the exemption granted under the orders of the Planning and Construction Law and of the Communications Law, the Company believes that it is not obliged to obtain building permits for miniature broadcasting installations, which are “wireless access facilities” under those laws.
4. In January 2008, the Planning Administration issued a draft amendment to NOP 36A (NOP 36/A/1), with the aim of changing the guidelines for the licensing of small and miniature broadcasting installations. The draft cancels the definition of a miniature broadcasting installation and changes the definition of a small broadcasting installation. In addition, different licensing tracks are defined (fast and standard), depending on the location and the public safety range of each installation. In these tracks, indemnification arrangements (of differing amounts) are set for claims for compensation under Section 197 of the Planning and Construction Law.

The change of definition of small broadcasting installations and large broadcasting installations, presents practical difficulties which could impede the Company's ability to provide the public with some of the services it is required by law to provide.

NOP 36/A/1 has not yet been approved by the government, and there is no certainty as to the final text that will be approved.

C. NOP 36B

Part B of NOP 36 contains guidelines for setting up large broadcasting facilities. In the January 2008 draft plan (which was presented to the government for approval in August 2010), the definition of a large broadcasting facility was changed so that the licensing of broadcasting facilities which prior to the proposed amendment were classified as large, would be according to NOP 36/A/1 (if and when approved), which does not include transition provisions for an abridged licensing proceeding. The change in definition for small and large broadcasting facilities presents practical difficulties which could impede the Company's ability to provide the public with the services it is required by law to provide.

The January 2008 draft contains a transition provision which is expected to allow grant of a license for existing broadcasting installations even if they do not meet the requirements of NOP 36B, subject to certain terms and restrictions, provided that they are in compliance with the safety restrictions described in the Plan. The January 2008 draft also proposes to include a provision requiring the license applicant (including for existing sites) to provide the local committee with a deed of indemnity for compensation under Section 197 of the Planning and Construction Law, if a court rules against the committee.

NOP 36B has not yet been approved by the government and there is no certainty as to the final text that will be approved.

The Companies assessments concerning the effect of the amendments to NOP 36 (Parts A and B) on the Company's operations and performance are forward-looking information. These assessments may not materialize, or they may materialize significantly differently than foreseen, in part depending on the final text of the relevant NOP 36. As mentioned above, at this stage, before publication of the final text of the NOP, the Company is unable to estimate the full impact of the amendments on the Company.

- D. For details on radiation permits for communications and broadcasting facilities, see Section 2.15

E. NOP 56 – Communications facilities in the Administered Territories

NOP 56 came into force in June 2008, and regulates the manner of erection and licensing of communications facilities in the Administered Territories. The Plan contains transition provisions for facilities erected with a permit for small installations.

The Plan also includes a requirement for production of a communications license and receipt of the consent of the Commissioner of Government Property at the Civil Administration.

The Company has arranged the licensing for 76 installations in the Administered Territories, and is in the process of licensing the remaining five installations in the Administered Territories.

F. Exemption from a permit to add antennas to existing lawful broadcasting facilities

On August 1, 2014, the Planning and Building (Works and Buildings that are Exempt from a Permit) Regulations, 2014, entered into force, which prescribe, inter alia, 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. The Company began activities to add antennas to the Company's broadcasting facilities pursuant to the provisions of the aforementioned regulations.

2.17 Substantial agreements

The following is a brief description of substantial agreements outside the normal course of the Company's business, which were signed in the reporting period and/or which are in force.

- 2.17.1** Agreements relating to bonds (Series 5-10) issued by the Company; for details, see Note 12.3 to the 2015 financial reports, and Section 6 to the Board of Directors' report.

2.17.2 Real estate

A. Asset transfer agreement between the Company and the State, January 31, 1984

An agreement between the State and the Company, under which the Company was granted the State's rights in assets which the Ministry of Communications used for providing telecommunication services, and the Company assumes the rights of the State in those assets and for the obligations and liabilities relating to those rights immediately prior to implementation of the agreement. Moreover, under this agreement, the State's rights, powers, obligations and duties, as well as the contracts and transactions that were in force for telecommunication services immediately prior to application of the agreement, were transferred to the Company.

- B. Settlement agreement dated May 15, 2003 between the Company and the State and Israel Lands Administration, in the matter of rights relating to real estate

See section 2.7.4.C.

C. Agreement between the Company and the Postal Authority dated June 30, 2004

An agreement between the Company and the Postal Authority to define and regulate the rights of the Company and the Postal Authority in their joint assets. The agreement listed the joint assets and defined the part of each party in them. It was determined that each of the parties shall have exclusive rights in its parts, except for the matter of rights in common property, building rights or rights for which there is an explicit other determination. The agreement determines, among other things, a mechanism of right of refusal if a party wishes to make a sale transaction and a priority right for a rental transaction. For a number of additional properties, the party with exclusive rights in them, in whole, will be one named party.

2.17.3 Various agreements with DBS

See section 5.18.4.

2.17.4 Employment agreements

A. A comprehensive pension agreement dated September 21, 1989, between the Company, the Histadrut and the joint representation of workers committees, and Makefet Fund – Center for Pension and Compensation Cooperative Association Ltd, provides a full and autonomous arrangement in everything relating to the pension insurance of Company employees. The agreement applies to all transferred employees (who were transferred from the Ministry of Communications to the Company), to all of the members of the cumulative pension fund who are employed by the Company on the date of execution of the pension agreement, and to all of the permanent and temporary employees of the Company, with the exception of special employee groups (students, employees under personal contracts or employees working according to another, alternative arrangement).

B. Special collective agreement for early retirement dated November 23, 1997, as amended and extended on September 4, 2000, March 18, 2004, April 17, 2005 and June 28, 2005, between the Company, the Histadrut and the Union.

A collective agreement for early retirement of employees in a pension track and an increased compensation track, under which Company employees retired in the past. The renewed collective agreement of December 2006 mentioned in Subsection F is based, inter alia, on this agreement. For information on this matter and on the matter of early retirement, also see Note 15 to the 2015 financial statements.

C. Agreement to affirm rights dated September 4, 2000 between the Company, the Histadrut and the Union.

A special collective agreement relating, inter alia, to affirmation of the rights of the transferred employees (who were transferred from the Ministry of Communications to the Company). This agreement affirms the rights of the transferred employees to any pension right to which they were entitled by power of their being former civil servants, under the Company's pension agreement, adopted by the Company as part of its pension agreement. Under this agreement, these rights become "personal rights" which cannot be cancelled except by a waiver of personal rights under law (in other words, by personal waiver by the employee himself or herself).

D. Generation 2000 agreement dated January 11, 2001 between the Company, the Histadrut and the Union

Following an amendment in July 2000 to the Hiring of Workers by Human Resource Contractors (Amendment) Law, 2000, a special collective bargaining agreement was signed on January 11, 2001 for hiring new employees and stipulating the terms of their salaries. The agreement applies to new employees and to employees who were previously employed at the Company through human resource companies, in positions listed in the appendix to the agreement (customer service representatives at call centers, administrative workers, typists, warehouse employees, secretaries, mail sorters and distributors etc., and similar administrative workers such as porters, drivers, forklift operators and others). Under the special collective agreement of December 2006, it was agreed that the Generation 2000 agreement would not apply to such employees who were hired by the Company after July 1, 2006. It was also agreed to insert minor amendments into the terms of employment of workers hired under the Generation 2000 agreement.

E. Agreements with alternative entities that replaced the Makefet Fund in everything relating to early retirement arrangements of Company employees

As of 2005, the early retirement arrangements of the Company's employees are implemented through alternative entities in place of Makefet Fund.

On April 24, 2014, the Company and Menorah Mivtachim Insurance Ltd. ("Menorah"), 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 signed by the Company, the Union and the Histadrut on February 12, 2014. The agreement period is until the end of 2016. The texts of the insurance policies are in the approval process at the Insurance Commissioner and at this stage, the payments are temporarily executed by entire payments by Menorah.

- F. With respect to the special collective agreement of December 2006 and its amendment in December 2010, see Section 2.9.4.

2.17.5 Management agreement

For details about the updated agreement between the Company and Eurocom Communications Ltd., under which the Company is granted regular management and advisory services in consideration of NIS 5.524 million per year, see the immediate report dated May 7, 2013, and the amending report dated June 10, 2013 (convening a extraordinary general meeting), which are included in this report by way of reference.

2.18 Legal proceedings

The Company's reporting policy is based on considerations of quality and of amount. The Company decided that the bar of amount materiality would be events affecting the Company's net profit by 5% or more according to the latest annual consolidated financial statements. Accordingly, this section describes legal proceedings involving NIS 120 million or more³⁵ (approximately NIS 90 million of the net profit), and legal proceedings in which the amount claimed is not stated in the statement of claim, except in the case of a claim which prima facie does not reach the above amount bar (and all unless the Company believes the claim has other aspects and/or implications beyond its monetary amount). In regards to class actions, it is noted that submission of class actions in Israel does not involve payment of a fee deriving from the amount of the claim. Accordingly, the amount of a claim in claims of this type may be significantly higher than the scope of true exposure for those claims.

Pending proceedings

	Date	Parties*	Instance	Type of proceeding	Description	Original Amount of the Claim (NIS in millions)
A.	February 2012	Claim against the Company, Telephone and two other additional cellular companies	District Court (Jerusalem)	Action and request to approve it as a class action	The plaintiffs alleged that the Respondents do not offer the disabled members of the public accessible handsets and services in a fitting manner, and that they are therefore in breach of the law and the regulations. In January 2014, a decision was made with the consent of the parties whereby the claim will be discussed together with another claim on the same matter, which was filed against other communication companies. In December 2015, an application was filed with the Court for approval of a settlement arrangement in a case at a minimal cost to the Company.	361
B.	July 2012 and November 2012 (Two claims that were unified)	Two shareholders vs. Company officers (including those that are no longer in office)	District Court (Tel Aviv, Economic Department)	Derivative claim and request to approve a derivative claim Declarative reliefs	It was argued that members of the Board of Directors were in breach of their duty of caution and fiduciary obligations towards the Company, by approving loans which were not used for the Company's benefit and were designated for the distribution of dividends, and were therefore in a conflict of interests. Alternatively, the Plaintiff alleges that the resolutions passed by the Board of Directors with respect to the aforementioned loans created a tax exposure for the Company due to the fact that the financing expenses are not recognized for tax purposes. Inter alia, declarative relief was requested for nullification of loans taken by the Company from the date of the change of control, and restitution of dividends by the Company's controlling shareholder. On September 17, 2014, a decision was made rejecting the two claims, since the court found, inter alia, that it was not proven that the respondents (officers) made their decisions in breach of their duty, or that they deviated from the confines of their prerogative, or that they damaged the Company. Two plaintiffs submitted appeals to the Supreme Court against the ruling, which was deliberated in November 2015 and awaiting a ruling.	900, in one claim 2,640 (net) in the other

³⁵ For reviewing claim amounts vis-à-vis this bar, the amounts were linked to the CPI. The amounts noted in this section are the original amounts (without linkage differentials). On the matter of the bar, where similar proceedings take place against a number of companies in the Group, the amount of the claim might be reviewed cumulatively in respect of all the proceedings together. In addition, it is clarified that if certain proceedings relate largely to the same legal or factual issues, or it is known that such issues are reviewed or considered together, then for setting the bar of quantitative materiality as noted in these sections, the amount involved was examined in all those proceedings together.

Chapter A (Description of Company Operations) of the Periodic Report for 2015

	Date	Parties*	Instance	Type of proceeding	Description	Original Amount of the Claim (NIS in millions)
C.	April 2013	Shareholder vs. the Company and the Company's Controlling Shareholder, B Communications Ltd.	District Court (Tel Aviv, Economic Department)	Declarative relief claim	The court was requested to declare that the controlling shareholder of the Company has a personal interest in the distribution of dividends distributed in 2013 with the approval of the general meeting, and to instruct the Company to publish information and documents, and to summon economic experts whose opinions were published by the Company.	**
	June 2013	A shareholder (the same shareholder that filed the claim in April 2013) against the Company and the (indirect) controlling shareholder of the Company, Eurocom Communications Ltd.	District Court (Tel Aviv, Economic Department)	Declarative relief claim	Request for a declarative ruling determining that the general meetings of the Company's shareholders dated April 24, 2013 and June 13, 2013 were illegally managed, and that the form of compensation determined and approved in the Company's general meeting dated June 13, 2013 relative to the services of four Company directors (as part of the management agreement with Eurocom) is illegal. The deliberation on both proceedings was postponed, at this stage, until a final decision is made relative to the appeal to reject the request to approve the derivative claims indicated in row B above (in view of the similarity of the claims in the foregoing proceedings).	**
D.	January 2015	Shareholder vs. the Company and Company Officers	District Court (Tel Aviv, Economic Department)	Request to approve a class action	Claim for compensation of shareholders for losses, which according to the claim, were caused by "omissions by the Company to report to the Tel Aviv Stock Exchange (TASE) and to conceal material information from the investors", relative to two significant and material issues: "Reduction of interconnection fees" and the "Reform in the wholesale market". The members of the represented group are divided into two separate groups: In regards to the reduction of interconnect fees - any person that purchased Company shares (except the Respondents and/or their representatives) as of February 28, 2013 and held the shares until May 29, 2014; and in respect to the reform in the wholesale market - any person that acquired Company shares (except the Respondents and/or their representatives) as of June 9, 2013 and held the shares (in whole or in part) until the date of submission of the claim or, alternatively, until January 15 to January 20, 2014. As it emerges from the Company's reports to the public (and as indicated in the petition), the Company reported on these two matters via immediate reports to the public, as well as via its periodic reports (annual and quarterly reports), which included all the material and relevant information relative to these matters, and all reports were lawful.	Approximately NIS 2 billion (based on the Shortage of Money method) and, alternatively, approximately NIS 1.1 billion (according to the Approximate Shortage of Money) method.

Chapter A (Description of Company Operations) of the Periodic Report for 2015

	Date	Parties*	Instance	Type of proceeding	Description	Original Amount of the Claim (NIS in millions)
E.	March 2015	Shareholder	District Court (Tel Aviv, Economic Department)	Motion for approval of a claim as a derivative claim, including a statement of derivative claim	The claim was filed against the Company ("the Company"), Mr. Shaul Elovitch, the controlling shareholder (indirectly) of the Company and Chairman of its Board of Directors, and Company directors who voted for the Company's transaction under the application, as set out below ("the Respondents"). According to the allegations in the application, the Company decided, through the Respondents, to enter into a transaction to purchase all the holdings and shareholders loans of Eurocom DBS (a company indirectly controlled by the Company's controlling shareholder) in DBS in return for NIS 680 million in cash and contingent considerations of a further NIS 370 million. The plaintiff claims that the consideration which is expected to be paid for the transaction is exorbitant and the decisions of the Respondents to enter into the transaction caused the Company great damage after they were in breach of their duty of care and fiduciary duties towards the Company and were negligent in their positions. The plaintiff also alleged that the Company's controlling shareholder violated his duty of fairness and that the Company was in breach of its duty of disclosure and reporting regarding the commitment of the trustee of Eurocom DBS' holdings in DBS to sell the holdings as of the end of March 2015. In view of the foregoing, the plaintiff requests that the court approve filing of a derivative claim on behalf of the Company against the Respondents for the damage allegedly incurred by the Company as a result of the Respondent's decisions with respect to the transaction of NIS 502 million. It is noted that on April 2, 2015, another similar application was filed to the same court. However, on June 25, 2015, the Court ruled to dismiss this application due to the similarity between the applications. An appeal filed by plaintiff of this application to the Supreme Court was dismissed in agreement on January 12, 2016 further to the recommendation of the Court.	502

Chapter A (Description of Company Operations) of the Periodic Report for 2015

	Date	Parties*	Instance	Type of proceeding	Description	Original Amount of the Claim (NIS in millions)
F.	August 2015	Customer vs. the Company	District Court (Tel Aviv)	Action and request to approve it as a class action	It was alleged that the Company abused its position as a monopoly to price its services in a manner that limits the ability of its competitors to offer fixed-line telephony services at competitive prices, among other things, by offering its customers fixed-line telephony services at the lowest price charged for Internet infrastructure services only, i.e. for a critical input for the activity of its competitors, which operate using VoB technology (in this matter it is noted that in November 2014, the Antitrust Authority ruled that the Company abused its position as a monopoly and the Company filed an appeal with the Antitrust Tribunal against the ruling - see Section 2.16.8G). The plaintiff argues that the damage to the public resulting from the above was estimated by reviewing the difference between the fixed-line telephony market price and comparing it with the weighted hypothetical price that would be charged in a market with competition that would lead to a long-term reduction in prices. According to the plaintiff's claims, the members of the represented group are all fixed-line telephony service subscribers, whether provided by the Company or its competitors, including through VoB technology, as of January 15, 2011 until the date of filing the application. In November 2015, the Company filed a motion for a stay of proceedings in the case for reasons of pending proceedings at the Antitrust Tribunal, which is deliberating the issues of the same nature as those at the center of the approval application (see Section 2.16.8G).	244
G.	November 2015	Customer vs. the Company	Central District Court	Action and request for certification as a class action	It was alleged that the Company abused its position as a monopoly by "preventing and blocking competition in general and effective competition in the Israeli communication market", and acted to delay and prevent the wholesale market reform, thereby causing damage to the Israeli public and earning unreasonable profits only as a result of abusing its power as a monopoly. According to the plaintiffs' allegations, the damage caused by the Company to the communication market in Israel is expressed by the Company's excessive and unreasonable profits and they wish to claim damages of NIS 800 million, which they allege is based on 10% of the Company's surplus operating income stemming from abuse of its monopolistic power. Accordingly, the plaintiffs set the amount of the claim at NIS 556 million, after the amount was reduced in another action (an application for certification of a class action dated August 2015, which is described in section F above, for NIS 244 million for claimed abuse of monopolistic power and refers to the Antitrust Commissioner's decision). It is noted that on March 10, 2016, a further claim against the Company was filed with the Central District Court, together with a motion for confirmation as a class action, in an amount of NIS 43 million, which includes claims regarding a delay in implementation of the wholesale telephony market reform.	556

Chapter A (Description of Company Operations) of the Periodic Report for 2015

Legal proceedings which ended during the reporting period or by the date of publication of the report

	Date of Filing of the Claim	Parties	Instance	Type of Proceeding	Description	Original Amount of the Claim (NIS in millions)
A				Damages claims - Hillel Station	Claim for damage to property and finances and physical injury, caused, according to the claim, as a result of prohibited radiation from the Hillel broadcasting station.	
	1. May 2005	Individuals vs. the State of Israel, Israel Broadcast Authority and the Company	District Court (Tel Aviv)	Damage to property and finances claim	Property damage claim - on January 18, 2016, the court dismissed the claim.	23
	2. December 2012	Individuals vs. the State of Israel, Israel Broadcast Authority and the Company	District Court (Center)	Body injuries claim	Body injury claim - on January 12, 2016, in view of the agreement of the parties to the court's proposal, the court dismissed the claim for body injury without ordering costs. In regards to the above two claims, it should be noted that at the end of 2003, the Company discontinued its broadcasts from the station, as requested by the State and the Broadcasting Authority, and from that date the site is no longer used for broadcasting.	**
B	June 2014	Customer vs. the Company	Regional (Haifa)	Action and request to approve it as a class action	According to the Plaintiff, a subscriber of the Company's Internet infrastructure, the Company does not allow existing subscribers to connect to its Internet infrastructure at the tariffs it offers to new subscribers for the same service. On August 11, 2015, the Court approved the plaintiff's withdrawal from the application for certification as a class action without ordering costs.	144

* Part of the proceedings was originally filed also against additional defendants that were deleted later on from the proceedings. The parties indicated in the table are according to the current situation.

** The amount of the claim is not indicated, or the claim is not a financial claim.

2.19 Business Goals and Strategies

2.19.1 Forward-looking information

The following review of Company strategy includes forward-looking information as defined in the Securities Law, and involves assessments about future developments in the economy in general relating to customer behavior and needs, the pace of adoption of new services, technological changes, regulatory policy, marketing strategies of competitors, and the effectiveness of the marketing strategy of the Company.

The Company's strategy and the business objectives stemming from it are based on internal research, secondary sources of information, and primarily – the reports of research companies, publications about the activities undertaken by similar communications operators in Israel and around the world, and the work of consultants who assist the Company.

Nevertheless, it is far from certain that the strategy and the main activities described here will actually be implemented or implemented in the way described. The circumstances that could lead to non-implementation of the strategy or even its failure lie in the general condition of the economy, frequent technological changes, regulatory constraints, the formation of a sustainable business model for new services that the Company intends to provide, and a superior marketing strategy by competitors. In addition, a change in ownership of the Company could result in a change in its strategy and its business objectives.

2.19.2 Strategy summary and intentions for the future

A. Vision and purpose

The Company's objective is to be a market leader in the domestic and business arena and to provide the customer with a total communications solution. The Company's objective is to be a market leader in the domestic and business arena and to provide the customer with a total communications solution. In the private sector the Company provides such solutions for the home; in the business sector the Company provides a smart network on which a range of advanced services operate.

The objective: To maintain the Company's competitive position and continue being the customer's first choice in telephony, Internet and telecommunications. To attain this goal, the Company has set itself a number of challenges:

1. Preservation of leader status in an environment of intensifying competition (leader in service and strengthening of perceived values – innovative products, reliability, proximity to the customer);
2. Encouraging the recruitment of new customers and fidelity motivators among existing customers;
3. Creation of new sources of income by launching new services and products;
4. Ongoing adaptation of the organization to the competitive and technological environment and operational excellence.

B. Means

To implement this strategy and attain these objectives, the Company uses and will continue to use the following means:

Business customers

Diverse bundles of products and services that meet the business needs of the customer;

Integrated telecommunications solutions according to customer needs, while applying a strategy of commitment to service quality and availability;

Encouragement of customer to migrate from basic services to managed solutions for organizational and inter-organizational connectedness.

Private customers

Wider bandwidth of customers and sale of advanced products and services on the new NGN;

Supply of differential debit tracks to suit customer needs;

Strengthening the positioning of the Company's telephony services, with emphasis on advanced applications and the penetration of advanced terminal handsets.

Levering Group assets for the purpose of providing the customer with a comprehensive communications solution.

Network

In order to attain its strategic objectives, the Company is working on improving the existing network and adapting it to its business goals, including by the deployment of optical fibers and by investing in the heart of the network. See also Sections 2.6.6 and 2.7.2, on the NGN.

2.19.3 Development trends in the company's business

- A. The Company is working to increase the data-transmission rates in the services it provides to its customers. The Company is working to increase data transfer speeds in the services it provides for its customers, and its marketing initiatives aim to transfer customers to faster Internet surfing speeds. For its business customers, the Company is also launching transmission and data communication services at high speeds and in a range of interfaces and managed services.
- B. The Company is working to continue integrating into IP (Internet Protocol) applications. To achieve this, it has established an IP network company to serve as a platform for the services it provides today and those it intends to provide in the future.
- C. The Company markets fixed-line and wireless home network services for surfing from a number of computers simultaneously, as well as additional services (Bphone, Bcloud, Free Wi-Fi, and Bhome).
- D. The Company has launched a range of debit tracks for telephony services alongside its basic tariff structure, so as to increase the extent of use of its services and vary the offering of tracks based on the needs of the customers.
- E. The Company markets bundles that include additional services to those of the Company (see Section 1.7.2.B).

2.19.4 Main projects – planned and in progress

As at the end of 2015, the Company has completed deployment of the NGN everywhere. With regard to the Company's deployment of an optic network as close as possible to the customer's premises, see section 2.7.2.

The Company is also developing and implementing advanced computer systems, among them a network engineering management system, and a service order and delivery management system.

2.20 Risk Factors

The Israeli market in which the Company operates is essentially stable. Nevertheless, there are risk factors stemming from the macroeconomic environment, from the unique characteristics of the industry in which the Company operates, and risk factors that are unique to the Company, as described in the following sub-sections:

2.20.1 Competition

The competition in the domestic fixed-line communications industry has recently intensified, both on the part of other domestic carriers, first and foremost HOT (holder of a general license), and on the part of cellular operators, and it strengthened significantly upon implementation of the wholesale market by communications groups and other communications operators (holders of a special or unified license) competing with the Company in selling end-to-end service packages based on the Company's infrastructures at prices prescribed by the regulator and not as commercial terms determined in negotiations (see Section 1.7.3). It is possible that there will be competition also from potential infrastructure owners (see Section 2.6). This has led to the churn of some of the Company's customers and lowering of prices for part of the Company's services and to a rise in the costs of acquiring new customers and retaining existing ones. The entities competing with the Company at present or those that might compete with it in the future, benefit from greater business flexibility than the Company, including the ability to cooperate with subsidiaries and affiliates for marketing joint packages of services (see Sections 1.7.2 and 1.7.3). The ability of HOT to offer such packages ("Triple Play" and even more) with tariff flexibility compared with the restrictions that prevent the Company from doing the same, harms the Company's ability to compete.

2.20.2 Government supervision and regulation

The Company is subject to government control and regulation relating, among other things, to the licensing of operations, setting permitted areas of operation, setting tariffs, operation, competition, payment of royalties, providing universal service, holding its shares, relations between the Company and its subsidiaries and a ban on ceasing or limiting its services (which could oblige the Company to provide services even in circumstances which are not economically worthwhile) – for details, see Section 2.16. This control and regulation result at times in government intervention that the Company believes impedes its business activities. Within this framework the Company is exposed to the imposition of various sanctions by the Ministry of Communications, including financial sanctions (see Section 1.7.4F).

In addition, the Minister of Communications has the authority to change the Company's license, get involved in existing tariffs and marketing offerings, and impose instructions on the Company. Significant changes in the regulatory principles applicable to communications as a whole and to the Company in particular, could oblige the Company to make changes in its strategic plans, and harm its ability to plan its business activities for the long term. On possible changes following the development of a competition policy document, see Section 1.7.3A. For possible restrictions by virtue of the Concentration Law on the renewal of licenses and allocation of new licenses, see Section 1.7.4H.

2.20.3 Tariff regulation

The Company's tariffs for its main services (including interconnect fees) are subject to government control and intervention. The Minister is authorized to intervene in existing tariffs and marketing offerings and impose instructions on the Company (see Section 2.16.1). On average, the Company's controlled tariffs erode in real terms. Significant changes in controlled tariffs, if implemented, could have a materially adverse effect on the Company's business and results. Regarding the uncertainty about continuing the updating arrangement for the Company's controlled tariffs – see Sections 1.7.3 and 2.16.1. Additionally, the restrictions applicable to the Company in marketing alternative payment bundles may make it difficult for the Company to provide an appropriate competitive solution to market changes and are materially manifested compared to those competing with the Company basis of its infrastructures in the sale of end-to-end service packages using wholesale BSA services supplied by the Company. In the context of the implementation of a wholesale market, the Ministry of Communications has the power to set the price for which the Company will sell its services to license holders. The low prices determined may adversely affect the Company's level of revenues and profits (for details about the wholesale market, including the Company's petition to the Supreme Court against the determination of the tariffs and the wholesale telephony services, see Section 1.7.3).

2.20.4 Difficult labor relations

The Company's implementation of human resources and organization plans (including retirement plans and restructuring), involves coordination with the workers and significant costs, including compensation for early retirement. The processes of implementation of such plans are liable to cause unrest in labor relations and to be damaging to the Company regular activities – see also Sections 2.9.3 and 2.17.4.

2.20.5 Restrictions on relations between the Company and companies in Bezeq Group

Structural separation - The Company's general license obliges it to ensure that its relations with its main investees in the Group do not result in preferring them over their competitors. Separation is required between the managements of the Company and those companies, as is separation between the business, financial and marketing systems, assets and employees, which causes duplication and high administration overheads. In addition, the Company is limited in its ability to offer joint service bundles with those companies (see Section 1.7.2). Due to entry of companies into direct competition with the Company based on the provision of a service bundle to the customer and the option of providing wholesale services for offering customers end-to-end services, and due to the option of utilizing DBS' losses for tax upon cancellation of the separation obligation and merger with the Company (see Note 6 of the 2015 financial statements), the risk that this factor will affect the Company's operations and results has increased. Nonetheless, on the matter of the possibility that in the future the Group will be granted a permit to provide non-divisible bundles of services and cancellation of the structural separation, and for information about additional changes deriving from the wholesale market, see Section 1.7.3.

2.20.6 Legal proceedings

The Company is a party to legal proceedings, including class actions, which could result in it being ordered to pay significant sums, most of which cannot be estimated, and therefore, no provisions have been made in the Company's financial statements for most of them. In addition, the Company's insurance policies are confined to cover limits and to certain causes, and might not cover claims for certain types of damages. In recent years, class actions against large commercial companies have become more numerous and severe. By their very nature, class actions may reach substantial amounts. In addition, since the Company provides communications infrastructures as well as billing services to other licensees, parties suing those licensees in other class actions are also likely to try to involve the Company as a party to such proceedings. For a description of legal proceedings, see Section 2.18.

2.20.7 Exposure to changes in exchange, inflation and interest rates

The Company measures exposure to changes in exchange rates and inflation by the surplus or deficit of assets against liabilities, based on the type of linkage. The Company's exposure to changes in currency exchange rates against the shekel is low. The Company's exposure to inflation rates is high, and therefore the Company takes steps to cover part of the inflation exposure. In addition, the Company has exposure to changes in the interest rates in relation to its borrowings. On this matter, see also Note 29 to the 2015 financial statements.

2.20.8 Electromagnetic radiation and licensing of broadcasting facilities

The subject of the electromagnetic radiation emitted from broadcast facilities is regulated mainly in the Non-Ionizing Radiation Law (see Sections 2.15 and 2.16). The Company is working to obtain permits to set up and operate its various broadcasting installations; however, the difficulties it faces in this area, including difficulties stemming from the change in policy by relevant entities and amendments to statutes and standards, could impact adversely on the infrastructure of these installations and on the regularity of provision of services using them, and as a result, on the Company's revenues from these services. The Company's third-party liability policy does not currently cover liability for electromagnetic radiation.

2.20.9 Frequent technological changes

The communications sector is characterized by frequent technological changes and by the shortening of the economic lifespan of new technologies - see Section 2.1.4. The

significance of these trends creates a need to invest numerous resources in technology upgrades, a lowering of entry barriers for new competitors, an increase in depreciation rates, and in certain cases, redundancy of technologies and networks owned by the Company, the cost of investment in which is still recorded on its balance sheets.

2.20.10 Dependence on macro-factors and on levels of business activity in the economy

Stability in the financial market and the strength of economies in countries around the world, have recently been subjected to high volatility. So far, the Israeli economy has displayed economic resilience, reflected in further economic expansion, maintaining low levels of unemployment and inflation rates within government targets. Nevertheless, the growth of the national deficit, rising housing prices and uncertainty in the political and defense arenas cast doubt over a continuation of these trends. The Company estimates that if the local market slides once again – following external or internal events – into a slow-down and a worsening of business activity, then its business results will be harmed, inter alia, as consequence of poorer revenues (including revenues from affiliates) and the difficulty in selling its real estate assets or due to an increase in the Group's finance costs.

2.20.11 Failure of Company systems

The Company provides services using various infrastructure systems that include, among others, exchanges, transmission, data communication and access systems, cables, computerized systems and others. Some of the Company's systems have backups, but nevertheless, damage to some or all of these systems, whether due to a technical fault or natural disaster (earthquake, catastrophe, fire), whether due to malicious damage (including through cyber-attacks and penetration of viruses), could cause extreme difficulties in providing service, including if the Company is unable to repair the systems.

It is noted that a significant part of the Company's activities (consolidated) are in its subsidiaries. The risk factors of these companies and the assessments of their managements as to the risk factors are described in Sections 3.20, 4.17 and 5.21.

The following table rates the effects of the risk factors described above on the Company's activities, in the estimation of its management. It is noted that this assessment of the extent of the impact of a risk factor reflects its extent assuming it is realized, and does not assess or give weight to the likelihood of its realization. The order in which the risk factors appear above and below is not necessarily according to the rate of risk.

Table of risk factors - Domestic fixed-line communications³⁶

	Extent of risk factor's impact on Company activities		
	Major	Moderate	Minor
Macro risks			
Exposure to changes in exchange, inflation and interest rates			X
Dependence on macro-factors and on levels of business activity in the economy		X	
Sector-specific Risks			
Increasing competition	X		
Government supervision and regulation	X		
Tariff control	X		
Electromagnetic radiation / Licensing of broadcasting facilities		X	
Frequent technological changes		X	
Risks unique to the Company			
Exposure in legal proceedings		X	

³⁶ It is clarified that the Group companies' assessments of the impact of the risk factors in the table (in this section and in sections 3.20, 4.17, and 5.21) did not estimate the probability of the realization of the risk factor but rather, the impact of the risk factor on the relevant company should it be realized. It is also noted that some of the Group companies make estimates of the probability of the scenarios of some of the risk factors mentioned in these sections for certain internal needs of their own, but no orderly estimate is made at the Group level of all the risks listed in the tables in this and the above sections.

	Extent of risk factor's impact on Company activities		
	Major	Moderate	Minor
Difficult labor relations		X	
Restrictions on relations between the Company and companies in Bezeq Group	X		
Failure of Company systems	X		

The information included in this Section 2.20 and the assessments regarding the impact of the risk factors on the Company's operations and business constitute forward-looking information as defined in the Securities Law. The information and assessments rely on data published by the Ministry of Communications, the Company's assessments of the market situation, its competitive structure, and possible developments in this market and in the Israeli economy. Actual results may differ significantly from these assessments if a change occurs in one of the factors taken into account in making them.

3. Pelephone – Mobile radio-telephone (cellular telephony)

3.1 General information about the segment of operation

3.1.1 Pelephone's segment of operation

Pelephone provides cellular communications services and sells and services terminal equipment. Pelephone's services are described more fully in Section 3.2. Pelephone is wholly owned by the Company.

3.1.2 Legislative and regulatory restrictions applicable to Pelephone

A. Communications laws and the cellular license

Pelephone's operations are regulated and controlled under the Communications Law and subsequent regulations, the Wireless Telegraph Ordinance, and the cellular license. The cellular license prescribes conditions and guidelines that apply to Pelephone's activities, (for details, see Section 3.15.2).

B. Tariff control

The interconnect fees (supplementary call and text message (SMS) fees collected by Pelephone from other operators) are fixed in the Interconnect Regulations. The other rates fall under certain regulatory control as regulated under the cellular license and the Communications Law (see section 3.15.2).

C. Environmental laws and planning and construction laws

The set-up and operation of a wireless communication infrastructure, including cellular communications, is subject to the provisions of the Non-Ionizing Radiation Law and the required Ministry of Environmental Protection permits, and the provisions of planning and construction laws (see Section 3.14.1).

3.1.3 Changes in the volume of operations in the segment

For financial information regarding the volume of Pelephone operations, see section 3.3.

Revenue from mobile radio telephony

The consistent competition in the cellular market (see section 3.1.8) has led to subscriber churn among the cellular operators and a price war which has led to substantial erosion of the average revenue per subscriber. These trends continued and even increased in 2015. In the reporting period the average revenue per subscriber decreased by 18% compared with the previous year.

With regard to revenue from hosting services see section 3.4.

Revenue from sale of terminal equipment

The opening of the market to parallel imports and multiple stores selling terminal equipment has led to a decline in the sales of cellular handsets and terminal equipment by the cellular operators. To minimize damage to revenues, Pelephone increased the range of equipment it sells and also sells non-cellular handset terminal equipment such as tablets, laptops and accessories. Pelephone's revenues from terminal equipment in 2015 amounted to NIS 891 million, constituting 31% of its total revenues compared with revenues in 2014 of NIS 966 million, which constituted 28% of total revenues. Most terminal equipment is sold with payments. The decrease in terminal equipment sales over the years has led to a decrease in trade receivables as well as a decline in trade payables to terminal equipment suppliers.

3.1.4 Market developments and changes in customer characteristics

The cellular market growth rate is lower due to penetration rate³⁷ saturation. Penetration rate at December 31, 2015 is 124%

3.1.5 Technological changes than can affect the segment of operation

The cellular communications market is dynamic with frequent technological developments in all areas of operation (handsets, network technologies and value added services). These developments impact the segment of operation on a number of levels:

A. Establishment of cellular networks using advanced technologies

Technology developments and the desire to widen the range and quality of services they offer, require the cellular operators to periodically upgrade their network technologies. The cellular networks in Israel primarily operate via 3.5G UMTS/HSPA and 4G LTE data technologies. In addition to these networks, Pelephone continues to operate its outdated CDMA technology network supporting limited subscriber activity (see Section 3.7.1).

Pelephone constantly reviews new technologies that come onto the market and the need to upgrade its existing network technologies, depending on the competitiveness of the market and the economic viability of such investment.

B. Allocation of 4G (LTE) frequencies

In August 2014 Pelephone launched its LTE network to provide LTE technology 4G services using a 5 MHz frequency bandwidth within the 1800 MHz spectrum it received from the Ministry of Communications.

In January 2015 Pelephone participated in a tender held by the State for the allocation of 4G (LTE) frequencies ("the Tender"). Under the Tender, Pelephone received 15 MHz within the 1800 MHz spectrum. The frequency allocation was executed in August 2015.

Pursuant to the provisions of the tender, receipt of a license for the frequencies is contingent upon an amendment to the existing license. Under license amendment, the requirements regarding deployment and quality of service via the 4G network are more stringent compared with the previous standards (regarding the launch of the LTE network, see section 3.7.1C). Further deployment of the network is currently underway.

C. Smartphones

The penetration of smartphones has led to a rise in the consumption of data transfer services while simultaneously increasing the supply of alternative applications and services to Pelephone's products and services provided by other entities. In addition, there has been an increase in the rate of smartphones that support LTE technology, a technology that allows better browsing. This increase has led to a further increase in consumption of 4G Data.

3.1.6 Critical success factors and the changes occurring in them

- A. Adapting Pelephone's cost structure and streamlining operations to enable Pelephone to confront the increased competition.
- B. Nationwide deployment of an advanced high-quality cellular network, regular maintenance of the high standard network and regular substantial investments in the cellular infrastructure for quality coverage of the entire country, the basis for providing Pelephone's services, and for providing customers with the most advanced services using cutting edge infrastructures and technologies. See also Section 3.7.1).

³⁷ Penetration rate - the ratio between the number of subscribers in the market and the total population in Israel (excluding foreign workers and Palestinians, although they are included in the number of subscribers).

- C. Diverse service and sales channels, including digital channels, enabling provision of high quality and efficient support and services for a wide range of customers, for successfully coping in a competitive market.
- D. A Brand that represents a high quality, reliable and state-of-the-art network.
- E. Top-notch and skilled work force.

3.1.7 Main entry and exit barriers

- A. Main entry barriers are:
 - 1. The industry penetration rate is high (see section 3.1.4).
 - 2. The need for a cellular license, allocation of frequencies involving high costs and a resource in short supply (see section 2.16.9), and the regulatory control of operations applicable to the market (see section 3.15.2).
 - 3. The need for significant financial resources for ongoing large-scale investments in infrastructures, which are affected by frequent technological developments (also see section 3.7.1C).
 - 4. The difficulty involved in setting up radio sites due to regulatory restrictions and public opposition.
- B. Main exit barriers are:
 - 1. The large investments and the time required to recoup them.
 - 2. The commitment to provide customers with services deriving from the terms of the cellular license and agreements made in accordance with those terms.

3.1.8 Structure of competition in the sector and changes occurring in it

A. General

As at reporting date there are five operators with cellular license operating in the cellular communications market in Israel (Pelephone, Cellcom, Partner, Golan Telecom and HOT Mobile) and a few MVNO operators with cellular licenses for hosting on another network, the main one being Rami Levy. The entry of new operators to the market since 2012 has led to fierce competition resulting in higher subscriber churn rates among the older operators, very substantial price erosion and eroded margins.

B. Entry and exit of MVNO operators

In 2012, subsequent to gaining the right to allocation of frequencies and operating licenses, Golan Telecom began operating as a new operator and HOT Mobile began operating a UMTS network. As part of their rights, the new operators undertook to establish independent nationwide networks (with temporary hosting on existing networks on a domestic roaming basis). In this regard see also sections C and D below).

In 2015 there were two main changes regarding this matter:

- 1. In January 2015, under the 4G frequency tender (see section 3.1.5A), Marathon 018 Ltd. ("Marathon 018") was awarded 5MHz bandwidth frequency, subject to compliance with the requirements under the tender. If Marathon 018 receives a cellular operator license, it will become the sixth non-MVNO operator.
- 2. In November 2015 Cellcom engaged in an agreement with Golan Telecom to acquire 100% of Golan Telecom's subscribers (also see section 3.6.3). This agreement, if it is approved, will reduce the number of infrastructure owning operators to four (or five if Marathon 018 is added as set out above).

To date Golan Telecom has not complied with its commitments under the provisions of its license to establish an nationwide independent network. If this

agreement is not approved, Golan Telecom will be required to operate on an infrastructure sharing basis (also see section 3.6.3).

C. Infrastructure sharing

In April 2015 the Minister of Communications approved a network sharing agreement between Partner and HOT Mobile with regard to operating active radio segment infrastructures. Subsequent to the foregoing approval, Partner and HOT Mobile set up a joint company that received a special license for provided cellular radio infrastructure services to a MVNO operator. This license is valid for 10 years.

The infrastructure sharing allows uniting the Company's sites to substantially reduce the radio sites' operating and maintenance costs.

D. Virtual operators - MVNO

Further to the government's decision to encourage competition in the cellular market, several MVNO licenses have been granted to virtual operators. Only a few holders of MVNO licensees operate on the private market, primarily Rami Levy.

In October 2015 Pelephone completed the acquisition of the MVNO operator, Alon Cellular Ltd. ("Alon Cellular"). Some of Alon Cellular's subscribers were hosted on Pelephone's network. As part of the acquisition, Pelephone gained approximately 70 thousand new subscribers.

For additional information about the structure of competition, see section 3.6.

3.2 Services and Products

3.2.1 Services

Description of the services Pelephone provides for its customers:

- A. **Basic telephone services (VOICE)** – basic voice services, call completion and auxiliary services such as call waiting, follow-me, voice mailbox, voice conference call and caller ID.
- B. **Browsing and data communications services** –internet browsing using 3G and 4G mobile devices.
- C. **Messaging service** – a service for sending and receiving SMS text messages and multimedia MMS messages.
- D. **Content services** - Pelephone offers its customers content services such as video services, Pelephone cloud backup and storage, anti-virus, a variety of televisions channels (Super TV) and a music library (Musix) that enables listening to a variety of music via mobile phone and PC.
- E. **Roaming services** - Pelephone offers roaming services to customers traveling to countries throughout the world by using their own personal handset, with roaming coverage in more than 220 countries. Pelephone also provides incoming roaming services for the customers of foreign operators staying in Israel.
- F. **Servicing and repair services** – Pelephone offers expanded repair and warranty services; for a monthly fee entitling the customer to mobile handset repair and warranty services, or for a one-time payment at the time of repair.

Pelephone provides these services to its subscribers as well as under hosting agreements.

3.2.2 Products

- A. **Terminal equipment** – Pelephone offers various types of mobile phones, on-board telephones, hands-free devices, and accessories that support its range of services. Pelephone also offers its customers other terminal equipment such as tablets, laptops, modems, television sets and game consoles.

In February 2016 Pelephone launched a private terminal equipment brand (GINI), including, in the first stage, the launch of several 4G device models and later will launch additional models of phablets and tablets.

3.3 Revenue from products and services

Breakdown of Pelephone's revenues from products and services (in NIS millions):

Products and Services	2015	2014	2013
Revenue from services	1,999	2,453	2,808
Percentage of Pelephone's total revenue	69.2%	71.7%	73.7%
Revenue from products (terminal equipment)	891	966	1,001
Percentage of Pelephone's total revenue	30.8%	28.3%	26.3%
Total revenue	2,890	3,419	3,809

3.4 Trade receivables

Breakdown of revenue from customers (in NIS million):

Products and Services	2015	2014	2013
Revenue from private customers	1,750	1,930	2,114
Revenue from business customers*	1,140	1,490	1,695
Total revenue	2,890	3,419	3,809

* The revenue from business track customers includes revenue from hosting agreements which amounted to NIS 46 million in 2015 (NIS 244 million in 2014).

At the end of 2015 Pelephone has 2.65 million subscribers.

It is noted that Pelephone has 925,000 pre-paid subscribers (customers who pay for communications services in advance), the revenues from these customers are not material in relation to Pelephone's total revenues.

In addition to Pelephone's abovementioned subscribers, who are end customers actually using Pelephone's network, Pelephone provides services under hosting agreements to other cellular operators that use Pelephone's network to provide services to their customers. Most of the income in 2015 came from Rami Levy and Alon Cellular. Most of the income in 2014 came from HOT Mobile, whose hosting agreement ended in December 2014.

3.5 Marketing, distribution and service

Pelephone's distribution system includes service and sales centers dispersed throughout the country that provide customer service, sales, repair and customer retention services. This distribution network is reinforced with stores and point of sale stands (some of which are operated by Pelephone employees, and others by authorized dealers). In addition, Pelephone operates through an external sales network. As a rule, these dealers are paid a commission on sales.

Pelephone's subscriber service network includes its website and special purpose call centers which provide information and service regarding various matters in three languages, technical support, information regarding customer billing, value added services, sales and general information.

3.6 Competition

3.6.1 General

As part of the regulatory measures adopted by the Ministry of Communications in recent years with the aim of increasing competition in the cellular telephony market, since 2012 several additional cellular operators entered the market. The entry of the new operators led to substantial increase in competition among all the cellular operators. The increased competition led to an increase in subscriber churn among the existing operators and to a

fierce price war that increase from year to year, leading to substantial erosion of prices and profit margins, in the private customer market as well as the business customer market. These trends continued and even increased in 2015.

Pelephone expects these trends to continue in 2016, leading to further erosion of revenues and profitability. Pelephone is introducing streamlining measures and cost structure adjustments in an effort to reduce the impact on profit margins.

Pelephone's foregoing estimates are forward-looking information, as defined in the Securities Law. These estimates may not materialize, may materialize in part or in a manner materially different from that forecast.

Breakdown, to the best of Pelephone's knowledge, of the number of subscribers of Pelephone and of its competitors in 2014 and 2015 (thousands of subscribers, approximate).

		Pelephone	Partner	Cellcom	Golan Telecom ⁽¹⁾	HOT Mobile	MVNOs ⁽¹⁾	Total subscribers in market
At Dec 31, 2014	No. of subscribers ⁽²⁾	2,586	2,837	2,967	630	974	130	10,124
	Market share	25.5%	28.0%	29.3%	6.2%	9.6%	1.3%	
At Dec 31, 2015	No. of subscribers ⁽²⁾	2,651	2,718	2,835	850	1,229	80	10,363
	Market share	25.6%	26.2%	27.4%	8.2%	11.9%	0.8%	

- (1) Golan Telecom and most of the other MVNOs are private companies which do not publish figures regarding the number of their subscribers and these figures are based on estimates.
- (2) The number of subscribers as at December 31, 2015 and December 31, 2014, are based on the public reports issued by Cellcom, Partner and HOT Mobile.

3.6.2 Regulatory measures and legislative amendments that increased competition in the segment

Over the past few years, the Ministry of Communications has promoted various regulatory measures for increasing competition in the cellular market. These measures have had immense impact on the structure of the market and its competition. Below is a description of other measures promoted by the Ministry in order to increase competition in the industry:

A. Infrastructure sharing

Further to the recommendations of an inter-ministerial team established by the Ministry of Communications, in May 2014 the Ministry published a "Policy for sharing broadband access networks belonging to holders of a general license, for providing mobile radio telephone services" paper ("the Policy Paper").

The main points of the policy paper are:

1. The Ministry of Communications 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 of Communications believes that active sharing of antennae, frequencies and radio equipment (multi-operator core network (MOCN)) is preferable to active sharing of antennae and radio equipment without the sharing of frequencies (multi-operator radio access network (MORAN)), in view of the need to streamline the frequency spectrum. However, the Ministry does not rule out the possibility that under special circumstances, it might consider it appropriate to approve a MORAN agreement if requested.
3. In general, the Ministry of Communications will allow the sharing of transmission from cellular sites to centralized radio-based stations in a bandwidth-sharing configuration, nonetheless, under exceptional conditions, and at the Ministry's

discretion, it might allow sharing of transmission from the cellular sites to centralized radio-based stations in other cases as well.

4. When reviewing individual network-sharing agreements, the Ministry of Communications will take into account the considerations specified in the Policy Paper, with regard 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 for examining each individual network-sharing agreement submitted for its approval, which provide, among other things, that MOCN based sharing will not be allowed for two cellular operators with fully deployed 3G network, but may be considered regarding a new operator with a partially deployed 3G network with an established operator with a fully deployed 3G network, and that the Ministry will allow MOCN based sharing, provided that at least 3 independent wireless access networks are being operated in every region in Israel. Other conditions are also prescribed in the Policy Paper.
6. The Ministry of Communications does not intend to permit any sharing of radio 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.
7. The Minister of Communications will consider revoking all or some of the network sharing approvals, depending on the circumstances, if it emerges that the level of competition, coverage or customer service are harmed.

B. Hosting prices for MVNO operators

In June 2014 the Ministry of Communications announced a hearing on the ruling, that in hosting agreements drawn up between cellular operators and MVNOs, the cellular operators may 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.

In November 2014 an order was received from the director of the Ministry of Communications regarding a mechanism for testing if the price charged from a MVNO is reasonable, based on the steps set out in the decision.

C. Consumer amendments to license

In February 2016 the Ministry of Communications announced a hearing under which it proposes a large number of amendments to the cellular companies' licenses regarding consumers. Pelephone is reviewing the various issues and their ramifications and is expected to file its response to the hearing in April 2016.

3.6.3 Infrastructure sharing agreements and providing right of use of networks

A. Partner - HOT Mobile

In April 2015 Partner and HOT Mobile announced that the Minister of Communications had approved the agreement between them for active radio segments network sharing, to establish a partnership to maintain, develop and operate a single state-of-the-art cellular network for both companies, in which each company will hold 50% of the rights. Subsequent to the foregoing approval, Partner and HOT Mobile set up a joint company that received a special license for provided cellular radio infrastructure services to a MVNO operator. This license is valid for 10 years.

B. Cellcom - Golan Telecom

In 2014 Cellcom announced that it had signed a 4G network active radio segment sharing agreement with Golan Telecom that had been hosted on Cellcom's network since its establishment. This agreement is in addition to the agreement to provide usage rights on the 2G and 3G networks, as aforesaid, which Cellcom had signed with Golan 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 components at the cellular sites.

In March 2015 the Minister of Communications announced that the infrastructure sharing agreements between Cellcom and Golan Telecom require essential amendments before the Ministry of Communications will re-examine the agreements in detail. With regard to the agreement for Cellcom to acquire Golan Telecom see section D below.

C. Pelephone - Cellcom

In September 2014 Pelephone engaged in a collaboration agreement with Cellcom for the maintenance of passive components at the cellular sites owned by Pelephone and Cellcom, by reducing costs through sharing the passive network components at these sites (including antennae), and for executing the establishment and maintenance of the shared sites, through a supplier that will be selected by Pelephone and Cellcom together. The supplier that will be chosen through a tender will sign separate agreements with Pelephone and Cellcom for a period of at least 5 years.

In July 2015 the Antitrust Commissioner's decision was received, that the foregoing engagement will be exempt from the conditions for approval of a restrictive agreement. The exemption was given, among other things, with the terms set out in the approval. Pelephone and Cellcom have not yet, at this stage, executed the engagement in practice. At the same time, Pelephone is reviewing executing a project for lowering the maintenance costs of the passive components internally by Pelephone's employees.

The infrastructure sharing model contains potential for reducing the costs for establishing and ongoing operation of the network. Consequently, if Pelephone does not receive permission to operate under any network sharing model, the costs of Pelephone's 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 of future impact of the policy paper on 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 of the impact of approval or non-approval for Pelephone operating under an infrastructure sharing model on the costs of its network.

D. Sale of Golan Telecom

In November 2015 Cellcom engaged in an agreement with Golan Telecom to acquire 100% of Golan Telecom's subscribers. The agreement contains various terms that include, among other things, obtaining the approval of the Ministry of Communications and the Antitrust Commissioner.

3.6.4 Positive and negative factors that affect Pelephone's competitive status

A. Positive factors

1. An extensively deployed high quality cellular network.
2. Its positioning as a high-speed, cutting edge cellular network.
3. A service array and diverse service interfaces for the customer, enabling a high grade of customer service.
4. A wide distribution network specialized in providing appropriate solutions for every type of customer, and skilled human resources.
5. Robust equity structure and positive cash flow.

B. Negative factors

1. As a subsidiary of Bezeq, Pelephone is subject to regulatory restrictions for entering other areas of operation and expanding the service bundles it can offer its customers, which do not apply to its competitors.

2. Restrictions of joint activities with the Company, including marketing of joint service bundles (see section 1.7.2).
3. The establishment, operating and maintenance costs of Pelephone's cellular networks are expected to be much higher if the infrastructure sharing agreements of the competitors are approved.

3.7 Property, plant and equipment

Pelephone's property, plant and equipment include its core network infrastructure equipment, radio sites, electronic equipment, computers, motor vehicles, terminal equipment, office furniture and equipment and leasehold improvements.

3.7.1 Infrastructure

A. Pelephone currently operates communications networks using three main technologies:

1. LTE 4G technology is based on GSM standards. The advantages of this technology are larger data communication capacity and faster download rates than with the 3G technologies. All the terminal devices that support this technology also support the 3G technologies and the transition between the technologies is seamless.
2. UMTS/HSPA, a digital technology based on the GSM (3G) standard. This technology is globally widespread, and enables subscriber identification and services to be provided through a SIM card, which can be moved from one handset to another. This technology supports download speeds of up to 42 Mbps and upload speeds of up to 5.7 Mbps.
3. CDMA technology. CDMA digital technology, which is less widespread than UMTS/HSPA and in which subscriber identification is by the identification of details burned onto his terminal equipment rather than by means of a SIM card. To date, this network serves a limited number of subscribers who seldom use the network. Pelephone is making efforts to move its existing subscribers from the CDMA network to the UMTS/HSPA network and is not expanding its investments in this network, other than what is required for ongoing maintenance.

B. As at the date of publication of this report, the infrastructures for Pelephone's networks are mainly based on two switch farms, which are connected to more than 2,280 sites.

C. Launching of the LTE network

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 implement additional adjustments to the network to support LTE. The equipment that will be supplied to Pelephone will also support Advanced 4.5G LTE technology.

In September 2014, the engagement with Pelephone was expanded and a three year framework agreement was signed, under which Ericsson will be Pelephone's exclusive supplier for expanding the deployment of the 4G LTE radio network.

The costs of establishing the network (payments to Ericsson and additional costs linked to the deployment and adaptation of the network) for 2014 through 2017 is expected to amount to NIS 600 million, including the cost of NIS 96 million for acquiring the frequencies. As at the end of 2015, in practice costs in the amount of NIS 350 million was invested, including costs for acquiring the frequencies, as set out above. In addition, over the coming decade Pelephone will be required to continue establishing new broadcasting sites, among other things to comply with the terms of the cellular license. With regard to the frequencies tender, see section 3.1.5A.

Pelephone's foregoing 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, regarding the speed of expanding and updating the network.

3.7.2 Premises used by Pelephone

Pelephone does not own land, and leases premises from others, including the Company, for its operations. Below is a description of the main premises used by Pelephone:

- A. The premises Pelephone uses for setting up its communications sites and network centers, as referred to in section 3.7.1, are spread throughout the country and are leased for varying periods (in many cases, for 5 years with an option to extend for a further 5 years). With regard to licensing of the sites, see Section 3.15.3.
- B. Pelephone has a permit agreement with the Israel Lands Administration (ILA). The permit agreement for the use of ILA land for erecting and operating communication sites regulates, inter alia, permit fees for such use until December 31, 2019.
- C. Pelephone's head offices are in Givatayim and cover a total area of 17,800 sq.m. The rental period is until December 31, 2020, and includes an option for early termination of the agreement, under certain conditions, from December 31, 2017.
- D. For its sales and service operations, Pelephone leases service centers and points of sale throughout the country.
- E. Pelephone has other lease agreements for warehouses (including a main logistics center where the central laboratory for repairing customer devices is located), offices, call centers, and two switch farms that it uses for its operations.

3.8 Intangible assets

3.8.1 Licenses

For details about Pelephone's cellular license and its license to operate in the Administered Territories, see section 3.15.2.

3.8.2 Frequency usage rights

Under its cellular license and the Wireless Telegraph Ordinance, Pelephone has rights of use of frequencies in the 850 MHz spectrum for operating the CDMA network, and in the 850 MHz and 2100 MHz spectrums to operate the UMTS/HSPA network, and in the 1800 MHz spectrum for operating the LTE technology network (see also section 3.15.1.B).

For information regarding the shortage of frequencies in Israel, see sections 3.1.5B.

For information concerning exposure to disruptions in the frequency ranges used by Pelephone, see section 3.20.3F.

3.8.3 Trademarks

Pelephone has a number of registered trademarks; its primary trademark is "Pelephone".

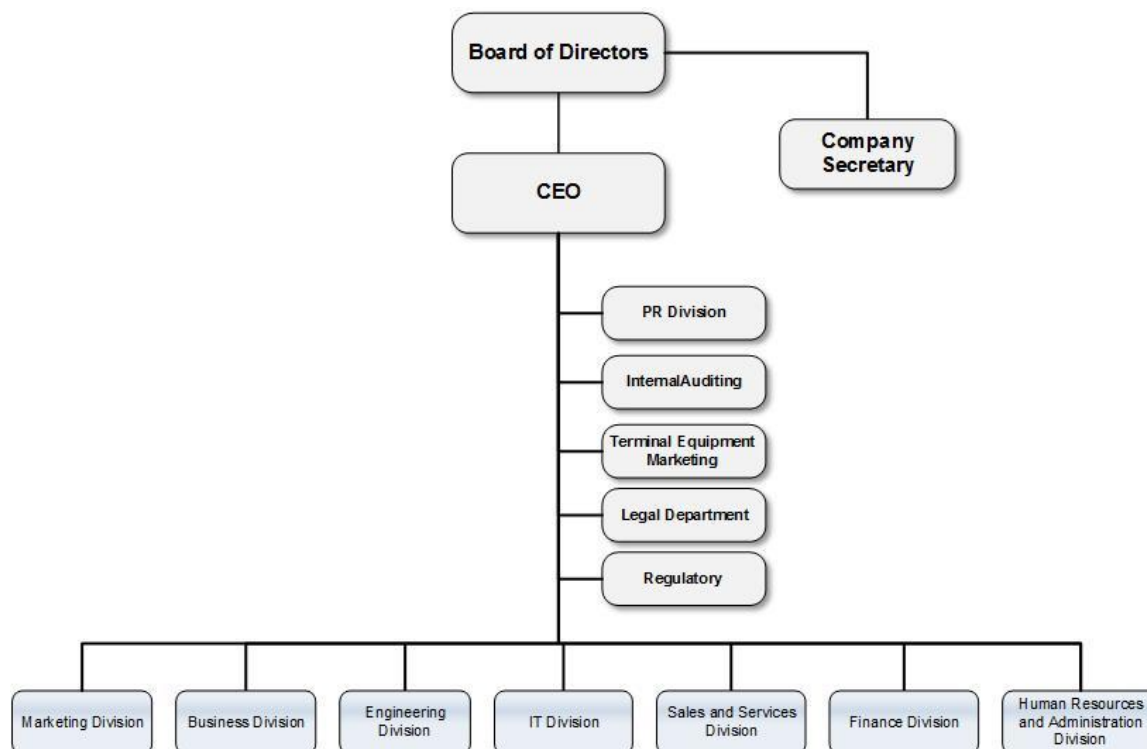
3.8.4 Software, computer systems and databases

Pelephone uses software and computer systems, some under purchased licenses and others which were developed by Pelephone's IT department. Many of these licenses are limited in time, and are periodically renewed. The primary systems used by Pelephone are: Oracle Application ERP system and Amdocs customer management and billing system.

3.9 Human resources

3.9.1 Organizational structure

Pelephone's organizational structure at reporting date:



3.9.2 Collective agreement

In December 2013, Pelephone signed a collective labor agreement between Pelephone and the New General Federation of Workers and Pelephone's workers committee (the "Committee"), which will apply to all Pelephone's employees, other than its senior management and certain employees in predefined positions. The agreement stipulates that Pelephone employees employed at date of signing of the agreement will receive employment tenure after 36 months and 48 months for new employees joining Pelephone subsequent to signing. In addition, the agreement sets out mechanisms for integrating the Committee in processes relating to placement, mobility and termination of employment of Pelephone's tenured employees.

The agreement also set quotas for streamlining layoffs to be made at Pelephone and severance pay for tenured employees whose employment will be terminated due to such streamlining, as well as annual wage hikes and other financial perks (such as participation in summer-school costs and social activities) which Pelephone will grant its employees during the agreement period.

The agreement is valid from date of signing through December 31, 2016. Thereafter the agreement will automatically be renewed for further period of 18 months each, unless one of the parties gives notice of their intention to change the agreement.

3.9.3 Inventory of positions

Breakdown of the number of employees at Pelephone, based on its organizational structure.

Department	Number of employees	
	December 31, 2015	December 31, 2014
Management and HQ	186	201
Marketing	43	46
Service – Private customers	1,424	1,719
Business customers	375	362
Logistics and terminal equipment division	185	199
Engineering and information systems	466	474
Total	2,679 ³⁸	3,001

The total number of employees in the above table includes employees employed in part time positions. The total number of positions³⁹ at Pelephone at December 31, 2015 was 2,234 (at December 31, 2014 - 2,515).

3.9.4 Remuneration plans for employees and managers

Pelephone customarily gives its employees and managers bonuses and incentives on a monthly, quarterly or annual basis, based on compliance with defined goals and the type of work carried out by the employee.

3.9.5 Terms of employment

The majority of Pelephone's employees are employed under monthly or annual contracts, based on the professions and positions in which they are employed. Most of the service and sales employees are shift workers who work part time and are employed on an hourly basis. Pelephone's other employees are employed under monthly contracts, and some of them are employed under a monthly contract with a global addition for extra hours. The employment contracts include confidentiality, non-competition, and intellectual property restrictions.

3.9.6 Voluntary retirement

In 2015 it was decided to retire 46 employees under a voluntary redundancy plan with an increased compensation track, at a total cost of NIS 5 million. These employees retired at the beginning of 2016.

3.9.7 Announcement of a labor dispute

On August 3, 2015 Pelephone was informed by the New General Federation of Workers - Cellular, Internet and High-Tech Workers Union that a labor dispute was announced pursuant to the Settlement of Labor Disputes Law, 1957 and strike starting August 17, 2015 onwards ("the Announcement"). According to the Announcement, the issues under dispute are Pelephone's unilateral decisions regarding: Organizational / structural changes that impact working conditions and the expansion of the business segments and their scope that Pelephone outsources. The employees demand negotiations regarding these issues.

Pelephone rejected the claims of the Workers Committee against it, and several meetings were held with the representatives of the Workers Committee under which it presented its detailed responses to the claims of the Workers Committee. Pelephone filed an application to the Regional Labor Court for interim relief to prevent continuing sanctions and labor disruptions ("the Application"). In September 2015 a hearing was held on the Application,

³⁸ Including 46 employees who retired from Pelephone under a voluntary redundancy plan at the beginning of 2016, as set out in section 3.9.6.

³⁹ The number of positions at Pelephone were calculated as follows: Total monthly work hours divided by the standard monthly work hours.

at the end of which the parties accepted the recommendation of the Court to continue intensive negotiations under the auspices of the Court and without either party taking actions. The parties requested another extension from the Court during which they will report the outcome of the negotiations. The next hearing was set for the beginning of May 2016.

3.9.8 Replacement of CEO

In October 2015 the CEO of Pelephone, Mr. Gil Sharon, announced the termination of his office. His replacement, Mr. Ran Guron, who served as Deputy CEO and VP Marketing of the Company, took office in November 2015.

3.10 Trade payables

3.10.1 Suppliers of terminal equipment

Pelephone purchases some of the terminal equipment and accessories from various importers in Israel and worldwide, and others it imports independently. In addition, Pelephone sells terminal equipment and accessories on consignment with the right to return terminal equipment to the suppliers. The agreements with most of the suppliers are based on framework agreements that set out, among other things, the supplier's technical support for the terminal equipment it supplies, the availability of spare parts and repair turnaround, as well as the supplier's product warranty as required by law. Most of these agreements do not include a purchase commitment on Pelephone's part, purchases are made on a regular basis by means of purchase orders based on Pelephone's needs.

In the event of termination of an engagement with a supplier of certain terminal equipment, Pelephone can increase quantities of terminal equipment purchased from other suppliers or purchase terminal equipment from a new supplier.

In May 2013, Pelephone signed an agreement with Apple Distribution International ("Apple") to continue purchasing and distributing iPhone devices in Israel. Under this agreement, Pelephone is required, under certain circumstances, to purchase a minimum annual quantity of devices for a period of three years at the manufacturer's current prices at date of purchase. Pelephone estimates that, as in recent years, these quantities will constitute a significant number of devices it expects to sell during the contract period.

The information in this section includes forward looking information based on Pelephone's past experience, estimates and projections. The actual outcome may differ significantly from the foregoing estimates, taking into account, inter alia, changes that may apply to the business conditions and consumer demand for Apple products.

In 2015, Pelephone's purchases from Apple accounted for less than 10% of its total purchases from all its suppliers. Other than Apple, the distribution of the purchase of terminal equipment among the suppliers is such that it does not create any significant dependence on a particular equipment supplier or model.

3.10.2 Infrastructure suppliers

Pelephone uses Ericsson UMTS/HSPA and LTE infrastructure equipment and Nortel and Motorola CDMA infrastructure equipment. Pelephone has long-term agreements with Ericsson for maintenance, support and upgrading of software for the UMTS/HSPA and an agreement for the deployment of the 4G LTE networks with Ericsson, and in its opinion, it may become dependent on Ericsson regarding support for this network and its expansion. In the opinion of Pelephone, it could become dependent on Ericsson in connection with support for this network. In addition, the cellular network uses transmission, for which the Company is Pelephone's main supplier.

3.11 Working capital

3.11.1 Working capital as defined in generally accepted accounting principles.

Pelephone's working capital in 2015 amounted to NIS 972 million and included current assets such as: cash and cash equivalents, trade receivables, other receivables, debit

balances and inventory, amounting to NIS 1,420 million; less all current liabilities such as trade and other payables, in an amount of NIS 448 million.

3.11.2 Credit policy

Credit in handset sales transactions – Pelephone grants most of its customers who purchase cellular handsets an option to spread payment up to 36 equal installments. In order to reduce its possible exposure from providing its customers credit, Pelephone acts according to a credit policy that is reviewed from time to time. Pelephone also examines the financial stability of its customers (based on parameters that it sets).

Pelephone discounts customers' debts arising from the sale of terminal equipment in transactions paid by credit card in installments. The discounting transactions are carried out on a non-recourse basis.

Credit in monthly billing for cellular services – Pelephone customers are billed once a month in billing cycles on different days throughout the month, for service consumption during the previous month.

From most of its suppliers, Pelephone receives credit for periods ranging from 30 days to EOM + 92 days.

Breakdown of average customer and supplier credit in 2015:

	Credit in NIS millions	Average credit days
Customers for sales of terminal equipment (*)	1,078	374
Customers for services (*)	320	49
Trade payables	392	44

(*) Net of doubtful debts.

3.12 Financing

3.12.1 General

Pelephone's operations are financed out of cash flow from operating activities. In 2015 Pelephone repaid the balance of its liabilities in an amount of NIS 93 million.

3.12.2 Credit facilities

As at December 31, 2015, Pelephone has no approved bank credit facilities.

3.12.3 Pelephone' preparations for raising capital during the coming year and its sources

Although Pelephone intends further investment in property, plant and equipment (mainly in the LTE network, see section 3.7.1), it estimates that it will not be required to raise finance in 2016 for its ongoing operations.

The foregoing information includes forward-looking information, as defined in the Securities Law, which is based on the company's estimates and business experience. The actual results may differ significantly from that set out above if any of the company's estimates do not materialize, including with regard to the scope or terms of investment in property, plant and equipment.

3.13 Taxation

See Note 6 to the 2015 financial statements.

3.14 Environmental risks and means for their management

3.14.1 Statutory provisions relating to the environment applicable to Pelephone's operations

The broadcasting sites used by Pelephone are "radiation sources" as defined in the Non-Ionizing Radiation Law. The erection and operation of these sites, excluding those listed in the addendum to the law, requires a radiation permit.

The law prescribes a two-step licensing mechanism for obtaining a radiation source operating permit under which the applicant first applies for a permit to construct a radiation source ("the Erection Permit"), which will be in effect for no more than three months and may be extended by the Commissioner for up to nine months, then for a permit to operate the radiation source ("the Operating Permit"), which will be in effect for five years or as otherwise determined by the Minister for Environmental Protection.

With regard to the Erection Permit, the law provides that the permit is contingent upon assessment of the maximum radiation levels to which human beings and the environment are expected to be exposed from the radiation source when in operation, including in the event of a malfunction, and the required measures for limiting the levels of exposure of human beings and the environment to the expected radiation from the radiation source when operating, including implementation of technological means that are in use ("the Limiting Measures").

With regard to the Operating Permit, the law provides that the permit is contingent upon application of the Limiting Measures and to measuring the levels of exposure of human beings and the environment to the radiation generated while the radiation source is operating. The law further provides that the Operating Permit is contingent upon presentation of a license under the Communications Law and in certain cases, also of a construction permit pursuant to the Building and Planning Law.

The law includes a punitive chapter under which, inter alia, the construction or operation of a source of radiation in contravention of the provisions of the permit and the construction or operation of a source of radiation without a permit, after having been warned in writing by the Commissioner, are strict liability offenses.

A limited number of town planning engineers operated in accordance with the mechanism prescribed in the Law and submitted their objections to providing an Operating Permit for one or another access facility.

It should be noted that regulation of the maximum permissible human exposure levels to radiation from a source of radiation and the safety ranges from communication broadcasting installations, including a limit on the placing of radiation masts on roof terraces, is still making its way through the Knesset's Interior Committee for Environmental Quality, as part of a proposed amendment to the regulations under the Non-Ionizing Radiation Law (the "Regulations") which was accompanied by disagreements between the government ministries.

In January 2009, the Radiation Supervisor at the Ministry of Environmental Protection published guidelines regarding safety ranges and maximum permitted exposure levels with respect to radio frequency radiation, including from cellular antennae.

A discussion by the Knesset's Interior Committee for Environmental Quality on May 4, 2011 resolved to request that the Minister for Environmental Protection delete, inter alia, the instruction distinguishing between a balcony and a roof terrace with regard to the prohibition on erecting and operating a source of radiation, from the wording of the proposed amendment to the regulations. The Minister of Environmental Protection replied to the committee chair that his ministry cannot agree to the request. In view of the above, promulgation of the amendment has been delayed.

On May 31, 2011, the World Health Organization's International Agency for Research on Cancer (IARC) published an announcement to the effect that radio frequency electromagnetic fields associated with the use of mobile phones may be carcinogenic to humans (Group 2B).

In this matter, it should be noted that from time to time, various documents are published on the websites of the Ministry of Environmental Protection at www.sviva.gov.il and of the World Health Organization at www.who.int.

It is further noted that the Ministry of Environmental Protection continuously monitors and supervises the broadcasting sites, operating a system which allows the computerized recordings from the control system at the broadcasting sites, to be used for checking and verifying that the broadcasting sites are in compliance with the Ministry's requirements.

Cellular services are provided through a cellular phone which emits non-ionizing radiation (also known as electromagnetic radiation). Consumer Protection Regulations (Information regarding Non-Ionizing Radiation from a Cellular Telephone) 2002, specify the maximum permitted radiation level for a cellular phone which is measured in units of Specific Absorption Rate (SAR) and requires that Pelephone informs its customers accordingly. To the best of Pelephone knowledge, all the cellular phones that it markets comply with the relevant SAR standards. Also see section 3.20.2E.

3.14.2 Pelephone's environmental risk management policy

Pelephone conducts periodic radiation tests to ascertain its compliance with permitted operating and international standards. These tests are outsourced and carried out by companies authorized by the Ministry of Environmental Protection. Pelephone applies an internal enforcement procedure for monitoring implementation of the provisions of the Non-Ionizing Radiation Law, under the supervision of a senior manager. The purpose of the procedure is to assimilate the provisions of the law and limit the possibility of violation.

3.14.3 Transparency for consumers

Pelephone is subject to relevant laws prescribing obligations to publicize and inform customers about the radiation sources that it operates and from the mobile handsets that it supplies. The Radiation Supervisor at the Ministry of Environmental Protection publishes information on the ministry's website concerning active cellular broadcasting facilities and those under construction. The Ministry for Protection of the Environment continuously monitors the cellular broadcasting facilities that Pelephone erects and operates, as it does to the other operators. Pelephone publishes information on its website regarding radiation emitted from cellular phones and Ministry of Health regulations regarding preventive caution to be taken when using cellular phones.

3.15 Restrictions on and control of Pelephone's operations

3.15.1 Statutory limitations

A. Communications Law

The cellular services provided by Pelephone are subject to the provisions of the Communications Law and its regulations. For details of the cellular permit granted to Pelephone under the Communications Law, see section 3.15.2.

The law authorizes the Director General of the Ministry of Communications to impose financial sanctions for violations of the provisions of the law and of orders and directives issued thereunder, and for violation of the terms of the license.

B. Wireless Telegraph Ordinance

See section 2.16.9 above, which is also applicable to Pelephone's operations.

For the allocation of radio frequencies to Pelephone, see section 3.8.2.

C. Installations emitting electromagnetic radiation – see section 3.14.

D. Consumer Protection Law

Pelephone's operations are subject to the Consumer Protection Law which regulates the obligations of an operator vis-à-vis consumer.

E. Change in interconnect fees (call completion fees)

Interconnect rates are fixed by the regulator. For details, see section 1.7.4B.

3.15.2 Pelephone's cellular licenses

A. General

Pelephone's cellular license is valid until September 8, 2022⁴⁰.

Furthermore, in April 2001, the Civil Administration for the Administered Territories granted Pelephone a general license for providing cellular services in the Administered Territories. The license is valid until September 2022 and the provisions of the general license granted to Pelephone by the Ministry of Communications (with certain adjustments) are applicable to it.

Breakdown of the primary provisions of Pelephone's cellular license:

1. Under certain circumstances, the Minister may modify the terms of the license, restrict or suspend it, and in certain instances even revoke it.
 2. The license is non-transferable and contains restrictions on the acquisition or transfer (including by way of a charge), directly or indirectly, of control or of 10% or more of any means of control in Pelephone, including a pledge on said means of control, unless the Minister has given prior consent.
 3. Pelephone is obliged to provide interconnect services to all other operators at equal terms and it must refrain from any discrimination in carrying out such interconnect service.
 4. Pelephone must refrain from granting infrastructure service priority to an affiliate licensee company (as defined in the license) over another licensee.
 5. Pelephone may not sell, lease or mortgage any of the assets used for the implementation of the license without the consent of the Minister of Communications, other than certain exceptions as set out in the license.
 6. In times of emergency, whoever is statutorily competent shall have the authority to issue Pelephone with certain instructions on its mode of operation and/or manner of provision of services (see section 3.20.2H).
 7. The license stipulates the types of payments Pelephone may bill its subscribers for with regard to cellular services, and the reports it is required to submit to the Ministry of Communications. The license also determines the Minister's power to intervene in tariffs, in certain cases.
 8. The license obligates Pelephone to a minimum standard of service.
 9. To secure Pelephone's undertakings and to compensate and indemnify the State of Israel for any damage that may be caused by acts committed by Pelephone, Pelephone is required to furnish a bank guarantees to the Ministry of Communications. In May 2015 Pelephone deposited guarantees in the amount of NIS 80 million to the Ministry of Communications, which replaced the previous guarantees given in the amount of USD 10 million, as required under the 4G LTE frequency allocation tender (see section 3.1.5B).
- B. With regard to the amendment to Pelephone's license for providing 4G LTE services see section 3.1.5B).
- C. Hearing in regard to the required coverage and quality

In July 2014, the Ministry of Communications published a hearing directed to holders of a general license for providing cellular services, including Pelephone ("the Operators"). The hearing discusses an amendment to the Operators licenses that 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

⁴⁰ The text of Pelephone's cellular license is published on the Ministry of Communications website at www.moc.gov.il

Administered Territories ("the Hearing"). Pelephone submitted its comments and reservations to the hearing. If the systems cover and quality requirements are tightened, as specified in the hearing, Pelephone and the other operators are likely to face significant costs.

D. Functional continuity in emergency situations

For details, see section 1.7.4G.2.

3.15.3 Site construction licensing

Pelephone's cellular service is provided, inter alia, through cellular sites deployed throughout Israel in accordance with engineering requirements. The constant need to upgrade and improve the quality of cellular services necessitates setting up cellular sites, configuration changes and changes in existing deployment of antennae.

Pelephone uses two main types of broadcasting sites along two tracks: macro sites that require a building permit from planning and construction committees (see reference to NOP 36) and wireless access devices ("access devices"), which are exempt from a building permit in accordance with Section 27 of the Communications Law and Section 266(C) of the Building and Planning Law ("the Exemption Provision").

Building permits under NOP 36

Licensing for the construction of cellular broadcasting sites that require building permits is governed under NOP 36, which came into force in 2002.

The NOP 36 licensing process requires, inter alia, that several approvals and permits be obtained from government authorities and regulators, including: a) An erection and operating permit from the Ministry of Environmental Protection, as set out in section 3.14.1; b) approval of the Civilian Aviation Administration in certain cases; c) IDF approval.

In addition, by law, as a condition for obtaining a permit for erecting a cellular communications broadcasting facility a deed of indemnity must be submitted to the local committee for impairment compensation claims. At the date of this update, Pelephone has deposited 234 indemnity notes with various local councils in accordance with the law.

Despite NOP 36 in its existing format, Pelephone (and its competitors) encounter difficulties in obtaining some of the required approvals, and in particular approvals from planning and construction authorities.

At the same time, criticism has been leveled at NOP 36 by various entities (including the argument that it is not applicable to 3G frequencies), which has led to a proposal to amend NOP 36 in a few rounds ("the Proposed New NOP 36A").

Licensing the construction of cellular broadcasting sites that require building permits is governed by NOP 36, which came into force in 2002. The amended NOP 36 is currently pending government approval.

As part of the "pergola reform" - 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 provides, among other things, that the addition of an antenna to an existing, lawful broadcasting facility is exempt from a permit, subject to compliance with a combination of conditions and exclusions, including consistency with the plans and the applicable spatial instructions, to be determined by the local planning committees.

On July 27, 2014 the Forum for Cellular Sanity and others filed a petition to the High Court of Justice ("HCJ") for an order nisi instructing the Minister of Interior to explain, inter alia, why Regulation 34 of the Planning and Building Regulations (Works and Buildings that are Exempt from a Permit), 2014 is invalid or alternatively, should be revoked, and to issue an order nisi deferring entry into force of Regulation 34 from August 1, 2014 until a ruling is issued otherwise under the petition.

On August 3, 2014 the State's response to the petition for an order nisi was filed to the HCJ, according to which, inter alia, the State's position is that the petition for an order nisi

should be denied due to the absence of any grounds for deferring the entry into force of Regulation 34. Pelephone's response to the petition for an order nisi was filed on August 10, 2014 under which Pelephone requests that the Court deny the petition.

In view of the foregoing, the HCJ handed a ruling on August 14, 2014 according to which, inter alia, HCJ does not accede to the petition for an order nisi and the petition will be heard.

On March 9, 2015 a hearing was held on the petition in HCJ and the petitioners arguments were heard, claiming that the petition in question is related to another petition, HCJ 5045/09 Forum for Cellular Sanity v. Attorney General and others, for which an order nisi was granted and arguments were heard (hereunder in this section: "the Other Petition"), and the link between the petitions should not be severed. In this context HCJ decided to defer the hearing on the petition until after a ruling is handed on the Other Petition. HCJ further stipulated, inter alia, that if a ruling is not handed on the Other Petition within 6 months, the petitioners may return and request that a hearing be held. HCJ further stated that the parties will be notified when a ruling is handed on the Other Petition, and the case will be noted in an internal reminder for another six months.

More than six months after the date of the hearing on the Petition and in the absence of a ruling in the Other Petition, application was filed with the High Court of Justice on January 21, 2016 for fixing a hearing on the Petition filed by the Forum for Cellular Sanity. In view of the foregoing, on January 25, 2016 the HCJ handed a ruling according to which the case will be fixed for a hearing before a panel and on January 28, 2016 a summons was received according to which a hearing was set for July 18, 2016.

Access devices exempt from building permits

The second track under which Pelephone sets up broadcasting sites is the access facility track. Access installations require specific radiation permits under the Radiation Law but are exempt from building permit if they are constructed pursuant to the conditions provided in the exemption provision.

Some local authorities have disputed the applicability of the exemption provision on cellular network access installations and their use. Pelephone's position on the applicability of the exemption was accepted in a number of rulings and decisions by local affairs courts and the use of such facilities and the supporting equipment was approved. Appeals have been filed against some of these rulings and decisions, some of which are still pending before the Supreme Court.

On September 9, 2009, the Attorney General summarized his position on the legal issue of access installations, according to which the Frequency Regulations for Access Installations, which contain the building permit exemption for wireless access installations as prescribed in Section 266C of the Building and Planning Law, were duly promulgated by authority and by law.

Nevertheless, the Attorney General determined that in view of the legal and factual changes which have occurred over the years since the regulations were promulgated, and in view of their importance, which were discussed and clarified during the team's deliberations and in its report, the arrangement in its present format does not properly balance the interest of efficiency and competition with the interests embodied in the Building and Planning Law.

The Attorney General further stipulated that the Ministries of the Interior and Communications shall, by the end of October 2009, file amendments which will prescribe conditions limiting and restricting the applicability of the building permit exemption and use thereof.

On June 16, 2009, the Forum for Cellular Sanity and others filed a petition (this petition was preceded by another petition to local government dated July 2008 which centered on the issue of access installations) to the High Court of Justice ("HCJ") for an order nisi instructing the Attorney General to explain, inter alia, why the State Prosecutor's response regarding Pelephone's application for leave of appeal must not be withdrawn, and to explain why the enforcement instructions issued to the urban claimants by the Attorney General should not be canceled, whereby indictments are not to be filed or administrative

demolition orders issued in respect of the erection and operation of cellular access installations without building permits.

On September 9, 2010, a revised statement was filed by the State to the HCJ whereby on September 7, 2010 the Minister of the Interior sent a draft of the Planning and Construction (Installation of a Cellular Wireless Communication access installation) Regulations, 2010 ("the Access Installation Regulations") for approval to the Knesset Economics Committee. The proposed Access Installation Regulations determine highly restrictive conditions for application of the building permit exemption for a wireless access installation.

In a later revised statement filed by the State to the HCJ on September 15, 2010, the State announced that the Attorney General believes, inter alia, that due to the delay in presenting the Access Installation Regulations for additional discussion and approval by the Economics Committee, instead of an interim order, a temporary injunction should be granted for the petitions, banning construction with building permit exemption of additional wireless access installations used by the cellular licensees for providing cellular services, until the promulgation of the Access Installation Regulations and until validation of the basic arrangement set out therein. The Attorney General also clarified that the basic arrangement set out in the Access Installation Regulations reflects the desired balance between all the various considerations relevant to the matter and in light of this, if the Access Installation Regulations are approved and promulgated and the basic arrangement prescribed therein takes effect, he believes the HCJ will have no grounds for intervention to include the cellular frequency sector in the Frequency Regulations for Access Installations.

In view of the foregoing, on September 16, 2010 the HCJ handed down a temporary injunction as requested in the Attorney General's statement dated September 15, 2010, stipulating that the injunction would be valid until validation of the arrangement prescribed in the draft Access Installation Regulations or until otherwise decided. On February 16, 2011 the HCJ qualified the temporary injunction permitting the cellular companies to replace access installations which were no longer used or which were not in working order, subject to the terms laid down in the HCJ ruling. The temporary injunction remains in place until otherwise decided.

On September 30, 2013 the HCJ issued an order nisi as requested in both petitions and ordered responses to be filed.

On September 15, 2014 a hearing was held on petitions filed with the High Court of Justice and the arguments of all the parties were heard. In this context, HCJ recommended that the parties attempt to reach 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 file 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 of the Knesset Economic Affairs Committee discussions. The parties were also granted permission to respond to the State's position within 30 days of receipt. HCJ also instructed the parties to advise, no later than January 20, 2015 as to whether they have reached agreement and determined that after receiving notice from all the parties, HCJ will decide on how the cases will continue. In the State's update notice to HCJ dated January 19, 2015 the State explained, among other things, that the Minister of the Interior at that time, Gideon Saar, announced his decision to terminate his position and consequently the terms of office of the relevant ministers changed. The State further stated that on December 8, 2014, the Knesset passed a bill to dissolve itself, ending the session and the Knesset went to pre-election recess. It may take a few weeks to for a new government following the elections on March 17, 2015. Under these circumstances, the State requested an extension from HCJ for filing its update notice until July 15, 2015, and on January 21, 2015 HCJ granted the requested extension.

Under this notice the State announced, among other things, that on May 14, 2015 a new government was formed in Israel and it was decided to transfer most of the authority of the Minister of the Interior under the Building and Planning Law, including the authority to regulate regulations under section 266C of the Building and Planning Law, to the Minister of Finance. The State further announced that on July 13, 2015 the Knesset approved the transfer of authorities from the Minister of Interior to the Minister of Finance. The Stated

added that the Minister of Finance should be given reasonable time for addressing the issue of regulating regulations under section 266C of the Building and Planning Law, and for formulating his opinion regarding the matter. Under the circumstances that were created and to enable the Minister of Finance as well as the Ministers of Communications and Environmental Protection to address the issues in the petition and to formulate their opinions, the State requested a further extension for filing its updated notice by December 15, 2015. On July 19, 2015 the HCJ awarded the requested extension.

On December 24, 2015 an updated notice was filed to the HCJ by the State according to which, inter alia, the State announced that it is reviewing the options recommended by the Minister of Finance, to whom the authority to regulate regulations under section 266C of the Building and Planning Law, 1965 was transferred only a few months previously, for regulating "balanced" regulations under the said section. The State further announced that the Deputy Attorney General (civil) will hold a hearing on the matter in the near future. Under these circumstances the State requested additional time to review the options for regulating "balanced" regulations and for filing, thereafter, another notice on its behalf, in another few months, on a date that will be fixed by the HCJ.

On November 19, 2015, Partner Communications Ltd. and HOT Mobile Ltd. filed a petition to the HCJ requesting that the temporary injunction of September 16, 2010 be limited. In the State's response, that was attached to the petition, the State made its consent to limiting the temporary injunction conditional that "at the end of one year from the date of limiting the temporary injunction ... the companies would dismantle and remove no less than 300 wireless access installations". On January 5, 2016 Cellcom Israel Ltd. filed a petition on its behalf stating that the limit contained in the temporary injunction will also apply to it, but without application of the condition to dismantle access installations, based on the arguments set out in its petition. On January 12, 2016, Pelephone Communications Ltd. also filed a similar petition regarding limiting the applicability of the order, and Pelephone also requested that the obligation to dismantle access installations also not apply to it, by noting its reasons, as set out in its petition.

In view of the foregoing, on January 27, 2016 the HCJ handed a decision according to which, inter alia, the State is required to file its response to the petitions of Cellcom and Pelephone to limit the temporary injunction also with regard to them, with reference to their request not to dismantle part of the access installations that they hold, by February 3, 2016.

Pelephone believes that if the Access Installation Regulations are approved as proposed, the option of using the building permit exemption track in order to erect cellular access installations will be severely restricted. A restriction of this track, together with the proposed tightening of the terms for construction of base sites in the parallel Proposed New NOP 36A track is likely to lead to noticeable tightening of obstacles restricting the construction of new broadcasting sites and access installations, and even to have an adverse effect on the quality of the cellular network.

At reporting date, Pelephone operates 461 wireless access installations.

Conclusion: Pelephone's ability to maintain and preserve the quality of its cellular services as well as its coverage is based partly on its ability to construct cellular sites and install information equipment, including broadcasting sites. The difficulties encountered by Pelephone in obtaining the permits and approvals required may have an adverse effect on the existing infrastructure, network performance and on the construction of the additional cellular sites required by the network.

Inability to resolve these issues in a timely manner is liable to prevent the achievement of the service quality targets laid down in the cellular license.

A few sites constructed years ago still lack approvals from the Civil Aviation Administration and the IDF, even though applications for such approvals were submitted a long time ago. Furthermore, there are administrative or other delays in some of the building and planning committees for issuing building permits for sites. Consequently, Pelephone operates several broadcasting sites before obtaining the requisite building permits. Building permit applications submitted by Pelephone to the building and planning authorities are at various review or approval stages.

Construction of a broadcasting site without a building permit constitutes a breach of the law and in some cases it has led to the issuing of demolition orders of sites or the filing of indictments or instigation of civil proceedings against Pelephone and some of its officers.

At the reporting date Pelephone has succeeded in most of the above cases in refraining from demolition or delaying implementation of the demolition orders as part of arrangements made with the planning and building authorities in order to attempt to regulate the missing licensing. These understandings did not require admission of guilt and/or conviction of Pelephone's officers. Notwithstanding, there is no certainty that this situation will continue in future, or that there will be no further cases where demolition orders will be issued and indictments will be filed because of building permits, including against officers.

Like other cellular operators in Israel, Pelephone might be required to dismantle broadcasting sites before the requisite approvals and permits have been obtained, on the dates stipulated in the law. Pelephone uses access installations to provide coverage and capacity for highly populated areas. If legal grounds are established requiring the simultaneous demolition of sites in a given geographic area, service in that area may deteriorate until alternative broadcasting sites can be established.

3.15.4 Antitrust

The document setting out the terms of the merger between Pelephone and the Company includes various restrictions as to cooperation between the companies which were updated in 2010 (see Sections 1.7.2 and 2.16.8D).

3.15.5 Standardization

Pelephone conducts routine durability and quality control tests of its facilities. The quality control and supervision do not detract from Pelephone's responsibility towards its customers for the quality of the services it provides.

Pelephone complies with the 2008 version of Israeli ISO 9001 requirements for mobile radio telephony (cellular) services and undergoes periodic inspections by the Institute of Quality & Control (IQC) for verifying compliance with the standard. The current IQC approval is valid until December 2016.

Once a year, an inspection is conducted to ensure that Pelephone's operations comply with the requirements of the standard. The last inspection was carried out in December 2015, and was successful.

3.16 Material agreements

3.16.1 For information regarding the agreements with Ericsson, see section 3.10.2.

3.16.2 For information regarding the agreement with Apple, see section 3.10.1.

3.16.3 Pelephone has an agreement with the Ministry of Finance Accountant General (the "Accountant General") for providing the government ministries with terminal equipment and cellular services until February 2016. In January 2016 the agreement was extended to August 31, 2016 or until a supplier is selected in a new tender and the reassignment of subscribers is completed, the earlier date.

3.16.4 For information regarding the agreement with the Israel Lands Administration, see section 3.7.2B.

3.16.5 With regard to the collective agreement between Pelephone and the New General Federation of Workers and the Pelephone Workers Committee, see section 3.9.2.

3.17 Legal proceedings⁴¹

Legal claims have been filed against Pelephone as part of the normal course of its business, including motions for certification as a class action suits.

3.17.1 Pending legal proceedings

Breakdown of proceedings for claims in material amounts and claims which could have material implications for Pelephone's operations:

	Date	Parties	Court	Type of Action	Details	Amount of Claim NIS million
A.	August 2010	Customer v. Pelephone	District (Central)	A financial claim filed with a motion to certify it as a class action.	The claimant claims that Pelephone should refrain from collecting Value Added Tax from customers who use its services when they are outside Israel. The motion also contains relief for an order instructing Pelephone to cease charging its customers VAT for such services which they use outside Israel, and an order instructing that the moneys collected to date be refunded. In August 2014 the Court dismissed the application for recognition. In October 2014 an appeal of the ruling was filed.	The amount of the claim is not stated, but the application is estimated in the tens of millions of shekels.
B.	February 2012	Customer v. Pelephone, the Company, Cellcom and Partner	District (Jerusalem)	A financial claim filed with a motion to certify it as a class action.	The action relates to failure to comply with the provisions of the law with respect to people with disabilities when rendering Bezeq's services. In December 2015 a settlement was signed between the parties to drop the suit in return for implementing a series of accessibility adjustments and benefits for people with disabilities set out in the settlement. This arrangement has been submitted to the court and is awaiting approval.	Approximately 361 for all the defendants, without noting an amount for each of the defendants.
C.	May 2012	Customer v. Pelephone	District (Tel Aviv)	Civil class action	The claimant alleges that Pelephone does not inform customers wishing to join its services using a handset that was not purchased from Pelephone, that if the handset does not support the 850 MHz frequency, they will only get partial reception over one frequency rather than two. In March 2014, the court certified the claim as a class action, and this subsequent to Pelephone announcing its agreement (for reasons of efficiency) to conduct the claim as a class action, while retaining its arguments.	Approx. 124
D.	August 2012	Customer v. Pelephone, Partner and Cellcom	District (Central)	A financial claim filed with a motion to certify it as a class action.	The claimants allege that under the repair services provided by the defendants for a fee (payment per repair or a monthly fee for repair service), if a certain part in the handset must be replaced, the defendants do not provide the customer with the spare part, and this in contravention of the law. Furthermore, the defendants reuse the replaced parts when providing repair services for other customers, thus ostensibly enriching themselves twice. The action also requests writs of mandamus and declaratory relief.	Approximately 120 for each of the defendants, in a total amount of approx. 360.
E.	November 2013	Customer v. Pelephone	District (Tel Aviv)	A financial claim filed with a motion to certify it as a class action.	The claimants allege that Pelephone does not grant the same perks to all its customers, thereby distinguishing between those customers that they allege Pelephone considers to be highly valuable and others, which they claim is in breach of Pelephone's license and the law. They also request as remedy that Pelephone refrain from granting such perks. The case is in mediation proceedings between the parties.	Approx. 300

⁴¹ For information concerning reporting policies and materiality, see section 1.1.

Chapter A (Description of Company Operations) of the Periodic Report for 2015

	Date	Parties	Court	Type of Action	Details	Amount of Claim NIS million
F.	May 2015	Customer v. Pelephone	District (Tel Aviv)	A financial claim filed with a motion to certify it as a class action.	They claim that Pelephone does not offer "Walla Mobile" tracks to all its existing customers and those who join are subscribers who want to transfer to a different track, and that this in in violation of the provisions of the license that obligates equality, and thereby it misleads its customers.	The amount of the claim is not stated, but the application is estimated to be in millions of shekels.
G.	August 2015	Customer v. Pelephone	District (Central)	A financial claim filed with a motion to certify it as a class action.	They claim that one of the communications companies made improper use of its database in violation of the Privacy Protection Law 1981, when it transferred or sold the customers' particulars to the other respondents, including Pelephone. The claim against Pelephone revolves mainly around the purchase or receipt of this information and using it for marketing purposes, in a way that violates the provisions of the Communications Law regarding sending of Spam. The applicant does not specifically mention the amount of the suit against Pelephone.	The amount of the claim is not stated, but the application is estimated in the tens of millions of shekels.
H.	November 2015	Customer v. Pelephone and two other cellular companies.	District (Central)	A financial claim filed with a motion to certify it as a class action.	They claim that the pre-paid prices of the companies are higher than the post-paid prices, which is due to cartelization of the three companies in this market.	Approximately 2,800 with regard to Pelephone (and the total amount against the three companies is in excess of 13,000)
I.	December 2015.	Customer v. Pelephone	District (Lod)	A financial claim filed with a motion to certify it as a class action.	They claim that Pelephone violates the mobility plan / rules in that, when attempting to move to another operator (the receiving operator) the applicant found out that she was deliberately blocked by Pelephone (the deserted operator) from moving. When calling Pelephone to clarify the issue, she found out that the unacceptable reason for blocking her was an attempt to retain her and prevent her from moving to a competitor. In addition, injunctions are sought to prevent such blocking.	The amount of the claim is not stated, but the application is estimated in the tens of millions of shekels.

3.17.2 Legal proceedings that ended during the Reporting Period

	Date of filing of the action	Parties	Court	Type of Action	Details	Amount of the original claim NIS million
	May 2015	Customer v. Pelephone	District (Tel Aviv)	A financial claim filed with a motion to certify it as a class action.	The claimants allege that Pelephone violated a settlement arrangement approved by the court in a ruling handed in another class action filed by the same applicant against Pelephone (see section 3.17.2.B to Chapter A of the Periodic Report for 2014). The matter of the claimed violation is related to sale of earphones by Pelephone. The applicant estimates the amount of the motion to be NIS 410 million. In January 2016 the plaintiff filed a motion for withdrawal from the claim and a ruling was handed approving the withdrawal.	Approx. 410

3.18 Business Goals and Strategy

Pelephone's main strategic objectives are:

- 3.18.1** Retaining its customer base.
- 3.18.2** Increasing transfer of data files over the network and regaining its technological lead.
- 3.18.3** Marketing of value-added supplementary services for browsing, such as data backup and storage, cloud solutions for businesses, anti-virus, Musix and video services
- 3.18.4** Selling terminal equipment such as mobile phones, tablets, laptops, accessories, etc.
- 3.18.5** Streamlining operations and revising Pelephone's cost structure.
- 3.18.6** Improving Pelephone's customer service and increasing customer satisfaction.
- 3.18.7** Constantly improving the cellular network infrastructures

3.19 Anticipated developments in the coming year

In 2016, a number of factors are expected to affect Pelephone's activities, the main ones being:

3.19.1 Continuation of the fierce competition and price wars

Pelephone expects the price to the customer to continue being a key component in competition and that the high customer churn rate between companies will continue also in 2016. These trends will lead to continued erosion of the profitability of the veteran companies and could even lead to a change in the structure of the cellular market.

3.19.2 Cellular network innovations

In 2016, Pelephone expects to continue investing in its cellular network and establishing its position as a high speed, top quality and cutting-edge network. Parallel to investing in the network Pelephone expects to continue promoting a few services and products that will allow it to increase revenues and its image advantage against the competitors, such as promoting a private brand of terminal equipment as part of the range of devices sold by Pelephone.

3.19.3 Increase in Pelephone subscribers' consumption of services

Pelephone expects that due to the erosion of tariffs and increase in number of subscribers using the 4G network, the increasing trend of data communications consumption will continue.

Pelephone's above assessments of developments during the year to come are forward-looking information as defined in the Securities Law. These assessments are based, inter alia, on the state of competition in the cellular sector, the existing regulatory situation and the manner in which innovative changes are implemented in regulation. These assessments may not materialize or may materialize in a manner materially different from that described, depending, inter alia, on the structure of competition in the market, changes in consumption habits of cellular customers and regulatory developments in the segment.

3.20 Risk Factors

Risk factors deriving from the macro-economic environment, the unique qualities of the sector in which Pelephone operates, and risk factors specific to Pelephone.

3.20.1 Macroeconomic risks

Exposure to changes in exchange rates – Pelephone is exposed to exchange rate risks as most of its terminal equipment, accessories, spare parts and infrastructure equipment are purchased in USD, whereas Pelephone's revenues are in NIS. Erosion of the NIS against the USD may affect Pelephone's profitability if it is unable to adjust selling prices at short notice.

3.20.2 Sector-specific risks

- A. Investments in infrastructure and technological developments – the cellular market in Israel and worldwide is characterized by substantial capital investments in the deployment of infrastructure. The frequent technological changes in infrastructure and terminal equipment and the fierce competition in various market segments impose a heavy financial burden on the companies operating in the market, requiring them to update their infrastructure technology from time to time.
- B. Customer credit – Pelephone's sales of terminal equipment are mostly credit-based. Most of this credit, which is not covered by either insurance or sureties, is exposed to risk. It is noted that the credit is spread among a large number of customers and Pelephone's collection mechanisms are efficient and competent.
- C. Regulatory developments – the industry in which Pelephone operates is subject to legislation and standardization relating to issues such as the environment, increased competition, tariffs, product warranty and repair, etc. Regulatory intervention in the industry may materially impact Pelephone's structure of competition and operating costs.
- D. Competition - the cellular market in Israel is highly saturated and fiercely competitive, and is exposed to risks as a result of technological and regulatory developments. The costs of establishing, maintaining and operating Pelephone's cellular network pro rata to the number of subscribers is expected to be higher for Pelephone if it will not be allowed to operate under some form of network sharing model, and/or if a Cellcom-Golan Telecom merger is approved (see section 3.6.3).
- E. Electromagnetic radiation – Pelephone operates hundreds of broadcasting facilities and sells electromagnetic radiation emitting terminal equipment (see Section 3.14). Pelephone is taking measures to ensure that the levels of radiation emitted by these broadcasting facilities and terminal equipment do not exceed the radiation levels permitted in the Ministry of Environmental Protection guidelines (the levels adopted are based on international standards). Even though Pelephone acts in accordance with the Ministry of Environmental Protection guidelines, if health risks are found to exist or if the broadcasting sites or terminal equipment are found to emit radiation levels exceeding the permitted radiation standards, thereby constituting a health hazard, this may have an adverse effect due to reduced consumption of Pelephone's services, difficulty in renting sites, compensation claims for physical and property damages in substantial amounts and attempts to exercise the deeds of indemnity deposited with the planning authorities with respect to section 197 of the Building and Planning Law. Pelephone's third-party liability policies do not currently cover electromagnetic radiation.
- F. Site licensing – establishing and operating cellular antennae require building permits from various planning and building committees, a process that involves, inter alia, obtaining several approvals from State entities and regulatory bodies. For further details of the difficulties Pelephone encounters when erecting and licensing sites, see section 3.15.3. These difficulties may impact the quality of the existing network and especially the deployment of the new network.
- G. Serious malfunction of information systems and engineering systems - Pelephone's information systems are networked throughout the country through designated communications lines and through the internet. Pelephone's business is highly dependent on these systems. Wide scale malicious damage (e.g.: viruses and cyber-attacks) or malfunction may adversely affect Pelephone's business and its results.
- H. State of emergency - during an emergency, legislative provisions and certain provisions of the cellular license empower competent authorities to take necessary measures for ensuring the security of the State and/or public safety, including: obligating Pelephone (as a cellular license holder) to provide services to the defense forces, the appropriation of engineering equipment and facilities belonging to Pelephone, and even to take control of the system.

3.20.3 Pelephone's risk factors:

- A. Property risks and liabilities – Pelephone is exposed to various property risks and liabilities. Pelephone employs the services of an external professional insurance consultant specializing in this field. Pelephone has insurance policies that cover the regular risks to which it is exposed with restriction on the terms of the policies, such as various property insurances, various liability insurances, loss of profit cover, third-party cover and officers liability insurance. Nonetheless, Pelephone's insurance policies do not cover certain types of risk, including certain faults arising from negligence or human error, radiation risks, terror, etc.
- B. Serious malfunctioning of the communications network – Pelephone's communications network is spread throughout the country via core network sites, antenna sites and other systems. Pelephone's business is totally dependent upon these systems. Wide scale malicious damage or malfunction might adversely affect Pelephone's business and results.
- C. Damage by force majeure, war, catastrophe - any damage to the switching farm and/or servers used by Pelephone for its core activities could have an adverse effect on Pelephone's business and its results.
- D. Legal proceedings – Pelephone is a party in legal proceedings, including class actions, which may result in it being liable for material amounts that cannot presently be estimated and no provision has been made in Pelephone's financial statements for these proceedings. Class action suits may reach high amounts, since a major part of the residents of Israel are Pelephone consumers, and a claim relating to a small amount of damage to a single consumer could grow into a material claim against Pelephone if certified as a class action applicable to all or a large proportion of those consumers.
- E. Labor relations - Pelephone has a collective agreement with the New General Federation of Workers and with the employees' committee which applies to most of its employees. Implementation of the collective agreement may reduce managerial flexibility and incur additional costs for Pelephone (see section 3.9.2).
- F. Frequency spectrums - 850 MHz, 1800 MHz and 2100 MHz The frequencies are exposed to interference and could impair the service quality of the networks operated by Pelephone. The factors that could cause interference include the fact that the 850 MHz frequency is also used for terrestrial television broadcasts by television stations in the Middle East on the same frequency, causing interference in Pelephone's 850 MHz UMTS/HSPA network. Furthermore, the Jordanian networks also use the same 2100 MHz frequency range that Pelephone uses and in view of the limited cooperation between the operators in Jordan and Pelephone, this could have an effect.

The chart below grades the impact of the foregoing risk factors on Pelephone's operations, as assessed by Pelephone's management. It should be noted that Pelephone's assessments of the extent of the impact of a risk factor reflect the scope of the effect of such risk factor, on the assumption that it the risk factor will be realized and the foregoing does not express an assessment or give weight to the chances of its realization as aforesaid. The order in which the risk factors appear above and below is not necessarily based on the extent of the risk⁴².

⁴² See footnote 36.

Summary of risk factors - cellular telephony

	Effect of risk factor on Pelephone's activities as a whole Risk factors		
	Major	Moderate	Minor
Macro risks			
Exposure to changes in the currency exchange rate.			X
Sector-specific Risks			
Investments in infrastructures and technological changes	X		
Customer credit		X	
Regulatory developments	X		
Competition	X		
Electromagnetic radiation	X		
Site licensing	X		
Severe malfunctions in information systems	X		
State of emergency	X		
Pelephone's risk factors:			
Severe malfunctions in the communications network			X
Natural disasters	X		
Legal proceedings	X		
Legal proceedings		X	
Difficult labor relations		X	
Frequency spectrums		X	

The information contained in Section 3.20 and Pelephone's assessments of the effect of the risk factors on its operations and businesses is forward-looking information as defined in the Securities Law. The information and assessments rely on data published by the Ministry of Communications, Pelephone's assessments of the market situation and its competitive structure. Actual results may differ significantly from these assessments if a change occurs in any of the factors taken into account in the assessments

4. Bezeq International – International telecommunications, Internet and NEP services

4.1 General

4.1.1 Structure and changes in segment of operations

Bezeq International operates in a number of key areas: providing ISP services; international telecommunications services; domestic telephony services; NEP services; as well as providing ICT (infrastructure and communication technologies) solutions and data transmission and PBX services.

Bezeq International's international telecommunications services, similar to those of its competitor international operators, are provided primarily via the domestic networks of the Company and of HOT and the cellular networks, for connecting the subscriber to the international exchange network. For information regarding the hearing announced by the Ministry of Communications concerning new regulation of the international telecommunications market see section 1.7.2.

4.1.2 Legislative and statutory restrictions applicable to Bezeq International

Bezeq International's segment of operations is primarily regulated by the Communications Law and its regulations, and the ITS licenses granted to Bezeq International (see Sections 4.13.1 and 4.13.2).

For key regulatory developments applicable to Bezeq International, see section 4.13.4.

4.1.3 Changes in the segment's volume of operations and profitability

For information regarding changes in the volume and profitability of Bezeq International's operations, see section 0.5.4.

4.1.4 Market developments and customer characteristics

The international telephony market in Israel has in recent years seen a decline in call volume, (incoming and outgoing), mainly due to the service bundles offered by the cellular companies that include international calls as well as the multiple free applications that enable calls via the web. In 2015 the international telephony market declined (in number of minutes) by 4%.

The internet market recorded in 2015 continued growth stagnation together with an increase in the surfing speeds consumed. Generally, the increase in demand for high speed browsing requires Bezeq International to periodically increase its operating capacity via its Jonah submarine cable and the international capacity rights it acquires (for information regarding other Bezeq International infrastructure providers, see section 4.9.2).

4.1.5 Main entry and exit barriers

- A. The main entry barrier of the international call market is the need for an ITS license under the Communications Law and investment in infrastructure (the volume of investments in infrastructure is lower than the volume of investments in a domestic carrier or cellular infrastructure), which is affected by frequent technological changes. However, change in the licensing policy, as set forth below, and expansion of the use of VoIP technology in this field, significantly reduces the effect of these barriers.
- B. The high penetration rate and multiple players in the market.
- C. The main entry barrier into the data and internet services market stems from investments in infrastructure (international capacity, access to the internet network and broad service network).
- D. The main exit barriers for these markets are long-term agreements with infrastructure suppliers and long term return on investments. Furthermore, Bezeq International is committed to providing service to its customers throughout their contract period.

4.1.6 Alternatives for Bezeq International products and the international telecommunications market competition structure and applicable changes

In the international telecommunications market, VoIP technology enables transmission of international calls over the internet for users of this technology, and for TDM network users, through software products (such as Skype and WhatsApp) and services of overseas communication providers, and the attractive cost of these services (including the lack of user fees) has led to steady growth in the number of users, and as a result, to a decline Bezeq International's revenues. At the same time, there are currently eight international telecommunication operators on the market that have ITS licenses from the Ministry of Communications for providing Bezeq International services.

For information regarding the hearing announced by the Ministry of Communications concerning new regulation of the international telecommunications market see section 1.7.2.

4.1.7 Structure of competition in the sector and applicable changes

In the internet access sector, some 60 companies have so far been granted ISP licenses, among them are five holders of international call licenses, domestic operators and all the cellular operators.

For further information regarding competition in the sector, see section 4.6.

4.2 Products and Services

Description of the main products and services provided by Bezeq International.

4.2.1 Internet services

In the internet services sector Bezeq International provides internet access services for private and business customers, including requisite terminal equipment and support over DSL based transmission and cable infrastructure; hosting services offering site and server storage services at a designated installation, including value added services (such as monitoring and control); information security services; internet and LAN network connection security using required terminal equipment or software, including monitoring; data services including international IP based data communication solutions for business customers with global deployment; and high speed Wi-Fi services, including public hotspots.

Bezeq International provides these internet services primarily via its exclusive wholly-owned Jonah submarine cable, launched in December 2011. As aforesaid, Bezeq International is the only ISP operating in Israel that owns infrastructure.

4.2.2 Voice (telephony) services

In the voice services sector Bezeq International provides international direct dialing (IDD) services to business and private customers; toll-free dialing overseas for business customers; international call hubbing and routing services - transferring international calls between foreign telecommunication providers (worldwide); phone-card services enabling prepaid and postpaid dialing from Israel overseas and from abroad to Israel, and the 1809 service that allows dialing from Israel to other countries. Furthermore, Bezeq International provides domestic telephony services.

4.2.3 International data services

Providing international data communication solutions for business customers including customized global deployment.

Customers can choose from a range of the most advanced data communication methods worldwide via Bezeq International's submarine cable (in this regard, see section 4.2.1) and the optic cables deployed from Israel to Europe over which Bezeq International has long-term user rights, and through its business partnerships with leading global telecom providers such as BT, which provide its customers access to their sophisticated global network services.

In addition to the foregoing services, Bezeq International offers ITS licensees to provide Bezeq International's services and ISP licensees the use of its international capacities

(through leasing or by purchasing indefeasible rights of use), over Bezeq International's submarine cable, and the user rights it acquired in European terrestrial infrastructures and in other international networks.

4.2.4 ICT solutions for business customers

Bezeq International provides ICT (Information and Communication Technology) solutions for business customers. These ICT solutions include a broad range of communication services such as server and site hosting services, maintenance and technical support services, networking and system services, out-tasking and outsourcing services, security and risk management services, IP based services, exclusive state-of-the-art cloud computing services, online backup services and sale of equipment.

In July 2014 Bezeq International launched a service for the self-employed and small business sector in which it offers its "Bigger" service, an innovative digital platform for managing the business's marketing and advertising.

4.2.5 PBX services

Bezeq International markets and maintains communication systems for the entire the Israeli market, and PBX exchanges, telephony networks and IP communications, mainly for its business customers. As part of its service contracts, Bezeq International provides maintenance services for various PBX exchange manufacturers. These services are given for gateways, PBX exchanges and network end points (NEP) for lines used as both internal and external lines.

4.3 Revenues

Breakdown of Bezeq International's revenue (in NIS millions):

	2015	2014	2013
Voice services	379	395	401
% of total revenue	24.02%	26.26%	27.98%
Revenue from business internet and telecommunication services (ISP, PBX, ICT, data)	1,199	1,109	1,032
% of total revenue	75.98%	73.74%	72.02%
Total revenue	1,578	1,504	1,433

4.4 Trade receivables

Breakdown of revenue from private and business customers (in NIS million):

NIS million	2015	2014	2013
Revenue from private customers	555	529	535
Revenue from business customers	1,023	975	898
Total revenue	1,578	1,504	1,433

Notes: Revenue data were reclassified

4.5 Marketing, distribution and service

4.5.1 Marketing

The marketing division concentrates all its activities around a few regular service providers, among them the PR firms representing Bezeq International, through which Bezeq International also remains in contact with the various advertising media and production companies. Bezeq International believes that loss of contact with any of its regular advertising or marketing service providers will not have a significant effect on its marketing and distribution channels.

4.5.2 Private market sales channels

- A. Recruitment and retention call centers for internet and telephony service customers.
- B. A national direct sales network offering door-to-door service, and operating points of sale and customer management.
- C. Customer technical support and service provided through service and support call centers.
- D. A distribution channel that includes external points of sale and field networks of resellers and dealers.
- E. The Company sells Bezeq International services as part of joint service bundles (see section 1.7.2B).

4.5.3 Business market sales channels

These channels include customer recruitment centers, business service and solution centers, and customer managers, based on customer type

4.6 Competition

4.6.1 Internet access services

- A. There are a number of competitors in this market, including Bezeq International, 013 Netvision (Cellcom), 012 Smile (Partner), Hot Net and two minor niche players whose share is not material.

Bezeq International estimates that its share of the internet access market at December 31, 2015 is 44%⁴³ compared with a market share of 42% at December 31, 2014⁴⁴.

- B. General characteristics of competition in 2015

- 1. Rate erosion -
- 2. HOT frequently collaborates with Bezeq International's direct competitors. Furthermore, HOT has independent internet access operations through Hot-Net.

- C. Developments in 2015:

- 1. Strengthening of the trend of selling service bundles. This trend received a further push in 2015 with the launch of the wholesale selling model (provider + infrastructure).
- 2. Continuation of the rising trend in value-added services sales.
- 3. Due to market saturation, emphasis is given to strengthening customer loyalty.

4.6.2 International telephony services

- A. As at the end of 2015, there are eight players in the market (including 014 Bezeq International, 013 Netvision, -12 Smile, Golan Telecom International Ltd. and Hot Mobile International Communications Ltd).

Bezeq International estimates that its market share for outgoing international calls at December 31, 2015 is 21% compared with a market share of 23% at December 31, 2014⁴⁵.

⁴³ This market share estimate is based on the assumption of an increase of 20,000 infrastructure customers during the fourth quarter of 2015, based on the growth figures published by the Company and HOT.

⁴⁴ Bezeq International's estimate of its market segment in the internet access sector is based on a calculation of the ratio between the number of subscribers it has, and the total number of ISP subscribers (based on public data for the Company and HOT).

⁴⁵ Based on Ministry of Communications publication of figures for outgoing calls.

B. General characteristics of competition in 2015

1. In 2015 the market declined in minutes (see section 4.1.4); alongside this trend, prices continued to erode.
2. A new competitor entered the international telephony market when WhatsApp launched its call service.
3. Competition is focused on specific population sectors.
4. The product is a commodity.

4.6.3 **Communication solutions for the business sector**

With the aim of increasing revenues from business customers, Bezeq International continues to supply ICT (Information Communication Technology) services, providing full solutions in areas such as system, networking, IT, hosting, voice, data, ISP, wireless (wireless networks), and cloud computing.

Bezeq International has adopted a comprehensive solution model with a single contact person, fully responsible for the process, dealing the customer (one service provider, one responsibility).

Since December 2011, Bezeq International uses its wholly-owned submarine optic communications cable between Israel and Italy.

The international capacity passing through Bezeq International's submarine cable serves the needs of Bezeq International and its various customers in addition to the Med Nautilus network capacity for which Bezeq International purchased user rights. Bezeq International is the only ISP in Israel that owns a submarine cable.

- A. In the ICT sector Bezeq International competes with competitors such as Binat, Teldor, IBM and others. In 2015 Bezeq International continued to establish its position in the ICT market and gained recognition and endorsement from leading global suppliers in the market.
- B. NEP services - the traditional telephone exchange sector includes a large number of competitors and fierce competition which has given rise to erosion of service prices. The prominent competitors are Teldor Communications, Tadiran, Eurocom. Data communications and IP telephony (adapting switchboards and terminal equipment to IP technology) is effected by the entry of new players from the IT sphere. These are companies such as: Binat, Teldor, MalamTeam, IBM. These companies are substantially different from traditional NEP companies and are on a higher technological level. Telecommunication companies are also conglomerating and new operators are entering the market with the intention of providing customers with comprehensive communications solutions that include telephony, transmission, data communications, internet, information security, etc.

4.6.4 Bezeq International promotes its business with emphasis on differentiating it from its competitors as the owner of its own international infrastructure (Jonah cable) for its customers' traffic providing high quality browsing performance, as well as its leading customer service.

4.6.5 The fact that, contrary to some of its competitors, Bezeq International is unable to offer its services as part of a non-detachable communications services bundle, adversely affects its operations.

4.7 **Property, plant and equipment, intangible assets and facilities**

Bezeq International's property plant and equipment include switching and internet equipment, marine cable, PBX equipment, office equipment, computers, vehicles and leasehold improvements.

Bezeq International has Veraz SoftSwitch switches. These switches are used to route Bezeq International's voice traffic. The value-added services, including dialing cards, are based on an intelligent network (IN) .

Bezeq International's technological infrastructures, which support voice, data and internet systems, are deployed at six sites, inside and outside Israel, inter alia, to provide services with high survivability.

Bezeq International's intangible assets include licenses (see section 4.13.2), software and discounted development costs. Bezeq International uses software and computer systems, some under purchased licenses and others which were developed by its IT department. Many of these licenses are limited in time, and are periodically renewed. The primary systems used by Bezeq International are: Oracle ERP system and IBM customer billing system.

Bezeq International has long-term agreements for the lease of the two main buildings in which it is based. With regard to one of the buildings, the lease period is until March 2024, with several exit options for Bezeq International during this period. The lease period of the other building is until December 2019 (with four equal extension options until 2027). Bezeq International has other lease agreements for warehouses (including a main logistics center) and for buildings where it operates the call centers that it uses for its operations.

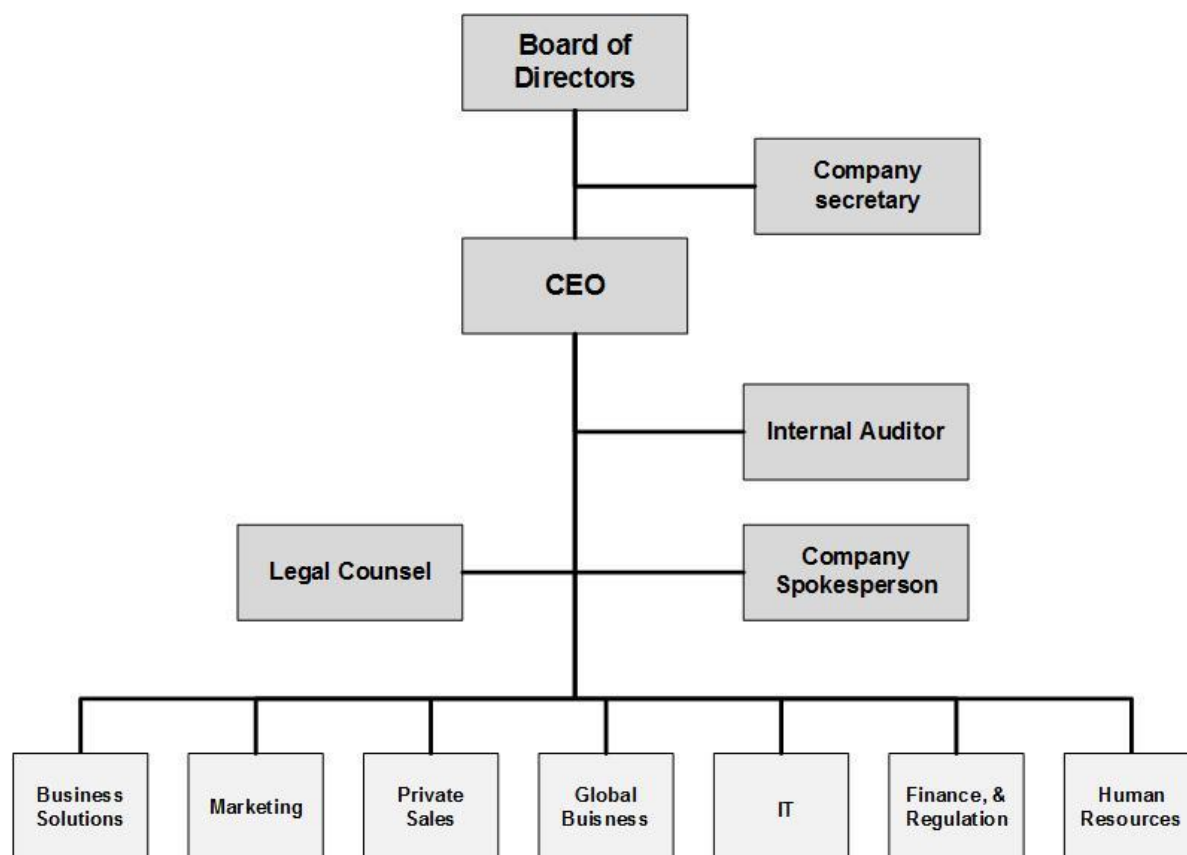
4.8 Human Capital

Breakdown of the Bezeq International employees in 2013 and 2014:

	Number of employees	
	December 31, 2015	December 31, 2014
Head office employees	1,157	1,173
Sales and service representatives	809	759
Total	1,966	1,932

Organizational structure

The following chart presents the organizational structure of Bezeq International:



Bezeq International perceives its employees as a substantial asset that it must retain and nurture.

In 2015 Bezeq International invested in excess of 2000 hours on training employees to reinforce professionalism, authority and technical skills, sales management training, service expertise and more. More than 1000 of the company's employees participated this year in a range of personal development courses and professional and managerial reserves were developed of the organization's talents. Approximately 240 company managers developed their business managerial skills in the annual training program.

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 therefore it is the representative workers union of Bezeq International's employees.

On January 12, 2016 Bezeq International signed a collective agreement with the New General Federation of Workers and the Bezeq International Workers Committee, the key issues being:

- The agreement will apply for all Bezeq International employees, other than the executive management (VPs and those who report directly to them) and another group of employees and managers that the parties agreed upon.
- The period after which Bezeq International's employees will be considered as tenured is 36 months, with an option for an extending for an additional six months with the Committee's agreement.
- The agreement prescribes mechanisms that include the Committee in decision making with regard to the termination of the employment of tenured employees, disciplinary measures imposed against them, and the execution of organizational changes.
- The agreement also provides for annual wage hikes and other financial benefits (such as subsidised summer camp and welfare activities) to be provided by Bezeq International for its employees during the agreement period.
- The agreement is valid until December 31, 2018. Thereafter the agreement will automatically be renewed for further period of 12 months each, unless one of the parties give notice of their intention to change the agreement.

4.9 Trade payables

4.9.1 Foreign operators

Bezeq International has collaboration agreements with some 200 foreign operators, under which Bezeq International transfers to and from these operators international calls (including outgoing calls from Israel, incoming calls to Israel and calls between various destinations outside of Israel) to some 240 destinations worldwide.

4.9.2 Capacity providers

Bezeq International is dependent upon the Company for domestic capacity to provide its services.

Under its agreement with Med Nautilus, Bezeq International purchased indefeasible rights of use to a particular non-specific part of the communication capacity transferred by the undersea cable system operated by Med Nautilus between Israel and Europe for a period of up to 15 years from the date on which it started using this capacity (with an option to extend the period of use). The periods of use are at least until 2017 – 2027, depending on the date of the start of use of the capacity. Bezeq International paid for these rights of use in a lump sum payment shortly before the date on which it started using the capacity.

As Bezeq International primarily uses its own submarine cable, the Med Nautilus capacity is used mainly for backup.

4.10 Working capital

The working capital in Bezeq International's 2015 financial statements is made up from current assets such as cash and cash equivalents, trade receivables, other receivables, current tax assets and inventories, amounting to NIS 456 million; less total current liabilities such as current maturities of loans from the Company, trade payables, other payables and provisions, amounting to NIS 314 million.

4.11 Financing

As at publication date of this report, Bezeq International has no bank liabilities and it does not use its approved line of credit. The source of Bezeq International's finance in recent years has been positive cash flows from operating activities and loans from the Company.

4.12 Taxation

See also Note 6 to the 2015 financial statements.

4.13 Restrictions and supervision of Bezeq International's operations

4.13.1 Legislative restrictions

Under the Communications Law, telecommunications operations and provision of telecommunications services, including international telecommunications services and internet access services, require licenses from the Minister of Communications. The Minister is authorized to amend the terms of the license, add to them or detract from them, while taking into consideration, inter alia, the government's telecommunications policy, interests of the public, compliance of the licensee to provision of services, contribution of the license to competition in the telecommunications industry, and the level of service therein

The law authorizes the Director General of the Ministry of Communications to impose financial sanctions for violations of the provisions of the law and of orders and directives issued thereunder, and for violation of the terms of the license.

4.13.2 Licenses

On February 21, 2016 Bezeq International's license was amended by the General Director of the Ministry of Communications and was replaced by a unified general license for providing telecommunications services ("Unified License").

The Unified License cancels and replaces the general license for providing international telecommunications services that was granted to Bezeq International on June 2, 1996, and the special general license for providing fixed-line domestic telecommunications services granted to B I P Telecom. Ltd. on February 8, 2009. In addition, the Unified License also cancels and replaces the special licenses for providing NEP and internet services granted to Bezeq International on January 15, 1996 and August 4, 2009, respectively.

The Unified License, which is valid until May 2, 2025, covers all the services that Bezeq International was permitted to provide to date.

Pursuant to Ministry of Communications requirements, Bezeq International provided a bank guarantee of NIS 5 million in compliance with the terms of the Unified License.

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.

4.13.3 Interconnect payments

For information concerning interconnect fees paid to domestic carriers and cellular operators, including the reduction of interconnect fees to cellular operators as of 2011, see section 1.7.3C.

4.13.4 Key regulatory developments

- A. For possible changes in the communications market that could also affect Bezeq International as a consequence of a policy to increase competitiveness, see section 1.7.3A.
- B. For information regarding the hearings announced by the Ministry of Communications in October 2013 and October 2014 concerning new regulation of the international telecommunications market see section 1.7.2A. Resolutions adopted subsequent to this hearing could have significant effects on the structure of competition in the

international telecommunications sector, and consequently also on the results of Bezeq International's operations in this sector. At this stage Bezeq International is unable to estimate the scope of this effect, which depends, inter alia, on the type of resolutions that will be adopted subsequent to the hearing.

C. Amendment to the Communications Law with respect to filtering of offensive content

In August 2012, the Ministry of Communications amended the ISP licenses (fixed and mobile), adding provisions to the licenses concerning filtering of offensive sites and content, as a supplementary measure to the provisions of the law with regard to this issue. The amendment stipulates that a license holder will be required, inter alia, to inform its subscribers about offensive websites and content which are not suitable for children and teenagers, and to include details of methods for blocking access to such sites and content. Likewise, the license holder must offer its subscribers an effective service for filtering offensive sites and content, for no additional payment.

On August 6, 2014 the Ministry of Communications published a hearing on the issue of amending Bezeq International's ITS license (corresponding with the bill discussed by the Economic Affairs Committee). The main points of the amendment are expansion of the existing obligation to inform customers and offer them an opportunity to protect themselves against offensive Internet content and requiring Bezeq International to provide its customers, free of charge, with the most advanced filtering software; solutions that in part are not applicable at this time.

D. With regard to the decisions of the Ministry of Communications concerning application of the engineering model and setting of the wholesale market prices, see section 1.7.3.

E. With regard to the Ministry of Communications decisions concerning application of the wholesale market model for the physical infrastructure (SLU) sector, see section 1.7.3.

4.14 Joint venture agreements

On January 18, 2010 Bezeq International signed an exclusive partnership agreement with British Telecom (BT) for providing global communications services to Israeli and multi-national companies operating in Israel. Under this agreement, Bezeq International will operate as a BT Alliance partner in Israel and will market a range of BT's global IT services and products (such as global data communication networks, MPLS and international access lines).

4.15 Legal proceedings⁴⁶

During its normal course of business, legal claims have been filed against Bezeq International, including motions to certify class actions.

4.15.1 Pending legal proceedings

	Date	Parties	Court	Type of Action	Details	Amount of Claim NIS million
A.	2008	Customer v. Bezeq International and other international operators	District (Central)	A financial claim filed with a motion to certify it as a class action.	Four claims, which were consolidated to form one suit relating to the use of international phone cards for dialing to destinations in the Philippines, Thailand and Nepal. The plaintiffs, who are foreign workers, claim that the phone cards provide an average of 50% of the time units indicated to the purchasers of the cards, Bezeq International also deducts call time for time unsuccessfully spent attempting to call someone, contrary to the declaration does not charge for units of round minutes, provides misleading information about the number of units on the card and formed a cartel with other international telecommunication companies regarding raising the prices for phone cards. The plaintiffs seek court recognition to file their claim as a class action on behalf of a group that includes anyone who purchased the relevant type of phone cards during the seven years prior to filing the claim and throughout the duration of the proceedings. The plaintiffs also petitioned the court to order Bezeq International to cease its foregoing conduct. In November 2010, the court recognized the motion to certify a class action on the grounds of deception. Nonetheless, the court dismissed part of the causes of action and determined that the deception ended after the purchase of several phone cards. A leave to appeal filed by Bezeq International was denied in September 2012 due to the settlement agreement signed between the other defendants in the proceedings and the plaintiffs.	1,159
B.	December 2011.	Customer v. Bezeq International	District (Central)	A financial claim filed with a motion to certify it as a class action.	According to the plaintiffs, during October 2011, Bezeq International failed to provide its internet customers with the browsing speed it had undertaken in the contract. The plaintiffs claim refund of the monthly fees and compensation for mental anguish. On March 13, 2016 the Court approved certification of the suit as a class action	Approx. 120
C.	February 2012	Customer v. Bezeq International and other international operators	District (Tel Aviv)	A financial claim filed with a motion to certify it as a class action.	Similar to the foregoing in line A above, the plaintiffs allege that the defendants misled customers who purchased overseas dialing services by means of pre-paid international phone cards, with respect to the number of minutes on the card.	2,700
D.	January 2015	Customer v. Bezeq International	District (Central)	A financial claim filed with a motion to certify it as a class action.	They claim that the Moresheet content filtering services that Bezeq International provides for its religious and traditional sector customers, for a fee, do not protect users from offensive content and that their exposure to such content caused them harm. It is further claimed that Bezeq International must compensate the customers who purchased content filtering services and who were not offered the basic filtering service which is provided free of charge.	Approximately 65, with the addition of NIS 1,000 for each member of the group, the size of which is unknown.
	December 2015.	Customer v. Bezeq International	District (Central)	A financial claim filed with a motion to certify it as a class action.	They claim that Bezeq International charged the listed customers for an overseas dialing plan at "premium prices" that were higher than the agreed price fixed in the communications plan. The plaintiffs contend that Bezeq International exceeded the applicability of the plan, fixed line destinations overseas and defined them as "premium destinations", without basis and by misleading customers.	Not noted.

⁴⁶ For information concerning reporting policies and materiality, see section 1.1

4.16 Goals, business strategy and expected development

Bezeq International set itself the goal of continuing to lead the basic internet services market in Israel for private and business customers, while maintaining its revenues in its traditional markets:

- 4.16.1** To continue its leadership in the internet access market with emphasis on further differentiation of Bezeq International based on its network performance and the quality of the customer services it provides.
- 4.16.2** To intensify and expand its cloud-based solutions.
- 4.16.3** To strengthen its status as one of the leading ICT players in Israel.
- 4.16.4** To increase customer satisfaction by strengthening and expanding service openings (automated services, social networks, etc.).

These objectives may not materialize or may materialize in part only, due to regulatory changes that could harm Bezeq International's ability to provide solutions for existing or changing market requirements, and due to all the other risk factors described below.

4.17 Risk Factors

Description of the risk factors deriving from the macro-economic environment, from the unique characteristics of the sector in which Bezeq International operates, and Bezeq International's company specific risk factors:

4.17.1 Changes in currency exchange rates

The primary currency in which Bezeq International operates is the NIS. Most of Bezeq International's revenues are from customers in Israel (although Bezeq International also provides services to customers worldwide and charges them in foreign currency, primarily the USD). On the other hand Bezeq International uses services from providers worldwide and pays them for these services in foreign currency, primarily in USD. Changes in the exchange rates of the currencies in which Bezeq International operates against the NIS exposes it to rate differentials on the gap generated, which could adversely affect its profitability by increasing financing expenses, as well as its cash flows. As there isn't a big gap between the currency linked income and expenses, exposure to this risk is not material. To protect itself against currency exposure, for specific material transactions, Bezeq International engages in hedging transactions and purchases other financial instruments.

4.17.2 Competition

For information concerning the effect of competition on Bezeq International's businesses, see section 4.6.

4.17.3 Frequent technological developments and infrastructure investments

Bezeq International's operations are characterized by frequent technological developments. The development of technologies constituting attractive alternatives to some of Bezeq International's products (such as WhatsApp and Skype) is likely to have a materially adverse effect on its operations. Furthermore, technological developments require frequent investment in infrastructure. See section 4.9.

4.17.4 Government supervision and regulation

For information relating to the application of the provisions of the law and licensing policies and their effect on Bezeq International, see section 4.13. Certain regulatory changes applicable to Bezeq International could have an adverse effect on its results and operations.

4.17.5 Legal proceedings

Bezeq International is party to legal proceedings, including class actions, some of which could result in its being required to pay substantial sums which, in the opinion of its legal counsel, could require the use of Bezeq International's financial resources. A provision has been made in the financial statements of Bezeq International and the Company for such

proceedings. For information concerning legal proceedings to which Bezeq International is a party, see section 4.15.

4.17.6 Failure of Bezeq International's systems and cyber attacks

In the event of damage to part or all of the systems used by Bezeq International to provide its services, whether due to various technical failures or force majeure, or deliberate damage by external elements (physical or virtual - by cyber-attacks) significant difficulties may be caused to the provision of its services.

4.17.7 Difficult labor relations

Bezeq International has a collective agreement with the New General Federation of Workers and with the employees' committee which applies to most of its employees. Implementation of the collective agreement could impact Bezeq International's ongoing operations.

The table below demonstrates the effects of the foregoing risk factors on Bezeq International's operations, as assessed by its management. It should be noted that Bezeq International's assessments with regard to the extent of the effect of a risk factor reflect the extent of effect of such risk factor, based on the assumption that the risk factor will be realized and the foregoing does not express an assessment or give weight to the chances of its realization as aforesaid. The order in which the risk factors appear above and below is not necessarily based on the extent of the risk⁴⁷.

Summary of risk factors - international telecommunications, internet and NEP services

	Effect of risk factor on Bezeq International's operation		
	Major	Moderate	Minor
Macro risks			
Exposure to changes in currency exchange rates			X
Sector-specific Risks			
Increasing competition		X	
Investments in infrastructure and technological changes		X	
Government supervision and regulation	X		
Special risks for Bezeq International			
Exposure in legal proceedings		X	
System failure and cyber attacks		X	
Labor relations			X

The information contained in section 4.17 and Bezeq International's assessments of the effect of the risk factors on its operations and businesses is forward-looking information as defined in the Securities Law. The information and assessments rely on data published by the Ministry of Communications, Bezeq International's assessments regarding the market situation and the structure of competition in it, and possible developments in the market and in the Israeli economy. Actual results may differ significantly from these assessments if a change occurs in any of the factors taken into account in the assessments.

⁴⁷ See footnote 36.

5. DBS – Multi-channel television

Since June 24, 2015 DBS is a wholly owned subsidiary of the Company, following completion of the acquisition transaction of DBS by Eurocom DBS. In this matter, see also Section 1.1.2.

5.1 General information about the segment of operation

DBS, also known by its trade name YES, provides multi-channel television broadcast services via satellite, as well as other services to subscribers in Israel and the Administered Territories.

DBS is the only company currently holding licenses (which are not exclusive) for multi-channel satellite television broadcasting.

5.1.1 Structure and changes in segment of operations

- A. There are to date two broadcasting licensees in the multi-channel television broadcasting sector, DBS and HOT of HOT Group that provides cable television services to subscribers, and has a pronounced monopoly under the Antitrust Law in the multi-channel television broadcasting sector ("the Broadcasting Sector"). Cellcom Group's Cellcom also operates in the multi-channel television sector, providing television services via the internet that enables, either by using a special streamer or application, viewing VOD content and a few linear channels (including the DTT content).

For information pertaining to additional communication services provided by HOT Group and by Cellcom, see section 1.7.1. For information regarding Cellcom's services see paragraph C below.

- B. Second Authority for Television and Radio (the "Second Authority") operates a digital terrestrial television broadcasting system (DTT, known as Idan Plus) through which certain channels are broadcast to the public, free of charge. As at reporting date it broadcasts the channels of the Broadcasting Authority (Channel 1 and Channel 33), the commercial channels (Channel 2 and Channel 10) and the Knesset Channel (Channel 99). The DTT operator may broadcast additional channels including radio channels, Educational TV Channel and subject-based and niche channels. The channels are broadcast for a broadcasting fee; however the Ministers of Communications and Finance may decide that the State will subsidize broadcasting fees applicable for subject-based channels and niche channels.

The subject-based channels may, under the Law, finance their broadcasts by charging a subscription fee in addition to the alternative of financing through commercials. The Ministers of Communications and Finance may appoint a private entity for operating the DTT system, in place of the Second Authority.

As at reporting date, the DTT is a partially alternative product to the multi-channel television broadcasts.

DBS believes that an increase in the number or range of channels broadcast via DTT, as well as the possibility of a private entity operating the DTT system, could increase the DTT alternatives to DBS's services, and may therefore have a material detrimental effect on DBS's results.

This assessment of DBS is forward-looking information, as defined in the Securities Law, based in part on the present version of the regulations and DBS's assessment with regard to its application. This assessment may not materialize or may materialize differently than expected, inter alia, depending on the channels that will be included in DTT, the regulatory decisions under the law and applicable regulatory restrictions, and the system and channels it will include.

- C. The increase in the bandwidths of communication infrastructures in Israel, together with technological developments enabling the transmission of video content (including channels) via the internet, cellular networks and other infrastructures, and compression capabilities enable wider use of these infrastructures for the transmission of video content.

1. Transmission of video content over additional communication infrastructures – this development has led to an increase in the number and range of video content accessible to the public (whether with or without authorization from the holders of title to the content⁴⁸) via the various communication infrastructures⁴⁹, and to a change in the format in which downloaded content is used for streaming. Viewing the content is by means of various items of terminal equipment, among them computers, televisions, tablets, and mobile phones. This trend allows diverse video content to be provided without the need for establishing specific network infrastructure (including by international entities) and as at reporting date, this is also not under regulatory supervision.

As at reporting date, there are additional providers (other than Cellcom) that enable VOD viewing via the internet, such as AppleTV and Netflix (which offer, at this stage, content that does not have Hebrew translation). To the best of DBS knowledge, other entities are considering launching similar services.

The establishment and development of such services could substantially affect competition among multi-channel television providers and this effect could intensify if providing of such content continues without regulatory supervision (regarding possible regulation of the transmission of such video content, see section 5.17.12).

2. DBS's services over the internet - DBS provides VOD services via the internet (see section 5.2) as well as its yesGO service (see sections 5.4 and 5.17.5).

For information regarding regulation of broadcasts via new broadcasting technologies, see section 5.17.12.

5.1.2 Legislation, restrictions and special constraints in the segment of operations

Operations in the broadcasting sector are subject to extensive communications regulation, particularly the Communications Law, a strict licensing and monitoring regime and Ministry of Communications policy decisions. Broadcasting operations are also under the ongoing supervision of the Council, which sets policy, makes rules and monitors many areas of the sector, including broadcasting content, compliance regarding original Israeli productions, broadcasting ethics, consumer protection and approval of the channels broadcast and price controls.

As at reporting date, providing multi-channel television services by non-licensed broadcasters is not subject to the foregoing supervision.

In September 2014 the Prime Minister and Minister of Communications appointed an advisory committee ("Filber Committee") with regard to regulation of the broadcasting and content sector in order to formulate recommendations regarding regulation, including applicability on new players and formulating legislative amendments. This, in view of the substantial proceeds recognized by the Ministry of Communications leading to consolidation of content consumption platforms and requiring regulatory adjustments.

On February 3, 2016 the Filber Committee submitted its interim recommendations which include, among other things, applicability of broad regulatory duties (including the duty to invest in and present original productions) and soft regulation (that includes the duty to mark and classify content and restrictions on marketing content) for major providers that are defined as audio-visual service providers whose market share exceeds 20% of the television provider market revenues (and so long as the market share is no less than 15%), and applicability of soft regulation only for non-major audio visual providers.

The Committee also intends reviewing relief of regulation applicable to the broadcasting segment with regard to basic bundles and narrow bundles, regulating launching and removing of channels, broadcasting dates and times and broadcasts in various languages, as well as regarding the Council's rules relating to original productions, relief regarding the length of series, production adequacy and premier broadcasting duties.

⁴⁸ DBS is a shareholder of Zira Ltd., which acts to prevent infringement of video content copyrights over the Internet.

⁴⁹ Also see section 2.6.5B.

The Committee further recommended that a gradual four year plan be drafted regarding investments in high-end original productions, according to which, among other things, such investment duty will apply to DBS and HOT in an amount that will not fall below 4% in the first year for implementing the recommendations and to 3% in the fourth year (for further information regarding the duty of investment in original productions see section 5.17.4).

All the entities interested were invited to submit their responses to the Committee's recommendations by February 24, 2016. In February 2016, DBS submitted its response to the interim conclusions.

5.1.3 Changes in the segment's volume of operations and profitability

For further information concerning the changes in the scope of DBS's operations and its profitability, see section 1.5.4D.

5.1.4 Technological developments that may have material effect on the area of operations

For information concerning broadcasting of video content over communications infrastructure, see section 5.1.1C.

5.1.5 Critical success factors in the segment of operations and changes occurring in it

DBS regards the following factors as critical to the success of its operations:

- A. Quality, differentiation, innovation and originality in the content, variety, branding and packaging of its broadcasts.
- B. Provision of television services while using advanced technologies such as personal television services, and in particular, PVR set top boxes and VOD services (see section 5.2), as well as HOT services.
- C. Access to content via the internet for viewing over various terminal devices (with regard to yesGo services, see section 5.4)
- D. Offering communication service bundles that including television and other services such as telephony and internet (see section 5.17.11).
- E. High level of customer service.
- F. Brand strength and its identification with quality, innovation and industry-leading content and services.
- G. Price

5.1.6 Main entry and exit barriers for the segment of operation

The main entry barriers are: (a) the need for broadcasting licenses; (b) the investments required of carriers in the sector, including for acquisition and production of content, and in the broadcasting sector for setting up special infrastructures; (c) the limited volume and the characteristics of the Israeli market; (d) television sector saturation.

In recent years, some of these entry barriers have started to crumble as a result of regulatory changes (such as DTT, see section 5.1.1B) and of technological developments enabling transfer of video content over existing communication infrastructures, which at reporting date are not under regulatory supervision (see section 5.1.1C) and therefore there are unlicensed players operating in the television sector.

The main exit barriers are: (a) with regard to licensed broadcasters there are regulatory barriers – termination of operations under the Broadcasting License depends on a decision of the Minister of Communications to cancel the license prior to the end of the license term, under the conditions set out in the license, including arrangements (which could be imposed on the licensee) for ensuring the continuation of broadcasts and services and minimization of harm to subscribers; (b) long-term contracts with important suppliers, and with entities which granted DBS long-term loans and subscribers.

5.1.7 Alternatives for products in the sector and changes therein

With regard to multi-channel television broadcasts, DBS considers the following services as the main alternatives to its products:

- A. A variety of terrestrial channels broadcast to the Israeli public free of charge (for information regarding the DTT system, see section 5.1.1B). In addition, many foreign channels may be received in Israel using relatively inexpensive terminal equipment.
- B. Access to video content via various infrastructures, including the internet and cellular networks (for further information see section 5.1.1C).

5.1.8 Structure of competition in the sector and changes therein

Following its entry into the sector, in December 2014, the competition in the multi-channel television sector also included, other than the competition among the licensed broadcasters, Cellcom that provides Cellcom TV services.

The penetration rates of DBS and HOT are estimated by DBS to be approximately 62% of households in Israel⁵⁰. DBS believes that its chances of penetrating an additional material segment are not high for the reason that most of the remaining households are not potential customers for DBS and HOT, and the available alternative services to their services. To the best of DBS's knowledge, there has not been material change in the overall number of subscribers of DBS and HOT in recent years, mainly due to the strengthening of alternative products, however over the past year there has been a moderate increase in DBS's share of this market. An increase in the number of subscribers may be accomplished mainly by recruiting subscribers from the competition and recruiting new subscribers following the natural growth in the number of households. The broadcasting sector is characterized by fierce competition, which requires an investment of substantial resources to retain existing subscribers and recruit new ones. In addition to Cellcom entering the sector, in 2015 competition also increased due to the increasing use of pirated broadcasts.

For further information regarding competition in the segment, see section 5.7.

5.2 Products and Services

5.2.1 Broadcasts

DBS's broadcasts provide its subscribers with a wide variety of channels: there are approximately 150 video channels (including several pay per view (PPV) channels and more than 20 are HD (High Definition) channels), in addition to radio, music and interactive services.

Under the terms of DBS's broadcasting license and the Council's decisions, these broadcasts include a basic package or one of the base packages that every subscriber is required to purchase (the maximum price for the basic package is supervised by the Ministry of Communications), as well as additional user selectable channels, either as packages or as individual channels, and PPV channels.

5.2.2 Advanced services

DBS markets PVR set top boxes which interface with DBS's electronic broadcasting schedule and enable receipt of exclusive services, including advance booking of recordings, recording of series and pausing of live broadcasts.

DBS provides HD broadcasts which can be received through HD Zapper set top boxes. These broadcasts allow superior quality viewing.

DBS also markets HDPVR set top boxes that enable HD broadcasts and PVR services. In addition, these set top boxes also enable MultiRoom service through which, via a home network, content recorded on such set top boxes can also be viewed through other (HD Zapper or HDPVR) set top boxes in the subscriber's home.

⁵⁰ DBS's assessment of the broadcasting market penetration rates is based on the total number of DBS and HOT subscribers (according to HOT's reports), divided by the total number of households in Israel according to Central Bureau of Statistics data for 2014. DBS has no official data regarding Cellcom's penetration rate as at 31.12.2015.

The majority of DBS subscribers use advanced set top boxes (HDPVR, PVR or HD Zapper). DBS believes that an increase in the number of subscribers using PVR set top boxes will contribute to increasing its revenues from these subscribers and to retaining them as subscribers; however this requires material financial investment.

For marketing methods of these set top boxes see section 5.9.2.

DBS also operates its yesGo service, allowing subscribers to view the channels included under this service that they have purchased for home television viewing and VOD content, over a variety of terminal devices (smartphones, tablets and PCs)

5.2.3 VOD services

DBS provides VOD services for its subscribers via the internet, allowing user selectable content viewing. These services are provided for a service subscription fee, with additional charge for some of the content. Connecting to a service requires, among other things, certain types of set top boxes. In recent years, the number of DBS subscribers connected to VOD services and the consumption of VOD services has increased significantly, inter alia, due to the increased supply of available content, increase in available band width at subscribers' homes and significant increase in use of advanced set top boxes. Regarding the issue of regulating DBS's VOD services, see section 5.17.12 below.

5.3 Revenue of products and services

Following is a table containing a breakdown of DBS' revenues (in NIS millions):

	2015	2014	2013
Revenue from broadcasts and multi-channel television services to subscribers	1,774	1,708	1,617
Percentage of revenue	99% *	99% *	99% *

* The revenues balance is mainly due to payments from channels for broadcasting by DBS.

5.4 New products

In the reporting year, DBS launched its state-of-the-art HDPVR converter known as yesQuattro that allows recording of up to 4 channels simultaneously, in addition to the channel being viewed, has enlarged recording volume and allows automatic recording of prime time content (6:00 PM to midnight) on two channels that the subscriber can select, for seven days (known as PrimeTime service).

5.5 Trade receivables

The overwhelming majority of DBS's subscribers are private customers. DBS usually engages with its subscribers in subscriber agreements which regulate the rights and obligations of subscribers in their relations with DBS. Pursuant to the provisions of the broadcasting license, the subscriber agreement was approved by the Council and the Standard Contracts Tribunal. (This approval has expired). The Council has several applications from DBS to amend the subscriber agreement, which have not yet been agreed.

5.6 Marketing and Distribution

5.6.1 Marketing of DBS services is by way of publication in the various media. DBS sales to new subscribers are carried out via two key distribution channels (some by DBS employees and some by external resellers.

A. Sales representatives working to recruit subscribers.

B. Call centers that receive telephone inquiries from people interested in joining DBS services, as well as telemarketing campaigns to potential subscribers.

5.6.2 DBS's sales to existing subscribers are carried out through call centers operated by its employees.

5.7 Competition

5.7.1 Competitors in the market

DBS's main competitor is HOT, which also provides multi-channel television services to subscribers, under a broadcasting license. Cellcom also operates in the market, as well as other services provided via the internet such as Netflix and pirated services (see section 5.1.1).

Breakdown of DBS and HOT subscriber numbers and market shares⁵¹ to the best of its knowledge, at December 31, 2013, 2014 and 2015*.

2015		2014		2013	
Subscribers (in thousands)	Market share	Subscribers (in thousands)	Market share	Subscribers (in thousands)	Market share
635	44%	630	42%	600	40%

* The number of subscribers is approximate and the market share is rounded. Subscriber – one household or small business customer. In the case of business customers who have more than a minimum number of set top boxes (such as hotels, kibbutz or gym), the number of subscribers are standardized.

5.7.2 Nature of competition today

Broadcasting competition focuses on broadcasting content, and price and quality of services, as well as offering additional services, such as HD and VOD services, and advanced set top boxes, as a result of the demand for advanced and personalized television broadcasting (allowing customers to select what content and when to view it).

Competition also involves offering additional communication services together with video content (for information regarding service bundles offered by HOT and Cellcom groups see section 1.7.1).

5.7.3 Positive and negative factors of the competition

A. DBS's management estimates that DBS has competitive advantages, the main ones being:

1. Using the most cutting-edge technology worldwide for providing its services.
2. The quality and variety of content DBS broadcasts to its subscribers.
3. The level, quality and availability of DBS's customer service.
4. Fostering and promoting the YES brand as a preferred, popular brand with a high level of loyalty.

B. However, DBS's competitive operations suffer from inferiority or from adverse factors in a number of areas, the main ones being:

1. Inferiority of infrastructure – DBS's infrastructure is inferior because the satellite infrastructure does not enable bidirectional communication; it does not enable the provision of VOD services and does not enable the transmission of telephony and internet services, in contrast to the infrastructure of HOT which enables the supply of these services.
2. Regulatory restrictions -

For information regarding restrictions on marketing joint service bundles see section 5.17.11 below.

For information regarding restrictions under the Commissioner's conditions for a merger see section 1.1.2 above.

⁵¹ The assessment of DBS's market share in 2013 – 2015 is based on the total number of DBS and HOT subscribers (according to HOT's reports). Market shares are measured with regard to the broadcasting sector only (and do not include non-licensed players)

The establishment of the wholesale market reform as set out in section 1.7.3 does not allow DBS to purchase services from the Company according to which, particularly if the wholesale market reform will include telephony services, could ease the entry and establishment of new players.

3. Space segments - the use of space segments involves heavy expenses. Regarding the restriction on its ability to expand its supply of broadcasts see section 5.8.
4. For information regarding the transmission of video content via additional communication infrastructures without regulatory supervision - see section 5.1.1C.

5.7.4 Main methods for coping with competition

Below are the main methods used by DBS for dealing with competition in the broadcasting sector:

- A. Content – DBS acts to purchase, produce and broadcast high-quality, innovative and diverse content, creating differentiation of its content;
- B. Service – DBS places an emphasis on its customer service;
- C. Technology – DBS invests in expanding its technological capacities by focusing on providing innovative and advanced services, such as HD services and personalized television broadcasts.
- D. Branding – cultivation, promotion and differentiation of the YES brand;

5.8 Production capacity

The number of channels which DBS is capable of broadcasting to its subscribers depends on the number of space segments uses, its compression capability and the bandwidth required for transmission of each types channel. As at the reporting date, DBS uses almost all the space segments at its disposal, consequently any increase in the number of channels it broadcasts, particularly of HD channels (which require greater bandwidth) would require additional space segments or improving its compression software. DBS obtains the space segments from a company that is wholly controlled by the Company (see section 5.18.1).

5.9 Property, plant and equipment

Below are the main components of DBS's property, plant and equipment:

5.9.1 Land

DBS leases several real estate properties for its operations. Its head offices and main broadcasting center are located on leased land in Kfar Saba. The lease periods for these sites expire in 2019 and the lease periods for the other properties leased by DBS vary from one to 8.5 years (these periods are based on the assumption that DBS will exercise its options to extend these leases).

5.9.2 Terminal equipment

DBS installs a receiver dish and other terminal equipment in its subscribers' homes, including set top boxes enabling reception of broadcasts and smart cards for decoding the encrypted broadcasts. Some set top boxes are rented to subscribers for a fixed rental that is paid throughout the broadcast reception period, and others are lent to subscribers (some of those on loan require a deposit which is amortized over the subscription period)⁵². DBS discounts the end equipment installation costs as part of its property, plant and equipment.

During the reporting period, DBS purchased set top boxes from two suppliers under framework agreements. HDPVR set top boxes, in a total amount of NIS 51 million, were purchased from Advanced Digital Broadcast S.A. ("ADB"), the decoder manufacturer, and

⁵² A negligible number of decoders is sold to subscribers.

Eurocom Digital Communications Ltd. ("Eurocom Digital Communications"), the importer that also provides product warranty for the set top boxes which ADB undertook under the agreement. Eurocom Digital Communications is controlled (indirectly) by Shaul Elovitch, the controlling shareholder of the Company (the "ADB Agreement"). HD Zapper set top boxes, in a total amount of NIS 31 million, were purchased from Altech and another supplier, which at reporting date no longer supplies set top boxes to DBS. DBS may become dependent upon these suppliers⁵³.

5.9.3 Broadcasting equipment and computer and communications systems

DBS has its central broadcasting center in Kfar Saba and a secondary broadcasting center close to Re'em Junction from where it transmits its broadcasts. The broadcasting centers operate reception and broadcasting equipment, as well as computer and communication systems. The secondary broadcasting center is operated by a third party which provides services for operating and maintenance of the secondary broadcasting center for DBS under a contract which is valid until the end of 2018 (with DBS having an extension option).

5.9.4 Operating and encryption systems

In the reporting year, DBS acquired from NDS Limited ("NDS") development, licensing, assimilation, maintenance and warranty services with regard to the operating systems of the broadcasting system and the set top boxes, and the hardware related to these services, including those connected to the encoding of DBS services, and viewing cards that allow the foregoing encoded content to be viewed.

Since January 2016 DBS purchases these services and products from Cisco Group companies ("Cisco"), which is an affiliate of NDS, and this under an agreement signed between Cisco and DBS which has replaced the engagement with NDS. According to the agreement between Cisco and DBS, Cisco provides DBS with similar services to those provided by NDS, and provides products connected with the relevant systems and provides DBS with various licenses required for operating the systems and set top boxes.

For these services and products DBS pays Cisco one-time payments and periodic payments part of which are in a fixed amount and part are based on the number of active set top boxes of each type, and the ratio of part of the payments is fixed in the agreement as minimum annual amounts. The term of the agreement with Cisco is until December 2020 (with an automatic extension mechanism, unless one of the parties decides to end the agreement, subject to prior notice period as set in the Cisco agreement).

DBS is dependent upon the regular supply of these services and products, including integration of the various set top boxes that DBS uses for the operating system.

In 2015 DBS payments to NDS amounted to NIS 27 million.

5.9.5 Computerized billing system

DBS uses software and computer systems for managing its subscriber agreements, including its billing and collection system. In this regard, DBS engaged in a set of agreements with NetCracker Technology Solutions Ltd. and NetCracker Technology EMEA Limited (together - "NetCracker"), under which NetCracker granted DBS a non-exclusive license for using the system, and it undertook to provide DBS with maintenance services as set out in the agreements, and the ordering of services is done under project agreements that are signed from time to time. In return for NetCracker's products and services, DBS undertook to pay consideration comprising, inter alia, variable system user license fees depending on the number of subscribers, and variable costs for training, software upgrading, and maintenance and support services for operating the system.

DBS is dependent upon NetCracker's system and services due to their importance for managing and monitoring services and content purchased by subscribers and for billing its subscribers. System malfunctions or shutdown of these services to DBS could cause

⁵³ Replacing a supplier with another supplier does not involve additional material costs, however a substantial preparatory period is required to adapt the decoders of the alternative supplier to the DBS broadcasting and transmission systems (which is also dependent on these service providers, Cisco - see section 5.9.4), which could, in the event of the termination of the engagement at short notice, cause DBS loss of revenues.

operational difficulties until the fault is repaired or the system/supplier is replaced. As at reporting date the current project agreement for services and technical support is until the end of 2016 when DBS intends to sign another project agreement.

In 2015 DBS payments to NetCracker amounted to NIS 10 million.

5.10 Intangible assets

5.10.1 Licenses

D.B.S. owns the following key licenses:

- A. Broadcasting license valid through January 2017⁵⁴ – this license is material to DBS's operations and is the main regulatory permit for its operations (for the conditions of this license, see section 5.17 below). DBS applied to the Ministry of Communications in July 2015 for an extension of the broadcasting license for a further 6 years and to the best of its knowledge, this application is under review.
- B. A satellite television license for broadcasting in the Administered Territories, valid through December 2016, the terms of which are similar to those of DBS's main broadcasting license, and DBS broadcasts to the Administered Territories under this license⁵⁵.
- C. License to perform uplink operations (transfer of broadcasts from DBS's broadcasting center to the broadcasting satellite and implementation of set and ancillary operation activities), which is valid until January 2017 or until the end of DBS's broadcast license, whichever is the earlier. This license is essential for DBS's operations and is the regulatory permit for the transmission of broadcasting messages from the broadcasting center to the broadcasting satellites and from them to the subscribers' homes⁵⁶.

5.10.2 Trademarks

DBS owns registered trademarks with the main ones designed to protect its trade name (YES).

5.11 Broadcasting rights

5.11.1 DBS has the broadcasting rights of two types of video content.

Content purchased from third parties, including content and channels, that own the broadcasting rights thereto;

Content which DBS invests in producing (in full or in part), and in addition to the actual right to include the content in its broadcasts, DBS generally also has rights in such content, at the rates specified in agreements with the producers. In most instances, DBS is also entitled to issue authorizations to use the rights and share the revenues stemming from additional use of the content, in addition to DBS broadcasting thereof

The broadcasting and distribution of content by DBS over various media involves payment of royalties to the owners of copyrights and performance rights to music, sound recordings, scripts and directing of content, and for secondary broadcasting included under the Copyright Law, 2007 and the Performers and Broadcasters Rights Law, 1984. Such royalties are paid to several organizations operating in Israel, for collecting royalties on behalf of the owners of the intellectual property rights, under blanket licenses. Royalty payments under these licenses are, at times, based on a fixed payment and sometimes on various pricing methods, and with respect to some of the organizations, DBS may be

⁵⁴ At the end of this period the agreement may be extended for additional periods of six years each, subject to the terms of the broadcasting license.

⁵⁵ DBS applied to the head of Civil Administration in the Judea and Samaria area to extend this license for a further 6 years and received a response in November 2015 according to which the Ministry will act to extend it only once the DBS's general broadcasting license in Israel has been extended.

⁵⁶ DBS applied in July 2015 to extend the uplink license for a further six years and to the best of its knowledge this application is under review.

required to pay additional amounts as royalties for transmitting content via certain media, and in amounts that DBS estimates are not expected to be material.

This estimate by DBS is a forward-looking statement, based among other things on estimates by DBS, including regarding the amount of use of the content and the positions of the various organizations, and should any of them change, this estimate may change accordingly.

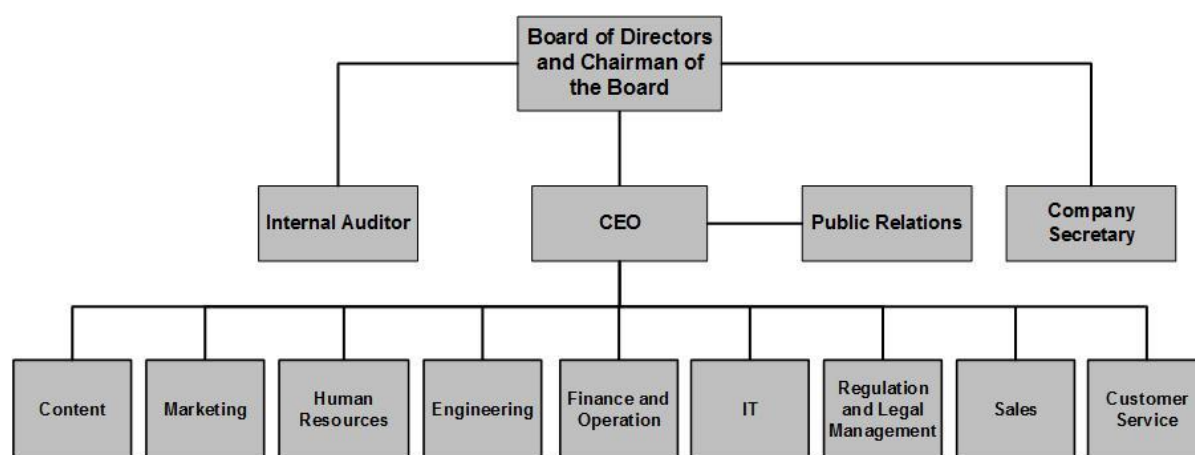
- 5.11.2** Given the many content providers from which DBS purchases broadcasting rights, DBS does not have a main content provider and is not materially dependent on any single content provider. However, with respect to broadcasts of Israeli sports, at the date of this report there is dependence on the purchase of the broadcasting rights of local sports channels by these providers.

In 2015, DBS paid for the purchase of broadcasting rights a total amount of NIS 189 million.

5.12 Human Capital

5.12.1 Organizational structure

DBS is made up of departments, each headed by a VP, who are members of DBS management.



(*) The Internal Auditor is not an employee of DBS.

5.12.2 DBS personnel by division

Division	Number of Employees	
	At Dec 31, 2015	At Dec 31, 2014
Marketing	37	36
Customer Service	1,169	1,227
Content Division	40	64
Engineering	118	106
Finance and Operations	115	106
Human Resources	60	59
Regulation and Legal Management	11	10
Technologies and Information	141	141
Management and Spokesperson	7	5
Sales	286	291
Total	1,984	2,042

5.12.3 Employee compensation schemes

DBS customarily awards its officers and managers, as well as some of its employees, annual bonuses based on attaining goals and performance assessment.

5.12.4 Benefits and employment agreements

DBS employees are employed under personal employment agreements, on the basis of a monthly salary or an hourly wage, with some of the employees also entitled to performance-based compensation. The employment agreements are generally for an undefined period, and each party may terminate the agreement by prior notice in accordance with the agreement or the law. DBS employs people in some of its departments on the weekly day of rest and on days of rest prescribed by the State, and it has an appropriate permit for such employment.

5.12.5 Labor union

On February 18, 2015 DBS received notice from the New Labor Federation ("the Histadrut") that more than one third of DBS employees had joined the Histadrut. On February 24, 2015, after reviewing the enrollment forms that DBS received from the Histadrut, DBS confirmed the Histadrut's notice and recognized it as the representative workers union of DBS and as at reporting date the parties are conducting negotiations to reach a collective agreement.

5.13 Trade payables

For a description of the engagement with Spacecom, see sections 5.8 and 5.18.1.

For a description of the agreements with the decoder suppliers, see section 5.9.2

For a description of the agreement with NDS and the engagement with Cisco, see section 5.9.4.

For a description of the agreement with NetCracker, see Section 5.9.5.

With respect to the purchase of the broadcasting rights to local sports channels, see section 5.11.2.

5.14 Working capital:

The working capital in DBS financial statements for 2015 are made up as follows: current assets such as cash and cash equivalents, short term bank deposits, other receivables, amounting to a total of NIS 319 million; current liabilities such as: borrowings from banks and current maturities of debentures, trade payables, other payables and provisions, amounting to a total of NIS 903 million.

5.15 Financing

5.15.1 Average interest rate on loans

Source of financing		Amount at December 31, 2015 (NIS millions)	Currency or linkage	Average interest rate	Effective interest rate
Long-term loans	Banking sources	64	NIS	3.45%	3.48%
	Non-bank (1)	1,210	CPI-linked NIS	6.2%	6.93%
	Shareholder loans(2)	4,567	CPI-linked NIS	6.1%	6.2%

(1) The non-banking credit, which is valid until December 31, 2015, is made up of debentures (see section 5.15.3).

(2) Loans provided to DBS by its shareholders are linked to the CPI and are divided into three types: A. interest-free loans; B. loans bearing annual interest of 5.5%; C. loans bearing annual interest of 11%; Also see section 5.18.4.

5.15.2 Bank financing

A. In the reporting year DBS was party to a financing agreement with a consortium of banks which was renewed in July 2012 (respectively: "the Financing Agreement" and

"the Banks"). According to the Financing Agreement, DBS received an on-going credit facility until the end of 2015 DBS in the amount of NIS 170 million, and a hedge facility of USD 10 million. According to the Financing Agreement in each quarter DBS is required to comply with EBITDA/debt ratio and (E-C)/maximum debt ratio criteria as set out in the Financing Agreement. As at December 31, 2015 DBS is in compliance with these covenants. On December 31, 2015 the Banks approved the repayment of the entire unpaid balance of the borrowings provided by the Banks under the Financing Agreement and on December 31, 2015 the Financing Agreement was terminated as well as all of DBS's liabilities thereunder towards the Banks, and accordingly, all the liens charged in favor of the Banks were canceled.

As at the reporting date, some of the Banks extended to DBS lines of credit and unsecured guarantees.

- B. In December 2014 DBS engaged in an agreement for bank borrowings ("the Loan Agreement") that is unsecured, in the amount of NIS 75 million, bearing fixed annual interest of 3.4%. The foregoing bank borrowings were extended for a period of five and a half years (until June 2020) and were repaid and will be repaid (principal and interest) in 11 consecutive semi-annual installments commencing June 2015.

The Loan Agreement provides grounds for calling for immediate repayment, including various violations of the Loan Agreement, dissolution procedures and receivership against DBS, cancellation or suspension of the broadcasting license, unauthorized change of control, material violation of material agreements defined in the Loan Agreement and calling for immediate repayment of amount due from DBS to debenture holders, other banks or financial institutions. In December 2015 an amendment to the Loan Agreement was signed, under which certain provisions in the Loan Agreement were amended or rescinded, including cancellation of DBS obligation to comply with financial covenants and restrictions applicable to dividends and DBS repayment of shareholders loans.

5.15.3 Institutional financing

- A. DBS has two debenture series issued to institutional investors and that were listed under the TACT institutional system at the TASE. A debenture series issued in 2007 under a deed of trust between DBS and Hermetic Trust (1975) Ltd. ("Trustee A" and "Deed of Trust A", respectively) and its expansion in April 2014 ("Debentures (Series A)") and a debenture series issued in 2010 under a deed of trust between DBS and Hermetic Trust (1975) Ltd. ("Trustee B" and "Deed of Trust B", respectively) that was expanded in 2011, 2012, 2013, 2014 and in April and May 2015 ("Debentures (Series B)").

Under Deed of Trust A, DBS created a first degree floating charge, unlimited in amount, in favor of Trustee A on all the company's assets (other than exceptions due to the provisions of the Communications Law), that contain a condition restricting the creation of additional charges (subject to exceptions set out in Deed of Trust A and the Deed of Pledge), and (subject to exceptions provided by the Communications Law) a first degree fixed charge, unlimited in amount, over the rights and assets of the company, including its rights under material agreements to which it is party, its unissued registered capital, its goodwill, certain intellectual property rights and insurance rights to which it is entitled under the insurance policy taken out for it.

Under Deed of Trust A DBS may record, in favor of holders of other debentures that it may issue, first degree liens and/or add them to liens in favor of Trustee A, without requiring the consent of Trustee A.

Deed of Trust A and Deed of Trust B set out usual events (such as insolvency proceedings, violation, exercise of liens on most of the company's assets and others) that, should they occur, following a warning period and under terms that were set in each Deed, establish the right to call for the immediate repayment of the debentures, subject to the provisions of the Deed of Trust, and the right to call for immediate repayment in the event of calling for immediate repayment of another DBS debenture series, if the outstanding balance exceeds the amount fixed in the Deed of Trust.

For further particulars relating to the debentures, see Note 12.4 to the financial statements.

- B. In September 2015 Bezeq signed a deed of guarantee to meet DBS's liabilities in favor of the holders of Debentures (Series B), against reducing the interest rate on Debentures (Series B), and cancellation of collateral (which were similar to those recorded in favor of Trustee A) and various provisions of Deed of Trust B, and all in accordance with the terms set in Deed of Trust B. For further information, see Note 12.4 to the 2015 financial statements.
- C. Until December 2015 DBS was party to a debenture dated May 2012 signed between DBS and several institutional investors providing it with a loan ("Debenture 2012"). On December 20, 2015 DBS made early redemption of the full outstanding balance of the loan provided under Debenture 2012, with a loan extended to it at that time by the Company (see section 5.15.4).

5.15.4 Loan from the Company

In December 2015 the Company provided DBS with a loan in the amount of NIS 323 million, bearing fixed annual interest of 3.6% (but no less than the minimum interest rate under section 3(J) of the Income Tax Ordinance [New Version] (for further information in this regard see section 2.13.8).

5.15.5 S&P Maalot ratings for DBS and its debentures

In October 2015 S&P Maalot announced that it was upgrading DBS rating (by making it equivalent to the rating of the Company following the Company's acquisition of all DBS shares), so that DBS is rated ilAA (stable) (issuer rating), and the stable outlook is based on the rating outlook of the Company. The debentures issued by DBS are rated by S&P Maalot as ilAA.

5.15.6 Credit facilities (in NIS millions)

Credit facility	Used as at Dec. 31, 2015	Used as at Dec. 31, 2014
0	0	4

5.15.7 Estimate regarding the need to raise sources of financing in 2016

According to the payment schedule for DBS's debentures, in 2016 DBS is expected to repay approximately NIS 458 million on account of principal and interest of its loans.

DBS finances its operations mainly from cash flows from ongoing operations and by raising debt.

The management of DBS believes that the financial resources available to it, including among other things receiving loans from the Company, will be sufficient for its operating needs in the coming year based on the projected cash flow approved by DBS's board of directors.

5.16 Taxation

DBS has losses for tax purposes and deductions for inflation carried forward to the next year and recognized in the statements of financial position in the amount of NIS 5.4 billion.

In December 2015 DBS received a stage A tax assessment for 2010 - 2011 (not part of an agreement), the main issue being non recognition of financing expenses recorded by DBS pertaining to shareholder loans. DBS intends submitting an objection against the assessment. This, further to the dispute between the Company and the tax assessor regarding financing income accrued on the shareholders loans provided by the Company to DBS (see Note 6 to the 2015 financial statements).

As part of the explanations regarding the assessment issued for DBS, it is noted that the assessment was issued as a precaution and without prejudice to the claims in the orders issued to the DBS shareholders, inter alia, since it has not been proven to the assessing officer that DBS is expected to pay these expenses. The assessment explanations also note that the shareholders of DBS did not report the financing income and even conducted a test, among other things, for impairment and this

in view of their opinion that DBS cannot even repay the principal of the loan it received. The assessing officer noted that he was reserving the right to add further arguments also due to DBS and the Company's intention to merge.

The significance of issuing this assessment to D B S, as the Company understands, is as follows:

1. The Company believes that the assessment was issued because the tax returns filed by DBS were about to be considered as final on December 31, 2015, as the overall issue is currently under discussion between the Company and the assessing officer.
2. This is not a new issue, rather the implication on DBS tax returns of the dispute between the Company and the assessing officer that was reported in the Note, and for which the Company has set aside an appropriate provision, based on the Company's estimates.

In view of the Company's acquisition of DBS's entire share capital and due to the possible merger between the companies in the future, discussions are currently being held between the Company and the assessing officers for an agreed upon and comprehensive solution of the issue, which is liable to impact the tax returns of the Company and of DBS, respectively.

5.17 Restrictions on and supervision of the company

5.17.1 General

DBS's operations are regulated by and subject to an extensive system of laws that apply to the area of broadcasting, including primary legislation (and specifically the Communications Law and subsequent regulations), secondary legislation (including the Communications Rules), as well as administrative directives and Council decisions.

Additionally, DBS's operations are subject to the provisions of its licenses, and particularly the broadcasting license.

5.17.2 Eligibility requirements for satellite broadcasts licensee, cross-ownership restrictions

The regulations of the satellite broadcasting license place various restrictions on a licensee, including eligibility requirements that relate to the holdings of the owner of the license and the interested parties, directly and indirectly, in the licensees under the Law of the Second Authority and the owners of daily newspapers.

5.17.3 Tariff control

The broadcasting license provides provisions regarding the types of fees the licensee may collect from its subscribers for services provided under the license, and those fixed in DBS price list. The vast majority of subscribers join special campaigns offering DBS services, including various content combination packages, related services, as well as the receipt and installation of terminal equipment at prices below the listed price.

The vast majority of subscribers join special offers, which offer the services of DBS, including different combinations of content packages, related services, as well as the receiving and installation of terminal equipment at prices which below the listed price for all components of the special offer and they appear in the DBS price list. The Council chairperson may intervene in campaigns or reductions offered by DBS if he/she finds that they are misleading to the public or discriminate between subscribers.

Under Section 6(49) of the Communications Law, the license may stipulate maximum prices that can be charged to subscribers. At the date of this report, no such prices had been set. Furthermore, under section 2K(2) of the Communications Law, the Minister may set the price for the basic package. For details of the basic package see section 5.1.4.

In December 2015 the Council issued a hearing document regarding setting of a price policy and applicability of transparency provisions ("Hearing Document"), addressing the multi-channel television market, including DBS.

Prior to issuing the Hearing Document the Council chairperson decided not to permit DBS, at this stage, to raise the price for its VOD services, out of apparent concerns of hidden

discrimination in the appendices. At the same time, the Council chairperson also decided not to approve the various price hikes announced by HOT.

The Hearing Document states, among other things, that based on the economic test conducted by the Council, the Council assumes that the current price structure in the multi-channel television market significantly harms competition and allegedly also raises concerns of discrimination and misrepresentation. Therefore, the Council initiated a hearing regarding its intention to prescribe comprehensive policies regarding prices in the multi-channel television market that will be based on various recommendations brought before the Council, including the recommendation to deny the option of raising the price of the current campaign within the period of the campaign; to provide that new campaigns will apply for subscribers for a limited period of 4 months only; to prohibit offering preferential prices to subscribers who threaten deserting or who are in the stages of disconnecting; to establish a prohibition on discrimination between campaigns and tracks offered at any given time; and to explore the option of canceling price gaps between existing customers unrelated to the date on which they joined and the track that they chose, as well as to define a standard uniform price for these subscribers.

- A. The Hearing Document also states that a recommendation was brought before the Council that if the reform and setting of a price policy will not achieve, within a reasonable time from a date set, the required objectives (as set out in the Hearing Document - significant improvement in transparency and simplifying the customers' ability to compare prices and the scope of the competitiveness), a more thorough investigation will examine applying price controls on the multi-channel television companies.
- B. The Hearing Document further states that in view of the economic study presented before the Council, and with special attention to the significance of the principle of transparency, the Council decided that it should order the duty of disclosure of all the price lists and campaigns of the companies in the multi-channel television market, by amending the licenses of the companies so that they will be required to publish on their websites all the campaigns offered at this time and thereafter, to all of the customers of the companies.
- C. Furthermore, the Hearing Document also notes that the Council decided that at this stage, and temporarily until the end of the hearing proceedings, it will put a freeze on price hikes in the multi-channel television market and will not allow companies to offer new campaigns (this decision regarding a temporary freeze was canceled in February 2016, also due to HOT and DBS undertaking to publish new campaigns).
- D. At the end of the Hearing Document, anyone wishing to, is invited to present their position with regard to the issues noted in the Hearing Document and in February 2016 DBS filed its response to the Hearing Document accordingly.
- E. If at the end of the Hearing proceedings the Council makes the decision under consideration, this could have a substantial adverse effect on DBS's revenues. This assessment of DBS is forward-looking information, as defined in the Securities Law, based in part on the decision under consideration and DBS's assessment with regard to its application. This estimate may not materialize, or it may materialize in a manner that differs significantly from that foreseen, in part depending on the actual decision that will be made and the method of costing that will be approved.

5.17.4 Obligation to invest in local productions

Under the provisions of the broadcasting license and the Council's decisions, in 2015 DBS was required to invest an amount no less than 8% of its revenue from subscription fees⁵⁷ in local productions, and according to the communications regulations and the decisions of the Council, DBS is required to invest different amounts of these investments in various genres of local productions. In 2015 DBS also supplemented investment shortfalls set by the Council for certain genres. The obligation to invest in local productions in 2016 remains at 8%, as aforesaid. In November 2015 the Council decided that the rate of the duty to

⁵⁷ Including DBS revenues from terminal equipment and installation, and pursuant to the Council's decision, also from VOD services.

invest in local production applicable for 2017 onwards will increase to 9%, so long as the Council does not order otherwise and so long as there is no decline in DBS's revenues or the number of its subscribers, at a rate and in a manner that are prescribed in the wording to be determined in the decision.

5.17.5 Requirement to transmit channels

In accordance with the requirements under the law and license, DBS is required to allow the producers of channels set out in the law to use its infrastructures to transmit broadcasts to its subscribers, and this in exchange for payment ("Transmission Fee") to be determined in the agreement, and lacking agreement - in exchange for a payment to be determined by the Minister, after consulting with the Council.

Pursuant to the amendment to the Communications Law in 2010, niche channels are exempt from fees other than to HOT and DBS.

5.17.6 Content of the broadcasts and obligations with respect to subscription

The broadcasting license sets out provisions that relate to the content of DBS's broadcasts, including an obligation to obtain the Council's approval of the channels broadcast by DBS. The Communications Law forbids holders of broadcasting licenses to broadcast commercials, other than a few exceptions.

The broadcasting license also includes provisions regarding the subscriber service terms, including discrimination prohibition.

5.17.7 Exit penalty restrictions

See section 1.7.4C.

5.17.8 Ownership of broadcast channels

Pursuant with the Communications Rules, DBS, including its affiliates as defined in the Communications Rules, may own up to 30% of the domestic channels it broadcasts (compared with the 20% applicable to HOT.) DBS is restricted under the Communications Law regarding ownership of news broadcast productions, however under the Communications Law (Telecommunications and Broadcasts) (Amendment No.59 and Temporary Order), 2014 and the Council's decision of March 2014, DBS broadcasts domestic news since April 2014. The Temporary Order was given for two years as of April 2014.

5.17.9 General provisions regarding the broadcasting license

The Minister and the Council have parallel authority to amend the broadcasting license. The Minister was authorized to cancel or postpone the broadcasting license for causes set out in the Communications Law and the broadcasting license. The Communications Law and broadcasting license stipulate restrictions on the transfer, attachment and encumbrance of the broadcasting license and any of the assets of the broadcasting license. The broadcasting license requires receipt of the approval of the Minister for specific changes in the holding of the means of control in DBS and imposes a reporting requirement regarding the holders of the means of control; hurting competition by way of an agreement, arrangement or understanding with a third party in terms of provision of broadcasts and services is prohibited, unless approved in advance and in writing by the Council; the obligation to file reports to the Ministry of Communications was defined as well as conditions regarding the regulation of the activity of the licenses; an obligation was stipulated to provide bank guarantees that are currently approximately NIS 40 million (principal) to the Ministry of Communications to guarantee DBS's undertakings under the license (in order to issue these guarantees, DBS shareholders provided securities to the issuing banks).

For information with respect to the restrictions relating to DBS regarding B Communications' acquisition of control in the Company, see section 1.7.6.

5.17.10 Wiring in subscribers' homes

In October 2012, the Ministry of Communications announced that it would cancel the administrative order applicable at that time, regulating subscriber churn between DBS and

HOT and reciprocal use of the infrastructure in subscribers' homes which in some cases is owned by the other provider. This announcement was further to the request by DBS and HOT to amend the administrative order, primarily for canceling the advance notice obligation for a subscriber connecting to another service provider. In 2013, DBS and HOT applied to the Ministry of Communications to amend this decision, so that the administrative instruction is not canceled but will be amended as they requested. As at reporting date the Ministry of Communications position on this issue has not yet been received.

5.17.11 Offering service bundles

Under the broadcasting license, DBS may offer joint service bundles that include service provided by the Company and service by DBS, subject to obtaining Ministry of Communications approval (and if no objections are raised within the period specified in the license, such approval will be deemed granted) and subject to conditions, the most important of which are the "unbundling" obligation, and the existence of a corresponding bundle marketed by a licensee that is unrelated to the Company (see section 1.7.2B). A joint service bundle that includes the Company's internet infrastructure service only, does not require Ministry of Communications approval and the unbundling obligation does not apply.

With regard to conditions published by the Commissioner with regard to the merger of the Company and DBS, see section 1.1.2.

DBS believes that in view of the development of competition between the communications groups and the growing importance of the supply of comprehensive communications services (see section 1.7.1C), if the restrictions with regard to the Company's collaboration with DBS (see section 1.7.2D) remain in place, the adverse impact of such restrictions on DBS's results may increase.

5.17.12 Regulation of the transmission of video content via media infrastructures

In July 2015, the committee that was appointed for examining regulation of the commercial broadcasts in 2014 submitted its final report. This report contains, among other things, the following recommendations: The establishment of a unified regulatory authority in the communications industry that will prescribe a list of issues that will be arranged through mutual regulation and a code of ethics, the duty to label and classify services, mandatory reporting dates for those entities that are required to report and measurable parameters for checking the level of competition in the communications sector.

For information regarding the Filber Committee interim report see section 5.1.2.

The committees' decisions, if applied, may affect the developing trend of video content transmitted over the web

DBS believes that the VOD services it provides over the web (see section 5.2.3), are not subject to the regulations currently applicable to the multi-channel television broadcasts and as far as it is aware. DBS also believes that the other services it provides via the internet (such as yesGo) are also not subject to such regulation. Nonetheless, from the Council's various decisions (also see section 5.17.3) it appears that the Council believes it is authorized to also regulate these services regarding DBS. Of the foregoing regulations will be formulated or applied, they may affect the foregoing services provided by DBS.

DBS's estimates in this instance are forward-looking information, as defined in the Securities Law, based in part on the recommendations of the foregoing interim report as published at this date. It is not certain that these recommendations will remain as is in the committee's final report, or that they will be implemented by the Ministry of Communications. These estimates may not materialize, or they may materialize in a manner that differs significantly from that foreseen, in part depending on the final recommendations of the committee, if they will be implemented and how they will be put into practice.

5.18 Material agreements

Following is a brief description of the main points of the agreements likely to be considered as material agreements not in the ordinary course of DBS's business, which have been signed and/or are valid in the period of the Periodic Report:

5.18.1 Space segment leasing agreement

Under the agreement with Spacecom Communications Ltd. ("Spacecom")⁵⁸, DBS leases Amos satellite space segments ("Space Agreement"). The term of the agreement is until 2028, whereby in the first stage, the space segments available for DBS use are on satellites Amos 2 and Amos 3, until the end of the Amos 2 shelf expectancy, which according to what DBS was told by Spacecom, is expected to be at the end of September 2016. Once Amos 2 expires, space segments will be available on Amos 3 (until the end of its life expectancy in 2022) and Amos 6, which as DBS was told by Spacecom, as at the reporting date, is expected to be launched in the third quarter of 2016 (which requires several weeks after launch before the satellite begins operating) and its life expectancy is expected to be until 2018⁵⁹.

The agreement is for the lease of 12 space segments, however from 2022 the lease will be for 9 space segments. From commencement of Amos 6 operations, DBS will have rights to lease up to two additional space segments (at the same price as the other segments) by giving notice up to the end of 5 years from the foregoing operations commencement date, and will be entitled to give notice of termination of the lease of the additional segments by prior notice.

In the event of malfunction or non-availability of space segments on any of the satellites, a mechanism will be applied for partial backup on that satellite or on another satellite, if DBS leases space segments on it at that time. Furthermore, Spacecom undertook to make its best reasonable efforts to backup segments that are not supported as aforesaid on the Amos satellites, and if Spacecom is not able to do so, to provide alternative capacity on a satellite of another operator (setting Spacecom's participation in any additional costs, in insignificant amounts, if incurred).

The leasing fee in 2015 amounted to approximately NIS 95 million.

DBS is materially dependent on Spacecom, as the exclusive holder of the rights and the sole provider of space segments used by DBS, which is also responsible for operation of the space segments. With respect to exposure to risks in the event malfunction or unavailability of any of the satellites, see section 5.21.3D.

In 2011, Spacecom notified DBS concerning a malfunction in the battery of the Amos 3 satellite, which could cause, during certain periods, limited activity of the satellite and took operational action to prevent harming DBS broadcasts. According to the information DBS received from Spacecom, to date the failure has not affected the service that DBS receives from Spacecom, and is not likely to have an effect.

This opinion is forward-looking information, as defined in the Securities Law, based in part on Spacecom's publications regarding the fault and its repercussions and on the materialization of Spacecom's estimates as submitted to DBS. Consequently, this opinion may not materialize, or may materialize in a manner different from that anticipated, in part depending on technical and operating conditions relating to the satellite and the malfunction, as well as on other operational or other measures, insofar as they are taken by Spacecom.

⁵⁸ A company controlled by the controlling shareholders in the Company.

⁵⁹ These estimates concerning the launch of Amos 6 satellite, commencement of the satellite operation and end of their life expectancy are forward-looking information, as defined in the Securities Law, based among other things on the information given by Spacecom to DBS and which, in part, is not in the control of Spacecom, and is dependent on its engagements with third parties. Consequently, these estimates may not materialize or may materialize in a manner significantly different from that expected, inter alia, depending on conditions relating to the launching of satellites, commencement of satellites operating, conditions required for their proper running and the end of the life expectancy of existing satellites, and other external factors that impact their operation and the operations of Spacecom.

5.18.2 Financing agreement with the Banks

For a summary of the agreement that terminated on December 31, 2015, see section 5.15.2.

For a summary of the agreement with a bank, see section 5.15.2.

5.18.3 Deeds of trust regarding Debentures (Series A) and Debentures (Series B) and Debenture 2012

For a summary of the main points of the Deeds of Trust and Debenture 2012 (that was redeemed during the reporting year), see Section 5.15.3.

5.18.4 Agreements between DBS and the Company

DBS and the Company are party to agreements that provide, inter alia, priorities for shareholders' loans granted to DBS subsequent to July 10, 2002 over earlier loans, whereby these agreements will bear CPI linkage differentials and annual accrued linked interest rate of 5.5%, and the loans granted after April 27, 2003 would bear CPI linkage differentials and an annual accrued linked interest rate of 11%.

5.19 Legal proceedings⁶⁰

5.19.1 Pending legal proceedings

	Date	Parties	Court	Type of Action	Details	Amount of Claim
A.	March 2013	Customer v. DBS	District (Central)	A financial claim filed with a motion to certify it as a class action.	The applicant claims that DBS disconnected customers from channel 5+ and reconnected them only after the said customers contacted the Company and requested reconnection but continued collecting fees for the channel from those customers who did not contact them and were, therefore, not reconnected. The parties conducted negotiations to end the proceedings by settlement. In May 2015 the parties filed a motion with the court to approve a settlement under which DBS will grant the members of the class action group a benefit and will pay compensation to the class action plaintiff and his legal fees ("the Settlement Agreement"). In September 2015, the Attorney General's position regarding the settlement agreement was received, according to which the settlement agreement should not be approved as is because it does not provide real compensation for the group members. During the hearing before the court in December 2015 on the motion to approve the settlement arrangement, the court suggested that the parties amend the settlement arranged so that part of the group members will be given a higher credit to purchase DBS products and another part will not be given the benefit. In February 2016, DBS filed an amended recommendation to the courts for granting a credit to part of the group members only, in a higher amount (with two alternatives) in the different credit format than that suggested by the court.	The applicant estimates the damage to himself at NIS 1,065 of which NIS 1,000 is non-monetary damage, but did not include a total amount for the suit.
B.	June 2014	Customer and apartment building representatives vs. DBS	District (Tel Aviv)	A financial claim filed with a motion (consolidated) to certify it as a class action.	It is claimed that DBS unlawfully charged residents in apartment buildings (subscribers and non-subscribers of DBS) for the electricity consumption for the satellite dishes and/or amplifiers and/or other devices that DBS uses, that are located on these apartment buildings. The applicant has petitioned the court, inter alia, to order DBS to refund to the members of the group, the amount collected for electricity consumption as aforesaid. The second lawsuit (that was originally filed with the District Court in Haifa, and was moved for hearing before the District Court in Tel Aviv in September 2014) includes a claim that DBS installed equipment in apartment buildings that operate on electricity and according to their claim, DBS connected the outside equipment without approval and consent of the apartment buildings in which the equipment was connected to the communal electricity and also consumed electricity without paying for it. In October 2015, the court ruled to consolidate the proceedings in both motions for certification and filing of consolidated statements.	NIS 80 million is for monetary and non-monetary damages allegedly caused due to the electricity consumption for DBS systems and an injunction ordering DBS to install electricity meters for measuring the electricity consumption of DBS's systems. The costs were estimated in the motion to amount to NIS 44.6 million.

⁶⁰ For information concerning reporting policies and materiality, see section 1.1.

Chapter A (Description of Company Operations) of the Periodic Report for 2015

	Date	Parties	Court	Type of Action	Details	Amount of Claim
C.	September 2014	Customer v. DBS	District (Tel Aviv)	A financial claim filed with a motion to certify it as a class action.	A claim regarding electronic advertisements sent by DBS to its customers, allegedly in contravention of Section 30A of the Communications Law, in breach of DBS's license and breach of the agreement between DBS and its customers. The applicants petitioned the court for relief for the inconvenience caused to the customers of DBS, harassment, loss of time, etc. and relief in an amount that will be determined at the court's discretion, for enrichment of DBS as a result of sending these messages.	NIS 402 million (with additional relief to be determined at the court's discretion).
D.	July 2015	Customer v. DBS	District (Central)	A financial claim filed with a motion to certify it as a class action.	A claim of discrimination of DBS customers who are not offered or given the best terms or the lowest price for the services they received from DBS; a claim of discrimination against new DBS customers over existing customers who are eligible for receiving a campaign or benefit for joining DBS; and a claim of discrimination of new members who are acquainted with the company's employees, over other new members. This, according to the allegations, is contrary to DBS obligation under its license and by law to refrain from discriminating with regard to the price for the services it provides. The applicant requests that DBS will compensate members of the group for the monetary difference between the price that each of them actually paid to DBS for the services, and the lowest price they could have paid for those services. In addition, the applicant requests that the court order DBS to offer and provide its services to everyone requesting its services at the same terms and to publish them in its various publications. In September 2015, following the filing of another motion to certify a class action against DBS which engages as alleged, in price discrimination, the court held that the two actions will be defined as related cases and in November 2015 the court ordered the consolidation of two motions to certify.	The applicant does not specify the amount of the claim, but the extent of the damage is estimated to be tens of millions of shekel. The amount of the second claim is estimated by the applicants to be NIS 13 million plus monetary damages as will be awarded by the Court,
E.	December 2015	Customer v. DBS and HOT	District (Central)	A financial claim filed with a motion to certify it as a class action.	A claim that DBS and HOT operate illegally by providing their customers with premium content services, (as part of the VOD service of DBS and HOT), that is provided under transactions for fixed periods and automatically renewable, while charging their customers for the service unilaterally, without the clients' consent and in violation of the law. Thus, allegedly, they charge their customers illegal amounts and while enriching themselves unjustly.	The applicants do not explicitly mention the amount of the claim, but believe that the conduct described provides DBS and HOT annual income of tens of millions of shekels.

5.19.2 Legal proceedings which ended during the reporting period or by the date of publication of the report

	Date of filing of the action	Parties	Court	Type of Action	Details	Amount of Claim
A.	February 2015	Customer v. DBS	District (Tel Aviv)	A financial claim filed with a motion to certify it as a class action.	It was claimed that the way subtitles are inserted in DBS's television broadcasts detract from the enjoyment of its hearing impaired customers. Thus, it is claimed that DBS misleads its customers regarding the quality of the service it provides and unjust enrichment. The applicant seeks, for the represented group, inter alia, relief of compensation for the alleged damages caused to users due to DBS's alleged deception. In July 2015 a ruling was handed according to which the court approved the motion for withdrawal filed by the applicant, with DBS's agreement.	NIS 126 million

5.20 Goals and Business Strategy

- 5.20.1** DBS's goals are to increase its operating margins and to continue streamlining efforts while maintaining its business and competitive position in the sector.
- 5.20.2** To achieve these goals, along with efforts to reduce costs, DBS intends to invest considerable effort in marketing and sales, and in appropriate marketing strategy designed to continue attracting subscribers; and to retain existing customers; continually improve the array of services to subscribers, create differentiation and innovation in its broadcasting content, to increase the amount of content purchased by each subscriber and expand DBS's value-added services, and to invest in the development and integration of advanced technologies and new services. These efforts include DBS's drive to increase the rate of penetration of advanced services, including the PVR set top boxes and VOD and HD services among its subscribers as well as to also provide its content on additional platforms, such as yesGo (see section 5.4 above), to increase DBS revenues and enhance subscriber loyalty to DBS's services.
- 5.20.3** DBS's foregoing goals are forward-looking information, based on forecasts by DBS's management, current trends in the broadcasting market and DBS's assessment regarding competition in the broadcasting sector, and the regulation which applies and which will apply to DBS and other players, taking into account the restrictions that apply and will apply to the Company, and which affect DBS. However, the forecasts of DBS's management may not materialize, or may materialize in a significantly different manner, due to changes in demand in the broadcasting market, fiercer competition in this sector, the entry of additional providers into the sector or alternative sectors, and in light of the regulatory restrictions which are or will be imposed on DBS or on its partnerships with the Company and other entities in the sector.

5.21 Risk Factors

Following is a list of the threats, weaknesses and other risk factors of DBS (the "Risks") attributable to the general environment, industry and special nature of its operations.

5.21.1 Macro risks

- A. Financial risks – a material part of DBS's expenses and investments are linked to fluctuations in the exchange rate of the US dollar (particularly content, satellite segments, purchase of set top boxes and additional logistics equipment). Therefore, sharp fluctuations in the exchange rate will have a effect on DBS's business results. In addition, the loans taken out by DBS from its shareholders and the debentures DBS issued are linked to the consumer price index and, therefore, sharp rises in inflation rates could have a material effect on DBS's business results.
- B. Recession – an economic recession, increase in unemployment rates and a decrease in disposable income might bring about a decrease in the number of DBS' subscribers, a decrease in DBS' revenues and harm to its business results.
- C. Security situation - An ongoing unstable security situation in large areas of Israel, which disrupts the day-to-day lives of the residents, could have an adverse effect on DBS's business results.

5.21.2 Sector-specific Risks

- A. Dependence on licenses - DBS provides multi-channel television broadcasts under a broadcasting license and other licenses. Violation of the provisions of the licenses and of the law under which the licenses are issued could bring about, subject to the license conditions, revoking, amendment or suspension of the licenses and consequently material harm to DBS's ability to continue operating.
- B. Regulation - DBS's operations and broadcasts are subject to obligations and restrictions set out in legislation and to a system of licensing, oversight and approvals from various regulatory bodies, and consequently DBS may be affected and restricted by policy considerations dictated by these entities and by their decisions and changes in communications legislation (see section 5.17). Regulatory changes may impact DBS's operations and may have an adverse effect on its financial results. Likewise, the entry of content providers transmitting video content, as set out in section 5.1.1C

above, without applicable regulation of their operations and/or without amending the regulations applicable to broadcasting licensees, may significantly affect DBS's financial results. Furthermore, as a provider of public services, DBS operations are subject, inter alia, to consumer protection regulation.

- C. Fierce competition - there is fierce competition with HOT (see section 5.1.8 above) and more recently with Cellcom, which requires DBS to constantly and continually invest in attracting and retaining customers, and dealing with high subscriber churn rates between the companies. For details regarding competition with HOT, see Section 5.7.
- D. Technological developments and improvements - the risk in the development of new technologies is that they will render existing technology inferior, forcing DBS to invest large amounts for retaining its competitive edge. Furthermore, such technological advances and developments may also facilitate increased accessibility to video content, allowing other providers to offer content viewing services without the need for heavy investment that may make it difficult for DBS to recruit new subscribers, retain existing subscribers and offer its services, requiring it to invest large amounts and posing a threat on its competitive standing (see section 5.1.1C).
- E. Alternative multi-channel broadcasting infrastructures - the DTT activity, and particularly its expansion, may have an adverse impact on the financial results of DBS (see section 5.1.1B)
- F. Piracy – the broadcasting sector is exposed to viewers' pirate connections for receiving broadcasts without paying subscription fees and is exposed to public access to content to which the broadcasting providers have rights.
- G. Exposure to class action lawsuits - there is exposure to class action lawsuits in material amounts

5.21.3 DBS specific risks

- A. Exposure to calls for immediate repayment of loans due to non-compliance with loan agreements - DBS failure to comply with the provisions of its agreements with financiers may, in accordance with and subject to their provisions, entitle the relevant lenders grounds to call in all the loans provided to DBS for immediate repayment and exercise of the securities provided by DBS to some of the lenders. With regard to the possibility of DBS debts being called for immediate repayment in the event that the credit provided by another lender is called for immediate repayment, see section 5.15.
- B. Restrictions resulting from the ownership structure - DBS is restricted in joint ventures with the Company with respect to offering communications service bundles that has a material impact on DBS's business status and competitive ability (see section 5.7.2).
- C. Existence of sufficient cash flow - DBS is required to maintain a cash flow which is sufficient for compliance with its business plan and with repayment of the credit it used. The absence of a sufficient cash flow may impact on the ability of DBS to increase its rate of penetration of advanced services (such as PVR and HDPVR set top boxes) and to make it more difficult for it to face the competitive threats in view of technological developments and consumption patterns in the field.
- D. Satellite malfunction and damage - DBS broadcasts via space segments on the Amos 2 and Amos 3 satellites stationed at identical points in space. Failure in one of the satellites, damage to one of them or unavailability (including unavailability of a new satellite designed to replace an earlier satellite that ceased broadcasting) could disrupt and reduce the volume of DBS transmissions, and as at the date of this report such disruption are likely to be more significant in the case of failure, damage or unavailability of the "Amos 2" satellite, on which the majority of DBS segments are leased. Nonetheless, the duplication of the satellites via which broadcasts are transmitted to subscribers as of reporting date (and which is expected to continue until 2022⁶¹), also in view of the partial backup mechanism prescribed in the Spacecom

⁶¹ See footnote 59.

agreement, significantly reduces the risk entailed by damage, failure or unavailability of one of them, and improves the sustainability of the broadcast. In such event it could be possible to broadcast most of DBS's channels via the space segments available to DBS on the other satellite, and perhaps even via additional segments on the same satellite that might be made available for DBS use by Spacecom, but not all the channels broadcast (for the agreement with Spacecom, see section 5.18.1). DBS is not insured against loss of revenues caused by satellite malfunction.

DBS's estimate as aforesaid in this paragraph is forward-looking information. This assessment is based on Spacecom providing space segments and Spacecom's assessment with regard to the continuing life of the satellite, the new satellites starting to operate and the end of the operation of the existing satellites. This estimate may not materialize or may materialize partially or differently if there will be changes in the life expectancy of the satellites or if Spacecom does not provide DBS with alternative segments due to unavailability or malfunction of the space segments or the satellites.

- E. Dependence on holders of rights in the space segments - DBS is materially dependent on Spacecom, as the exclusive holder of the rights and the sole provider of space segments used by DBS, and is also responsible for operating the space segments (see Section 5.18.1).
- F. Dependence on providers of software, equipment, content, infrastructure and services - DBS is dependent on certain providers of software, equipment, content and services, including broadcast encryption services (see section 5.13). Failure to receive the products or services they provide could harm DBS's ability to function and results.
- G. Dependence on use of internal wiring - DBS is dependent on the use of internal wiring in some subscriber homes, which is owned by HOT (see section 5.17.10). Denying the use of Hot infrastructure would constitute a substantial barrier to DBS's subscriber recruitment.
- H. Damage to broadcasting centers - damage to a broadcasting center operations may cause a significant difficulty for continuing broadcasts, however, splitting of broadcasts into two broadcasting centers (Kfar Saba and Re'em Junction) reduces the risk involved if one sustains damage and improves the survivability of some of the broadcasts. In the event of damage to one of the broadcasting centers, DBS will be able to continue broadcasting only part of its channels from the other broadcasting center. This is more significant in the event of damage to the Kfar Saba center, which is the only center with the capacity for broadcasting some of DBS key channels. All the broadcasting centers have identical encryption systems and therefore backup is also available for the encryption system in the event of damage to one of the broadcasting centers. Damage to DBS's logistics center could also be a cause of disruption of its operations.

DBS's assessment as set out in this paragraph is forward-looking information. This estimate is based on the provision of services from the supplier that operates the secondary broadcasting site in the event of damage to the Kfar Saba broadcasting center. Malfunction of DBS's computer systems - A significant malfunction in DBS's central computer systems is liable to wreak havoc with its operational capability.

- I. Malfunction of DBS's computer systems - a significant malfunction in DBS's central computer systems is liable to significantly affect its operational capability. DBS has a remote backup site, designed to be activated and provide partial computer services within a few hours in the event of malfunction, however, it will be impossible to execute significant DBS operational capacities without the proper operation of the central computer systems
- J. DBS's estimate with respect to its backup capability, as aforesaid in this paragraph, is forward-looking information. This estimate is based on the functioning of the remote backup site. This estimate might not be realized or might be realized to some or other extent if this functioning is not enabled.
- K. Technical inferiority and the inability to offer integrated services - DBS's technology is inferior to that of Hot. This technical inferiority prevents DBS from providing telephony and internet services, and various interactive services, including VOD, via its infrastructure; and therefore depends on third parties for providing them.

- L. Malfunction of the encryption system or its enforcement – DBS's broadcasts are based on the encryption of broadcasts transmitted via satellite and encoded via smart cards that are installed in the set top boxes in subscribers' homes. Defects in the encryption system or its enforcement or a breach thereof could make it possible to view broadcasts without payment to DBS, thereby causing a reduction in revenues and a breach of the agreements between DBS and its content suppliers.
- M. Lack of exclusivity on frequencies - The spectrum of frequencies used by DBS to transmit its broadcasts from the broadcasting satellites to the satellite dishes installed in subscriber homes, and which is allocated in accordance with the license from the Ministry of Communications, is defined as a frequency spectrum with a secondary allocation, such that an Israeli party that is allowed to make authorized primary use the frequency spectrum. If the foregoing owner of the primary allocation uses the frequency spectrum, this may cause adverse impact on the quality and/or availability of DBS broadcasts to its subscribers, which may adversely affect the financial results of DBS. At the date of this report, to the best of DBS's knowledge, the primary allocation holder has not made use of said frequencies in a manner that caused any real and/or lengthy disruptions to DBS broadcasts.
- N. Broadcast disturbances - as DBS's broadcasts are wireless transmissions from broadcasting centers to broadcasting satellites and from them to the receiver dishes in subscriber homes, the broadcast of wireless signals in the same frequency spectrum, whether or not they originate in Israel, and extreme weather conditions of heavy rain, hail or snow could cause disruptions to the quality and/or availability of the broadcasts provided by DBS to its subscribers and may cause material harm to its financial results.
- O. Labor relations - as set out in section 5.12.5, DBS is currently negotiating for signed a collective agreement with the Histadrut and the Workers Committee and the absence of such collective agreement could make labor relations at DBS difficult. Signing a collective agreement is likely to reduce DBS's managerial flexibility and incur additional costs.

Breakdown of risk factors ranked according to their impact, in the opinion of DBS management. It should be noted that DBS's assessments of the extent of the impact of a risk factor reflect the scope of the effect on DBS of such risk factor, on the assumption that it the risk factor will be realized and the foregoing does not express an assessment or give weight to the chances of its realization as aforesaid. Likewise, the order of appearance of the risk factors above and below is not necessarily based on the risk involved in each risk factor, or the probability of its occurrence⁶²:

⁶² See footnote 36.

Summary of risk factors - multi-channel television

	Extent of Impact		
	Major	Moderate	Minor
Macro risk			
Financial risks		X	
Recession / economic downturn			X
Security situation			X
Sector-specific risk			
Dependence on licenses	X		
Changes in regulation	X		
Intense competition	X		
Technological developments and changes		X	
Alternative infrastructures		X	
Unlawful viewing		X	
Exposure to class action lawsuits		X	
Company-specific risk			
Exposure to credit being called for immediate repayment as a result of failure to comply with the finance agreements		X	
Restrictions caused by ownership structure		X	
Need for sufficient cash flow		X	
Satellite malfunction and damage	X		
Dependence on space segment supplier	X		
Dependence on suppliers of content, equipment and infrastructure	X		
Dependence on use of internal wiring		X	
Damage to broadcasting centers	X		
Malfunction of computer systems	X		
Technical inferiority and inability to offer integrated services		X	
Malfunction of encryption system	X		
Lack of exclusivity on frequencies		X	
Disturbances in broadcasts	X		
Labor relations			X

The information included in this Section 5.21 and the assessments of DBS regarding the impact of the risk factors on DBS's operations and business constitute forward-looking information as defined in the Securities Law. The information and estimates are based on data published by regulatory agencies, DBS assessments of the market situation and the structure of competition, possible developments in the market and the Israeli economy, and the factors mentioned above in this section. Actual results may differ significantly from these assessments if a change occurs in any of the factors taken into account in the assessments.

March 16, 2016

Date

Bezeq The Israel Telecommunication Corporation Ltd.

Names and titles of signatories:

Shaul Elovitch, Chairman of the Board of Directors

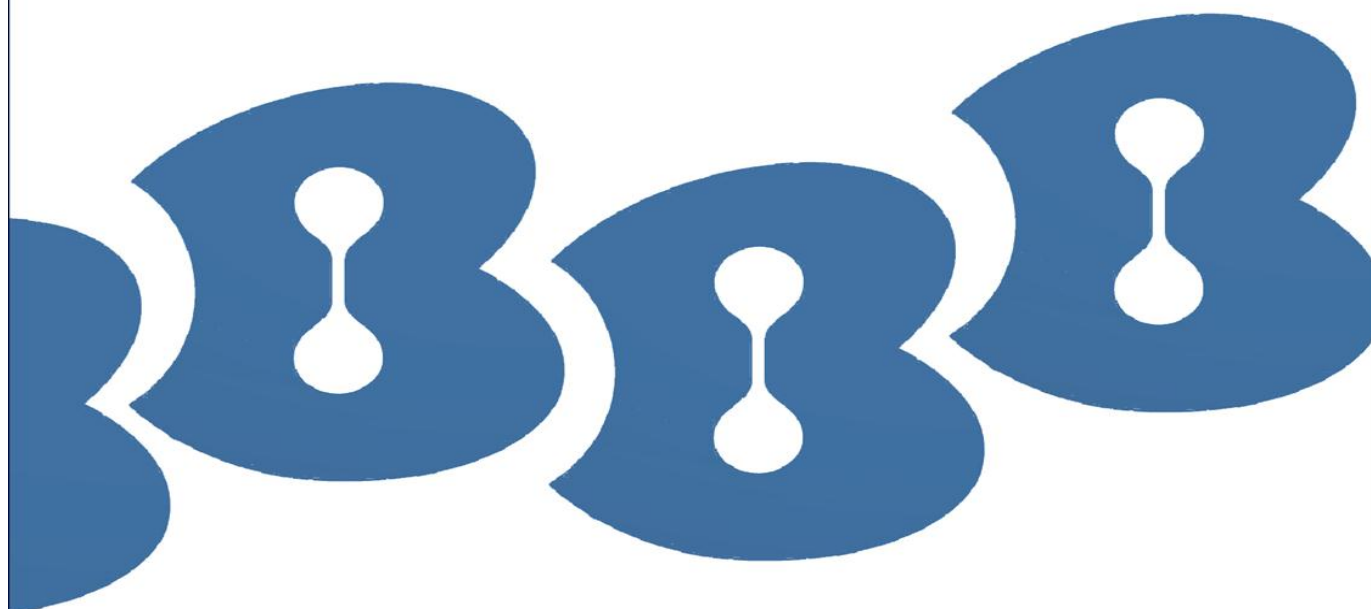
Stella Handler, CEO

Bezeq - The Israel Telecommunication Corp. Ltd.

Chapter B -

Board of Directors' Report on the State of the Company's Affairs for the Year Ended

December 31, 2015



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 year ended December 31, 2015.

On March 23, 2015, the Company assumed control of DBS Satellite Services (1998) Ltd. ("DBS") and has consolidated DBS from that date ("DBS's First Time Consolidation").

On June 24, 2015, the Company completed the acquisition of all rights to DBS' shares.

For more information, see Note 11.2 to the financial statements.

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**

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

The Group's results were as follows:

	2015	2014	(decrease)	
	NIS millions	NIS millions	NIS millions	%
Profit	1,721	2,111	(390)	(18.5)
EBITDA	4,254	4,507	(253)	(5.6)
(operating profit before depreciation and amortization)				

Results for the year were affected by a principle understanding reached with the tax assessor for tax payments on financing income from the Company's shareholder loans to DBS (see Note 6.6.2 to the financial statements).

Results for the previous year include gains on the sale of all holdings in the shares of Coral-Tell Ltd. (see Note 23 to the financial statements).

As of the second quarter of 2015, revenues, expenses and cash flows for the annual reporting period include the results of Multi-Channel Television operations, as detailed below.

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

	Dec. 31, 2015	Dec. 31, 2014	Increase (decrease)		
	NIS millions	NIS millions	NIS millions	%	
Cash and current investments	1,317	2,883	(1,566)	(54.3)	The decrease was mainly attributable to the Domestic Fixed-Line Communications segment, including the acquisition of DBS's shares and loans to the amount of NIS 680 million. However, the decrease was partially offset by DBS's First-Time Consolidation to the amount of NIS 156 million. For more information, see Section 1.3 - Cash Flows, below.
Current trade and other receivables	2,327	2,487	(160)	(6.4)	The decrease was mainly attributable to a reduction in trade receivable balances in the Cellular Communications segment, caused by a reduction in service revenues including revenues from telecom operator hosting services and a reduction in installment-based terminal equipment sales. The decrease was partially offset by DBS's First Time Consolidation to the amount of NIS 163 million.
Inventory	115	96	19	19.8	
Non-current trade and other receivables	674	566	108	19.1	The increase was attributable to an increase in receivables balances from real estate sales in Domestic Fixed-Line Communications operations.
Broadcasting rights	456	-	456	-	The balance was attributable to DBS's First Time Consolidation.
Property, plant and equipment	6,894	6,079	815	13.4	The increase was mainly due to DBS's First Time Consolidation to the amount of NIS 770 million.
Intangible assets	3,332	1,793	1,539	85.8	The increase was attributable to the DBS's First Time Consolidation, mainly comprising customer relations, brand value, and goodwill (see Note 11.2 to the financial statements).
Deferred tax assets	1,178	-	1,178	-	After completing the acquisition of DBS, the Company attributed surplus acquisition costs to a deferred tax asset, net (See Note 11.2.4 d to the financial statements).
Deferred costs and non-current investments	361	352	9	2.6	
Investments in investees as per the equity method	25	1,057	(1,032)	(97.6)	The decrease was due to the reversal of DBS's investment, presented as per the equity method, and its first time consolidation.
Total assets	16,679	15,313	1,366	8.9	

1.1 Financial Position (Contd.)

	Dec. 31, 2015	Dec. 31, 2014	Increase (decrease)	
	NIS millions	NIS millions	NIS millions	%
Debt to financial institutions and debenture holders	10,713	10,087	626	6.2
Liabilities towards Eurocom D.B.S. Ltd.	233	-	233	-
Trade and other payables	1,657	1,374	283	20.6
Other liabilities	1,665	1,411	254	18.0
Total liabilities	14,268	12,872	1,396	10.8
Total equity	2,411	2,441	(30)	(1.2)

Explanation
The increase was attributable to DBS's First Time Consolidation (including attributed surplus acquisition costs) to the amount of NIS 1.35 billion and a debenture issue in the Domestic Fixed-Line Communications segment in the fourth quarter of 2015. The bulk of this increase was offset by repayment of debentures and loans in the Domestic Fixed-Line Communications and the Cellular Communications segments.
Obligation to pay a contingent consideration in a business combination (see Note 11.2.1 to the financial statements).
The increase was attributable to DBS's First Time Consolidation, to the amount of NIS 485 million, which was partially offset by a reduction in these balances in the Group's other operating segments.
The increase was attributable to the Domestic Fixed-Line Communications segment, mainly following an increase in liabilities for employee benefits and taxes.
Equity comprises 14.5% of the balance sheet total, as compared to 15.9% of the balance sheet total on December 31, 2014. For more information, see Note 19 to the financial statements.

1.2 Results of operations

1.2.1 Highlights

	2015	2014	Increase (decrease)	
	NIS millions	NIS millions	NIS millions	%
Revenues	9,985	9,055	930	10.3
Depreciation and amortization	1,684	1,281	403	31.5
Labor costs	1,957	1,768	189	10.7
General and operating expenses	3,869	3,366	503	14.9
Other operating income, net	95	586	(491)	(83.8)
Operating profit	2,570	3,226	(656)	(20.3)
Finance expenses, net	263	130	133	102.3
Share in the gains (losses) of investees	12	(170)	182	-
Income tax	598	815	(217)	(26.6)
Profit for the year	1,721	2,111	(390)	(18.5)

Explanation
The increase was attributable to DBS's First Time Consolidation, to the amount of NIS 1,333 million, and increased revenues in the Domestic Fixed-Line Communications segment and the International Communications, Internet and NEP Services segment. The increase was materially offset by lower revenues in the Cellular Communications segment.
The increase was mainly attributable to DBS's First Time Consolidation, to the amount of NIS 245 million, and a write-down of surplus acquisition costs incurred when assuming control.
The increase was attributable to DBS's First Time Consolidation to the amount of NIS 201 million.
The increase was attributable to DBS's First Time Consolidation to the amount of NIS 695 million. The increase was partially offset by lower expenses in the Cellular Communications segment and in the Domestic Fixed-Line Communications segment.
Last-year data include gains on the sale of shares in Coral-Tell Ltd. to the amount of NIS 582 million, which were partially offset by an increase in net revenues in Domestic Fixed-Line Communications operations (see Note 23 to the financial statements).
The increase in net expenses was mainly attributable to financing income on shareholder loans to DBS recognized in 2014 and which are not included since April 1, 2015, following the first-time consolidation. The increase was partially offset, mainly by a reduction in a provision for interest on previous years' taxes following a proposed agreement reached with the tax assessor in the Domestic Fixed-Line Communications segment (see Note 6.6.2 and Note 24 to the financial statements). On first-time consolidation, DBS's finance expenses, to the amount of NIS 91 million were primarily offset by write-downs of surplus acquisition costs attributed to DBS's debentures.
Following DBS's First Time Consolidation in the second quarter of 2015, this item includes the effects of this segment's results only in the first quarter of 2015.
The decrease was attributable to a reduction in pre-tax profit, mainly due to gains on the sale of Coral-Tell Ltd. shares which were included in the last-year period

1.2.2 Operating segments

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

	2015		2014	
	NIS millions	% of total revenues	NIS millions	% of total revenues
Revenues by operating segment				
Domestic Fixed-Line Communications	4,407	44.1	4,317	47.7
Cellular Communications	2,890	28.9	3,419	37.8
Intl. Communications, Internet and NEP Services	1,578	15.8	1,504	16.6
Multi-Channel Television	1,774	17.8	1,724	19.0
Other and offsets*	(664)	(6.6)	(1,909)	(21.1)
Total	9,985	100	9,055	100

	2015		2014	
	NIS millions	% of segment revenues	NIS millions	% of segment revenues
Operating profit by segment				
Domestic Fixed-Line Communications	2,148	48.7	1,980	45.9
Cellular Communications	157	5.4	449	13.1
Intl. Communications, Internet and NEP Services	240	15.2	232	15.4
Multi-Channel Television	250	14.1	273	15.8
Other and offsets*	(225)	-	292**	-
Consolidated operating profit/ % of Group revenues	2,570	25.7	3,226	35.6

(*) Offsets include the results of Multi-Channel Television operations in periods where these operations were included as an associate company.

(**) Including NIS 582 million in gains on the sale of Coral-Tell Ltd.'s shares.

1.2.2. Operating segments (contd.)

B Domestic Fixed-Line Communications Segment

	2015	2014	Increase (decrease)	
	NIS millions	NIS millions	NIS millions	%
Fixed-line telephony	1,586	1,668	(82)	(4.9)
Internet - infrastructure	1,542	1,394	148	10.6
Transmission, data communications and others	1,279	1,255	24	1.9
Total revenues	4,407	4,317	90	2.1
Depreciation and amortization	725	688	37	5.4
Labor costs	912	895	17	1.9
General and operating expenses	721	777	(56)	(7.2)
Other operating income, net	99	23	76	330.4
Operating profit	2,148	1,980	168	8.5
Finance expenses, net	332	400*	(68)	(17.0)
Income tax	492	478	14	2.9
Segment profit	1,324	1,102*	222	20.1

* Re-stated, see Note 27.2 to the financial statements.

Explanation

The decrease was mainly due to a reduction in ARPU. There was also a decrease in the number of subscriber lines.

The increase was mainly attributable to growth in the number of internet subscribers (including wholesale service subscribers) and in ARPU (retail).

The increase was mainly attributable to increased salaries and ancillary costs, offset by employee retirement.

The decrease was mainly due to a reduction in call completion fees to telecom operators, building maintenance costs, and consultancy costs.

Net income was up mainly due to an increase in capital gains on real estate sales, and reduced costs for termination of employment by way of early retirement. The increase was partially offset, mainly by an increase in expenses for legal actions.

Net finance expenses were down mainly due to a decrease in provisions for interest on previous years' taxes following a principle understanding reached with the tax assessor, and a decrease in interest expenses following debenture and loan repayments. The decrease was partially offset, mainly by cancellation of finance expenses in the previous year due to a contingent liability.

The tax rate on profit after finance expenses, net was 27.1%, as compared to 30.3% last year. Tax expenses in 2015 were affected, among other factors, by a proposed agreement reached with the tax assessor concerning finance income on shareholder loans to DBS (see Note 6.6.2).

1.2.2 Operating segments

C Cellular Communications segment

	2015	2014	Increase (decrease)		Explanation
	NIS millions	NIS millions	NIS millions	%	
Services	1,999	2,453	(454)	(18.5)	The decrease was due to a NIS 211 million reduction in hosting service revenues, following termination of the contract with HOT Mobile in December 2014. The decrease was further due to lower rates resulting from increased market competition, and migration of existing customers to cheaper plans at current market prices, both of which lowered ARPU. Revenues from repair services were also down.
Terminal equipment sales	891	966	(75)	(7.8)	The decrease was mainly attributable to a reduction in the number of terminal equipment sold, partially offset by higher selling prices. The decrease was attributable, among other things, to increased sales to the Accountant General's office in 2014.
Total revenues	2,890	3,419	(529)	(15.5)	
Depreciation and amortization	419	430	(11)	(2.6)	
Labor costs	381	417	(36)	(8.6)	The decrease was mainly attributable to a reduction in the workforce.
General and operating expenses	1,928	2,105	(177)	(8.4)	Expenses were down, mainly due to lower terminal equipment sales costs, following a decrease in the number of units sold, which was partially offset by an increase in costs following a change in the sales mix. These were coupled with a decrease in rental costs, content expenses, doubtful debt expenses and advertising expenses, and a decrease in repair service costs and extended warranties following the decrease in the number of service subscribers and the number of repairs. The decrease in expenses was partially offset by an increase in frequency leasing fees following the acquisition of 4G LTE frequencies.
Other expenses	5	18	(13)	(72.2)	Other expenses comprised one-time expenses from an early retirement program implemented in each year. The decrease was mainly attributable to a reduction in the number of retiring employees.
Operating profit	157	449	(292)	(65.0)	
Finance income, net	49	56	(7)	(12.5)	The decrease in net finance income was mainly due to a reduction in the credit component of installment-based terminal equipment sales, which was partially offset by lower interest expenses due to a reduction in the average debt balance. The decrease was further offset by lower currency-related expenses following a more moderate rise in the USD exchange rate in 2015.
Income tax	55	132	(77)	(58.3)	The decrease was attributable to the reduction in income before taxes.
Segment profit	151	373	(222)	(59.5)	

1.2.2 Operating segments

D International Communications, Internet and NEP Services

	2015	2014	Increase (decrease)		Explanation
	NIS millions	NIS millions	NIS millions	%	
Revenues	1,578	1,504	74	4.9	The increase was attributable to greater revenues from enterprise communication solutions (ICT), higher internet service revenues due to growth in the number of subscribers, and an increase in revenues from data communication services. The increase was partially offset by lower revenues from outgoing calls, following a decrease in minutes caused by ongoing competition with cellular providers and increased use of substitute software products.
Depreciation and amortization	132	130	2	1.5	
Salary expenses	303	298	5	1.7	This increase was mainly attributable to an increase in the number of employees providing outsourced services in ICT operations. The increase was due to an increase in ICT equipment costs, internet services and data communications services, corresponding with the above revenues.
Operating, general and other expenses	903	844	59	7.0	
Operating profit	240	232	8	3.4	
Finance expenses, net	8	9	(1)	(11.1)	
Share in the earnings of associates	-	1	(1)	(100)	
Income tax	60	60	-	-	
Segment profit	172	164	8	4.9	

1.2.2 Operating segments

E Multi-Channel Television

	2015	2014	Increase (decrease)		Explanation
	NIS millions	NIS millions	NIS millions	%	
Revenues	1,774	1,724	50	2.9	This increase was mainly attributable to an increase in the average number of subscribers.
Depreciation and amortization	322	297	25	8.4	
Labor costs	270	267	3	1.1	This increase was mainly attributable to higher content-related costs.
General and operating expenses	932	887	45	5.1	
Operating profit	250	273	(23)	(8.4)	
Finance expenses, net	90	111	(21)	(18.9)	Net expenses were down, mainly due to linkage differences on debentures following a decrease in the CPI in 2015, finance income from a reduction in the interest rate on the debentures (see Note 12.4 to the financial statements) and currency-related income, which was partially offset by a change in the fair value of financial assets.
Finance expenses for shareholder loans, net	513	483	30	6.2	The increase in expenses was attributable to an increase in interest and factoring expenses, partially offset by lower linkage differences.
Tax expenses	1	1	-	-	
Segment loss	(354)	(322)	(32)	9.9	

1.3 Highlights from the Group's consolidated quarterly statements of income (NIS millions)

	Q1 2015	Q2 2015	Q3 2015	Q4 2015	2015	Explanation
						Since the second quarter of 2015, revenue and expense data include the results of the Multi-Channel Television segment.
Revenues	2,174	2,603	2,602	2,606	9,985	
Operating expenses	1,538	1,809	1,950	2,118	7,415	Net expenses were up in the third quarter, as compared to the second quarter, mainly due to lower capital gains on real estate sales in the Domestic Fixed-Line Communications segment. The increase in the fourth quarter, as compared to the third quarter, was mainly due to expenses from termination of employment by way of early retirement in Domestic Fixed-Line Communications operations, to the amount of NIS 116 million (see Note 15.5 to the financial statements).
Operating profit	636	794	652	488	2,570	
Finance income (expenses), net	(37)	(129)	(100)	3	(263)	In the fourth quarter, as compared to the third quarter - net finance expenses changed to net finance income, mainly due to a reduced provision for interest on previous years' taxes following a principle understanding reached with the tax assessor in Domestic Fixed-Line Communications operations.
Profit after finance income (expenses), net	599	665	552	491	2,307	
Share in the gains (losses) of investees	16	-	(1)	(3)	12	
Profit before income tax	615	665	551	488	2,319	
Income tax	152	183	144	119	598	Tax expenses in the fourth quarter were affected, among other factors, by a principle understanding reached with the tax assessor concerning finance income on shareholder loans (see Note 6.6.2 to the financial statements).
Profit for the period	463	482	407	369	1,721	
Basic earnings per share (NIS)	0.17	0.18	0.15	0.13	0.63	
Diluted earnings per share (NIS)	0.17	0.17	0.15	0.13	0.62	

1.4 Cash flow

	2015	2014	Change		Explanation
	NIS millions	NIS millions	NIS millions	%	
Net cash from operating activities	3,740	3,796	(56)	(1.5)	The decrease in net cash from operating activities was mainly attributable to the Cellular Communications segment, due to a material decrease in net profits and a more moderate decrease in trade receivables balances as compared to last year's decrease. This decrease was mostly offset by DBS's First Time Consolidation, in the amount of NIS 356 million, and an increase in cash from operating activities in the Domestic Fixed-Line Communications segment.
Net cash from (used in) investing activities	283	(1,546)	1,829	-	The increase in net cash from investing activities was due to an increase in the net proceeds on the sale of held-for-trade financial assets in the Domestic Fixed-Line Communications segment, and was also due to NIS 299 million in cash added in the first quarter of 2015 after assuming control of DBS. The increase was partially offset by NIS 250 million in cash used in investing activities in DBS, which was consolidated for the first time, and by frequency purchases in the Cellular Communications segment, and net proceeds received last year on the sale of holdings in Coral-Tell Ltd.'s shares.
Net cash used in financing activities	(4,128)	(2,200)	(1,928)	87.6	The increase in net cash used in financing activities was mainly attributable to an increase in debenture repayments and a decrease in debenture issuances, and receipt of loans in the Domestic Fixed-Line Communications segment. The increase was further attributable to payments to Eurocom D.B.S. for the acquisition of DBS's shares and loans to the amount of NIS 680 million, and DBS's First Time Consolidation to the amount of NIS 633 million (mainly net debenture repayments). This increase was partially offset by a decrease in the total dividend payments.
Net increase (decrease) in cash	(105)	50	(155)	-	

Average volume in the reporting year:

Long-term liabilities (including current maturities) to financial institutions and debenture holders: NIS 10,946 million.

Supplier credit: NIS 903 million.

Short-term credit to customers: NIS 2,201 million. Long-term credit to customers: NIS 516 million.

1.4 Cash Flows (contd.)

As of December 31, 2015, the Group had a working capital deficit of NIS 1,146 million, as compared to a surplus of NIS 1,690 million on December 31, 2014.

According to its separate financial statements, the Company had a working capital deficit of NIS 2,139 million as of December 31, 2015, as compared to a working capital surplus of NIS 386 million on December 31, 2014.

The change in the Group's working capital was mainly attributable to the Domestic Fixed-Line Communications segment, mainly due to lower current investments and higher current liabilities and DBS's First Time Consolidation which brought in a working capital deficit of NIS 584 million.

The Company's Board of Directors has reviewed, among other things, the Company's cash requirements and resources, both at present and in the foreseeable future, the Company's and the Group's investment needs, the Company's and the Group's available credit sources, and has conducted sensitivity analysis to unexpected deterioration in the Company and the Group's business. In this context, the Company's Board of Directors has determined that the aforesaid working capital deficit does not indicate any liquidity problem in the Company and the Group and that there is no reasonable concern that the Company and the Group will fail to meet their existing and foreseeable obligations on time (even in the event of unexpected deterioration in the Company's and the Group's business). The Company and the Group can meet their existing and foreseeable cash requirements, both through available cash balances, through cash from operating activities, through dividends from subsidiaries, through guaranteed credit facilities for 2016 and 2017 under pre-determined commercial terms, and by raising debt from bank and non-bank sources.

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. The connection between remuneration given pursuant to Regulation 21 and recipient's contribution to the company

In the Board of Directors meeting of March 16, 2016, which was preceded by the Company's Remuneration Committee's meetings of March 3, 2016, March 6, 2016, and March 8, 2016, the Board of Directors reviewed the remuneration of officers and principal shareholders in the Company, detailed in Section 7 of Chapter D to the Periodic Report for 2015 ("the Periodic Report"), pursuant to Regulation 21 to the Periodic and Immediate Reports Regulations, 1970 ("the Periodic and Immediate Reports Regulations"), namely the Company's CEO, the Deputy CEO and CFO, the former Deputy CEO and VP Marketing, Pelephone's former CEO, CEO of Bezeq International, and CEO of DBS ("the Executives"), and found it to comply with the Company's remuneration policy as approved by the general meeting on September 3, 2013 (as amended).¹

Remuneration of Principal Shareholders in the Company

Management agreement with Eurocom Communications Ltd. ("Eurocom Communications")

The Board of Directors reviewed the details of the management agreement with Eurocom Communications, as well as the services rendered by Eurocom Communications to the Company since the start of the year, through Messrs. Shaul Elovitch, Or Elovitch, and Amikam Shorer.²

The Board of Directors was also presented comparative data, based on a comparative paper prepared by Ernst & Young Kost Forer Gabbay & Kasierer in preparation for the Board of Directors' discussion of this matter in March 2016, concerning management agreements in other public companies of similar size to that of the Company, or as close as possible in size.

The Board of Directors discussed the scope and nature of the services rendered by Eurocom Communications in the reporting year, and found the remuneration given to Eurocom Communications in 2015 under the management agreement to be reasonable and fair considering the management agreement's contribution to the Company, for the following reasons:

Consultancy services pursuant to the management agreement were provided by professionals having extensive knowledge and experience in the Company's various telecom markets, and having extensive knowledge of the regulatory framework applicable to the operations of the Company and its subsidiaries. The consultants also possess extensive managerial backgrounds, including in such fields as strategy, business development, technological development, etc. They also possess expertise in capital markets and financing, and have significant commercial-economic experience. These persons invested significant time and effort in rendering the consultation services in the reporting year (beyond the time invested by some of these persons as directors in the Company and in Group subsidiaries).

The consultation services significantly contributed to the Company in strategic planning and in the Group's preparation for upcoming regulatory changes, in a time of significant change in the communications market.

Mr. Elovitch's contribution as executive chairman in the Company (unpaid) and in all its subsidiaries: Pelephone, DBS, Bezeq International, and Walla. His fees as executive chairman were included in the management fees paid to Eurocom Communications.

In the reporting period, the following directors did not receive remuneration: Or Elovitch, Orna Elovitch-Peled, and Amikam Shorer, for their service as directors in the Company and/or in Company subsidiaries, and such remuneration was included in the management fees paid to Eurocom Communications.

Comparative data presented to the Board of Directors in the E&Y report indicate, that the remuneration paid under the management agreement, compared to other companies of similar size to the Company, close thereto, as concerns management fees, chairman's remuneration and hourly consultation fees, was fair, reasonable, and did not exceed generally accepted levels.

¹ For more information on the remuneration of senior officers, see also Note 28 to the 2015 annual financial statements, and Regulation 21 (Section 7) to Chapter D of the periodic report.

² Details of the management agreement are included in the immediate report dated May 7, 2013, as amended on June 10, 2013. The amended management agreement was approved according to Section 275 of the Companies Law in the Company's general meeting of June 13, 2013.

Employee director

It is noted that the Company's Board of Directors did not conduct a discussion pursuant to Regulation 10(b)(4) to the Periodic and Immediate Reports Regulations, concerning the reasonability and fairness of remunerations paid for 2015 to the employee director, Mr. Rami Nomkin, as he is remunerated pursuant to his employment in the Company and in accordance with the collective agreement, and not by virtue of his services as a director in the Company.

3. Market Risk - Exposure and Management

The Company's market risk officer

The Company's market risk management officer is Deputy CEO and CFO Dudu Mizrahi.

For details concerning his education and experience, see Section 15 in Chapter D of the Periodic Report.

Market risks and the Company's risk management policies

The Company is exposed to market risks as a result of changes in interest rates, exchange rates, and the CPI.

The Company follows a financial risk management policy adopted by the Board of Directors on June 26, 2008, and updated on October 18, 2012. Under this policy, the Company implements partial hedges, depending on the circumstances and its own judgment. These partial hedges primarily seek to reduce its exposure to changes in the CPI and to changes in foreign currency exchange rates.

The Company monitors the Group's risk management on a regular basis. As part of this review, when necessary, the Company recommends changes in risk exposure and management. Once every quarter, the Company reports to the Board of Directors on risks and hedges.

In cases where Management considers deviating from the stated policy, its recommendations are brought before the Company's Board of Directors.

CPI risk - The Company has a significant surplus of liabilities over CPI-linked assets, and the bulk of its financial exposure stems from the risk of an increase in the CPI. The rate of inflation also affects the Company's operating income and expenses in the course of the year.

In order to minimize its exposure to the CPI, the Company's Board of Directors decided to implement partial hedges, at its discretion, as follows:

- a. Hedging will mainly be carried out through CPI-shekel forward transactions, which guarantee a fixed rise in the CPI over a designated period of time.
- b. Transactions will be subject to judgment and will be carried out in accordance with market trading restrictions, and will be reviewed in relation to inflationary expectations reflected in the bond market and inflation forecasts, and in relation to the Bank of Israel's inflation target range.
- c. The hedging position may be reduced by closing existing transactions before their final expiration date.
- d. The Company will strive for hedging transactions to meet the terms required for the application of hedge accounting.
- e. Hedging transactions will be made according to the repayment schedules of the CPI-linked financial debt.
- f. As long as the CPI exposure is more than NIS 500 million, hedging will not be less than 40% of the exposure for CPI-linked financial debt, and will not exceed 100% thereof; where exposure is less than NIS 500 million, hedging will not exceed 50% of the exposure from CPI-linked financial debt.

The Company carried out hedging transactions against the CPI in order to minimize the said risk. The Company did not incur material costs in making these hedges.

Interest risk - The Company's exposure to changes in interest rates depends largely on the nature of its financial liabilities and assets, as well as on its future financing needs. Some of the Company's liabilities bear fixed interest and so a change in interest rates would affect their fair value and not their carrying amount. Other liabilities bear variable interest based on the prime / STD rate.

As of the reporting date, the Company does not hedge against these exposures. However, it is possible that the Company will do so under future market conditions. The Company also accounts for such influences when considering the types of loans it takes.

Risks and risk management in consolidated subsidiaries

In accordance with the Board of Directors' decision, each of the Group companies is required to maintain a risk management policy and to routinely monitor its implementation. The market risk management officers in the principal consolidated subsidiaries are those companies' CFOs.

For more information concerning financial risk management in the Group, and for information on the linkage terms of balances on the Group's balance sheet (linkage bases report), see Note 29 to the financial statements.

Below are summaries of the sensitivity analysis tables (NIS millions)

Sensitivity to changes in the USD/NIS exchange rate

	USD exchange rate	Loss from changes		Fair value of liabilities	Gain from changes	
		10%	5%		5%-	10%-
2015	3.902	(57)	(29)	(995)	29	57
2014	3.889	(36)	(18)	(289)	18	36

Surplus liabilities exposed to the USD exchange rate grew by NIS 706 million, mainly due to DBS's First Time Consolidation (mainly firm commitments - space segments).

Sensitivity to changes in the CPI

	Loss from changes			Fair value of liabilities	Gain from changes		
	1.5%	0.2%	0.1%		0.1%-	0.2%-	1.5%-
2015	(72)	(9)	(5)	(7,012)	5	10	72
2014	(23)	(3)	(2)	(4,064)	2	3	23

Surplus liabilities exposed to changes in the CPI grew by NIS 2,948 million, mainly due to DBS's First Time Consolidation.

Sensitivity to changes in the real NIS-based interest rate

	Loss from changes			Fair value of liabilities	Gain from changes		
	16%	10%	5%		5%-	10%-	16%-
2015	9	6	3	(5,419)	(3)	(6)	(9)
2014	(59)	(37)	(19)	(2,527)	19	38	62

Surplus liabilities exposed to changes in the real NIS-based interest rate increased by NIS 2,892 million, mainly due to DBS's First Time Consolidation.

Sensitivity to changes in the nominal NIS-based interest rate

	Gain from changes			Fair value of liabilities	Loss from changes		
	16%	10%	5%		5%-	10%-	16%-
2015	28	17	9	(2,714)	(9)	(17)	(29)
2014	35	22	11	(2,972)	(11)	(22)	(26)

Surplus liabilities exposed to changes in the nominal NIS-based interest rate decreased by NIS 258 million, mainly following repayment of debentures (Series 8) and loan repayments, which were partially offset by the issue of debentures (Series 9).

Sensitivity to changes in the USD-based interest rate

	Gain from changes			Fair value of liabilities	Loss from changes		
	16%	10%	5%		5%-	10%-	16%-
2015	12	8	4	(725)	(4)	(8)	(13)
2014	-	-	-	-	-	-	-

Surplus liabilities exposed to changes in the USD-based interest rate in 2015 were attributable to DBS's First Time Consolidation due to firm commitments - space segments.

Sensitivity to changes in marketable securities prices

	Gain from changes		Fair value of assets	Loss from changes	
	10%	5%		5%-	10%-
2015	19	10	193	(10)	(19)
2014	146	73	1,465	(73)	(146)

Total assets exposed to changes in marketable securities prices was down NIS 1,272 million, following a decrease in current investments in the Domestic Fixed-Line Communications Segment.

4. Aspects of Corporate Governance

4.1 Community involvement and donations by Group companies

Bezeq supports the community from a deep-rooted commitment to social responsibility. This support is made through monetary donations, contributions of communications infrastructures, and by encouraging employees to volunteer in a range of activities for the community. The bulk of Bezeq's monetary donations focus on education.

In 2015, the Group donated a total of NIS 10.3 million.³

Bezeq also aids in funding the connection of schools in Israel to the fiber optic cable network, at an estimated cost of NIS 11 million in 2015.

4.2 Disclosure concerning the auditor's fees

Below are the fees paid to the auditors of the principal consolidated companies in the Group for auditing and audit-related services:

Company	Auditor	Details	2015		2014	
			Fees (NIS Thousands)	Hours	Fees (NIS Thousands)	Hours
Bezeq - The Israel Telecommunications Corp. Ltd.	Somekh Chaikin	Audit and audit-related services	2,900	16,800	2,900	16,440
		Other services ⁴	338	1,132	796	2,791
Pelephone Communications Ltd.	Somekh Chaikin	Audit and audit-related services	1,200	8,062	1,353	8,490
		Other services ⁴	417	1,214	144	474
Bezeq International Ltd.	Somekh Chaikin	Audit and audit-related services	622	4,250	622	4,012
		Other services ⁴	131	502	66	337
D.B.S. Satellite Services (1998) Ltd.*	Somekh Chaikin	Audit and audit-related services	930	7,461	-	-
		Other services ⁴	53	132	-	-

* First consolidated in the second quarter of 2015.

The auditors' fees were discussed by the Board of Directors Financial Statements Examination Committee, and approved by the Company's Board of Directors and the boards of each of the Group companies. The fees were determined on the basis of the hours worked and the hourly rate in the previous year, adjusted for changes and events which occurred in the reporting year.

4.3 Directors with accounting and financial expertise and independent directors

Information concerning directors with accounting and financial expertise and independent directors is included in Sections 2 and 9 to the corporate governance questionnaire and in Section 14 of Chapter D to the periodic report.

³ Of this amount, the Company donated NIS 1.4 million to various entities following a settlement reached in a class action brought against the Company.

⁴ "Other services" rendered to key companies in the Group in 2015 and 2014 included, inter alia, tax and accounting consultancy services and special certifications.

4.4 Disclosure concerning the internal auditor in a reporting company

Details	
Internal auditor	Lior Segal
Start of tenure date	Jan. 24, 2011
Compliance with statutory requirements	The internal auditor complies with the conditions set forth in Section 3(a) and 8 to the Internal Audit Law, and Section 146(b) to the Companies Law.
Employment method	Company employee.
Method of appointment	<u>Manner of appointment and summary of reasons for approving the appointment:</u> The appointment was approved by the Board of Directors on January 24, 2011, following the Audit Committee's recommendation. Prior to his appointment, the internal auditor served as manager of internal processes and controls and as corporate governance compliance officer. The appointment was based on his qualifications and professional experience. <u>Duties, powers, and tasks of the internal auditor:</u> The powers and responsibilities of the Company's internal auditor are set forth in the Company's internal audit procedure, approved by the Company's Audit Committee. According to the procedure, the internal auditor's responsibilities and powers are as follows: Examining propriety of actions carried out by the Company, its officers and personnel, examining the integrity of financial and operating information, examining financial and liability management, and examining the Company's IT systems and its information security set-up. The internal auditor is also charged with investigating employee complaints according to the arrangements set forth by the Audit Committee pursuant to Section 117(6) to the Companies Law, 1999. The internal auditor is authorized to receive any information, explanation, and document required for the performance of his duties; he has right of access to all regular or computerized data bank, database, and automated or non-automated data processing work plan of the Company and its units; and to be granted entry to all Company property. The internal auditor is also entitled to be invited to all Management, Board of Directors and Board committee meetings.
The internal auditor's organizational superior	The Company's CEO.
Work plan	In 2015, the internal auditor followed an annual work plan, derived from the work plan for the period 2015-2017. <u>Considerations in determining the internal audit work plan</u> The guiding principle underlying the internal audit work plan is the risk inherent in the Company's processes and operations. To assess these risks, the internal audit referred to a Company risk survey conducted by the risk management officer, and to other sources which affected the risk assessment in those processes, such as meetings with Management, findings from previous audits, and other relevant activities. The main considerations taking into account in formulating the work plan are reasonable coverage of most of the Company's operating activities based on exposure to material risks, considering existing controls in the Company's operations and previous audit findings. <u>Parties involved in formulating the work plan</u> The internal auditor, Management, the CEO, the Board of Directors' Audit Committee, and the Chairman of the Board. <u>The party accepting and approving the work plan</u> The Board of Directors' Audit Committee. <u>The auditor's discretion in deviating from the work plan</u> The Chairman of the Board or the chairman of the Audit Committee may propose topics which urgently require auditing, and may also recommend narrowing or halting an audit approved in the work plan. The internal auditor is granted discretion to deviate from the work plan. <u>Examination of material transactions</u> The internal auditor attends discussions at Board meetings where material transactions are approved and reviews the relevant material sent in preparation for these discussions.

Details	
The audit and material investees	The internal audit unit's work plan does not include an audit of material investees. All material investees of the Company have their own internal auditors (either as employees or through third-party services). Investee audit reports are discussed by the boards of these companies, which include Company directors. The internal auditor may, under the Company's internal audit procedure and at his discretion, obtain the audit reports of these subsidiaries and he is obligated to meet with each of the subsidiaries' internal auditors at least once a year, to discuss the audit plan and its implementation in the subsidiary.
Scope of employment	Approximately 8,800 hours were devoted to internal audit work. This includes hours worked by third parties and four full-time internal auditors, in addition to the internal auditor. The scope of employment is set according to the audit work plan, formulated in accordance with the scope and complexity of the activities of the various companies. <u>Scope of internal audit activities in material investees:</u> Telephone - 5,500 hours; Bezeq International - 2,200 hours; DBS - 1,000 hours.
Preparation of the audit	The internal audit is conducted in accordance with the Companies Law, 1999 and the Internal Audit Law, 1992, and complies with generally accepted auditing standards set by the Institute of Internal Auditors (IIA). The auditor updated the Board of Directors of the standards which he follows. In 2013, the internal auditor conducted a self-assessment of internal auditing activities, and assessments were also completed by a third party. These assessments indicate that internal auditing activities comply with the required standards.
Access to information.	The internal auditor was supplied with documents and information as stipulated in Section 9 of the Internal Audit Law, and is granted permanent and direct access to the Company's information systems, including financial data.
Internal auditor's report	The internal auditor submits audit reports in writing. Audit reports are submitted regularly during the reporting year to the Chairman of the Board, the CEO, and the chairman and members of the Audit Committee. Reports are submitted near the date of discussion by the Committee (usually three days before the said date). The Audit Committee discussed audit reports on the following dates: January 7, 2015; January 11, 2015; January 27, 2015; February 25, 2015; March 22, 2015; May 5, 2015; July 30, 2015; August 12, 2015; September 3, 2015; October 25, 2015; and December 16, 2015. In addition to the audit reports, the auditor submitted reviews and reports to the Audit Committee on various matters as requested by the Committee, and briefed the Committee on the implementation of the decisions in the audit reports that were discussed by the Committee (some, in meetings held in addition to the ones noted above).
The Board of Directors' assessment of the internal auditor's work	The Board of Directors believes that the scope of the Company's audits, the nature and continuity of the internal auditor's activities as well as the audit work plan, are reasonable under the circumstances and can achieve the goals of the audit.
Remuneration	The terms of the internal auditor's employment were discussed and approved by the Company's Audit Committee and Board of Directors on January 3, 2016 and January 7, 2016, respectively, and were updated as follows: total monthly salary of NIS 46,000 and an annual bonus based on pre-determined targets set by the Audit Committee and approved by the Board of Directors, of up to 62.5% of the annual salary excluding ancillary costs. In 2015, employment terms included a total monthly salary of NIS 40,000 and an annual bonus of up to 25% of the annual salary excluding ancillary costs. In 2011, the Company's Board of Directors approved an allocation of 41,000 Company warrants to the internal auditor, under the 2010 employee stock options plan. These options were exercised in 2015. On March 7, 2016, the Company's Audit Committee approved the bonus for the Company's internal auditor for 2015, to the amount of NIS 116,000 (24% of his annual salary). The Board of Directors believes that the compensation paid to the internal auditor did not affect his professional judgment.

4.5 Provisions of the Sarbanes-Oxley Act of 2002 (SOX)

Starting 2011, the Company ceased to apply the provisions of the Securities Regulations (Periodic and Immediate Reports) (Amendment), 2009, concerning internal controls, and instead applies the provisions of the Sarbanes-Oxley Act of 2002 (SOX) as a significant subsidiary of a US-listed company. Accordingly, the Company's 2015 periodic report includes a management report and management confirmation in SOX-compliant format. For more information, see Chapter E to the periodic report for 2015.

5. Disclosure Concerning the Company's Financial Reporting

5.1 Disclosure of valuations

The following table discloses valuations pursuant to Regulation 8B to the Securities Regulations (Periodic and Immediate Reports), 1970:

	Pelephone	Bezeq fixed-line	DBS	Bezeq's investment in DBS (attached to the financial statements as of March 31, 2015)	PPA (attached to the financial statements as of December 31, 2015)
Subject of valuation	Value in use of Pelephone's operations for test of impairment of goodwill recognized in the Company's financial statements in accordance with IAS 36.	Value in use of Bezeq fixed-line operations to test for impairment of goodwill attributed for these operations in the Company's financial statements pursuant to IAS 36.	Value in use of DBS Satellite Services (1988) Ltd. to test for impairment of goodwill attributed for its operations in the Company's financial statements pursuant to IAS 36.	Valuation of Bezeq's investment in DBS Satellite Services (1988) Ltd., in shares, options to shares and various shareholder loans, as part of the Company executing a contract in which Bezeq will assume control of the shares in DBS	Allocation of costs in a business combination (PPA) upon assuming control of DBS. Satellite Services (1988) Ltd., following exercise of an option to buy 8.6% of the company's shares and acquisition of the company's other shares and shareholder loans.
Date of valuation	December 31, 2015; the valuation was signed on March 9, 2016.			March 23, 2015; valuation signed on May 19, 2015.	March 23, 2015; valuation signed on March 15, 2016.
Value prior to the valuation	NIS 2,468 million carrying amount of Pelephone's net operating assets* (NIS 1,027 million - goodwill).	NIS 5,382 carrying amount of net operating assets of Bezeq fixed-line operations (NIS 265 million - goodwill).	NIS 1,872 million carrying amount of net operating assets of D.B.S. Satellite Services (1988) Ltd. (NIS 120 million - goodwill).	Balance of the Company's investment in DBS in the Company's ledgers - NIS 1,064 million.	N/A
Value set in the valuation	NIS 6,492 million. The Company concluded that there is no impairment requiring a write-down of goodwill recognized in the Company's books.	NIS 14,093 million. The Company concluded that there is no impairment requiring a write-down of goodwill recognized in the Company's books.	NIS 2,620 million. The Company concluded that there is no impairment requiring a write-down of goodwill recognized in the Company's books.	NIS 1,076 million.	Brand value (before attributing deferred taxes) - NIS 347 million. Customer relations value (before attributing deferred taxes) - NIS 790 million. Deferred tax asset net of deferred tax liability - NIS 1,170 million. Goodwill 100% (residual value) - NIS 385 million.

5. Disclosure Concerning the Company's Financial Reporting

5.1. Disclosure of valuations (contd.)

	Telephone	Bezeq fixed-line	DBS	Bezeq's investment in DBS (attached to the financial statements as of March 31, 2015)	PPA (attached to the financial statements as of December 31, 2015)
Assessor's identity and profile	Giza Singer Even Ltd. The work was done by a team headed by Udi Rosenberg, CEO of Giza Zinger Even. Udi holds a BA in Economics and an MBA from Ben Gurion University, and has 20 years of experience in commercial credit and economic analysis. The assessor has no dependence on the Company.			Fahn Kanne Consulting Ltd. The valuation was done by a team headed by Mr. Shlomi Bartov, CPA, partner and CEO of Fahn Kanne Consulting. Mr. Bartov has extensive experience in consulting and supporting some of the largest companies in Israel. Fahn Kanne Consulting is a subsidiary of Fahn Kanne & Co., a part of the Grant Thornton International Ltd. (GTIL) network, the special advisory services branch of the global Grant Thornton network, specializing in spearheading international transactions, valuations and transaction consulting, global IPOs, executive consultancy, and project financing. The assessor has no dependence on the Company.	
Valuation model	Discounted Cash Flow method (DCF).			The valuation was conducted using the income approach, using the discounted cash flows (DCF) method. Value was assigned to share capital and shareholder debt based on repayment order of the new shareholder loans and the extent of the shareholders' investments.	Fair value of customer relations was valued using the income method, using the multi period excess earnings method. Fair value for the brand was valued using the relief from royalties method.
Assumptions used in the valuation	Discount rate - 10% (post-tax). Comparative companies for setting the discount rate - Cellcom and Partner. Permanent growth rate - 2.5%. Scrap value of total value set in valuation - 80%.	Discount rate - 7.5% (post-tax). Permanent growth rate - 1%. Scrap value of total value set in valuation - 67%.	Discount rate - 8.5% (post-tax). Permanent growth rate - 1%. Scrap value of total value set in valuation - 68%.	Discount rate - 8.5% (post-tax). Permanent growth rate - 1%. Scrap value of total value set in valuation - 80%.	Customer relations - discount rate - 8.5% (post-tax). Brand - discount rate - 9.5% (post-tax). Deferred tax asset, net - based on the Company's assumption whereby losses deductible from income tax will total NIS 5.4 billion.

(*) Telephone's net operating assets do not include trade receivable balances from installment-based terminal equipment sales presented at present value.

5.2 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.

6. Details of debt certificate series

Data on the Company's debentures in circulation, as of December 31, 2015:

		Debentures (Series 5)	Debentures (Series 6)	Debentures (Series 7)	Debentures (Series 8)	Debentures (Series 9)	Debentures (Series 10)
a.	Issue date (excluding expansions)	June 1, 2004	July 3, 2011	July 3, 2011	July 3, 2011	15.10.2015	15.10.2015
b	Total par value upon issue (including expansions)	NIS 2,386,967,000	NIS 2,874,231,609	NIS 733,759,000	NIS 1,329,363,000	NIS 388,451,000	NIS 400,000,000
c	Par value	NIS 397,828,629(1)(2)	NIS 2,874,231,609	NIS 733,759,000	NIS 886,286,312(4)	NIS 388,451,000	NIS 400,000,000
d	Par value revalued to the reporting date (CPI-linked)	NIS 488,207,952(3)	NIS 2,953,178,129	NIS 733,759,000	NIS 886,286,312	NIS 388,451,000	NIS 400,000,000
e	Accrued interest, revalued to the reporting date	NIS 15,093,763	NIS 9,105,633	NIS 946,549	NIS 4,209,860	NIS 1,181,538	NIS 733,333
f	Fair value as included in the financial statements	NIS 509,618,474	NIS 3,278,348,573	NIS 750,562,081	NIS 932,904,972	NIS 407,057,803	NIS 406,040,000
g	Stock exchange value	NIS 509,618,474	NIS 3,278,348,573	NIS 750,562,081	NIS 932,904,972	NIS 407,057,803	NIS 406,040,000
h	Type of interest	Fixed, 5.3%	Fixed, 3.7%	Variable - STL for one year plus 1.4% margin	Fixed, 5.7%	Fixed, 3.65%	Fixed, 2.2%
i	Principal repayment dates	June 1 every year from 2011 through 2016	December 1 every year from 2018 through 2022	December 1 every year from 2018-2022	June 1 every year from 2015 through 2017	December 1 every year from 2022 through 2025	December 1 every year from 2022 through 2025
j	Interest repayment dates	June 1 every year through June 1, 2016	June 1 and December 1 every year, from Dec. 1, 2011 through Dec. 1, 2022	March 1, June 1, Sept. 1 and Dec. 1 every year, from Sept. 1, 2011 through Dec. 1, 2022	June 1 and December 1 every year, from Dec. 1, 2011 through June 1, 2017	June 1 and December 1 every year, from Dec. 1, 2015 through Dec. 1, 2025	June 1 and December 1 every year, from Dec. 1, 2015 through Dec. 1, 2025
k	Linkage	Principal and interest linked to increases in the CPI (base index - April 2004)	Principal and interest linked to increases in the CPI (base index - May 2011)	Unlinked	Unlinked	Unlinked	Principal and interest linked to increases in the CPI (base index - August 2015)

6. Details of debt certificate series (contd.)

Data on the Company's debentures in circulation, as of December 31, 2015:

		Debentures (Series 5)	Debentures (Series 6)	Debentures (Series 7)	Debentures (Series 8)	Debentures (Series 9)	Debentures (Series 10)
l	Liability in relation to Company's total liabilities	Immaterial	Material	Material	Material	Immaterial	Immaterial
m	Trustee	Hermetic Trust (1975) Ltd. Trustee POC - Dan Avnon and Merav Ofer Oren, joint-CEOs Email – hermetic@hermetic.co.il , Telephone - 03-5544553 Address - 113 Hayarkon St., Hermetic House, Tel Aviv	Reznik Paz Nevo Trusts Ltd. Trustee POC - Yossi Reznik, CPA, and Adv. Adi Ma'ayan Email - yossi@rpn.co.il , @rpn.co.il adim, Tel: 03-6389200; Fax: 03-6389222 Address - 14 Yad Harutzim St., Tel Aviv		Strauss Lazar Trust Co. (1992) Ltd. Trustee POC - Uri Lazar, CPA Email - @slcpa.co.il ori Tel: 03-6237777; Fax: 03-5613824 Address - 17 Yitzchak Sadeh St., Tel Aviv	Reznik Paz Nevo Trusts Ltd. (see trustee details for debentures (Series 6 and 7)).	
n	Rating	Debentures (Series 5-10) are rated Aa2 Stable by Midroog Ltd. ("Midroog") and ilAA/Stable by Standard & Poor's Maalot Ltd. ("Maalot"). For current and historical ratings data for the debentures, see the immediate report of September 10, 2015 (ref. no. 2015-01-118998) (Midroog), and the immediate report of September 7, 2015 (ref. no. 2015-01-115938), and the immediate report of April 21, 2015 (ref. no. 2015-01-004083) (Maalot). The rating reports are included in this Board of Directors' Report by way of reference.					
o	Compliance with the deeds of trust	The Company was in compliance with all the terms and obligations under the deeds of trust for Series 5-10, and none of those circumstances were in effect entitling calls for immediate repayment of the debt certificates. No collateral was given to secure payment to holders of the debt certificates.					
p	Pledges	The debt certificates are not secured by any pledge	As concerns debentures (Series 6-10), the Company has undertaken not to create additional pledges on its assets unless it simultaneously create ledges towards the debenture holders and the lending banks (negative pledges) and subject to such exceptions as detailed in Note 12.3.2 to the financial statements.				

- (1) On June 1, 2015, the Company repaid NIS 397,827,674 par value in debentures
- (2) Of which NIS 146.7 million par value held by a wholly-owned subsidiary.
- (3) Of which NIS 180.0 million are held by a wholly-owned subsidiary.
- (4) On June 1, 2015, the Company repaid NIS 443,076,688 par value in debentures.

7. Miscellaneous

For information concerning the liabilities balances of the reporting corporation and those companies consolidated in its financial statements as of December 31, 2015, see the Company's reporting form on the MAGNA system, dated March 17, 2016.

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

Shaul Elovitch
Chairman of the Board

Stella Handler
CEO

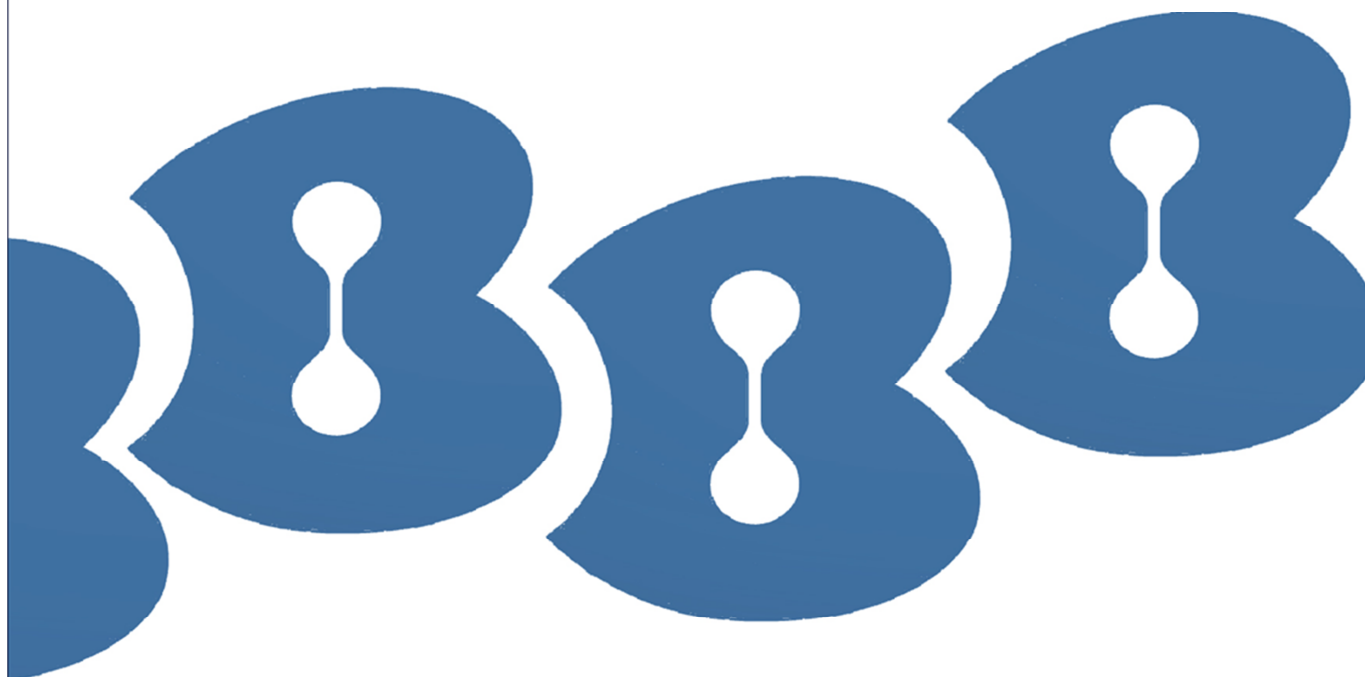
Signed: March 16, 2016

"Bezeq" The Israel Telecommunication Corporation Limited

Part C:

Consolidated Financial Statements for the Year Ended

December 31, 2015



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

Contents	Page
Auditors' Report	2
Financial Statements	
Consolidated Statements of Financial Position	6
Consolidated Statements of Income	8
Consolidated Statements of Comprehensive Income	8
Consolidated Statements of Changes in Equity	9
Consolidated Statements of Cash Flows	10
Notes to the Consolidated Financial Statements	
1. Basis of Preparation	11
2. Significant Accounting Policies	14
3. Cash and Cash Equivalents	25
4. Investments, Including Derivatives	25
5. Trade and Other Receivables	25
6. Income Tax	26
7. Broadcasting Rights, Net of Rights Exercised	29
8. Property, Plant and Equipment	30
9. Intangible Assets	32
10. Deferred Expenses and Non-Current Investments	34
11. Investees	34
12. Debentures, Loans and Borrowings	38
13. Trade and Other Payables	43
14. Provisions	44
15. Employee Benefits	44
16. Contingent Liabilities	47
17. Agreements	49
18. Securities, Pledges and Guarantees	49
19. Capital	50
20. Revenues	51
21. General and Operating Expenses	51
22. Salaries	51
23. Other Operating Expenses (Income), Net	52
24. Financing Expenses (Income), Net	52
25. Share-Based Payments	52
26. Earnings per Share	53
27. Segment Reporting	53
28. Transactions with Interested and Related Parties	59
29. Financial Instruments	68
30. Selected Condensed Data from the Financial Statements of Telephone Communications Ltd., Bezeq International Ltd., and DBS Satellite Services (1998) Ltd.	75



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

Auditors' Report to the Shareholders of

"Bezeq "the Israeli Telecommunication Corporation Ltd.

We have audited the accompanying consolidated statements of financial position of "Bezeq "the Israeli Telecommunication Corporation Ltd. (hereinafter "the Company") as of December 31, 2015 and 2014 and the consolidated income statements, statements of comprehensive income, statements of changes in shareholders' equity and statements of cash flows, for each of the three years, in the period ended December 31, 2015. These financial statements are the responsibility of the Company's Board of Directors and of its Management. Our responsibility is to express an opinion on these financial statements based on our audit.

We did not audit the financial statements of certain consolidated subsidiaries whose assets constitute approximately 1.2% of the total consolidated assets as of December 31, 2015 and 2014, and whose revenues constitute approximately 1%, 1.2% and 1.6% of the total consolidated revenues for the years ended December 31, 2015, 2014 and 2013, respectively. The financial statements of those companies were audited by other auditors whose reports thereon were furnished to us, and our opinion, insofar as it relates to amounts emanating from the financial statements of such companies, is based solely on the reports of the other auditors.

We conducted our audit in accordance with generally accepted auditing standards in Israel, including standards prescribed by the Auditors Regulations (Manner of Auditor's Performance) - 1973. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors and by Management of the Company, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and on the reports of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company and its consolidated subsidiaries as of December 31, 2015 and 2014 and their results of operations, changes in equity and cash flows, for each of the three years in the period ended December 31, 2015, in accordance with International Financial Reporting Standards (IFRS) and in accordance with the Securities Regulations (Annual Financial Statements) - 2010.

We have audited, in accordance with Auditing Standards of the Public Company Accounting Oversight Board (United States) the Internal Control over Financial Reporting of "Bezeq" the Israeli Telecommunication Corporation Ltd. as of December 31, 2015, and our report dated March 16, 2016 expressed an unqualified opinion on the effectiveness of internal control over financial reporting of "Bezeq" the Israeli Telecommunication Corporation Ltd.

Without qualifying our abovementioned opinion, we draw attention to lawsuits filed against the Company and its Subsidiaries which cannot yet be assessed or the exposure in respect thereof cannot yet be calculated, as set forth in Note 16.

Somekh Chaikin

Certified Public Accountants (Isr.)

March 16, 2016



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

Auditor's Attestation Report

The Board of Directors and Stockholders

"Bezeq"- The Israel Telecommunication Corporation Ltd.

We have audited "Bezeq"- The Israel Telecommunication Corporation Ltd.'s (hereinafter "The Company") internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying "Management's Annual Report on Internal Control Over Financial Reporting". Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.



Somekh Chaikin

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The Company Acquired DBS Satellite services (1998) Ltd. ("DBS") during 2015. The Company's management excluded from its assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2015, DBS's internal control over financial reporting. DBS' revenues represent 13.4% of the revenues in the consolidated financial statements of 2015. Our audit of internal control over financial reporting of the company excluded an evaluation of the internal control over financial reporting of DBS.

We also have audited, in accordance with generally accepted auditing principles in Israel, the consolidated balance sheets of the Company and its subsidiaries as of December 31, 2015, and 2014, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2015, and our report dated March 16, 2016 expressed an unqualified opinion on those consolidated financial statements with an explanatory paragraph referring to Note 15 regarding the claims made against the Company and its subsidiaries for which at this point the exposure cannot be assessed or calculated.

Somekh Chaikin

Certified Public Accountants

Jerusalem, Israel
March 16, 2016

Consolidated Statements of Financial Position as at December 31

		2015	2014
Assets	Note	NIS million	NIS million
Cash and cash equivalents	2.3, 3	555	660
Investments, including derivatives	2.3, 4	762	2,223
Trade receivables	2.3, 5	2,058	2,227
Other receivables	2.3, 5	269	260
Inventory	2.10	115	96
Total current assets		3,759	5,466
Trade and other receivables	2.3, 5	674	566
Broadcasting rights, net of rights exercised	2.4, 7	456	-
Property, plant and equipment	2.5, 8	6,894	6,079
Intangible assets	2.7, 9	3,332	1,793
Deferred tax assets	2.16, 6	1,178	-
Deferred expenses and non-current investments	2.9, 10	361	352
Investments in equity-accounted investees	11.3	25	1,057
Total non-current assets		12,920	9,847
Total assets		16,679	15,313

Consolidated Statements of Financial Position as at December 31 (Contd.)

		2015	2014
	Note	NIS million	NIS million
Debentures, loans and borrowings	2.3, 12	1,913	1,481
Trade and other payables	13	1,657	1,374
Current tax liabilities		624	600
Employee benefits	2.12, 15	378	259
Liability to Eurocom DBS Ltd, related party	11.2	233	-
Provisions	2.13, 14	100	62
Total current liabilities		4,905	3,776
Loans and debentures	2.3, 12	8,800	8,606
Employee benefits	2.12, 15	240	233
Derivatives and other liabilities		226	171
Deferred tax liabilities	2.16, 6	51	17
Provisions	2.13, 14	46	69
Total non-current liabilities		9,363	9,096
Total liabilities		14,268	12,872
Total equity	19	2,411	2,441

Total liabilities and equity	16,679	15,313

Shaul Elovitch
Chairman of the Board of

Stella Handler
CEO

David (Dudu) Mizrahi
Deputy CEO and CFO

Date of approval of the financial statements: March 16, 2016

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

Consolidated Statements of Income for the Year Ended December 31

		2015	2014	2013
	Note	NIS million	NIS million	NIS million
Revenues	2.14, 20	9,985	9,055	9,563
Costs of activity				
General and operating expenses	21	3,869	3,366	3,576
Salaries	22	1,957	1,768	1,872
Depreciation and amortization	2.5, 2.7, 8, 9, 10	1,684	1,281	1,311
Other operating income, net	23	(95)	(586)	(15)
		7,415	5,829	6,744
Operating profit		2,570	3,226	2,819
Finance expenses	2.15, 24			
Financing expenses		376	486	573
Financing income		(113)	(356)	(428)
Financing expenses, net		263	130	145
Profit after financing expenses, net		2,307	3,096	2,674
Share in earnings (losses) of equity accounted investees	11.2	12	(170)	(252)
Profit before income tax		2,319	2,926	2,422
Income tax	2.16, 6	598	815	651
Equity for the year attributable to shareholders of the Company		1,721	2,111	1,771
Earnings per share (NIS)	26			
Basic earnings per share		0.63	0.77	0.65
Diluted earnings per share		0.62	0.77	0.65

Consolidated Statements of Comprehensive Income for the Year Ended December 31

	2015	2014	2013
	NIS million	NIS million	NIS million
Profit for the year	1,721	2,111	1,771
Items of other comprehensive income (loss) (net of tax)	7	(36)	6
Total comprehensive income for the year attributable to shareholders of the Company	1,728	2,075	1,777

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

Comprehensive Statements of Changes in Equity for the Year Ended December 31

	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
Attributable to shareholders of the Company							
Balance as at January 1, 2013	3,837	100	256	390	(38)	(2,090)	2,455
Income in 2013	-	-	-	-	-	1,771	1,771
Other comprehensive income (loss) for the year, net of tax	-	-	-	-	(16)	22	6
Total comprehensive income for 2013	-	-	-	-	(16)	1,793	1,777
Transactions with shareholders recognized directly in equity							
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
Income in 2014	-	-	-	-	-	2,111	2,111
Other comprehensive income (loss) for the year, net of tax	-	-	-	-	(38)	2	(36)
Total comprehensive income for 2014	-	-	-	-	(38)	2,113	2,075
Transactions with shareholders recognized directly in equity							
Dividend to Company shareholders (Note 19.2)	-	-	-	-	-	(2,069)	(2,069)
Share-based payments	-	-	(1)	-	-	-	(1)
Exercise of options for shares	13	110	(110)	-	-	-	13
Balance as at December 31, 2014	3,855	253	131	390	(105)	(2,083)	2,441
Income in 2015	-	-	-	-	-	1,721	1,721
Other comprehensive income (loss) for the year, net of tax	-	-	-	-	7	-	7
Total comprehensive income for 2015	-	-	-	-	7	1,721	1,728
Transactions with shareholders recognized directly in equity							
Dividend to Company shareholders (Note 19.2)	-	-	-	-	-	(1,777)	(1,777)
Exercise of options for shares	19	115	(115)	-	-	-	19
Balance as at December 31, 2015	3,874	368	16	390	(98)	(2,139)	2,411

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

Consolidated Statements of Cash Flows for the Year Ended December 31

		2015	2014	2013
	Note	NIS million	NIS million	NIS million
Cash flows from operating activities				
Profit for the year		1,721	2,111	1,771
Adjustments:				
Depreciation and amortization	8,9,10	1,684	1,281	1,311
Profit from sale of the shares of Coral Tell Ltd.		-	(582)	-
Share in losses (profits) of equity-accounted investees	11.2	(12)	170	252
Financing expenses, net		307	229	278
Capital gain, net	23	(234)	(175)	(159)
Profit from gaining control in DBS	11.2	(12)	-	-
Income tax expenses	6	598	815	651
Miscellaneous		(13)	(8)	7
Change in trade and other receivables	5	322	549	646
Change in inventory		(20)	28	9
Change in trade and other payables	13	(271)	(39)	27
Change in provisions	14	18	(63)	(29)
Change in employee benefits	15	110	3	2
Change in other liabilities		4	4	11
Net income tax paid		(462)	(527)	(625)
Net cash from operating activities		3,740	3,796	4,152
Cash flow used for investing activities				
Purchase of property, plant and equipment	8	(1,324)	(1,081)	(1,042)
Investment in intangible assets and deferred expenses	9,10	(311)	(194)	(186)
Acquisition of financial assets held for trading and others		(1,785)	(2,720)	(1,570)
Proceeds from the sale of financial assets held for trading and others		3,260	1,635	1,528
Proceeds from the sale of property, plant and equipment		151	230	312
Cash in a company consolidated for the first time	11.2.3	299	-	-
Miscellaneous		(7)	(12)	41
Net consideration for the sale of Coral Tell Ltd. shares		-	596	-
Net cash from (used in) investment activities		283	(1,546)	(917)
Cash flows used in financing activities				
Issue of debentures and receipt of loans	12	1,010	1,446	1,364
Repayment of debentures and loans	12	(2,192)	(1,149)	(1,120)
Dividends paid	19	(1,777)	(2,069)	(2,830)
Interest paid		(494)	(431)	(453)
Increase in the rate of holding in a subsidiary		-	-	(50)
Payment to Eurocom DBS for acquisition of shares and DBS loan	11.2	(680)	-	-
Miscellaneous		5	3	(2)
Net cash used for financing activities		(4,128)	(2,200)	(3,091)
Increase (decrease) in cash and cash equivalents, net		(105)	50	144
Cash and cash equivalents as at January 1		660	610	466
Cash and cash equivalents as at the end of the year		555	660	610

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

1. Basis of Preparation

1.1. 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 27 – Segment Reporting).

1.2. Material events in the reporting period

On March 23, 2015, the Company gained control in DBS Satellite Services (1998) Ltd. (“DBS”) and began consolidation as at that date. On June 24, 2015, the Company completed the acquisition of the entire rights in DBS shares. For further information see Note 11.2, Investees. The accounting policy applied for the business combination with DBS is described in Note 2.1.1 below.

1.3. Definitions

In these financial statements:

The Company: Bezeq The Israel Telecommunication Corporation Limited

The Group: Bezeq The Israel Telecommunication Corporation Limited and its subsidiaries, as follows:

Subsidiaries: Companies, the financial statements of which are fully consolidated, directly or indirectly, with the financial statements of the Company, as set out in Note 11.1.

Associates: Companies, including a partnership, in which the Group’s investment is included, directly or indirectly, in the consolidated financial statements on the equity basis.

Investees: Subsidiaries or associates

Related parties: As defined in IAS 24, Related Party Disclosures

Interested parties: As defined in paragraph (1) of the definition of an “interested party” in section 1 of the Securities Law, 1968

1.4. Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (“IFRS”) and in accordance with the Securities Regulations (Annual Financial Statements), 2010

The consolidated financial statements were approved by the Board of Directors on March 16, 2016.

1.5. Functional currency and presentation currency

The consolidated financial statements are presented in NIS, which is the Group’s functional currency, and have been rounded to the nearest million. The NIS is the currency that represents the principal economic environment in which the Group operates.

1.6. Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for the following items:

- * Financial instruments, including financial derivatives, at fair value through profit or loss
- * Inventories measured at the lower of cost and net realizable value
- * Equity-accounted investments
- * Deferred tax assets and liabilities
- * Provisions
- * Assets and liabilities for employee benefits
- * Liability for payment of contingent consideration in a business combination

For further information about the measurement of these assets and liabilities see Note 2, Significant Accounting Policies.

1.7. Operating cycle

The Group's operating cycle is up to one year. As a result, current assets and current liabilities include items the realization of which is intended and anticipated to take place within one year from the date of the financial statements.

1.8. Classification of expenses recognized in the statement of income

Costs and expenses in the statement of income are presented and analyzed on the basis of the function of the expenses. The classification is compatible with the understanding of the Group's businesses, which address a wide range of services using common infrastructure. All of the costs and expenses are used to provide services.

1.9. Use of estimates and judgment

The preparation of financial statements in conformity with IFRS requires the Group's management to make judgments and use estimates 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 preparation of accounting estimates used in the preparation of the Group's financial statements requires management to make assumptions regarding circumstances and events that involve considerable uncertainty. Management of the Company prepares the estimates on the basis of past experience. In exercising its judgment when making the estimates, management relies on experience, various facts, external circumstances, and reasonable assumptions according to the relevant circumstances of each estimate.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about significant estimates and judgments and for which changes in the assessments and assumptions could potentially have a material effect on the financial statements:

Subject	Principal assumptions	Possible effects	Reference
Useful life of property, plant and equipment and intangible assets	Assumptions of the useful life of groups of property, plant and equipment and intangible assets	Change in the value of property, plant and equipment and intangible assets and in depreciation and amortization expenses	Note 8 and Note 9
Fair value measurement of the Company's investment in DBS prior to gaining control in DBS	Assumption of expected cash flows from the operations of DBS, discount rate and assumptions about the identity of the relevant market participant.	Change in profit/loss from gaining control	Note 11
Attribution of excess cost arising from acquisition of control in DBS	Assumption of expected cash flows from identifiable assets in the business combination, timing of recognition, and scope of the deferred tax asset for carry-forward losses	Change in the value of identifiable tangible and intangible assets in the business combination and changes in the value of goodwill	Note 11
Fair value measurement of contingent consideration in a business combination	Assumption of expected cash flows and assumption of DBS's losses for tax purposes.	Change in the value of a liability for contingent consideration recognized in a business combination	Note 11
Measurement of recoverable amounts of cash-generating units that include goodwill	Assumption of expected cash flows from cash-generating units	Recognition of impairment loss	Note 9
Deferred taxes	Assumption of anticipated future realization of the tax benefit in the future, including assumptions for the use of carry-forward losses in DBS.	Recognition or reversal of deferred tax asset in profit or loss	Note 6
Uncertain tax positions	The extent of the certainty that the Group's tax positions will be accepted (uncertain tax positions) and the risk of it incurring any additional tax and interest expenses. This is based on an analysis of a number of matters including interpretations of tax laws and the Group's past experience	Recognition or reversal of income tax expenses	Note 6
Provisions and contingent liabilities	Assessment of the likelihood of claims against Group companies and measuring potential liabilities attributable to claims	Reversal or creation of a provision for a claim and recognition of income/expenses respectively	Note 14 and Note 16
Post-employment employee benefits	Actuarial assumptions such as discount rate, future salary increases and churn rate	Increase or decrease in the post-employment defined benefit obligation	Note 15

1.10 Determining fair value

When preparing the financial statements, the Group is required to determine the fair value of certain assets and liabilities. Further information about the assumptions made in determining fair values is disclosed in Note 29.7 regarding fair value.

2. Significant Accounting Policies

The accounting policies set out below have been applied consistently by Group entities for all periods presented in these consolidated financial statements.

2.1. Consolidation of the financial statements

2.1.1 Business combinations

In view of the consolidation of DBS as from March 23, 2015, as described in Note 1.2 and Note 11.2, below is a description of the accounting policy for the consolidation of DBS in these financial statements:

- A. The Group implemented the acquisition method for all business combinations. The acquisition date is the date on which the acquirer obtained control over the acquiree.
- B. The Group recognized goodwill at acquisition based on the fair value of the consideration transferred, and the fair value at the acquisition date of any pre-existing equity right of the Group in the acquiree, less the net amount of the identifiable assets acquired and the liabilities assumed.
- C. The consideration transferred includes the fair value of the assets transferred to the previous owners of the acquiree and the liabilities incurred by the acquirer to the previous owners of the acquiree, **including the obligation to acquire the acquiree's equity instruments**. In addition, the consideration transferred includes the fair value of any contingent consideration.
- D. In the step acquisitions, the difference between the fair value at the acquisition date of the Group's pre-existing equity rights in the acquiree and the carrying amount at that date is recognized in the statement of income **under other operating income or expenses**.
- E. Costs associated with the acquisition that were incurred by the Group in the business combination such as advisory, legal, valuation and other professional or consulting fees were recognized as expenses in the period the services are received.

2.1.2 Subsidiaries

Subsidiaries are entities controlled by the Company. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date of loss of control.

Control exists when the Group is exposed or has rights to variable returns from its involvement with the acquiree and it has the ability to affect those returns through its power over the acquiree. Substantive rights held by the Group and others are taking into account when assessing control.

The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

2.1.3 Transactions eliminated on consolidation

Intra-group balances and income and expenses arising from intra-group transactions, are eliminated in the consolidated statements.

2.2. Foreign currency transactions

Transactions in foreign currency are translated into the functional currency of the Group at the exchange rate on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies on the reporting date are retranslated to the functional currency at the exchange rate at that date.

2.3. Financial instruments:

2.3.1 Non-derivative financial assets

Non-derivative financial assets comprise mainly investments in exchange traded funds, trade and other receivables, and cash and cash equivalents.

The Group initially recognizes financial assets at the date the Group becomes a party to contractual provisions of the instrument, meaning the date that the Group fulfills its obligations under the contract.

Financial assets are derecognized when the contractual rights of the Group to the cash flows from the asset expire, or the Group transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred.

Regular way sales of financial assets are recognized on the trade date, meaning on the date the Group undertook to sell the asset.

2.3.2 Classification of financial assets and the accounting treatment in each group

The Group classifies its financial assets as follows:

Cash and cash equivalents

Cash comprises cash balances available for immediate use and call deposits. Cash equivalents comprise short-term highly liquid investments (with original maturities of three months or less) that are readily convertible into known amounts of cash and are exposed to insignificant risks of change in value.

Financial assets at fair value through profit or loss

A financial asset is classified at fair value through profit or loss (mainly the Group's investment in exchange-traded funds and deposit notes) if it is classified as held for trading or is designated as such upon initial recognition. These financial assets are measured at fair value, and changes therein are recognized in the statement of income.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

2.3.3 Non-derivative financial liabilities

Non-derivative financial liabilities include debentures issued by the Group, loans and borrowings from banks and other credit providers, and trade and other payables.

The Group initially recognizes debt instruments as they are incurred. Financial liabilities are initially recognized at fair value plus any attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest method.

Financial liabilities are derecognized when the obligation of the Group, as specified in the agreement, expires or when it is discharged or canceled.

CPI-linked assets and liabilities that are not measured at fair value

The value of CPI-linked financial assets and liabilities, which are not measured at fair value, is revalued in each period according to the actual increase in the CPI.

2.3.4 CPI-linked assets and liabilities that are not measured at fair value

The value of CPI-linked financial assets and liabilities, which are not measured at fair value, is revalued in each period according to the actual increase in the CPI.

2.3.5 Offsetting financial instruments

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group currently has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

2.3.6 A. Hedge accounting

The Group holds derivative financial instruments to hedge cash flows for risks to future changes in the CPI.

Forward contracts are measured at fair value. Changes in the fair value of the derivative hedging instrument designated as a cash flow hedge are recognized through other comprehensive income, in a hedging reserve under equity, to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognized in profit or loss. The amount recognized in the hedging reserve is removed and included in profit or loss in the same period as the hedged cash flows affect profit or loss under the same line item in the statement of income as the hedged item.

B. Economic hedging

In addition, the Group holds derivative financial instruments to hedge cash flows for foreign currency risks. Hedge accounting is not applied for these instruments. The derivative instruments are recognized at their fair value; fair value changes are recognized immediately in the statement of income.

2.4. Broadcasting rights

Broadcasting rights are stated at cost, net of rights exercised.

The costs of rights to broadcast acquired content include the amounts paid to the rights provider, plus direct costs for adjusting the rights to the broadcast. Broadcast rights are amortized in accordance with the actual broadcasts of the total number of expected broadcasts based on the management's estimate or broadcasts permitted under the agreement (the part that is unamortized at the end of the agreement term is amortized in full upon its termination), or on a straight line basis in accordance with the term of the rights agreement or the economic life, whichever is shorter. ***The net adjustment of the broadcasting rights is presented as an adjustment of earnings as part of the ongoing operations in the statements of cash flows.***

2.5. Property, plant and equipment

2.5.1 Recognition and measurement

The Group elected to measure items of property, plant and equipment at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to acquisition of the asset. The cost of self-constructed assets includes the cost of materials, direct labor and financing costs as well as any other cost directly attributable to bringing the asset to the condition for its use intended by the management, and the estimated costs of dismantling and removing the items and restoring the site on which they are located when the Group has an obligation to vacate and restore the site. The cost of purchased software that is integral to the functionality of the related equipment is recognized as part of the cost of the equipment.

Spare parts, servicing equipment and stand-by equipment are classified as property, plant and equipment when they meet the definition of property, plant and equipment in IAS 16, and are otherwise to be classified as inventory.

When major parts of the property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of the property, plant and equipment.

Gain or loss from the disposal of an item of property, plant and equipment is determined by comparing the proceeds from disposal of the asset with its carrying amount. ***Gain or***

loss from the sale of property, plant and equipment is recognized under "other income" in the statement of income.

2.5.2 Subsequent expenditure

The cost of replacing part of an item of property, plant and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefit embodied in the replaced item will flow to the Group and its cost can be measured reliably. The costs of day-to-day servicing are recognized in the statement of income as incurred.

2.5.3 Depreciation

Depreciation is recognized in the statement of income on a straight-line basis over the estimated useful life of each part of an item of property, plant and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets under finance lease agreements are depreciated over the shorter of the lease term and their useful lives. An asset is depreciated when it is ready for use, meaning when it reaches the location and condition necessary for it to be capable of operating in the manner intended by management.

Leasehold improvements are depreciated over the shorter of the lease term, including the extension option held by the Group and intended to be exercised and the expected life of the improvement.

The estimated useful lives for the current and comparative periods are as follows:

	Year	Average depreciation for the reported period (%)
Fixed line and international network equipment (switches, transmission, power)	4-12	12
Network	12-33	6
Equipment and infrastructure for multichannel television	3-15	14
Subscriber equipment and installations	4-6	20
Vehicles	6-7	15
Office and general equipment	5-14	15
Electronic equipment, computers and internal communication systems	3-7	24
Cellular network	4-15	13
Buildings	25	4
Seabed cable	4-25	4

Depreciation methods, useful lives and residual values are reviewed at least in each reporting year and adjusted as required.

2.6. Non-current assets held for sale

Non-current assets which will most probably be realized by way of a sale rather than ongoing use are classified as assets held for sale. These assets are presented at the lower of the carrying amount and fair value, less selling costs.

2.7. Intangible assets

2.7.1 Goodwill

Goodwill that arises upon the acquisition of subsidiaries is included in intangible assets. Subsequent to initial recognition, goodwill is measured at cost less accumulated impairment losses. Goodwill is measured at least once a year to assess impairment.

2.7.2 Software development costs

Software development costs are recognized as an intangible asset only if the development costs can be measured reliably; the software is technically and commercially applicable; and the Group has sufficient resources to complete the development and intends to use the software. The costs recognized as an intangible asset include the cost of the materials,

direct labor and overhead expenses directly attributable to preparation of the asset for its intended use. Other development costs are recognized in the statement of income as incurred.

Capitalized development costs are measured at cost less amortization and accumulated impairment losses.

2.7.3 Software

Software that is an integral part of the hardware, which cannot function without the programs installed on it, is classified as property, plant and equipment. However, licenses for stand-alone software which add functionality to the hardware are classified as intangible assets.

2.7.4 Rights to frequencies

Rights to frequencies refer to frequencies assigned to Telecel for cellular activities, after it won the dedicated tenders of the Ministry of Communications. Depreciation of the asset is recognized in the statement of income on the straight line method over the term of the allocation of frequencies, which started from the use of the frequencies. The 4G frequencies (LTE) are amortized over a period of 10 years. The 3.5G frequencies (UMTS / HSPA) are amortized over a period of 13 years and seven months.

2.7.5 Other intangible assets

Other intangible assets acquired by the Group, which have a definite useful life, are measured at cost less amortization and accumulated impairment losses.

2.7.6 Subsequent expenditure

Subsequent expenditure is recognized as an intangible asset only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure, including expenditure relating to generated goodwill and brands, is recognized in the statement of income as incurred.

2.7.7 Amortization

Amortization of intangible assets is recognized in the statement of income on a straight-line basis over the estimated useful life of the intangible assets, from the date on which the assets are available for use. Goodwill is not systematically amortized but is tested for impairment at least once a year.

Estimated useful lives for the current and comparative periods are as follows:

Type of asset	Amortization period
Frequency usage right	Over the term of the license for 10 to 14 years starting from the use of the frequencies
Computer programs and software licenses	3-10 years depending on the term of the license period or the estimated time of use of the software
Customer relationships acquired in a business combination	5-7 years based on the estimated customer churn rate
Brand acquired in a business combination	12
Other rights	2-6 years, depending on the useful life

Amortization methods and useful lives are reviewed at least at each reporting year and adjusted if appropriate.

2.8. Leased assets

Leases, including leases of land from the Israel Land Administration, where the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. ***Subsequent to initial recognition, the assets are measured at cost less accumulated amortization and impairment losses.***

Other leases are classified as operating leases and the leased assets are not recognized in the Group's statement of financial position. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease.

At inception or upon reassessment of an arrangement, the Group determines whether such an arrangement is or contains a lease. An arrangement is a lease or contains a lease if the following two criteria are met:

- A. The fulfillment of the arrangement is dependent on the use of a specific asset or assets; and
- B. The arrangement contains rights to use the asset

If, in accordance with these terms, the Group determines that the agreement does not contain a lease, the agreement is accounted for as a service agreement and payments for the service are recognized in profit or loss on a straight line basis, over the service period.

2.9. Right of use of capacities

Transactions for acquiring an infeasible right of use (IRU) of seabed cable capacities are accounted for as service transactions. The prepaid expense is amortized on a straight-line basis as stated in the agreement and no more than the expected estimated useful life of those capacities.

Identifiable capacities which serve the Group exclusively fulfill the definition of a finance lease and were recognized in property, plant and equipment. The asset is depreciated on a straight-line basis as stated in the agreement and no more than the expected estimated useful life of those capacities.

2.10. Inventory

Inventories are measured at the lower of cost and net realizable value. ***The Group elected to base the cost of inventories on the moving average principle.***

The inventories include terminal equipment and accessories intended for sale and service, as well as spare parts used for repairs in the repair service provided to its customers.

Slow-moving inventory of terminal equipment, accessories and spare parts are stated net of the provision for impairment.

2.11. Impairment

2.11.1 Non-derivative financial assets

The Group tests a financial asset for impairment when objective evidence indicates that one or more loss events have had a negative effect on the estimated future cash flows of that asset.

Significant financial assets are tested for impairment on an individual basis. Other financial assets are assessed for impairment collectively in groups that share similar credit risk characteristics, taking into account past experience. The financial statements include specific provisions and Group provisions for doubtful debts, which properly reflect, in the estimation of the management, the loss inherent in debts for which collection is in doubt.

2.11.2 Non-financial assets

Timing of impairment testing

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the recoverable amount of the asset is estimated.

The Group assesses the recoverable amount of goodwill once a year, or more frequently if there are indications of impairment.

Measurement of recoverable amount

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset (for which future cash flows were not adjusted).

Determining cash-generating units

For the purpose of impairment testing, the assets are grouped together into the smallest group of assets that generates cash from continuing use that are largely independent of other assets or groups of assets ("cash-generating unit").

Allocation of goodwill to cash-generating units

For purposes of goodwill impairment testing, cash-generating units to which goodwill has been allocated are aggregated so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes, but in any event is not larger than an operating segment. Goodwill acquired in a business combination is allocated for the purpose of impairment testing to cash-generating units that are expected to generate benefits from the synergies of the combination.

2.12. Employee benefits

2.12.1 Post-employment benefits

The Group has a number of post-employment benefit plans. The plans are usually financed by deposits with insurance companies and they are classified as defined contribution plans and defined benefit plans.

A. Defined contribution plans

A defined contribution plan is a post-employment benefit plan under which the Group pays fixed contributions into a separate entity and has no legal or constructive obligation to pay further amounts.

The Group's obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense in the statement of income in the periods during which services are rendered by employees.

B. Defined benefit plans

The Group's net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods. That benefit is presented at its present value, and the fair value of any plan assets is deducted. The calculation is performed annually by a qualified actuary. The discount rate is the yield at the reporting date on high-quality linked corporate debentures denominated in NIS, with maturity dates approximating the terms of the Group's obligations.

Net interest costs on a defined benefit plan are calculated by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability.

The Group elected to recognize the interest costs that were recognized in profit or loss under financing expenses.

Re-measurement of the net defined benefit liability comprises actuarial gains and losses and the return on plan assets (excluding interest). Re-measurements are recognized immediately directly in retained earnings through other comprehensive income.

When the benefits of a plan are improved or curtailed, the portion of the increased benefit relating to past service by employees or the gain or loss on curtailment are recognized immediately in profit or loss when the plan improvement or curtailment occurs.

2.12.2 Other long-term employee benefits

The Group's net obligation in respect of long-term employee benefits other than pension plans is the amount of future benefit that employees have earned in return for their service in the current and prior periods. The amount of these benefits is stated at its present value. The discount rate is the yield at the reporting date on high-quality linked corporate debentures denominated in NIS, with maturity dates approximating the terms of the Group's obligations. Any actuarial gains or losses are recognized in the statement of income in the period in which they arise.

2.12.3 Termination benefits

Termination benefits are recognized as an expense when the Group is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to terminate employment before the normal retirement date. Termination benefits for voluntary redundancies are recognized as an expense if the Group has made an offer of voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

2.12.4 Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognized for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

The employee benefits are classified, for measurement purposes, as short-term benefits or as other long-term benefits depending on the date when the benefits are expected to be to be wholly settled,

In the statement of financial position the employee benefits are classified as current benefits or as non-current benefits according to the time the liability is due to be settled.

2.13. Provisions

A provision is recognized if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

2.13.1 Legal claims

Contingent liabilities are accounted for according to IAS 37 and its related provisions. Accordingly, the claims are classified by likelihood of realization of the exposure to risk, as follows:

- A. More likely than not – more than 50% probability
- B. Likely – probability higher than unlikely and less than 50%
- C. Unlikely – probability of 10% or less

For claims which the Group has a legal or constructive obligation as a result of a past event, which are more likely than not to be realized, the financial statements include provisions which, in the opinion of the Group, based, inter alia, on the opinions of its legal advisers retained in respect of those claims, are appropriate to the circumstances of each case, despite the claims being denied by the Group companies. There are also a small

number of legal proceedings, most of which were received recently, for which the risks cannot be assessed at this stage, therefore no provisions have been made.

Note 16 describes the amount of additional exposure due to contingent liabilities that are likely to be realized.

2.13.2 Site dismantling and clearing costs

The provision in respect of an obligation to dismantle and clear sites is recognized for those rental agreements where Pelephone has an undertaking to restore the rental property to its original state at the end of the rental period, after dismantling and transferring the site, and restoring the site when required. The provision is measured by discounting the future cash flows by risk-free discounted interest reflecting the time until the expected termination of the contract for dismantling of the site by Pelephone. The carrying amount of the provision is adjusted in each period to reflect the time that has passed and is recognized as a financing expense.

2.14. Revenues

Revenues are measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates.

2.14.1 Sale of equipment

Revenues from sales of terminal equipment are recognized in the statement of income when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs can be estimated reliably and the Group companies have no continuing involvement with the goods.

Revenues from the sale of terminal equipment to subscribers in long-term credit arrangements are recognized upon delivery to the customer at the present value of the future cash flow expected from them, **at the relevant interest rate for transactions of this kind** (see Note 5). Financing income in respect of these transactions is recognized in the statement of income over the period of the installments by the effective interest method.

2.14.2 Revenues from services

Revenues from services rendered are recognized in the statement of income proportionately over the term of the agreement or upon providing the service if the flow of the economic benefits associated with providing the service is likely.

2.14.3 Reporting gross or net revenues

When the Group acts as an agent or intermediary without bearing the risks and rewards deriving from the transaction, its revenues are recognized on a net basis (as profit or commission). The Group operates as an agent mainly for certain content services provided by other suppliers and payment is collected by the Group. However, when the Group acts as a main supplier and bears the risks and rewards associated with the transaction, its revenues are recognized on a gross basis (such as interconnect fees).

2.15. Financing income and expenses

Financing income includes mainly interest income from deposits, income interest and linkage from loans provided to an associate, income interest accrued using the effective interest method in respect of the sale of terminal equipment in installments, gains on the disposal of available-for-sale financial assets, and changes in the fair value of financial assets at fair value through profit or loss.

Financing expenses include interest and linkage expense on borrowings, debentures issued, loss from hedge transactions, impairment losses recognized on financial assets (except for a provision for doubtful debts, which is recognized under operating and general expenses), and financing expenses for provisions arising from legal claims.

In the statements of cash flows, **interest received and dividends received are presented as part of cash flows from investing activities. The Group elected to present interest and**

linkage differences paid for loans and debentures under cash flows used for financing activities.

2.16. Income tax expenses

Income tax expenses include current and deferred taxes and are recognized in the statement of income, or in other comprehensive income to the extent that the expenses relate to items recognized in other comprehensive income.

Current taxes

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date. Current taxes also include taxes in respect of prior years.

Uncertain tax positions

A provision for uncertain tax positions, including additional tax and interest expenses, is recognized when it is more likely than not that the Group will have to use its economic resources to pay the obligation

Deferred taxes

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The Group does not recognize deferred taxes for the following temporary differences:

1. Initial recognition of goodwill
2. Differences arising from investment in subsidiaries and associates, if it is probable that they will not reverse in the foreseeable future and if the Group controls the date of reversal.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognized for carry-forward losses, tax benefits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Offsetting deferred tax assets and liabilities

The Group sets off deferred tax assets and liabilities if there is a legally enforceable right to offset deferred tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, and they intend to settle deferred tax liabilities and assets on a net basis or their deferred tax assets and liabilities will be realized simultaneously.

2.17. Dividends

An obligation relating to a dividend proposed or declared subsequent to the reporting date is recognized only in the period in which the declaration was made (approval of the general meeting). In the statements of cash flows, ***a dividend that has been paid is recognized under financing activities.***

2.18. New standards and interpretations not yet adopted

Standard	Subject	Implementation and transition provisions	Expected effects
IFRS 9 (2014), Financial Instruments	IFRS 9 (2014) 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 (2014) will be effective for annual periods starting from January 1, 2018. Early application is permitted. IFRS 9 (2014) will be applied retrospectively, except for a number of exemptions.	The Group is examining the effects of adopting IFRS 9 (2014) on the financial statements.
IFRS 15, Revenues from Contracts with Customers	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 (2014) will be effective for annual periods starting from January 1, 2018. Early application 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 (2014) on the financial statements.
IFRS 16, Fair Value Measurement: Leases	The standard replaces the previous instructions under IAS. For lessees, IFRS 16 eliminates the current classification of leases as either operating leases or finance leases and introduces a single lessee accounting model for all leases on a balance sheet (other than a number of exceptions), which are substantially similar to the accounting treatment for finance leases today. By contrast, the accounting treatment in the lessors' financial statements is expected to remain the same as the accounting treatment today. In addition, the standard establishes new and expanded disclosure requirements, both by lessors and by the lessees.	The standard will be effective for annual periods starting from January 1, 2019. Early application is possible, provided that the Company also applies IFRS 15, Revenue from Contracts with Customers.	The Group will examine the effects of adopting the standard on the financial statements.

3. Cash and Cash Equivalents

As at December 31, 2015, cash and cash equivalents include mainly bank deposits for an average period of 90 days.

4. Investments, Including Derivatives

	December 31, 2015	December 31, 2014
	NIS million	NIS million
Bank deposits	556	710
Exchange traded funds	139	1,508
Monetary and other reserves	67	5
	762	2,223

Investments in ETFs and financial funds are investments held for trading and are presented at fair value as at the date of the financial statements. ETFs were exercised in January 2016, the deposits are repayable until April 2016, and the other investments are exercisable in 2016.

5. Trade and Other Receivables

5.1 Composition of trade and other receivables

	December 31, 2015	December 31, 2014
	NIS million	NIS million
Trade receivables*		
Open accounts and checks receivable	841	986
Credit cards	434	343
Revenues receivable	240	250
Current maturities of long-term receivables	534	632
Related and interested parties	9	16
	2,058	2,227
Other receivables and current tax assets		
Prepaid expenses	135	103
Other receivables (mainly from real estate sales)	118	131
Current tax assets	16	26
	269	260
Long-term trade and other receivables		
Trade receivables – open debts	509	531
Other receivables (for the sale of real estate)	165	35
	674	566
	3,001	3,053

* The amount of trade receivables is stated net of the provision for doubtful debts

5.2 Discounted interest rates for long-term trade payables are based the estimated credit risk of trade payables. The discounted interest rates used by the Group in 2015 are 3.4% - 3.6% (in 2014: 4.3% - 3.6%).

5.3 Expected payment dates for long-term trade and other receivables:

Expected payment dates	December 31, 2015
	NIS million
2017	385
2018	281
2019	8
	674

5.4 Aging of trade receivables at the reporting date:

	December 31, 2015		December 31, 2014	
	Trade receivables, gross	Provision for doubtful debts	Trade receivables, gross	Provision for doubtful debts
	NIS million	NIS million	NIS million	NIS million
Not past due	2,377	(11)	2,607	(12)
Past due up to one year	201	(47)	174	(61)
Past due one to two years	74	(50)	78	(52)
Past due more than two years	88	(65)	73	(49)
	2,740	(173)	2,932	(174)

5.5 Change in provision for doubtful debts during the year:

	2015	2014
	NIS million	NIS million
Balance as at January 1	174	202
Impairment loss recognized	34	30
Bad debts	(35)	(58)
Balance as at December 31	173	174

6. Income Tax**6.1. Corporate tax rate**

The tax rate relevant to the Company is 26.5% in 2015 and 2014 and 25% in 2013.

As at December 31, 2015, the deferred tax balances were calculated according to the enacted tax rate expected to apply on the utilization date (26.5%). For information about the decrease in tax rates as from 2016, see Note 6.7 below.

6.2. Components of income tax expenses

	Year ended December 31		
	2015	2014	2013
	NIS million	NIS million	NIS million
Current tax expenses	567	781	579
Deferred taxes	31	34	72
Income tax expenses	598	815	651

6.3. Reconciliation between the theoretical tax on the pre-tax profit and the tax expense

	Year ended December 31		
	2015	2014	2013
	NIS million	NIS million	NIS million
Profit before income tax	2,319	2,926	2,422
Statutory tax rate	26.5%	26.5%	25%
Income tax at the statutory tax rate	614	775	606
Adjusted tax calculated for the Company's share in the losses of equity-accounted investees	(3)	45	63
Expenses (benefits) not recognized for tax purposes, net	(13)	(5)	23
Differences in the tax rate and other adjustments	-	-	(41)
Income tax expenses	598	815	651

6.4. Unrecognized deferred tax assets and liabilities

The calculation of deferred taxes does not take into account the taxes that would be applicable in the case of disposal of investments in subsidiaries and associates, since the Group intends to retain the investment. Deferred taxes in respect of a distribution of profit in subsidiaries and associates were also not taken into account since the dividends are not taxable.

6.5. Recognized tax assets and deferred tax liabilities and their changes

	Balance as at January 1, 2014	Changes recognized in the statement of income	Changes recognized in equity	Balance as at December 31, 2014	Changes recognized in the statement of income	Changes recognized in equity	Business combination (see Note 11.2)	Balance as at December 31, 2015
NIS million								
Carry-forward losses for DBS	-	-	-	-	(7)	-	1,426	1,419
Property, plant and equipment	(315)	(35)	-	(350)	(3)	-	-	(353)
Intangible assets	-	-	-	-	37	-	(301)	(264)
Employee benefit plans	230	(23)	-	207	1	-	-	208
Other	90	24	12	126	(59)	5	45	117
	5	(34)	12	(17)	(31)	5	1,170	1,127
Presented in the statement of financial position								
Deferred tax assets	60			-				1,178
Deferred tax liabilities	(55)			(17)				(51)
	5			(17)				1,127

6.6. Final tax assessments

- 6.6.1 The Company has final tax assessments up to and including 2005.
- 6.6.2 In 2013, the Company signed an agreement with the tax assessor for 2006-2008, which includes undisputed income. In addition, a decision was received according to the best judgment of the tax assessor, whereby financing expenses accumulated on the shareholders' loans that the Company provided DBS should be added to the Company's undisputed income. The Company filed a reservation on this decision. The reservation was dismissed and on February 24, 2015, the Company received orders which it appealed at the Court. For 2009-2010, a decision was reached according to the tax assessor's best judgment regarding the aforesaid, and regarding other matters, mainly non-recognition of financing expenses for various reasons. The Company filed a reservation on the assessment. Subsequent to the date of the financial statements, the Company reached an agreement in principle with the assessor regarding payment of taxes in the amount of NIS 460 million on financing income that accrued up to December 31, 2015 on shareholders loans provided to DBS. In addition, it was agreed that the losses of DBS as at December 31, 2014, which will be recognized in a merger or offset from the income of DBS, will amount to NIS 5.4 billion and the balance of the shareholder loan will be considered as equity in the financial statements of DBS. The agreement in principle has not yet resulted in a signed agreement.
- The provision in the financial statements was reduced and amounted to the agreed amount and included an adequate provision for tax for the other disputed income. A deferred tax asset was also recognized for the carry-forward losses of DBS, based on the Company's estimates and taking into account the above.
- 6.6.3 Pelephone has received final tax assessments up to and including 2012.
- 6.6.4 Bezeq International has received final tax assessments up to and including 2012.
- 6.6.5 DBS has received final tax assessments up to and including 2009.

6.7. Change in the rate of corporate tax subsequent to the date of the financial statements

On January 4, 2016, the Knesset plenum approved a bill to amend the Income Tax Ordinance, including a reduction in corporate tax by 1.5% from 26.5% to 25%, as from January 1, 2016. Consequently, in 2016, the Group expects to reduce the tax assets and liabilities for deferred taxes and recognize an expense of NIS 64 million for deferred taxes.

7. Broadcasting Rights, Net of Rights Exercised

	December 31, 2015	December 31, 2014
	NIS million	NIS million
Cost	621	-
Less rights exercised	(165)	-
	456	-

As at December 31, 2015, DBS has agreements for the acquisition of broadcasting rights. In 2015, acquisition of these broadcasting rights amounted to NIS 189 million.

8. Property, Plant and Equipment

	Land and buildings	Fixed line and international network equipment (switches, transmission, power)	Cables and fixed line and international network infrastructure	Cellular network	Equipment and infrastructure for multichannel television	Subscriber equipment	Office equipment, computers and vehicles	Total
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Cost								
Balance as at January 1, 2014	1,594	2,311	11,420	2,528	-	591	928	19,372
Additions	43	241	285	255	-	203	82	1,109
Disposals	86	(129)	(131)	(254)	-	(82)	(158)	(668)
Balance as at December 31, 2014	1,723	2,423	11,574	2,529	-	712	852	19,813
Additions	41	273	254	254	164	225	71	1,282
Consolidation	16	-	-	-	749	-	36	801
Disposals	(132)	(99)	(160)	(86)	(46)	(59)	(117)	(699)
Balance as at December 31, 2015	1,648	2,597	11,668	2,697	867	878	842	21,197
Depreciation and impairment losses								
Balance as at January 1, 2014	1,122	1,058	8,834	1,482	-	299	604	13,399
Depreciation for the year	40	227	187	304	-	132	106	996
Disposals	73	(128)	(131)	(254)	-	(79)	(142)	(661)
Balance as at December 31, 2014	1,235	1,157	8,890	1,532	-	352	568	13,734
Depreciation for the year	46	237	195	314	189	159	105	1,245
Disposals	(118)	(99)	(160)	(85)	(46)	(59)	(109)	(676)
Balance as at December 31, 2015	1,163	1,295	8,925	1,761	143	452	564	14,303
Carrying amount								
January 1, 2014	472	1,253	2,586	1,046	-	292	324	5,973
December 31, 2014	488	1,266	2,684	997	-	360	284	6,079
December 31, 2015	485	1,302	2,743	936	724	426	278	6,894

- 8.1** The residual value of the Group's copper cables is assessed at the end of each quarter. The residual value is NIS 140 million as at December 31, 2015 and NIS 190 million as at December 31, 2014. The change in the residual value is mainly due to the decrease in the price of copper.
- 8.2** Property, plant and equipment in the Group is derecognized at the end of each year upon reaching full depreciation, except for land, buildings, vehicles, copper cables and specific components for Pelephone's UMTS network, which are derecognized upon their sale. In 2015, the Group derecognized fully depreciated property at a cost of NIS 557 million (in 2014, NIS 707 million).
- 8.3** The Group companies reviewed the useful life of the property, plant and equipment through the depreciation committee, in order to determine the estimated useful life of their equipment. The change is not expected to have a material impact on the depreciation expenses of the Group. Following the findings of the committees, minor changes were made in the estimated useful life of certain assets.
- 8.4** Most of the real estate assets used by the Company are leased under a capitalized finance lease from the Israel Lands Administration as from 1993 for 49 years, with an option for an extension of another 49 years. Lease rights are amortized over the term of the lease period.
- 8.5** In 2013, the Company started to install a fiber optic network that will reach the subscriber's home. As at December 31, 2015, the unexercised investment in assets amounts to NIS 294 million.
- 8.6** At the reporting date, there are agreements to purchase property, plant and equipment amounting to NIS 75 million (in 2014, NIS 88 million).
- 8.7** In accordance with the Telecommunications Order (Telecommunications and Broadcasts) (Determination of Essential Service Provided by Bezeq The Israel Telecommunication Corp. Ltd.), 1997, approval from the Prime Minister and Minister of Communications is required to confer rights in some of the Company's assets (including switches, cable network, transmission network, and information and databases).
- 8.8** In accordance with its cellular license, Pelephone is not permitted to sell, lease or pledge any of its assets used for the implementation of the license, without the consent of the Minister of Communications, except for:
- A. A pledge on one of the license assets in favor of a bank operating lawfully in Israel, to receive bank credit, provided that it submitted notice to the Ministry of Communications regarding the pledge it intends to register, noting that the pledge agreement includes a clause ensuring that in any event, exercise of the rights by the bank will not impair, in any way, the services provided under the license.
 - B. Sale of items of equipment when implementing an upgrade, including sale of equipment by the trade-in method.
- 8.9** For information about pledges for loans and borrowings, see Note 12.

9. Intangible Assets

	Goodwill	Software and licenses	Cellular communication usage rights	Customer relations and brand - multichannel television	Other	Total
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Cost						
Balance as at January 1, 2014	1,225	1,243	384	-	291	3,143
Acquisitions or additions from in-house development	-	162	-	-	15	177
Disposals	-	(68)	-	-	(9)	(77)
Deconsolidation	(179)	-	-	-	(86)	(265)
Balance as at December 31, 2014	1,046	1,337	384	-	211	2,978
Acquisitions or additions from in-house development	-	188	96	-	28	312
Consolidation	385	148	-	1,137	-	1,670
Disposals	-	(60)	-	-	(51)	(111)
Balance as at December 31, 2015	1,431	1,613	480	1,137	188	4,849
Amortization and impairment losses						
Balance as at January 1, 2014	53	712	146	-	172	1,083
Amortization for the year	-	205	28	-	28	261
Disposals	-	(68)	-	-	(9)	(77)
Deconsolidation	(47)	-	-	-	(35)	(82)
Balance as at December 31, 2014	6	849	174	-	156	1,185
Amortization for the year	-	242	31	141	20	434
Disposals	-	(60)	-	-	(42)	(102)
Balance as at December 31, 2015	6	1,031	205	141	134	1,517
Carrying amount						
January 1, 2014	1,172	531	238	-	119	2,060
December 31, 2014	1,040	488	210	-	55	1,793
December 31, 2015	1,425	582	275	996	54	3,332

9.1. Assessment of impairment of cash-generating units that include goodwill

To assess impairment, goodwill was attributed to the Group's operating segments as follows:

	December 31, 2015	December 31, 2014
	NIS million	NIS million
Cellular communications (Telephone)	1,027	1,027
Domestic fixed-line communication (Bezeq) *	265	-
Multichannel television (DBS) *	120	-
Other	13	13
	1,425	1,040

* Goodwill acquired in the business combination with DBS, as described in Note 11.2 below.

9.2. Assessment of cellular communications goodwill (Pelephone)

The value in use for Bezeq Group of a cellular cash-generating unit (Pelephone), was calculated using the future discounted cash flow (DCF) method, based on the expected cash flow for the next five years. The expected cash flow is based on Pelephone's results in recent years, such that future growth and market shares are affected by directions in the cellular market, such as price competition, regulation and the operation scope of the new cellular operators. The revenue forecast is based on assumptions regarding the number of users, average revenue per user, and sales of terminal equipment. The main assumption underlying the forecast is the recovery in Pelephone's business activity as from 2017, due to the expected stabilization of the market and the start of competitive balance. In addition, the valuation included synergies on the Group revenue level based on the high certainty of the structural separation in the long term.

The operating, sales, marketing and investment expenses were adjusted for Pelephone's volume of operations. The cost of nominal capital used is 10% (after tax). In addition, it was assumed that the permanent growth will be 2.5%. The valuation was made by an independent appraiser. Based on this valuation, the Group was not required to record amortization for impairment of a cellular communication cash-generating unit.

9.3. Assessment of goodwill impairment in domestic fixed-line communications (Bezeq)

The value in use for Bezeq Group of a domestic fixed line cash-generating unit was calculated using the future discounted cash flow (DCF) method, based on the expected cash flow for the next five years. The expected cash flow is based on results of the domestic fixed-line communications segment in recent years, taking into account the effect of opening up the wholesale market in 2015. The revenue forecast is based on assumptions about the number of users and average revenue per user of internet infrastructure, the number of users and average revenue per user of telephony services, and revenue from transmission, data communication and other revenue. The main assumption underlying the forecast is that the wholesale market will function properly and will provide effective competition to the infrastructure owners. In addition, the effect of the elimination of the structural separation on the domestic fixed-line communication segment was not taken into account.

The operating, sales, marketing and investment expenses were adjusted for domestic-fixed line communication operations. The price of nominal capital used is 7.5% (after tax). In addition, it was assumed that the permanent growth will be 1%. The valuation was made by an independent appraiser. Based on this valuation, the Group was not required to record amortization for impairment of a fixed line domestic communications cash-generating unit.

9.4. Assessment of goodwill impairment for multichannel television (DBS)

The value in use for Bezeq Group of a multichannel television cash-generating unit was calculated using the discounted cash flow (DCF) method, based on the expected cash flow for the next five years. The expected cash flow is based on the results of DBS in recent years, such that future growth and market shares are affected by directions in the multichannel television market, such as competition, regulation, and the entry of new players. The revenue forecast is based on assumptions regarding the number of users and average revenue per user. The main assumption underlying the forecast is erosion in market share and a decrease in average revenue per user due to the expected increase in competition in the coming years.

The operating, sales, marketing and investment expenses were adjusted for the volume of operations of DBS. The price of nominal capital used is 8.5% (after tax). In addition, it was assumed that the permanent growth will be 1%. The valuation was made by an independent appraiser. Based on this valuation, the Group was not required to record amortization for impairment of a multichannel television cash-generating unit.

10. Deferred Expenses and Non-Current Investments

	December 31, 2015	December 31, 2014
	NIS million	NIS million
Deferred expenses (see Note 10.1 below)	256	253
Non-current investments (see Note 10.2 below)	105	99
	361	352

10.1 Deferred expenses include prepaid expense amounts for acquisition of an indefeasible right of use (IRU) of seabed cable capacities. The prepaid expense is amortized on a straight-line basis up to 2022 and 2027 according to the period set out in the agreements.

10.2 Non-current investments include a bank deposit for loans to the Company's employees with a redemption date that has yet to be determined and a deposit for hedge transactions.

11. Investees**11.1. Subsidiaries:**

The place of incorporation of the companies held directly by the Company is Israel. Information about companies held directly by the Company and the Company's rights in capital:

	Company's equity rights as at 31 December	
	2015	2014
Pelephone Communications Ltd.	100%	100%
Bezeq International Ltd.	100%	100%
Bezeq Online Ltd.	100%	100%
Bezeq Zahav (Holdings) Ltd.	100%	100%
Walla! Communications Ltd.	100%	100%
DBS Satellite Services (1998) Ltd., see Note 11.2 for information about the business combination in 2015.	100%	49.78%
Stage One Venture Capital Fund	-	71.8%

The Company's subsidiaries have investments in other subsidiaries that are not material.

11.2. Business combination in 2015**11.2.1 Acquisition transaction**

As of December 31, 2014, the Company holds 49.78% of the share capital of DBS and it holds options that confer the right to 8.6% in DBS shares, which the Company is unable to exercise. Accordingly, the Company accounted for its investment in DBS in accordance with the equity method.

On March 26, 2014, the Company received the decision of the Antitrust Authority, according to which, under the terms set out in the decision, the merger between the Company and DBS ("the Merger") will be permitted.

Further to the aforesaid, on February 10, 2015, the Board of Directors' subcommittee that was established for this matter, the audit committee and the Board of Directors of the Company approved the Company's engagement in a transaction with Eurocom DBS. In the transaction, the Company will acquire the entire holdings of Eurocom DBS in DBS ("the Acquisition Transaction"), which at this date represent 50.22% of the issued share capital of DBS (41.62% fully diluted) and all the shareholder loans provided by Eurocom to DBS. It was further decided

that prior to the Acquisition Transaction, the Company and DBS will accept the merger terms and the Company will exercise the option granted, at no cost, for the allotment of DBS shares at a rate of 8.6% of the issued capital of DBS.

Under the terms of the acquisition transaction, the Company was required to pay Eurocom DBS NIS 680 million in cash on the closing date, against acquisition of the shares and shareholder loans. Eurocom DBS will also be entitled to two additional contingent considerations, as follows: the first additional consideration of up to NIS 200 million will be paid in accordance with the amount of the carry-forward losses of DBS used for tax purposes and the second additional consideration of up to NIS 170 million will be paid in accordance with the business results of DBS in the next three years.

On March 23, 2015, the general meeting of the Company's shareholders approved the acceptance of the merger terms and exercise of the option, and the Company's engagement in the Acquisition Transaction, as described above. Subsequently, the Company and DBS announced the acceptance of the merger terms, and on March 25, 2015, the Company exercised the option and it was allotted DBS shares at a rate of 8.6% of the issued capital of DBS, so that as from this date, the Company holds 58.4% of DBS. Accordingly, the Company consolidated the financial statements of DBS as from March 23, 2015 (the date that the general meeting approved exercise of the option to DBS shares by the Company). In view of the Company's holding of 49.78% of DBS shares prior to gaining control, the acquisition transaction was accounted for in the financial statements as a step acquisition.

The Company's engagement in the transaction with Eurocom DBS for acquisition of the entire holdings of Eurocom DBS in DBS is subject to the approval of the Ministry of Communications for transfer of control in DBS such that the Company will control DBS and will hold the entire issued and paid up share capital of DBS. This approval was received unconditionally on June 23, 2015, and on June 24, 2015, the transaction was completed. On the completion date, the Company transferred the cash consideration of NIS 680 million to Eurocom DBS and Eurocom DBS transferred its rights and the rights to DBS shares to the Company and assigned to the Company its entire rights in the shareholders loans of DBS. On completion of the transaction, DBS became a wholly owned subsidiary (100%) of the Company.

As at December 31, 2015, the Company has a liability to Eurocom DBS for the first additional consideration of NIS 204 million (including accrued interest) and NIS 29 million for the second additional consideration.

11.2.2 Valuation at the acquisition date

At the date of the business acquisition, the Company presented its investment in shares, share options and loans to DBS prior to acquisition of control, according to the equity method based on a valuation by an independent assessor. In accordance with the valuation, the fair value of the Company's investments prior to acquisition of control is estimated at NIS 1.076 billion. Accordingly, the Company recognized a profit of NIS 12 million from the gain of control under other operating income in the statement of income.

The valuation was based on the income approach, whereby the discounted cash flow method (DCF) was applied on the basis of the forecasted cash flow for 2015 through to 2019. The cash flow forecast was based on the results of DBS for 2011-2014 and the three months ended March 31, 2015. In the valuation, it was assumed that the market share of DBS is expected to remain stable and will be 42%-43% throughout the years of the forecast. It was also assumed that gradual erosion in the ARPU of DBS is expected between 2015 and 2018, while in 2019 and thereafter, it is expected that a fixed nominal ARPU will be maintained. The revenue forecast was based on the forecast of the number of users, average income and competition in the market.

Assumed cost of capital: 8.5% (net of tax). In addition, it was assumed that the permanent growth will be 1%.

The valuation was based on assumptions regarding the identity of the relevant market participant that might acquire the Company's holdings in DBS and does not take into account the specific operational and tax synergies between the companies.

11.2.3 Identifiable assets and liabilities acquired in a business combination:

	March 23, 2015
	NIS million
Cash and cash equivalents	299
Trade and other receivables	182
Broadcasting rights	449
Property, plant and equipment	801
Intangible assets (including excess cost attributed to customer relations and brand as described below)	1,284
Deferred tax asset, net of deferred tax liabilities (see Note 11.2.4 C below)	1,170
Debentures, loans, and borrowings (including excess cost attributed to debentures as described below)	(1,946)
Trade payables and other liabilities	(632)
Contingent liabilities (including excess cost attributed to contingent liabilities as described below)	(19)
Identifiable assets, net	1,588

11.2.4 Attribution of identifiable excess cost in the business combination

The Company attributed the acquisition cost in relation to the fair value of the assets and liabilities that were acquired in the business combination. The attribution was based on the valuation prepared by an external assessor. During the year, the attribution was adjusted as follows:

	March 23, 2015
	NIS million
Customer relations (see section A below)	790
Brand (see section B below)	347
Deferred tax asset, net of deferred tax liabilities (see section C below)	1,170
Debentures (see section D below)	(160)
Contingent liabilities (see section E below)	(10)
Goodwill (see section F below)	385
Total excess cost	2,522

- A. **Customer relations:** The valuation was based on the income approach, using the multi-period excess earning method. Under this approach, the value of the asset is derived from the present value of the cash flows that are expected to arise from it over the remaining economic life of the asset. Amortization will be based on the customer churn rate.
- B. **Brand:** The valuation was prepared in accordance with the relief from royalty method. In accordance with this method, the value of the asset is estimated as the present value of the appropriate royalty that the entity would have to pay a third party for the use of the asset, if the company did not own it. The useful life of the brand assumed in the model is 12 years.
- C. **Deferred tax asset:** Following completion of the acquisition transaction on June 24, 2015, and in accordance with the agreement in principle that was made with the Tax Authority regarding use of the carry-forward losses of DBS, the Company believes that will be able to take advantage of the tax

asset for the accrued losses from future profits of DBS and due to the possible merger between the companies.

The Company accounted for completion of the acquisition transaction and the agreement in principle that was made with the Tax Authority as described in Note 6.6 after acquiring control, as new information obtained in the measurement period regarding the facts and circumstances that existed at the acquisition date and, therefore, as at December 31, 2015, the Company recognized a deferred tax asset at the date control was acquired and updated the liability for the first contingent consideration accordingly (retrospectively).

Composition of the tax asset:

	March 23, 2015
	NIS million
Tax asset for cumulative losses of DBS	1,426
Tax reserve for attributed excess cost	(256)
Deferred tax asset, net	1,170

- D. **Debentures:** The excess cost reflects the fair value of the debentures at the acquisition date based on a capitalization rate of 1.9%-2.3%.
- E. **Contingent liabilities:** The amounts represent a present obligation arising from a class action filed by DBS customers.
- F. **Goodwill:** Following the business combination with DBS, goodwill was recognized as follows:

	March 23, 2015
	NIS million
Consideration value	897
Fair value of the investment in DBS prior to the acquisition	1,076
Less the fair value of net identifiable assets	(1,588)
Goodwill	385

To assess impairment, goodwill of NIS 265 million was allocated to the domestic-fixed line communications segment, and goodwill of NIS 120 million was allocated to the multichannel television segment. Goodwill is allocated on the basis of the valuation of an external assessor and the Company's estimates regarding the cash-generating units that are expected to benefit from the synergy of the business combination.

11.2.5 Effect of the business combination on the statement of income

The contribution of DBS to Group revenue in 2015 amounted to NIS 1,333 million and its contribution to profit as from the date of the business combination amounted to NIS 49 million (this amount includes amortization of surplus cost amounting to NIS 43 million).

The management estimates that had the business combination taken place on January 1, 2015, the revenue in the consolidated statement of income would have increased by NIS 434 million and there would have been no significant change in consolidated profit in 2015. When determining the amounts, the management assumed that the fair value adjustments at the date of the business combination are the same as the adjustments that would have been received had the business combination taken place on January 1, 2015.

11.2.6 Shareholder loans

The Company provided a shareholder loan to DBS between 1999 and 2005. In addition, at the acquisition date of the rights of Eurocom in DBS in June 2015, as

described in section 11.2.1 above, the Company acquired the shareholders loan provided by Eurocom to DBS. The total amount of the shareholder loans in accordance with the contractual terms and fair value as at December 31, 2015 (including interest and linkage differences) is NIS 5.1 billion and NIS 1.4 billion, respectively.

For the purpose of rating the Debentures (Series A) issued by DBS, with a balance of NIS 368 million as at December 31, 2015 (as described in Note 12.4 below), in 2007, DBS undertook to S&P Maalot (and to S&P Maalot alone) that it would not make any repayment on account of the shareholder loans proved to it up to the date that the undertaking is provided, until the end of the life of the debentures in July 2017.

It is noted that in December 2015, the Company provided another shareholder loan to DBS, amounting to NIS 323 million, as described in Note 12.4.3 below.

11.2.7 Financial position of DBS

Since the beginning of its operations, DBS has accumulated considerable losses. The losses of DBS in 2015 and 2014 amounted to NIS 354 million and NIS 322 million, respectively. As a result of these losses, as at December 31, 2015, DBS had an equity deficit and a working capital deficit of NIS 5,018 million and NIS 584 million, respectively.

The management of DBS believes that the financial resources at its disposal, which include the deficit in working capital and receipt of loans from the Company, will be sufficient for its operations for the coming year, based on the cash flow forecast approved by DBS's board of directors.

11.3. Equity-accounted associates

The Group's investment in associates as at December 31, 2015 includes the Company's investments in immaterial associates amounting to NIS 25 million.

The Group's investment in associates as at December 31, 2014 included the Company's investment in DBS amounting to NIS 1,026 million and from investments in other immaterial associates amounting to NIS 31 million. In 2015, the Company acquired control in DBS and started to consolidate its financial statements as described in Note 11.2 above.

12. Debentures, Loans and Borrowings

12.1. Composition:

	December 31, 2015	December 31, 2014
	NIS million	NIS million
Current liabilities		
Current maturities of debentures	1,202	862
Current maturities of bank loans	711	619
	1,913	1,481
Non-current liabilities		
Debentures	6,291	5,451
Bank loans	2,509	3,155
	8,800	8,606
	10,713	10,087

12.2. Debentures and loan terms

		December 31, 2015		December 31, 2014			
	Note	Carrying amount	Nominal value	Carrying amount	Nominal value	Interest rate range	
		NIS million	NIS million	NIS million	NIS million		
Loans							
Total unlinked loans at variable interest	12.3	1,331	1,331	1,656	1,656	Prime +0.2%	-0.33% to 0.25%
Total unlinked loans at fixed interest	12.3	1,589	1,589	1,796	1,796	6.85% - 5%	
Total unlinked loans at fixed interest	12.3	300	300	300	300	2.4%	
CPI-linked loans at fixed interest		-	-	22	18	4.45%-4.6%	
Total loans		3,220	3,220	3,774	3,770		
Debentures issued to the public							
CPI-linked debentures at fixed interest - Series 5	12.3.1	310	251	613	503	5.3%	
CPI-linked debentures at fixed interest - Series 6	12.3	3,087	2,874	3,165	2,874	3.7%	
Unlinked debentures at variable interest - Series 7	12.3	734	734	734	734	One year Makam +1.4%	
Unlinked debentures at fixed interest - Series 8	12.3	886	886	1,329	1,329	5.7%	
Unlinked debentures at fixed interest - Series 9	12.3	388	388	-	-	3.65%	
CPI-linked debentures at fixed interest - Series 10	12.3	400	400	-	-	2.2%	
Total debentures issued to the public		5,805	5,533	5,841	5,440		
Non-marketable debentures issued to financial institutions:							
Unlinked debentures at fixed interest	12.3	400	400	400	400	6.65%	
CPI-linked debentures at fixed interest	12.4	1,288	1,097	-	-	5.35%-8.4%	
CPI-linked debentures at fixed interest		-	-	72	58	4.4%-4.6%	
Total debentures issued to financial institutions		1,688	1,497	472	458		
Total debentures		7,493	7,030	6,313	5,898		
Total interest-bearing liabilities		10,713	10,250	10,087	9,668		

12.3. Loans and debentures issued by the Company

Below are details of the terms that the Company undertook for the loans that were received and the debentures that were issued:

- 12.3.1 For Debentures (Series 5), standard grounds were established for immediate repayment, including breach events, insolvency, dissolution procedures or receivership.
- 12.3.2 For Debentures (Series 6 to 10) and bank loans and for debentures issued to financial institutions in the amount of NIS 400 million, the Company has undertaken not to create additional pledges on its assets unless pledges are created at the same time in favor of the debenture holders and the lending banks (negative lien). The lien includes exceptions, including regarding a lien on assets that will be purchased or expanded by the Company, if the undertakings underlying the lien are created for the purchase or expansion of those assets and for the matter of a token lien.
- 12.3.3 For Debentures (Series 6 to 8) and bank loans and for debentures issued to financial institutions in the amount of NIS 400 million, standard grounds were

included for immediate repayment of the debentures and loans, including breach events, insolvency, dissolution procedures or receivership. In addition, a right was determined to call for immediate repayment if a third party lender calls for immediate repayment of the Company's debts in an amount exceeding the amount determined.

- 12.3.4 For Debentures (Series 6 to 10) and banks loans in the amount of NIS 2.03 billion as at December 31, 2015 (out of the total bank loans in the amount of NIS 3.2 billion), and for debentures issued to financial institutions in the amount of NIS 400 million, the Company has undertaken that if the Company makes an undertaking towards any entity in respect of compliance with financial covenants, the Company will also provide the same undertaking to these debenture holders and banks (subject to certain exceptions).
- 12.3.5 For Debentures (Series 6 to 10), the Company has undertaken to the debenture holders to take steps so that, to the extent under its control, the debentures will be rated by at least one rating agency, so long as there are debentures of the relevant series in circulation.
- 12.3.6 In addition, for Debentures (Series 9 and 10), standard grounds were included for immediate repayment of the debentures, including events of default, insolvency, liquidation proceedings, or receivership, as well as the right to call for immediate repayment if a third party lender calls for immediate repayment of the Company's debts (in an amount exceeding NIS 150 million, if another series of marketable debentures is called for immediate repayment - an unlimited amount), in the event of the sale of more than 50% of the Group's assets (consolidated) such that communications will cease being the Group's main activity, in the event of a change of control following which the current controlling shareholders in the Company will cease being controlling shareholders (other than transfer of control to a transferee that received approval to control the Company in accordance with the provisions of the Communications Law or change in control under other circumstances that were established), in the event that a going concern qualification is recorded in the Company's financial statements for two consecutive quarters, in the event of a material deterioration in the Company's business compared with the situation at the time of the issue, and there is real concern that the Company will not be able to repay the debentures on time (as set out in section 35I(1)(a)(1) in the Securities Law), all under the terms set out in the deed of trust of the debentures.

As at December 31, 2015 and the approval date of the financial statements, the Company was in compliance with all its liabilities, there were no grounds to call for immediate repayment, and financial covenants were not set out as described above.

12.4. Non-marketable debentures issued by DBS

- 12.4.1 DBS has two series of debentures with a balance of NIS 1,288 million as at December 31, 2015. The debentures were issued for institutional investors and were listed on the TACT-Institutional system of the TASE. Below are details of the terms that DBS undertook in respect of the debentures:
 - A. Standard events were established (such as insolvency proceedings, default and exercise of pledges on most of the Company's assets), which, should they occur, after the warning periods that were established, will allow the right to call for immediate repayment of the debentures subject to the provisions in the deeds of trust, and the right to call for immediate payment if another debenture series issued by DBS is called for immediate repayment, if the balance for settlement exceeds the amount set out in the deed of trust (a right that was cancelled for Debentures (Series B), following a letter of guarantee provided by the Company as described in section 12.4.2 below).

- B. In accordance with the deed of trust for Debentures (Series A) (with a par value of NIS 305 million as at December 31, 2015), DBS created an unlimited floating first lien in favor of Trustee A on all of its assets (other than exemptions arising from the provisions of the Communications Law), including a stipulation that limits additional pledges (subject to the exceptions set out in Deed of Trust A and the mortgage deed), and (subject to exceptions in accordance with the Communications Law) unlimited fixed first pledges on the rights and assets of DBS, including its rights under material agreements to which it is a party, its unissued registered capital, goodwill, certain intellectual property rights and insurance rights under its insurance policies.

Under Deed of Trust A, DBS may register first pledges in favor of additional holders of debentures that it might issue and/or add them to pledges in favor of Trustee A, without the consent of Trustee A.

- 12.4.2 In September 2015, the Company signed a letter of guarantee for the undertakings of DBS to pay the entire balance of its debts of NIS 1.05 billion to holders of Debentures (Series B), (amounting to NIS 792 million as at December 31, 2015) against a reduction of 0.5% in the annual interest rate for the debenture and cancellation of securities (which were similar to those registered in favor of Trustee A) and certain provisions of the deed of trust and the debenture (including the DBS's undertaking to comply with the financial covenants and restrictions on distribution of a dividend by DBS), all in accordance with the terms of the deed of trust of the debenture and the debenture. In accordance with the terms of the debenture, a reduction in the interest rate and cancellation of the collateral and certain provisions in the debentures are contingent on the rating of the Company not falling below a rating of AA- by Maalot or a corresponding rating ("the Minimum Rating"), a condition that was fulfilled as at the date of the guarantee. If, in the future, the rating of the Company falls below the Minimum Rating, then the reduction in the interest rate will be cancelled, the collateral that was cancelled will be provided again, the provisions that were cancelled will be applicable again, and the guarantee will expire.
- 12.4.3 Up to December 2015, DBS was a party to another debenture series opposite several institutions ("the 2012 Debentures"). On December 20, 2015, DBS paid the full unpaid balance of Debenture 2012 ahead of its repayment date plus a premature repayment fee of NIS 323 million through a loan provided by the Company at that date.

12.5. Reportable credit

Below is information about the Group's reportable credit, in accordance with Legal Bulletin No. 104-15: Reportable Credit Events, issued by the Israel Securities Authority on October 30, 2011. All loans and debentures were taken by the Group without a specific purpose. The loan principal is repayable in equal payments with the interest payable on the outstanding loan principal, as set out in the table below.

Lender	Date of loan	Date of final repayment	Type of loan	Amount of the original loan or par value (NIS million)	Estimated reserve (plus interest payable) December 31, 2015 (NIS million)	Number of principal payments in the year	Principal payments as from	Number of interest payments in the year	Interest rate December 31, 2015	Fair value of the liability December 31, 2015 (NIS million)	Imputed effective interest at fair value as at December 31, 2015	Imputed effective interest at fair value as at December 31, 2014	Special conditions	Right to early repayment
Bank A*	May 12, 2011	November 12, 2020	Unlinked fixed interest NIS	500	505	2	2017	2	6.85%	576	2.1%	2.55%	Notes 12.3.2 to 12.3.4	Yes
Bank B**	May 12, 2011	November 12, 2020	Unlinked variable interest NIS	500	501	2	2017	2	Prime + 0.2%	501	1.8%	1.95%	Notes 12.3.2 to 12.3.4	Yes
Debentures (Series 5)	June 1, 2004	June 1, 2016	CPI-linked fixed interest	1,507	318	1	2011	1	5.30%	322	2.1%	0.97%	Note 12.3.1.	No
Debentures (Series 6)	July 3, 2011	December 1, 2022	CPI-linked fixed interest	2,874	2,962	1	2018	2	3.70%	3,278	1.43%	1.45%	Notes 12.3.2 to 12.3.5	No
Debentures (Series 7)	July 3, 2011	December 1, 2022	Unlinked variable interest NIS	734	735	1	2018	4	Makam + 1.4%	751	1.08%	0.93%	Notes 12.3.2 to 12.3.5	No
Debentures (Series 8)	July 3, 2011	June 1, 2017	Unlinked fixed interest NIS	1,329	890	1	2015	2	5.70%	933	0.46%	0.85%	Notes 12.3.2 to 12.3.5	No
Debentures (Series 9)	October 15, 2015	December 1, 2025	Unlinked fixed interest NIS	388	390	1	2022	2	3.65%	407	3.08%	-	Note 12.3	No
Debentures (Series 10)	October 15, 2015	December 1, 2025	CPI-linked fixed interest	400	401	1	2022	2	2.2%	406	2.04%	-	Note 12.3	No
DBS Debentures (Series A)	July 5, 2007	July 5, 2017	CPI-linked fixed interest	808	376	1	2010	2	8.4%	400	1.79%	2.44%	Note 12.4	No
DBS Debentures (Series B)	November 8, 2010	November 8, 2019	CPI-linked fixed interest	1,244	841	1	2013	2	5.35%	914	1.61%	2.62%	Note 12.4	No

* The Group's loans from Bank A amount to NIS 964 billion

* The Group's loans from Bank B amount to NIS 1.764 billion

For information about the Company's agreements for undertakings to provide credit for 2016-2017, see Note 12.6 below.

12.6. Undertakings to provide credit for 2016-2017

In 2015, the Company entered into agreements with banks and financial institutions, whereby the Company received an undertaking from these institutions to provide credit to the Company in a total amount of NIS 1.4 billion to refinance its future debt in 2016 (with an average duration of between 4.6 to 4.9 years and a fixed NIS interest rate of 3.7% to 4.3 %), and an undertaking to provide credit of NIS 600 million in 2017 (with an average duration of 4.5 years and an average fixed NIS interest rate of 4.3%).

The terms of all the undertakings and the loans to be provided thereunder include terms that are similar to the terms provided for other loans taken by the Company, as described in section 12.3 above, including the following: an undertaking to refrain from creating additional pledges on the Company's assets (with certain restrictions); an undertaking that if the Company assumes an undertaking towards a party in respect of compliance with financial covenants, the Company will also assume the same undertaking for this credit (subject to certain exceptions); and standard terms for immediate repayment (such as default events, insolvency, liquidation or receivership), and cross default (with certain restrictions), which will also apply, with the required changes, to the periods of the undertaking to provide credit.

In addition, some of the undertakings to provide credit in 2017 also include terms that are similar to the terms that were established for Debentures (Series 9 and 10) as set out in Note 12.3.6 above.

Subsequent to the date of the financial statements, the Company signed another agreement to provide a loan of NIS 300 million in 2017.

13. Trade and Other Payables

	December 31, 2015	December 31, 2014
	NIS million	NIS million
Trade payables (open accounts)*	913	664
Other payables, including derivatives		
Liabilities to employees and other liabilities for salaries	369	324
Institutions	79	127
Expenses due	90	110
Accrued interest	72	64
Deferred income	85	50
Derivative instruments	22	16
Other	27	19
Total other payables	744	710
Total trade and other payables	1,657	1,374

* Of which, the carrying amount of trade payables that are related parties and interested parties as at December 31, 2015 amounts to NIS 17 million (as at December 31, 2014, NIS 3 million).

14. Provisions

	Customer claims	Additional legal claims	Dismantling and clearing of cellular and other sites	Total
	NIS million	NIS million	NIS million	NIS million
Balance as at January 1, 2015	24	35	72	131
Provisions created	18	13	1	32
Provisions used	(4)	(4)	(4)	(12)
Provisions canceled	(3)	(2)	(20)	(25)
Consolidation of DBS	17	3	-	20
Balance as at December 31, 2015	52	45	49	146
Presented in the statement of financial position as:				
Current provisions	52	45	3	100
Non-current provisions	-	-	46	46
	52	45	49	146

For further information about legal claims, see Note 16.

15. Employee Benefits

Employee benefits include post-employment benefits, other long-term benefits, termination benefits, short-term benefits and share-based payments. For further information about share-based payments, see Note 25 below.

15.1. Liabilities for employee benefits

		2015	2014
	Note	NIS million	NIS million
Current liabilities for:			
Holiday		104	86
Sick pay	15.4	117	111
Voluntary redundancy	15.5	150	55
Current maturities of pensioner benefits	15.3.4	7	7
Total current liability for employee benefits		378	259
Non-current liabilities for:			
* Liability for pensioner benefits	15.3.4	114	121
Severance compensation (net) (see composition below)	15.3.1	55	48
Early notice	15.3.3	16	20
Pension	15.3.2	55	44
Total non-current liabilities for employee benefits		240	233
Total liabilities for employee benefits		618	492
Composition of liabilities for severance pay:			
Liabilities for severance pay		221	215
Fair value of plan assets		(166)	(167)
		55	48

15.2. Defined contribution plans

- 15.2.1 Liabilities for employee benefits at retirement age in respect of the period of their service in the Company and its subsidiaries, and for employees to which Section 14 of the Severance Pay Law – 1963 applies, are covered in full by regular payments to pension funds and insurance companies

	2015	2014	2013
	NIS million	NIS million	NIS million
Amount recognized as an expense for a defined contribution plan	199	191	182

- 15.2.2 The pension rights of Company employees for the period of their employment in the civil service through January 31, 1985, are covered by a pension fund ("the Makefet Fund"), which assumed the State's obligation following an agreement between the Government of Israel, the Company, the Histadrut and the Makefet Fund.
- 15.2.3 The severance obligation to employees who leave their employment on terms entitling them to compensation is covered, for the period from February 1, 1985, by regular contributions to such pension funds and insurance companies (in accordance with Section 14 of the Severance Pay Law).
- Severance pay for the period of employment in the civil service through January 31, 1985, is paid by the Company, and the monies accumulated in the Makefet Fund for that period are kept in a fund that will be used for the employees' rights.
- 15.2.4 For certain employees, the Group has an obligation to pay severance in excess of the amount accumulated in the compensation fund which is in the employees' names. See section 15.3.1 below.

15.3. Defined benefit plans

Obligations for defined benefit plans in the Group include the following:

- 15.3.1 The severance obligation for the balance of the obligation not covered by contributions and/or insurance policies in accordance with the existing labor agreements, the Severance Pay Law, and the salary components which the managements of the companies believe entitle the employees to receive compensation. For this part of the obligation, there are deposits in the name of Group companies in pension funds and insurance companies. The deposits in pension funds and insurance companies include accrued linkage differences and interest. Withdrawal of the reserve monies is contingent upon fulfillment of the provisions in the Severance Pay Law.
- 15.3.2 An obligation in accordance with the collective agreement of 2006 for employees who transferred from civil service to the Company, and who are entitled, following retirement, to a supplement in pension payments for the difference between the Civil Service Law and the standard policy of Makefet. The Company also has an obligation to a number of senior employees who are entitled to voluntary redundancy terms (pension and retirement grants) which are not dependent on the existing retirement agreements for all employees
- 15.3.3 An obligation in accordance with the employment agreements of some of the senior employees in the Group for payment of a benefit for notice upon severance.
- 15.3.4 Company retirees receive, in addition to pension payments, benefits which consist mainly of a holiday gift (linked to the dollar exchange rate), financing for the upkeep of retiree clubs and social activities. The Company's liability for these costs accumulates during the employment period. The Company's financial statements include the liabilities for expected costs in the severance period.

15.4. Provision for illness (other long-term benefit)

The financial statements include a provision in respect of redemption and use of sick leave. The right to accumulate sick leave was taken into account for all employees in the Group. Only employees eligible under the terms of the employment agreement may redeem sick leave. The provision was computed on the basis of an actuarial calculation, including the assumption of positive accumulation of days by most of the employees and use of days by the last in first out (LIFO) method.

15.5. Termination benefits

- 15.5.1 According to the collective agreement of December 2006, between the Company and the employees union and the New Histadrut, and according to the amendment to the agreement of August 2015, the Company may, at its discretion, terminate the employment of 163 permanent employees in each of the years 2015-2021 (the Company's right is accumulated over the years).

The Company recognizes expenses for voluntary redundancy when the Company is committed demonstrably, without realistic possibility of withdrawal, to a defined plan to terminate employment before the defined date, according to a defined plan. The collective agreement allows the Company to dismiss employees, but does not create a demonstrable commitment without realistic possibility of withdrawal. Accordingly, the expenses for voluntary redundancy are recognized in the Company's financial statements at the approval date of the plan.

In 2015, voluntary redundancy expenses amounted to NIS 117 million.

15.6. Actuarial assumptions

The main actuarial assumptions for defined benefit plans at the reporting date are as follows:

- 15.6.1 Mortality rates are based on the rates published in Insurance Circular 2013-3-1 of the Ministry of Finance.
- 15.6.2 Churn rates were determined on the basis of the past experience of the Company and the subsidiaries, distinguishing between different employee populations and taking into account the number of years of employment. The churn rates include a distinction between severance with entitlement to full severance compensation and severance without entitlement to this right.
- 15.6.3 The discount rate (nominal) is based on the yield on linked high-quality corporate debentures with maturity dates approximating those of the gross obligation.
- 15.6.4 The main discount rates are as follows:

	December 31, 2015	December 31, 2014
	Average discount rate	Average discount rate
Severance compensation	4.1%	3.7%
Retirement benefits	4.74%	4.7%

- 15.6.5 Assumptions regarding salary increments for calculation of the liabilities were made on the basis of the management's assessments, distinguishing between the groups of employees. The main assumptions (in nominal terms) regarding salary increases of the main employee groups are as follows:

Salary increase assumptions	
Permanent employees in the Company	Average adjustment of 7% for young employees, decreasing gradually to 2.7% at the age of 66.
Permanent employees in the Company	Average adjustment of 3.2% for young employees, decreasing gradually to 1.4% at the age of 66.
Company's employees that are not permanent	6.5% for young employees decreasing gradually to 0%, 3.5% for senior employees
Telephone employees	An increase of 3.1% as from 2015, as set out in the collective agreement at Telephone

Regarding the Company's employees, as well as the assumption of the age-dependent wage increase, an expected individual wage growth was assumed for 2016-2026, arising from the collective agreement that was signed in August 2015.

15.6.6 Sensitivity analysis for actuarial assumptions

Changes in the actuarial assumptions which are reasonably possible as at the reporting date, are not expected to have a material effect on the liabilities for employee benefits.

15.6.7 Average weighted useful life of liabilities for the main severance benefits:

	December 31, 2015	December 31, 2014
	Years	Years
Severance compensation	10.2	10.9
Retirement benefits	14.4	15.7

16. Contingent Liabilities

During the normal course of business, legal claims were filed against Group companies or there are pending claims against the Group ("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 claims, the financial statements include adequate provisions (as described in Note 14), where provisions are required to cover the exposure resulting from such claims.

In the opinion of the managements of the Group companies, the additional exposure (beyond these provisions) as at December 31, 2015 for claims filed against Group companies on various matters and which are unlikely to be realized, amounted to NIS 5.5 billion. There is also additional exposure of NIS 4 billion 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, 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 16.2 below.

16.1 Following is a detailed description of the Group's contingent liabilities as at December 31, 2015, classified into groups with similar characteristics:

Claims group	Nature of the claims	Provision	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.	10	115	-
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.	52	3,112	4,083
Supplier and communication provider claims	Legal claims for compensation for alleged damage as a result of the supply of the service and/or the product.	3	222	6
Claims for punitive damages, real estate and infrastructure	Claims for alleged physical damage or damage to property caused by Group companies and in relation to real estate and infrastructure. The additional amount of exposure for punitive damages does not include claims for which the insurance coverage is not disputed.	2	35	-
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	2,047*	-
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.	19	15	-
Total legal claims against the Company and subsidiaries		97	5,546	4,089

* This sum includes a total exposure of NIS 2 billion for a claim filed by a shareholder against the Company and officers in the Company, which the plaintiff estimates at NIS 1.1 billion or NIS 2 billion (according to the method of calculating the damage to be determined).

16.2 Subsequent to the reporting date, claims amounting to NIS 93 million were filed against Group companies. At the approval date of the financial statements, the chances of these claims cannot yet be assessed. In addition, claims with exposure of NIS 549 million came to an end.

17. Agreements

- 17.1** Group companies have operating lease agreements for land, property and vehicles used by Group companies. The minimum future contractual rental payments during the next five years, calculated according to the rental fees in effect as at December 31, 2015, are as follows:

	Real estate	Vehicles	Total
Year ended December 31	NIS million	NIS million	NIS million
2016	238	132	370
2017	227	104	331
2018	174	62	236
2019	139	-	139
2020	99	-	99
2021 onwards	104	-	104
	981	298	1,279

- 17.2** In May 2013, Pelephone signed an agreement with Apple International (“Apple”) for continued acquisition and distribution of iPhones in Israel. According to the agreement, under certain circumstances, Pelephone is required to purchase a minimum number of iPhones every year for three years at the prices in effect at the manufacturer on the actual purchase date. Pelephone believes that, similar to previous years, these quantities will constitute a substantial part of the quantities of iPhones that it expects to sell in the agreement period.
- 17.3** Pelephone has open orders for the acquisition of terminal equipment amounting to NIS 74 million (as at December 31, 2014, NIS 95 million).
- 17.4** DBS has agreements for the acquisition of channels. In 2015, expenses for consumption of channels acquired by DBS amounted to NIS 287 million.
- 17.5** For information about agreements for the acquisition of broadcasting rights by DBS, see Note 7. For information about agreements for the purchase of property, plant and equipment, see Note 8.6 above.
- 17.6** On October 26, 2015, the District Planning and Building Committee approved the validation of the outline plan for an area of 70 dunam (net) for warehouses and offices in Saqiya (near the Messubim junction). As at this date, the Company is entitled to receive this area in a capitalized lease contract for 49 years that commenced on March 22, 1993 with an option to extend for another 49 years, for no consideration. This right was granted to the Company under the settlement agreement of May 15, 2003 between the Company and the government of Israel and the Israel Lands Administration, which was given the force of a court ruling on March 10, 2004. Exercise of the right is subject to approval from the planning institutions for planning the complex, which was received on October 26, 2015.
- As at the reporting date, the fair value of the Company's rights to the land is estimated at NIS 450 million.
- 17.7** For information about agreements for undertakings to provide credit for 2016-2017, see Note 12.6 above.
- 17.8** For information about agreements with related parties, including the agreement between DBS and Space Communications Ltd. for the lease of space segments, see Note 28.3.2.

18. Securities, Pledges and Guarantees

The Group's policy is to provide tender, performance and legal guarantees. In addition, the Company provides bank guarantees, where necessary, for banking obligations of subsidiaries.

- 18.1** The Group companies have guarantees of NIS 190 million in favor of the Ministry of Communications to secure the terms of their licenses (mostly linked to the USD exchange rate).
- 18.2** The Group companies have bank guarantees totaling NIS 92 million in favor of third parties.
- 18.3** For information about the conditions for loans and borrowings, see Note 12.

- 18.4 For information about the guarantee provided by the Company in respect of DBS's liability for Debentures (Series B), see Note 12.4.2.

19. Capital

19.1. Share capital

	Registered share capital		Issued and paid up share capital	
	Number of shares		Number of shares	
	December 31, 2015	December 31, 2014	December 31, 2015	December 31, 2014
Ordinary shares of NIS 1 par value	2,825,000,000	2,825,000,000	2,762,148,573	2,743,283,920

19.2. Dividends

19.2.1 Dividend distribution policy

On August 4, 2009, the Board of Directors resolved to distribute a dividend to the shareholders amounting to 100% of the semi-annual profit (after tax) (profit for the period attributable to the shareholders of the Company), in accordance with the consolidated financial statements of the Company. Application of the policy to distribute a dividend is subject to the provisions of the law, including the distribution criteria prescribed in the Companies Law, and the estimation of the Board of Directors of the Company regarding the Company's ability to meet its existing and anticipated liabilities, taking into consideration the projected cash flow, the Company's operations and liabilities, the cash balance, its plans and position as will be from time to time and subject to the approval of the general meeting of the Company's shareholders regarding any specific distribution, as set out in the articles of association of the Company. As at the publication date, the policy is in effect.

It is noted that following the Board of Director's resolution of February 10, 2015 regarding the Company's engagement with Eurocom DBS for acquisition of the full holdings of Eurocom DBS in DBS, the Board of Directors determined that the revaluation gains, which are expected to arise for the Company in accordance with accounting principles, if the transaction is completed, will be excluded from the dividend policy and will not be distributed as a dividend. These gains amounted to NIS 12 million.

19.2.2 Distributions made by the Company in 2014-2015:

Distribution date	Distributed amount per share (NIS)	2015	2014
		NIS million	NIS million
April 4, 2014	0.294	-	802
October 2, 2014	0.463	-	1,267
May 27, 2015	0.307	844	-
October 26, 2015	0.339	933*	-
		1,777	2,069

* The dividend is distributed for profits of the first half of 2015 amounting to NIS 945 million less revaluation gains of NIS 12 million for the gain of control in DBS, which were excluded from the Company's dividend policy as explained in Note 19.2.1 above.

19.2.3 On March 16, 2016, the Board of Directors of the Company resolved to recommend to the general meeting of the Company's shareholders the distribution of a cash dividend to the shareholders in the amount of NIS 776 million. As at the approval date of the financial statements, the dividend has not yet been approved by the general meeting.

19.2.4 The Company also issued share options to employees, managers and senior employees in the Group (see Note 25).

20. Revenues

	Year ended December 31		
	2015	2014	2013
	NIS million	NIS million	NIS million
Domestic fixed-line communication			
Fixed-line telephony	1,543	1,636	1,908
Internet - infrastructure	1,530	1,394	1,283
Transmission and data communication	840	802	794
Other services	212	220	220
	4,125	4,052	4,205
Cellular communications			
Cellular services and terminal equipment	1,948	2,399	2,744
Sale of terminal equipment	884	966	1,000
	2,832	3,365	3,744
International communications, internet and NEP services	1,487	1,425	1,367
Multichannel television	1,333	-	-
Other	208	213	247
	9,985	9,055	9,563

21. General and Operating Expenses

	Year ended December 31		
	2015	2014	2013
	NIS million	NIS million	NIS million
Terminal equipment and materials	880	928	1,071
Interconnectivity and payments to domestic and international operators	909	847	905
Maintenance of buildings and sites	616	639	607
Marketing and general	640	603	614
Content costs	458	58	65
Services and maintenance by sub-contractors	199	137	162
Vehicle maintenance	167	154	152
	3,869	3,366	3,576

Operating and general expenses are presented net of expenses of NIS 63 million recognized in 2015 for investments in property, plant and equipment and intangible assets (in 2014, NIS 63 million and in 2013, NIS 64 million),

22. Salaries

	Year ended December 31		
	2015	2014	2013
	NIS million	NIS million	NIS million
Salaries and incidentals - operating	1,871	1,691	1,741
General and administrative	585	560	589
Share-based payments	-	1	34
Total salaries and incidentals	2,456	2,252	2,364
Less salaries recognized in investments in property, plant and equipment and intangible assets	499	484	492
	1,957	1,768	1,872

23. Other Operating Expenses (Income), Net

	Year ended December 31		
	2015	2014	2013
	NIS million	NIS million	NIS million
Profit from the sale of property, plant and equipment (mainly real estate)	(234)	(175)	(167)
Profit from sale of the shares of Coral Tell	-	(582)	-
Provision for severance pay in voluntary redundancy (see Note 15.5)	117	176	90
Others	22	(5)	62
Other operating income, net	(95)	(586)	(15)

24. Financing Expenses (Income), Net

	Year ended December 31		
	2015	2014	2013
	NIS million	NIS million	NIS million
Interest expenses for financial liabilities	339	386	428
Linkage and exchange rate differences	51	44	58
Financing expenses for employee benefits	16	21	15
Reduction of the provision for assessor interest expenses (see Note 6.6.2)	(76)	-	-
Other financing expenses	46	35	72
Total financing expenses	376	486	573
Income for credit in sales	52	84	122
Interest and linkage differences from loans to an associate	21	213	226
Other financing income, net	40	59	80
Total financing income	113	356	428
Financing expenses, net	263	130	145

25. Share-Based Payments

As of December 31, 2015, the Company has one option plan settled in shares through the net exercise mechanism. All the options that were granted are non-marketable, the exercise price is adjusted for changes in capital and distribution of a dividend. Additional information:

Name of plan	Number of options granted (before forfeiture and exercise) (thousands)	Number of options in circulation as at December 31, 2015 (in thousands)	Exercise price as at December 31, 2015 (NIS)	Weighted average of remaining contractual life
Employee option plan of 2010	69,495	4,347	2.72	One month

In 2015, 27 million options were exercised, for which the Company issued 19 million ordinary shares of NIS 1 par value each.

26. Earnings per Share

Basic and diluted earnings per share

The calculation of basic earnings per share was based on the profit attributable to holders of ordinary shares, and on a weighted average number of ordinary shares outstanding, calculated as follows:

	2015	2014	2013
	NIS million	NIS million	NIS million
Profit attributable to holders of ordinary shares	1,721	2,111	1,771
Weighted average number of ordinary shares (basic)	2,750	2,736	2,726
Effect of share options exercised	13	19	15
Weighted average number of ordinary shares (diluted)	2,763	2,755	2,741

The average market value of the Company's shares for purposes of calculating the dilutive effect of share options was based on quoted share prices for the period in which the options were outstanding.

27. Segment Reporting

27.1 The Group operates in various segments in the communications sector, so that every company in the Group operates in one separate business segment. The primary reporting format, by business segments, is based on the Group's management and internal reporting structure.

Each company provides services in the segment in which it operates, using the property, plant and equipment and the infrastructure it owns (see also Note 20). The infrastructure of each company is used only for providing its services. Each of the companies in the Group is exposed to different risks and yield expectations, mainly in the matter of the technology and competition in the segment in which it operates. Accordingly, the separable component in the Group is each company in the Group.

Based on the above, the business segments of the Group are as follows:

1. Bezeq The Israel Telecommunication Corp. Ltd.: fixed line domestic communications
2. Pelephone Communications Ltd.: cellular communications
3. Bezeq International Ltd.: international communications, internet services and network end point
4. DBS Satellite Services (1998) Ltd.: multichannel television

The other companies in the Group are presented under the "Other" item. Other operations include call center services (Bezeq Online) and online shopping and classified ads, (through Walla). These operations are not reported as reporting segments as they do not fulfill the quantitative thresholds.

Inter-segment pricing is set at the price determined in a transaction between unrelated parties.

The results, assets and liabilities of a segment include items directly attributable to that segment, as well as those that can be allocated on a reasonable basis.

Segment capital expenditure is the total cost incurred during the period for acquisition of property, plant and equipment and intangible assets.

It is noted that the Company's investment in DBS was accounted for using the equity method up to March 23, 2015. As from this date, the financial statements of DBS are consolidated with the financial statements of the Group as described in Note 11.2 above. The Group reports on multichannel television as an operating segment without adjustment to ownership rates and excess cost in all reporting periods.

- 27.2** After DBS became a wholly-owned subsidiary of the Company on June 24, 2015, the Company updated the internal management reporting structure for financing income for the shareholders loans that were provided to DBS. Accordingly, the Company restated financing income under the separate interim financial information. As from 2015, the Company no longer recognizes financing income for the shareholders loans under the financing income of the fixed-line domestic communications segment. Financing expenses in the multichannel television segment include financing expenses for the loans without any change. The comparative figures were restated to reflect the change in the reporting structure: financing income in the amount of NIS 213 million was eliminated in the fixed-line domestic communications segment for the year ended December 31, 2014, and NIS 226 million in the year ended December 31, 2013.

27.3 Operating segments

Year ended December 31, 2015							
	Domestic fixed-line communication	Cellular communications	International communications and internet services	Multichannel television	Other	Adjustments	Consolidated
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	4,122	2,831	1,485	1,774	197	(440)	9,969
Inter-segment revenues	285	59	93	-	24	(445)	16
Total revenues	4,407	2,890	1,578	1,774	221	(885)	9,985
Depreciation and amortization	725	419	132	322	13	73	1,684
Segment results – operating profit (loss)	2,148	157	240	250	(15)	(210)	2,570
Finance expenses	362	4	15	635	2	(642)	376
Financing income	(30)	(53)	(7)	(32)	(17)	26	(113)
Total financing expenses (income), net	332	(49)	8	603	(15)	(616)	263
Segment profit (loss) after financing expenses, net	1,816	206	232	(353)	-	406	2,307
Share in profits (losses) of associates	-	-	-	-	(2)	14	12
Segment profit (loss) before income tax	1,816	206	232	(353)	(2)	420	2,319
Income tax	492	55	60	1	-	(10)	598
Segment results – net profit (loss)	1,324	151	172	(354)	(2)	430	1,721
Segment assets	7,311	3,269	1,160	1,667	659	1,163	15,229
Investment in associates	-	-	4	-	7	14	25
Goodwill	-	-	6	-	10	1,409	1,425
Segment liabilities	12,117	513	343	6,685	104	(5,494)	14,268
Investments in property, plant and equipment and intangible assets	837	419	127	281	33	(80)	1,617

Year ended December 31, 2014							
	Domestic fixed-line communication	Cellular communications	International communications and internet services	Multichannel television	Other	Adjustments	Consolidated
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	4,045	3,361	1,419	1,724	209	(1,724)	9,034
Inter-segment revenues	272	58	85	-	17	(411)	21
Total revenues	4,317	3,419	1,504	1,724	226	(2,135)	9,055
Depreciation and amortization	688	430	130	297	23	(287)	1,281
Segment results – operating profit	1,980	449	232	273	629	(337)	3,226
Finance expenses	472	21	18	620	2	(647)	486
Financing income	(72)*	(77)	(9)	(26)	(11)	(161)*	(356)
Total financing expenses (income), net	400*	(56)	9	594	(9)	(808)*	130
Segment profit (loss) after financing expenses, net	1,580*	505	223	(321)	638	471*	3,096
Share in profits (losses) of associates	-	-	1	-	(3)	(168)	(170)
Segment profit (loss) before income tax	1,580*	505	224	(321)	635	303*	2,926
Income tax	478	132	60	1	147	(3)	815
Segment results – net profit (loss)	1,102*	373	164	(322)	488	306*	2,111
Segment assets	8,483	3,541	1,207	1,820	682	(2,517)	13,216
Investment in associates	-	-	4	-	11	1,042	1,057
Goodwill	-	-	6	-	10	1,024	1,040
Segment liabilities	12,369	696	392	6,484	107	(7,176)	12,872
Investments in property, plant and equipment and intangible assets	835	339	110	332	17	(332)	1,301

	Year ended December 31, 2013						
	Domestic fixed-line communication	Cellular communications	International communications and internet services	Multichannel 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
Finance expenses	534	46	23	654	6	(690)	573
Financing income	(91)*	(137)	(9)	(7)	-	(184)*	(428)
Total financing expenses (income), net	443*	(91)	14	647	6	(874)*	145
Segment profit (loss) after financing expenses, net	1,555*	699	213	(379)	(10)	596*	2,674
Share in profits (losses) of associates	-	-	1	-	-	(253)	(252)
Segment profit (loss) before income tax	1,555*	699	214	(379)	(10)	343*	2,422
Income tax	410	178	56	2	5	-	651
Segment results – net profit (loss)	1,145*	521	158	(381)	(15)	343*	1,771

* Restated See section 27.2 above

27.2. Adjustments for segment reporting of revenue, profit or loss, assets and liabilities

	Year ended December 31		
	2015	2014	2013
	NIS million	NIS million	NIS million
Revenues			
Revenues from reporting segments	10,649	10,964	11,355
Revenues from other segments	221	226	262
Cancellation of revenues from inter-segment sales except for revenues from sales to an associate reporting as a segment	(445)	(411)	(421)
Cancellation of revenues for a segment classified as an associate (up to the date of acquisition of control)	(440)	(1,724)	(1,633)
Consolidated revenues	9,985	9,055	9,563
Profit or loss			
Operating profit for reporting segments	2,795	2,934	3,101
Cancellation of expenses for a segment classified as an associate (up to the date of acquisition of control)	(59)	(273)	(268)
Financing income (expenses), net	(263)	(130)	(145)
Share in profits (losses) of associates	12	(170)	(252)
Profit (loss) for operations classified in other categories and other adjustments	(16)	574	(5)
Amortization of excess cost	(150)	(9)	(9)
Consolidated profit before income tax	2,319	2,926	2,422
	December 31, 2015	December 31, 2014	
	NIS million	NIS million	
Assets			
Assets from reporting segments	13,417	15,061	
Assets attributable to operations in other categories	676	703	
Goodwill not attributable to an operating segment	1,409	1,024	
Surplus cost not attributable to an operating segment	2,173	-	
Investment in an associate (mainly loans) reported as a segment	-	1,026	
Cancellation of assets for a segment classified as an associate	-	(1,820)	
Less inter-segment assets and other adjustments	(996)	(681)	
Consolidated assets	16,679	15,313	
Liabilities			
Liabilities from reporting segments	19,658	19,941	
Liabilities attributable to operations in other categories	104	107	
Cancellation of liabilities for a segment classified as an associate	-	(6,484)	
Less inter-segment liabilities	(5,494)	(692)	
Consolidated liabilities	14,268	12,872	

28. Transactions with Interested and Related Parties

28.1. Identity of interested and related parties

The Company's interested and related parties as defined in the Securities Law and in IAS 24 – Related Party Disclosures include mainly B Communications Ltd. ("B Communications"), related parties of B Communications, associates, directors and key management personnel in the Company or the parent company and a person who is close to a family member of any of these individuals.

28.2. Balances with interested and related parties

	December 31	
	2015	2014
	NIS million	NIS million
Trade receivables - associates	9	15
Loan to an associate *	-	2,181
Liabilities to related parties, net *	(17)	(41)
Liability to Eurocom DBS Ltd. for contingent consideration (see Note 11.2.1)	(233)	-

* The Company provided a shareholder loan to DBS between 1999 and 2005. As from the date of acquisition of control in DBS as described in Note 11.2 above and consolidation of the financial statements of DBS in the Group's consolidated financial statements, these loans are not shown in the statement of financial position.

28.3. Transactions with interested and related parties

	Year ended December 31		
	2015	2014	2013
	NIS million	NIS million	NIS million
Revenues			
From associates (including financing income for shareholders' loans) *	30	229	246
From related parties	10	9	8
Expenses			
To related parties	127	119	126
To associates	3	1	7
Property, plant and equipment			
Related parties	76	76	66
Acquisition of holdings from Eurocom DBS in DBS (see Note 11.2.1)	913	-	-

* Income from associates is mainly from financing income for the shareholder loans to DBS described in Note 11.2.6 and Note 28.2 above.

Transactions with interested and related parties

28.3.1 Negligible transactions

On March 7, 2011, the Company's Board of Directors resolved to adopt guidelines and regulations to classify a transaction of the Company or its subsidiary with an interested party as a negligible transaction, which is not an extraordinary transaction, as set out in Article 41(A)(6) of the Securities Regulations (Annual Financial Statements), 2010 ("the Annual Financial Statements Regulations"). These guidelines and regulations are also used to assess the scope of disclosure in the periodic report and prospectus (including shelf offering reports) regarding a transaction of the Company, a company under its control and a subsidiary or associate with a controlling shareholder or in which the controlling shareholder has a personal interest as set out in Article 22 of the Securities Law (Periodic and Immediate Reports), 1970 ("the Periodic Reports Regulations") and Article 54 of the Securities Regulations (Prospectus Details and Draft Prospectus – Structure and Form), 1969, and to assess the need to submit an immediate report for the

transaction of the Company, as set out in Article 37(A)(6) of the periodic reports regulations (types of transactions determined in the financial statements regulations) and the prospectus details regulations referred to above ("the Interested Party Transactions").

From time to time, the Company and its subsidiaries carry out negligible transactions, which are not extraordinary transactions, with an interested party in the Company or with related parties, of the types and nature detailed below:

1. Sales of communications services and products by Group companies, including: basic communication services (telephony, transmission and PRI) and hosting at server farms; cellular services, value added services and sales and upgrading of cellular end equipment; web browsing services, international telephony services, hosting services and data communication services; multichannel television services
2. Purchase of devices from Eurocom Group companies (companies owned by the controlling shareholder of the Company or companies controlled by the controlling shareholder at the approval date of the agreement), including acquisition of electronic equipment, terminal equipment, communication equipment, and pit covers
3. Acquisition of maintenance and development services from companies in the Eurocom Group, including maintenance, development and upgrading services for systems used in the Group companies, maintenance and spare parts for exchanges, content development services and communication applications.
4. Sales of maintenance, upgrading and development services by Group companies, including: maintenance of equipment, content development services and communication applications
5. Sale of user rights in communication infrastructure, call transfer, including sale of user rights in international communication infrastructure and supply of a local segment in Israel, hosting services at server farms, and reciprocal call transfer and completion agreements with Eurocom Group companies.
6. Placement and outsourcing services
7. Rental, management and real estate acquisition agreements, including rental of areas used for communication facilities and warehouses; and rental of areas to Eurocom Group companies in properties owned by the Company
8. Acquisition of advertising and content services, including agreements to acquire media slots from media companies in the Eurocom Group; agreement for to use content on Pelephone's cellular portal; acquisition of portals from Eurocom Group companies; media content management services by Eurocom Group companies.
9. Transactions relating to joint marketing, advertising, discounts and sponsorship with Eurocom Group companies or related to products of Eurocom Group companies, including distribution agreements (dealer) for marketing Company services, joint marketing campaigns, consignment agreements for the sale of Eurocom Digital Communications equipment, and technological sponsorship at exhibitions organized by the Company.
10. Contribution to the community together with Eurocom Group companies and contribution to organizations/projects in which the controlling shareholder of the Company or his relative volunteers as an officer. These contributions are part of the Company's contribution policy.

In the absence of special qualitative considerations all the circumstances, a transaction that is in the Company's regular course of business, is carried out in market conditions and has no material effect on the Company, shall be deemed negligible if all the following parameters exist:

- A. The amount of the transaction does not exceed NIS 10 million.

- B. The Company is not required to issue an immediate report for the transaction under Article 36 of the periodic reports regulations or any other law.
- C. The transaction does not include the terms of the office and employment (as defined in the Companies Law, 1999, ("the Companies Law") of an interested party or his relative, and does not constitute a transaction as set out in section 270(4) of the Companies Law (transaction of a public company with a holder of control therein, directly or indirectly, including through a company he controls, in respect of receiving services from it by the Company and if such person is also an officer - as to the conditions of his office and employment, and if he is an employee of the Company but not an officer, as to his employment by the Company).

According to the provisions of the Companies Law, as amended from time to time, once a year, before publication of the annual financial statements, the audit committee will review the parameters set out above, and whether they require updating. In general, each transaction will be tested separately for negligibility. Notwithstanding the aforesaid, separate transactions that are part of the same continuing transaction or very similar transactions that are carried out routinely and repeatedly, will be tested as one transaction on an annual basis for negligibility, provided the scope of the transaction does not exceed NIS 10 million, as set out above.

The Board of Directors may, from time to time and at its discretion, amend the parameters for a negligible transaction. This amendment will be duly reported.

28.3.2 Below are transactions listed in section 270(4) of the Companies Law, which are not considered as negligible transactions

Approval date of the general meeting (after approval of the Company's audit committee and Board of Directors), unless otherwise stated.	Nature of the transaction	Amount of the transaction	Nature of the personal interest
April 25, 2013 Approved by the Company's Board of Directors in accordance with the Companies Regulations (Relief in Transactions with Interested Parties), 2000 ("the Relief Regulations for Transactions with Interested Parties")	Extension of the arrangements approved at the Company's general meeting on October 14, 2010, between the Company and DBS and between Bezeq International and DBS for reciprocal marketing of products and services until December 31, 2015	The fees to be paid by the parties to each other will be in accordance with the criteria approved by the general meeting as part of the original approval for the agreement	Section B below
May 8, 2013	Approval of the Company's vote at the general meeting of DBS in favor of DBS's agreement with Space Communications Ltd. ("Space Communications") for leasing space segments, in which the original agreement will be amended and extended. The agreement is valid until the end of 2028.	Total amount of up to USD 227 million (net including discounts for satellite segments leased in the existing agreement)	Section D below.
June 13, 2013	The amendment to the Company's three-year agreement with Eurocom Communications Ltd. ("Eurocom Communications") for ongoing management and consultation services valid until May 31, 2016, unless one of the parties announces its intention to terminate the agreement with three months' notice. For further information see section E below.	NIS 5.5 million per year	Section E below
November 6, 2013 Approved by the Company's Board of Directors in accordance with the relief regulations for transactions with interested parties	Amendment and extension of the agreement between DBS and Eurocom Digital Communications Ltd. ("Eurocom") and Advanced Digital Broadcast SA ("ADB") for the purchase of YesMaxTotal3 converters, for a period up to December 31, 2016.	The total cost will be USD 10 million per year	Sections A and B below
January 27, 2014	Approval of the Company's vote at the general meeting of DBS in favor of DBS's agreement with Eurocom and ADB for the acquisition of an additional quantity of yesMaxTotal converters and power supplies for yesMax HD converters, until June 30, 2015.	For converters: Total cost of USD 14 million In addition, there is an additional 2.42% of the price for the cost of the hard drive only, if there are changes due to an increase in hard drive prices For power supplies: a total cost of USD 197 thousand	Sections A and B below
November 27, 2014 Approved by the Company's Board of Directors in accordance with the relief regulations for transactions with interested parties	Extension of supplier credit terms in accordance with the agreement between DBS and Space Communications for lease of space segments, up to December 31, 2014.	NIS 874 thousand	Section D below.

Approval date of the general meeting (after approval of the Company's audit committee and Board of Directors), unless otherwise stated.	Nature of the transaction	Amount of the transaction	Nature of the personal interest
January 14, 2015	Approval of the Company's vote at the general meeting of DBS in favor of DBS's agreement with Eurocom and ADB for the order of an additional quantity of yesMaxTotal converters, until December 31, 2015.	A total cost of USD 12 million and an additional price of up to 1.9% for the cost of the hard drive only, if there are changes due to an increase in hard drive prices	Sections A and B below
March 23, 2015	Approval of the Company's acquisition agreement with Eurocom DBS Ltd. ("Eurocom DBS") whereby the Company will acquire the entire holdings of Eurocom DBS in DBS shares DBS and all the shareholder loans provided by Eurocom DBS to DBS (including acceptance of the terms established by the Antitrust Commissioner's in his approval of the merger on March 26, 2014, both by the Company and by DBS, and announcement of the exercise of the Company's option for the allotment of 6,221 DBS shares, at no cost, representing 8.6% of the share capital of DBS).	The total cost is comprised of: A. Total cash of NIS 680 million B. Total cash of up to NIS 200 million (subject to certain conditions) C. Total cash of up to NIS 170 million (subject to certain conditions) For information about the conditions relating to B and C, see Note 11.2 above.	Section F below.
October 19, 2015	Approval of the Company's vote at the general meeting of shareholders of DBS in favor of DBS's agreement with Eurocom and ADB for the order of yesMaxTotal3 converters, under the existing agreement, until December 31, 2017	Total cost of USD 14 million	Section A and B below
December 8, 2015	Amendment to the framework agreement between Pelephone and Eurocom Cellular Communications Ltd., so that it will be extended to other products and brands, including related services for all products and its extension until December 31, 2018 (or three years after the acquisition date of any additional products or brands, whichever is earlier).	Annual scope of up to NIS 50 million (for all the products)	Section C below

A transaction with a controlling shareholder that is not an irregular transaction that was in effect in the reporting period:

Approval date of the general meeting (after approval of the Company's audit committee and Board of Directors)	Nature of the transaction	Amount of the transaction	Nature of the personal interest
November 27, 2014 Approved by the Company's Board of Directors as a transaction with a controlling shareholder that is not an irregular transaction	The Company's agreement to bring forward payments with Eurocom, according to which DBS may advance, at the supplier's request, payments that are due, or will be due, to Eurocom for orders of converters.	Up to a total cost of USD 6 million	Sections A and B below

The financial values of the transactions described in section 28.3.2 above, which were carried out in 2015, are as follows.

	Amounts included in the consolidated statement
	NIS million
Expenses	105
Property, plant and equipment	46
Acquisition of Eurocom DBS holdings in DBS (see Note 11.2.1)	913

- A. B Communications Ltd., the controlling shareholder of the Company, has a personal interest, since Eurocom is a related company to B Communications. Eurocom is controlled by Eurocom Communications, which is the controlling shareholder (tiered) of B Communications.

In addition, the director Shaul Elovitch has a personal interest as the controlling shareholder (tiered) in Eurocom Communications; directors Or Elovitch and Orna Elovitch-Peled have a personal interest being a relative of the controlling shareholder; the director Amikam Shorer has a personal interest being an employee and/or officer in Eurocom Group companies.

- B. B Communications has a personal interest in the transaction, since as at the date of this transaction, 50.2% of the shares of DBS were held by Eurocom DBS Ltd, which is controlled by Eurocom Communications, the controlling shareholder (tiered) of B Communications.

In addition, the directors Shaul Elovitch, Or Elovitch, Orna Elovitch-Peled, and Amikam Shorer have a personal interest as described in section A above.

- C. B Communications has a personal interest in the transaction, since Eurocom Cellular Communications Ltd. (a party to the transaction) is a related company to B Communications. Eurocom Cellular Communications Ltd. is controlled by Eurocom Communications, which is the controlling shareholder (linked) of B Communications.

In addition, the directors Shaul Elovitch, Or Elovitch, Orna Elovitch-Peled, and Amikam Shorer have a personal interest as described in section A above.

- D. See section B above; in addition, Or Elovitch, Shaul Elovitch, and Amikam Shorer serve as directors in Space Communications (Or Elovitch serves as chairman of the board of directors of Space Communications).

- E. Eurocom Communications will provide the services of Shaul Elovitch, who will serve as executive chairman of the Board of Directors of the Company and its subsidiaries. Executive chairman services will be provided in a scope of 70% and will include: service as active chairman of the Board of Directors of the Company and all its subsidiaries; management of work interfaces with the managements of the Company and its subsidiaries; active supervision authority for the effective management and performance of the Board of Directors of the Company and its subsidiaries; management of formation of the Group's strategy (subject to approval by the Company's Board of Directors); and more

Eurocom will provide directors on its behalf, to serve on the boards of directors of the Company and the subsidiary companies, in addition to the chairman of the board of directors.

Eurocom will also provide ongoing consultation services in diverse areas, in a monthly scope of at least 45 hours of monthly consulting services, provided by Or Elovitch, Amikam Shorer, and any other party set out in the agreement.

For services provided by the Eurocom Communications as described above, the Company will pay the following consideration to Eurocom Communications: (a) NIS 1.7 million per year for the participation of directors serving on behalf of the Company's controlling shareholders, as part of their membership and position as directors in the Company and/or its subsidiaries and the various committees, subject to adjustments in accordance with their number and presence in

meetings; (b) NIS 3.5 million per year for the service and activities of Shaul Elovitch as active chairman of the boards of directors of the Company and its subsidiaries; (c) NIS 324 thousand per year for ongoing consultation services.

- F. B Communications has a personal interest in the approval of the transaction, since as at the date of the transaction, B Communications is a company controlled (indirectly) by Eurocom Communications, which is controlled by Shaul and Yosef Elovitch (linked and indirectly), who are also the controlling shareholders in Eurocom DBS (through other companies and indirectly), which, as at the transaction date, held DBS shares.

The controlling shareholders have another personal interest arising from the fact that upon acceptance of the merger conditions by DBS as set out above, Eurocom DBS was released from its obligation to sell its shares in DBS, which was imposed on it by the Antitrust Commissioner as described in Note 11.1.1. above. To the best of the Company's knowledge, Eurocom Communications is a private company controlled by Eurocom Holdings (1979) Ltd., a private company controlled by Shaul Elovitch and his brother Yosef Elovitch.

The controlling shareholders have an additional personal interest arising from the purchase of liability insurance for directors for their service on the board of directors of DBS in the period up to the completion date of the acquisition transaction, as set out in the table.

- G. For further information about the transactions included in section 270(4) of the Companies Law, regarding D&O insurance and indemnity, see Note 28.6 below.

28.4. Benefits for key officers

Benefits for employment of key managers, including:

	Year ended December 31		
	2015	2014	2013
	NIS thousands	NIS thousands	NIS thousands
Number of managerial key officers	5	4	4
Salary (28.4.1)	8,519	7,468	8,078
Bonus:	7,375	5,940	5,302
Share-based payments	(130)	(651)	2,578
	15,764	12,757	15,958

- 28.4.1 Key officers in the Group include the chairman of the Board of Directors (who is not entitled to remuneration for his position, beyond the consideration paid as part of the management services agreement with Eurocom Communications Ltd.), the CEO of the Company and the CEOs of Bezeq International, DBS (as from March 23, 2015, the date of initial consolidation of DBS in the financial statements of the Group), Pelephone (as from November 8, 2015), and the former CEO of Pelephone (up to November 7, 2015). As set out in Note 28.3.2 above, in 2015, the Company paid Eurocom Communications NIS 3.5 million for the service and activity of Shaul Elovitch as active chairman of the Board of Directors of the Company and its subsidiaries. This amount is not included in the benefits described above.

- 28.4.2 In 2015, changes in other provisions (which are included in total salary) include a reduction in the provision, mainly due to payment of early notice to the former CEO of Pelephone amounting to NIS 0.4 million. In 2014, the changes in other provisions include a reduction in provisions, mainly due to the payment for the early notice and leave for the former CEO of Bezeq International, amounting to NIS 0.7 million and creation of a provision for early notice and leave of the incumbent CEO of Bezeq International, amounting to NIS 0.8 million. In 2013, the changes in other provisions include a reduction in provisions due to the payment of the early notice and leave for the former CEO of the Company amounting to NIS 1.2 million and creation of a provision for early notice and leave of the incumbent CEO amounting to NIS 1.1 million.

28.5. Benefits for directors

	Year ended December 31		
	2015	2014	2013
	NIS thousands	NIS thousands	NIS thousands
Remuneration for directors who are not employed by the Company, see section 28.5.1	2,912	2,818	2,168
Number of directors receiving remuneration	6	6	5
Salary of employee-directors, see 28.5.2	587	1,608	1,358
Number of directors receiving a salary, see 28.5.2	1	2	2
Management fees to the controlling shareholder (see section 28.3.2)	5,524	5,524	5,062

28.5.1 The directors serving on the Company's Board of Directors, except for the outside directors and the independent directors, do not receive remuneration from the Company.

28.5.2 The salary is paid to an employee-director for his work in the Company and he does not receive any additional pay for his service as a director in the Company. In 2015 and as at the approval date of the financial statements, one director who is an employee serves in the Company.

28.6. Additional benefits for directors and officers

Approval date of the general meeting (after approval of the Company's Board of Directors), unless otherwise stated.	Nature of the transaction	Amount of the transaction
March 8, 2010	Conversion of the D&O liability insurance policy to a run-off policy	-
May 20, 2015 Approved by the Company's Board of Directors in accordance with the relief regulations for transactions with interested parties (following approval by the Company's Board of Directors on April 8, 2014 for the period up to April 13, 2015 and approval of the Company's Board of Directors of April 13, 2015 for the period up to June 14, 2015).	Renewal of the Company's insurance policy for directors and officers liability in the Company and its subsidiaries, in accordance with the Company's compensation policy, for the period up to June 13, 2016 (inclusive), and for a further period of one year up to June 13, 2017 (subject to exercise of the option by the insurer), including the approval of the compensation committee and the Board of Directors that the terms of the agreement for the CEO and for the officers who are controlling shareholders or their relatives are the same as those of the other officers.	The liability limit is up to USD 150 million per claim and in total for all claims in the insurance year (plus reasonable legal expenses). The annual premium is USD 320 thousand. Total annual premium up to April 13, 2015: USD 234.5 thousand; total premium for the extension period until June 14, 2015: USD 55,430 (reflecting an annual cost of USD 332.5 thousand)
January 17, 2007	Undertaking to indemnify officers in the Company, in accordance with the letters of indemnity, as amended on October 26, 2011.	Up to 25% of the Company's equity at the time the indemnity is granted
November 5, 2014	Extension of the validity of the letters of undertaking for indemnification of directors who are controlling shareholders or their relatives for the period up to October 25, 2017.	-

In addition, subsequent to the reporting date, on March 16, 2016, the Company's Board of Directors, recommended that the general meeting of the Company's shareholders, which convened on May 3, 2016, approve the amendment to the letters of undertaking for indemnification and exemption and to grant them to officers and directors (including those who are controlling shareholders in the Company and/or their representative).

28.7. For guarantees provided to DBS, see Note 12.4.

29. Financial Instruments

29.1. General

The Group is exposed to the following risks, arising from the use of financial instruments:

- A. Credit risk
- B. Liquidity risk
- C. Market risk (which includes currency, interest, CPI risks and other price risks)

This Note provides qualitative and quantitative information about the Group's exposure to each of the above risks, an explanation as to how the risks are managed, and the measurement processes.

29.2. Framework for financial risk management

The Board of Directors has overall responsibility for the Group's financial risk management. The purpose of financial risk management in the Group is to define and monitor those risks constantly, and to minimize their possible effects arising from the exposure on the basis of assessments and expectations for parameters that affect the risks.

The Group's policy is to partially hedge, in accordance with the rules determined by the Board of Directors, the exposure arising from fluctuations in foreign exchange rates and the CPI.

29.3. Credit risk

Management monitors the Group's exposure to credit risks on a regular basis. Cash and investments in deposits and securities are deposited in highly-rated banks.

Trade and other receivables

The Group's management regularly monitors customer debts, and the financial statements include provisions for doubtful debts which properly reflect, in the management's estimation, the loss inherent in doubtful debts. In addition, the balances of the trade receivables are widely spread.

Investments in financial assets

Any investments in securities are made in liquid, marketable and low-risk securities. Transactions involving derivatives are made with entities that have a high credit rating.

As at the reporting date, there is no material concentration of credit risks.

29.4. Liquidity risk

The Group estimates that its liquidity risk is low.

For information about the terms of the debentures issued by Group companies and the loans received, and an agreement to receive future loans, see Note 12 above.

The following are the contractual maturities of financial liabilities received in practice up to December 31, 2015, including estimated interest payments (based on known CPI and interest rates on December 31, 2015):

December 31, 2015							
	Carrying amount	Contractual cash flow	First half of 2016	Second half of 2016	2017	2018 to 2020	2021 and thereafter
NIS million							
Non-derivative financial liabilities							
Trade and other payables	1,550	1,550	1,548	2	-	-	-
Loans	3,219	3,528	85	723	924	1,564	231
Debentures	7,493	8,311	862	517	1,155	3,358	2,415
Liability to Eurocom DBS	233	233	233	-	-	-	-
	12,495	13,622	2,728	1,242	2,079	4,922	2,646
Financial liabilities for derivative instruments							
	168	168	22	-	-	114	32

It is not expected that the cash flows included in the analysis of the repayment dates will be materially earlier, or in amounts that are materially different. For further information about the financial covenants, see Note 12.

29.5. Market risks

The purpose of market risk management is to manage and oversee the exposure to market risks within accepted parameters to prevent significant exposures to market risks that will influence the Group's results, liabilities and cash flow.

During the normal course of its business, the Group takes full or partial hedging action and takes into account the effects of the exposure in its considerations for determining the type of loans it takes and in managing its investment portfolio.

29.5.1 Exposure to CPI and foreign currency risks

CPI risk

Changes in the rate of inflation affect the Group's profitability and its future cash flows, mainly due to its CPI-linked liabilities. In applying a policy of minimizing the exposure to the CPI, the Group makes forward contracts against the CPI. Hedging transactions are performed against the hedged debt repayment schedules. The Company applies hedge accounting for these forward contracts.

A considerable part of these cash balances is invested in shekel deposits and ETFs-deposit, which are exposed to changes in their real value as a result of a change in the rate of the CPI.

Foreign currency risk

The Group is exposed to foreign currency risks mainly due to payments for purchases of terminal equipment and property, plant and equipment, some of which are denominated in or linked to the USD or EUR. In addition, the Group provides services for customers and receives services from suppliers worldwide for which it is paid and it pays in foreign currency, mainly the dollar.

Statement of financial position in accordance with linkage basis as at December 31, 2015:

December 31, 2015					
	Unlinked	CPI-linked	In or linked to foreign currency (mainly USD)	Non-monetary balances	Total balances
	NIS million	NIS million	NIS million	NIS million	NIS million
Current assets					
Cash and cash equivalents	538	-	17	-	555
Investments, including derivatives	751	-	11	-	762
Trade receivables	2,019	21	18	-	2,058
Other receivables	19	107	-	143	269
Inventory	-	-	-	115	115
Non-current assets					
Trade and other receivables	482	192	-	-	674
Broadcasting rights, net of rights exercised	-	-	-	456	456
Property, plant and equipment				6,894	6,894
Intangible assets				3,332	3,332
Deferred tax assets				1,178	1,178
Deferred expenses and non-current investments	55	-	50	256	361
Equity-accounted investments	-	-	-	25	25
Total assets	3,864	320	96	12,399	16,679
Current liabilities					
Debentures, loans and borrowings	1,220	693	-	-	1,913
Trade and other payables	1,313	62	205	77	1,657
Current tax liabilities	-	624	-	-	624
Employee benefits	378	-	-	-	378
Liability to Eurocom DBS Ltd.	233	-	-	-	233
Provisions	38	62	-	-	100
Non-current liabilities					
Loans and debentures	4,619	4,181	-	-	8,800
Employee benefits	192	-	48	-	240
Derivatives and other liabilities	-	147	5	74	226
Deferred tax liabilities	-	-	-	51	51
Provisions	46	-	-	-	46
Total liabilities	8,039	5,769	258	202	14,268
Total exposure in the statement of financial position	(4,175)	(5,449)	(162)	12,197	2,411
Details of forward contracts					
Forward contracts	(2,437)	2,021	416	-	-

Statement of financial position in accordance with linkage basis as at December 31, 2014:

December 31, 2014					
	Unlinked	CPI-linked	In or linked to foreign currency (mainly USD)	Non-monetary balances	Total balances
	NIS million	NIS million	NIS million	NIS million	NIS million
Current assets					
Cash and cash equivalents	653	-	7	-	660
Investments, including derivatives	2,223	-	-	-	2,223
Trade receivables	2,187	16	24	-	2,227
Other receivables	3	107	-	150	260
Inventory	-	-	-	96	96
Non-current assets					
Trade and other receivables	509	57	-	-	566
Property, plant and equipment	-	-	-	6,079	6,079
Intangible assets	-	-	-	1,793	1,793
Deferred expenses and non-current investments	90	-	9	253	352
Equity-accounted investments	-	2,181	-	(1,124)	1,057
Total assets	5,665	2,361	40	7,247	15,313
Current liabilities					
Debentures, loans and borrowings	1,074	407	-	-	1,481
Trade and other payables	1,148	46	132	48	1,374
Current tax liabilities	-	600	-	-	600
Employee benefits	259	-	-	-	259
Provisions	15	46	-	1	62
Non-current liabilities					
Loans and debentures	5,313	3,293	-	-	8,606
Employee benefits	183	-	50	-	233
Derivatives and other liabilities	-	94	-	77	171
Deferred tax liabilities	-	-	-	17	17
Provisions	69	-	-	-	69
Total liabilities	8,061	4,486	182	143	12,872
Total exposure in the statement of financial position	(2,396)	(2,125)	(142)	7,104	2,441
Details of forward contracts					
Forward contracts on CPI	(2,361)	2,361	-	-	-

29.5.2 CPI

In 2015, the known CPI decreased by 0.9% (in 2014, a decrease of 0.1%; in 2013, an increase of 1.91%)

29.5.3 Sensitivity analysis for the change in the CPI for the change in the USD exchange rate

An increase/decrease of 1% in the CPI at the reporting date would not have a material effect on profit and on capital. In addition, an increase/decrease of 10% in the USD exchange rate at the reporting date would not have a material effect on profit and on capital.

29.5.4 Interest rate risk

Group is exposed to interest rate risk due to its liabilities for debt instruments bearing variable interest.

A. Type of interest

The interest rate for the Group's interest-bearing financial instruments at the reporting date is as follows:

	Carrying amount	
	2015	2014
	NIS million	NIS million
Fixed-interest instruments		
Financial assets (mainly deposits and trade receivables)	2,154	2,577
Financial liabilities (loans and debentures)	(8,648)	(7,697)
	(6,494)	(5,120)
Variable-interest instruments		
Financial liabilities (loans and debentures)	(2,065)	(2,390)

B. Fair value sensitivity analysis for fixed rate instruments

The Group's assets and liabilities at fixed interest are not measured at fair value through profit or loss. Accordingly, a change in interest rates at the reporting date will not affect profit or loss.

C. Sensitivity analysis of cash flow for instruments at variable interest

An increase/decrease of 1% in the interest rates at the reporting date will not have a material effect on profit and on capital.

29.6. Cash flow hedge accounting

29.6.1 The Company entered into several forward contracts, as described in the table below, to reduce exposure to changes in the CPI for CPI-linked Series 5 and Series 6 debentures. These transactions hedge specific cash flows of some of the debentures and are recognized as cash flow hedge accounting. The expiry date of these transactions complies with the repayment schedule of the relevant debentures. The fair value of the forward contracts is based on available market information (tier 2 in the fair value hierarchy)

Hedged item	Repayment dates	Number of Transactions	Nominal value NIS million	Fair value NIS million	Capital reserve NIS million
December 31, 2015					
Series 5 debentures	6.2016	2	322	(22)	3
Series 6 debentures	12.2018 to 12.2022	8	1,699	(146)	67
		10	2,021	(168)	70
December 31, 2014					
Series 5 debentures	6.2015 to 6.2016	4	662	(35)	16
Series 6 debentures	12.2018 to 12.2022	8	1,699	(75)	47
		12	2,361	(110)	63

Subsequent to the date of the financial statements, the Company entered into a new transaction to hedge Debentures (Series 6). The scope of the transaction is NIS 295 million. The maturity date of this transaction is December 2018.

29.6.2 DBS has forward transaction to reduce exposure to changes in the USD exchange rate. As at March 31, 2015, the net fair value of these transactions is NIS 11 million.

29.7. Financial instruments measured at fair value

The table below presents an analysis of the financial instruments measured at fair value.

	December 31, 2015	December 31, 2014
	NIS million	NIS million
Level 1: investment in exchange-traded funds and financial funds (see Note 29.7.2)	193	1,513
Level 2 - future credit from banks	2	-
Level 2: forward contracts (see Note 29.7.3)	(157)	(110)
Level 3: contingent consideration for a business combination for the business results of DBS (see Note 29.7.4)	(233)	-
Level 3: investment in non-marketable shares	2	9

29.7.1 The fair value of investments in financial funds and ETFs is determined by reference to their average quoted selling price at the reporting date (level 1).

29.7.2 The fair value of forward contracts on the CPI or foreign currency is based on discounting the difference between the price in the forward contract and the price of the present forward contract for the balance of the contract term until redemption, at an appropriate interest rate (level 2). The estimate is made under the assumption that a market participant takes into account the credit risks of the parties when pricing such contracts.

29.7.3 Information about fair value measurement of contingent consideration in a business combination (Level 3)

Below is the fair value of the contingent consideration liability for a business combination, as described in Note 11.2.1:

	December 31, 2015	
	Maximum additional consideration under the agreement	Fair value
	NIS million	NIS million
Additional consideration for tax synergy (first additional consideration)(A)	200	204
Additional consideration for the business results of DBS (second additional consideration) (B)	170	29
	370	233

A. First additional consideration

The fair value of the additional first contingent consideration was calculated on the basis of the agreement in principle with the tax assessor for the scope of the carryforward losses of DBS as described in Note 6.6 above and it includes accrued interest.

B. Second additional consideration

The fair value of the first additional consideration was estimated by the assessor, using the Monte Carlo simulation with risk neutral measure of the underlying asset which is the expected cash flow of DBS for 2016-2017.

29.8. Financial instruments at fair value for disclosure purposes only

The table below shows the differences between the carrying amount and the fair value of financial liabilities.

The fair value of debentures issued to the public is based on their quoted closing price at the reporting date (Level 1).

The fair value of the loans and non-marketable debentures is based on the present value of future principal and interest cash flows, discounted at the rate of market interest for similar liabilities, plus the required adjustments for a risk premium or non-marketable, as at the reporting date (Level 2).

	December 31, 2015			December 31, 2014		
	Carrying amount (including accrued interest)	Fair value	Discount rate (weighted average)	Carrying amount	Fair value	Discount rate (weighted average)
	NIS million		%	NIS million		%
Bank loans (unlinked)	1,904	2,044	2.05%	2,112	2,292	2.27%
Debentures issued to the public (CPI-linked)	3,816	4,006	1.55%	3,820	4,033	1.37%
Debentures issued to the public (unlinked)	1,279	1,340	1.25%	1,335	1,426	0.85%
Debentures issued to financial institutions (CPI-linked)	1,310	1,314	1.66%	-	-	-
Debentures issued to financial institutions (unlinked)	403	458	2.11%	403	467	2.55%
	8,712	9,162		7,670	8,218	

29.9. Offset of financial assets and liabilities

The Group has agreements with various communication companies to supply and receive communication services. In accordance with the agreements, each party has the right to offset the amounts due by each party. The table below presents the carrying amount of the offset balances as stated in the statement of financial position:

	December 31, 2015	December 31, 2014
	NIS million	NIS million
Trade and other receivables, gross	147	151
Offset amounts	(115)	(114)
Trade and other receivables presented in the statement of financial position	32	37
Trade payables, gross	157	165
Offset amounts	(115)	(114)
Trade and other payables presented in the statement of financial position	42	51

30. Selected Condensed Data from the Financial Statements of Pelephone Communications Ltd., Bezeq International Ltd., and DBS Satellite Services (1998) Ltd.

30.1. Pelephone Communications Ltd.

Data from the statement of financial position

	December 31, 2015	December 31, 2014
	NIS million	NIS million
Current assets	1,420	1,658
Non-current assets	1,854	1,883
	3,274	3,541
Current liabilities	448	610
Non-current liabilities	70	86
Total liabilities	518	696
Equity	2,756	2,845
	3,274	3,541

Selected data from the statement of income

	Year ended December 31		
	2015	2014	2013
	NIS million	NIS million	NIS million
Revenues from services	1,999	2,453	2,808
Revenues from sales of terminal equipment	891	966	1,001
Total revenues from services and sales	2,890	3,419	3,809
Cost of services and sales	2,383	2,537	2,711
Gross profit	507	882	1,098
Selling and marketing expenses	247	309	320
General and administrative expenses	98	106	109
Other operating expenses	5	18	61
	350	433	490
Operating profit	157	449	608
Financing expenses (income)			
Financing expenses	4	21	46
Financing income	(53)	(77)	(137)
Financing income, net	(49)	(56)	(91)
Income before income tax	206	505	699
Income tax	55	132	178
Profit for the year	151	373	521

30.2. Bezeq International Ltd.

Data from the statement of financial position

	December 2015	31, December 31, 2014
	NIS million	NIS million
Current assets	456	487
Non-current assets	714	730
	1,170	1,217
Current liabilities	314	313
Non-current liabilities	29	79
Total liabilities	343	392
Equity	827	825
	1,170	1,217

Selected data from the statement of income

	Year ended December 31		
	2015	2014	2013
	NIS million	NIS million	NIS million
Revenues	1,578	1,504	1,433
Operating expenses	1,015	951	879
Gross profit	563	553	554
Selling and marketing expenses	209	209	205
General and administrative expenses	116	112	119
Other revenues, net	(2)	-	3
Operating profit	240	232	227
Financing expenses (income)			
Financing expenses	15	18	23
Financing income	(7)	(9)	(9)
Financing expenses (income), net	8	9	14
Share in the profits of equity-accounted investees	-	1	1
Income before income tax	232	224	214
Income tax expenses	60	60	56
Profit for the year	172	164	158

30.3. DBS Satellite Services (1998) Ltd.

Data from the statement of financial position

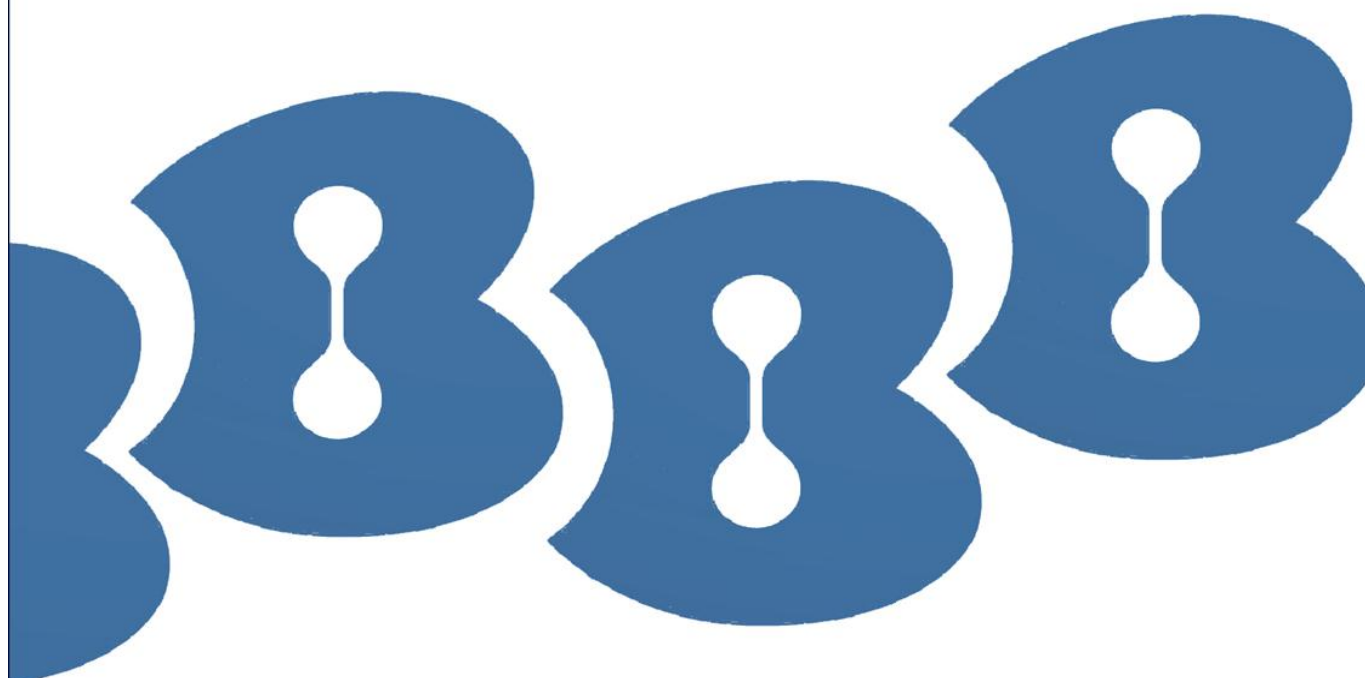
	December 2015	31, December 31, 2014
	NIS million	NIS million
Current assets	319	405
Non-current assets	1,348	1,387
	1,667	1,792
Current liabilities	903	952
Non-current liabilities	892	4,054
Loans from shareholders	4,890	1,450
Total liabilities	6,685	6,456
Capital deficit	(5,018)	(4,664)
	1,667	1,792

Selected data from the statement of income

	Year ended December 31		
	2015	2014	2013
	NIS million	NIS million	NIS million
Revenues from services	1,774	1,724	1,635
Operating expenses	1,289	1,203	1,130
Gross profit	485	521	505
Selling and marketing expenses	140	154	154
General and administrative expenses	95	94	84
	235	248	238
Operating profit	250	273	267
Financing expenses (income)			
Financing expenses	122	137	168
Financing expenses for shareholder loans, net	513	483	486
Financing income	(32)	(26)	(7)
Financing expenses, net	603	594	647
Loss before income tax	(353)	(321)	(380)
Income tax	1	1	1
Loss for the year	(354)	(322)	(381)

**“Bezeq” The Israel
Telecommunication Corporation
Limited**

**Pro Forma Consolidated Financial
Statements for the Year Ended
December 31, 2015**



Contents	Page
Auditors' Report	2
Pro Forma Consolidated Financial Statements as at December 31, 2015	
Pro Forma Consolidated Statements of Income and Comprehensive Income	3
Notes to the Pro Forma Consolidated Financial Statements	7



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

Auditors' Report to the Shareholders of

"Bezeq "the Israeli Telecommunication Corporation Ltd.

We have audited the accompanying pro forma financial information of "Bezeq "the Israel Telecommunication Corporation Ltd. (hereinafter "the Company") comprising of the pro forma consolidated statements of income and the pro forma consolidated statements of comprehensive income for each of the three years in the period ended December 31, 2015. These pro forma financial statements are the responsibility of the Company's Board of Directors and of its Management. Our responsibility is to express an opinion on these pro forma financial statements based on our audit.

We did not audit the financial statements of certain consolidated subsidiaries whose revenues constitute approximately 1% of the total consolidated revenues for the years ended December 31, 2015, 2014 and 2013. The financial statements of those companies were audited by other auditors whose reports thereon were furnished to us, and our opinion, insofar as it relates to amounts emanating from the financial statements of such companies, is based solely on the reports of the other auditors.

We conducted our audit in accordance with generally accepted auditing standards in Israel, including standards prescribed by the Auditors Regulations (Manner of Auditor's Performance) - 1973. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors and by Management of the Company, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and on the reports of other auditors, the pro forma consolidated financial statements referred to above presents fairly, in all material respects, the pro forma results of operations of the Company and its consolidated subsidiaries for each of the three years in the period ended December 31, 2015, in accordance with the requirements of Regulation 9a of the Securities Regulations (Periodic and Immediate Reports), 1970, as it is based on the assumptions set forth in Note 2.

Somekh Chaikin
Certified Public Accountants (Isr.)

March 16, 2016

Pro Forma Consolidated Statements of Income

Year ended December 31, 2015			
	Prior to the pro forma event	Adjustments for pro forma information	Pro forma information
	NIS million	NIS million	NIS million
Revenues	9,985	434	10,419
Costs of activity			
General and operating expenses	3,869	230	4,099
Salaries	1,957	69	2,026
Depreciation and amortization	1,684	83	1,767
Other operating income, net	(95)	12	(83)
	7,415	394	7,809
Operating profit	2,570	40	2,610
Financing expenses (income)			
Financing expenses	376	64	440
Financing income	(113)	(21)	(134)
Financing expenses, net	263	43	306
Profit after financing expenses, net	2,307	(3)	2,304
Share in profits (losses) of equity-accounted investees	12	(17)	(5)
Profit before income tax	2,319	(20)	2,299
Income tax	598	4	602
Profit for the year	1,721	(24)	1,697
Earnings per share (NIS)			
Basic earnings per share	0.63	(0.01)	0.62
Diluted earnings per share	0.62	(0.01)	0.61

Pro Forma Consolidated Statements of Comprehensive Income

Year ended December 31, 2015			
	Prior to the pro forma event	Adjustments for pro forma information	Pro forma information
	NIS million	NIS million	NIS million
Profit for the year	1,721	(24)	1,697
Items of other comprehensive income (net of tax)	7	-	7
Total comprehensive income for the year	1,728	(24)	1,704

Shaul Elovitch
Chairman of the Board of Directors

Stella Handler
CEO

David (Dudu) Mizrahi
Deputy CEO and CFO

Date of approval of the pro forma financial statements: March 16, 2015

The attached notes are an integral part of these pro forma consolidated financial statements.

Pro Forma Consolidated Statements of Income

Year ended December 31, 2014			
	Prior to the pro forma event	Adjustments for pro forma information	Pro forma information
	NIS million	NIS million	NIS million
Revenues	9,055	1,710	10,765
Costs of activity			
General and operating expenses	3,366	872	4,238
Salaries	1,768	267	2,035
Depreciation and amortization	1,281	484	1,765
Other operating income, net	(586)	1	(585)
	5,829	1,624	7,453
Operating profit	3,226	86	3,312
Financing expenses (income)			
Financing expenses	486	98	584
Financing income	(356)	188	(168)
Financing expenses, net	130	286	416
Profit after financing expenses, net	3,096	(200)	2,896
Share in losses of equity-accounted investees	(170)	165	(5)
Profit before income tax	2,926	(35)	2,891
Income tax	815	(47)	768
Profit for the year	2,111	12	2,123
Earnings per share (NIS)			
Basic earnings per share	0.77	0.01	0.78
Diluted earnings per share	0.77	-	0.77

Pro Forma Consolidated Statements of Comprehensive Income

Year ended December 31, 2014			
	Prior to the pro forma event	Adjustments for pro forma information	Pro forma information
	NIS million	NIS million	NIS million
Profit for the year	2,111	12	2,123
Items of other comprehensive loss (net of tax)	(36)	-	(36)
Total comprehensive income for the year	2,075	12	2,087

The attached notes are an integral part of these pro forma consolidated financial statements.

Pro Forma Consolidated Statements of Income

Year ended December 31, 2013			
	Prior to the pro forma event	Adjustments for pro forma information	Pro forma information
	NIS million	NIS million	NIS million
Revenues	9,563	1,624	11,187
Costs of activity			
General and operating expenses	3,576	841	4,417
Salaries	1,872	253	2,125
Depreciation and amortization	1,311	449	1,760
Other operating income, net	(15)	-	(15)
	6,744	1,543	8,287
Operating profit	2,819	81	2,900
Financing expenses (income)			
Financing expenses	573	131	704
Financing income	(428)	219	(209)
Financing expenses, net	145	350	495
Profit after financing expenses, net	2,674	(269)	2,405
Share in losses of equity-accounted investees	(252)	251	(1)
Profit before income tax	2,422	(18)	2,404
Income tax	651	(72)	579
Profit for the year	1,771	54	1,825
Earnings per share (NIS)			
Basic and diluted earnings per share	0.65	0.02	0.67

Pro Forma Consolidated Statements of Comprehensive Income

Year ended December 31, 2013			
	Prior to the pro forma event	Adjustments for pro forma information	Pro forma information
	NIS million	NIS million	NIS million
Profit for the year	1,771	54	1,825
Items of other comprehensive loss (net of tax)	6	-	6
Total comprehensive income for the year	1,777	54	1,831

The attached notes are an integral part of these pro forma consolidated financial statements.

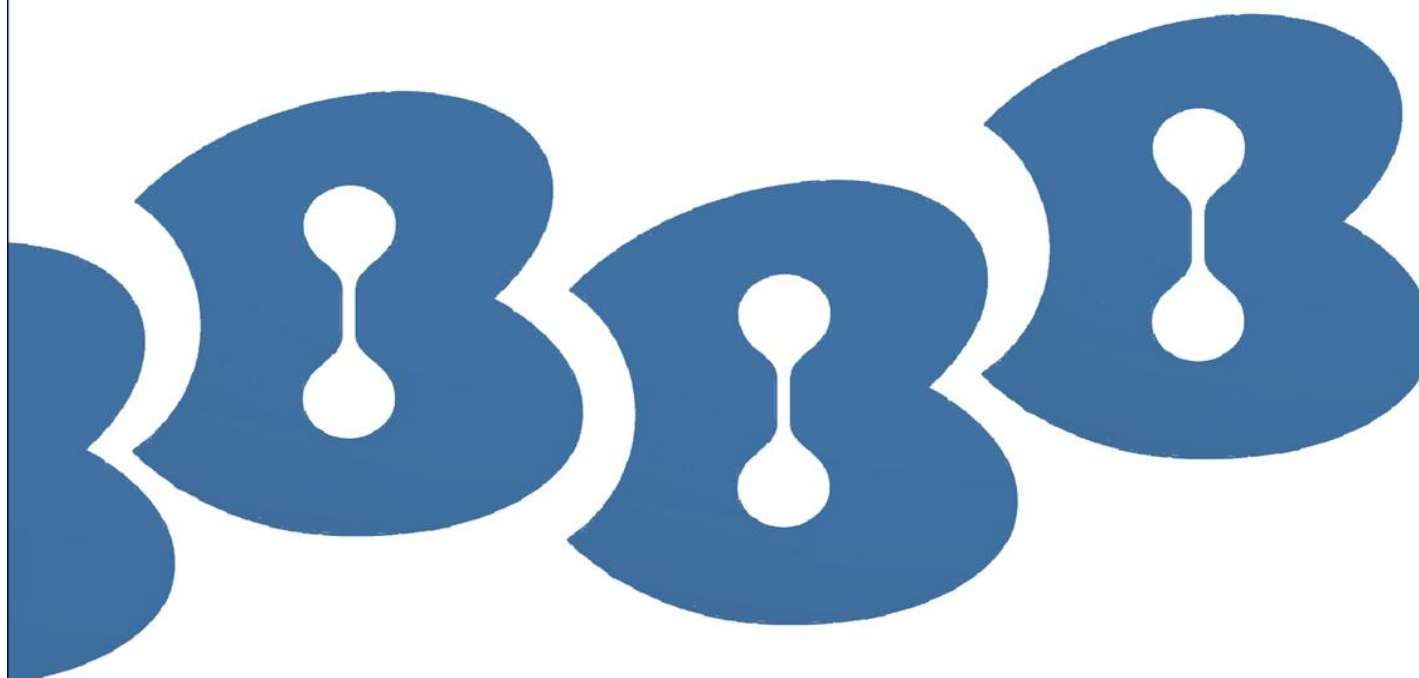
1. General

- 1.1** These pro forma consolidated financial statements are prepared in accordance with Regulation 9A of the Israel Securities Regulations (Periodic and Immediate Reports), 1970 and refer to the acquisition of control in DBS. Up to March 23, 2015, the Company held 49.78% of DBS shares and accounted for this investment using the equity method. On this date, the general meeting of the Company's shareholders approved the acceptance of the merger terms and exercise of the option, and the Company's engagement in the Acquisition Transaction, as described in Note 11.2 to the Group's financial statements. As from March 23, 2015, the Company consolidates the financial statements of DBS in the Group's financial statements.
- 1.2** The pro forma consolidated financial statements are based on the consolidated financial statements of the Company and the financial statements of DBS for the year ended December 31, 2015, which were prepared in accordance with International Financial Reporting Standards (IFRS).

2. Assumptions and adjustments used to prepare the pro forma financial statements

- 2.1** The pro forma consolidated financial statements have been prepared to reflect the results of the Company's operations for 2013-2015. The reports were prepared under the assumption that the business combination with DBS, which is described in Note 11.2 to the Group's consolidated financial statements, was completed on January 1, 2013.
- 2.2** Prior to acquiring control in DBS, as described above, the Company held 49.78% of its shares and accounted for this investment using the equity method. Accordingly, the consolidated statements of income included equity gains for this investment. In addition, for the purpose of the pro forma statement of income, the equity gains that were recognized up to March 23, 2015 were eliminated. In addition, a gain in the amount of NIS 12 million from the acquisition of control was eliminated in the pro forma statement of income for 2015.
- 2.3** Income and expenses arising from transactions between the Company and DBS were eliminated in the pro forma consolidated statements.
- 2.4** The adjustments for pro forma information included additional amortization of surplus cost amounting to NIS 30 million in 2015. In addition, in each of the years 2013 and 2014, amortization of excess cost amounting to NIS 150 million was included. The amortization was based on the estimated forecasted useful life and fair value of the excess cost as at the date of the business combination.
- 2.5** The Company assumes that there is no change in measurement of the fair value of DBS and allocation of surplus cost in the periods. In addition, the Company assumed that there was no change in the fair value measurement of the contingent consideration in 2013 and 2014.

**Bezeq The Israel Telecommunication
Corporation Ltd.
Separate Financial Information for
Year ended
December 31, 2015**



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

Contents	Page
Auditors' Report	2
Separate Financial Information	
Information pertaining to Financial Position	3
Information pertaining to Profit or Loss and Comprehensive Income	5
Information pertaining to Cash Flows	6
Notes to the Separate Financial Information	7



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

To:

The Shareholders of "Bezeq" the Israeli Telecommunication Corporation Ltd.

Dear Sirs,

Subject: Special auditors' report on separate financial data according to Regulation 9C of the Securities Regulations (Periodic and Immediate Reports) – 1970

We have audited the separate financial data presented in accordance with Regulation 9C of the Securities Regulations (Periodic and Immediate Reports) – 1970 of "Bezeq" the Israeli Telecommunication Corporation Ltd. (hereinafter – "the Company") as of December 31, 2015 and 2014 and for each of the three years, the last of which ended December 31, 2015. The separate financial data are the responsibility of the Company's Board of Directors and of its Management. Our responsibility is to express an opinion on the separate financial data based on our audit.

We did not audit the financial statements of equity accounted investees the investment in which amounted to approximately NIS 587 million and NIS 596 million as of December 31, 2015 and 2014, respectively, and the Company's share in their profits (losses) amounted to approximately NIS 2 million, NIS 499 million and NIS (7) million for each of the three years, the last of which ended December 31, 2015. The financial statements of those companies were audited by other auditors whose reports thereon were furnished to us, and our opinion, insofar as it relates to amounts emanating from the financial statements of such investees, is based solely on the reports of the other auditors.

We conducted our audit in accordance with generally accepted auditing standards in Israel. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial data are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the separate financial data. An audit also includes assessing the accounting principles that were used in preparing the separate financial data and the significant estimates made by the Board of Directors and by Management of the Company, as well as evaluating the separate financial data presentation. We believe that our audit and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and on the reports of the other auditors, the separate financial data has been prepared, in all material respects, in accordance with Regulation 9C of the Securities Regulations (Periodic and Immediate Reports) - 1970.

Without qualifying our abovementioned opinion, we draw attention to lawsuits filed against the Company which cannot yet be assessed or the exposure in respect thereof cannot yet be calculated, as set forth in Note 11.

Somekh Chaikin
Certified Public Accountants (Isr.)
March 16, 2016

Information pertaining to the Financial Position as at December 31

		2015	2014
	Note	NIS million	NIS million
Assets			
Cash and cash equivalents		110	248
Investments, including derivatives	3.1	648	2,175
Trade receivables	3.2	668	720
Other receivables	3.2	119	133
Loans granted to investees	10.2	288	261
Total current assets		1,833	3,537
Trade and other receivables	3.2	180	51
Property, plant and equipment	5	4,753	4,620
Intangible assets		255	295
Investment in investees		7,217	6,325
Loans granted to investees	10.2	374	272
Non-current investments	3.1	101	86
Total non-current assets		12,880	11,649

Total assets		14,713	15,186

Separate Financial Information as at December 31, 2015

		2015	2014
	Note	NIS million	NIS million
Liabilities			
Debentures, loans and borrowings	3.4	1,660	1,570
Loan from a Subsidiary	10.2	434	-
Trade and other payables	3.3	636	720
Current tax liabilities		619	590
Employee benefits		330	223
Liability to Eurocom DBS Ltd, an affiliate		233	-
Provisions	11	60	48
Total current liabilities		3,972	3,151
Debentures and loans	3.4	7,879	8,787
Loan from a Subsidiary	10.2	-	434
Employee benefits		203	203
Derivatives and other liabilities		215	169
Deferred tax liabilities	4.2	33	1
Total non-current liabilities		8,330	9,594
Total liabilities		12,302	12,745
Equity			
Share capital		3,874	3,855
Share premium		368	253
Reserves		308	416
Deficit		(2,139)	(2,083)
Total shareholders' equity		2,411	2,441
Total liabilities and equity		14,713	15,186

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: March 16, 2016

The attached notes are an integral part of the separate financial information.

Information pertaining to Profit or Loss for the year ended December 31				
		2015	2014	2013
	Note	NIS million	NIS million	NIS million
Revenues	6	4,407	4,317	4,478
Cost of Activities				
Salaries		912	895	980
Amortization and depreciation		725	688	683
General and operating expenses	7	721	777	895
Other operating expenses (income), net	8	(99)	(23)	(78)
		2,259	2,337	2,480
Operating profit		2,148	1,980	1,998
Financing expenses				
Financing expenses		362	472	534
Financing revenues		(30)	(72)*	(91)*
Financing expenses - net		332	400	443
Profit after financing expenses, net		1,816	1,580	1,555
Share in earnings of investees, net		397	1,009*	626*
Profit before income tax		2,213	2,589	2,181
Taxes on income	4.1	492	478	410
Profit for the year attributable to the Company's controlling shareholders		1,721	2,111	1,771

* Restated due to change in accounting policy, see Note 2.3

Information pertaining to Comprehensive Income for the year ended December 31				
		2015	2014	2013
		NIS million	NIS million	NIS million
Profit for the year attributable to the Company's controlling shareholders		1,721	2,111	1,771
Items of other comprehensive income (loss), net of tax		7	(36)	6
Total comprehensive income for the year attributable to equity holders of the Company		1,728	2,075	1,777

The attached notes are an integral part of the separate financial information.

Information pertaining to Cash Flows for the year ended December 31

	2015	2014	2013
	NIS million	NIS million	NIS million
Cash flows from operating activities			
Profit for the year	1,721	2,111	1,771
Adjustments:			
Amortization and depreciation	725	688	683
Share in earnings of investees, net	(397)	(1,009)*	(626)*
Financing expenses - net	323	432*	493*
Capital gain, net	(233)	(175)	(161)
Income tax expenses	492	478	410
Sundries	(19)	3	22
Change in trade and other receivables	53	59	31
Change in trade and other payables	(75)	85	40
Change in provisions	12	(62)	(29)
Change in employee benefits	104	3	3
Net cash (used in) from operating activities due to transactions with subsidiaries	2	5	(35)
Net income tax paid	(350)	(359)	(328)
Net cash from operating activities	2,358	2,259	2,274
Cash flows from investing activities			
Investment in intangible assets	(71)	(82)	(86)
Proceeds from the sale of property, plant and equipment	146	221	304
Acquisition of financial assets held for trading and others	(1,535)	(2,654)	(1,486)
Proceeds from the sale of financial assets held for trading and others	3,065	1,617	1,441
Acquisition of property, plant and equipment	(778)	(740)	(703)
Sundries	(7)	(14)	23
Net cash from the investment activities with subsidiaries	109	931	1,080
Net cash used for investing activities	929	(721)	573
Cash flow from finance activities			
Issue of debentures and receipt of loans	782	1,446	1,360
Repayment of debentures and loans	(1,349)	(920)	(928)
Dividend paid	(1,777)	(2,069)	(2,830)
Payment to Eurocom DBS for acquisition of DBS shares and loans	(680)	-	-
Interest paid	(384)	(421)	(433)
Sundries	3	3	-
Net cash (used in) from financing activities due to transactions with subsidiaries	(20)	434	-
Net cash from financing operations (used for financing operations)	(3,425)	(1,527)	(2,831)
Increase (decrease) in cash and cash equivalents	(138)	11	16
Cash and cash equivalents at January 1	248	237	221
Cash and cash equivalents at the end of the year	110	248	237

* Restated due to change in accounting policy, see Note 2.3

The attached notes are an integral part of the separate financial information.

Notes to the Separate Financial Information as at December 31, 2015

1. General

Below is a breakdown of financial information from the Group's consolidated financial statements as at December 31, 2015 ("the Consolidated Statements") published as part of the periodic reports, pertaining to the Company itself ("the Separate Financial Information"), presented pursuant to Regulation 9C ("the Regulation") and the Tenth Addendum to the Securities Regulations (Periodic and Immediate Reports), 1970 ("the Tenth Addendum") with respect to the separate financial information of the corporation.

The separate financial information should be read in conjunction with the Consolidated Statements.

In this Separate Financial Information -

The Company - Bezeq The Israel Telecommunication Corporation Limited

"Associate", "Investee", "Group", "Subsidiary", "Interested Party" - as these terms are defined in the Company's consolidated financial statements for 2015.

2. Significant Accounting Standards applied in the Separate Financial Information

The accounting policies specified in the Consolidated Statements were consistently applied by the Company for all the periods presented in this Separate Financial Information, including the method for classifying financial information in the consolidated statements, with the required changes from the aforesaid:

2.1. Presentation of the financial information

The information pertaining to the financial position, profit or loss, comprehensive income and cash flows include information included in the Consolidated Statements, which refer to the Company separately. The investment balances and results of the operations of investees are accounted using the equity method. Cash flows for ongoing activities, investment activities and financing for transactions with investees are presented separately, in net figures, under the relevant item based on the nature of the transaction.

2.2. Transactions between the Company and investees

2.2.1 Presentation

Intra-group balances and income and expenses arising from intra-group transactions, which were derecognized in the preparation of the Consolidated Statements, are presented separately from the balance for investees and the profit relating to investees, together with similar third party balances.

2.2.2 Measurement

Transactions carried out between the Company and its subsidiaries are measured in accordance with the recognition and measurement principles set out in the International Financial Reporting Standards ("IFRS"). These principles outline the accounting treatment for third party transactions.

2.3. Changes in accounting policy

As a result of completion of the transaction to acquire Eurocom DBS entire holdings in DBS shares and shareholders loans on June 24, 2015, as set out in Note 11.2 to the Consolidated Statements, the Company changed its accounting policies with regard to presenting financing revenues for shareholders' loans given to DBS.

Prior to acquisition of the entire holdings of DBS shares and shareholders' loans, the Company presented the financing revenue from the shareholders' loans under the financing income item in the statement of income and the Company's share for DBS financing expenses was presented under the item, "share in profits (loss) of investees". As a result of the acquisition of

100% of the rights in DBS and in view of the Company's position than it is not expected to collect such financing income, the Company came to the conclusion that the financing revenues for shareholders loans to DBS less DBS profits (losses) should be presented in the Statements of Income included under the Separate Financial Information.

The change in accounting policy was applied retrospectively. Breakdown of the effect of retrospective application on the relevant items in the statement of profit or loss:

For the year ended December 31, 2014 (audited)			
	As previously reported	Effect of retrospective application	As reported in these financial statements
	NIS million	NIS million	NIS million
Financing expenses	472	-	472
Financing revenues	(285)	213	(72)
Financing expenses - net	187	213	400
Share in earnings of investees, net	796	213	1,009
For the year ended December 31, 2013 (audited)			
	As previously reported	Effect of retrospective application	As reported in these financial statements
	NIS million	NIS million	NIS million
Financing expenses	534	-	534
Financing revenues	(317)	226	(91)
Financing expenses - net	217	226	443
Share in earnings of investees, net	400	226	626

3. Financial Instruments

3.1. Investments, including derivatives

	December 31, 2015	December 31, 2014
	NIS million	NIS million
Deposits in a bank	506	710
Exchange Traded Notes (ETN)	139	1,465
Derivatives	3	-
	648	2,175

Investments in ETNs and monetary reserves are investments held for trade and are presented at fair value as at the date of the financial statements. ETNs were exercised in January 2016, the deposits will mature by April 2016.

The balance for noncurrent investments includes a bank deposit for providing loans to the Company's employees for which the maturity date is yet to be set and a deposit related to hedging transactions.

3.2. Trade and other receivables

	Exercise Dates	Unlinked	Israeli CPI linked	Total
		NIS million	NIS million	NIS million
December 31, 2015				
Current assets				
Trade receivables	2016	668	-	668
Other receivables	2016	22	97	119
Total current assets		690	97	787
Non-current assets				
Trade and other receivables	2017-2018	15	165	180
December 31, 2014				
Current assets				
Trade receivables	2015	720	-	720
Other receivables	2015	38	95	133
Total current assets		758	95	853
Non-current assets				
Trade and other receivables	2016-2017	16	35	51

3.3. Trade and other payables, including derivatives

	Unlinked (including non- financial items)	Israeli CPI linked	In foreign currency or linked thereto (primarily USD)	Total
	NIS million	NIS million	NIS million	NIS million
December 31, 2015				
Trade payables	118	-	6	124
Other payables, including derivatives	466	46	-	512
	584	46	6	636
December 31, 2014				
Trade payables	142	-	25	167
Other payables, including derivatives	497	56	-	553
	639	56	25	720

3.4. Debentures and loans

3.4.1 Composition:

	December 31, 2015	December 31, 2014
	NIS million	NIS million
Current liabilities		
Current maturities of debentures (1)	965	973
Current maturities of bank loans	695	597
	1,660	1,570
Non-current liabilities		
Debentures (2)	5,420	5,633
Bank loans	2,459	3,154
	7,879	8,787
	9,539	10,357

(1) Of which NIS 180 million (NIS 183 million in 2014) are for current maturities of debentures held by Bezeq Zahav (Holdings) Ltd. ("Bezeq Zahav") as described in Note 10.2 below.

(2) In 2014 an amount of NIS 182 million of which are for debentures held by Bezeq Zahav, as described in Note 10.2 below.

3.4.2 Terms and debt repayment schedule

	December 31, 2015		December 31, 2014	
	Balance		Balance	
	Carrying amount	Nominal value	Carrying amount	Nominal value
	NIS million	NIS million	NIS million	NIS million
Total unlinked loans at variable interest	1,331	1,331	1,656	1,656
Total unlinked loans at fixed interest	1,823	1,823	2,095	2,095
Total loans	3,154	3,154	3,751	3,751
Debentures issued to the public				
CPI-linked debentures at fixed interest - Series 5	490	398	978	796
Debenture Series 6-10	5,495	5,282	5,228	4,937
Total debentures issued to the public	5,985	5,680	6,206	5,733
Debentures issued to financial institutes:				
Unlinked debentures at fixed interest	400	400	400	400
Total debentures issued to financial institutions	400	400	400	400
Total debentures	6,385	6,080	6,606	6,133
Total interest-bearing liabilities	9,539	9,234	10,357	9,884

For further information see Note 12 to the Consolidated Statements - Debentures, Loans and Borrowings, and Note 10.2.1 below.

3.5. Liquidity risk

Below are contractual maturity dates of financial liabilities, including estimated interest payments (based on known CPI and interest rates at December 31, 2015):

	December 31, 2015						
	Carrying amount	Contractual cash flows	First half of 2016	Second half of 2016	2017	2018-2020	2021 and thereafter
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Non-derivative financial liabilities							
Trade and other payables	561	561	561	-	-	-	-
Loan from an Subsidiary	434	449	449	-	-	-	-
Loans	3,154	3,457	75	715	908	1,528	231
Debentures	6,385	7,158	1,030	97	724	2,892	2,415
Liability to Eurocom DBS	233	233	233	-	-	-	-
Financial liabilities - derivatives							
Forward contracts (on the consumer price index)	168	168	22	-	-	114	32
	10,935	12,026	2,370	812	1,632	4,534	2,678

3.6. Currency and CPI risks

For information regarding CPI hedging transactions that the Company carried out during 2015, see Note 29.6.1 to the Consolidated Statements. These transactions were recognized in the financial statements as cash flow hedges.

4. Income tax expenses

4.1. General

	Year ended December 31		
	2015	2014	2013
	NIS million	NIS million	NIS million
Current tax expense	454	412	347
Deferred tax expense	38	66	63
Income tax expenses	492	478	410

4.2. Changes in recognized deferred tax assets and tax liabilities during the year

Composition of and changes in deferred tax assets and tax liabilities during the year:

	Balance at January 01, 2014	Total recognized in profit or loss	Recognized in equity	Balance at December 31, 2014	Total recognized in profit or loss	Recognized in equity	Balance at December 31, 2015
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Employee benefit plan	199	(13)	-	186	(1)	1	186
Property, plant and equipment	(200)	(39)	-	(239)	(16)	-	(255)
Provisions and others	51	(14)	15	52	(21)	5	36
	50	(66)	15	(1)	(38)	6	(33)

5. Property, plant and equipment

	2015	2014
	NIS million	NIS million
Costs		
Balance as at January 1	15,950	15,477
Additions	766	755
Disposals	(501)	(282)
Balance at December 31,	16,215	15,950
Depreciation		
Balance as at January 1	11,330	11,051
Depreciation for the year	613	569
Disposals	(481)	(290)
Balance at December 31,	11,462	11,330
Amortized cost as at December 31	4,753	4,620

For further information see Note 8 to the Consolidated Statements - Property, Plant and Equipment

6. Revenues

	Year ended December 31		
	2015	2014	2013
	NIS million	NIS million	NIS million
Fixed-line telephony	1,586	1,668	1,971
Internet - infrastructure	1,542	1,394	1,287
Transmission and data communication	1,058	1,022	990
Other services	221	233	230
	4,407	4,317	4,478

7. Operating and general expenses

	Year ended December 31		
	2015	2014	2013
	NIS million	NIS million	NIS million
Maintenance of buildings and sites	202	217	233
Marketing and general expenses	188	213	212
Interconnectivity and payments to communications operators	145	161	220
Services and maintenance by sub-contractors	60	61	64
Vehicle maintenance	78	76	76
Terminal equipment and materials	48	49	90
	721	777	895

8. Other operating expenses (income), net

	Year ended December 31		
	2015	2014	2013
	NIS million	NIS million	NIS million
Profit from disposal of property plant and equipment (mainly real estate property)	(233)	(175)	(169)
Provision for voluntary redundancy severance payments	117	176	90
Others	17	(24)	1
Other operating expenses (income), net	(99)	(23)	(78)

9. Investees

9.1 For further information regarding the issue of increasing control and completion of the acquisition transaction for Eurocom DBS's entire holdings in DBS shares and shareholders' loans in 2015, see Note 11.2 to the Consolidated Statements.

9.2 Investees held directly by the Company:

	Company's interest in equity at		Investment in investees (equity-accounted) at	
	December 31, 2015	December 31, 2014	December 31, 2015	December 31, 2014
			NIS million	NIS million
Pelephone Communications Ltd.	100%	100%	3,775	3,864
Bezeq International Ltd.	100%	100%	827	824
Bezeq Online Ltd.	100%	100%	6	9
Walla! Communications Ltd.	100%	100%	587	596
DBS Satellite Services (1998) Ltd. - see Note 11.2 to the Consolidated Statements regarding business combinations in 2015	100%	49.78%	2,022	-
Bezeq Zahav (Holdings) Ltd.	100%	100%	-	-
StageOne Venture Capital Fund	-	71.8%	-	6
			7,217	5,299

The Company's investees have investments in other investees which are not material. For details of the loans provided to investees, see Note 10.2

10. Substantial Agreements and Transactions with Investees

10.1. Financial Guarantees

- 10.1.1 The Company provided a guarantee in favor of banks for credit to Bezeq International of up to NIS 65 million if it will be granted.
- 10.1.2 The Company provided a bank guarantee for DBS, which DBS had provided in favor of the State of Israel, in accordance with the terms of DBS's license. At December 31, 2015, the balance of the Company's share in the guarantee amounts to approximately NIS 20 million (linked to the CPI). With the acquisition of the entire holdings in DBS, this guarantee is expected to increase by a further approximately NIS 20 million.
- 10.1.3 For further information regarding guarantees provided by the Company for compliance with DBS's liabilities to pay the entire balance of its debts to holders of DBS debentures Series B, see Note 12.4.2 to the Consolidated Statements.
- 10.1.4 For information pertaining to guarantees provided by the Company to various entities, see Note 18 to the Consolidated Statements - Securities, Liens and Guarantees.

10.2. Loans

Loans from investees

- 10.2.1 In 2004, Bezeq Zahav acquired debentures Series 5 issued by the Company. The par value balance held by Bezeq Zahav at December 31, 2015 amounted to NIS 147 million. These debentures are repayable in six equal annual installments in each of the years 2011 through 2016. The interest rate set for these debentures is 5.3% per annum. The purchase was made through a loan from the Company which is at the same terms as those of the debentures.
- 10.2.2 In May 2014 the Company received a loan from Walla in the amount of NIS 434 million. The loan bears annual interest of 4.07% and is repayable in May 2016.

Loans to investees

Breakdown of balances of loans provided to investees:

	December 31, 2015	December 31, 2014
	NIS million	NIS million
Short-term loans and current maturities		
Bezeq Zahav	180	183
Bezeq International	108	78
	288	261
Non-current liabilities		
Bezeq Zahav	-	182
Bezeq International	16	64
Bezeq On Line	35	26
DBS	323	-
	374	272
	662	533

Description of the terms of the loans provided to investees (as presented in the Statement of Financial Position):

Balance				
	In NIS millions	Maturity Dates	Number of installments	Interest rate spread
Bezeq Zahav (*)	180	2011-2016	6	5.3%
Bezeq International				
	32	2012-2016	5	5.1%
	32	2013-2017	5	4.68%-4.7%
	60	2016	1	3.05%
Bezeq On Line				
	35	2018-2023	6	4.31%-4.86%
DBS				
	323	2018-2022	5	3.6%
	662			

(*) Loan linked to CPI For further information regarding the loan that the Company provided to Bezeq Zahav with respect to debentures Series 5, see section 10.2.1 above.

10.3. Service provision agreements

As the Company and its investees are communications providers, they are engaged in agreements and arrangements for providing and receiving various services in the communications sector, such as:

transmission agreements, interconnectivity arrangements, billing agreements, various agreements regulating the communications services jointly provided by two companies, rental agreements (primarily for communications installations), collaboration agreements and publication of antenna sites of investees, management service agreements, etc.

The terms of the foregoing service agreements were set according to generally accepted tariffs for this type of service.

Breakdown of the volume of transactions and carrying balances:

Year ended December 31			
	2015	2014	2013
	NIS million	NIS million	NIS million
Transactions			
Revenues			
Pelephone	139	130	155
Bezeq International	155	134	118
DBS	4	4	4
Others	3	3	3
Total	301	271	280
Expenses			
Pelephone	39	46	56
Bezeq International	30	32	19
DBS	-	1	1
Others	3	3	2
Total	72	82	78

December 31		December 31
2015		2014
NIS million		NIS million
Balances (liabilities) due to the Company		
Pelephone	19	19
Bezeq International	24	15
DBS	1	2
Total	44	36

For further information, see Note 28 to the Consolidated Statements - Transactions with Interested and Related Parties

10.4. Dividends

Breakdown of dividends received from investees:

Year ended December 31			
	2015	2014	2013
	NIS million	NIS million	NIS million
Pelephone Communications Ltd.	243	419	601
Bezeq International Ltd.	170	159	165
StageOne Venture Capital Fund	1	2	6
	414	580	772

For information regarding dividends subsequent to balance sheet date, see Note 12 to the below.

11. 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 approximately NIS 60 million, where provisions are required to cover the exposure arising from such litigation.

In the Company's opinion, the additional exposure (exceeding the foregoing provisions), as of December 31, 2015 due to legal claims filed against the Company on various matters, which are unlikely to be realized, amounts to a total of approximately NIS 3 billion. This amount includes exposure of NIS 2 billion for a claim by shareholders against the Company and officers of the Company which the plaintiff estimates to be approximately NIS 1.1 billion or approximately NIS 2 billion (based on the method to be fixed of calculating the damages) Furthermore, the amount of the exposure includes an amount of NIS 372 million 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, the Company has further exposure in the amount of NIS 877 million for claims, the success of which cannot be assessed at this stage. 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.

Subsequent to the reporting date, lawsuits were filed in a total amount of approximately NIS 68 million, the success of which cannot yet be assessed at this stage.

For further information concerning contingent liabilities see Note 16 to the Consolidated Statements.

12. Subsequent events

1. On March 2, 2016 the board of directors of Pelephone resolved to distribute a dividend to the Company in the amount of NIS 66 million in May 2016.
2. On February 29, 2016 the board of directors of Bezeq International resolved to distribute a dividend to the Company in the amount of NIS 83 million in May 2016.
3. On February 25, 2016 the board of directors of Walla resolved to distribute a dividend to the Company in the amount of NIS 434 million in May 2016.
4. On February 10, 2016 the Company provided Bezeq International a loan in the amount of NIS 125 million to be repaid in three equal annual installments from February 2017. This loan bears annual interest of 3.05%.

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

PPA upon Assuming Control of D.B.S. Satellite Services (1998) Ltd. (Yes), as at March 23, 2015

March 2016

The information contained in this report constitutes a convenience translation only. 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.

Definitions and terms

Term	Description
The Company or Yes	D.B.S. Satellite Services (1998) Ltd.
Bezeq	Bezeq Israel Communications Corp.
Eurocom	Eurocom D.B.S. Ltd.
HOT	HOT Communications Systems Ltd.
Cellcom	Cellcom Israel Ltd.
Partner	Partner Communications Ltd.
Spacecom	Spacecom Communications Ltd.
DTT or Idan+	A terrestrial radio transmission distribution system known as Digital Terrestrial Television (DTT) or Idan+, operated by the Second Authority for Television and Radio, through which various channels are distributed to the public free of charge.
Financial Statements	The Company's audited financial statements of 2013 and 2014, and the unaudited financial statements of 1Q15.
CBS	The Central Bureau of Statistics
OTT	Over the Top - A technology that employs public internet infrastructures in order to provide TV and video services by demand
VOD	Video on Demand - An interactive service offered by Yes, which confers access to such contents as movies, series, TV shows, original productions and children's contents by means of advanced set-top boxes Using this service, users can view TV contents by way of personal order. This service requires a 2.5MB wireless internet connection.
YesMax Total	A recording Yes set-top box that provides HD quality video, VOD services, YesStreamer services (that allow users to view contents streamed from their personal computers on their TV screens) and YesMultiroom services.
YesMax	A recording Yes set-top box

Definitions and terms

Term	Description
YesHD	A non-recording Yes set-top box that provides HD-quality video capabilities
YesMultiroom	A Yes service that allows users to view recorded contents using their home network
YesGO	In 2014, the Company launched an application by the name of YesGO that allows subscribers to view contents through a variety of end-user devices (smartphones, tablets and computers) in some of the channels broadcast by the Company, which the subscriber has purchased as part of the TV broadcast contents viewed at his home, as well as VOD contents.
PPV	Pay Per View - The Company's video channels in which pay per view is enabled.
PVR	Personal Video Recorder decoders used for the Company's recording set-top boxes, and which provide an interface to the Company's electronic broadcasting schedule, so as to enable services such as ordering recordings in advance, recording TV series, and pausing live broadcasts
HD ZAPPER	Decoders that allows users to receive HD-quality TV broadcasts for non-recording YesHD set-top boxes, which include an optional paid VOD service.
HD PVR	Decoders used for HD-quality recording set-top boxes, namely, YesMax Total units.
ARPU	Average Revenue Per User - A measurement of average revenue per subscriber/client
Related Parties	as defined in IAS 24 - Related Party Disclosures
EBITDA	Operating profit before financing, taxes plus depreciation and amortization

Table of Contents

CHAPTER	PAGE
1. General	5
2. Cost of the business combination calculation	13
3. Company overview	17
4. Industry outlook and principal risk factors	24
5. Financial statements analysis	34
6. Methodology	42
7. Tangible assets and liabilities	47
8. Intangible assets	51
9. Appendices	61

1. General

General

Purpose of Valuation

We were asked by Bezeq's management ("the Client") to provide our opinion as regards the proper accounting treatment of the allocation of the excess costs which may arise as upon the exercise of the warrants into an additional 8.6% of Yes's shares, and the holding of 58.38% of Yes's share capital, as well as the acquisition of the remaining shares and shareholder's loans of Yes, so that after the acquisition, Bezeq will hold 100% of Yes's share capital and shareholder's debt ("the Work"). The Work carried out is current for March 23, 2015 ("the Business Combination Date").

The engagement for the performance of the Work was entered into in July 2015.

This Work replaces our previous Work prepared and published in August 2015.

About Yes

Yes was founded in 1998, and commenced its first broadcasts in July 2000. Yes is the only Israeli company that provides multi-channel TV services to subscribers using satellite communications. Yes is also the first Israeli company that provided digital broadcasts and interactive TV services.

Since its founding, the Company accumulated approx. 630,000 clients, which comprise 42% of the Israeli multi-channel TV market. The Company has approximately 2,300 employees.

Structure of Transaction

Until March 23, 2015, Bezeq held 49.78% of Yes shares (not including warrants exercisable into approximately 8.6% additional Yes shares). The remaining shares are held by Eurocom, a company controlled by Mr. Shaul Elovitch. These shares were held via a trustee, so as to meet the Antitrust Authority's requirement of not actively holding Yes shares concurrently with the control over Bezeq.

In view of the Antitrust Commissioner's position, and the Supreme Court's decision in 2009 not to approve the merger of Bezeq and Yes, Bezeq was prevented from increasing its Yes holdings or from controlling Yes, in a manner that restricts the group's ability to benefit from all of the advantages that would have stemmed from full group operations.

On March 26, 2014, the Antitrust Commissioner approved the merger between Yes and Bezeq. As a result, Bezeq may immediately exercise its option to purchase 8.6% of Yes's shares and to become the Company's controlling shareholder.

On March 23, 2015, Bezeq's general meeting of shareholders approved the acceptance of the terms of the merger and the exercise of the option, as well as Bezeq's engagement in the purchase transaction, as provided above, in accordance with Section 275(A)(3) of the Companies Law, 1999.

Pursuant to this, Bezeq and Yes announced the acceptance of the terms of the merger, and on March 25, 2015, Bezeq exercised the option to allot shares in Yes, at a rate of 8.6% of Yes's issued share capital, so that, as of that date, the percentage of the Company's holdings in Yes amounts to approximately 58.4%.

On February 10, 2015, the Subcommittee, the Audit Committee and Bezeq's Board of Directors approved Bezeq's entry into a transaction with Eurocom, under which Bezeq is to purchase all of Eurocom's holdings in Yes, which, until that date, comprised 50.22% of Yes's issued share capital (41.62% in full dilution), as well as all of the shareholder's loans granted by Eurocom to Yes.

General (Cont'd)

Under the terms of the purchase transaction, Bezeq will pay Eurocom, upon completion, in exchange for the purchase of the shares and shareholder's loans, a total of NIS 680 million, in cash. In addition, Eurocom will be entitled to two additional conditional considerations, as follows:

1. An additional consideration of up to NIS 200 million will be paid according to the tax synergy; and
2. An additional consideration of up to NIS 170 million will be paid according to Yes's business results in the next three years.

Accounting Principles

For the purpose of preparing this work, we made use, *inter alia* of the following accounting standards:

- A. International Financial Reporting Standard 3 - Business Combinations.
- B. International Accounting Standard (IAS) 32 - Financial Instruments: Presentation.
- C. International Accounting Standard (IAS) 39 - Financial Instruments: Recognition and Measurement.
- D. International Accounting Standard (IAS) 38 - Intangible Assets.
- E. International Accounting Standard (IAS) 12 - Income Taxes
- F. International Financial Reporting Standard 13 - Fair Value Measurement
- G. AICPA Practice Aid series: "Assets Acquired in a Business Combination to Be Used in Research and Development Activities: A Focus on Software, Electronic Devices, and Pharmaceutical Industries".

Information Sources

In preparing our Work, we relied, *inter alia*, on the following data:

Data received from the Client:

- The Company's 2015 budget.
- The financial statements presentation of 1Q15.
- The Company's draft financial statements of March 31, 2015.
- The Company's detailed financial forecast for 2015-2018, under the assumption that the Company will continue to operate at the Stand Alone level (namely, without taking into account the synergies between Bezeq and Yes that will stem from the merger).
- A presentation for investors, which describes Yes' business operations.
- Temporary allocation work of the PPA, prepared by us for the purposes of the pro forma report of September 30, 2014.
- Temporary allocation work of the PPA, prepared by us for March 23, 2015.
- Reports on signs of impairment in Yes in Bezeq's books of March 10, 2013 and March 4, 2014, which were prepared by Itzhak Suari Ltd.
- Report on excess cost recognized by Bezeq for Yes of March 2013, which was prepared by Itzhak Suari Ltd.
- Data presented by the Company in the virtual data room.
- Report on excess cost recognized by Bezeq for Yes of March 2013, which was prepared by Itzhak Suari Ltd.

General (Cont'd)

- The Company's management's assessment of the expected loss balance for tax purposes as at December 31, 2014.
- Additional information obtained by us from public sources, including the company's public reports, rating reports and other public information.
- Additional information obtained at meetings and through conversations and emails from the Company's management.

Publicly-available Data:

- The Company's audited financial statements and those of Bezeq of December 31, 2014, December 31, 2013 and December 31, 2012.
- Fairness opinion of February 10, 2015, which was prepared by Prof. Amir Barnea.
- Yes' valuation of February 10, 2015, which was prepared by Merrill Lynch International.
- Financial and other data of public companies that hold operations that are similar to those assessed.
- Complementary data obtained by us from public sources.

Business Combination Date

In accordance with International Financial Reporting Standard 3R (IFRS3R) IFRS, all business combinations are to be accounted for using the Acquisition Method, according to which the buyer recognizes the assets acquired and the liabilities and contingent liabilities assumed (including those that were previously not recognized by the acquired entity) at their fair value as at the date of the acquisition.

Section 8 of the Standard stipulates that the acquisition date is the date on which the buyer actually receives control over the acquired entity. Control means the power to determine the financial and operating policy of an entity or business so as to produce benefits from its operations.

It was disclosed to us that the Business Combination Date that pertains to the purposes of this Work is March 23, 2015 ("the Business Combination Date").

It should be noted that, due to the fact that the amount of time between Business Combination Date and March 31, 2015 is insignificant, the PPA was effected according to balance sheet balances and profit and loss data as at March 31, 2015.

Summary of Work Results

A summary of the PPA Results as calculated in this Work, is presented in the following table:

	Carrying amount	Fair value	Deferred tax	Fair value after tax		
	Mar 31, 2015	Mar 31, 2015	Mar 31, 2015	Mar 31, 2015		
Fair value estimate of Bezeq's share in Yes's share capital and shareholder loans				1,076		
Plus the cash consideration to be paid to Eurocom for its share in the investment in Yes				680		
Plus the fair value of the first additional consideration mechanism (in accordance with Appendix B of the agreement) - losses				200		
Plus the fair value of the second additional consideration mechanism (in accordance with Appendix C of the agreement) – future performance				17		
Cost of business combination				1,973		
Attribution of excess cost to assets and liabilities						
Assets:						
Cash	299	299		299		
Trade receivables	173	173		173		
Other receivables	9	9		9		
Fixed assets, net	801	801		801		
Intangible assets (cost of subscriber acquisition, software programs and licenses)	148	148		148		
Broadcasting rights net of rights exercised	449	449		449		
Deferred tax asset for tax losses			1,427	1,427		
Total tangible assets	1,879	1,879	1,427	3,306		
Liabilities:						
Credit line from banks	79	79		79		
Trade payables and service providers	450	450		450		
Other payables (neutralization of interest payable – debentures)	120	120		120		
Provisions	9	19	(3)	17		
Debentures including interest payable and current maturities	1,748	1,908	(42)	1,866		
Trade payables and other long-term liabilities	16	16		16		
Employee benefits	5	5		5		
Total tangible liabilities	2,428	2,598	(45)	2,553		
Excess tangible liabilities over tangible assets	(550)	(719)	1,472	753		
Attribution of excess cost to additional identified intangible assets:					Useful Life	Amortization Method
Brand		347	(92)	255	12 years	Linear over the useful life determined
Customer relationships		790	(209)	580	7 years	Years 1-2: 20%; Years 3-4: 15%; Years 5-7: 10%
Total intangible assets		1,137	(301)	835		
Goodwill (residual value)				385		

Value of goodwill is derived from the difference between the cost of the business combination and the fair value of the tangible assets, the intangible assets and the liabilities in the acquired company. The value of goodwill is subject to changes due to deferred taxes attributed to the intangible assets. The value of goodwill, as it appears in this Work, is a residual value, and therefore we do not express our opinion about its specific value.

Fair Value - Accounting Principles

Following is a review of principal accounting aspects that concern the “market participant” issue, in accordance with International Financial Reporting Standard 13 - Fair Value Measurement (IFRS 13) (“the Standard”).

- The Standard defines the term “Fair Value” as the exit price, namely, the price which would have been received upon the sale of an asset or the price which would have been paid for the transfer of a liability in an arms’ length transaction upon the date of measurement. As provided in Section 2 of the Standard, a Fair Value measurement must be **objective**, under market conditions, and **not** a subjective measurement.
- Under Section 23 of the Standard, an entity doesn’t need to identify specific market participants. The entity shall identify characteristics that generally distinguish market participants, while taking into account specific factors that pertain to the item being assessed and the principal market (as well as all market participants with which the entity will enter into a transaction in that market).
- Under the Standard, a market participant must possess the suitable knowledge in the line of business in which the company operates. At present, Yes’s principal operation is the provision of multi-channel TV services to subscribers using satellite communications. However, according to information disclosed to us, in the absence of Bezeq’s direct holding in Yes, Yes might have engaged in other communications-related lines of business, including the provision of landline telephone services, internet services, etc. Therefore, it appears that the relevant line of business in this case is **the communications line of business in its entirety, including TV contents**.
- Under the Standard, a fair value measurement is not a company-specific value, and the fair value is not specific to one of those “market participants” who would be willing, for example, to pay a price that is higher than that which the other market participants would be willing to pay based on a risk assessment and/or the existence of specific synergies from its particular standpoint.

Our sources clearly indicate that a market participant is not necessarily the entity which might optimally exploit the synergies and the capacity to use the item whose fair value is being examined.
- Moreover, the de facto existence / non-existence of the willingness or capacity to sell at the time of the measurement irrelevant, and Yes’s fair value measurement from the standpoint of a market participant must be carried out at its fair value, even if Bezeq, as previously stated, had not been willing to effect a transaction for the sale or acquisition of the holdings in Yes under these or other terms.
- **In light of the above, it appears that in the case of Yes, the definition of market participant can be extended to include local or global market players, which possess interest in the communications industry, and which possess the means needed to carry out an investment in Yes. Therefore, the fair value of Yes set-top box and the purchase price allocation to the assets and liabilities of the company is examined in this Work from the standpoint of a market participant that is not necessarily Bezeq, namely, in disregard of the specific synergies attributed to the merger between Bezeq and Yes, but in view of existing synergies when considering, as a whole, any market participant who is an unrelated/independent party to the transaction.**

Limiting conditions

This Work constitutes as a recommendation for a purchase price allocation in accordance with International Financial Reporting Standard 3R (IFRS3R). This Work is not necessarily an indication for the intrinsic value of Bezeq's investment in Yes, and, in particular, does not take into account the specific synergies (such as the utilization of losses for tax purposes, reduced costs, etc.) which can be attributed to a potential full merger between Bezeq and Yes.

This Work is intended for Bezeq's management, and we shall not be obligated towards any third party without first approving, in writing, that third party's reliance on the findings of this Work. This Work or any part, abstract or summary thereof, must not be made public through public (or private) media channels without our advance and written consent. However, subject to the consent of the Company and Bezeq, we do not object to this Work's addition to Bezeq's financial statements and/or immediate reports.

This Work is based, inter alia, on data, projections and estimates received from Bezeq's management. The responsibility with regard to the reliability of the information, data representations, assessments and various explanations provided to us is assumed by the providers of said information, and we cannot confirm the veracity, completeness and fairness of these data. It should be stressed that this Work does not include due diligence, and it excludes any examination and verification of the aforementioned data. Therefore, our Work shall not be regarded as confirming and shall not serve to verify the veracity, completeness and accuracy of the data provided to us.

Under no circumstances will we be held liable for any loss, damage, cost or expense incurred in any way or fashion as a result of acts of fraud, misrepresentations, deception, the disclosure of erroneous information or the prevention of the disclosure of information to us.

It is possible that we have obtained certain historical financial data which we used in the course of preparing this Work, using unaudited financial data as they appeared in a virtual data room, which is under the company's management's responsibility. We did not independently examine the veracity or completeness of the data on which we relied (including their comparison with data appearing in the Company's audited financial statements), and we do not express any opinion or make any promise of any kind as regards the data used by us or the Company's financial statements.

It is our understanding that our findings will be used to assist Bezeq in determining the cost of the business combination and the purchase price allocation to the tangible and intangible assets and liabilities acquired, for the purposes of financial reporting in accordance with IFRS 3R. This Work is solely intended to meet the information and usage purposes of Bezeq's management and of its independent auditors. It must not be used, distributed, quoted from or referred to in any way whatsoever for any other purpose, including, without limitation, for the registration, acquisition or sale of securities. This Work must not be submitted or referred to, in whole or in part, in a registration report or in any other document. However, we agree that the assumptions and results of this Work shall be included and/or cited in reports filed with the Securities Authority.

This Work does not constitute as legal advice or opinion. The interpretation of the various documents examined by us was carried out strictly for the purpose of this financial opinion. The information appearing in our Work does not presume to include all of the information which a potential investor may require, and it is not intended to assess the company's value for another investor, given that different investors may have different objectives and considerations in mind, as well as other examination methods based on other assumptions. Accordingly, the estimated financial value on the basis of which various entities may engage in financial actions may be different.

Limiting conditions (Cont'd)

Moreover, changes in market conditions may also result in valuations that are essentially different from the ones specified on the date of the valuation. We do not assume any responsibility whatsoever for changes in market conditions that occur following the date of the valuation and we are not obligated to update our Work, analysis, conclusions or other documents that pertain to our services following the date of the valuation, for any reason whatsoever.

In this Work we also address forward-looking information disclosed to us by the Company's management. Forward-looking information included in this Work reflects our assessment regarding various parameters and based on the information available to us. If these assessments fail to materialize, actual outcomes may significantly differ from those we have assessed.

The assessments of data relating to cash flows included in this document are strictly intended for obtaining an indication of fair value, and are not meant to be used as forecasts or projections of future performance. Moreover, given that events and circumstances often do not occur as expected, normally there are differences between the assessment of results and actual results, and these differences may be substantial.

It is agreed that you and others for which the services under the agreement (including between any third parties) will be provided are not entitled to receive from us, whether under this contract or by way of claims for damages, by law or otherwise, any compensation for cumulative loss and damages in an amount that exceeds twice the fees paid for the services that directly resulted in the damage or loss in connection with claims that arise from this agreement or that are related in any other fashion to the provision of the services.

It is agreed that you may not file any claim or institute any legal proceedings in connection with the services or otherwise under this agreement against our owners of managers, directors, managers or employees, except in cases where an act was maliciously or committed or an act of fraud was committed by any of the above.

It is agreed that this Work is intended for you only, and that we shall not be obligated towards any third party unless we first approved, in writing, that third party's reliance on the written report.

It is hereby stressed that the conclusions of our work, should they be relayed to the client in the course of relaying the information, strictly constitute as the expression of an opinion, and that any decision in connection with the services provided, whether it included the assumptions and conclusions of our present Work or otherwise, shall be made by the client alone, and the client shall be held solely responsible therefor.

Given the fact that the calculation were made using electronic spreadsheets, some rounding differences may be found.

We wish to mention that we have no personal interest in or dependence on the shares of Bezeq and/or of Yes.

For the purposes of this Work, we assumed that the data disclosed to us were accurate, complete and fair, and nothing was ever brought to our attention that may indicate the improbability of the data we used. If any other information comes to light, our recommendations will change accordingly. Therefore, we reserve the right to update our Work in light of new data which were not presented to us prior to the provisions of the Work's recommendations.

The reader must examine all of the assumptions made in the course of the Work.

Fahn Kanne Consulting Ltd.

March 8, 2016

2. Cost of the business combination calculation

Calculating the cost of the business combination

General

The cost of the business combination was calculated according to the results of the valuation of Yes's shares and shareholder's loans.

Summary of the Estimated Cost of the Business Combination

Following is a summary of the total cost of the business combination, as calculated by us in the course of the valuation:

NIS millions	Fair value after tax
Estimated Fair value of Bezeq's share in Yes's share capital and shareholder loans	1,076
Plus the cash consideration to be paid to Eurocom for its share in the investment in Yes	680
Value of contingent consideration for tax losses	200
Value of contingent consideration for performance	17
Cost of business combination	1,973

Estimated Fair value of Bezeq's share in Yes's share capital and shareholder's loans

We were asked to allocate, for accounting purposes, the value of Bezeq's investment in Yes, in its entirety, to the various types of investment vehicles - the various types of shareholder's loans, the share capital and options, and this allocation was carried out based on the order of precedence of the shareholder's loans' repayment, as determined in the arrangement between the shareholders and the company of December 30, 2002, in which it was decided that the loans granted by some of the shareholders to the company as of July 10, 2002, shall take precedence over the old shareholder's loans.

Following is a summary of the calculation of the value of Bezeq's share in Yes:

Value of share capital and shareholder loans NIS millions	Total	Bezeq's share	Value of Bezeq's share	Value of Eurocom's share
Value of new shareholder loans (11%)	1,013	88.0%	892	122
Value of new shareholder loans (5.5%)	246	75.2%	185	61
Value of share capital + owner's debt	1,259		1,076	183
As a % of the overall value	100%		86%	14%

In order to allocate the value, and according to the order of precedence of the shareholder's loans' repayment, the full value of the share capital and owner's debt was allocated only to the owners of the new loans, and based on the scope of the investment made by the shareholders by and after April 27, 2003. After attributing the full total value to two types of the new shareholder's loans, the total value attributed in each of the two new shareholder's loans between Bezeq and Eurocom Group was allocated based on the ratio of their investments.

It should be noted that the allocation of the full value strictly to the new shareholder's loans was carried out because, according to the operation's projected cash flow, the repayment of the full balances of the new shareholder's loans is not expected.

Calculating the cost of the business combination (Cont'd)

The cash consideration to be paid to Eurocom for its share of the investment in Yes

Under Section 6.1 of the purchase agreement of February 11, 2015 between Eurocom and Bezeq, it was stipulated that, in exchange for the shareholder's loans and sold shares, Bezeq shall pay Eurocom a total of NIS 680 million, subject to the allocation of the acquired shareholder's loans, free of any encumbrance, to the buyer and the transfer of the sold shares, free of any encumbrance.

Estimated fair value of the mechanism of the first additional consideration - Losses for tax purposes

The calculation of the additional consideration component for the utilization of Yes's losses for tax purposes (a total of NIS 5.4 billion) was calculated based on the terms stipulated under the draft sale agreement (as provided in Appendix B of the agreement).

Under the agreement, the consideration paid for the losses shall be calculated according to the alternative of the merger between Bezeq and Yes (as defined in the agreement). However, if during the reconciliation period (10 years as of the beginning of 2015), no final decision is made with regard to this alternative, the first additional consideration shall be calculated based on the utilization of actual losses by Yes (as defined in the agreement). Given the fact that, according to the company's assessments, the merger between Bezeq and Yes is expected to take place, the value of the mechanism of the additional consideration for the losses was calculated based on the merger alternative.

Under the agreement, the merger alternative consideration shall be calculated for each "total loss" amount equal or higher than the lower threshold of NIS 3 billion, and up to the upper threshold of NIS 5.4 billion. Should it be determined in a final decision that the "total loss" amount is between the lower and upper thresholds, Bezeq will pay the seller the relative part of a maximum consideration of NIS 200 million, which is to be calculated on a pro rata basis (linearly) based on the part of the "total loss" recognized above the lower threshold relative to the difference between the upper and lower threshold (NIS 2.4 billion, "the Delta").

According to the assessment of Bezeq's management, the most likely scenario as of the date of the business combination is the payment of the full maximum consideration of NIS 200 million.

Calculating the cost of the business combination (Cont'd)

Estimated fair value of the mechanism of the second additional consideration - meeting cash flow targets

A consideration of up to NIS 170 million is conditional upon the Company's meeting free cash flow targets in 2015-2017, and shall be divided into two components (NIS 100 million and 70 million, as provided below).

The calculation of the value of the conditional consideration was made using a Monte Carlo simulation, by way of modeling the risk-adjusted stochastic behavior (risk neutral measure) of the underlying asset, namely, the projected cash flow. It should be noted that, in modeling the risk neutral measure of the cash flow, the drift parameter was defined as the risk-free interest rate added by the G parameter, which consists of the differences between the cash flow's projected growth and the yield needed for it.

Given that the conditional consideration calculation mechanism is derived from the value of the overall future cash flow in 2015-2017, it therefore follows that under any scenario included in the simulation the value of the cash flow was monitored in each of the aforementioned years, and a cumulative cash flow was calculated. Based on the cumulative cash flow generated in the 100,000 scenarios simulated, the conditional consideration which would have been received in each scenario was calculated.

The value of the conditional consideration until the date of the assessment was calculated based on the discounting of the expected value of the future conditional consideration at a risk-free interest rate.

Following is an account of the principal parameters used in constructing the model:

- **Expected value of projected cash flow:** a cash flow was assumed according to the valuation - NIS 185 million in 2015, NIS 257 million in 2016, and NIS 248 million in 2017.
- **Return of expected cash flow:** derived from the expected value of the assumed cash flow.
- **Fluctuation (standard deviation) of the cash flow's expected value:** the standard deviation of the change in the free cash flow was estimated at 38%, based on the historical standard deviation of the Yes' cash flow in the last 7 years.
- **Risk-free interest:** the risk-free interest rate was estimated on the basis of risk-free yield curves over a period of three years, as at March 31, 2015 - approx. 0.27% (source: RBT).
- **Number of scenarios:** the simulation included approx. 100,000 scenarios.

The value of the consideration obtained by the Monte Carlo simulation is NIS 17 million.

3. Company overview

About the Company

Principal Shareholders

- The Company's shares are held by Bezeq at a rate of 58.36%. The remaining shares are held by Eurocom, a company controlled by Mr. Shaul Elovitch. These shares are held via a trustee, so as to meet the Antitrust Authority's requirement of not actively holding Yes shares concurrently with the control over Bezeq.
- On March 26, 2014, the Antitrust Commissioner approved the merger between Yes and Bezeq.
- The principal owner investments in Yes were made over the years by way of shareholder's loans. The investments were affected by difficulties in obtaining bank financing, by the partial or absent participation of the other shareholders during the capital-raising phase, and by the regulatory restrictions on the augmentation of Bezeq's investment in Yes, which stemmed from the fear of its adversely affecting competition within the multi-channel television market.
- The regulatory restrictions were reflected in the restriction of Bezeq's holding percentage to no more than 50%, and, in part of that period, in restrictions on any cash investment that exceeds Bezeq's part of the shares. Bezeq appealed against these restrictions in various legal frameworks. On August 20, 2009, the Supreme Court ruled that the merger between Bezeq and Yes shall not be approved.
- In November 2001, the company's shareholders reached an agreement that stipulated the mechanism of the holdings' dilution, as not all of the shareholders invest in the company according to the original holding percentages. In 2001-2006, Bezeq granted shareholder's loans that exceed its relative part in the Company's shares, in exchange for shares and options, which may be exercised without consideration, and whose exercise increased Bezeq's holdings in the Company to 58.36%.

Description of the Company and the Company's holding structure¹

- Yes was founded in 1998, and commenced its first broadcasts in July 2000. Yes is the only Israeli company that provides multi-channel TV services to subscribers using satellite communications. Moreover, Yes is also the first Israeli company that provided digital broadcasts and interactive TV services.
- Since its founding, the Company accumulated approx. 630,000 clients, which comprise 42% of the multi-channel TV market.
- The Company has more than 2,000 employees. The Company's total income in 2014 amounted to NIS 1,724 million, and is expected to amount to NIS 1,749 million in 2015.
- The Company broadcasts more than 150 channels (video, radio, music, games and information channels), including HD-quality channels, EPG (Electronic Program Guide), smart recording set-top boxes (also using HD technology), Video on Demand (VOD) services and streaming technology, that enables users to view videos, listen to audio and view images in various formats from their personal computer on their television screens, and to access various online contents.
- The Company holds 20% of ZIRA (Copyrights in the Internet) Ltd., an Israeli company held by 11 media companies founded for the purpose of struggling against copyright infringements caused as a result of online piracy. The company represents, inter alia, the content corporations Reshet, Keshet, Channel 10, HOT, United King and others.

¹ Sources: the Company's website, Management's Presentation, and Bezeq's financial statements of 2013-2014.

About the Company

- In an arrangement between the shareholders and the company of December 30, 2002 it was decided that the loans granted by some of the shareholders to the company as of July 10, 2002 (the "New Shareholder's Loans"), shall take precedence over the old shareholder's loans. In other words, loans received between July 10, 2002 and April 27, 2003, which carry an annual interest of 5.5%, and loans received on April 27, 2003 or later, which carry an annual interest of 11%, shall take precedence.
- Under the agreements, the New Shareholder's Loans shall be payable in full to the Company prior to any distribution of dividends by the Company and/or the repayment of the old shareholder's loans provided to the Company by the shareholder's loan, subject to the Company's cash flow and its undertakings in accordance with agreements entered into with the banks and some of the debenture holders.
- Moreover, investments by the shareholders in new shareholder's loans grant the right to choose between the allotment of shares and between options for shares as derived from their investment. This right grants Bezeq the possibility to continue investing in Yes without exercising its right to additional shares in the Company, which will cause it to possess a holding that exceeds the current holding percentage of the Company's shares.
- Following is the distribution of shareholder's loans, all of which are CPI-linked, by order of precedence, and Bezeq share therein, as at March 31, 2015 (in NIS millions):

Breakdown of shareholder loans by their specified terms	Interest rate	Balance as at March 31, 2015	Bezeq's share of the investments	% of Bezeq's share
Old shareholder loans	0%	2,345	1,193	50.9%
New shareholder loans:				
Loans granted by April 27, 2003	5.5%	497	374	75.2%
Loans granted after April 27, 2003	11%	2,052	1,806	88.0%
Total new loans		2,549	2,180	85.5%
Total		4,894	3,372	68.9%

Approval of the merger with Bezeq

- On February 10, 2015, the Subcommittee, the Audit Committee and Company's Board of Directors approved Bezeq's entry into transaction with Eurocom, under which Bezeq is to purchase all of Eurocom's holdings in Yes, which, until that date, comprised 50.22% of Yes's issued share capital (41.62% in full dilution), as well as all of the shareholder's loans granted by Eurocom to Yes (approx. NIS 1,522 as at March 31, 2015).
- It was further decided that, prior to the purchase transaction, Bezeq and Yes shall accept the terms of the merger and Bezeq shall exercise the option granted to it without consideration to allot shares in Yes at a rate of approx. 8.6% of Yes's issued share capital.
- In Bezeq's general meeting of shareholders, which convened on **March 23, 2015**, the meeting decided to approve the acceptance of the terms determined by Antitrust Commissioner, in the merger approval decision issued by him on March 26, 2014, and announced the exercise of the existing option to allot 6,221 Yes shares, which comprise 8.6% of Yes's shares, for no consideration. In addition, it was decided to approve the entry into the purchase agreement with Eurocom.

About the Company (Cont'd)

Approval of the merger with Bezeq (Cont'd)

- On April 29, 2014, Standard & Poor's Maalot increased Yes's rating to 'iIA' from the previous 'iIA-' rating, and, concurrently, added the rating to Creditwatch, outlook positive. The rating's addition to the watch list with a positive outlook expresses the assessment as regards the positive potential of the merger for the Company. This is due to the benefits that may be obtained by the Company owing to the possibility of receiving financial support from Bezeq (should Bezeq become a parent company) as needed, the possibility of expanding the client base, to the expected reduction in costs and, ultimately, to the abolishment of structural separation.
- In January 2015, Standard & Poor's Maalot ratified the rating of Yes's debentures as stated above.
- **It should be noted that a key working assumption in this Work is that a market participant (as defined in IFRS 13) is that it constitutes as a local or global market player, who possesses an affinity to the communications industry, which is not necessary Bezeq. Accordingly, the fair value of Yes is examined in this Work irrespective of the specific synergies attributed to the possible future merger between it and Bezeq, but in view of the existing synergies, considered as a whole, of any market participant that is an unrelated / independent party to the transaction.**

About the Company (Cont'd)

Products and services

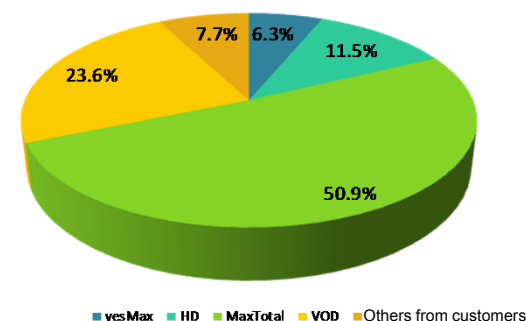
- **Channels** - Yes broadcasts include a large variety of channels: approx. 150 different video channels (of which 5 are Pay Per View channels and 20 are HD (High Definition) channels), in addition to radio, music and interactive service channels.
- **Channel Packages** - Under Yes's broadcasting license and in accordance with Council resolutions, broadcasts include either a basic package or any of the basic packages which each subscriber is required to purchase, as well as additional channels which the subscriber may purchase at his discretion, whether as packages or as discrete and PPV channels.
- **Advanced Services** - Yes markets PVR decoders to its clients. These decoders provide an interface to Yes's electronic broadcasting schedule, and enable services such as prerecording orders, recorded TV series, and live broadcast pausing. Moreover, PVR decoders enable users to view the contents which Yes stores in the decoder's memory from time to time (push video).

Yes delivers HD-resolution TV broadcasts, which may be received by HD ZAPPER decoders. These broadcasts allow users to enjoy high-quality video contents. Moreover, Yes markets HDPVR decoders to its clients, namely, HD-YesMax Total recording set-top boxes that enable both HD-quality video and PVR services. In addition, these decoders enable the MultiRoom service, through which it is possible, via the user's home network, to watch contents recorded by these decoders using other decoders (HD ZAPPER or HDPVR decoders) at the subscriber's home.

- The majority of Yes subscribers make use of advanced decoders (PVR or HD ZAPPER). In D.B.S's assessment, the increase in the number of Yes subscribers who make use of the aforementioned decoders will contribute to the increase of its revenues from these subscribers and their retention as its subscribers, although it does necessitate a significant financial investment.
- **VOD Services** - Yes provides its subscribers with VOD services through the internet, which enable subscribers to view the contents of their choosing. The services are provided in exchange for subscriber fees, with some contents requiring additional payment. Connecting to the service requires the use of certain decoders as well as an internet connection of a suitable bandwidth. In recent years, a significant increase in the number of Yes subscribers connected to VOD services and in the consumption of VOD services has been observed, inter alia due to the larger assortment of contents available through this service, the increase in available bandwidth at subscribers' homes, and the significant increase in the use of advanced decoders.

The following diagram presents the internal subdivision of the Company's revenues from advanced services, current for 1Q15:

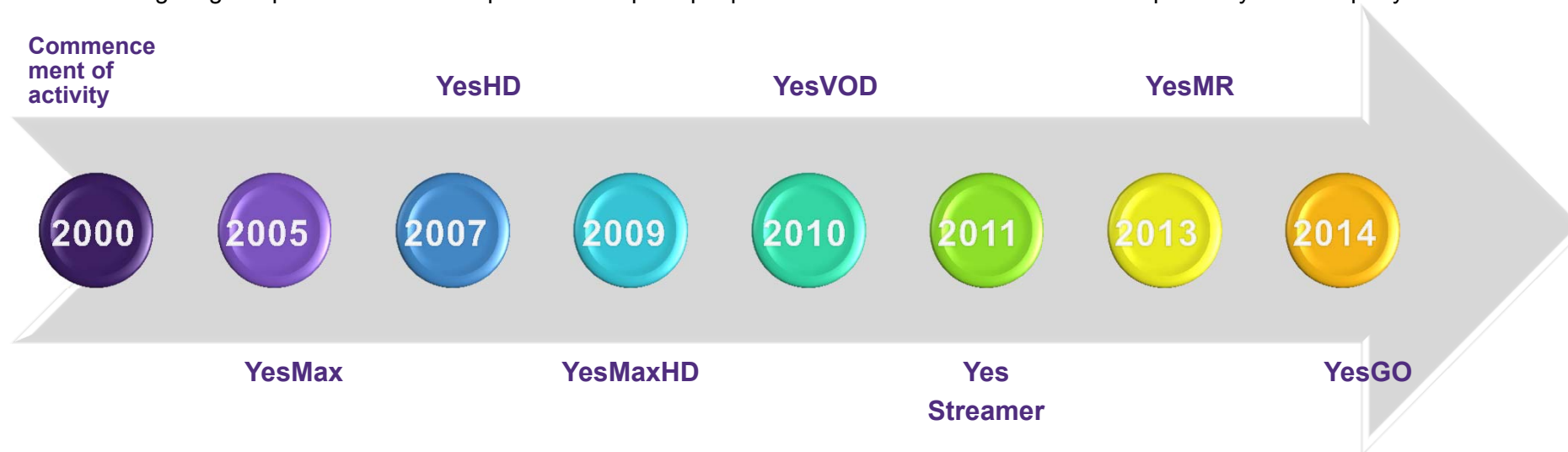
Distribution of revenues from advanced services Q1/2015



About the Company (Cont'd)

In 2014, the Company launched an application by the name of YesGO that allows subscribers to view contents through a variety of end-user devices (smartphones, tablets and computers) in some of the channels broadcast by the Company, which the subscriber has purchased as part of the TV broadcast contents viewed at his home, as well as VOD contents.

The following diagram presents the development of the principal products and services launched to the public by the Company over time:



As we can see in the diagram above, it appears that every year or two the Company launches a new product for its clients.

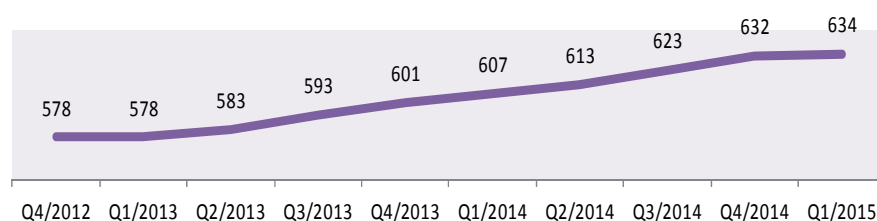
Soon, the Company is expected to launch the Yesmaxtotal3 set-top box, which will enable users to retroactively record two channels at the same time, also with respect to programs that were broadcast up to seven days prior to the recording.

About the Company (Cont'd)

Subscribers

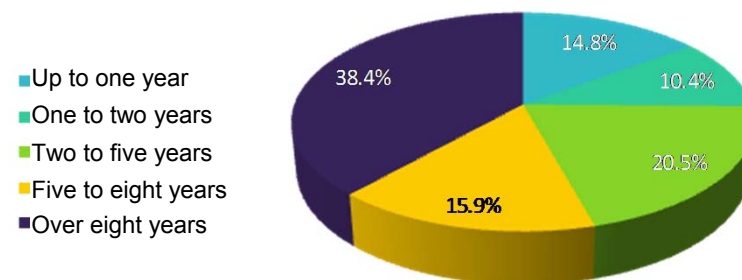
- The number of subscribers in 1Q15 amounted to approx. 634 thousand subscribers, which indicates a slight increase relative to the number of subscribers in 2014. In 2014, the number of subscribers increased by 5% relative to 2013 (the number of subscribers at the end of 2014 amounted to approx. 632 thousand subscribers, compared with 601 thousand subscribers at the end of 2013). The number of Company subscribers demonstrated a growth trend of 4% between 2012 and 2013 (the number of subscribers at the end of 2013 amounted to approx. 601 thousand subscribers, compared with 578 thousand subscribers at the end of 2012).

Number of subscribers at the end of the period (thousands)



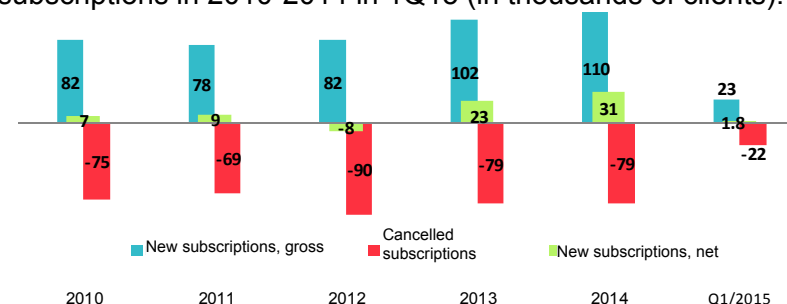
- Subscriber Loyalty** - As at the end of 2014, the number of Company subscribers who have remained loyal subscribers for over 8 years amounted to approx. 38% of all Company subscribers. However, Company subscribers who are the least loyal cumulatively comprise a significant portion of all Company subscribers (namely, 62% of the total number of Company subscribers).

Breakdown of subscribers by duration of subscription



- New vs. Cancelled Subscriptions** - In 1Q15, the number of new subscriptions exceeded the number of cancelled subscriptions, and the net number of new subscriptions amounted to 1.8 thousand, relative to approx. 31 thousand in 2014 and approx. 23 thousand in 2013. The percentage of cancelled subscriptions in 1Q15 amounted to approx. 3.4%, namely, a cancellation rate of 13.6% in annual terms. This compared to 12.8% in 2014 and 13.5% in 2013. The average number of cancelled subscriptions in 2011-2014 amounts to approx. 80 thousand clients per year, and the average number of new subscriptions in 2011-2014 amounts to approx. 93 thousand clients.

The following diagram presents the number of new and cancelled subscriptions in 2010-2014 in 1Q15 (in thousands of clients):



4. Industry outlook and principal risk factors

Economic environment and principal risk factors

Regulation

- **General** - Yes's operations are regulated by an elaborate system of laws that apply to broadcasting operations, which includes primary legislation (in particular the Communications Law and the regulations enacted in accordance therewith), as well as secondary legislation and the administration provisions and the resolutions of the Commercial Broadcasts Council. In addition, Yes's operation is subject to the provisions of its licenses, principal among which is its broadcasting license. In July 2013, the Communications Law (Telecommunications and Broadcasting, Amendment 57, the Authority and Council for Commercial Broadcasts, 2013) bill was published, which stipulated the establishment of the Commercial Broadcasts Authority. This authority shall serve as a regulatory entity that will possess all of the regulatory powers currently maintained by the Second Authority, the Second Authority Council and the Council, and shall engage in the regulation of commercial broadcasting in Israel.
- **Eligibility criteria for satellite broadcasting license holders - restrictions on cross ownerships** - The Satellite Broadcasting License Regulations stipulate various restrictions on license holders, and, indirectly, eligibility criteria that concern the holdings of the license holder and its principal shareholders, directly and indirectly, and cable broadcasting franchisees, and franchisees under the Second Authority Law, as well as daily newspapers.
- **Regulation of Rates** - The broadcasting license includes provisions regarding the types of payments which the license holder may collect from its subscribers for service rendered by virtue of the license, and these are determined in Yes's price list. The majority of subscribers pay for packages that include the various services offered by Yes, including various combinations of content packages, additional services, and end-user equipment items and the installation thereof, at prices that are lower than those specified in the price list.

Yes is obligated to inform the Chairman of the Council of any price list changes approved by the Council immediately upon publication, and the Chairman may in some cases prevent price list changes. The Chairman of the Council may also intervene in special sales or discounts offered by Yes, should he hold that they are misleading the public or that they discriminate between subscribers.

In accordance with Section 6-49 of the Communications Law, it is possible to specify the maximum prices which may be collected from subscribers in the license. As of the date of this report, no such prices were determined. In addition, in accordance with Section 6-11 2 of the Communications Law, the Minister may determine the price of basic packages.

- **The obligation to invest in local productions** - in accordance with the broadcasting license requirements and Council resolutions, for 2013, Yes had to invest no less than 8% of its income from subscriber fees in local productions. In 2014, Yes completed the investments determined for it in the past by the Council in certain categories. The obligation to invest in local productions in 2015 was also 8%, as previously stated.
- **Content of broadcasts and subscription-related obligations** - The broadcasting license contains provisions that concern the contents of Yes broadcasts, including the mandatory approval by the Council of the channels broadcast by Yes. the Communications Law forbids broadcasting license holders from broadcasting commercials, subject to several exceptions. Moreover,, the broadcasting license includes conditions relating to the terms of the services rendered to subscribers, including the prohibition against any discrimination between them.

Economic environment and principal risk factors (Cont'd)

Regulation (Cont'd)

- **Restrictions relating to exit fees** - Yes is not allowed to collect exit fees for the cancellation of the agreement by the subscriber from subscribers whose average monthly bill is lower than NIS 5,000, and who entered into an agreement with Yes that entered into force on August 8, 2001 or later, and with respect to such subscribers who had entered into an agreement with Yes before August 8, 2011, payment for agreement cancellation is limited to 8% of the average monthly bill until the date of cancellation, multiplied by the number of months remaining before the end of the commitment period.

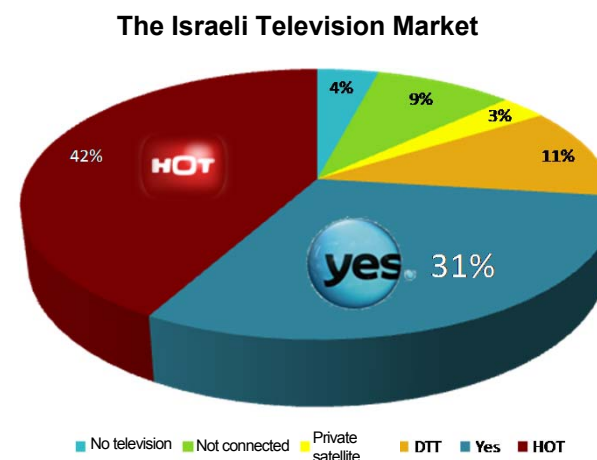
In addition, it is forbidden to deprive the subscriber of any benefit which he would have received had he not terminated the agreement, and to render immediately payable the remaining payments for the subscriber's end-user equipment in the event of agreement cancellation. These legislative amendments have, in the Company's assessment, led to an increase in the number of subscription cancellations.

On October 15, 2013, the Ministry of Communications furnished the Company with a preliminary regulatory report, according to which the Company is denying customers who cancel their agreement with the Company of their monthly credit for end-user equipment (routers), allegedly in violation of the above described prohibitions. The Company's position is that it acted lawfully, and its response was delivered to the Ministry of Communications.

Competition in the TV line of business

According to data received from the Company, the principal players that possess a significant share of the Israeli TV market are the Company and its main competitor, **HOT**.

Following is the distribution of the Israeli TV market, according to the Company's assessments for 2014:



In December 2014, Cellcom launched a service that allows users to view video contents using OTT technology through the internet, in addition to DTT contents.

To the best of the Company's knowledge, other entities are currently considering the possibility of launching similar services.

The establishment and development of such service may significantly affect competition in the broadcasting segment, which is currently based on designated infrastructures.

Economic environment and principal risk factors (Cont'd)

Consumption habits of Israeli households

- According to a CBS survey, the accelerated developments over the past two decades in new communications technologies have resulted in changes in the consumption habits of Israeli households. Over the years, a steady increase in expenditures on communications and in the percentage of ownership over communications products has been observed.
- According to CBS data for 2013, approx. 61.8% of households have a cable network or satellite TV subscription, and approx. 16.8% of households own a satellite dish, and 14.1% own a digital set-top box.
- When comparing income deciles, it appears that the higher the income decile, the higher the percentage of cable network or satellite TV subscriptions.
- However, between 2001 and 2013, an ongoing decrease in the percentage of cable network or satellite TV subscribers, mostly due to the use of alternative media such the internet, satellite dishes and digital set-top boxes. The decrease in the percentage of cable network or satellite TV subscribers that began in 2001 stopped in 2011, and remained similar in 2012-2013. In 2001, approx. 73.2% of all households were cable network or satellite TV subscribers, as opposed to 61.8% in 2011-2013.

Percentage of Multi-channel TV Subscribers



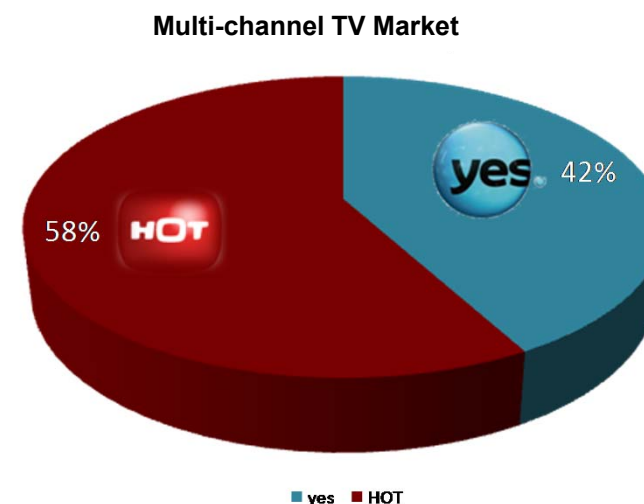
¹ Survey conducted by the Central Bureau of Statistics of October 29, 2014 ("Initial Findings from the 2013 Household Expenditures Survey; Income, Expenditures and Product Ownership of Israeli Households").

Economic environment and principal risk factors (Cont'd)

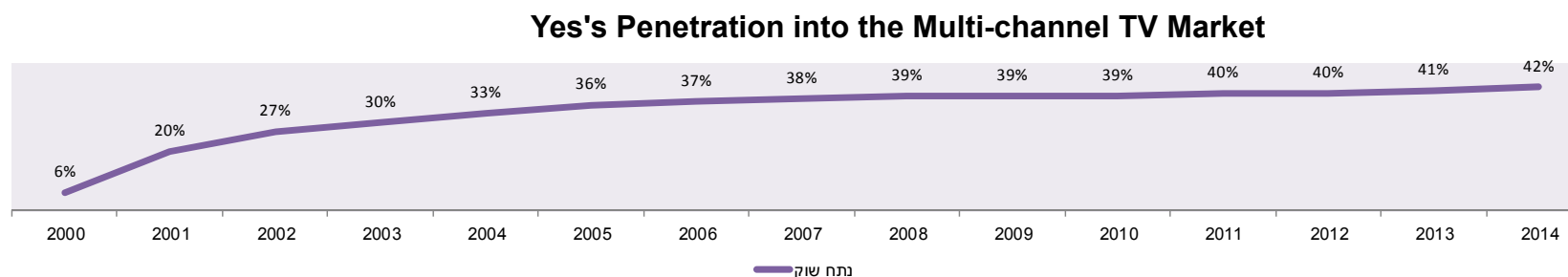
The Multi-channel TV Market

- According to data received from the Company, the multi-channel TV market is estimated at approx. NIS 4 billion a year, and in Israel there are currently approx. 1.5 million multi-channel TV subscribers.
- According to Company data, the penetration rate of multi-channel TV broadcasting companies is estimated at approx. 62% of all Israeli households. At present, the multi-channel TV market only includes Yes and its main competitor - HOT. HOT maintains a market share of 58%, whereas Yes controls the remaining share of the market, namely, 42% (at the end of 2008, the Company's market share was 38%).
- The distribution of market shares between these competing companies has remained stable, as opposed to previous years where a moderate increase in the Company's penetrate rate was observed, concurrently with a moderate reduction of HOT's market share.
- It appears that in order to maintain the existing penetration rate, the Company will have to continue recruiting new subscribers, in addition to preserving existing customers.

The following diagram presents the distribution of the multi-channel TV market in 2014:



The following chart presents the rates of the Company's penetration into the multi-channel TV market between 2000 and 2014, based on Company data:



Economic environment and principal risk factors (Cont'd)

Technological Developments

- Technological developments and the development of new technologies may render inferior the technology used today, and might force the Company to invest substantial sums of money in order to maintain its competitive standing.
- Such improvements and developments may serve to enhance current accessibility to video contents and may enable other entities to offer content viewing services without having to invest substantial sums of money, in a manner that could make it difficult for the Company to recruit and retain subscribers and to offer its services.
- The expansion of DTT, which constitutes as an alternative infrastructure to multi-channel TV, may adversely affect the Company's financial results. In February 2008, the Knesset enacted an amendment which permits DTT broadcasts. This law authorizes the Second Authority for Television and Radio as the agency responsible for these broadcasts in Israel. The name of this project is Idan+ (Accessible Digital Israeli Channels). Broadcasts are received for free, but the TV receiver's possession requires users to pay the radio and television toll to the Broadcasting Authority (a toll that is also imposed on multi-channel TV customers). DTT includes 6 channels (1, 2, 10, 23, 33 and 99). In order to watch the channels, users must make the one-time purchase of a digital set-top box, with prices ranging between NIS 250 - 450.
- Some tech-savvy users do not need Yes's and/or HOT's services as they download content from the internet using various means (torrents, streaming websites and others, applications that stream torrent links and others).

Contents viewed through the internet are usually available for immediate viewing a significant amount of time before they are broadcast by multi-channel TV companies.

- These two developments (DTT and the internet), which are situated on both ends of the technological scale, can provide a substitute for multi-channel TV services. However, the number of people currently making use of these developments is relatively small.
- It should be noted that the addition of DTT channels and increased internet bandwidths could make the services provided through the internet more attractive.
- In addition, a new technology exists that allows broadcasts to be transmitted through the internet (OTT), and this technology is employed by the Company today as part of its VOD services. It appears that this technology could allow new and existing competitors to provide substitute services as an alternative to multi-channel TV services.
- It should be noted that in addition to Cellcom, which entered the market using its "Cellcom TV" services, it is possible that Golan Telecom (which recently announced its intention to enter this market) and Partner are expected to enter this market. It appears that the ability of these players to rely on this platform and to extend it to additional paid channels could be a key factor in their successful penetration into the market. However, given the technologies limitations of OTT, it is possible that it might not be able to provide live broadcasts in a satisfactory quality (for example, sports broadcasts).
- **Moreover, it is doubtful whether these players could offer content that is as extensive and versatile as those currently offered by Yes and HOT to their customers.**

Economic environment and principal risk factors (Cont'd)

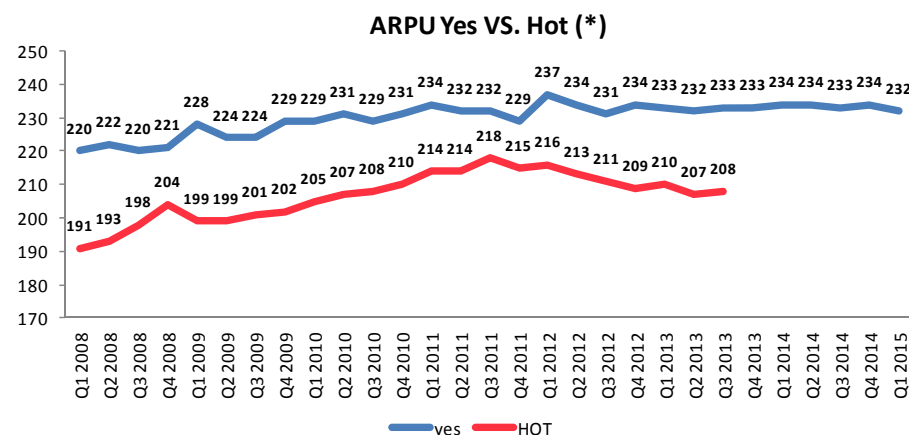
Marketing narrow packages

- At present, Yes and HOT are obligated to offer a “narrow package” to their customers - Packages that include a relatively small number of channels (approx. 25) at a lower price ranging between NIS 99 - 130.
- It appears that narrow packages are uncommon, and they comprise only 1% of the total number of Yes’s subscribers. Yes and HOT price the narrow packages at approx. NIS 120 a month.
- However, it is expected that the introduction of new competitors into this segment (such as Partner and Cellcom), which are expected to price the packages at less than NIS 100, may decrease the prices of Yes’s and HOT’s narrow packages, and may add to the number of subscribers who would want to switch to the narrow packages.
- On December 29, 2014, Cellcom announced its launching of the new “Cellcom TV” service, which relies primarily on the internet. The new service includes TV-channel and VOD broadcasts, and it combines Idan+ (DTT) channels, which are received through the airwaves via Cellcom’s set-top box, and an online VOD library that contains movies and TV series which can be viewed at any time. The service, which is provided for NIS 99 a month, includes only one set-top box. However, many questions could be asked about this “fledgling” service: what is the bandwidth involved? Is it suitable for all Israeli population groups? Does it compete with mobile network operators or in the multi-channel TV market (with Hot and Yes), and so on. In light of the above, the price may result in the escalation of existing competition and to a reduction in prices (to an extent and with an intensity which at present cannot be evaluated) and may affect the Company’s financial results.

Economic environment and principal risk factors (Cont'd)

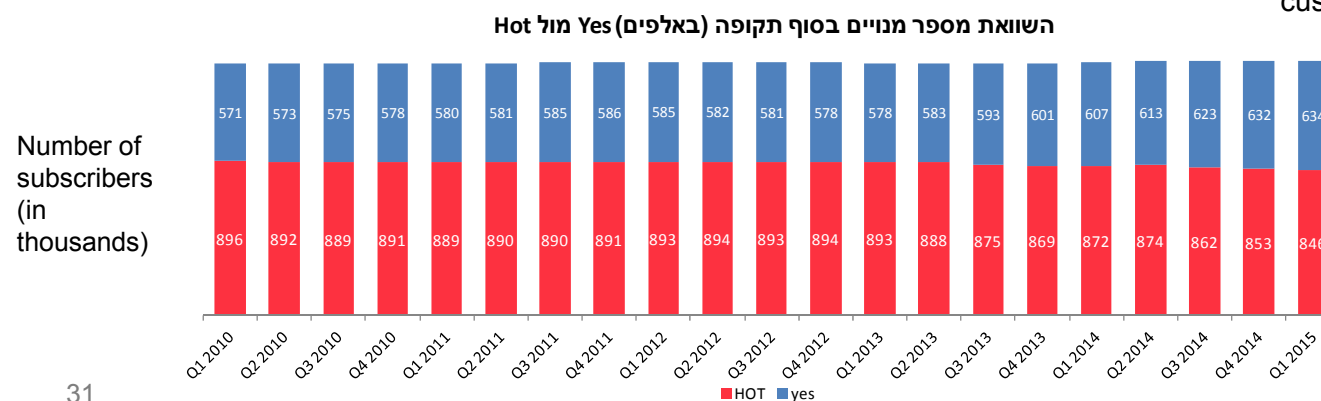
Competition with HOT

The following diagram presents the development of Yes's ARPU relative to HOT (according to available HOT data) between 2008-2014, and current for 1Q15.



* HOT's ARPU data are presented based on the data processing carried out by Bezeq and Fahn Kanne Consulting

The following diagram presents a comparison of the number of YES subscribers relative to HOT (according to available HOT data) between 2010-2014, and current for 1Q15.



- It should be noted that HOT currently controls a larger market share than that of the Company, and therefore the number of HOT subscribers is higher than that of the Company. However, as we can see, Yes's ARPU is higher than HOT's.
- We were informed by the Company that its ability to collect excess premium relative to its primary competitor, HOT, stems, inter alia from:
 - The high-quality service it provides to its customers, as opposed to its competitor, which uses outsourcing services in order to reduce costs.
 - The creation of a preferable user experience, both in terms of technology and in terms of the better quality and diversity of the contents provided by the Company to its customers relative to HOT.

Economic environment and principal risk factors (Cont'd)

Following is a depiction of the Israeli communications market, broken down by holding groups and the services offered by telecommunication companies:

- While in the past most of the competition in the communications market was reflected in the competition between independent telecommunication providers within each segment of activity, in recent years an increasing trend of switching to competition between telecom groups that operate simultaneously in several telecom segments.
- In recent years, there has been a growing trend of “service basket” consumption (packages that include various combinations of multiple telecom services). The telecom groups market, or may market in the future, “common” service baskets that consist of various telecom services offered by the companies of each group.
- As a rule, the marketing of the common basket allows the telecom group to offer more attractive prices to the customer relative to the prices he would have to pay for each service separately (in some cases, this is done by way of “cross-subsidization” between the various components included in the basket), as well as a comprehensive solution that makes it unnecessary to enter into contracts with multiple suppliers.
- With regard to the marketing of common service baskets, the restrictions that apply to Bezeq are more stringent than those applicable to the other groups. Bezeq is subject to multiple restrictions in the context of forming collaborations between group companies, principal among which are the following:
 - Mandatory structural separation - The Company must maintain structural separation between itself and its subsidiaries (including the full separation between the companies’ managements). However, pursuant to the Company’s market share’s shrinkage to less than 85%, in May 2010 the Company was permitted to offer common service baskets with the subsidiaries to private subscribers, and in July 2012, business subscribers were offered common service baskets, and all subject to their approval by the Ministry of Communication and subject to several conditions stipulated under the domestic operator license.
 - Other restrictions on the provision of benefits to group companies and collaborations between them, including, without limitation, the restriction of the Antitrust Commissioner with respect to the approval of mergers between the company and group companies.
 - Restrictions concerning control of Yes.



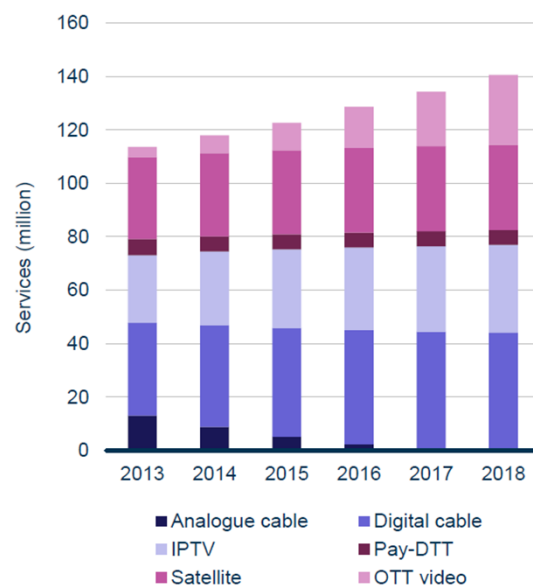
* Given the regulatory processes and ongoing market changes, the above presented communications map is strictly indicative and may change over time

Economic environment and principal risk factors (Cont'd)

Global review - analysis of the influence of OTT services on traditional TV service in West Europe.

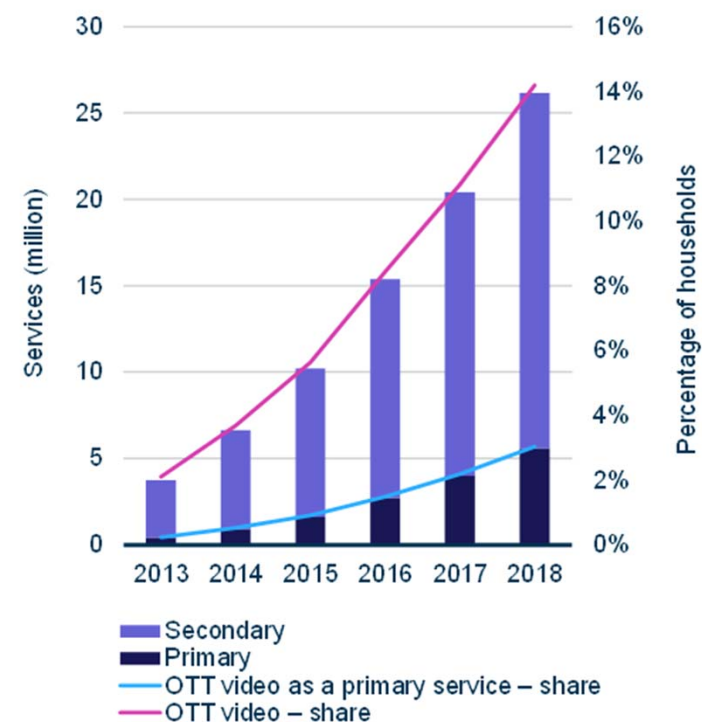
The data presented in the chart below indicate that the scope of paid television services in West Europe is expected to grow by approx. 24% (an average growth rate of 4%) between 2013-2018, and eventually reach a scope of services that amounts to approx. 141 million. The main source of growth in this market is expected to be the OTT video sector, which is destined to multiply itself by almost 7, and reach a scope of services that amounts to approx. 26 million households. Compare this to traditional paid television services, which are expected to grow by only 4.2% in 2013-2018 (an annual growth rate of 0.8%). **In other words, based on these data, the traditional television services sector is not expected to diminish in the years reviewed.**

Figure 9: Pay-TV services, by platform, Western Europe, 2013–2018
[Source: Analysys Mason, 2013]



The following diagram indicates that OTT, as a substitute for multi-channel television services, is expected to serve as a mere niche (approx. 3% of households), whereas for the vast majority of households OTT services are going to be strictly complementary and/or secondary to cable network or satellite television.

Figure 15: OTT video services to the TV set, by primary and secondary, Western Europe, 2013–2018 [Source: Analysys Mason, 2013]



Source: Research Report by Analysis Mason Limited 2013, "Pay-TV and OTT video services in Western Europe: forecasts and analysis 2013–2018", August 2013

5. Financial statements analysis

Balance Sheet

Following are the company's balance sheet balances according to reported figures, as at December 31 of the years 2012-2014, and according to the draft quarterly statements of March 31, 2015 (in thousand NIS).

Cash and Cash Equivalents

As at March 31, 2015, the cash and cash equivalent balance of the Company amounted to approx. NIS 299 million, approx. 62% of the Company current assets, as opposed to the end of 2014, when the cash and cash equivalent balance of the Company amounted to approx. NIS 239 million, approx. 55% of the Company current assets, and to approx. NIS 125 million, approx. 43% of the Company's current assets in 2013.

Trade Receivable

The Company signs an agreement with all of its subscribers which governs the various rights and obligations of subscribers with respect to their relationship with the Company.

Normally, the Company does not engage in factoring transactions and avoids the early obtainment of revenues from customers. Namely, payment is made at the beginning of each month with respect to customers who pay by credit card. Other Company customers - according to their credit terms (normally net + 30 or 60).

The Company's DSO (Days Sales Outstanding) ratio has maintained relative stability over the three-year period, and represents, approximately, a balance of private customers for a single month (net+0) and a balance of business customers for a longer period.

Other receivables

The increase in the receivables balance in 2014 stems both from the increase in prepaid expenses and in the increase in other receivables, primarily due to the change in the value of hedging transactions.

Balance sheet NIS thousands	31.12.2012	31.12.2013	31.12.2014	31.3.2015
Current assets				
Cash and cash equivalents	-	125,263	239,146	298,649
Trade receivables	163,043	164,277	178,017	172,865
Other receivables	1,674	1,615	16,404	9,330
Total current assets	164,717	291,155	433,567	480,844
<i>Percentage of current assets in balance sheet</i>	<i>11.9%</i>	<i>18.0%</i>	<i>23.8%</i>	<i>25.6%</i>
Non-current assets				
Fixed assets, net	745,365	775,131	797,696	800,912
Intangible assets	99,864	133,728	146,805	147,507
Broadcasting rights net of rights exercised	377,349	416,598	441,813	449,303
Total non-current assets	1,222,578	1,325,457	1,386,314	1,397,722
<i>Percentage of non-current assets in balance sheet</i>	<i>88.1%</i>	<i>82.0%</i>	<i>76.2%</i>	<i>74.4%</i>
Total assets	1,387,295	1,616,612	1,819,881	1,878,566
Current liabilities				
Credit line from banks	69,322	35,785	14,837	14,837
Current maturities for debentures	174,305	292,168	377,388	371,363
Trade payables and service providers	403,104	467,929	429,572	450,470
Other payables	147,746	161,318	148,783	159,763
Provisions	6,200	12,360	9,673	9,491
Total current liabilities	800,677	969,560	980,253	1,005,924
<i>Percentage of current liabilities in balance sheet</i>	<i>57.7%</i>	<i>60.0%</i>	<i>53.9%</i>	<i>53.5%</i>
Non-current liabilities				
Credit line from banks	-	-	64,065	63,765
Debentures	1,364,840	1,387,616	1,361,557	1,337,220
Loans from shareholders	3,085,742	3,571,900	4,054,456	4,117,543
Trade payables and other long-term liabilities	92,033	24,931	18,588	16,321
Employee benefits	5,837	5,779	5,216	5,031
Total non-current liabilities	4,548,452	4,990,226	5,503,882	5,539,880
<i>Percentage of non-current liabilities in balance sheet</i>	<i>327.9%</i>	<i>308.7%</i>	<i>302.4%</i>	<i>294.9%</i>
Total liabilities	5,349,129	5,959,786	6,484,135	6,545,804
Equity				
Equity	29	29	29	29
Premium on shares	85,557	85,557	85,557	85,557
Warrants	48,219	48,219	48,219	48,219
Capital reserve	1,537,271	1,537,271	1,537,271	1,537,271
Capital reserve for share-based payments	10,280	10,280	10,280	10,280
Loss balance	(5,643,190)	(6,024,530)	(6,345,610)	(6,348,594)
Total equity	(3,961,834)	(4,343,174)	(4,664,254)	(4,667,238)
<i>Percentage of equity deficit in balance sheet</i>	<i>-285.6%</i>	<i>-268.7%</i>	<i>-256.3%</i>	<i>-248.4%</i>
Liabilities and equity	1,387,295	1,616,612	1,819,881	1,878,566

Balance Sheet (Cont'd)

Broadcasting rights - net of rights exercised

The Company owns broadcasting rights in video contents (movies and series) of two kinds:

1. Broadcasting rights acquired from third parties - including discrete contents and channels
2. Broadcasting rights owing to original productions in whose production the Company invests (partially or wholly), where, in addition to the actual right to include the contents in its broadcasts, the Company usually maintains interest in those contents, the percentage of which is specified in the agreements signed with the producers.

Normally, the Company is also entitled to assign authorizations to use rights and participate in revenues derived from other uses of the contents other than broadcasts at the Company, subject to agreements with suppliers.

- Broadcasting rights are presented in the Company's balance sheet at cost net of rights exercised.
- In 1Q15, an increase in the broadcasting rights balance of approx. 1.6% was observed, and in 2014 an increase in the broadcasting rights balance of approx. 6% was observed relative to 2013. In 2013 and 2012, an increase in the broadcasting rights balance of approx. 10% and 14% was observed, respectively. The principal causes of this increase are as follows:
 - Increased investments in original productions in accordance with the resolution issued by the Cable and Satellite Broadcasting Council. the amount invested in original productions was previously only derived from a certain percentage of revenues from contents. The Council determined that, as of 2012, the percentage invested in original productions shall be derived from content revenues in addition to revenues from equipment installation, sale or borrowing fees. In addition, the Company was permitted to pay the sum of the 2012 investment in equal installments over a period of three years.

- In 2011, the rights amortization policy was changed to the straight-line method, which led to a longer estimated useful life for this asset.
- USD exchange rate fluctuations.
- Increased prices of purchased contents and the commencement of discounting the costs of translation to the broadcasting rights.

Fixed assets

- Fixed Assets comprise a significant balance of the Company's total assets, and amount to approx. NIS 801 million and approx. NIS 798 million as at March 31, 2015 and December 31, 2014, respectively (approx. 43% and 44% of the statement of financial position's total, respectively). This Section includes two substantial balances:
 1. Digital satellite decoders: approx. NIS 490 million and approx. NIS 486 million as at March 31, 2015 and December 31, 2014, respectively. The estimated useful life of this equipment ranges between 4-8 years.
 2. Discounted installation costs amounting to approx. NIS 225 million and approx. NIS 229 million as at March 31, 2015 and December 31, 2014, respectively. The estimated useful life of installation costs is subdivided as follows: 13-15 years (for infrastructures in buildings) and 1-3 years (for infrastructures in apartments).
- We should not that the fixed assets balance contains additional balances that are significantly smaller, such as broadcasting and reception equipment, whose amortized cost amounted, as at March 31, 2015 and December 31, 2014, to approx. NIS 36 million and NIS 34 million, respectively.

Balance Sheet (Cont'd)

Intangible assets

Intangible assets consist of two principal components:

1. **Subscriber acquisition costs** - In 2011, a law was enacted which prohibits the Company from collecting exit fees from its customers. The Company switched to a contract model that does not stipulate a commitment period. As a result, the Company lost its secured revenue from that customer, against which it would by then have discounted the customer acquisition costs. In light of the changes in legislation and the Company's business model, the Company elected to implement an accounting policy and to discontinue the discounting of customer acquisition costs, despite the fact that there are certain accounting interpretations that permit, under certain circumstances, the continued discounting of customer acquisition costs even in cases where no customer commitment period applies. In light of this, as of the law's entry into force, the Company no longer discounts the cost of its subscribers' acquisition as an asset, in accordance with IAS38.
2. **Programs and licenses** - The increase in intangible assets in 2013 relative to 2012 stems mainly from two projects:
 - A. **TRIO** - The upgrade of the Company's management systems, which includes the development of three systems:
 - A new RBM system.
 - CRM system.
 - The integration of customer and billing management into SAP.
 - B. **TVE** - The development of a mobile phone viewing technology.

Deferred taxes, net

- Note 25 to the 2014 Financial Statements clarifies that, even though the Company has significant tax losses and inflation-related deduction which may be carried forward for an unlimited time until utilization (a total of NIS 5.4 billion), the Company does not recognize deferred taxes assets, as it is not expected that it will in the foreseeable future have any taxable income against which the aforementioned carried forward losses will be utilized.
- The aforementioned are accounted for in accordance with the principles of International Accounting Standard 12, Income Taxes (IAS 12).
- Of the accumulated loss of approx. 5.4 billion, a total of NIS 2.3 billion is derived from financing expenses on loans from shareholders (Bezeq: approx. NIS 1.8 billion; Eurocom Group: approx. NIS 0.5 billion).

Profit and Loss Statement

Following is a summary of profit and loss data for the years 2011-2014 (audited) and for 1Q15 (the draft financial statement received) (in NIS thousands):

Profit and Loss Statements – D.B.S. Satellite Services 1981 Ltd.	Audited 2011	Audited 2012	Audited 2013	Audited 2014	Reviewed Q1 2014	Draft Q1 2015
Revenues	1,618,809	1,635,994	1,635,216	1,723,938	423,724	440,174
<i>Growth</i>		1.1%	-0.05%	5.4%		3.9%
Cost of revenues	1,028,168	1,067,087	1,051,618	1,110,450	268,750	295,096
Gross profit	590,641	568,907	583,598	613,488	154,974	145,078
<i>Gross profit (%)</i>	36.5%	34.8%	35.7%	35.6%	36.6%	33.0%
Selling and marketing expenses	152,737	166,274	153,712	153,624	39,614	35,663
General and administrative expenses	143,036	149,884	162,372	187,284	42,478	50,376
Operating profit (loss)	294,868	252,749	267,514	272,580	72,882	59,039
<i>Operating profit (%)</i>	18.2%	15.4%	16.4%	15.8%	17.2%	13.4%
Financing expenses	168,991	155,431	167,677	136,669	33,463	40,587
Financing income	(23,163)	(1,859)	(6,979)	(26,056)	(15,912)	(41,992)
Financing expenses for loan from shareholders	377,529	407,826	486,158	482,556	88,906	63,087
Earnings (loss) before tax	(228,489)	(308,649)	(379,342)	(320,589)	(33,575)	(2,643)
Income tax	1,128	1,668	1,352	1,106	186	341
Actuarial profit (loss) from defined benefit plan*	(80)	(1,235)	(646)	0	0	0
Depreciation and amortization	276,393	248,250	262,735	297,554	69,731	76,411
EBITDA	571,261	500,999	530,249	570,134	142,613	135,450
<i>EBITDA (%)</i>	35.3%	30.6%	32.4%	33.1%	33.7%	30.8%

* This does not include actuarial profit (loss) from defined benefit plan of significant values, as provided in the Company's financial statements.

Profit and Loss Statement (Cont'd)

Revenues

In 1Q15, the Company's total revenues amounted to approx. NIS 440 million, its revenues in 2014 amounted to NIS 1,724 million.

The Company's revenues are subdivided into three major types:

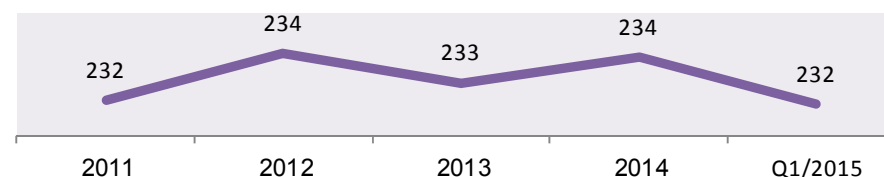
- **Revenues from basic services to customers** - These include revenues from basic content and equipment services, the leasing of regular set-top boxes, and basic channel broadcasts at fixed monthly prices.
- **Revenues from advanced services to customers** - These include revenues from technical services and installation fees, revenues from advanced services by supplying advanced set-top boxes, such as: YesMax, YesMax Total and YesHD, and the provision of YesMultiroom services, through which it is possible to view recorded contents via the home network and/or VOD service for which the customer pays fixed monthly fees.
- **Non-customer revenues** - These primarily include revenues from channels and revenues from the sale of content in accordance with the Company's specific agreements with suppliers for the sale of content purchased by the Company.

ARPU Analysis

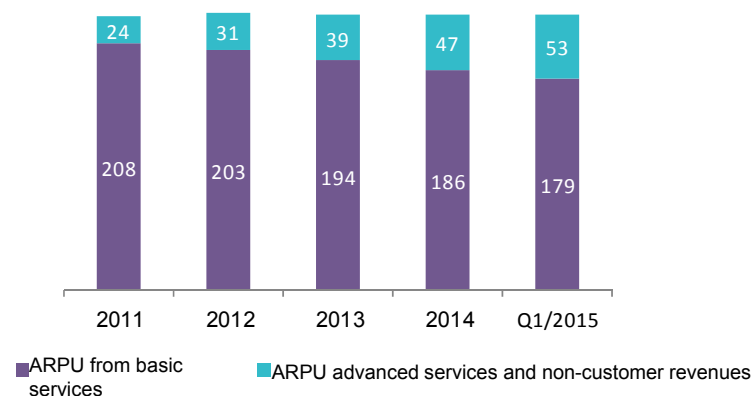
The term "ARPU" and the variations thereof is a key term in the world of communications. Mobile network operators, ISPs and cable network companies measure themselves in terms of ARPU (Average Revenue per User).

- The data indicate that in 1Q15 the Company's ARPU amounted to NIS 232, as opposed to NIS 234 at the end of 2014, which reflects a decrease by approx. 1%. In 2014, no significant ARPU changes were observed. In 2013, ARPU decreased by approx. 1% to approx. NIS 233 (compared to approx. NIS 234 in 2012).

ARPU (Average Revenue per User, in NIS)



Distribution of ARPU between basic and advanced services



Profit and Loss Statement (Cont'd)

Cost of Revenues

The majority of cost of revenue expenses consist of the costs of contents, broadcasting rights exercised, and depreciation and amortization. In the first three months of 2015, the total cost of revenue amounted to approx. NIS 295 million (approx. 67% of all revenues), an increase of approx. 6.3% annualized over 2014.

In 2014, the Company's cost of revenue amounted to approx. NIS 1,110 million (approx. 64% of all revenues), as opposed to NIS 1,052 million in 2013 (approx. 64%% of all revenues), which constitutes an increase of approx. 6%. The increase stemmed mainly from the increase in depreciation, broadcasting rights exercised and content costs.

Selling and Marketing Expenses

Selling and marketing expenses consist mostly of salary and wages and advertising expenses. Selling and marketing expenses in 1Q15 amounted to approx. NIS 35.6 million (approx. 10% of all revenues in this quarter), as opposed to approx. NIS 39.6 million in 1Q14, which constitutes a decrease of approx. 9.3% relative to the same quarter of the previous year.

In 2013 and 2014, an increase in selling expenses was observed, which was offset by a decrease in advertising and depreciation expenses. In 2013-2014, the selling and marketing expenses amounted to approx. NIS 154 million (approx. 9% and 9.3% of all revenues, respectively), as opposed to NIS 166 million (approx. 10%% of all revenues) in 2012.

Between 2012 and 2013, selling and marketing expenses decreased by approx. 7.6%. This decrease stems mainly in the decrease in depreciation and amortization expenses which resulted from the discontinued discounting of subscriber acquisition costs (namely, sales commissions paid to marketers and salespersons) as of the end of 2011.

G&A Expenses

G&A expenses primarily consist of salary and wages and depreciation and amortization. G&A expenses in 1Q15 amounted to approx. NIS 50 million (approx. 11% of all revenues), as opposed to approx. NIS 42 million in 1Q14, which constitutes an increase of approx. 19%.

In 2014, the Company's G&A expenses amounted to approx. NIS 187 million (approx. 11% of all revenues), as opposed to NIS 162 million in 2013 (approx. 10%% of all revenues) and as opposed to approx. NIS 150 million (approx. 9% of all revenues) in 2012.

In 2014, G&A expenses increased by approx. 15%, as opposed to an increase of approx. 8% and 5% in these expenses in 2013 and 2014, respectively.

Profit and Loss Statement (Cont'd)

Financing Expenses, Net

The majority of financing expenses stem from shareholder loans and interest expenses for financial liabilities. In the first three months of 2015, net financing expenses amounted to approx. NIS 62 million (approx. 14% of all revenues), as opposed to 2014, in which net financing expenses amounted to approx. NIS 593 million (approx. 34% of all revenues), and as opposed to 2013, in which net financing expenses amounted to approx. NIS 647 million (approx. 40% of all revenues). The decrease in net financing expenses in 2014 and in the first three months of 2015 stems mainly from margin revenues resulting from changes in the fair value of financial assets, in fair value through profit and loss, and in the effects of the consumer-price index.

Income Tax

According to data received from the Company and the 2013 tax adjustment report, the Company has tax losses and a deduction for inflation that are carried forward to the following years and that amount, as at December 31, 2014 and December 31, 2013, to approx. NIS 5.4 billion and NIS 5.3 billion, respectively.

We were informed that, of the accumulated tax losses, as at December 31, 2014, of approx. 5.4 billion, a total of NIS 2.3 million is derived from financing expenses on loans from shareholders (Bezeq: approx. NIS 1.8 billion; Eurocom Group: approx. NIS 0.5 billion).

In the Company's profit and loss statements, tax expenses amounting to NIS 1,106 thousand and NIS 1,352 thousand were recognized in 2013 and 2014, respectively.

6. Methodology

Methodology

Accounting for Business Combinations - General

International Financial Reporting Standard 3R ("IFRS 3R" or "the Standard") - Business Combinations concerns the matter of business combinations and examines the terms of the recognition and measurement of identifiable assets acquired in a business combination and in transferred liabilities, non-controlling interest in the acquired entity, and goodwill.

The Standard defines a business combination transaction as a transaction or other event in which the buyer receives control over one or more of the acquired businesses. A business combination transaction can be carried out in a number of ways that stem from legal, tax-related or other reasons.

The date of the acquisition is the date on which the buyer assumes control over the acquired entity.

The Standard stipulates that business combinations are to be accounted for using the Acquisition Method, which requires the following:

1. The identification of the buyer;
2. The determination of the acquisition date;
3. The recognition and measurement of identifiable assets acquired and transferred liabilities and non-controlling interest in the acquired entity;
4. The recognition and measurement of goodwill or profit from an incidental transaction.

Costs needed to carry out the transaction, such as attorney's fees, consultation, G&A, and debt or capital issue costs for the purposes of the acquisition, shall be recognized by the buyer as expenses in the period in which these costs were incurred and in which the services for said costs were received. Debt and capital issue costs shall be recognized in accordance with IAS 32 and IAS 39.

Intangible assets

Identification Capacity Criterion

An intangible asset is a non-financial asset devoid of any physical substance. An intangible asset can be identified if it meets either of the following conditions:

1. Separability condition: the asset can be separated, namely, it is possible to separate it from the entity or split it, it may be sold or transferred, and it is possible to grant a license to use, lease out or replace it, separately or together with a related contract, an identifiable related asset or a related liability, regardless of whether the buyer intends to do so;
2. Contractual-legal condition: the asset is derived from contractual or other legal rights, regardless of whether these can be carried forward or can be separated from the entity or from other rights or obligations.

An intangible asset which cannot be separated by itself complies with the separability condition if it can be separated together with a related contract, an identifiable asset or a liability.

Examples of identified intangible assets

The examples of intangible assets include the following items:

Intangible assets related to customers:

- Contracts with customers and associated customer relationships;
- Non-contractual customer relationships;
- Client lists;
- Order or production backlog.

Methodology (Cont'd)

Contract-based intangible assets:

- License and royalties;
- Franchise agreements;
- Operating and Broadcasting agreements;
- Various rights of use.

Intangible assets related to marketing:

- Trademarks;
- Trade names
- Domain names;
- Non-competition agreements.

Intangible assets related to art:

Such as literature, magazines, plays, musical pieces, paintings, photographs, etc.

Determining the fair value of intangible assets

The intangible assets are measured at fair value as at the date of acquisition.

in accordance with IAS 38, the quoting of market prices in an active market constitutes as the most reliable estimate of fair value for intangible assets. The suitable market price is usually the bid price. If the aforementioned prices are unavailable, the price in a similar transaction that took place at about the same time could form the basis for the fair value estimation, on the condition that no substantial changes in financial conditions took place between the date of this transaction and the date of the measurement.

In the absence of an active market for the intangible asset, its fair value shall be the price that would have been paid on the date of the acquisition between informed, willing parties on the basis of the best available information. In determining this value, the entity must consider the results of recent transactions in similar assets.

It is possible to employ pricing methods designed to determine fair value and which reflect conventional transactions and methods in the line of business to which the asset belongs. Such methods include:

- The use of multipliers that reflect the ratio between market transactions and the asset's profitability indexes (such as revenues, operating profit or market size) or the flow of royalties that could have been generated by leasing out the asset (the "relief from royalties" approach), or
- Discounting the asset's projected net cash flows.

Under IAS 38, if the intangible asset meets identifiability criteria, it therefore follows that there exists sufficient information that allows the reliable measurement of the asset's fair value.

Principal valuation methodologies

As a rule, there are multiple valuation methods in general, and multiple intangible asset valuation methods in particular. Naturally, each method has its own advantages and disadvantages, and one should employ each method according to its applicability to the case in question and/or to the assessment's situation and purpose.

1. **The Income Approach** - According to this approach, the value of the asset is derived from the current value of the cash flows which are expected to be derived from it over the remainder of its economic life. In this method, first we must estimate the cash flows which are expected to be derived from the asset in the future, based, inter alia, on an operational financial analysis.

Methodology (Cont'd)

In the second phase, these cash flows must be brought to the current values by way of discounting them to the date of the asset's valuation. Cash flow discounting is carried out using a rate of return which should reflect the time value of money and the business risk.

The fair value estimated using this method is actually the current value of future cash flows which are expected to be derived from the asset, including its salvage value, if any applies, at the end of the projection period.

When assessing value using this approach, it is common practice to employ the following methods, which are derived from the aforementioned financial approach:

- **Discounting of Excess Earnings** - Under this method, the intangible asset's value is estimated by way of discounting the "excess earnings" attributed to the asset. "Excess earnings" are defined as the difference between the operating profit expected from the evaluated asset and between the fair rate of return on the fair value of the assets that contribute and participate in the evaluated operation. The contribution of these contributing assets is reflected in the use which the intangible asset makes in other assets in the process of generating income or in the structure of expenses. In general, the contributing assets are usually fixed assets, human resources, brand, license, basic technology and more. In most cases, there will be more than one contributing asset.
 - **Relief from Royalties** - Under this method, the value of an intangible asset is estimated by way of discounting the "adequate royalty" payments which the owner of the asset would have been required to pay for using the asset had it not been owned by him.
 - This method is primarily used to estimate the value of intangible assets that are legally registered in the Company's name, such as: brands, trademarks, domain names, databases, patents, etc.
2. **Market Approach** - Under this method, the fair value takes into account the prices recently paid for similar assets, based on the analysis of similar transactions (as much as practicable) between willing buyers and sellers, including adjustments to the market prices specified, so as to reflect the condition and usability of the evaluated asset relative to the corresponding assets in the market. Consequently, this approach is often inapplicable to the valuation of intangible assets, and can be used strictly as a general and comparative measure for the results of other valuation methods.
 3. **Cost Approach** - Under this method, fair value is estimated based on the asset's replacement cost net of depreciation that reflects the functional, financial or technological aging of the existing asset relative to the new one. Cost Approach valuation results can be viewed as the upper limit of the value in cases where the asset can be easily replaced or renewed, as no careful foreign investor would purchase an existing asset at a price that is higher than the price of producing an equivalent asset which provides it with similar financial benefits. This principle normally does not apply to unique intangible assets that are legally protected against duplication, such as patents or copyrights (however, one should consider the territorial borders of such protection), or when the development periods of a substitute intangible asset are significant, or when the uncertainty of self-development is unusually high.

Methodology (Cont'd)

Useful life

The buying entity must assess whether the intangible asset's useful life is finite or undefined, and, if finite, must estimate its length. The entity shall consider a useful life duration as undefined if, after all relevant factors are analyzed, there appears to be no limit to the period in which the asset is expected to generate net cash flows for the entity.

An intangible asset with a defined useful life will be amortized over the course of its useful life, subject to an impairment test.

However, an intangible asset with an undefined useful life will not be amortized. Instead, the buying entity must test for the asset's impairment once a year or more frequently, if there is any indication of this asset's impairment. Moreover, the entity shall periodically examine the useful life of the intangible asset in question, so as to determine whether the events and circumstances still support the assessment that the useful life is undefined.

Tax benefit

According to the AICPA Practice Aid Series¹ guide, each intangible asset valuation must include:

- A. The expected tax payments for the cash flows attributed to the intangible asset and
- B. Tax benefits that will stem from the amortization of the intangible asset for tax purposes.

The guide also mentions that adding the effects of tax is common for the Income and Cost Approaches, but is not characteristic of the Market Approach, as tax benefits in such cases are already included in the market price quoted during the negotiations for the acquisition of the asset between market participants. The team that authored the guide believes that these two tax effects should be included in the value of the intangible asset, whether the purpose of the transaction was to sell assets of the acquired company for tax purposes and whether it was to sell shares of the acquired company (without introducing any changes to the tax base of the acquired assets and the liabilities received). Accordingly, the value of the in accordance with must also include the value of the tax benefit, even if we are dealing with a business combination by way of the acquisition of shares which, in practice, does not allow the amortization of the intangible assets for tax purposes.

In the absence of explicit provisions relating to the amortization of intangible assets, it was assumed for the purposes of this Work that the amortization of the intangible assets acquired shall be recognized for income tax reporting purposes. Given that the Tax Authority's opinion is yet to be expressed about this matter, our Work relied on the provisions set out in the AICPA Practice Aid Series guide.

The tax benefit in all the intangible assets evaluated was calculated using a straight line amortization method for the projection period used for the assessment of the intangible assets itself, or for a period of 10 years (the maximum period of goodwill amortization according to income tax provisions), whichever is lower.

¹ AICPA Practice Aid Series - Assets Acquired in a Business Combination to Be Used in Research and Development Activities: A Focus on Software, Electronic Devices, and Pharmaceutical Industries.

7. Tangible assets and liabilities

Tangible assets and liabilities

Current Assets

The balance of current assets includes cash and cash equivalents, trade receivables and other receivables. Since these are current financial assets, according to accepted accounting principles these should be presented at current values as at balance sheet date. Therefore, it was assumed it is unnecessary to discount these amounts given the insignificant difference between the discounted amounts and the amounts found in the books.

Broadcasting rights, net of rights exercised

The Company owns broadcasting rights in video contents (movies and series) of two kinds:

1. Broadcasting rights acquired from third parties - including discrete contents and channels
2. Broadcasting rights owing to original productions in whose production the Company invests (partially or wholly), where, in addition to the actual right to include the contents in its broadcasts, the Company usually maintains interest in those contents, the percentage of which is specified in the agreements signed with the producers.

Broadcasting rights are presented in the Company's balance sheet at cost net of rights exercised.

The financial value of the broadcasting rights was estimated using the Cost Approach. Under this approach, it was assumed that the rights previously paid for are not materially different from the costs which would have been paid for similar rights on the date of the allocation, owing to the relatively minor time differences (one year) between the date of payment and the date of allocation. Accordingly, in our assessment, the value of the asset presented in the books reflects its fair value.

As additional support for this, we should stress that we are dealing with a broad distribution of content providers, where the acquisition of broadcasting rights is effected according to framework agreements

that were determined by negotiations, and it is likely that these were entered into under market conditions. Moreover, in its books, the Company examines the life of the assets ascribed to the broadcasting rights and determines the relevant amortization period based on the projected life of these assets.

According to the balance specified in the books, the value of the broadcasting rights is estimated at approx. NIS 449 million.

Fixed assets

- Fixed Assets comprise a significant balance of the Company's assets, and amount to approx. NIS 801 million and approx. NIS 798 million as at March 31, 2015 and December 31, 2014, respectively (approx. 43% and 44% of the statement of financial position's total, respectively). This Section includes two substantial balances:

1. Digital satellite decoders: approx. NIS 486 million and approx. NIS 490 million as at December 31, 2014 and March 31, 2015, respectively. The estimated useful life of this equipment ranges between 4-8 years.
2. discounted installation costs amounting to approx. NIS 229 million and approx. NIS 225 million as at December 31, 2014 and March 31, 2015, respectively. The estimated useful life of installation costs is subdivided as follows: 13-15 years (for infrastructures in buildings) and 1-3 years (for infrastructures in apartments).

- We should not that the fixed assets balance contains additional balances that are significantly smaller, such as broadcasting and reception equipment, whose amortized cost amounted, as at December 31, 2014 and March 31, 2015, to approx. NIS 36 million and NIS 34 million, respectively.

Tangible assets and liabilities (Cont'd)

It was assumed that the financial value of fixed assets is not materially different from that appearing in the books. Under this approach, it was assumed that the costs previously paid for the assets correspond to the amounts which would have been paid today for the same assets. It was assumed that the amortization appearing in the financial statements also reflects a financial amortization.

Intangible assets, net

Intangible assets consist of two principal components:

1. Cost of Subscriber Acquisition

In 2011, a law was enacted which prohibits the Company from collecting exit fees from its customers, and the Company switched to a contract model that does not stipulate a commitment period. As a result, the Company lost its secured revenue from that customer, against which it would by then have discounted the customer acquisition costs. In light of the changes in legislation and the Company's business model, the Company elected to implement an accounting policy and to discontinue the discounting of customer acquisition costs.

The Company's sales entail a variety of sales commissions. Commissions can be directly identified with customer contracts. The Company's cost of subscriber acquisition are based on the balance of sums actually paid in the past and which are yet to be amortized in the financial statements over the subscribers' average contractual commitment period.

The financial value of the cost of subscriber acquisition was estimated using the Cost Approach. Under this approach, it was assumed that the costs of royalties previously paid to salespersons correspond to the amounts which would have been paid today for the same services, given the relatively minor time differences between the date of payment and the date of allocation.

The amortization appearing in the financial statements also reflects a financial amortization according to the subscribers' contractual period. Accordingly, in our assessment, the value of the asset presented in the books reflects its fair value.

2. Software Programs and Licenses

The financial value of software programs was also assessed using the Cost Approach, and, in our assessment, the value of the asset presented in the books reflects its fair value.

Current Liabilities

Credit line from banks, payables (without interest payable for debentures), trade payables and service providers were estimated according to their accounting balance in the Company's books.

Following are the assumptions used for estimating the fair value of the remaining current liabilities:

- **Current maturities for debentures and interest payable for debentures** - see "Debentures" below.

- **Provisions** - Several lawsuits or pending legal proceedings have been filed against the Company. The actual provision in the Company's books for lawsuits, as at March 31, 2015, amounted to approx. NIS 9,491 thousand. We were informed that the provisions found in the books does not reflect the exposure stemming from two class action suits of approx. NIS 20 million. For the purposes of this Work, it was assumed that the provision found in Yes's books must increase by approx. NIS 10 million so that it will reflect the fair value of the contingent liabilities.

Tangible assets and liabilities (Cont'd)

Debentures

The Company has three debenture series: Debenture Series A, Debenture Series B and Debenture Series C.

Debenture Series A - Issued in 2007 for institutional investors, which was listed on the TASE Tact Institutional system. In 2014, the Company completed additional Debenture Series A issues by way of series expansion, that amounted to approx. NIS 253 million.

Debenture Series A - Issued in 2010 for institutional investors and was listed on the TASE and expanded each year between 2011-2014. In 2014, the Company completed additional Debenture Series B issues that amounted to approx. NIS 179 million.

In April 2015, the Company completed additional Debenture Series B issues by way of series expansion, that amounted to approx. NIS 198 million.

Debenture Series C - Issued in 2012 for institutional investors.

The price of the debentures has risen, and therefore the calculated yield to maturity of each of the debentures has decreased between 2012 and 2014. The yield to maturity of debentures with longer average durations, namely, those of Debenture Series C is lower than that of Debenture Series B, which has a shorter average duration, although the collateral of each series is identical. It appears that in the past the Company obtained the debentures at higher interest rates, whereas today the interest rates are lower.

According to data received from the Company concerning the fair value calculation of the debentures in the Company's books as at March 31, 2015, the interest rates on the basis of which the projected cash flows were discounted are 1.9%, 2.1% and 2.3% for Debenture Series A, Debenture Series B, and Debenture Series C, respectively and as presented below:

Debenture Series	Discount Rate
Series A	1.9%
Series B	2.1%
Series C	2.3%

Therefore, their fair value as at March 31, 2015 of all three debenture series amounts to approx. NIS 1,908 million.

Other Long-term Liabilities

It was assumed that the accounting balance of other long-term liabilities reflects their fair value.

8. Intangible assets

Intangible assets

Accounting Principles

In March 2004, the International Accounting Standards Committee published a revised version of IAS 38, which concerns intangible assets. The Standard determines how intangible assets (that are not specifically addressed in other accounting standards) are to be accounted for, and requires the entity to recognize an intangible asset if and when certain defined criteria are met.

Under the Standard, in order for a certain item to meet the definition of an intangible asset, it must be a non-financial asset, devoid of any physical substance and identifiable. It is further stipulated that the fair value of the asset be reliably measurable.

Section 12 of IAS 38 stipulates that an intangible asset meets the identifiability condition whenever it meets any of the following criteria:

- **Financial criterion** - the asset can be separated, namely, it is possible to separate or split it from the entity, it may be sold or transferred, and it is possible to grant a license to use, lease out or replace it, separately or together with a related contract, a related asset or a related liability.
- **Legal criterion** - the asset is derived from contractual or other legal rights, regardless of whether these rights can be carried forward or can be separated from the entity or from other rights or obligations.

For the purpose of preparing this opinion, we examined several items which could constitute as possible intangible assets. Each item was examined to see if it meets the identifiability criterion described above, and, accordingly, if it could be recognized

separately from goodwill (under the assumption, of course, that the asset meets all of the other conditions included in the definition), or if it fails to meet this criterion, and therefore constitutes as goodwill.

Identified and estimated intangible assets

Potential intangible assets were examined through a review of documents and other relevant information about the operation and through conversations with Yes's management.

After this examination, the intangible assets identified whose fair value was estimated in the course of this Work are as follows:

- **Brand**
- **Customer Relationships**

In addition, we identified intangible assets whose fair value is not included in the attribution of the cost of acquisition on the grounds described below:

- **Broadcasting license** - TV broadcasting requires a license issued by the Ministry of Communications by virtue of the Communications Law (Telecommunications and Broadcastings). This license was granted to Yes in 1999 and entails an obligation assumed by the Company to pay royalties to the State of Israel, which are calculated on an income basis, as defined in relevant regulations. Under the Communications Regulations, 2006, the percentages of royalties that apply over the years are as follows:

2011 - 1.75%; 2012 - 1.75%; from 2013 onwards - 0%.

The Company's license is due to expire in January 2017. At the end of this period, it may be renewed for additional periods, six years each.

Intangible assets (Cont'd)

Accounting Principles (Cont'd)

Identified and estimated intangible assets (cont'd)

Broadcasting license (cont'd)

Under Paragraph 21 of IAS38, "An intangible asset shall be recognized if, and only if: (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and (b) the cost of the asset can be measured reliably. "

Under Paragraph 38 of IAS38, the only circumstances under which it may not be possible to reliably measure the fair value of an intangible asset, which was acquired in a business combination, are when the intangible asset is derived from legal or other contractual rights, and when it is "(A) inseparable; (B) separable, but there is no history or evidence of any replacement transactions of identical or similar assets, and any other method of estimating fair value will depend on variables that cannot be measured."

In our assessment, and according to conversations we held with the Company's management, in the case of the licenses held by Yes, it is not possible to measure the fair value of the intangible asset using the Income or Comparison Approach, as there is no history or there are no swap transactions of identical or similar assets in the market. Furthermore, it is difficult to estimate the variables needed to make use of these fair value valuation techniques. Therefore, the value of the licenses was not estimated in the course of this reference work.

- **Commercial agreements** - Yes is party to several commercial agreements, chief among which are the following:
 - Content providers - The broadcasting rights whose acquisition also affects content costs, as previously stated, are purchased by the Company from a large number of content providers, and so the Company is not depended on a primary and/or single content provider. However, with regard to Israeli sports broadcasts, the Company depends on the acquisition of the broadcasting rights of two local sports channels from two providers - the Sports Channel and Charlton.
 - Satellite segments - Under the agreement with Spacecom Ltd., the Company leases space segments that belong to Amos Series satellites (Spacecom Agreement). The agreement stipulates the lease of 12 space segments. However, as of 2022, the lease shall encompass 9 space segments. The Company is materially dependent on Spacecom, as the holder of its exclusivity rights and sole supplier.
 - Acquisition of decoders -The Company buys decoders primarily from Eurocom, as well as from ADB (Advanced Digital Broadcast S.A.). Given the structure of the market in which Yes operates, there are only a few "players" that purchase the aforementioned products in considerable quantities. Moreover, there is only a small number of available suppliers, and therefore there exists no public information about agreements of this kind.

It was assumed that the agreements are performed at market prices, and that they do not reflect an improvement or worsening with respect to market conditions.

Intangible assets (Cont'd)

- Client list - It is prohibited by law to make commercial use (beyond the internal use of the Company for its own purposes) of the customer list, and therefore they do not have any significant financial value.
- Deferred taxes - The Company has tax losses and inflation-related deduction which may be carried forward for an unlimited time until utilization that amount to NIS 5.4 billion, as at December 31, 2014.
- Following are the sources of Yes's accumulated tax losses and an estimate of the losses for which deferred taxes will be recognized:

	NIS Millions
Business losses, without financing expenses for loans from shareholders	3,084
Losses that stem from financing expenses for loans from Bezeq	1,803
Losses that stem from financing expenses for loans from Eurocom	522
Total losses for tax purposes	5,409

The tax asset amounting to approx. NIS 1,427 million included in the PPA work was calculated based on the assumption that the amount of losses that will be recognized by the Income Tax Authority will amount to approx. NIS 5.4 billion and on an assumed corporate tax rate of 26.5%.

- Owned channels - Yes has 10 channels fully-owned by itself. Some of these channels are included in the basic packages and some are included in packages offered for an additional payment. It is not possible to purchase these channels separately from the basic packages or the packages to which they belong. Moreover, the majority of Yes's customers buy additional channel packages in addition to the basic packages, which belong to various tracks. Therefore, and because these channels are viewed domestically and privately and as part of broader packages, their independent value cannot be reliably determined.

Discount rate (WACC)

We have estimated the nominal discount rate of the Company in a “market participant” view **at 8.5%**, based on the following parameters:

- **Risk-free interest rate (Rf)** - We estimated this rate at approx. 2.01% according to a yield to maturity of unlinked State of Israel debentures for a period of 12 years.
- **Beta (β)** - According to the beta values of the similar companies presented in the table below, we estimated the Company's leveraged beta at 0.87.
- **The Israeli market's risk premium (Rm-Rf)** - According to Damodaran data, we estimated the market's risk premium at 6.80%.
- **Additional risk premium (ARP)** - According to a study of Duff&Phelps Valuation Handbook 2014, we estimated the additional risk premium of the Company at 2.81%.
- **Interest on debt (Rd)** - The Company's interest on debt (before tax) is estimated at 4.51%, according to the yield to maturity of the debentures whose risk level is similar to that of the Company's liabilities, for an average duration of 12 years.
- **Leverage (D/D+E)** - Based on the average debt levels of similar companies, we used a leverage of 30%.
- **Tax rate** - Israeli statutory corporate tax rate 26.5%.

Risk-free interest rate (Rf)		
Risk-free interest rate	2.01%	Risk-free, 12-year linked debenture interest
Beta (β)		
Unleveraged beta	0.67	
Leveraged beta for calculation purposes	0.87	According to the leverage of similar companies in the line of industry
Return on equity (Re)		
Rf	2.01%	
Rm-Rf	6.80%	Israel's risk premium according to Damodaran
Beta	0.87	According to data of similar companies (Bloomberg)
ARP (size)	2.81%	Duff & Phelps Valuation Handbook 2014
RE	10.75%	
Interest on debt (Rd)		
Rd	4.51%	Return of debentures (NIS, 12 years, A rating)
Tax	26.5%	Israeli corporate tax rate
Rd* (1-Tax)	3.32%	
Discount rate		
Re	10.75%	
E/D+E	70%	
Rd*(1-Tax)	3.32%	
D/D+E	30%	
WACC	8.5%	

Name of Company	Adjusted Beta	R ²	Market Value	Net Debt	D/E	Tax Payment Country	Tax Rate	Un-leveraged Beta	D/D+E
Sky PLC	0.683	11%	18,050	6,545	0.36	UK	21%	0.53	27%
DISH Network Corp	0.974	19%	32,236	4,901	0.15	USA	40%	0.89	13%
SKY Network Television Ltd	0.546	3%	2,300	336	0.15	New Zealand	28%	0.49	13%
Liberty Global PLC	0.943	22%	44,497	45,001	1.01	USA	40%	0.59	50%
DIRECTV	0.802	18%	43,794	16,177	0.37	USA	40%	0.66	27%
Bezeq The Israeli Telecommunication Corp Ltd	0.712	3%	20,674	7,204	0.35	Israel	27%	0.57	26%
Weighted Average (Based on R² Value)	0.854	17%	34,735	19,292	0.49		36%	0.666	30%
Simple Average	0.777	13%	26,925	13,361	0.40		33%	0.621	26%

Customer Relationships

Customer Relationships

Results of the estimated value of the customer relationships asset

Following are the results of the estimated value of the customer relationships intangible asset:

Estimated fair value of customer relationships	NIS millions
Present Value of Customer Relationship Flows, before tax benefit	645
Value of tax benefit	<u>144</u>
Fair value plus tax benefit	790

Appendix A is attached hereto, and includes the cash flows projection used for the valuation of this intangible asset.

The method chosen

The fair value of the customer relationships intangible asset was estimated using the Income Approach, under which the Multi Period Excess Earnings Method was implemented. According to this approach, the value of the asset is derived from the current value of the cash flows which are expected to be derived from it over the remainder of its economic life. In this method, first we must estimate the cash flows which are expected to be derived from the asset in the future, based, inter alia, on an operational financial analysis. In the second phase, these cash flows must be brought to the current values by way of discounting them to the date of the asset's valuation. Cash flow discounting is carried out using a rate of return which should reflect the time value of money and the business risk.

Revenues from all customers projection

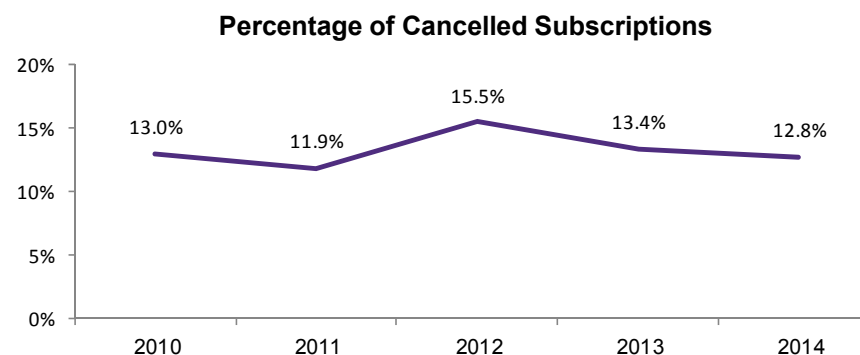
The analysis of revenues from customers was carried out based on the future operation projection received from Bezeq's management. For more information about the assumptions used for formulating this projection, see the valuation performed for the Company.

Churn rate

In 2014, the number of new subscriptions exceeded the number of cancelled subscriptions, and the net number of new subscriptions amounted to 31 thousand. The average number of cancelled subscriptions in 2011-2014 amounts to approx. 79 thousand customers.

The churn rate of subscriptions in 2014 amounts to approx. 12.8%, as opposed to 13.4% in 2013.

According to the average percentage of cancelled subscriptions in 2010-2014 presented below, the percentage of subscriptions cancelled by existing customers was determined to be **13.3%**.



Customer Relationships (Cont'd)

Operating Profit

It was assumed that the operating profit for existing customers will be identical to the operating profit of the operational projection, while neutralizing expenses directly related to the recruitment of new customers (such as agents' commissions, part of the salespersons' salary, etc.).

Accordingly, the operating profit is estimated at 19.8% for the last nine months of 2015, and at 19.0% in 2016, at 17.9% in 2017, at 18.0% in 2018 and at 17.9% from 2019 onwards.

Contributory charges of the customer relationships asset

Under the Income Approach, financial expenses for the use of the other assets of the entity, which the asset needed during its economic life, must be ascribed to the evaluated intangible asset. These expenses should include the expenses needed to support the existence of the intangible asset, including contributory charges that reflect the recognition of financial lease fees which the intangible asset must pay the entity's various assets, both tangible and intangible.

- **Contributory charges for working capital** - The Company's working capital represents the funds needed by the firm to finance its regular course of business and to bridge the time gaps between the date on which funds are expended in the course of production and the date on which payments are received in exchange for sold products.

For the purpose of calculating the contributory charges for working capital, it was assumed that the contributory return for the Company's working capital is equal to the risk-free return (return after tax). The working capital balances were determined according to a working capital rate of -25% (namely, a negative rate), which has been Yes's average working capital rate in recent years.

- **Contributory charge for fixed assets** - Most of the Company's fixed assets consist of broadcasting and recording equipment, digital satellite decoders, leasehold improvements, discounted installation costs, furniture and office supplies. The rate of return for fixed assets was determined according to the average balance of fixed assets from the Company's revenues over the years 2010-2014, and is estimated at 45%.

	2011	2012	2013	2014	Average
Fixed assets balance	676	745	775	798	749
Revenues	1,619	1,636	1,635	1,724	1,653
Return on fixed assets	42%	46%	47%	46%	45%

The contributory rate of return on fixed assets is estimated to be equal to the return on debt.

- **Contributory charge for the broadcasting rights balance** - The rate of return on the broadcasting rights balance was determined according to the average rate over the years 2010-2014, and is estimated at 24%. The contributory return on the broadcasting rights balance is estimated to be equal to the return on debt.

	2011	2012	2013	2014	Average
Broadcasting rights balance	331	377	417	442	392
Revenues	1,619	1,636	1,635	1,724	1,653
Return on broadcasting rights	20%	23%	25%	26%	24%

Customer Relationships (Cont'd)

Contributory charges of the customer relationships asset (cont'd)

- **Contributory charge for Assembled Workforce** - Under IFRS 3R, the human resources asset is not an identifiable asset, which is to be recognized separately from goodwill, and shall be included in goodwill. On the other hand, according to the Income Approach, we must consider contributory charges for the recruitment and training of the operation's human resources, which would have been necessary had the owner of the intangible asset been required to re-recruit the human resources needed for current operations so as to provide the products to the customer's relations.

Based on estimates provided to us by the Company's management, we included a relative charge for a two-month training period in the cash flow projection.

The rate of return used for calculating the contributory charge for Assembled Workforce is the WACC rate as determined in this Work.

- **Contributory charge for the brand** - The contributory charges for the brand were estimated according to the estimated royalty rate of 3% of expected revenues (while taking the abandonment rate of subscriptions into consideration).

Tax rate

We assumed that the Company's profits will be taxed according to the Israeli company tax rate, namely, 26.5%. We disregarded carry-forward tax losses, which do not form part of the customer relationships asset.

Discount rate

Yes's weighted discount rate is estimated at 8.5%. This rate encompasses the risks reflected in the cash flow and in the realization of the Company's expected cash flow. The Company's cash flow includes both its cash flow from existing customers and its cash flow from future customers. In our assessment, the risk level of the cash flow that stems from existing customers is similar to that of future customers. Therefore, the discount rate used by us in discounting revenues from customer relationships was estimated by us at 8.5%.

The useful life of the customer relations asset and the rate of amortization

The economic useful life of the customer relationships as previously stated is set to 7 years, and amortization is to be effected according to the trend of existing customer abandonment, with the aforementioned trend being spread over an amortization period of 7 years, as follows: years 1-2 - 20%; years 3-4 - 15%; years 5-7 - 10%.

Inclusion of tax benefit in asset value

it was assumed that the asset's amortization will be recognized for tax purposes throughout the asset's estimated period of amortization for tax purposes. The tax benefit from the amortization of customer relationships was calculated under the assumption of a linear amortization of the intangible asset over a period of 10 years, according to the period of amortization for tax purposes of goodwill.

Brand

Brand

Brand fair value estimate - Results

Following are the results of the estimated value of the brand intangible asset:

Estimated fair value of brand	NIS Millions
Present Value of brand Royalty Flows, before tax benefit	287
Value of tax benefit	60
Fair value plus tax benefit	347

Appendix B is attached hereto, and includes the cash flows projection used for the valuation of this intangible asset.

Method chosen for estimating the value of the brand

The brand's fair value estimate was carried out using the Relief from Royalties method, which is one of the types of the Income Approach, as described above. Under this approach, the value of the asset is estimated as the current value of adequate royalties which the entity would have had to pay to a third party for the use thereof, had it not been the owner of that asset. Normally, royalties paid for the use of an asset such as a brand are paid out of the entity's revenues in each year. Therefore, the revenues projection of the brand activity was based on the projection of revenues from the Yes brand.

Revenue projection

It was assumed that all of the projected revenues of the Company are ascribed to the Yes brand name.

The analysis of revenues was carried out based on the future operation projection received from Bezeq's management. For more information about the assumptions used for formulating this projection, see the valuation performed for the Company.

Royalty rate

The rate of savings on royalties is estimates based on several information sources, as follows:

- According to the royalty transactions database obtained from ktmine.com (a website that contains a list of royalty transactions in various lines of business), the royalty rates for the brand asset in the communications segment normally range between 1%-10%. It should be noted that no royalty rates were found for the cable network television business.
- Two royalty transactions were found in the television business at royaltysource.com. In the first transaction, a usage license was granted in CBS's name in exchange for royalties equal to 7% of the revenues, and in the second transaction a usage license was granted in Virgin's name in exchange for royalties equal to 0.25%.
- The royalty rate as determined in the Yes's previous PPA, which was prepared in 2009, was determined according to the work prepared by Itzhak Suari Ltd., and was equal to 2%.
- A common rule of thumb assumes that approx. 25% of the operating profit can be ascribed to brand-based royalties. According to the cash flow projections, the operating profit ranges between 12-16%, and, in the representative year, the operating profit amounts to 15%. According to these data, the rate of brand-based royalties should be between 3%-4%.

In our assessment, branding is highly significant in the Israeli multi-channel television industry. Moreover, Yes's ARPU has been higher than Hot's ARPU over the past few years. We were informed by the Company that Yes's ability to collect excess premiums relative to its principal competitor, HOT, stems from the high-quality service it provides to its customers relative to its competitor, which uses outsourcing services in order to reduce costs, and from the creation of a preferable user experience, both in terms of technology and in terms of the better quality and diversity of the contents provided by the Company to its customers relative to HOT.

Based on our review of the data and the information sources mentioned above, it appears that the suitable royalty rate for the Yes brand name is **3%**.

Brand (cont'd)

Tax rate

We assumed that the Company's profits will be taxed according to the Israeli company tax rate, namely, 26.5%. We disregarded carry-forward tax losses, which do not form part of this asset.

Discount rate

In our assessment, the risk level of the cash flow generated by the brand is higher than the Company's average risk level. Therefore, theoretical brand-generated royalties were discounted at a discount rate of 9.5%, which is derived from a weighted discount rate (WACC) of 8.5%, plus a 1% margin.

Useful life

The brand's useful life assumed by the model is 12 years, both in light of the limited useful life of communications brands in the past (*Tevel*, *Golden Channels*, *Matab*, etc.), and owing to the difficulty of estimating the development of the various parameters that pertain to an estimate that is beyond this period.

Tax benefit

The asset's fair value estimate should include the tax shield that stems from the asset's amortization. It was assumed, for the purposes of this Work, that the estimated asset can be amortized for tax purposes for a period of 10 years.

9. Appendices

Appendix A - Customer Relationships Valuation (in NIS millions)

NIS millions	Actual 2014	Actual Q1/15	Projected Q2-Q4/15	Projected 2016	Projected 2017	Projected 2018	Projected 2019	Projected 2020	Projected 2021	Projected 2022	Projected 2023	Projected 2024
Estimated total revenues from Yes products	1724	440	1,309	1,765	1,737	1,731	1,748	1,766	1,783	1,801	1,819	1,837
Growth rate			1.5%	0.9%	-1.6%	-0.3%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Survivorship of customer			<u>95%</u>	<u>84%</u>	<u>73%</u>	<u>63%</u>	<u>55%</u>	<u>48%</u>	<u>41%</u>	<u>36%</u>	<u>31%</u>	<u>27%</u>
Revenues from existing customers, net		440	1,244	1,483	1,266	1,094	958	839	735	643	563	493
Operating profit margin (%)			19.8%	19.0%	17.9%	18.0%	17.9%	17.9%	17.9%	17.9%	17.9%	17.9%
Operating profit			246	282	227	197	172	150	132	115	101	88
	Royalty Rate											
Return on brand	3.0%		(37)	(45)	(38)	(33)	(29)	(25)	(22)	(19)	(17)	(15)
Operating profit net of return on brand			209	238	189	164	143	125	110	96	84	74
Tax expense	26.5%		(55)	(63)	(50)	(44)	(38)	(33)	(29)	(25)	(22)	(19)
After tax operating cash flow			154	175	139	121	105	92	81	71	62	54
	Royalty Rate											
Return on working capital	1.5%		5	5	5	4	4	3	3	2	2	2
Return on fixed assets	3.3%		(19)	(22)	(19)	(16)	(14)	(13)	(11)	(10)	(8)	(7)
Return on broadcasting rights	3.3%		(10)	(12)	(10)	(9)	(8)	(7)	(6)	(5)	(4)	(4)
Return on assembled workforce	8.5%		(3)	(3)	(3)	(2)	(2)	(2)	(2)	(1)	(1)	(1)
Net cash flow for discounting			127	143	112	97	85	74	65	57	50	44
Years to discount			0.38	1.25	2.25	3.25	4.25	5.25	6.25	7.25	8.25	9.25
Discount factor	8.5%		1.03	1.11	1.20	1.30	1.41	1.53	1.67	1.81	1.96	2.13
Net discounted cash flow			123	129	93	75	60	48	39	31	25	20
Calculation summary												
Present Value of Customer Relationship Flows, before tax benefit	645											
Value of tax benefit	144											
Fair value plus tax benefit	790											

Appendix B - Brand Valuation (in NIS millions)

		Actual 2014	Actual Q1/15	Projected Q2-Q4/15	Projected 2015	Projected 2016	Projected 2017	Projected 2018	Projected 2019	Projected 2020	Projected 2021	Projected 2022	Projected 2023	Projected 2024	Projected 2025	Projected 2026	Projected Q1/2027
Projection of revenues from Yes brand		1,724	440	1,309	1,749	1,765	1,737	1,731	1,748	1,766	1,783	1,801	1,819	1,837	1,856	1,874	476
Growth rate					1.5%	0.9%	-1.6%	-0.3%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Pretax relief from royalty	3.0%			39	52	53	52	52	52	53	54	54	55	55	56	56	14
Tax expenses	26.5%			(10)	(14)	(14)	(14)	(14)	(14)	(14)	(14)	(14)	(14)	(15)	(15)	(15)	(4)
Aftertax royalty				29	39	39	38	38	39	39	39	40	40	41	41	41	10
Years to discount				0.38		1.25	2.25	3.25	4.25	5.25	6.25	7.25	8.25	9.25	10.25	11.25	11.88
Discount factor	9.5%			1.0		1.1	1.2	1.3	1.5	1.6	1.8	1.9	2.1	2.3	2.5	2.8	2.9
Discounted cash flow net of tax				28		35	31	28	26	24	22	21	19	17	16	15	4

Calculation summary

Present value of cash
flow 287

Tax shield 60

**Fair value plus tax
benefit 347**

Appendix C - WARA Calculation (in NIS millions)

WARA calculation:	NIS thousands	Discount rate	Weight
Working capital, net	-303	1.5%	-0.1%
Fixed assets	801	3.3%	0.7%
Intangible assets in Yes's books	148	8.5%	0.3%
Broadcasting rights net of rights exercised	449	3.3%	0.4%
Deferred tax asset for tax losses	1,427	8.5%	3.2%
Customer relationships	580	8.5%	1.3%
Brand	255	9.5%	0.6%
Goodwill (residual value)	<u>385</u>	19.0%	2.0%
Enterprise Value	3,742		8.5%
Less total financial liabilities and other assets/liabilities, net:	(1,769)		
Total cost of business combination	1,973		

About the Authors

Fahn Kanne Consulting is a subsidiary of Fahn, Kanne & Co., which is one of the six largest accounting firms in Israel. Fahn Kanne Consulting provides first-class financial, accounting and business consultation services, as well as financial and accounting management and control services to organizations and companies.

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Shlomi Bartov, CPA

Partner and CEO, Fahn Kanne Consulting - MBA in business administration (TAU); BA in economics and accounting (TAU). Mr. Bartov is highly experienced in providing support and consultation to some of the largest companies in Israel.

Roman Falk, CPA

Director, Fahn Kanne Consulting - MA in economics (TAU); BA in economics and accounting, cum laude (TAU).

Bezeq The Israel Telecommunication Corporation Ltd.

Chapter D Additional Information about the Company Corporate Governance Questionnaire

**For period ended
December 31, 2015**



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.

1. Regulation 10A: Summary of the Company's consolidated statements of income for each of the quarters of the reporting year

See section 1.3 to the Director's Report, attached to the second part of this report.

2. Regulation 10C: Use of proceeds for securities

On October 14, 2015 the Company allotted 388,451,000 Debentures (Series 9) and 400,000,000 Debentures (Series 10) of the Company, under a Shelf Offering Memorandum dated October 13, 2015 (Ref. No.: 2015-01-134100) (the Shelf Offering Memorandum") which was issued under the Company's Shelf Prospectus dated May 30, 2014, as amended with correction of a clerical error on June 5, 2014 (Ref. No.: 2014-01-084171). The total proceeds (gross) received by the Company for allotment of Debentures (Series 9 and 10) under the Shelf Offering Memorandum amount to a total of NIS 788,451 thousands ("the Issue Proceeds"), which was not earmarked specifically under the Shelf Offering Memorandum. The Company uses the Issue Proceeds for its ongoing business operations and for rescheduling existing debt.

3. Regulation 11: Breakdown of material investments in subsidiaries and related companies as at the date of the statements of financial position¹

Company name:	Name of holder	Class of share	Number of shares	Total par value	Rate of holding in the issued equity and in the voting rights	Rate of holdings in rights to appoint directors	Company's separate balance sheet value² (in NIS millions)
Pelephone Communications Ltd. ("Pelephone")	The Company	Ordinary NIS 1 shares	302,460,000	302,460,000	100%	100%	3,775
Bezeq International Ltd. ("Bezeq International")	The Company	Ordinary NIS 0.1 shares	1,136,986,301	113,698,630	100%	100%	951
D.B.S. Satellite Services (1998) Ltd. ("DBS")	The Company	Ordinary NIS 1 shares	36,117	36,117	100%	100% ³	2,345
Walla Communications Ltd. ("Walla")	The Company	Ordinary shares without nominal value	47,340,970	-	100%	100%	587

¹ For details relating to other investees held directly or indirectly by the Company, see Note 9 to the consolidated financial statements.

² The enclosed values include loans provided as follows: To Bezeq International - NIS 124 million and too DBS - NIS 323 million. For further information pertaining the loans provided, maturity dates, and the loans provided to other investees, see Note 10.2 to the separate financial information attached to the Periodic Report.

³ Until March 23, 2015 the Company held 49.78% of the share capital of DBS and held options that granted the right to 8.6% of DBS shares. On March 23, 2015 the Company exercised its option and it was allotted DBS shares equivalent to 8.6% of the issued share capital of DBS, thus as of that date, the Company's holdings in DBS was 58.4%. On June 24, 2015 the Company completed a transaction for the acquisition of the rest of the issued and paid up share capital of DBS (which was held by Eurocom DBS) and as at the reporting date, the Company holds the entire issued and paid up share capital of DBS. For further information see Note 11.2 to the financial statements and the Company's immediate report dated June 24, 2015 (Ref. No.: 2015-01-056178), the information contained therein is noted here by way of reference.

4. Regulation 12: Material changes in investments in subsidiaries and affiliates in the reporting period:

Date of change	Nature of the change ⁴	Company name:	Reported amounts (NIS thousands)
1-12.2015	Linkage differentials and interest on shareholders loans	DBS	154
Mar 15, 2015	Repayment of loan provided by the Company to Bezeq International	Bezeq International	8
June 24, 2015	Acquisition of shares ³ and shareholders' loans	DBS	897
Sept 10, 2015	Repayment of loan provided by the Company to Bezeq International	Bezeq International	30
Sept 16, 2015	Repayment of loan provided by the Company to Bezeq International	Bezeq International	8
Dec 20, 2015	Repayment of loan provided by the Company to Bezeq International	Bezeq International	32
Mar 8, 2015	Loan provided by the Company to Bezeq International	Bezeq International	50
Sept 10, 2015	Loan provided by the Company to Bezeq International	Bezeq International	10
Dec 20, 2015	Loan provided by the Company to DBS	DBS	323

5. Regulation 13: Revenues of material subsidiaries and the revenues of the Company from them as at the date of the statement of financial position (in NIS millions)⁵

Company name:	Profit (loss) for the period	Comprehensive income(loss) for the period	Dividends	Management fees	Interest income
Pelephone	151	154	243	6	-
Bezeq International	172	173	170	1.5	7
DBS	(354)	(354)	-	-	167
Walla	(2)	(1)	-	-	- ⁶

6. Regulation 20: Stock Exchange Trading

In 2015, 18,813,295 ordinary shares of NIS 1 par value of the Company were listed for trading due to exercising of options under an options plan for executive officers from December 25, 2007 and exercising of options from an options plan for employees from December 20, 2010.

In 2015, 388,451,000 NIS par value debentures (Series 9) and 400,000,000 NIS par value debentures (Series 10) were listed for trading subsequent to a public issue by the Company in October 2015.

⁴ The repayment amounts set out in this Regulation refer to principal amounts only.

⁵ In addition, subsequent to reporting date, the subsidiaries announced distribution of dividends, as follows: 1. On March 2, 2016 the board of directors of Pelephone resolved to distribute a dividend to the Company in the amount of NIS 66 million in May 2016. 2. On February 29, 2016 the board of directors of Bezeq International resolved to distribute a dividend to the Company in the amount of NIS 83 million in May 2016. 3. On February 25, 2016 the board of directors of Walla resolved to distribute a dividend to the Company in the amount of NIS 434 million in May 2016.

⁶ In 2015 the Company recorded interest expenses in the amount of NIS 18 million for the loan provided to the Company by Walla in 2014.

7. Regulation 21: Remuneration of interested parties and executive officers

Below is a breakdown of the remunerations paid in 2015, as recognized in the financial statements for 2015, to each of the five highest-paid executive officers in the Company or in a company under its control, and which were paid to them in lieu of their service in the Company or a company under its control, (employer's cost and on annual basis):

Recipient					Remuneration (in NIS thousands)					Total (NIS thousands)	Section below
Name	Position	Sex	Scope of position	Rate of holding in equity of the company	Fee ⁷	Bonus ⁸	Share-based payment	Phantom options: ⁹	Other (management fees)	Total	
Eurocom Communications Ltd.	Consultancy and management services, including services of chairperson and directors	Corporation	-	¹⁰ 26.34%	-	-	-	-	5,524	5,524	A.
Gil Sharon ¹¹	CEO of Pelephone (former)	Male	Full-time	-	2,615	2,775	-	(130)	-	5,260	B.
Stella Handler	Company CEO	Female	Full-time	-	2,283	2,142	-	-	-	4,425	C.
Moti Elmaliach	CEO, Bezeq International Ltd.	Male	Full-time	-	1,721	1,467	-	-	-	3,188	D.
Ron Eilon ¹²	CEO of DBS	Male	Full-time	-	1,611	991	-	-	-	2,602	E.
Dudu Mizrachi	Deputy CEO and CFO	Male	Full-time	-	1,578	674	-	104	-	2,356	F.
Ran Guron ¹³	Deputy CEO and VP Marketing	Male	Full-time	-	1,453	870	-	-	-	2,322	G.

⁷ The remuneration amounts include the cost of salaries and ancillary salary costs, including perks and social benefits such as telephone expenses, customary type of company car, study fund (for some of the managers), reimbursement of expenses and leave pay, sick leave and customary annual recreation days.

⁸ The bonus amounts that appear in the table are as recognized in the 2015 statements and include performance based bonus and retirement bonus (if paid), all in accordance with the Company's Compensation Policy. The performance based bonus in the table is for 2015 (at reporting date, it is yet to be paid to senior officers) and includes a contingent portion that will to these officers by way of the distribution described in footnote 15 section B. In 2015 bonuses were paid to the foregoing officers for 2014, the amount of which (including the contingent portion that was not actually paid in 2015, but will be paid in 2016) is included in the corresponding table in the Company's annual report for 2014 (published on March 3, 2015).

⁹ This refers to a revaluation that was recognized in the financial statements of the reporting year for share-based payment of phantom options granted on December 30, 2010. The value was revised according to the actual exercise of the phantom options.

¹⁰ Eurocom Communications Ltd. holdings in the Company that are noted in the table are indirect, as at date of publication of this report.

¹¹ Mr. Sharon ceased serving as CEO of Pelephone subsequent to the reporting period, on January 25, 2016 (including early notice period). For details see section B below. Prior notice payments are not presented in this report because the expense therefor is recognized in the Company's financial statements for the year during which he commenced his office as CEO of Pelephone.

¹² Since consolidation of DBS statements with the Company's financial statements, on March 23, 2015, Ron Eilon's recognized remuneration is included in the Company's financial statements.

¹³ Mr. Guron served as Deputy CEO and VP Marketing of the Company until November 8, 2015 on which date he commenced his office as CEO of Pelephone. The remuneration components set out in the table relate to his office in the Company (the reporting company) only. For further details, see section G below.

Breakdown of the terms of employment of the senior officers who appear in the foregoing table:

A. Eurocom Communications Ltd.

Eurocom Communications Ltd. ("Eurocom Communications"), the controlling shareholder (indirect) of the Company, provides the Company with various consultancy and management services. On June 13, 2013 the Company's general meeting approved engaging with Eurocom Communications Ltd. in an amended agreement for providing shared consultancy and management services, including the services of the acting Chairman of the board of directors provided by Mr. Shaul Elovitch (the controlling shareholder of the Company) equivalent to a 70% position, the services of directors in the Company and its subsidiaries and ongoing consultancy services, for a period of three years as of June 1, 2013 through to May 31, 2016 in return for an annual fee of NIS 5.524 million (for a description of the highlights of this agreement, see the immediate report for convening of a general meeting dated May 7, 2013, as amended under an amendment report dated June 10, 2013) ("the Management Agreement"). For the period from January 1, 2015 through to December 31, 2015, the amount paid to Eurocom Communications for these services amounted to NIS 5,524,000 (excluding VAT).

Under the management agreement, of the management fees paid to Eurocom Communications, an annual amount of NIS 3.5 million (NIS 290,000 per month) is paid for the services provided to the Company by the Chairman of the Board, Mr. Shaul Elovitch.

B. Gil Sharon

Was employed during the reporting year and through to January 25, 2016 (below in this section: "**Date of Retirement**") as CEO of the subsidiary, Pelephone. Gil Sharon was employed in this position since October 11, 2005 under a personal employment contract dated January 19, 2006. Pursuant to the employment contract, Gil Sharon's monthly salary amount to NIS 185 thousand. On December 30, 2010 Gil Sharon was granted 3,000,000 phantom options, which as at reporting date have been exercised in full.¹⁴

The 2015 bonus goals for the Gil Sharon were preset by the Company's board of directors in January 2015, following approval by the Company's compensations committee and were based on Pelephone's working plan for 2015, and included¹⁵: an EBITDA goal (based on Pelephone's separate financial statements), representing 25% of the bonus calculation; a cash flow goal based on Pelephone's FFO cash flows, representing 25% of the bonus calculation; a goal composed of items relating to Pelephone's competitive position in the market, representing 20% of the bonus calculation; company-wide operating expenses goal (without terminal equipment expenses and depreciation expenses in additional investments), representing 10% of the bonus calculation; and the chairperson of Pelephone's board of directors assessment of the CEO's performance, representing 20% of the annual bonus calculation for Gil Sharon for 2015. The precondition for receiving the bonus was that the FFO¹⁶ result for 2015 (less events as set out below) would not fall below 25% of the goal set in Pelephone's budget for 2015. This precondition was met. The rate of Mr. Sharon's compliance with the

¹⁴ For details of the revised value recognized in the financial statements in the reporting year for these options, see the above table.

¹⁵ Under the compensation policy approved by the general meeting on September 3, 2013 (and amendments), and the 2015 bonus goals set by the Company's compensations committee and board of directors: (a) The CEOs of the Company and of the material subsidiaries are eligible to receive up to 100% of their annual salaries (without ancillary benefits) and the VPs are eligible for 50%, for full compliance with the goals that will be prescribed for each calendar year. In addition, an outperformance formula was set at up to 125% of the annual salaries for the CEOs of the Company and of the material subsidiaries and up to 62.5% of the annual salaries for the Company's VPs; (b) full compliance with the EBITDA goal constitutes 40% of the bonus and compensation for which such compliance will be paid as follows: 1. 60% of the bonus eligibility for compliance with the EBITDA for 2015 will be paid following the date of approval of the financial statements for that year. 2. The balance of the bonus eligibility for 2015, i.e. 40%, will be paid in 2017 and only if the minimum EBITDA goal set by the Company's board of directors, compared with the 2016 budget, is achieved; (c) if an officer working in the Company/Group at the end of 2015 and meets the EBITDA goal, but his/her employment is terminated, for any reason whatsoever, or alternatively he/she is transferred to another position within the Group, before the end of 2016, the Group's remunerations committee and board of directors may decide at their discretion whether such officer is eligible to receive the contingent compensation or part thereof upon such resignation/transfer, with taking into account, among other things, forecasts for 2016.

¹⁶ Funds from operations (FFO) - cash flows from operations before changes in working capital and before changes in other asset and liability items. The FFO index weights the foregoing performance compared with measurable goals (the goals are not described in detail due to the fact that they include confidential information, the disclosure of which may adversely affect the Company) and may be subject to neutralizing events decided and set out in the compensations policy. This index is also used by the rating agencies when assessing the Company's performance.

bonus goals for 2015, was 125%. On March 16, 2016, the Company's board of directors reviewed Mr. Sharon's compliance with the goals and based on the rate of compliance with the said goals, the bonus granted to Mr. Sharon for 2015 is 125% of his annual salary, amounting to NIS 2,775 thousand. It should be noted that, for the purpose of calculating Mr. Sharon's bonus for 2015 (as well as for calculating the FFO for testing compliance with the preconditions for eligibility for the annual bonus), the expenses incurred from the provisions made for voluntary redundancy of employees were neutralized as well as failure to meet the plan for increasing revenues from MVNOs. 40% of Mr. Sharon's eligibility for compensation with regard to compliance with Pelephone's EBITDA goal for 2014 ("contingent compensation for 2014"), amounting to NIS 220 thousand, will be paid to Mr. Sharon in 2016 after approval of the financial statements for this year by the board of directors on March 16, 2016, and this in view of achieving the minimum EBITDA goal set by the board of directors for the 2015 budget year. In addition, according to the Company's compensation policy, 40% of the Mr. Sharon's eligibility for compensation with regard to compliance with Pelephone's EBITDA goal for 2015 amounting to NIS 277.5 thousand is a contingent compensation ("contingent compensation for 2015"). The Company's compensations committee and board of directors approved payment of the contingent compensation for 2015 in accordance with their powers under the provisions of the compensation policy, and this in view of Mr. Sharon's retirement from the Group.

C. Stella Handler

Employed in the Company as CEO since April 14, 2013 under a personal employment agreement dated on May 8, 2013. The agreement is unlimited in time with either party having the right to terminate it with prior notice of 6 months. In the reporting year, the CEO's monthly salary (gross) amounted to NIS 143 thousand.

The CEO's bonus goals for 2015 were pre-set by the Company's board of directors in January 2015 and are based on the Company's annual work plan for 2015. They were also approved by the general meeting on March 16, 2015 and included four goals¹⁷: EBITDA goals for the Company (separate), representing 30% of the bonus calculation; a FCF cash flow goal, representing 30% of the bonus calculation; an after tax profit goal, representing 20% of the bonus calculation; and a chairman of the board assessment goal of the CEO's performance, representing 20% of the bonus calculation. With regard to each of the foregoing criteria, a scale was set for calculating the bonus based on rate of compliance, as follows: for compliance of lower than 95% of a goal, the CEO will not be eligible for a bonus regarding that criterion; for 95% - 100% compliance with a goal, the CEO will be eligible for 60% - 100% pro-rata of that criterion; and for 100% - 102.5% compliance with a goal, the CEO will be eligible for 100% - 160% pro-rata of the relevant criterion. The precondition for receiving the bonus was that the ¹⁸ FFO result for 2015 (NIS 2,393.4 million) would not fall below 20% of the FFO result of Company for 2014. This precondition was met. The rate of compliance of the Company's CEO with the bonus goals for 2015, was 125%. On March 16, 2016, the Company's board of directors reviewed the CEO's compliance with the goals and based on the rate of compliance with the said goals, the bonus granted to the CEO for 2015 is 125% of her annual salary, amounting to NIS 2,142 thousand. It should be noted that, for the purpose of calculating the bonus of the CEO of Company for 2015 (as well as for calculating the FFO for testing compliance with the preconditions for eligibility for the annual bonus), the expenses incurred from the settlement with the tax authorities with regard to the DBS loans, provisions made for voluntary redundancy of employees and the amendment of the financing income recorded from DBS (accounting amendment) were neutralized. 40% of the Company CEO's eligibility for compensation with regard to compliance with the Company's EBITDA goal for 2014 ("contingent compensation for 2014"), amounting to NIS 253 thousand, will be paid to the Company's CEO in 2016 after approval of the financial statements for this year by the board of directors on March 16, 2016, and this in view of achieving the minimum EBITDA goal set by the board of directors for the 2015 budget year. 40% of the eligibility for compensation with regard to compliance with the Company's EBITDA goal for 2015 ("contingent compensation for 2015"), amounting to NIS 257 thousand, will be paid to the Company CEO only in 2017 (after approval of the financial statements for this year), and this only if the minimum EBITDA goal set by the board of directors for the 2016 budget year, is achieved.

D. Moti Elmaliach

Employed as CEO of the subsidiary, Bezeq International, under a personal employment agreement dated May 28, 2014. The agreement is unlimited in time with either party having the right to terminate

¹⁷ See sub-section 15 above.

¹⁸ See sub-section 16 above.

it with prior notice of 6 months. In the reporting year, the Bezeq International CEO's monthly salary (gross) amounted to NIS 102 thousand. It is noted that subsequent to the date of the Periodic Report, the employment agreement of the CEO of Bezeq International was amended so that his monthly salary (gross) is NIS 110,000.

The bonus goals for the CEO of Bezeq International were preset by the Company's board of directors in January 2015, following approval by the Company's compensations committee, and were based on Bezeq International's working plan for 2015, and included¹⁹: an EBITDA goal (based on Bezeq International's separate financial statements), representing 30% of the bonus calculation; a goal based on Bezeq International's FFO cash flows, representing 30% of the bonus calculation; a goal based on Bezeq International's net profit, representing 20% of the bonus calculation; and the chairperson of Bezeq International's board of directors assessment of the CEO's performance, representing 20% of the calculation for the annual bonus of the CEO of Bezeq International for 2015. The precondition for receiving the bonus was that the FFO²⁰ result for 2015 (NIS 306.8 million) would not fall below 20% of the FFO result of Bezeq International for 2014. This precondition was met. The rate of compliance of the CEO of Bezeq International with the bonus goals for 2015 was 120%. On March 16, 2016, the Company's board of directors reviewed the compliance of the CEO of Bezeq International with the goals and based on the rate of compliance with the said goals, the bonus granted to the CEO of Bezeq International for 2015 is 120% of his annual salary, amounting to NIS 1,467 thousand. 40% of the eligibility of the CEO of Bezeq International for compensation with regard to compliance with the Bezeq International's EBITDA goal for 2014 ("contingent compensation for 2014"), amounting to NIS 89 thousand, will be paid to the Company's CEO in 2016 after approval of the financial statements for this year by the board of directors on March 16, 2016, and this in view of achieving the minimum EBITDA goal set by the board of directors for the 2015 budget year. In addition, 40% of eligibility of the CEO of Bezeq International for compensation with regard to compliance with the Bezeq International's EBITDA goal for 2015 ("contingent compensation for 2015"), amounting to NIS 167 thousand, will be paid to the CEO of Bezeq International only in 2017 (after approval of the financial statements for this year), and this only if the minimum EBITDA goal set by the board of directors for the 2016 budget year, is achieved.

E. Ron Eilon

Employed as CEO of the subsidiary, DBS, under a personal employment agreement dated August 28, 2006. The agreement is for an unlimited period, and it may be terminated by either party at any time and for any reason with 12 months written prior notice by DBS and 6 months prior notice by DBS's CEO.²¹ In the reporting year, the DBS CEO's monthly salary (gross) amounted to NIS 129 thousand.

The bonus goals of the CEO of DBS for 2015 were set by the board of directors of DBS in March 2015 (prior to date of consolidation of DBS statements in the Company's financial statements on March 23, 2015), based on the annual work plan for DBS for 2015, and included: an EBITDA goal (separate) representing 80%; and an assessment goal by the chairman of the board of directors of DBS, representing 20%. On the date of approval of the goals by the board of directors of DBS, eligibility for an annual bonus of the CEO of DBS was fixed at 100% of his annual salary (without ancillary benefits) for full compliance with the goals. In addition, a bonus formula was fixed for performance exceeding these goals of up to 125% of the CEO of DBS's annual salary. The rate of compliance of the CEO of DBS with the bonus goals for 2015, was 82%. On March 16, 2016 the Company's board of directors reviewed the compliance of the CEO of DBS with the goals and based on the rate of compliance with said goals, the bonus awarded to the CEO of DBS for 2015, for his office as an executive officer of the Company as of the date of consolidation of DBS statements with the Company's financial statements, is 82% of the annual salary of the CEO of DBS, in the amount of NIS 956 thousand. It should be noted that, for the purpose of calculating the bonus for the CEO of DBS for 2015, the expenses incurred due to reclassification of the costs of the IT systems were deducted.

F. Dudu Mizrahi

Employed as CFO & Deputy CEO since January 1, 2013 (in the Company since May 1996). The agreement is for an unlimited period, and it may be terminated by either party with 6 months prior notice. In the reporting year, the monthly salary (gross) of the CFO & Deputy CEO amounted to NIS

¹⁹ See sub-section 15 above.

²⁰ See sub-section 16 above.

²¹ Under the employment agreement, the CEO will give DBS an additional three months prior notice if he is so required by written request of DBS.

92 thousand. On December 30, 2010 the CFO & Deputy CEO was granted 400,000 phantom options, which were exercised in full in the reporting year.²²

The bonus goals for the CFO & Deputy CEO were preset by the Company's board of directors in January 2015, based on the Company's annual work schedule for 2015 and included²³: a goal based on the EBITDA for the Company (separate), representing 30% of the bonus calculation; a goal based on the Company's (separate) FCF, representing 20% of the bonus calculation; a goal based on operating expenses, representing 15% of the bonus calculation; a goal based on profit after tax of Bezeq Fixed-line, representing 15% of the bonus calculation; a goal based on performance assessment by the chairman of the board representing 10% of the bonus calculation; and a goal based on administrative assessment including compliance with streamlining, automation and proactivity criteria and the Company's preparations for wholesale, representing 10% of the bonus calculation. The rate of compliance of the CFO & Deputy CEO with the set of bonus goals for 2015, was 123%. On March 16, 2016 the Company's board of directors reviewed the compliance of the CFO & Deputy CEO with the goals and based on the rate of compliance, the bonus awarded to the CFO & Deputy CEO for 2015 is 61% of his annual salary, amounting to NIS 674 thousand. It should be noted that, for the purpose of calculating the bonus of the CFO & Deputy CEO for 2015, the expenses incurred from the settlement with the tax authorities with regard to the DBS loans, provisions made for voluntary redundancy of employees and the amendment of the financing income recorded from DBS (accounting amendment) were neutralized. The contingent compensation for 2014 for the CFO & Deputy CEO, in the amount of NIS 81 thousand, will be paid to him in 2016 after approval of the financial statements for this year by the board of directors on March 16, 2016, and this in view of achieving the minimum EBITDA goal set by the board of directors for the 2015 budget year. Similarly, the contingent compensation for 2015 for the CFO & Deputy CEO, in the amount of NIS 82 thousand, will only be paid to him in 2017 (after approval of the financial statements for 2016), and this in view of achieving the minimum EBITDA goal set by the board of directors for the 2016 budget year.

G. Ran Guron:

Employed in the reporting year and through to November 8, 2015 as Deputy CEO and VP Marketing of the Company. Mr. Guron served in this position since March 16, 2011 (in the Company since December 18, 2005). On November 8, 2015 he ceased his office as Deputy CEO and VP Marketing of the Company and began his office as CEO of the subsidiary, Pelephone. The components of the compensation received by Mr. Guron as set out in this chapter, relate to his office in 2015 in the Company only. In the reporting year, Mr. Guron's monthly salary (gross) amounted to NIS 95 thousand.

Upon approval of Mr. Guron's appointment as CEO of Pelephone and of the terms of his office and employment by the Company's board of directors, it was decided that with regard to 2015 he would be compensated based on the goals set for him as Deputy CEO and VP Marketing of the Company.

The bonus goals for Mr. Guron were preset by the Company's board of directors in January 2015, based on the Company's annual work schedule for 2015 and included²⁴: EBITDA goals for the Company (separate), representing 30% of the bonus calculation; a goal based on the Company (separate) FCF, representing 20% of the bonus calculation; personal management goals, representing 40% of the bonus calculation; a goal based on the chairman of the board assessment of compliance with streamlining, automation and proactivity, and the Company's preparation for wholesale, representing 10% of the bonus calculation. The rate of Mr. Guron's compliance with the bonus goals for 2015, was 102%. Subsequent to the reporting year, on March 16, 2016 the Company's board of directors reviewed Mr. Guron's compliance with the goals and according to the rate of compliance with these goals, the bonus granted to Ran Guron for his office as Deputy CEO and VP Marketing of the Company in 2015 was 51% of his annual salary in the Company. In addition, the Company's board of directors approved, at the same date, following approval by the Company's compensation committee and in accordance with its compensation policy, a retirement bonus for Mr. Guron for his resignation from his position in the Company in 2015, after more than 10 years of devoted service, so that the total bonus relating to his office in the Company in the reporting year amounted to NIS 870 thousand. It should be noted that, for the purpose of calculating Mr. Guron's bonus for 2015, the expenses incurred from the settlement with the tax authorities with regard to the DBS loans, provisions made for

²² For details of the revised value recognized in the financial statements in the reporting year for these options, see the above table.

²³ See sub-section 15 above.

²⁴ See sub-section 15 above.

voluntary redundancy of employees and the amendment of the financing income recorded from DBS (accounting amendment) were neutralized. The contingent compensation for 2014 for Mr. Guron, in the amount of NIS 84 thousand, will be paid to him in 2016 after approval of the financial statements for this year by the board of directors on March 16, 2016, and this in view of achieving the minimum EBITDA goal set by the board of directors for the 2015 budget year. In addition, according to the Company's compensation policy, 40% of Mr. Guron's eligibility for compensation with regard to compliance with the Company's EBITDA goal for 2015 amounting to NIS 86 thousand is a contingent compensation ("contingent compensation for 2015"). The compensations committee and board of directors approved payment of the contingent compensation for 2015 in accordance with their powers under the provisions of the compensation policy, and this in view of the termination of Mr. Guron's office in the Company.

With regard to Mr. Guron's office at reporting date as CEO of Pelephone, it is noted that, at the meeting of the Company's board of directors on January 26, 2016, the budget alternative was chosen as the prerequisite for the CEO of Pelephone's eligibility for annual bonus for 2015. The FFO budget of Pelephone for 2016 is 499.4 million (before "neutralizing" accounting events and/or special events based on the closed list of events prescribed by the board of directors when approving the 2016 budget, and which the compensation committee of Bezeq may decide to deduct from the calculation of goals for the purpose of bonus for 2016, including for the purpose of calculating the FFO results for examining compliance with the prerequisites for eligibility for the annual bonus as aforesaid).

Other interested parties who receive remuneration from the Company

- A. Rami Nomkin** - an employee director (appointed as a director by the general meeting on January 17, 2007) dealing with the Company's community contribution and the resource management division. He transferred from the Ministry of Communications in 1966. Rami Nomkin's total salary for 2015 amounted to NIS 562 thousand and is linked to the professional salary tables. This salary does not include a bonus for 2015 in the amount of NIS 25 thousand, which as at reporting date has not yet been paid and which was set in accordance with the criteria for all the Company's employees, based on the Company's EBITDA and cash flows (FCF) results. All the remunerations paid to Mr. Nomkin are due to his being an employee of the Company and not for his service as a Company director.
- B. Remuneration of four external directors** is in accordance with the maximum tariffs prescribed in the Companies Regulations (Rules Concerning Remuneration and Expenses for an External Director), 2000 (for external expert directors) linked to the CPI as set in said regulations and which was updated under an amendment which took effect on March 6, 2008 and which was approved by the general meeting on June 1, 2008. The remuneration for 2015 for Mordechai Keret is NIS 549,407; for Yitzhak Edelman is NIS 532,960; for Tali Simon is NIS 528,706 and for Haggai Herman is NIS 427,896 (including the reimbursement of travel expenses, pursuant to the approval of the general meeting).
- C. Remuneration for two independent directors** is based on the maximum tariff (for an expert external director) as prescribed in the Companies Regulations (Rules Concerning Remuneration and Expenses for an External Director), 2000, linked to the CPI as set in said regulations and which was updated under the foregoing amendment. The remuneration in 2015 for Eldad Ben Moshe is NIS 368,022 and for Yehoshua Rosenzweig is NIS 504,758 (including the reimbursement of travel expenses, pursuant to the approval of the general meeting).

8. Standard 21A: The controlling shareholder of the Company

To the best of the Company's knowledge, the final controlling shareholder of the Company is Mr. Shaul Elovitch, through his holdings in Eurocom Holdings (1979) Ltd. ("Eurocom Holdings") and Eurocom Communications Ltd. ("Eurocom Communications")²⁵. Eurocom Communications is the controlling shareholder in Internet Gold-Golden Lines Ltd., ("Internet Gold"), which controls B Communications Ltd. ("B Communications"), the controlling shareholder (wholly owned) of B Communications (S.P. 1) Ltd. ("B Communications 1") and its wholly owned subsidiary, B

²⁵ To the best of the Company's knowledge, the controlling shareholders in Eurocom Communications are as follows: a. Eurocom Holdings (1979) Ltd., which holds 99.33% of the issued and paid up share capital of Eurocom Communications; Eurocom Holdings (1979) is a private company held by Mr. Shaul Elovitch, who holds 80% of its ordinary shares and 75% of its management shares, and his brother Mr. Yosef Elovitch, who holds 20% of its ordinary shares and 25% of its management shares; b. Mr. Shaul Elovitch, who holds 0.67% of the issued and paid up share capital of Eurocom Communications

Communications (S.P. 2) Ltd. ("B Communications 2"). Each of the aforesaid companies is also considered to be the controlling shareholder of the Company, in accordance with the Securities Law, 1968 ("Securities Law"). Furthermore, pursuant to the Securities Law, the Company deems Mr. Yosef Elovitch²⁶, the brother of Mr. Shaul Elovitch, as a joint shareholder with Mr. Shaul Elovitch, and therefore as a controlling shareholder in the Company.

It should be noted that, Ms. Iris Elovitch, wife of Shaul Elovitch, holds a negligible number of Bezeq shares (72,360), Ms. Orna Elovitch-Peled, wife of Or Elovitch, a director in the Company and daughter-in-law of Mr. Shaul Elovitch, holds a negligible holding for her minor daughter (11,556 shares), and Shaul Elovitch and his brother, Yosef Elovitch, the controlling shareholders (indirect) in the Company, jointly hold a negligible number of Bezeq shares (1,000,000). In addition, Shaul and Yosef Elovitch hold 5% of the issued and paid up share capital of Internet Zahav and B Communications, and this rate includes a negligible rate of shares held by other relatives of Shaul and Yosef Elovitch.

It is noted that, as at the date of publication of this report, B Communications 2 holds 714,169,560 Bezeq shares. 691,338,246 of these shares are held in trust by Mishmeret Trust Services Co. Ltd. ("Mishmeret"), as trustee for B Communications (S.P. 2) Ltd as the owners on the one hand, and for holders of debentures (USD series 144A) issued by B Communications, and various other entities with which B Communications engaged with regard to these debentures, as collateral under the said issue. The balance of the shares (22,831,314 shares) are held by B Communications 2, and are pledged as collateral in favor of debenture holders and the entities defined above.

Furthermore, in addition to the foregoing, B Communications is the owner and indirect holder of 14,204,153 shares of Bezeq.

9. Regulation 22: Transactions with the controlling shareholder

Below are particulars, to the best of the Company's knowledge, concerning all transactions with the controlling shareholders of the Company, or in which the controlling shareholders have a personal interest, which the Company, its subsidiaries or its related companies engaged in during the reporting year or subsequent to the end of the reporting year and until the date on which this report is submitted, or which is still valid at the reporting date, and for further information regarding negligible procedures in the Company see Note 28 to the financial statements.

10. Regulation 24: Holdings of interested parties and executive officers in the Company:

A. Company shares and securities convertible into shares of the Company

Details of holdings of interested parties and executive officers of the Company are presented in this report as reference to the report on the holdings of the Company's interested parties and executive officers dated February 2, 2016.

B. The Company's other securities

As at the date of the periodic report, 146,683,433 debentures (Series 5) of NIS 1 par value each of the Company are held by the subsidiary, Bezeq Zahav (Holdings) Ltd.

11. Regulation 24 A: Registered capital, issued capital, and convertible securities

A. Registered capital and issued capital:

The Company's registered equity as at the publication date of the periodic report is 2,825,000,000 ordinary shares of NIS 1 par value each (the "Ordinary Shares").

B. The Company's issued and paid up share capital as at the publication date of the periodic report is 2,765,409,114 ordinary shares.

C. 2010 Employee Options Plan: Under the employee options plan, which includes up to 70,000,000 options that are exercisable for ordinary shares, based on an outline dated December 20, 2010, (which includes 87,455 options allotted to two employee directors, on January 25, 2011 under a

²⁶ See sub-section 25 above.

private placement report dated December 20, 2010) (less disposals), 66,342,379 options exercisable into ordinary shares (subject to a net exercise mechanism) were allotted at exercise price of NIS 2.72. As at the publication date of the periodic report, 66,244,851 of these options have been exercised into shares and the balance of unexercised options is 97,528. The plan will be valid until December 31, 2017.

12. Standard 24B: Register of Shareholders

The Company's Register of Shareholders is presented in this report by way of a link to the Company's statement of equity and inventory of registered securities of the Company and adjustments made on March 15, 2016.

13. Regulation 25A Registered Address of the Company

Address: 132 Menachem Begin Avenue, 27th Floor, Azrieli Center, (Triangle Tower), Tel Aviv

Telephone 1: 03-626-2200; Telephone 2: 03-626-2201; Fax: 03-626-2209

Email: Linoryo@bezeq.co.il (Company Secretary).

14. Regulation 26: Directors of the company

Name I.D.: Date of birth: Citizenship:	Address for delivery of court notices:	Membership on Board of Directors Committees: Serves as an external or independent director	Employee of the Company, a subsidiary, related company or interested party:	Date of commencement of term of office:	Education and employment during the past five years and details of the companies in which he serves as a director (other than the Company):	Related to other interested parties in the Company:	Does the Company consider the director as having accounting and financial expertise
Shaul Elovitch 042089367 Jan 4, 1948 Israeli	2 Dov Friedman Street, Ramat Gan, 5250301	Chairman of the board of directors, member of the security committee The director is not an external director.	Yes, see details of employment during past five years	April 14, 2010 (On May 6, 2015 his term of office was extended to a further term of one year)	Occupation during past five years: Chairman and owner of Eurocom Group for more than 25 years. The companies in which he serves as a director: Chair of the board of the following companies: Pelephone; Bezeq International; Bezeq Zahav Holdings Ltd.; Walla; Bezeq Online Ltd.; DBS; Eurocom Holdings (1979) Ltd.; Eurocom Communications Ltd.; Eurocom Cellular Communications Ltd.; Eurocom Industries (1986) Ltd.; Eurocom Digital Communications Ltd.; Trans-Global Industries PTE Ltd.; Internet Gold – Golden Lines Ltd.; Eurocom DBS; B. Communications; Director at Eurocom General Management Ltd.; D.M. 3000) Engineering Ltd.; Space Communication Ltd.; Satcom Systems Ltd.; Gilat Satcom Ltd.; Gaya Com Ltd.; IP Planet Network Ltd.; Israsat International Communications Ltd.; B Communication (S.P. 1) Ltd.; B Communication (S.P. 2) Ltd.; Eurocom Media-Net Holdings Ltd.; Eurocom Networks 21 Ltd.; Eurocom Networks and Technologies Ltd; Eurocom Holdings and Investment Ltd.; Eurocom Management and Investment Ltd.; Eurocom Investment Management 2005 Ltd.; Eurocom Real Estate Ltd.; Mivnei Dolinger Construction and Investment Ltd.;	Father of Or Elovitch and father- in-law of Orna Elovitch Peled who, inter alia, served as officers in Bezeq and its subsidiaries in the reporting year. Brother of Yosef Elovitch, controlling shareholder (indirect) of Bezeq	Yes

Name I.D.: Date of birth: Citizenship:	Address for delivery of court notices:	Membership on Board of Directors Committees: Serves as an external or independent director	Employee of the Company, a subsidiary, related company or interested party:	Date of commencement of term of office:	Education and employment during the past five years and details of the companies in which he serves as a director (other than the Company):	Related to other interested parties in the Company:	Does the Company consider the director as having accounting and financial expertise
					Mivnei Dolinger (City Gate) Construction and Investment Ltd.; R.F. Investments and Promotion 1988 Ltd.; Continental – Construction & Investment Company – D.A. Ltd.; Eurocom Project Management (1990) Ltd.; MNB Tulip Trustees (2002) Ltd.; Shem VeTehila Assets and Investments Ltd.		
Yitzhak Edelman: 50066174 July 1, 1950 Israeli	9 Rahel Hmeshoreret St., Herzliya	Audit committee, committee for reviewing financial statements, Chairman of Compensation Committee The director is an external director.	No	February 1, 2008 (term of office extended by a further 3 years (third term of office as of February 1, 2014)	Education: BA Accounting and Economics from Tel Aviv University; Advanced Business Management course at Harvard. The companies in which he serves as a director: Bank of Israel; Advanced Vision Technology Ltd. (AVT.); Y. Edelman Consulting and Management Ltd.; Swiftnet Co. Ltd. (external director)	No	Yes. The Company also considers the director as and as an external expert director
Orna Elovitch Peled 028735587 June 8, 1971 Israeli	2 Dov Friedman Street, Ramat Gan, 525031	No The director is not an external director.	Yes, see details of companies in which she serves as a director.	April 14, 2010 (On May 6, 2015 her term of office was extended to a further term of one year)	Education: B.Sc. majoring in Finance and Economics, New York Institute of Technology. Masters degree - Executive MBA - Recanati College international MBA program Occupation during past five years: As of May 26, 2015 Executive VP of Adika Style Ltd. The companies in which she serves as a director – DBS; Bezeq International; Walla' Orna Nadav Peled Ltd.	Yes. Wife of Mr. Or Elovitch, a director at the Company and daughter-in-law of Mr. Shaul Elovitch, the controlling shareholder (through holdings).	No

Name I.D.: Date of birth: Citizenship:	Address for delivery of court notices:	Membership on Board of Directors Committees: Serves as an external or independent director	Employee of the Company, a subsidiary, related company or interested party:	Date of commencement of term of office:	Education and employment during the past five years and details of the companies in which he serves as a director (other than the Company):	Related to other interested parties in the Company:	Does the Company consider the director as having accounting and financial expertise
Or Elovitch 038475117 May 24, 1976 Israeli	2 Dov Friedman Street, Ramat Gan, 525031	No The director is not an external director.	Yes, see details of employment during past five years	April 14, 2010 (On May 6, 2015 his term of office was extended to a further term of one year)	Education: BA in Business Administration, College of Management; MBA majoring in Finance, City University of New York Occupation during past five years: CEO of Eurocom Communications Ltd. as of 2011, Executive VP Business Development and Investments in Eurocom Communications Ltd. until 2011; The companies in which he serves as a director: Chair of the board of the following companies: Space- Communications Ltd.; board of directors of Eurocom Capital Finances Ltd.; board of directors of Enlight Renewable Energy Solutions Ltd. Director of Satcom Systems Ltd.; B Communications; Pelephone; DBS; Bezeq International; Bezeq Online; Bezeq Zahav Holdings; Walla (and other private Walla Group companies - such as Price Compare, Shopmind Ltd., Walla Pay Ltd.); B Communications (S.P.1) Ltd.; B Communications (S.P.2) Ltd.; Israsat International Communications Ltd.; Gilat Satcom Ltd.; Gaya Com Ltd.; I P Planet Network Ltd.; Telserv Limited; Eitag Ltd.; The Time News Ltd.	Yes. Son of Shaul Elovitch, the controlling shareholder of the Company and husband of Orna Elovitch- Peled, and nephew of Yosef Elovitch (brother of Shaul Elovitch), a controlling shareholder (through holdings)	Yes

Name I.D.: Date of birth: Citizenship:	Address for delivery of court notices:	Membership on Board of Directors Committees: Serves as an external or independent director	Employee of the Company, a subsidiary, related company or interested party:	Date of commencement of term of office:	Education and employment during the past five years and details of the companies in which he serves as a director (other than the Company):	Related to other interested parties in the Company:	Does the Company consider the director as having accounting and financial expertise
Eldad Ben Moshe 058774290 Jun 8, 1964 Israeli	17 Bazelet Street, Shoham, 60850	Audit committee. The director is not an external director. The director is an independent director.	No	April 14, 2010 (On May 6, 2015 his term of office was extended to a further term of one year)	Education: B.A Economics and Accounting, and advanced Accountancy studies - Tel Aviv University; MBA - Tel Aviv University; CPA Occupation during past five years: CEO of Inrom Industries Ltd. and Inrom Building Industries Ltd.; Inrom Industrial Investments Limited Partnership; Senior partner in FIMI Fund The companies in which he serves as a director: Chair of the board of the following companies: Ytong, Ltd.; Ytong Flooring Ltd.; Carmit Mister Fix Ltd.; Alony Marble Ltd.; Orlite Industries (Millennium 2000) Ltd.; Ordan Metal and Casting Industries, Ltd.; Nirlat Paints, Ltd.; Anan Dvash Sameah Ltd.; Anan Dvash Ltd. Director of the following companies: Nimni Paints North Ltd.; Gomix Partnership Management Co. Ltd.; Gomix Limited Partnership; Link Color NA INC.; Urdan Industries (USA) Inc.; Univercol Paints Ltd.; Inrom Building Industries Ltd.; Nirlat Ltd.; Ham- Let (Israel Canada) Ltd.	No	Yes

Name I.D.: Date of birth: Citizenship:	Address for delivery of court notices:	Membership on Board of Directors Committees: Serves as an external or independent director	Employee of the Company, a subsidiary, related company or interested party:	Date of commencement of term of office:	Education and employment during the past five years and details of the companies in which he serves as a director (other than the Company):	Related to other interested parties in the Company:	Does the Company consider the director as having accounting and financial expertise
Haggai Herman 059153650 Jan 5, 1965 Israeli	32 Levi Eshkol Street, Givat Shmuel 5442540	Audit committee, compensation committee The director is an external director.	No	3.9.14	Education: B.Sc Industrial Engineering and Management from Tel Aviv University, MBA from Tel Aviv University, graduate of Training Course for Directors in Business and Public Companies from Bar Ilan University. Occupation during past five years: From 2003, CEO and in charge of merger and integration at Visionix Ltd. The companies in which he serves as a director: Herman Scientific-Business Ventures Ltd.	No	Yes
Rami Nomkin: 042642306 Jan 14, 1949 Israeli	126 Mohaliver Street, Yahud	No The director is not an external director.	Yes, see details of employment during past five years	Jan 17, 2007 (On May 6, 2015 his term of office was extended to a further term of one year)	Education: High School Occupation during past five years: Since 2011 - in Bezeq's PR Division Since 2014, works in Bezeq's human resources division The director is an employee director.	No	No
Mordechai Keret 054759915 May 7, 1957 Israeli	POB 21383 Tel Aviv Jaffa 6121301	Chairperson of the Audit Committee; Chairperson of the Compensations Committee; Financial Statements Review Committee; Security Committee, Internal enforcement committee The director is an external director.	No	Feb 4, 2010 (term of office extended by a further 3 years (third term of office) as of February 1, 2014)	Education: CPA - BA in Accounting and Finance, Tel Aviv University Occupation during past five years: From 2002 to date - CEO and owner of Keret Management and Holdings Ltd. The companies in which he serves as a director: TIA Investment Co. Ltd. – external director, Priortech Ltd.; ISSTA Lines, Ltd.; ISSTA Israel Student Travel Co. Ltd.; ISSTA Assets Ltd.; ISSTA Worldwide Hotels Ltd.; Histour Eltve Ltd; Shirliad Sea City (2009) Ltd.; Shirliad Holdings Ltd.; Keret Management an Holdings Ltd.; Tarya P2P Ltd.; Skyline International Development Ltd. (external director)	No	Yes. The Company also considers the director an external expert director

Name I.D.: Date of birth: Citizenship:	Address for delivery of court notices:	Membership on Board of Directors Committees: Serves as an external or independent director	Employee of the Company, a subsidiary, related company or interested party:	Date of commencement of term of office:	Education and employment during the past five years and details of the companies in which he serves as a director (other than the Company):	Related to other interested parties in the Company:	Does the Company consider the director as having accounting and financial expertise
Amikam Shorer 059821983 Jul 27, 1967 Israeli	2 Dov Friedman Street, Ramat Gan, 525031	Security committee, internal enforcement committee The director is not an external director.	Yes, see details of employment during past five years	April 14, 2010 (On May 6, 2015 his term of office was extended to a further term of one year)	Education: BA LLB, Bar Ilan University Occupation during past five years: Deputy Chairman of Board (and Director) of Eurocom Communications Ltd. since 2011; Executive VP Business Affairs at Eurocom - Communications Ltd. 2005 - 2011; Chairman of Board of E.G.R.E Ltd. 2011 - 2014; CEO Enlight Renewable Energy Ltd. 2008 - 2010 The companies in which he serves as a director: Deputy Chairman of Board of Eurocom Communications Ltd.; Director at Enlight Renewable Energy Ltd.; Pelephone.; Bezeq International; DBS; Walla; Bezeq Online Ltd.; Bezeq Zahav Holdings Ltd.; Space Communications Ltd.; Gilat Satcom Ltd.; Gaya Com, Ltd.; I.P. Planet Network Ltd.; Israsat International Communications Ltd.; SGilat Satcom Russia Ltd.; Phoenix Data Pty. Ltd.; B Communications (SP 1); B Communications (SP 2); Eurocom Capital Underwriting Ltd.; Satcom Systems; Ranitech Yezum 2007 Ltd.; TCL Teleserve Communications Ltd.; TNL Teleserve Network Ltd.; Teleserve Ltd.;	No	No

Name I.D.: Date of birth: Citizenship:	Address for delivery of court notices:	Membership on Board of Directors Committees: Serves as an external or independent director	Employee of the Company, a subsidiary, related company or interested party:	Date of commencement of term of office:	Education and employment during the past five years and details of the companies in which he serves as a director (other than the Company):	Related to other interested parties in the Company:	Does the Company consider the director as having accounting and financial expertise
Yehoshua Rosenzweig 013841069 Aug 17, 1952 Israeli	30 Six Day War Street (31st Floor Champion Tower), Bnei Brak 5120261	Internal enforcement committee - Chair; audit committee; committee for reviewing financial statements; remuneration committee and security committee. The director is not an external director. The director is an independent director.	No (other than as a director in subsidiaries)	Nov 22, 2010 (On May 6, 2015 his term of office was extended to a further term of one year)	Education: LL.B, Bar Ilan University; LL.M and LL.D, New York University. Occupation during past five years: (a) Law firms: from 2005 Attorney at Rosenzweig & Aviram Law firm; 2012-2013 Attorney at Agmon & Co. and Rosenzweig HaCohen & Co. law firms. (b) Public: Matana Foundation (Board member); Chair of Bar Ilan University Executive Committee ; Chair of advisory committee to the Government Companies Authority (since 2011). The companies in which he serves as a director: Chair of the board of the following companies: Waterfall Security Solutions Ltd.; Mailwaze Email Solutions Ltd.; Director at Rosenram Development Co. Ltd.; Pelephone; Bezeq International; Rosenram Trust Co. Ltd.; Rosenzweig Legal Services Ltd.; Rosetta Genomics Ltd.; Alrov Real Estate & Hotels Ltd.; Babua Simulation Investments (1996) Ltd.; Moinian Limited; 3D Space Sound Solutions Ltd.; Podcast Israel Media Ltd.	No	Yes

Name I.D.: Date of birth: Citizenship:	Address for delivery of court notices:	Membership on Board of Directors Committees: Serves as an external or independent director	Employee of the Company, a subsidiary, related company or interested party:	Date of commencement of term of office:	Education and employment during the past five years and details of the companies in which he serves as a director (other than the Company):	Related to other interested parties in the Company:	Does the Company consider the director as having accounting and financial expertise
Tali Simon 024017006 Mar 7, 1969 Israeli	43 Yigal Mozenson St., Tel Aviv	Audit committee; remuneration committee; committee for reviewing financial statements The director is an external director.	No	Jan 21, 2013 (term of office extended by a further 3 years (second term of office) as of January 21, 2016)	Education: CPA, BA Economics and Accounting, Ben Gurion University Occupation during past five years: CFO Gazit Globe Israel (Development) Ltd. and its subsidiaries (G Israel Shopping Centers Ltd.; G Kfar Saba Ltd.; G West Ltd.) The companies in which she serves as a director during past five years: External director at Fungaya Real Estate Ltd. 8/2010 - 5/2011 The companies in which she serves as a director – Acad Construction and Investments Ltd.; Acad Equipment (1979) Ltd.; G Bulgaria EAD PLOVDIV RETAIL CENTER AD TRIDENTAD G MACEDONIA AD Horev Center Management Co. Ltd.; Tali Simon Consultancy Ltd.	No	Yes. The Company also considers the director as an external expert director

15. Regulation 26A Senior office holders:

Name	I.D.:	Date of birth:	Date of commencement of term of office:	The office he holds in the Company:	Is he and interested party in the Company or a family member of another senior officer or of an interested party:	Education and business experience over the past five years:
Stella Handler	016750549	Dec 4, 1961	April 14, 2013	CEO	Yes. Interested party in the Corporation by her office as Company CEO.	MA in economics from the Hebrew University in Jerusalem MBA, Hebrew University in Jerusalem 2011-2013 Chair of board of directors of HOT Communications Systems Ltd. 2003-2011 – CEO 012 Telecom Smile Ltd.
Dudu Mizrachi	024810368	January 28, 1970	June 28, 2007	Deputy CEO and CFO	No	BA Economics, Hebrew University in Jerusalem 2007-2012 VP Economics and Budgets at Bezeq

Name	I.D.:	Date of birth:	Date of commencement of term of office:	The office he holds in the Company:	Is he and interested party in the Company or a family member of another senior officer or of an interested party:	Education and business experience over the past five years:
Guy Hadas	029654472	September 8, 1972	December 9, 2007	VP Corporate Communications	No	BA in Economics and Media, Tel Aviv University MBA, Tel Aviv University
Itamar Harel	028054666	October 18, 1970	October 25, 2007	VP, Manager of Private Division	No	MBA in Marketing and Accounting, Hebrew University
Linor Yochelman	032037939	Feb 11, 1975	Aug 19, 2007	In charge of internal enforcement and Group Secretary	No	BA Business Administration, Interdisciplinary Center, Herzliya LL.B, Interdisciplinary Center, Herzliya
Ehud Mezuman:	052176336	Feb 17, 1954	October 25, 2007	VP Human Resources	No	3 years studies at Tel Aviv University – Social Sciences (no degree)
Amir Nachlieli	23012313	May 30, 1967	Jan 1, 2009	VP, Legal Counsel	No	MBA (expanded major in Finance), Tel Aviv University BA Economics, Hebrew University LL.B, Hebrew University
Danny Oz:	054299953	Jun 16, 1956	Sept 1, 1998	Controller and deputy CFO	No	BA Economics & Accounting, Hebrew University, Certified Public Accountant's License EMBA – Integrative Administration, Hebrew University
Yaakov Paz	058610999	Oct 21, 1963	Nov 1, 2007	VP, Manager of Business Division	No	External director at Nextcom Ltd. 2006 - 2015; CEO and owner of Kobi Paz Communications and Management Ltd.
Sharon Fleischer Ben Yehuda	028531648	Apr 25, 1971	Jun 1, 2006	VP Regulation	No	BA Political Science, , Hebrew University in Jerusalem MA Public Policy and Administration, Hebrew University
Yaakov Jano	024280018	July 26, 1969	Sept 1 2015	VP IT and Network	No	B.Sc. degree in computer engineering from the Haifa Technion MBA - Beer Sheva University Electronics and communications technician, Bezeq College in Jerusalem Head of Technologies at Israel Prison Services - 2015; Manager of Bezeq's Computing Infrastructure Division 2014 - 2015; Manager of Bezeq's Technology and Operations Division 2010 - 2012
Eyal Kamil:	057248999	Aug 30, 1961	Dec 5, 2006	VP Operations & Logistics	No	BA, Industrial Engineering & Management, Tel Aviv University MBA, Tel Aviv University
Lior Segal:	025695701	Sept 9, 1973	Jan 24, 2011	Internal Auditor	No	MBA, LLB, BA Accounting and Diploma in Accounting- all from the Tel Aviv University; Diploma in internal and public auditing on behalf of the IMC; Israel Bar Association license and Israel CPA license; Director of I. A Israel) Institute of Internal Auditors in Israel.
Gil Rosen	013377445	January 28, 1972	February 1, 2016	VP Marketing	No	MBA Business Administration, Interdisciplinary Center, Herzliya Acting CEO IMMMR, subsidiary of Deutsche Telecom 2015 - February 1, 2016; VP Future Communications and New Media at Deutsche Telecom 2012 - 2015; Head of Innovation Center at AT&T Israel 2010 - 2012; VP Innovation and Digital Services at Amdocs 2007 - 2012

Name	I.D.:	Date of birth:	Date of commencement of term of office:	The office he holds in the Company:	Is he and interested party in the Company or a family member of another senior officer or of an interested party:	Education and business experience over the past five years:
Ran Guron	024113268	Dec 25, 1968	Nov 8, 2015	CEO of subsidiary, Pelephone	No	BA Economics and Business Administration, Hebrew University MBA, Hebrew University Deputy CEO and VP Marketing of the Company Jan 1, 06 - Nov 8, 15
Moti Elmaliach	055734941	Mar 24, 1959	May 15, 2014	CEO of the subsidiary, Bezeq International	No	MBA - Tel Aviv University BA Social Sciences - Tel Aviv University CEO of Eurocom Digital Communications Ltd. 2006 - 2014; Chairman of Board of D.M. (3000) Engineering Ltd. 2007 - 2014 ; Chair of the board of directors of Discount Tafnit 2011 - 2015; Director of Cross Israel Highway Ltd. since Nov 3, 2015; CEO and owner of E.M. Records Ltd.
Ron Eilon	059211722	May 27, 1965	Aug 28, 2006	CEO of subsidiary, DBS	No	BA Economics from the Hebrew University in Jerusalem; MA Economics and Accounting from the Hebrew University in Jerusalem

Gil Sharon and Yuval Keinan served as executive officers of the Company during part of the reporting period.

Name	I.D.:	Date of birth:	Term of office	The office he holds in the Company:	Is he and interested party in the Company or a family member of another senior officer or of an interested party:	Education and business experience over the past five years:
Gil Sharon	058381351	Sept 12, 1963	Oct 11, 2005 - Jan 25, 2016	CEO of subsidiary, Pelephone	No	B.A. Economics and Political Science from the Hebrew University in Jerusalem MBA, Tel Aviv University
Yuval Keinan	032089245	Feb 23, 1975	Aug 1, 07 - Oct 19, 15	VP IT and Network	No	BA Computer Science, Mercier College

16. Regulation 27: The Auditors of the Company

Somekh Chaikin, Certified Public Accountants

Address: KPMG 17 Ha'arba'a St., Millennium Tower, Tel Aviv 64739

Tel: 03-684-8000

17. Standard 29 (A) Recommendations and Resolutions of the Board of Directors before the General Meeting and their Resolutions which are not subject to the approval of the General Meeting for the issues prescribed in Regulation 29(A)

- A. For information pertaining to extraordinary transactions see Note 28.3.2 to the financial statements.
- B. Resolution adopted on March 25, 2015 – to recommend to the general meeting of shareholders of the Company to pay the shareholders of the Company a cash dividend in the total sum of NIS 844 million.
- C. Resolution adopted on August 30, 2015 – to recommend to the general meeting of shareholders of the Company to pay the shareholders of the Company a cash dividend in the total sum of NIS 933 million.
- D. Resolution adopted on March 16, 2016 – to recommend to the general meeting of shareholders of the Company to pay the shareholders of the Company a cash dividend in the total sum of NIS 776 million.
- E. Resolution adopted on March 16, 2016 - to recommend to the general meeting of shareholders of the Company to approve amendments to the Company's Articles of Association, mainly adjustment of provisions in the Company's Articles to the provisions of the law, as these have changed and/or will change from time to time, and including amendment of the provisions in the Articles that relate to indemnification, insurance and exemption for officers. For further information see Immediate Report for convening of a general meeting dated March 17, 2016, noted here as reference.

18. Regulation 29 (C): Resolutions adopted at an Extraordinary General Meeting

- A. Approval of DBS order of additional decoders from Eurocom Digital Communications Ltd. and Advanced Digital Broadcast S.A. (resolution dated January 14, 2015). For details see Note 28.3.2 to the financial statements.
- B. Approval of the amendment to the Company's compensations policy and approval of the performance based compensation goals (goals for the annual bonus) for the Company's CEO for 2015 (Resolution of March 16, 2016). For further information regarding the Company's compensations policy see section 2.9.6 of Chapter A of this report.
- C. Approval for accepting the conditions prescribed by the Antitrust Commissioner in his decision of March 26, 2014 to approve the merger, by both the Company and by DBS (in the Company's vote at the general meeting of DBS) and to announce the exercise of the Company's option for allocation from YES, free of charge, of 6,221 shares of YES, representing 8.6% of YES shares. The Company also resolved to approve the Company's engagement in the purchase agreement with Eurocom DBS Ltd ("Eurocom DBS") under which the Company will purchase Eurocom DBS's total holding of DBS shares and all the shareholders loans provided by Eurocom DBS to DBS (resolution dated March 23, 2015). For further information see Notes 11.2 and 28.3.2 to the financial statements.
- D. Approval of the distribution of a cash dividend to the Company's shareholders in the amount of NIS 844 million. (Resolution adopted on May 6, 2015).
- E. Board of directors election of the following directors to an additional term of office in the Company: Shaul Elovitch, Or Elovitch, Orna Elovitch-Peled, Amikam Shorer, Rami Nomkin (employee director), and Dr. Yehoshua Rosenzweig (Resolution adopted on May 6, 2015).
- F. Approval of the appointment of Somekh Chaikin & Co. accounting firm as the Company's auditors for 2015 and until the next annual general meeting, and the board of directors authority to determine their fee for 2015 (Resolution adopted on May 6, 2015).
- G. Approval of the distribution of a cash dividend to the Company's shareholders in the amount of NIS 933 million. (Resolution adopted on September 21, 2015).
- H. Approval of DBS order of additional decoders from Eurocom Digital Communications Ltd. and Advanced Digital Broadcast S.A. (resolution dated October 19, 2015). For details see Note 28.3.2 to the financial statements.
- I. Approval of the extension, expansion and amendment of the engagement of Pelephone Communications in a framework agreement with Eurocom Cellular Communications Ltd, which regulates the procurement and supply of Nokia and ZTE products (resolution dated December 8, 2015). For details see Note 28.3.2 to the financial statements.
- J. Subsequent to the reporting period the general meeting of the Company resolved to reappoint Yitzhak Edelman and Tali Simon for an additional term of office as external directors of the Company (resolution adopted on January 14, 2016).

- K. Subsequent to the reporting period, the general meeting of the Company resolved to approve the performance based compensation goals (goals for the annual bonus) for the Company's CEO for 2016 (Resolution of March 2, 2016).

19. Regulation 29A (4): Exemption, insurance and obligation of indemnification of officers

For further information regarding exemption, insurance and obligation of indemnification of officers see Note 28.6 to the financial statements.

March 16, 2016

Date

Bezeq – The Israel Telecommunication Corp. Ltd.

Signatories and their positions:

Shaul Elovitch, Chairman of Board of Directors

Stella Hendler, CEO

CORPORATE GOVERNANCE QUESTIONNAIRE¹

BOARD OF DIRECTORS AUTONOMY

			True	False
1.		Did two or more external directors hold office in the Company during each reporting year? This question can be answered True, if the period during which two external directors did not hold office does not exceed 90 days, as provided in section 363a (B) (10) of the Companies Law. Nonetheless, for any (True/False) answer, the period (in days) during which two or more external directors did not hold office in any reporting year, should be indicated (including a term of office approved retroactively, while differentiating between the various external directors): Director A: <u>0</u> Director B: <u>0</u> Number of external directors who held office in the Company as at the date of publication of this questionnaire: <u>4</u>	√	
2.		Number² of independent directors³ who held office in the Company as at the date of publication of this questionnaire: <u>6/11</u>. Number of independent directors defined in the bylaws⁴ of the corporation⁵: _____ ☒ Not relevant (there are no provisions the memorandum of association).	_____	_____
3.		A survey conducted among the external directors (and the independent directors) during the reporting year found that they are in compliance with the provisions of Sections 240 (b) and (f) of the Companies Law regarding the absence of a relationship between the external directors (and independent directors) who held office in the Company, and they are in compliance with the conditions required for holding office as an external director (or independent director). See comment at the end of the questionnaire.	√	
4.		None of the directors who held office in the Company during the reporting year are subordinate⁶ to the CEO, directly or indirectly (other than a director who represents the employees, if the Company has employee representation). If your answer is False (i.e., a director is subordinate to the CEO as aforesaid), please indicate the number of directors who <u>do not</u> comply with the foregoing restriction: _____.	√	

¹ Published in the framework of proposals for legislation to improve financial statements dated March 16, 2014.

² In this questionnaire, Number or Rate means a specific number out of a total; for example, 3/8.

³ Including "External Directors" as defined in the Companies Law.

⁴ In this respect, the Memorandum of Association includes the specific legal provision that applies to the Company (for example, in a bank, the provisions of the Commissioner of Banks).

⁵ A debentures company is not required to respond to this question.

⁶ In this question, holding office as a director in an investee that is controlled by the Company will not be deemed as being "subordinate". On the other hand, a director that holds office as an officer of the Company (except for director) and/or an employee in a company that is controlled by the Company will be considered "subordination" in the matter of this question.

BOARD OF DIRECTORS AUTONOMY

			True	False
5.		All the directors who notified about a personal interest in the approval of a transaction on the agenda for the meeting, were not present at the meeting and did not participate in the vote, as set forth in Section 278 (b) to the Companies Law: If your answer is False: Was the director present to exhibit a specific topic as set forth in the last clause of Section 278(a)? ☐ Yes ☐ No (Mark an X in the appropriate checkbox) Indicate the percentage of meetings in which such directors were present and/or participated in the vote, except for the circumstances described in Subsection (a) above	√	
6.		The controlling shareholder (including a relative and/or representative acting on his/her behalf), who <u>is not</u> a director or other senior executive officer in the Company, <u>did not</u> participate in the Board of Directors' meetings held during the reporting year. If your answer is False (i.e., a controlling shareholder and/or his/her relative and/or representative who is not a board member and/or senior executive officer in the Company participated in Board of Directors' meetings, as aforesaid), indicate the following details concerning the participation of any additional person in the meetings, as aforesaid: Identity: _____. Position in the corporation: _____ (if any). Details of the relationship to the Controlling Shareholder (if the individual who participated is not the Controlling Shareholder): _____. Was this due to the presentation of a specific topic: ☐ Yes ☐ No (Mark an X in the appropriate checkbox). The extent of his/her participation⁷ in Board of Directors' meetings held during the reporting year: _____. Other participation: _____ ☐ Not applicable (the Company has no controlling shareholders).	√	

⁷ Distinguishing between a controlling shareholder and his/her relative and/or any person representing him/her.

DIRECTORS' QUALIFICATIONS AND SKILLS

			True	False
7.		The Company's Articles of Association <u>do not</u> include a provision restricting the option of immediately terminating the office of all the Company's directors who are not external directors (in this matter - an ordinary majority decision is not considered a restriction)⁸. If your response is False (i.e., there is such restriction), please indicate -		X
	A.	The term of office set in the Articles of Association for a director: <u>With regard to a director who is not an external director - from the date of appointment until the date of the following general meeting; with regard to an external director - pursuant to the provisions of the Companies Law.</u>		
	B.	The majority required as prescribed in the Articles of Association for terminating the terms of office of the directors: <u>Extraordinary majority (75%)</u> see comment at the end of the questionnaire.		
	C.	The requisite quorum prescribed in the Articles of Association for a general meeting convened to terminate the term of office of directors: <u>Ordinary quorum - two members holding together or representing at least 51% and above of the company's voting power.</u>		
	D.	The majority required to change these provisions in the Articles of Association: <u>Extraordinary majority (75%)</u> . see comment at the end of the questionnaire.		
8.		The Company has a training program for new directors, regarding the Company's area of business and the laws applicable to the Company and its directors, as well as a plan for further training the directors in office, which is adapted, inter alia, to the director's position in the Company. If your response is True - indicate whether the program was implemented during the reporting year: X Yes ☐ No (Mark an X in the appropriate checkbox).	√	
9.	A.	The Company set a minimum number of directors for the Board of Directors who are required to have accounting and financial expertise. If your response is True - indicate the minimum number set: <u>Four directors (including one external director).</u>	√	
	B.	The number of directors who held office during the reporting year was: Directors with accounting and financial expertise⁹: <u>8</u>. Directors with professional qualifications¹⁰: <u>4</u>. If there were changes in the number of directors during the reporting year, please provide information of the lowest number (other than during a period of 60 days from the change) of each class of directors who held office during the reporting year.	_____	_____

⁸ A debentures company is not required to respond to this question.

⁹ Following the Board of Director's assessment, in compliance with the provisions of the Companies Regulation (Conditions and Criteria for a Director with Accounting and Financial Expertise and for a Director with Professional Qualifications) 2005.

¹⁰ See Footnote 9 above.

DIRECTORS' QUALIFICATIONS AND SKILLS

				True	False
10.		A.	Throughout the reporting year, the Board of Directors was composed of both men and women. If your answer is False - indicate the period (in days) during which this did not occur: _____. You may answer True for this question if the period during which the board did not include both men and women did not exceed 60 days, nonetheless if your answer is (True/False), please indicate the period (in days) during which the board did not include both men and women: _____.	√	
		C.	The number of men and of women serving on the Company's Board of Directors at the date of publication of this questionnaire: Men: <u>9</u> ; Women; <u>2</u> .	_____	_____

BOARD MEETINGS (AND CONVENING OF THE GENERAL MEETING)

						True	False
11.	A.	Number of Board of Directors' meetings held during each quarter in the reporting year: Q1 (2015) <u>7</u> Q2 <u>4</u> Q3 <u>6</u> Q4 <u>6</u>				_____	_____
	B.	Indicate, alongside the names of the Company's directors who held office during the reporting year, their rate ¹¹ of participation in meetings of the Board of Directors (in this subsection, including meetings of the Board of Directors' committees to which they belong, as noted below), held during the reporting year (and with regard to their term of office): see comment at the end of the questionnaire. (Please insert additional lines according to the number of directors)					
		Director's Name	Participation in Board of Directors Meetings	Participation in Audit Committee meetings¹²	Participation in meetings of the Financial Statements Review Committee¹³	Participation in meetings of the Compensation Committee¹⁴	Participation in meetings of other Board of Directors' committees on which he/she serves (by indicating the name of the committee)
		Shaul Elovitch - Chairman of the Board of Directors	20/20				
		Yitzhak Edelman	22/22	20/20	13/13	10/11	
		Yehoshua Rosenzweig	22/22	18/20	12/13	11/11	Internal Compliance Committee – 1/1
		Mordechai Keret	22/22	20/20	13/13	11/11	Internal Compliance Committee – 1/1
	Eldad Ben-Moshe	22/22	19/20				

¹¹ See Footnote 2.

¹² With regard to a company director serving on this committee.

¹³ With regard to a company director serving on this committee.

¹⁴ With regard to a company director serving on this committee.

BOARD MEETINGS (AND CONVENING OF THE GENERAL MEETING)

							True	False
		Tali Simon	22/22	20/20	12/13	10/11		
		Haggai Herman	22/22	20/20		10/11		
		Amikam Shorer	20/20				Internal Compliance Committee – 1/1	
		Rami Nomkin	22/22					
		Orna Elovitch-Peled	20/20					
		Or Elovitch	20/20					
12.		During the reporting year, the Board of Directors held at least one discussion concerning the management of the Company's businesses by the CEO and his subordinate officers, at which they were not present, after they were given the opportunity of expressing their position.						X

SEPARATION OF THE ROLES OF THE CEO AND BOARD CHAIR

			True	False
13.		Throughout the reporting year, a Chair of the Board of Directors was in office in the Company. You may answer True for this question if the period during which the board was not chaired by a chairperson did not exceed 60 days (as set forth in section 363A(2) of the Companies Law) nonetheless if your answer is (True/False), please indicate the period (in days) during which the board was not chaired by a chairperson: <u>0</u> .	√	
14.		Throughout the reporting year, the Company was managed by a CEO. You may answer True for this question if the period during which the Company was not managed by a CEO did not exceed 90 days (as set forth in section 363A(6) of the Companies Law) nonetheless if your answer is (True/False), please indicate the period (in days) during which the Company was not managed by a CEO: <u>0</u> .	√	
15.		In a company in which the Chair of the Board of Directors also acts as the CEO and/or exercises his/her authority, the CEO/Chair duality was approved in accordance with the provisions of Section 121(C) of the Companies Law ¹⁵ . ☒ Not applicable (since such duality does not exist in the Company).		
16.		The CEO <u>is not</u> a relative of the Chair of the Board of Directors. If your response is False (i.e., the CEO is related to the board chair) -	√	
	A.	Please indicate the relationship between the parties: _____.	_____	_____
	B.	The office was approved in accordance with Section 121(C) of the Companies Law ¹⁶ : ☐ Yes ☐ No (Mark an X in the appropriate checkbox).	_____	_____
17.		The Controlling Shareholder or their relatives <u>do not</u> serve as CEO or as other senior officers in the Company, other than as directors. ☐ Not applicable (the Company has no controlling shareholders).	√	

¹⁵ In a debentures company, approval in accordance with Section 121(D) of the Companies Law.

¹⁶ In a debentures company, approval in accordance with Section 121(D) to the Companies Law.

AUDIT COMMITTEE

			True	False
18.		The following persons <u>did not</u> serve on the Audit Committee during the reporting year:	_____	_____
	A.	Controlling Shareholder or their relative. ☐ Not applicable (the Company has no controlling shareholders).	√	
	B.	Chair of the Board of Directors.	√	
	C.	A director employed by the Company or by the Company's Controlling Shareholder, or by another company controlled by them.	√	
	D.	A director who regularly provides services to the Company, or to the Company's Controlling Shareholder, or to a company controlled by them.	√	
	E.	A director whose primary source of income is the Controlling Shareholder. ☐ Not applicable (the Company has no controlling shareholders).	√	
19.		Persons who are not eligible to be a member of the Audit Committee, including the Controlling Shareholder or their relatives, did not participate in Audit Committee meetings during the reporting year, other than pursuant to the provisions of Section 115(E) of the Companies Law.	√	
20.		The requisite quorum for discussion and decision making at all Audit Committee meetings held during the reporting year was a majority of the Committee's members, whereby the majority of the participants were independent directors and at least one was an external director. If your response is False - please indicate the number of meetings at which this requirement was not met: _____.	√	
21.		The Audit Committee held at least one meeting during the reporting year with the participation of the Internal Comptroller and the Auditor, as the case may be, and in the absence of Company officers who are not members of the Audit Committee, concerning flaws in the management of the Company's business.	√	
22.		Every Audit Committee meeting with the participation of persons who are not eligible to serve as members of the Committee, was with the approval of the Committee Chair and/or at the request of the Committee (with respect to the Company's legal counsel and secretary, who are not a Controlling Shareholder or his/her relative).	√	
23.		In the reporting year, arrangements were in effect as set forth by the Audit Committee in respect of the manner of handling complaints by Company employees about defects in the administration of its business, and about the defense that will be provided to employees who made such complaints.	√	
24.		The Audit Committee (and/or the Financial Statements Review Committee) was convinced that the scope of the Auditor's work and their fees for the reporting year were appropriate for carrying out a proper audit and review.	√	

DUTIES OF THE FINANCIAL STATEMENTS REVIEW COMMITTEE ("THE COMMITTEE") PRIOR TO THE APPROVAL OF THE FINANCIAL STATEMENTS

			True	False
25.	A.	Indicate the time (in days) set by the Board of Directors as reasonable time for providing recommendations prior to the Board of Directors' meeting at which periodic or quarterly statements will be approved: <u>3 days when approving periodic reports, and 2 days when approving quarterly reports.</u>	_____	_____
	B.	Actual number of days that elapsed between the date on which the recommendations were sent to the Board of Directors and the date on which the financial statements were approved: Q1 Report (2015): <u>3 days</u> Q2 Report: <u>3 days</u> Q3 Report: <u>3 days</u> Annual Report: <u>3 days</u>	_____	_____
	C.	Number of days that elapsed between the date on which the draft of the financial statements was sent to the directors and the date on which the financial statement were approved: Q1 Report (2015): <u>3 days</u> Q2 Report: <u>3 days</u> Q3 Report: <u>3 days</u> Annual Report: <u>6 days</u>		
26.	The Company's Auditor was invited to all meetings of the Committee and of the Board of Directors at which the Company's financial statements for the quarters of the reporting year were discussed. If your response is False, please indicate the rate of participation: _____.		√	
27.	During the reporting year, the Committee was in compliance with all the conditions as set forth below:		_____	_____
	A.	The number of Committee members was not less than three (during the Committee's discussion and approval of said reports).	√	
	B.	All the conditions pursuant to Section 115(b) and (c) of the Companies Law were met (with regard to the office of the members of the Audit Committee).	√	
	C.	The Audit Committee's Chair is an external director.	√	
	D.	All the Committee's members are directors and the majority are independent directors.	√	
	E.	All the members of the Committee can read and understand financial statements, and at least one of the independent directors has accounting and financial expertise	√	
	F.	The Committee members provided declarations prior to their appointment.	√	
	G.	The requisite quorum for the Committee's discussions and decisions was a majority of its members, provided that the majority of the participants consisted of independent directors and at least one was an external director.	√	
	If your answer is False concerning one or more of the subsections to this question, please specify for which report (periodic/quarterly) the condition was not met: _____.		_____	_____

COMPENSATION COMMITTEE

		True	False
28.	In the reporting year, the committee comprised at least three members, and the external directors constituted the majority (on the date of the meetings of the committee). ☐ Not relevant (no meeting were held).	√	
29.	The conditions of service and employment of all members of the Compensation Committee in the reporting year comply with the Companies Regulations (Rules Concerning Remuneration and Expenses of External Directors) 2000.	√	
30.	In the reporting year, the following persons did not serve in the Compensations Committee:	√	
	A. The Controlling Shareholder or their relative. ☐ Not applicable (the Company has no controlling shareholders).	√	
	B. The Chair of the Board of Directors	√	
	C. A director employed by the Company or by the Company's Controlling Shareholder, or by another company controlled by them.	√	
	D. A director who regularly provides services to the Company, or to the Company's Controlling Shareholder, or to a company controlled by them.	√	
	E. A director whose primary source of income is the Controlling Shareholder. ☐ Not applicable (the Company has no controlling shareholders).	√	
31.	In the reporting year, the Controlling Shareholder or their relatives were not present at the meetings of the Compensation Committee, except if the Chair of the committee determined that one of them was required to present a specific topic.	√	
32.	The Compensation Committee and the Board of Directors did not exercise their authority pursuant to the provisions of Sections 267A(C), 272(C)(3) and 272(C1)(1)(C) to approve a transaction or compensation policy, despite the objection of the General Meeting. If your response is "Incorrect", indicate _____ Type of transaction approved: _____ Number of times their authority was exercised in the reporting year: _____	√	

INTERNAL AUDITOR

		True	False
33.	The Chair of the Board of Directors or the CEO of the Company is responsible within the Company for the Internal Auditor.	√	
34.	In the reporting year, the Chair of the Board of Directors or the Chair of the Audit Committee approved the work plan. Furthermore, indicate the audit subjects covered by the Internal Auditor in the reporting year: <u>Procurement, Treasury, Payments, Inventory, Compensation etc.</u> (Mark X in the appropriate checkbox)	√	
35.	Scope of employment of the Internal Auditor in the Company in the reporting year (in hours ¹⁷): <u>approximately 17,500 hours.</u>	√	
	In the reporting year, there was a meeting (of the Audit Committee or of the Board of Directors) in which the findings of the Internal Auditor were discussed.	√	
36.	The Internal Auditor, his/her relatives, accountant or any person on his/her behalf do not have any interest in the Company, and do not have material business relationships with the Company, a controlling shareholder, their relatives or companies under their control.	√	

¹⁷ Including working hours invested in companies held by the Company and conducting audits outside Israel, as the case may be, both by the Internal Auditor and by the internal auditors of the Company's subsidiaries.

TRANSACTIONS WITH INTERESTED PARTIES

		True	False
37.	The Controlling Shareholder or a relative (including a company under their control) <u>are not</u> employed by the Company and do not provide it with management services. If your response is False (i.e., the Controlling Shareholder or a relative are employed by the Company or provide it with management services) please indicate - - The number of relatives (including the Controlling Shareholder) employed by the Company (including companies under their control and/or through a management company) is: <u>See note at end of the questionnaire.</u> - Were their employment contracts and/or management service agreements duly approved by the bodies prescribed by law? ☒ Yes - <u>The Controlling Shareholder of the Company provides the Company with management services in accordance with an updated agreement approved by the General Meeting on June 13, 2013.</u> ☐ No (Mark an X in the appropriate checkbox) ☐ Not applicable (the Company has no controlling shareholder) _____.		X
38.	To the best of the Company's knowledge, the Controlling Shareholder does not have other businesses in the Company's area of operations (in one or more areas). <u>See note at the end of the questionnaire.</u> If your response is False, please indicate whether an arrangement has been made between the Company and its Controlling Shareholder for delimiting the operations: ☐ Yes ☐ No (Mark an X in the appropriate checkbox) ☐ Not applicable (the Company has no controlling shareholders).	√	

Concluding Notes To The Questionnaire

Board of Directors Autonomy

Section 3 - In respect of the classification by the Audit Committee or the relationship of an external director as a negligible relationship, see the report of the invitation to the General Meeting of Shareholders of the Company dated December 10, 2015.

Directors' Qualifications and Skills

Sections 7B and 7D - pursuant to the provisions of the Company's bylaws in effect on the date of publication of this report. For additional details about suggested modifications to the Company's bylaws, see the report of the invitation to the General Meeting published by the Company on March 17, 2016.

■ Board Meetings (and Convening of the General Meeting)

Section 11B - In the reporting year, one Board meeting was held whose agenda included only one topic related to issues that the Controlling Shareholder had a personal interest in. In this meeting, and pursuant to the law, the Controlling Shareholder and its representatives were not present; that is, directors Shaul Elovitch, Or Elovitch, Orna Elovitch-Peled, and Amikam Shorer

■ Transactions with Interested Parties

Section 37 - The Company and companies under its control do not employ controlling shareholders or their relatives. Eurocom Communications Ltd. ("Eurocom"), which is controlled by the Controlling Shareholder of the Company, provides the Company with management services. As part of the management services, Eurocom puts at the disposal of the Company the services of the Chair of the Board of Directors, Mr. Shaul Elovitch, as well as the services of consultants on behalf of the management company, including Or Elovitch, the son of the Controlling Shareholder.

Section 38 - The Controlling Shareholder is not directly involved with the Company's operations. However, companies under the control of the Controlling Shareholder provide key services, equipment and other means that the Company and its subsidiaries/affiliates purchase for running their operations. The key products and services purchased from companies controlled by the Controlling Shareholder as aforementioned are cellular telephony and landline terminal equipment, decoders, and satellite capacity for cable television services. It should also be noted that the Controlling Shareholder engages in the distribution, through distributors, of a specific product that is also sold by a subsidiary of the Company acting as a distributor. In terms of the Company, the scope of operations is negligible.

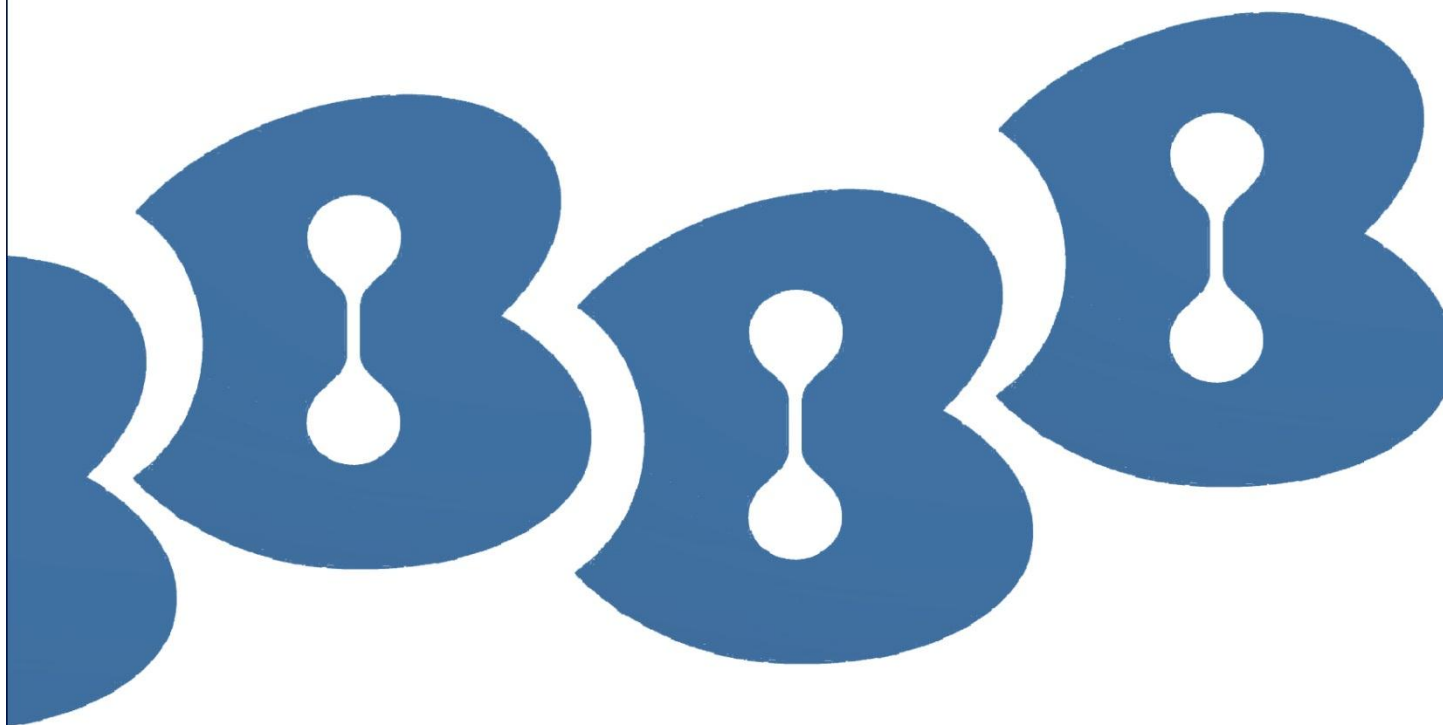
Chairman of the Board of Directors

Chairman of the Audit Committee

Chairman of the Financial Statements Review Committee

Bezeq The Israel Telecommunication Corporation Ltd.

Chapter E – Report Concerning Effectiveness of Internal Controls (SOX format)



CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our periodic report (hereinafter - "the Report") is documented, processed, summarized and reported within the time periods specified in the law, and that such information is summarized and communicated to our chief executive officer and chief financial officer to allow timely decisions regarding required disclosure. The management, including the chief executive officer and chief financial officer, conducted an evaluation of our disclosure controls and procedures, as defined under United States Rule 13a-15(e) of the Exchange Act of 1934, as of December 31, 2015. Based upon that evaluation, the chief executive officer and chief financial officer have concluded that, as of such date, our disclosure controls and procedures are effective.

Management's Annual Report on Internal Control Over Financial Reporting

The management, including the chief executive officer and chief financial officer, is responsible for establishing and maintaining adequate internal control over financial reporting, as defined under United States Rules 13a-15(f) and 15d-15(f) of the Exchange Act of 1934. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards (IFRS). Internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that the company's receipts and expenditures are being made only in accordance with appropriate authorization; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management assessed the effectiveness of the internal control over financial reporting as of December 31, 2015. In conducting its assessment of internal control over financial reporting, the management based its evaluation on the framework in "Internal Control – Integrated Framework (2013)" issued by the Committee of Sponsoring Organizations, or the COSO, of the Treadway Commission. Based on this assessment, the Company's management has concluded that the Company's internal control over financial reporting is effective as of December 31, 2015.

It should be noted that during 2015 the Company gained full control in DBS and purchased all of the outstanding shares of DBS. For details of the acquisition, see Note 11.2 of the consolidated financial statements. In accordance with the SEC directives regarding the assessment of the effectiveness of internal controls over financial reporting of business combinations which was implemented during the reporting year, the Company's management excluded the assessment of internal controls over the financial reporting of DBS in this report. DBS' results are included in the consolidated financial statements for the year ended December 31, 2015 and its revenues represent 13.4% of the revenues in the consolidated financial statements of 2015.

Auditors' Attestation Report

Our independent auditors, Somekh Chaikin, an Israeli partnership and a member firm of KPMG International, have issued an audit report on the effectiveness of our internal control over financial reporting. The audit report on internal control over financial reporting also excluded an evaluation of the internal control over financial reporting of DBS. The report is included on page 3 of the consolidated financial statements.

Changes in Internal Control over Financial Reporting

The acquisition of all the outstanding shares of DBS represents a material change in internal controls over financial reporting since the previous assessment of the effectiveness of internal controls over financial reporting made by the Company's management. In light of the complexity and scope of DBS activities, the use of separate accounting systems and internal control procedures by DBS, as well as in order to ensure the Company's ability to evaluate the internal controls over the financial reporting of DBS in the best possible manner, the Company's management decided to adopt the concession granted in accordance with the directives of the SEC, so that the first-time implementation of the assessment of the effectiveness of internal controls and procedures of DBS will begin on December 31, 2016.

With the exception of the acquisition noted above, there were no changes in our internal control over financial reporting during the period covered by the Report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Stella Handler, certify that:

1. I have reviewed this periodic report (hereinafter - "the Report") of Bezeq The Israel Telecommunication Corporation Ltd. (hereinafter - "the Company");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in United States Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in United States Exchange Act of 1934 Rules 13a-15(f) and 15d-15(f)) for the company and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards (IFRS);
 - (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent function¹):

¹ The board of directors' committee to examine the financial statements.

- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: March 16, 2016

_____ *

Stella Handler

Chief Executive Officer

* The originally executed copy of this Certification will be maintained at the Company's offices and will be made available for inspection upon request.

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Dudu Mizrahi, certify that:

1. I have reviewed this periodic report (hereinafter - "the Report") of Bezeq The Israel Telecommunication Corporation Ltd. (hereinafter - "the Company");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in United States Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in United States Exchange Act of 1934 Rules 13a-15(f) and 15d-15(f)) for the company and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards (IFRS);
 - (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent function²):

² The board of directors' committee to examine the financial statements.

- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: March 16, 2016

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Dudu Mizrahi

Chief Financial Officer

* The originally executed copy of this Certification will be maintained at the Company's offices and will be made available for inspection upon request.