May 25, 2016

Quarterly report for period ended March 31, 2016

- Update to Chapter A (Description of Company Operations) of the Periodic Report for 2015
- Directors' Report on the State of the Company's Affairs for the period ended March 31, 2016
- Interim Financial Statements as at March 31, 2016

bezeq

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

bezeq

Update to Chapter A (Description of Company Operations) [1] to the Periodic Report for 2015 ("Periodic Report") of "Bezeq" - The Israel Telecommunication Corporation Ltd. ("the Company")

1. General development of the Group's business

Section 1.1.2 - Merger of the Company and DBS

Regarding the Purchase Transaction in which context the Company acquired from Eurocom DBS all its holdings in DBS - on March 21, 2016, the Company paid Eurocom DBS the first installment (of three) for the consideration which is contingent on the business results of DBS in the next three years.

Section 1.4 - Dividend distribution

For information about a dividend distribution in the amount of NIS 776 million in respect of profits from the second half of 2015 that was approved by a general meeting of the Company's shareholders on May 3, 2016, see Note 7.2 to the Company's Financials for the period ended March 31, 2016.

Outstanding, distributable profits at the report date - NIS 300 million[2] (surpluses accumulated over the last two years, after subtracting previous distributions).

---

[1] The update is further to Regulation 39A of the Securities Regulations (Periodic and Immediate Reports), 1970, and includes material changes or innovations that have occurred in the corporation in any matter which must be described in the periodic report. The update relates to the Company's periodic report for the year 2015 and refers to the section numbers in Chapter A (Description of Company Operations) in the said periodic report.

[2] Including revaluation gains in the amount of approximately 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.

Section 1.5.4 - Main results and operational data

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

	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015
Revenues (NIS million)	1,112	1,088	1,101	1,105	1,113
Operating profit (NIS million)	536	427	512	662	547
Depreciation and amortization (NIS million)	183	185	184	180	176
EBITDA (Earnings before income tax depreciation and amortization) (NIS million)(1)	719	612	696	842	723
Net profit (NIS million)	328	340	256	382	346
Cash flow from current operations (NIS million)	539	668	686	456	548
Payments for investments in property, plant & equipment and intangible assets (NIS million)	195	197	230	191	231
Proceeds from the sale of property, plant & equipment and intangible assets (NIS million)	41	33	21	80	12
Free cash flow (NIS million) (2)	385	504	477	345	329
Number of active subscriber lines at the end of the period (in thousands)(3)	2,166	2,181	2,193	2,204	2,208
Average monthly revenue per line (NIS) (ARPL)(4)	59	60	60	60	61
Number of outgoing minutes (in millions)	1,316	1,379	1,373	1,396	1,459
Number of incoming minutes (in millions)	1,347	1,403	1,410	1,386	1,429
Total number of active subscriber lines at the end of the period (in thousands)(7)	1,503	1,479	1,448	1,418	1,390
Number of active subscriber lines at the end of the period (in thousands) - wholesale(7)	290	244	177	78	11
Average monthly revenue per Internet subscriber (NIS) - retail	91	89	88	88	87
Average broadband speed per Internet subscriber (Mbps)(5)	38.9	37.8	36.7	34.9	33.2
Churn rate (6)	2.9%	2.7%	2.6%	2.4%	2.4%

(1) EBITDA (Earnings before income tax 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.

(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 plans with a range of speeds, the maximum speed per plan 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.

B. Pelephone

	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015
Revenue from services (NIS million)	455	477	521	502	499
Revenue from sale of terminal equipment (NIS million)	216	236	208	219	228
Total revenue (NIS million)	671	713	729	721	727
Operating profit (NIS million)	1	11	61	53	32
Depreciation and amortization (NIS million)	104	100	109	106	104
EBITDA (Earnings before income tax depreciation and amortization) (NIS million)(1)	105	111	170	159	136
Net profit (NIS million)	13	11	55	49	36
Cash flow from current operations (NIS million)	185	14	163	202	351
Payments for investments in property, plant and equipment and intangible assets, net (NIS million)	51	65	90	199	72
Free cash flow (NIS million) (1)	134	(51)	73	3	279
Number of subscribers at end of the period (thousands) (2)	2,692	2,651	2,569	2,566	2,565
Average monthly revenue per subscriber (NIS) (ARPU) (3)	57	60	68	65	65
Churn rate (4)	5.2%	6.7%	6.4%	6.1%	6.5%

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

(2) Subscriber data includes 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.

C. Bezeq International

	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015
Revenue (NIS million)	395	405	389	391	393
Operating profit (NIS million)	37	58	59	62	61
Depreciation and amortization (NIS million)	33	35	33	32	32
EBITDA (Earnings before income tax depreciation and amortization) (NIS million)(1)	70	93	92	94	93
Net profit (NIS million)	26	42	41	45	44
Cash flow from current operations (NIS million)	49	96	69	74	62
Payments for investments in property, plant and equipment and intangible assets, net (NIS million) (2)	37	21	28	26	53
Free cash flow (NIS million) (1)	12	75	41	48	9
Churn rate (3)	5.2%	4.6%	4.4%	4.2%	4.1%

(1) On the definition of EBITDA (earnings before income tax 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.

D. DBS

	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015
Revenues (NIS million)	439	449	446	439	440
Operating profit (NIS million)	57	47	74	70	59
Depreciation and amortization (NIS million)	76	88	78	80	76
EBITDA (Earnings before income tax depreciation and amortization) (NIS million)(1)	133	135	152	150	135
Net profit (loss) (NIS million)	(71)	(110)	(75)	(166)	(3)
Cash flow from current operations (NIS million)	158	105	145	106	149
Payments for investments in property, plant and equipment and intangible assets, net (NIS million)	59	43	75	82	65
Free cash flow (NIS million) (1)	99	62	70	24	84
Number of subscribers (at the end of the period, in thousands) (2)	629	635	637	636	632
Average monthly revenues per subscriber (ARPU) (NIS)(3)	231	235	233	231	232
Churn rate (4)	4.2%	3.5%	3.9%	3.1%	3.4%

(1) On the definition of EBITDA (earnings before income tax 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.

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

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

Section 1.7 - General environment and the influence of outside factors on the Group's activity

Section 1.7.3 - Regulatory oversight and changes in the regulatory environment - wholesale market

Subsection (C) - List of wholesale services and hearing regarding wholesale service files and their prices: further to the description of the petition filed by the Company in HCJ, further to the revised notice submitted by the State to HCJ on January 11, 2016 regarding a review of changes to be made on two issues, on April 4, 2016, the Ministry of Communications distributed a hearing (to the Company and the license holders) regarding a mechanism for reviewing and revising the forecast for demand for the purpose of updating the wholesale market tariffs for 2017 - 2018. On May 10, 2016, the Company submitted its comments on the hearing, whereby, among other things, the components to be examined for the purpose of updating the transfer tariffs should be limited and steps should be taken to guarantee the reliability of the data and prevent manipulation. Furthermore, on May 2, 2016, the Ministry distributed a hearing about revising the service level requirements and introducing a SLA (service level agreement) for the BSA and telephony service, which includes a proposed amendment to the service file on this matter, the purpose of which, according to the Ministry, is to determine that the same level of service should apply to the services in the file and to the retail, telephony and Internet infrastructure services. Furthermore, to ensure that the duty of providing equal service across the board and that a reasonable level of service are maintained in view of the increasing number of subscribers who will be using the Company's infrastructures, the hearing proposes establishing a mechanism for reporting and submitting information. The hearing is scheduled for responses by May 24, 2016.

In the matter of the Company's petition to HCJ regarding the retail market - on May 5, 2016, another hearing on the petition was held on the subject of tariffs and the court is due to hand down its decision on the petition.

Regarding an administrative petition filed by the Company against the imposition of fines in the amount of NIS 8.5 million for implementation of the broadband reform - on May 18, 2016, a preliminary hearing on the petition was held and the case was scheduled for a hearing.

Section 1.7.4 - Regulatory oversight and changes in the regulatory environment - additional topics

Subsection (D) - further to a description in the Ministry of Communications clarifying document dated October 31, 2013 concerning non-discrimination between subscribers, on April 21, 2016 the Ministry circulated a letter to license holders whereby it intends to examine the possibility of conducting a hearing on the issue of licensing provisions with respect to price discrimination between subscribers, given that the rules and regulations relating to such price discrimination for communications companies are not uniform (fixed line / mobile / telecom / broadcasting) and that consideration should be given to formulating a set of rules that would standardize the regulations for all relevant entities, in a manner that is also consistent with the changes and developments in the market. The letter also mentions that the professional opinion of the Antitrust Authority on this matter was recently accepted.

2. Bezeq ("the Company") - Domestic fixed-line communications

Section 2.9.6 - Officers and senior management in the Company

On the Company's compensation policy – on May 3, 2016, a general meeting of the Company's shareholders approved the new compensation policy, which entered into force from that date for three years. On this matter, see also an immediate report dated May 4, 2016 about the results of a general meeting of the Company's shareholders on May 3, 2016 to which the new compensation policy was attached, included here by way of reference.

Section 2.11 – Working capital

For information about the Company's working capital, see Section 1.3 in the Directors Report.

At March 31, 2016, the Company has a working capital deficit of NIS 1,557 million (this figure refers to the Company's separate financial statements. In the Company's consolidated financial statements as at March 31, 2016, there is a working capital deficit in the amount of NIS 971 million.

Section 2.13 - Financing

On a shelf prospectus for the issuance of various Company securities that was published on May 29, 2014 - on May 11, 2016, the Israel Securities Authority granted permission to extend the period of the securities offering in accordance with the shelf prospectus until May 29, 2017.

Section 2.13.1 – Average and effective interest rates on loans, Section 2.13.4 - Credit received during the Reporting Period, and Section 2.13.5 - Company debentures

On April 21, 2016, the Company completed an issuance by way of an expansion of an existing series of marketable debentures (Series 9) in accordance with a shelf prospectus dated May 30, 2014, as amended due to a clerical error on June 5, 2014. Within the context of this issuance, a total of NIS 714,050,000 par value was issued in consideration of NIS 769 million. The conditions of the issued debentures are the same as those of the Series 9 debentures in circulation. On this, see also the Company's reports (shelf offering Report dated April 19, 2016 and the Company's announcement about the results of the issuance in accordance with a shelf offering report dated April 21, 2016), which are included in this report by way of reference, as well as Section 4 of the Directors Report and Note 14 to the Company's Financials for the period ended March 31, 2016.

The following is an up-to date table of the distribution of long-term loans (including current maturities), including information about the aforementioned issuance:

Loan term	Source of financing	Amount (NIS million)	Currency or linkage	Type of interest and change mechanism	Average interest rate	Effective interest rate	Interest range in 2016
Long-term loans	Banks	1,317	Unlinked NIS	Variable, based on prime rate*	1.64%	1.65%	1.64%
	Banks	1,517	Unlinked NIS	Fixed	5.20%	5.26%	2.40%-6.85%
	Non-bank sources	734	Unlinked NIS	Variable, based on annual STL rate**	1.47%	1.52%	1.47%-1.56%
	Non-bank sources	2,660	Unlinked NIS	Fixed	4.95%	5.07%	3.65%-6.65%
	Non-bank sources***	3,632	CPI-linked NIS	Fixed	2.61%	2.66%	2.20%-5.30%

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

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

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

Section 2.13.6 - Credit rating

In connection with an issuance made by the Company in April 2016 (see update to Section 2.13.4) - on April 17, 2016, Standard & Poor's Maalot Ltd. affirmed the ilAA[3] rating (no change from the previous rating) for an issue of the Company's debentures up to an amount of NIS 800 million par value by means of an expansion of Series 9 Debentures. Additionally, on the same day, Midroog Ltd. announced a rating of Aa2.il outlook stable (no change from the previous rating) for debentures issued by the Company in the amount of NIS 800 million par value by means of an expansion of Series 9 Debentures. On this, see two immediate reports published by the Company on April 17, 2016 and April 18, 2016, which are included in this report by way of reference.

On April 25, 2016, Standard & Poor's Maalot Ltd. affirmed a rating of ilAA/Stable for the Company and its debentures (Series 5-10) and for Pelephone, as detailed in the full rating report published in an Immediate Report issued by the Company on April 25, 2016, which is included here by way of reference.

On this, see also Section 4 of the Directors' Report.

Section 2.14 - Taxation

For information about taxation, see Note 5 to the Company's Financial Statements for the period ended March 31, 2016.

[3] Company rating ilAA/Stable.

Section 2.17.4 - Employment agreements

Subsection (E) - on an agreement between the Company and Menorah Mivtachim Insurance Ltd. (“Menorah”) relating to arrangements for pension payments - the Commissioner of Insurance approved the policy and it entered into force on March 31, 2016. Accordingly, as of May 1, 2016, Menorah issues policies for retiring employees, and payment of the annuities and related payments is made on the basis of these policies.

Section 2.17.5 - Management agreement:

For information about approval by the Board of Directors of the Company’s revised agreement with Eurocom Communications Ltd. to provide the Company with ongoing management and consulting services for a period of three years commencing June 1, 2016 in consideration of NIS 6,432 thousand per annum, see an immediate report dated May 26, 2016 (Convening of a special general meeting), which is included here by way of reference.

Section 2.18 – Legal proceedings

Subsection (A) - on an action together with an application for its certification as a class action from February 2012 on the subject of the accessibility of handsets and services to the disabled public - in April 2016 a compromise settlement in this case was validated as a court ruling thus concluding the proceeding. On this, see also the update to Section 3.17 B.

3. <u>Mobile radio-telephone (cellular telephony) - Pelephone Communications Ltd. ("Pelephone")</u>

Section 3.6 - Competition

In an announcement on April 12, 2016, the Antitrust Authority stated that it opposed a merger between the mobile phone companies Cellcom and Golan Telecom. The Authority stipulated that approval of the merger would result in the disappearance of an entity that increases competition and that as a result the market might revert to a situation in which the large cellular companies have no incentive to compete and that they merely follow each other’s lead in raising prices for the consumer.

On May 19, 2016, the Ministry of Communications announced its decision to reject the request for the said merger due to concerns that competition in the cellular sector would be harmed.

Section 3.7 - Property, plant and equipment, and facilities

On March 21, 2016, Pelephone reported that on that morning a fire broke out in Pelephone’s switching facilities in Kiryat Aryeh in Petach Tikva. The fire caused disruption to surfing and to incoming and outgoing calls for a large number of Pelephone subscribers, including customers of the companies hosted on its network. Pelephone took action on the very same day to transfer these subscribers to a different switch. In the evening of March 27, 2016, Pelephone reported to the Company that work to repair the support system in the switching facility at which the fire had taken place, had been successfully completed and the facility was now fully up and running.

Section 3.17 – Legal proceedings

A. <u>Information on additional claims</u>

On March 23, 2016, Pelephone received a claim and an application for its recognition as a class action, which was filed in the Tel Aviv-Jaffa District Court. The plaintiff argues that due to the broadband malfunction on Pelephone’s network on March 21, 2016, as a result of a fire in one of its installations, Pelephone customers were unable (whether fully or partially) to receive the services they are entitled to, including making and receiving calls, text messages and cellular surfing. The plaintiff has asked for a monetary refund and compensation for all Pelephone customers who suffered from the malfunction and for compensation for the loss of income for Pelephone customers who require the services in order to conduct their business. The amount of compensation requested per customer is a refund of the proportional amount paid by the customer for each day of the malfunction, plus NIS 10 per private customer and NIS 1,010 per business customer.[4]

B. Information on terminated claims

Section 3.17.1B - on a claim and application for its certification as a class action from February 2012 that was filed in the Jerusalem District Court against Pelephone, the Company, Cellcom and Partner - in April 2016, the court approved the compromise settlement between the parties to drop the suit in return for implementing a series of accessibility adjustments and benefits for people with disabilities. In addition, the group of defendants will credit the plaintiffs with insignificant amounts. On this, see also the update to Section 2.18.

Section 3.17 D – on a claim and application for its certification as a class action from August 2012 that was filed in the Central Region District Court against Pelephone, Cellcom and Partner on the subject of repair services - on May 24, 2016, the court approved the application to abandon process as part of a compromise settlement between the parties, with no significant cost to Pelephone.

4. Bezeq International – international communications, Internet and NEP services - (“Bezeq International”)

There are no updates to this chapter.

5. DBS - Multi-channel television Satellite Services (1998) Ltd. (“DBS”)

Section 5.9.2 - Terminal equipment

In April 2016, DBS entered into framework agreement with Draco Ltd. (supplier of decoders) and Altech (manufacturer of decoders) for the development and supply of advanced HDPVR decoders. DBS might be dependent on these entities.[5]

Section 5.16 - Taxation

DBS submitted its objection to the tax assessments for 2010-2011 that it received in December 2015, and it received an extension to submit a detailed objection with respect to these tax assessments until September 2016.

Section 5.17.3 - Tariff control

Pursuant to the Hearing Document published by the Council, in March 2016, the Council passed a resolution on the policy of special offers and the application of transparency instructions, the main points of which are as follows:

1. Each primary deal (a deal including the broad basic package, the narrow basic package or any other basic package that will be offered in the future) will be priced for a defined and fixed period of 4 to 18 months only ("the First Price Period") during which no price increase will be allowed.
2. Notwithstanding the foregoing, it will be possible to grant an additional discount during the first four months of the First Price Period.
3. It will not be possible to cancel a special deal during the First Price Period, unless permitted by law.
4. It will be possible to agree in advance with a subscriber on the price that will apply after the First Price Period, subject to the following conditions: (a) The continuation prices must be set out in the rules and regulations of the special deal for which the subscriber signed up; (b) DBS may

---

4 Notably, after this claim was filed, Pelephone received two other applications for certification as class actions in connection with the same event where a motion had been filed to strike them out under Section 7 of the Class Actions Law, 2006.

5 Replacing one manufacturer with another does not, of itself, involve additional material costs, however a substantial preparatory period is required to adapt the decoders of the alternative supplier to the broadcasting and distribution systems of DBS (which is also dependent on the supplier of these services, Cisco, as noted in Section 5.9.4 of the Periodic Report), which could, in the event of the termination of the engagement at short notice, cause DBS to lose revenues.

adjust the continuation prices only for linkage to the CPI, where this has been specified in the rules and regulations of the special deal; (c) DBS must provide the subscriber with written notice during the period of notification specified in Section 13A of the Consumer Protection Law, (d) following the expiration of the First Price Period DBS may terminate the special deal in a notice provided at least 30 days in advance.

5. All primary deals must be publicized on the website (excluding special retention offers). It is not mandatory to publish bonuses and compensation offers (the Council has authorized the Chairman of the Council to reach agreements also on publication to people who do not subscribe to Internet services).
6. The customer service centers must offer subscribers the best deals that are relevant to them.
7. The provisions of the decision will not apply at this stage to business customers and with respect to economies of scale, including kibbutzim, workers' committees and the like.
8. The Council does not intend to prevent differentiation between special deals targeting new customers and those targeting existing customers.
9. A preparatory period of three months has been set, which the Chairman of the Council has been authorized to extend if he considers this necessary.

Section 5.19.1 - Pending legal proceedings

In April 2016, a claim was filed against DBS in the Tel Aviv District Court together with a motion to certify it as a class action. According to the plaintiffs, who are DBS subscribers, the condition included in the agreement between DBS and its customers, which allows a subscription to be put on hold for a limited period thus avoiding the payment of a subscription fee for this period, and provided that the freeze is for a period of at least 30 days (“the Condition”) is a discriminatory condition and is unreasonable in a standard contract. Furthermore, the plaintiffs contend that DBS allows customers to have their subscription frozen for shorter periods if they make the request by phone - which the plaintiffs argue misleads consumers and is unfair conduct and, among other things, is in breach of the provisions of the Contracts Law, the consumer protection laws and constitutes unjust enrichment.

The claimants have asked the court to order the cancellation of the terms of the agreement and alternatively to determine that DBS’s conduct as described above is misleading and is made not in good faith. The court is also asked to instruct DBS to compensate the subscribers who are members of the group in the total amount of NIS 736 million for the periods in which they ostensibly did not utilize its services but they were deprived of their right to freeze their subscription, as claimed, in view of the aforementioned condition.

May 25, 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.

Board of Directors' Report on the State of the Company's Affairs for the Period Ended March 31, 2016

bezeq

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 three months ended March 31, 2016 ("Quarter").

The Board of Directors' report includes a condensed review of its subject-matter, and was prepared assuming the Board of Directors' report of December 31, 2015 is also available to the reader.

On March 23, 2015, the Company assumed control of DBS Satellite Services (1998) Ltd. ("DBS") and has consolidated DBS from that date ("DBS's Consolidation").

On June 24, 2015, the Company completed the acquisition of all rights to DBS' shares.

For more information, see Note 4.2 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.

	1-3.2016	1-3.2015	Increase (decrease)	
	NIS millions	NIS millions	NIS millions	%
Profit	288	463	(175)	(37.8)
EBITDA (operating profit before depreciation and amortization)	1,023	953	70	7.3

Revenues, expenses and cash flows for the reported Quarter include the results of the Multi-Channel Television segment as detailed below (in the same quarter last year, this segment's results were included under the 'Share in the earnings of investees accounted for under the equity method' item).

Profit for the present Quarter, as compared to the same quarter last year, was mainly influenced by lower operating profits in the Cellular Communications segment and International Communications, Internet and NEP Services segment, and higher taxes due to the lower corporate income tax rate applied to deferred tax assets, DBS's consolidation at the end of the first quarter of 2015, and higher net finance expenses 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

	Mar. 31, 2016	Mar. 31, 2015	Increase (decrease)		
	NIS millions	NIS millions	NIS millions	%	Explanation
Cash and current investments	**1,777**	3,709	(1,932)	(52.1)	The decrease was mainly due to a reduction in current investments in the Domestic Fixed-Line Communications segment, including for dividend payments and DBS's acquisition.
Current trade and other receivables	**2,341**	2,576	(235)	(9.1)	The decrease was due to a reduction in trade receivables in the Cellular Communications segment, mainly due to lower revenues from services and a decrease in trade receivables in the other Group segments.
Inventory	**123**	87	36	41.4	
Non-current trade and other receivables	**662**	541	121	22.4	The increase was attributable to an increase in receivables balances from real estate sales in Domestic Fixed-Line Communications operations.
Property, plant and equipment	**6,902**	6,956	(54)	(0.8)	
Intangible assets	**3,260**	3,450	(190)	(5.5)	The decrease was mainly due to write-downs of excess acquisition costs attributed to intangible assets upon assuming control of DBS.
Deferred tax assets	**1,105**	1,170	(65)	(5.6)	Tax assets were reduced mainly a result of the corporate income tax rate going down from 26.5% to 25% on January 1, 2016.
Other non-current assets	**863**	848	15	1.8	
Total assets	**17,033**	19,337	(2,304)	(11.9)	

1.1. Financial Position (Contd.)

	Mar. 31, 2016	Mar. 31, 2015	Increase (decrease)		
	NIS millions	NIS millions	NIS millions	%	Explanation
Debt to financial institutions and debenture holders	**10,605**	11,912	(1,307)	(11.0)	The decrease was mainly due to repayment of loans in the Domestic Fixed-Line Communications segment, and net repayment of debentures in the Multi-Channel Television segment.
Trade and other payables	**1,843**	2,027	(184)	(9.1)	The decrease was reported across all Group segments.
Liability towards Eurocom D.B.S. Ltd.	**206**	898	(692)	(77.1)	A payment was made to Eurocom D.B.S Ltd. for the purchase of DBS's loans and shares.
Other liabilities	**1,686**	1,576	110	7.0	The increase was mainly due to employee benefit liabilities in the Domestic Fixed-Line Communications segment.
Total liabilities	**14,340**	16,413	(2,073)	(12.6)	
Total equity	**2,693**	2,924	(231)	(7.9)	Equity comprises 15.8% of the balance sheet total, as compared to 15.1% of the balance sheet total on March 31, 2015.

1.2 Results of operations

1.2.1 Highlights

	1-3.2016 NIS millions	1-3.2015 NIS millions	Increase (decrease) NIS millions	%	Explanation
Revenues	**2,559**	2,174	385	17.7	The increase was due to DBS's Consolidation to the amount of NIS 439 million, and was partially offset by decreased revenues in the Cellular Communications segment.
Depreciation and amortization expenses	**449**	317	132	41.6	The increase was mainly due to DBS's Consolidation, to the amount of NIS 76 million, and a write-down of excess acquisition costs incurred when assuming control.
Salary expenses	**513**	439	74	16.9	The increase was mainly due to DBS's Consolidation to the amount of NIS 61 million.
General and operating expenses	**1,018**	799	219	27.4	The increase was due to DBS's Consolidation to the amount of NIS 245 million, and was partially offset by decreased expenses in the Cellular Communications segment.
Other operating expenses (income), net	**5**	(17)	22	-	The change in net expenses was mainly due to expenses reported in the International Communications, Internet and NEP Services segment following the signature of a collective agreement in the present Quarter.
Operating profit	**574**	636	(62)	(9.7)	
Finance expenses, net	**102**	37	65	175.7	The increase in net expenses was due to increased expenses in the Domestic Fixed-Line Communications segment; DBS's Consolidation, to the amount of NIS 19 million; and finance income from the shareholders' loan extended to DBS, to the amount of NIS 21 million, recognized in the last-year quarter but which were not included from April 1, 2015 following the consolidation.
Share in (losses) gains of investees	**(1)**	16	(17)	-	The last-year quarter includes the effect of DBS's results.
Income tax	**183**	152	31	20.4	Following the decrease in the corporate income tax rate, from 26.5% to 25%, applicable from January 1, 2016, the Group decreased its tax assets and liabilities for deferred taxes and recognized deferred tax expenses of NIS 64 million.
Profit for the period	**288**	463	(175)	(37.8)	

1.2.2 Operating segments

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

	1-3.2016		1-3.2015	
	NIS millions	**% of total revenues**	**NIS millions**	**% of total revenues**
Revenues by operating segment				
Domestic Fixed-Line Communications	**1,112**	**43.5**	1,113	51.2
Cellular Communications	**671**	**26.2**	727	33.4
International Communications, Internet and NEP Services	**395**	**15.4**	393	18.1
Multi-Channel Television	**439**	**17.2**	440	20.2
Other and offsets*	**(58)**	**(2.3)**	(499)	(22.9)
Total	**2,559**	**100**	2,174	100

	1-3.2016		1-3.2015	
	NIS millions	**% of segment revenues**	**NIS millions**	**% of segment revenues**
Operating profit by segment				
Domestic Fixed-Line Communications	**536**	**48.2**	547	49.1
Cellular Communications	**1**	**0.1**	32	4.4
International Communications, Internet and NEP Services	**37**	**9.4**	61	15.5
Multi-Channel Television	**57**	**13.0**	59	13.4
Other and offsets*	**(57)**	**-**	(63)	-
Consolidated operating profit/ % of Group revenues	**574**	**22.4**	636	29.3

(*) Offsets in the last-year quarter are mainly for the Multi-Channel Television segment, whose results were included as an associate company.

1.2.2. Operating segments

B Domestic Fixed-Line Communications Segment

	1-3.2016	1-3.2015	Increase (decrease)		
	NIS millions	NIS millions	NIS millions	%	Explanation
Fixed-line telephony	**384**	403	(19)	(4.7)	The decrease was due to lower average revenues per phone line and a decrease in the number of lines.
Internet – infrastructure	**394**	383	11	2.9	The increase was mainly due to growth in the number of internet subscribers (including wholesale service subscribers) and in ARPU (retail).
Transmission, data communications and others	**334**	327	7	2.1	
Total revenue	**1,112**	1,113	(1)	(0.1)	
Depreciation and amortization	**183**	176	7	4.0	
Labor costs	**230**	227	3	1.3	
General and operating expenses	**172**	180	(8)	(4.4)	The decrease was mainly due to a reduction in call completion fees to telecom operators, and advertising costs.
Other operating income, net	**9**	17	(8)	(47.1)	The last-year quarter included gains from assuming control of DBS.
Operating profit	**536**	547	(11)	(2.0)	
Finance expenses, net	**101**	75*	26	34.7	The increase in expenses was mainly due to recognition of finance expenses on the fair value of future long-term bank credit.
Income tax	**107**	126	(19)	(15.1)	The tax rate on profit after finance expenses, net was 24.6%, as compared to 26.7% in the same quarter last year. The decrease was mainly due the corporate income tax rate going down from 26.5% to 25% on January 1, 2016.
Segment profit	**328**	346*	(18)	(5.2)	

* Re-stated, see Note 12.1 to the financial statements.

1.2.2 Operating segments

C Cellular Communications segment

	1-3.2016	1-3.2015	Increase (decrease)		Explanation
	NIS millions	NIS millions	NIS millions	%	
Services	**455**	**499**	(44)	(8.8)	The decrease was due to market competition driving down rates and migration of existing customers to cheaper plans offering greater data bandwidth at current market prices, both of which served to lower ARPU. Revenues from repair services were also down.
Terminal equipment sales	**216**	**228**	(12)	(5.3)	The decrease was mainly due to a change in the sales mix.
Total revenue	**671**	**727**	(56)	(7.7)	
Depreciation and amortization	**104**	**104**	-	-	
Labor costs	**96**	**96**	-	-	
General and operating expenses	**470**	**495**	(25)	(5.1)	The decrease was mainly due to a reduction in the cost of handset sales following a change in the sales mix and a reduction in call completion fees and leasing costs. This decrease in expenses was partially offset, mainly by an increase in frequency leasing fees following the acquisition of 4G LTE frequencies.
Operating profit	**1**	**32**	(31)	(96.9)	
Finance income, net	**12**	**14**	(2)	(14.3)	
Income tax	**-**	**10**	(10)	(100)	The decrease was attributable to the reduction in income before taxes.
Segment profit	**13**	**36**	(23)	(63.9)	

1.2.2 Operating segments

D International Communications, Internet and NEP Services

	1-3.2016 NIS millions	1-3.2015 NIS millions	Increase (decrease) NIS millions	Increase (decrease) %	Explanation
Revenue	**395**	393	2	0.5	This increase was attributable to revenues from enterprise communication solutions (ICT), and higher internet service revenues due to growth in the number of subscribers. The increase was 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	**33**	32	1	3.1	
Labor costs	**83**	77	6	7.8	The increase was mainly due to salary updates after signing the collective agreement in the present Quarter.
General and operating expenses	**228**	223	5	2.2	The increase was due to higher internet service expenses, offset by lower expenses for outgoing calls, corresponding with the above revenues, and by an increase in advertising expenses.
Other expenses	**14**	-	14	-	Other expenses comprise a one-time sign-on bonus and salary updates for prior periods following the collective agreement's signature in the present Quarter.
Operating profit	**37**	61	(24)	(39.3)	
Finance expenses, net	**2**	1	1	100	
Tax expenses	**9**	16	(7)	(43.8)	
Segment profit	**26**	44	(18)	(40.9)	

1.2.2 Operating segments

E Multi-Channel Television

	1-3.2016	1-3.2015	Increase (decrease)		
	NIS millions	NIS millions	NIS millions	%	Explanation
Revenue	**439**	440	(1)	(0.2)	
Depreciation and amortization	**76**	76	-	-	
Labor costs	**61**	69	(8)	(11.6)	
General and operating expenses	**245**	236	9	3.8	The increase was mainly due to increased advertising and sales promotion expenses, and content costs.
Operating profit	**57**	59	(2)	(3.4)	
Finance expenses (income), net	**19**	(1)	20	-	The increase in net expenses was mainly due to a change in the fair value of financial assets and a decrease in income from linkage differences on debentures, which were partially offset by a decrease in interest and factoring expenses.
Finance expenses for shareholder loans, net	**108**	63	45	71.4	The increase in net expenses was mainly due to a reduction in income from linkage differences due to a more moderate decrease in the CPI in the present Quarter as compared to the same quarter last year, and due to an increase in interest expenses.
Income tax	**1**	-	1	-	
Segment loss	**(71)**	(3)	(68)	-	

1.3 Cash flow

	1-3.2016	1-3.2015	Change		
	NIS millions	NIS millions	NIS millions	%	Explanation
Net cash from operating activities	**922**	961	(39)	(4.1)	The decrease in net cash from operating activities was mainly attributable to the Cellular Communications segment, mainly due to a more moderate decrease in trade receivables balances as compared to the decrease posted in the same quarter last year. The decrease was mostly offset by DBS's Consolidation to the amount of NIS 158 million.
Net cash used in investing activities	**(123)**	(378)	255	(67.5)	The decrease in net cash used in investing activities was mainly due to the sale of held-for-trade financial assets in the Domestic Fixed-Line Communications segment in the present Quarter as compared to net purchases in the same quarter last year. This decrease was partially offset by NIS 299 million in cash added in the last-year quarter after assuming control of DBS.
Net cash used in financing activities	**(133)**	(75)	(58)	77.3	The increase in net cash used in financing activities was mainly due to NIS 58 million paid to Eurocom D.B.S. for the acquisition of DBS's shares and loans (see Note 4.2.2).
Increase in cash	**666**	508	158	31.1	

<u>Average volume in the reported Quarter:</u>

Long-term liabilities (including current maturities) to financial institutions and debenture holders: NIS 10,659 million.

Supplier credit: NIS 939 million.

Short-term credit to customers: NIS 2,050 million. Long-term credit to customers: NIS 503 million.

1.3. Cash Flows (contd.)

As of March 31, 2016, the Group had a working capital deficit of NIS 971 million, as compared to a working capital surplus of NIS 567 million on March 31, 2015.

According to its separate financial statements, the Company had a working capital deficit of NIS 1,577 million as of March 31, 2016, as compared to a working capital deficit of NIS 37 million on March 31, 2015.

The change in the Group's working capital was mainly attributable to the Domestic Fixed-Line Communications segment, due to a decrease in current investments which was partially offset by a decrease in liabilities to Eurocom D.B.S. Ltd.

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, has reviewed 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. Corporate Governance

Disclosure concerning the financial statements’ approval process

2.1 Committee

The Company’s Financial Statements Review Committee is a separate committee which does not serve as the Audit Committee. The Committee comprises 4 members, as follows: Yitzhak Idelman, chairman (external director); Mordechai Keret (external director); Tali Simone (external director); and Dr. Yehoshua Rosenzweig (independent director). All Committee members have accounting and financial expertise. All Committee members have submitted a statement prior to their appointment. For more information concerning the directors serving on the Committee, see Chapter D of the Company's Periodic Report for 2015.

2.2 Financial statements approval process

A. The Financial Statements Review Committee discussed and finalized its recommendations to the Company's Board of Directors in its meetings of May 17, 2016, and May 22, 2016.

   The Committee’s meeting of May 17, 2016, was attended by all Committee members and by the Deputy CEO and CFO, Mr. Dudu Mizrahi; Company Comptroller, Mr. Danny Oz; the Internal Auditor, Mr. Lior Segal; Company Secretary, Mrs. Linor Yochelman; the Legal Counsel, Mr. Amir Nachlieli; Mr. Rami Nomkin - director; the external auditors; and other Company and Group officers.

   In addition to the above persons, the Committee's meeting of May 22, 2016, was attended by Chairman of the Board, Mr. Shaul Elovitch, and other Company and Group officers.

B. The Committee reviewed, inter alia, the assessments and estimates made in connection with the financial statements; internal controls over financial reporting; full and proper disclosure in the financial statements; and the accounting policies adopted on material matters.

C. The Committee submitted its recommendations to the Company’s Board of Directors in writing on May 22, 2016.

The Board of Directors discussed the Financial Statements Review Committee's recommendations and the financial statements on May 25, 2016.

D. The Company’s Board of Directors believes that the Financial Statements Review Committee’s recommendations were submitted a reasonable time (three days) prior to the Board meeting, taking into account the scope and complexity of these recommendations.

E. The Company’s Board of Directors adopted the Financial Statements Review Committee’s recommendations and resolved to approve the Company’s financial statements for the first quarter of 2016.

3. Disclosure Concerning the Company’s Financial Reporting

Due to 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.

4. Details of Debt Certificate Series

4.1 On April 21, 2016, the Company completed the issue of 714,050,000 debentures of NIS 1 par value each, effected as an expansion of Series 9 pursuant to a shelf offering report. Total proceeds (gross) were NIS 769 million. The terms of the debentures issued as aforesaid are identical to the terms of the Debentures (Series 9) already in circulation.

4.2 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 Company's immediate report of April 18, 2016 (ref. no. 2016-01-050395) and its immediate report of September 10, 2015 (ref. no. 2015-01-118998) (Midroog), and its immediate reports of April 25, 2016 (ref. no. 2016-01-055276) and April 17, 2016 (ref. no. 2016-01-050347) (Maalot).

The rating reports are included in this Board of Directors’ Report by way of reference.

5. Miscellaneous

For information concerning the liabilities balances of the reporting corporation and those companies consolidated in its financial statements as of March 31, 2016, see the Company's reporting form on the MAGNA system, dated May 26, 2016.

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

Shaul Elovitch	Stella Handler
Chairman of the Board	CEO

Signed: Wednesday, May 25, 2016

Bezeq The Israel Telecommunication Corporation Limited

Condensed Consolidated Interim Financial Statements as at March 31, 2016

(Unaudited)

bezeq

Contents	Page

Somekh Chaikin
KPMG Millennium Tower
17 Ha-Arbaa Street, PO Box 609
Tel Aviv 6100601, Israel
972-3-6848000

Review Report to the Shareholders of

Bezeq The Israel Telecommunication Corporation Ltd.

Introduction

We have reviewed the accompanying financial information of "Bezeq" -The Israel Telecommunication Corporation Ltd. and its subsidiaries (hereinafter – "the Group") comprising of the condensed consolidated interim statement of financial position as of March 31, 2016 and the related condensed consolidated interim statements of income, comprehensive income, changes in equity and cash flows for the three-month period then ended. The Board of Directors and Management are responsible for the preparation and presentation of this interim financial in accordance with IAS 34 "Interim Financial Reporting", and are also responsible for the preparation of financial information for this interim period in accordance with Section D of the Securities Regulations (Periodic and Immediate Reports), 1970. Our responsibility is to express a conclusion on this interim financial information based on our review.

We did not review the condensed interim financial information of a certain consolidated subsidiary whose assets constitute 1% of the total consolidated assets as of March 31 2016, and whose revenues constitute 0.9% of the total consolidated revenues for the three month period then ended. The condensed interim financial information of that company was reviewed by other auditors whose review report thereon was furnished to us, and our conclusion, insofar as it relates to amounts emanating from the financial information of that company, is based solely on the said review report of the other auditors.

Scope of Review

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

Conclusion

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

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

Without qualifying our abovementioned conclusion, we draw attention to lawsuits filed against the Group which cannot yet be assessed or the exposure in respect thereof cannot yet be estimated, as set forth in Note 6.

Somekh Chaikin

Certified Public Accountants (Isr.)

May 25, 2016

Condensed Consolidated Interim Statements of Financial Position

	March 31, 2016	March 31, 2015	December 31, 2015
	(Unaudited)	(Unaudited)	(Audited)
Assets	NIS million	NIS million	NIS million
Cash and cash equivalents	**1,221**	1,168	555
Investments	**556**	2,541	762
Trade receivables	**2,042**	2,290	2,058
Other receivables	**299**	286	269
Inventory	**123**	87	115
Total current assets	**4,241**	6,372	3,759
Trade and other receivables	**662**	541	674
Broadcasting rights, net of rights exercised	**456**	460	456
Property, plant and equipment	**6,902**	6,956	6,894
Intangible assets	**3,260**	3,450*	3,332
Deferred tax assets	**1,105**	1,170*	1,178
Deferred expenses and non-current investments	**384**	359	361
Investments in equity-accounted investees	**23**	29	25
Total non-current assets	**12,792**	12,965	12,920
Total assets	**17,033**	19,337	16,679

Condensed Consolidated Interim Statements of Financial Position (Contd.)

	March 31, 2016	March 31, 2015	December 31, 2015
	(Unaudited)	(Unaudited)	(Audited)
Liabilities and equity	**NIS million**	**NIS million**	**NIS million**
Debentures, loans and borrowings	**2,073**	1,852	1,913
Trade and other payables	**1,843**	2,027	1,657
Current tax liabilities	**622**	670	624
Liability to Eurocom DBS Ltd, related party	**206**	898*	233
Employee benefits	**380**	274	378
Provisions	**88**	84	100
Total current liabilities	**5,212**	5,805	4,905
Loans and debentures	**8,532**	10,060	8,800
Employee benefits	**238**	238	240
Derivatives and other liabilities	**262**	218	226
Deferred tax liabilities	**50**	23	51
Provisions	**46**	69	46
Total non-current liabilities	**9,128**	10,608	9,363
Total liabilities	**14,340**	16,413	14,268
Total equity	**2,693**	2,924	2,411
Total liabilities and equity	**17,033**	19,337	16,679

Shaul Elovitch Chairman of the Board of	**Stella Handler** CEO	**David (Dudu) Mizrahi** Deputy CEO and CFO

* Restated, see Note 4.2.1 for information about a business combination in the prior period.

Date of approval of the financial statements: May 25, 2016

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

Condensed Consolidated Interim Statements of Income

	Note	Three months ended March 31		Year ended December 31
		2016	2015	2015
		(Unaudited)	(Unaudited)	(Audited)
	Note	NIS million	NIS million	NIS million
Revenue	8	**2,559**	2,174	9,985
Costs of activity				
General and operating expenses	9	**1,018**	799	3,869
Salaries		**513**	439	1,957
Depreciation and amortization		**449**	317	1,684
Other operating expenses (income), net		**5**	(17)	(95)
Total operating expenses		**1,985**	1,538	7,415
Operating profit		**574**	636	2,570
Financing expenses (income)	10			
Finance expenses		**132**	101	376
Financing income		**(30)**	(64)	(113)
Financing expenses, net		**102**	37	263
Profit after financing expenses, net		**472**	599	2,307
Share in earnings (losses) of equity accounted investees		**(1)**	16	12
Profit before income tax		**471**	615	2,319
Income tax	5	**183**	152	598
Profit for the period		**288**	463	1,721
Earnings per share (NIS)				
Basic earnings per share		**0.1**	0.17	0.63
Diluted earnings per share		**0.1**	0.17	0.62

Condensed Consolidated Interim Statements of Comprehensive Income

	Three months ended March 31		Year ended December 31
	2016	2015	2015
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Profit for the period	**288**	463	1,721
Items of other comprehensive income (loss) (net of tax)	**(10)**	17	7
Total comprehensive income for the period	**278**	480	1,728

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

Condensed Consolidated Interim Statements of Changes in Equity

	Share capital	Share premium	Capital reserve for employee options	Capital reserve for transactions between a corporation and a controlling shareholder	Other reserves	Deficit	Total
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Three months ended March 31, 2016 (Unaudited)							
Balance as at January 1, 2016	3,874	368	16	390	(98)	(2,139)	2,411
Profit for the period	**-**	**-**	**-**	**-**	**-**	**288**	**288**
Other comprehensive loss for the period, net of tax	**-**	**-**	**-**	**-**	**(10)**	**-**	**(10)**
Total comprehensive income for the period	**-**	**-**	**-**	**-**	**(10)**	**288**	**278**
Transactions with shareholders recognized directly in equity							
Exercise of options for shares	**4**	**16**	**(16)**	**-**	**-**	**-**	**4**
Balance as at March 31, 2016	**3,878**	**384**	**-**	**390**	**(108)**	**(1,851)**	**2,693**
Three months ended March 31, 2015 (Unaudited)							
Balance as at January 1, 2015	3,855	253	131	390	(105)	(2,083)	2,441
Profit for the period	-	-	-	-	-	463	463
Other comprehensive income for the period, net of tax	-	-	-	-	17	-	17
Total comprehensive income for the period	-	-	-	-	17	463	480
Transactions with shareholders recognized directly in equity							
Exercise of options for shares	3	19	(19)	-	-	-	3
Balance as at March 31, 2015	3,858	272	112	390	(88)	(1,620)	2,924
Year ended December 31, 2015 (Audited)							
Balance as at January 1, 2015	3,855	253	131	390	(105)	(2,083)	2,441
Profit for 2015	-	-	-	-	-	1,721	1,721
Other comprehensive income 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	-	-	-	-	-	(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.

Condensed Consolidated Interim Statements of Cash Flows

	Three months ended March 31		Year ended December 31
	2016	2015	2015
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Cash flows from operating activities			
Profit for the period	**288**	463	1,721
Adjustments:			
Depreciation and amortization	**449**	317	1,684
Share in the losses (profits) of equity-accounted investees	**1**	(16)	(12)
Financing expenses, net	**113**	67	307
Profit from gaining control in DBS	**-**	(12)	(12)
Capital gains, net	**(11)**	(11)	(234)
Income tax expenses	**183**	152	598
Change in trade and other receivables	**(12)**	84	322
Change in inventory	**(9)**	9	(20)
Change in trade and other payables	**39**	(45)	(271)
Change in provisions	**(12)**	3	18
Change in employee benefits	**1**	4	110
Change in other liabilities	**(3)**	(1)	(9)
Net income tax paid	**(105)**	(53)	(462)
Net cash from operating activities	**922**	961	3,740
Cash flow used for investing activities			
Purchase of property, plant and equipment	**(294)**	(302)	(1,324)
Investment in intangible assets and deferred expenses	**(51)**	(66)	(311)
Acquisition of financial assets held for trading and others	**-**	(440)	(1,785)
Proceeds from the sale of financial assets held for trading and others	**196**	121	3,260
Proceeds from the sale of property, plant and equipment	**42**	13	151
Cash in a company consolidated for the first time	**-**	299	299
Miscellaneous	**(16)**	(3)	(7)
Net cash used for investing activities	**(123)**	(378)	283
Cash flows used in financing activities			
Repayment of debentures and loans	**(50)**	(58)	(2,192)
Issue of debentures	**-**	-	1,010
Dividends paid	**-**	-	(1,777)
Interest paid	**(32)**	(20)	(494)
Payment to Eurocom DBS for acquisition of shares and DBS loan	**(58)**	-	(680)
Miscellaneous	**7**	3	5
Net cash used for financing activities	**(133)**	(75)	(4,128)
Net increase (decrease) in cash and cash equivalents	**666**	508	(105)
Cash and cash equivalents at beginning of period	**555**	660	660
Cash and cash equivalents at end of period	**1,221**	1,168	555

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

Notes to the Financial Statements

1. General

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"). The Group is a principal provider of communication services in Israel (see also Note 12 – Segment Reporting).

2. Basis of Preparation of the Financial Statements

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

2.2 The condensed consolidated interim financial statements do not contain all the information required in full annual financial statements, and should be reviewed in the context of the annual financial statements of the Company and its subsidiaries as at December 31, 2015 and the year then ended, and their accompanying notes ("the Annual Financial Statements"). The notes to the interim financial statements include only the material changes that have occurred from the date of the most recent Annual Financial Statements until the date of these consolidated interim financial statements.

2.3 The condensed consolidated interim financial statements were approved by the Board of Directors on May 25, 2016.

2.4 Use of estimates and judgment

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

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

3. Reporting Principles and Accounting Policy

The Group's accounting policy applied in these condensed consolidated interim financial statements is consistent with the policy applied in the Annual Financial Statements.

4. Group Entities

4.1 A detailed description of the Group entities appears in Note 11 to the Annual Financial Statements. Below is a description of the material changes that occurred in connection with the Group entities since publication of the Annual Financial Statements.

4.2 DBS Satellite Services (1998) Ltd. ("DBS")

4.2.1 Business combination in the prior period measured in the prior period in provisional amounts

As described in Note 11.2 to the Annual Financial Statements regarding a business combination in 2015, in March 2015 the Company acquired control in DBS. Accordingly, the statement of income and statement of cash flows for the three months ended March 31, 2015 include the operating results of DBS based on the equity method.

In the financial statements as at March 31, 2015, provisional amounts were included for attribution of excess costs arising from the acquisition. On completion of the acquisition and the preparation of an agreement in principle with the tax authorities for the deductible carryforward losses of DBS, as described in Note 11.2.4 to the Annual Financial Statements, amounts were adjusted retrospectively as follows:

	March 31, 2015		
	As previously reported	**Effect of retrospective adjustment**	**As reported in these financial statements**
	(Unaudited)	**(Unaudited)**	**(Audited)**
	NIS million	**NIS million**	**NIS million**
Deferred tax asset, net of deferred tax liabilities	-	1,170	**1,170**
Goodwill	1,438	(1,053)	**385**
Liability to Eurocom DBS	(781)	(117)	**(898)**

4.2.2 Further to Note 11.2.1 regarding the additional consideration to be paid to Eurocom DBS based on the operating results of DBS in the three years as from the acquisition transaction, in March 2016 the Company paid the first installment (out of three) in the amount of NIS 58 million for the operating results of DBS in 2015.

4.2.3 <u>Financial position of DBS</u>

Since the beginning of its operations, DBS has accumulated considerable losses. The loss of DBS in 2015 amounted to NIS 354 million and the loss in the three months ended March 31, 2016 amounted to NIS 71 million. As a result of these losses, as at March 31, 2016, DBS had an equity deficit and a working capital deficit of NIS 5,089 million and NIS 559 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.

5. <u>Income Tax</u>

5.1 On January 4, 2016, the Knesset plenum approved a bill to amend the income tax ordinance that includes a reduction in corporate tax by 1.5% from 26.5% to 25%, as from January 1, 2016. Consequently, in the financial statements for the first quarter of 2016, the Group reduced the deferred tax assets and liabilities and recognized an expense of NIS 64 million for deferred tax expenses.

5.2 Further to Note 6.6.2 to the Annual Financial Statements regarding the decision according to the tax assessor's best judgment for 2009-2010 and the Company's reservation on this assessment, the reservation was rejected and on March 30, 2016, the Company received a written assessments order in accordance with section 152(B) of the Income Tax Ordinance. The Company and the tax assessor are continuing negotiations for a signed agreement in accordance with the agreement in principal, as set out in section 6.6.2 to the Annual Financial Statements.

6. <u>Contingent Liabilities</u>

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 legal claims, the financial statements include appropriate provisions of NIS 86 million, where provisions are required to cover the exposure arising from such legal claims.

In the opinion of the managements of the Group companies, the additional exposure (beyond these provisions) as at March 31, 2016 for claims filed against Group companies on various matters and which are unlikely to be realized, amounted to NIS 8 billion. There is also additional exposure of NIS 1.1 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 6.2 below.

6.1 Below is a description of the contingent liabilities of the Group as at March 31, 2016, 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**	**111**	**-**
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.	**50**	**5,614**	**1,132**
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**	**216**	**2**
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.	**3**	**45**	**-**
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**	**2,001***	**-**
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.	**9**	**14**	**-**
Total legal claims against the Company and subsidiaries		**86**	**8,001**	**1,134**

* 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).

6.2 Subsequent to the reporting date, claims amounting to NIS 756 million were filed against Group companies, and another claim without a monetary estimate. At the approval date of the financial statements, the chances of these claims cannot yet be assessed. In addition, claims with exposure of NIS 522 million came to an end.

7. Equity

7.1 Below are details of the Company's equity:

Registered			Issued and paid up		
March 31, 2016	March 31, 2015	December 31, 2015	March 31, 2016	March 31, 2015	December 31, 2015
(Unaudited)	(Unaudited)	(Audited)	(Unaudited)	(Unaudited)	(Audited)
Number of shares	Number of shares	Number of shares	Number of shares	Number of shares	Number of shares
2,825,000,000	2,825,000,000	2,825,000,000	**2,765,425,752**	2,746,010,675	2,762,148,573

7.2 On May 3, 2016, the general meeting of the Company's shareholders approved the recommendation of the Company's Board of Directors of March 16, 2016 to distribute a cash dividend of NIS 776 million to the Company's shareholders. The dividend will be paid on May 30, 2016.

8. Revenue

	Three months		Year Ended
	March 31		December 31
	2016	2015	2015
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Domestic fixed-line communication			
Fixed-line telephony	**374**	395	1,543
Internet - infrastructure	**386**	383	1,530
Transmission and data communication	**212**	207	840
Other services	**59**	58	212
	1,031	1,043	4,125
Cellular telephony			
Cellular services and terminal equipment	**444**	486	1,948
Sale of terminal equipment	**216**	224	884
	660	710	2,832
International communications, internet and NEP services	**377**	371	1,487
Multichannel television	**439**	-	1,333
Other	**52**	50	208
	2,559	2,174	9,985

9. General and Operating Expenses

	Three months March 31 2016 (Unaudited) NIS million	Three months March 31 2015 (Unaudited) NIS million	Year Ended December 31 2015 (Audited) NIS million
Terminal equipment and materials	**216**	226	880
Interconnectivity and payments to domestic and international operators	**212**	212	909
Maintenance of buildings and sites	**154**	150	616
Marketing and general	**177**	129	640
Content costs	**154**	13	458
Services and maintenance by sub-contractors	**63**	34	199
Vehicle maintenance	**42**	35	167
	1,018	799	3,869

10. Financing Expenses (Income), Net

	Three months March 31 2016 (Unaudited) NIS million	Three months March 31 2015 (Unaudited) NIS million	Year Ended December 31 2015 (Audited) NIS million
Interest expenses for financial liabilities	**90**	90	339
Linkage and exchange rate differences	**-**	-	51
Decrease of provision for tax assessor interest expenses	**-**	-	(76)
Other financing expenses	**42**	11	62
Total financing expenses	**132**	101	376
Income for credit in sales	**11**	15	52
Interest and linkage differences from loans to an associate	**-**	21	21
Linkage and exchange rate differences	**14**	10	-
Other financing income, net	**5**	18	40
Total financing income	**30**	64	113
Financing expenses, net	**102**	37	263

11. Financial Instruments

11.1. Fair value

11.1.1 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 methods used to estimate the fair values of financial instruments are described in Note 29.8 to the Annual Financial Statements.

	March 31, 2016		**March 31, 2015**		**December 31, 2015**	
	Carrying amount (including accrued interest)	**Fair value**	**Carrying amount (including accrued interest)**	**Fair value**	**Carrying amount (including accrued interest)**	**Fair value**
	(Unaudited)		**(Unaudited)**		**(Audited)**	
	NIS million		**NIS million**		**NIS million**	
Loans from banks and institutions (unlinked)	**1,883**	**2,018**	2,131	2,328	1,904	2,044
Debentures issued to the public (CPI-linked)	**3,828**	**4,071**	3,793	4,072	3,816	4,006
Debentures issued to the public (unlinked)	**1,296**	**1,353**	1,354	1,432	1,279	1,340
Debentures issued to financial institutions (CPI-linked)	**1,293**	**1,306**	1,748	1,908	1,310	1,314
Debentures issued to financial institutions (unlinked)	**410**	**463**	410	480	403	458
	8,710	**9,211**	9,436	10,220	8,712	9,162

11.1.2 Fair value hierarchy

The table below presents an analysis of the financial instruments measured at fair value, with details of the evaluation method. The methods used to estimate the fair value are described in Note 29.7 to the Annual Financial Statements.

	March 31, 2016	**March 31, 2015**	**December 31, 2015**
	(Unaudited)	**(Unaudited)**	**(Audited)**
	NIS million	**NIS million**	**NIS million**
Level 1: investment in exchange-traded funds and financial funds	**46**	1,392	193
Level 2 - future credit from banks	**(21)**	-	2
Level 2: forward contracts	**(216)**	(144)	(157)
Level 3: contingent consideration for a business combination	**(235)**	(218)*	(233)
Level 3: investment in non-marketable shares	**-**	9	2

* Restated, see Note 4.2.1 for information about a business combination in the prior period.

12. Segment Reporting

12.1 Further to Note 11.2 to the annual financial statements, the Company's investment in DBS was presented on the basis of 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. The Group reports on multichannel television as an operating segment without adjustment to ownership rates and excess cost in all reporting periods.

In addition, 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 for the three months ended March 31, 2015 in its separate financial information.

As from the second quarter of 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 in the segment reporting were restated to reflect the change in the reporting structure: financing income in the amount of NIS 21 million was eliminated in the fixed-line domestic communications segment for the three months ended March 31, 2015.

12.2 Operating segments

	Three months ended March 31, 2016 (Unaudited)						
	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	1,032	660	377	438	49	-	2,556
Inter-segment revenues	80	11	18	1	5	(112)	3
Total revenues	1,112	671	395	439	54	(112)	2,559
Depreciation and amortization	183	104	33	76	5	48	449
Segment results – operating profit	536	1	37	57	(9)	(48)	574
Finance expenses	109	-	4	143	1	(125)	132
Financing income	(8)	(12)	(2)	(16)	(5)	13	(30)
Total financing expenses (income), net	101	(12)	2	127	(4)	(112)	102
Segment profit (loss) after financing expenses, net	435	13	35	(70)	(5)	64	472
Share in losses of associates	-	-	-	-	(1)	-	(1)
Segment profit (loss) before income tax	435	13	35	(70)	(6)	64	471
Income tax	107	-	9	1	-	66	183
Segment results – net profit (loss)	328	13	26	(71)	(6)	(2)	288

	Three months ended March 31, 2015 (Unaudited)						
	Domestic fixed-line communication	Cellular communications	International communications and internet services	Multi-channel television *	Other	Adjustments	Consolidated
	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million	NIS million
Revenues from external sources	1,042	709	368	440	49	(440)	2,168
Inter-segment revenues	71	18	25	-	4	(112)	6
Total revenues	1,113	727	393	440	53	(552)	2,174
Depreciation and amortization	176	104	32	76	3	(74)	317
Segment results – operating profit	547	32	61	59	(2)	(61)	636
Finance expenses	98	3	4	104	-	(108)	101
Financing income	(23)*	(17)	(3)	(42)	(4)	25*	(64)
Total financing expenses (income), net	75*	(14)	1	62	(4)	(83)*	37
Segment profit (loss) after financing expenses, net	472*	46	60	(3)	2	22*	599
Share in profits (losses) of associates	-	-	-	-	-	16	16
Segment profit (loss) before income tax	472*	46	60	(3)	2	38*	615
Income tax	126	10	16	-	-	-	152
Segment results – net profit (loss)	346*	36	44	(3)	2	38*	463

* Restated See section 12.1 above

	Year ended December 31, 2015 (Audited)						
	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

12.3 Adjustment of profit or loss for reporting segments

	Three months ended March 31		Year ended December 31, 2015
	2016	2015	
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Operating profit for reporting segments	**631**	699	2,795
Cancellation of results for a segment classified as an associate (up to date of gaining control)	**-**	(59)	(59)
Financing expenses, net	**(102)**	(37)	(263)
Amortization of excess costs for intangible assets	**(46)**	-	(150)
Share in profits (losses) of associates	**(1)**	16	12
Loss for operations classified in other categories and other adjustments	**(11)**	(4)	(16)
Consolidated profit before income tax	**471**	615	2,319

13. Condensed Financial Statements of Pelephone, Bezeq International, and DBS

13.1. Pelephone Communications Ltd.

Selected data from the statement of financial position

	March 31, 2016	March 31, 2015	December 31, 2015
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Current assets	**1,541**	1,695	1,420
Non-current assets	**1,793**	1,866	1,854
	3,334	3,561	3,274
Current liabilities	**563**	750	448
Long-term liabilities	**68**	89	70
Total liabilities	**631**	839	518
Capital	**2,703**	2,722	2,756
	3,334	3,561	3,274

Selected data from the statement of income

	Three months ended March 31		Year Ended December 31,
	2016	2015	2015
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Revenue from services	**455**	499	1,999
Revenue from sales of terminal equipment	**216**	228	891
Total revenue from services and sales	**671**	727	2,890
Cost of services and sales	**579**	607	2,383
Gross profit	**92**	120	507
Selling and marketing expenses	**66**	63	247
General and administrative expenses	**25**	25	98
Other operating expenses	**-**	-	5
	91	88	350
Operating profit	**1**	32	157
Finance expenses	**-**	3	4
Financing income	**(12)**	(17)	(53)
Financing income, net	**(12)**	(14)	(49)
Profit before income tax	**13**	46	206
Income tax	**-**	10	55
Profit for the period	**13**	36	151

13.2. Bezeq International Ltd.

Selected data from the statement of financial position

	March 31, 2016	March 31, 2015	December 31, 2015
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Current assets	**529**	544	456
Non-current assets	**724**	750	714
	1,253	1,294	1,170
Current liabilities	**379**	437	314
Long-term liabilities	**104**	71	29
Total liabilities	**483**	508	343
Capital	**770**	786	827
	1,253	1,294	1,170

Selected data from the statement of income

	Three months ended March 31		Year Ended December 31,
	2016	2015	2015
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Revenue from services	**395**	393	1,578
Operating expenses	**258**	251	1,015
Gross profit	**137**	142	563
Selling and marketing expenses	**57**	53	209
General and administrative expenses	**29**	28	116
Other expenses (income), net	**14**	-	(2)
	100	81	323
Operating profit	**37**	61	240
Finance expenses	**4**	4	15
Financing income	**(2)**	(3)	(7)
Financing expenses (income), net	**2**	1	8
Profit before income tax	**35**	60	232
Income tax	**9**	16	60
Profit for the period	**26**	44	172

13.3. DBS Satellite Services (1998) Ltd.

Selected data from the statement of financial position

	March 31, 2016	March 31, 2015	December 31, 2015
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Current assets	**382**	453*	319
Non-current assets	**1,345**	1,398	1,348
	1,727	1,851	1,667
Current liabilities	**941**	978*	903
Long-term liabilities	**880**	1,422	892
Loans from shareholders	**4,995**	4,118	4,890
Total liabilities	**6,816**	6,518	6,685
Capital deficit	**(5,089)**	(4,667)	(5,018)
	1,727	1,851	1,667

Selected data from the statement of income

	Three months ended March 31		Year ended December 31,
	2016	2015	2015
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Revenue from services	**439**	440	1,774
Operating expenses	**321**	320*	1,289
Gross profit	**118**	120	485
Selling and marketing expenses	**38**	36	140
General and administrative expenses	**23**	25*	95
	61	61	235
Operating profit	**57**	59	250
Finance expenses	**35**	41	122
Financing expenses for shareholder loans, net	**108**	63	513
Financing income	**(16)**	(42)	(32)
Financing expenses (income), net	**127**	62	603
Loss before income tax	**(70)**	(3)	(353)
Income tax	**1**	-	1
Loss for the period	**(71)**	(3)	(354)

* Reclassified

14. Subsequent Events

On April 21, 2016, the Company completed the issuance of 714,050,000 debentures of NIS 1 par value each by expansion of Series 9 in accordance with the shelf offering memorandum. The total consideration (gross) that was received amounted to NIS 769. For information about the terms of the debentures, see Note 12 to the Annual Financial Statements.

Bezeq The Israel Telecommunication Corporation Ltd.

Condensed Separate Interim Financial Information as at March 31, 2016

(Unaudited)

bezeq

Contents	**Page**

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 Israel Telecommunication Corporation Ltd.

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

Introduction

We have reviewed the separate interim financial information presented in accordance with Regulation 38D of the Securities Regulations (Periodic and Immediate Reports) – 1970 of “Bezeq”- The Israel Telecommunication Corporation Ltd. (hereinafter – “the Company”) as of March 31, 2016 and for the three-month period then ended. The separate interim financial information is the responsibility of the Company’s Board of Directors and of its Management. Our responsibility is to express a conclusion on the separate interim financial information based on our review.

We did not review the separate interim financial information of an investee company the investment in which amounted to NIS 146 million as of March 31, 2016, and the loss from this investee company amounted to NIS 4 million for three-month period then ended. The financial statements of that company were reviewed by other auditors whose review report thereon was furnished to us, and our conclusion, insofar as it relates to amounts emanating from the financial statements of that company, is based solely on the said review report of the other auditors.

Scope of Review

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

Conclusion

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

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

Somekh Chaikin
Certified Public Accountants (Isr.)

May 25, 2016

Condensed Interim Information of Financial Position

	March 31, 2016	March 31, 2015	December 31, 2015
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Assets			
Cash and cash equivalents	**432**	195	110
Investments, including derivatives	**509**	2,495	648
Trade receivables	**708**	789	668
Other receivables	**140**	167	119
Dividend receivable from investees (Note 5)	**583**	241	-
Loans granted to investees	**278**	308	288
Total current assets	**2,650**	4,195	1,833
Trade and other receivables	**182**	38	180
Property, plant and equipment	**4,796**	4,683	4,753
Intangible assets	**246**	287	255
Investment in investees	**6,594**	7,116*	7,217
Loans granted to investees	**450**	262	374
Non-current investments	**118**	90	101
Total non-current assets	**12,386**	12,476	12,880
Total assets	**15,036**	16,671	14,713

Condensed Interim Information of Financial Position (contd.)

	March 31, 2016	March 31, 2015	December 31, 2015
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Liabilities			
Debentures, loans and borrowings	**1,829**	1,611	1,660
Loan from an investee	**434**	-	434
Trade and other payables	**760**	827	636
Current tax liabilities	**622**	623	619
Employee benefits	**325**	222	330
Liability to Eurocom DBS Ltd, an affiliate	**206**	898*	233
Provisions (Note 4)	**51**	51	60
Total current liabilities	**4,227**	4,232	3,972
Loans and debentures	**7,621**	8,675	7,879
Loan from an investee	**-**	434	-
Employee benefits	**200**	196	203
Derivatives and other liabilities	**252**	200	215
Deferred tax liabilities	**43**	10	33
Total non-current liabilities	**8,116**	9,515	8,330
Total liabilities	**12,343**	13,747	12,302
Equity			
Share capital	**3,878**	3,858	3,874
Share premium	**384**	272	368
Reserves	**282**	414	308
Deficit	**(1,851)**	(1,620)	(2,139)
Total equity	**2,693**	2,924	2,411
Total liabilities and equity	**15,036**	16,671	14,713

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: May 25, 2016

* Restated due to business combinations measured in the previous period in provisional amounts, see Note 1.3.2

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

Condensed Interim Information of Profit or Loss

	Three months ended March 31		Year ended December 31
	2016	2015	2015
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Revenue (Note 2)	**1,112**	1,113	4,407
Cost of Activities			
Salaries	**230**	227	912
Amortization and depreciation	**183**	176	725
Operating and general expenses (Note 3)	**172**	180	721
Other operating income, net	**(9)**	(17)	(99)
Cost of Activities	**576**	566	2,259
Operating profit	**536**	547	2,148
Financing expenses (income)			
Financing expenses	**109**	98	362
Financing income	**(8)**	(23)*	(30)
Financing expenses - net	**101**	75	332
Profit after financing expenses, net	**435**	472	1,816
Share in profits (losses) of investees, net	**(40)**	117*	397
Income before taxes on income	**395**	589	2,213
Taxes on income	**107**	126	492
Income for the period	**288**	463	1,721

* Restated due to change in accounting policy in the previous period, see Note 1.3.1

Condensed Interim Information of Comprehensive Income

	Three months ended March 31		Year ended December 31
	2016	2015	2015
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Income for the period	**288**	463	1,721
Items of other comprehensive income (loss) for the period, net of tax	**(10)**	17	7
Total comprehensive income for the period attributable to equity holders of the Company	**278**	480	1,728

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

Condensed Interim Information of Cash Flows

	Three months ended March 31		Year ended December 31
	2016	2015	2015
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Cash flows from operating activities			
Income for the period	**288**	463	1,721
Adjustments:			
Amortization and depreciation	**183**	176	725
Share in earnings of investees, net	**40**	(117)*	(397)
Financing expenses - net	**103**	82*	323
Capital gains from obtaining control in an investee	**-**	(12)	-
Capital gain, net	**(11)**	(11)	(233)
Income tax expenses	**107**	126	492
Miscellaneous	**(2)**	(1)	(19)
Change in other receivables	**(55)**	(74)	53
Change in trade and other payables	**2**	20	(75)
Change in provisions	**(9)**	3	12
Change in employee benefits	**(8)**	(8)	104
Net cash (used in) from operating activities due to transactions with investees	**(7)**	(18)	2
Net income tax paid	**(92)**	(81)	(350)
Net cash from operating activities	**539**	548	2,358
Cash flows from investing activities			
Investment in intangible assets	**(16)**	(20)	(71)
Proceeds from the sale of property, plant and equipment	**41**	12	146
Acquisition of financial assets held for trading and others	**-**	(440)	(1,535)
Proceeds from the sale of financial assets held for trading and others	**138**	120	3,065
Purchase of property, plant and equipment	**(179)**	(211)	(778)
Miscellaneous	**(16)**	(3)	(7)
Net cash from investment activities due to transactions with investees	**(64)**	(44)	109
Net cash from (used for) investing activities	**(96)**	(586)	929
Cash flow from finance activities			
Issue of debentures	**-**	-	782
Repayment of debentures and loans	**(49)**	-	(1,349)
Dividend paid		-	(1,777)
Payment to Eurocom DBS for acquisition of DBS shares and loans	**(58)**		(680)
Interest paid	**(17)**	(18)	(384)
Miscellaneous	**3**	3	3
Loan received from an investee	**-**	-	(20)
Net cash (used in) from financing activities due to transactions with subsidiaries			
Net cash used for finance activities	**(121)**	(15)	(3,425)
Increase (decrease) in cash and cash equivalents	**322**	(53)	(138)
Cash and cash equivalents at beginning of period	**110**	248	248
Cash and cash equivalents at the end of the period	**432**	195	110

* Restated due to changes in accounting policy, see Note 1.3.1

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

Notes to the Condensed Separate Interim Financial Information

1. Manner of preparing Financial Information

1.1. Definitions

"The Company": "Bezeq" The Israel Telecommunication Corporation Limited

"Investee", the "Group", "Subsidiary": as these terms are defined in the Company's consolidated financial statements for 2015.

1.2. Principles used for preparing financial information

The condensed separate interim financial information is presented in accordance with Regulation 38(D) of the Securities Regulations (Periodic and Immediate Reports),1970 ("the Regulation") and the Tenth Addendum of the Securities Regulations (Periodic and Immediate Reports),1970 ("the Tenth Addendum") with respect to the separate interim financial information of the corporation. They should be read in conjunction with the separate financial statements for the year ended December 31, 2015 and in conjunction with the condensed interim consolidated financial statements as at March 31, 2016 ("the Consolidated Financial Statements").

The accounting policies used in these condensed separate interim financial information are in accordance with the accounting policies set out in the separate financial information as of and for the year ended December 31, 2015.

1.3. Restatement due to business combinations executed during the previous period

As a result of completion of the transaction to acquire Eurocom DBS's entire holdings in DBS shares and shareholders loans on June 24, 2015, as set out in Note 11.2 to the Annual Consolidated Statements, various amounts are restated as set out below.

1.3.1 Changes in accounting policies in the previous period

As a result of completing the acquisition of control in DBS as set out above, the Company changed its accounting policies with regard to statement of financing income with regard to shareholders loans provided to DBS.

Prior to acquisition of the entire holdings of DBS shares and shareholders' loans, the Company presented the financing income from the shareholders' loans under the financing income item in the statement of profit or loss 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 income for shareholders loans to DBS less DBS's 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:

	Three months ended March 31, 2015 (unaudited)		
	As previously stated	Effect of retrospective application	As reported in these financial statements
	NIS million	NIS million	NIS million
Financing expenses	98	-	98
Financing income	(44)	21	(23)
Financing expenses - net	54	21	75
Share in earnings of investees, net	96	21	117

1.3.2 Measurement of the business combination in the previous period in arbitrary amounts

In the separate financial information as at March 31, 2015, arbitrary amounts were included with regard to the allocation of excess costs arising from the acquisition When the acquisition was completed and after an agreement in principle was reached with the tax authorities with regard to the discountable carried forward losses of DBS, as described in Note 11.2.4 to the Annual Consolidated Statements, the amounts were adjusted retrospectively as follows:

	Balance as at March 31, 2015 (unaudited)		
	As previously stated	Effect of retrospective application	As reported in these financial statements
	NIS million	NIS million	NIS million
Investment in investees	6,999	117	7,116
Liability to Eurocom DBS	(781)	(117)	(898)

2. Revenue

	Three months ended March 31		Year ended December 31
	2016	2015	2015
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Fixed-line telephony	**384**	403	1,586
Internet - infrastructure	**394**	383	1,542
Transmission and data communication	**273**	266	1,058
Other services	**61**	61	221
	1,112	1,113	4,407

3. Operating and General Expenses

	Three months ended March 31		Year ended December 31
	2016	2015	2015
	(Unaudited)	(Unaudited)	(Audited)
	NIS million	NIS million	NIS million
Maintenance of buildings and sites	**49**	51	202
Marketing and general expenses	**43**	47	188
Interconnectivity and payments to communications operators	**34**	38	145
Services and maintenance by sub-contractors	**17**	16	60
Vehicle maintenance	**17**	17	78
Terminal equipment and materials	**12**	11	48
	172	180	721

4. Contingent Liabilities

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

In the opinion of the Company's management, based, inter alia, on legal opinions as to the likelihood of success of these litigations, the financial statements include appropriate provisions in the amount of NIS 51 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 March 31, 2016 due to legal claims filed against the Company on various matters, which are unlikely to be realized, amounts to a total of 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 NIS 1.1 billion or NIS 2 billion (based on the method to be fixed of calculating the damages) In addition, the Company has further exposure in the amount of NIS 878 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 reporting date, claims for which exposure amounted to NIS 373 million were concluded.

For further information concerning contingent liabilities see Note 6 to the Consolidated Statements.

5. Dividends from investees

5.1 On March 2, 2016 the board of directors of Pelephone Communications Ltd. decided to distribute a dividend in cash to the Company in the amount of NIS 66 million, which will be paid in May 2016.

5.2 On February 29, 2016 the board of directors of Bezeq International Ltd. decided to distribute a dividend in cash to the Company in the amount of NIS 83 million, which will be paid in May 2016.

5.3 On February 25, 2016 the board of directors of Walla Communications Ltd. decided to distribute a dividend in cash to the Company in the amount of NIS 434 million, which will be paid in May 2016. The dividend will be received by way of offsetting a loan that the Company received from Walla and that is due for repayment on the same date.

6. Events in and subsequent to the reporting period

6.1 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. The loan bears annual interest of 2.56%.

6.2 On May 23, 2016 the Company received a loan from Pelephone in the amount of NIS 325 million. This loan bears annual interest of 3.41% and will be repaid in four equal annual installments from December 1, 2022.