August 23, 2017

# “Bezeq” - The Israel Telecommunication Corp. Ltd.

# Quarterly report for period ended June 30, 2017

Update to Chapter A (Description of Company Operations) of the Periodic Report for 2016

Directors' Report on the State of the Company's Affairs for the period ended June 30, 2017

Interim Financial Statements as at June 30, 2017

# Update to Chapter A (Description of Company Operations) of the Periodic Report for 2016

# Update to Chapter A (Description of Company Operations) [1] to the Periodic Report for 2016 ("Periodic Report") of "Bezeq" - The Israel Telecommunication Corporation Ltd. ("the Company")

## 1. General development of the Group's business

### Section 1.1 - Group activities and business development (Merger of the Company and DBS) and on an event that deviates from the Company's business

On June 20, 2017, the Israel Securities Authority (ISA) launched a public investigation ("the Investigation") in which, among other things, the offices of the Company and DBS were searched and documents were seized. As the ISA informed the Company, the investigation addresses suspicions of crimes under the Securities Law and Penal Code in respect of transactions relating to the controlling shareholder. As far as the Company is aware, the investigation relates to the purchase of DBS shares by the Company from Eurocom D.B.S. Ltd., a company controlled by the Company's controlling shareholder. The investigation was later expanded to include transactions to provide satellite communications services between DBS and Spacecom Communications Ltd. ("Spacecom"), a company controlled by the Company's controlling shareholder, and with respect to dealings between the Ministry of Communications and the Company.

As part of the investigation, the Chairman of the Company's Board of Directors, CEO of the Company, the CEO and CFO of DBS were questioned, and as far as the Company is aware also other senior officers and functionaries in the Group ("Those Under Investigation").

At of the date of the report, some of Those Under Investigation were released with certain restrictions, which include restrictions on contact with employees and senior officers of the Bezeq Group and Eurocom as well as other restrictions.

Restrictions were imposed on the Chairman of the Board which include, *inter alia*, dealing with matters relating to the Ministry of Communications and/or DBS. He is also barred from being in contact with members of the Board of Directors, senior officers and employees of the Group companies. Matters relating to the Bezeq Group companies (excluding DBS) may only be handled by the CEOs of those companies (excluding the CEO of the Company and of DBS) and/or through the director David Granot, who was appointed Interim Acting Chairman of the Board of the Company, and this pursuant to agreements reached between the Chairman of the Board of the Company and the ISA.

Restrictions were imposed on the CEO of the Company which include, *inter alia*, dealing with the Company's regulatory affairs exclusively with and through the Acting Chairman of the Board, engaging in transactions with the controlling shareholders and activity with the controlling shareholder, handling the affairs of DBS (except for marketing matters relating to DBS, with and through the Company's VP Marketing). She is also barred from making direct or indirect contact with members of the Company's Board of Directors (excluding the Acting Chairman of the Board).

Following the opening of the public investigation, during the months June - August 2017, several legal proceedings were initiated against the Company, its senior officers and companies in the group that hold the controlling interest in the Company, including motions to certify a class action and to disclose documents prior to the filing of a motion for certification of a derivative claim. For information about these proceedings, see the update to Section 2.18.

For information on this matter, see also the Company's Immediate Reports dated June 20, 22 and 23, 2017, and dated July 11, 14, and 23, 2017, included here by way of reference.

<u>On the Second Contingent Payment under the terms of the Purchase Transaction</u>

The Company revised the estimate of the Second Contingent Payment in view of its assessment that it is now unlikely that the merger of DBS with the Company will take place in 2017, and taking into account the revised forecast for the free cash flow of DBS for 2017. According to the agreement between the

[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 2016 and refers to the section numbers in Chapter A (Description of Company Operations) in the said periodic report.

parties, and insofar as the final amount[2] of the contingent payment is deducted from the advance amounts that the Company paid Eurocom D.B.S. in respect of that payment (in the amount of NIS 119 million), Eurocom D.B.S. will have to return the difference to the Company. On this matter, see also Note 4.2 to the Company's financial statements for the period ended June 30, 2017.

In view of the updated estimate of the Second Contingent Payment, and in light of reports that discussions are underway between companies in the Eurocom Group and their creditors, in August 2017 the Company wrote to Eurocom D.B.S. (with a copy to the banks, who to the best of its knowledge are the principal creditors of Eurocom Group) asking for information about the ability of Eurocom D.B.S. to make the payment to the Company and with a request to be party to the discussions with Eurocom Group's creditors, and to any move that involves a change in the collaterals or assets of Eurocom Group. In response, Eurocom D.B.S. replied to the Company that discussions are in fact underway with bank creditors in an effort to settle Eurocom Group's debt package by consent, that it is working and intends to continue to work in full transparency on this matter, that as the discussions progress it will certainly wish to discuss the subject with the Company and that it will update the Company fully with the details of the evolving discussions, that are relevant to the Company, and in a manner that will provide the Company with a full picture.

## Section 1.4 - Dividend distribution

For information about a dividend distribution in the amount of NIS 578 million in respect of profits from the second half of 2016 that was approved by a general meeting of the Company's shareholders on May 9, 2017, and that were distributed on May 29, 2017, and a recommendation by the Board of Directors on August 23, 2017 in connection with a dividend distribution in the amount of NIS 708 million in respect of profits in the first half of 2017, see Note 10 to the Company's financial statements for the period ended June 30, 2017.

Outstanding, distributable profits at the report date - NIS 708 million (surpluses accumulated over the last two years, after subtracting previous distributions).

[2] The final settlement of accounts is expected to be soon after the signing of the Company's financial statements for 2017 (or at the date of the merger, whichever is earlier).

### Section 1.5.4 - Main results and operational data[3]

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

| | Q2 2017 | Q1 2017 | Q4 2016 | Q3 2016 | Q2 2016 | Q1 2016 |
|---|---|---|---|---|---|---|
| Revenues (NIS million) | 1,058 | 1,078 | 1,082 | 1,089 | 1,100 | 1,112 |
| Operating profit (NIS million) | 496 | 513 | 481 | 519 | 540 | 536 |
| Depreciation and amortization (NIS million) | 177 | 180 | 161 | 188 | 185 | 183 |
| EBITDA (Earnings before income taxes, depreciation and amortization) (NIS million)(1) | 673 | 693 | 642 | 707 | 725 | 719 |
| Net profit (NIS million) | 317 | 319 | 235 | 343 | 326 | 328 |
| Cash flow from current activities (NIS million) | 465 | 600 | 482 | 526 | 517 | 539 |
| Payments for investments in property, plant & equipment, intangible assets and other investments (NIS million) | 219 | 210 | 205 | 207 | 227 | 195 |
| Proceeds from the sale of property, plant & equipment and intangible assets (NIS million) | 16 | 10 | 15 | 22 | 54 | 41 |
| Free cash flow (NIS million) (2) | 262 | 400 | 292 | 341 | 344 | 385 |
| Number of active subscriber lines at the end of the period (in thousands)(3) | 2,077 | 2,100 | 2,119 | 2,137 | 2,151 | 2,167 |
| Average monthly revenue per line (NIS) (ARPL)(4) | 55 | 57 | 56 | 58 | 58 | 59 |
| Number of outgoing minutes (in millions) | 1,100 | 1,180 | 1,139 | 1,297 | 1,257 | 1,316 |
| Number of incoming minutes (in millions) | 1,220 | 1,281 | 1,252 | 1,383 | 1,314 | 1,348 |
| Number of active subscriber lines at the end of the period (in thousands) (7) | 1,593 | 1,580 | 1,558 | 1,539 | 1,521 | 1,503 |
| Of which the number of active subscriber lines at the end of the period - retail (in thousands) (7) | 444 | 414 | 377 | 347 | 323 | 290 |
| Average monthly revenue per Internet subscriber (NIS) - retail | 91 | 91 | 90 | 89 | 90 | 91 |
| Average bundle speed per Internet subscriber - retail (Mbps)(5) | 47.2 | 45.1 | 43.2 | 41.8 | 40.2 | 38.9 |
| Churn rate (6) | 2.4% | 2.8% | 2.4% | 2.6% | 2.4% | 2.9% |

(1) EBITDA (Earnings before income taxes, 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 bundles with a range of speeds, the maximum speed per bundle is taken into account.

(6) The number of telephony subscribers (gross) 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.

3 On the initial application of IFRS 15 - Revenue from Contracts with Customers, commencing January 1, 2017, see Note 3.2 to the Company's Financial Statements for the period ended June 30, 2017.

B. Pelephone

| | Q2 2017 | Q1 2017 | Q4 2016 | Q3 2016 | Q2 2016 | Q1 2016 |
|---|---|---|---|---|---|---|
| Revenue from services (NIS million) | 449 | 435 | 439 | 468 | 456 | 455 |
| Revenue from sale of terminal equipment (NIS million) | 183 | 193 | 213 | 181 | 202 | 216 |
| Total revenue (NIS million) | 632 | 628 | 652 | 649 | 658 | 671 |
| Operating profit (NIS million) | 30 | 5 | (4) | 27 | 8 | 1 |
| Depreciation and amortization (NIS million) | 99 | 94 | 89 | 92 | 95 | 104 |
| EBITDA (Earnings before income taxes, depreciation and amortization) (NIS million)(1) | 129 | 99 | 85 | 119 | 103 | 105 |
| Net profit (NIS million) | 34 | 16 | 3 | 32 | 13 | 13 |
| Cash flow from current activities (NIS million) | 193 | 117 | 65 | 152 | 180 | 185 |
| Payments for investments in property, plant & equipment, intangible assets and other investments, net (NIS million) | 82 | 73 | 63 | 64 | 63 | 51 |
| Free cash flow (NIS million) (1) | 111 | 44 | 2 | 88 | 117 | 134 |
| Number of subscribers at the end of the period (thousands) (2) (5) | 2,410 | 2,430 | 2,402 | 2,348 | 2,260 | 2,692 |
| Average monthly revenue per subscriber (NIS) (ARPU) (3) (6) | 61 | 60 | 62 | 68 | 68 | 57 |
| Churn rate (4) | 6.1% | 7.9% | 6.3% | 6.1% | 6.2% | 5.2% |

(1) Regarding the definition of EBITDA (earnings before income taxes, 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. The churn rate in Q2 2017 does not include the effect of the disconnection of 83,000 CDMA subscribers when the network was closed down and in Q2 2016 it does not include the writing off of CDMA subscribers as noted in note 6.

(5) Regarding the writing off of the CDMA subscribers, see Section 3.4 in the Description of Company Operations in the 2016 Financials ("Section 3.4"). On June 28, 2017, Pelephone discontinued operation of the CDMA network, as a result of which 83,000 subscribers ceased to receive service and were written off the subscriber listings.

(6) In Q2 2016, Pelephone wrote off 499,000 CDMA subscribers. The effect of writing off the CDMA subscribers led to an increase of NIS 10 in Pelephone's ARPU in Q1 and Q2 2017 and an average of NIS 12 in Q2, Q3 and Q4 2016. The effect of writing off the subscribers on the ARPU for the whole of 2016 is NIS 9.

C. Bezeq International

| | Q2 2017 | Q1 2017 | Q4 2016 | Q3 2016 | Q2 2016 | Q1 2016 |
|---|---|---|---|---|---|---|
| Revenues (NIS million) | 407 | 384 | 392 | 384 | 377 | 395 |
| Operating profit (NIS million) | 45 | 49 | 47 | 45 | 47 | 37 |
| Depreciation and amortization (NIS million) | 33 | 33 | 34 | 35 | 35 | 33 |
| EBITDA (Earnings before income taxes, depreciation and amortization) (NIS million)(1) | 78 | 82 | 81 | 80 | 82 | 70 |
| Net profit (NIS million) | 33 | 36 | 33 | 33 | 33 | 26 |
| Cash flow from current activities (NIS million) | 69 | 52 | 86 | 65 | 69 | 49 |
| Payments for investments in property, plant & equipment, intangible assets and other investments, net (NIS million)(2) | 46 | 29 | 25 | 24 | 33 | 37 |
| Free cash flow (NIS million) (1) | 23 | 23 | 61 | 41 | 36 | 12 |
| Churn rate (3) | 5.0% | 5.3% | 5.2% | 5.5% | 4.5% | 5.2% |

(1) On the definition of EBITDA (earnings before income taxes, 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

| | Q2 2017 | Q1 2017 | Q4 2016 | Q3 2016 | Q2 2016 | Q1 2016 |
|---|---|---|---|---|---|---|
| Revenues (NIS million) | 416 | 424 | 438 | 434 | 434 | 439 |
| Operating profit (NIS million) | 49 | 52 | 68 | 62 | 77 | 57 |
| Depreciation and amortization (NIS million) | 71 | 70 | 71 | 75 | 74 | 76 |
| EBITDA (Earnings before income taxes, depreciation and amortization) (NIS million)(1) | 120 | 122 | 139 | 137 | 151 | 133 |
| Net profit (loss) (NIS million) | (151) | 19 | 395 | (142) | (114) | (71) |
| Cash flow from current activities (NIS million) | 169 | 51 | 207 | 154 | 110 | 158 |
| Payments for investments in property, plant & equipment, intangible assets and other investments, net (NIS million) | 52 | 60 | 41 | 50 | 58 | 59 |
| Free cash flow (NIS million) (1) | 117 | (9) | 166 | 104 | 52 | 99 |
| Number of subscribers (at the end of the period, in thousands) (2) | 603 | 608 | 614 | 618 | 623 | 629 |
| Average monthly revenue per subscriber (ARPU) (NIS)(3) | 229 | 232 | 237 | 233 | 231 | 231 |
| Churn rate (4) | 3.8% | 4.3% | 3.6% | 4.5% | 3.6% | 4.2% |

(1) On the definition of EBITDA (earnings before income taxes, 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 decoders (such as a hotel, kibbutz, or gym), the number of subscribers is calculated by dividing the total payment received from the business customer by the average revenue from a small business customer. The number of subscribers was corrected retrospectively due to an insignificant change in the counting of subscribers among large customers.

(3) Monthly ARPU is calculated by dividing total DBS revenues (from content and equipment, premium channels, advanced products, and other services) by the average number of customers. The average monthly revenue was corrected retrospectively due to an insignificant change in the counting of subscribers among large customers.

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

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

State Comptroller's Report dated July 12, 2017

On July 12, 2017, the State Comptroller published a report regarding the Ministry of Communications' actions to regulate the fixed-line communication segment. By its very nature, the State Comptroller's report deals with criticism of government ministries (primarily with respect to issues pertaining to the Company) and its findings are directed at those entities

The report includes three reports on the following topics:

- Implementation of the wholesale market reform.
- The investment in infrastructures in the fixed-line communications segment, and structural aspects, including reference to the Ministry of Communications' actions in connection with the cancellation of the structural/corporate separation in the Company.
- The Prime Minister's conflicts of interests in his capacity as Minister of Communications.

The Company is unable to evaluate the impact of the aforementioned report on it, if at all.

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

Section 1.7.2.1(B) - Cancellation of the structural separation and the announcement of the Director General of the Ministry of Communications from December 21, 2016 - to the best of the Company's knowledge, the Ministry of Communications appointed a team that includes a Ministry of Finance representative, who is charged with advancing the cancellation of the structural separation. The Company believes that the chances of concluding the hearing proceedings in 2017 are slim.

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

Section 1.7.3.5 - Wholesale telephony market - on May 18, 2017, the then Acting Minister of Communications issued a decision regarding the "format for provision of telephony services for resale and setting the payment thereof on Bezeq's network." According to the decision, the Acting Minister of Communications adopted the recommendation of the Ministry's professional echelon, and determined the following:

A. A format was determined for provision of telephony services whereby the Company will allow another license holder to purchase telephony services from the Company to enable incoming and outgoing for customers of other license holders. The telephony service for resale will be provided for one year from July 31, 2017[4] , after a two-month preparation period.

B. Maximum payments were set for the service, including a fixed monthly payment of NIS 16 per line and variable payment for outgoing calls of 1.6 agorot per minute of outgoing call.

   The final maximum payments will be determined after a hearing has been held and if it becomes clear in the hearing that the payments must be adjusted, an appropriate amendment will be made to the payments and amounts will be offset (retroactively from the date of the decision) between the relevant operators.

C. The date of provision of wholesale telephony services (at wholesale prices) on the Company's network was postponed for the 14 months of the arrangement. Moreover, the decision stated that the option to extend the arrangement or turn it into a permanent arrangement will be reviewed (a recommendation on this matter will be put for a public hearing).

On June 28, 2017, the Company submitted its comments on the hearing in which it argued, inter alia, that there were serious defects in the calculations on which the maximum payments recommended for the service are based, and that these tariffs are lower than they should be.

The Company is ready to provide the service from July 31, 2017.

The Company believes that implementation of the above service may have an adverse effect on its financial results. Nevertheless, at this stage, the Company is unable to estimate the extent of the effect

[4] The original date set in the decision is July 17, 2017, however the relevant regulations were published on June 1, 2017 and they stipulate that the regulations will enter into force 60 days from their date of publication.

since it depends on different variables, including the results of the late hearing, the marketing of the services by competitors, the volume of customer demand for calls and the price levels of alternative products currently available on the market (such as VoB services), etc.

On this matter, see also the Company's Immediate Report dated May 23, 2017 (to which the decision of the Acting Minister of Communications and recommendations of the professional echelon in the Ministry of Communications were attached), included here by way of reference.

Notably, the tariffs for HOT's wholesale services were published on June 26, 2017.

**Section 1.7.4 Additional regulatory aspects relevant to the entire Group or several Group companies**

Section 1.7.4.5 - Consumer Legislation

A. On July 26, 2017, the Consumer Protection Bill, Amendment no. 55 (Professional human response on IVR systems), 2017, passed its first reading. Accordingly, the dealers listed in the Second Schedule to the Consumer Protection Law will be obligated to provide a human response after the option to choose a language on an IVR system, where the waiting time will not be more than the number of minutes that has yet to be defined and consumers will not be directed to a voice mail service. Insofar as the bill is approved in its current format, the costs of operating the call centers of the Group's companies are likely to increase significantly.

B. On August 15, 2017, the Company received a request to produce documents from the Consumer Protection and Fair Trade Authority, whereby the Authority is conducting an investigation against the Company on suspicion of breaches of the Consumer Protection Law. Among other things, the request is for data and detailed information in relation to consumers of surfing packages and/or the Company's internet infrastructures. The Company must respond to the request by September 3, 2017.

## 2. Bezeq ("the Company") - Domestic Fixed-Line Communications

**Section 2.7.2 – Domestic fixed-line communications infrastructure and equipment**

On the expansion of the distribution of optical fiber infrastructures to the customer's premises as a basis for future provision of more advanced and broadband communication services than those currently provided - since by the end of 2016 the distribution of optical fibers was significant whereas advanced technologies that facilitate extensive high-speed provision of the service are still being tested and have not yet reached the necessary technological readiness, the Company slowed the pace of distribution of the fibers significantly in 2017. The Company is focusing its efforts on testing the readiness of the new technologies, which will allow it to provide the service more extensively, and on investments in the existing network with the purpose of increasing the bandwidth, quality and durability of the network.

**Section 2.9.5 - Officers and senior management in the Company**

On the approval of an amended compensation policy for the Company – on April 5, 2017, a special general meeting of the Company's shareholders approved the amendments to the compensation policy according to the text attached as an addendum to the Report on Call for a General Meeting that was included in the 2016 Financials 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.

### Section 2.13 - Financing

**Section 2.13.1 – Average and effective interest rates on loans, Section 2.13.4 - Credit received during the Reporting Period / commitments to extend credit, and Section 2.13.5 - Company debentures**

Debentures

In May and June 2017, the Company completed an issuance of debentures in the total amount of NIS 1.1 billion par value as follows:

1. Public issuance of NIS 384,467,000 par value debentures (Series 9) by way of an expansion of series, in accordance with a shelf prospectus from May 2014, as amended due to a clerical error

in June 2014 ("the Shelf Prospectus") and a shelf offering report dated May 25, 2017 ("the Shelf Offering Report").

2. Issuance of traded Series 6 and 10 debentures of the Company to the bearers of Series B debentures of DBS, which are traded on the TASE's TACT (Tel Aviv Continuous Trading) Institutional System ("DBS Debentures"), in consideration of debentures of DBS that they own. The issuance took place in accordance with the shelf prospectus and the shelf offering report, as follows: NIS 125,000,000 par value DBS debentures were exchanged for NIS 125,750,000 par value debentures (Series 6), and NIS 436,307,797 par value DBS debentures were exchanged for NIS 481,683,808 par value debentures (Series 10).

3. Two private placements of Series 9 debentures of the Company to classified investors in the total amount of NIS 108,000,000 par value, to which restrictions apply regarding resale, as defined in Section 15C of the Securities Law and under the Securities Regulations (Details Concerning Sections 15A - 15C of the Law), 2000.

With respect to all the foregoing, see also the Company's Immediate Reports dated May 25, 2017, May 29, 2017, June 4, 2017, June 11, 2017 and June 18, 2017, included here by way of reference as well as Note 8 to the Company's financial statements for the period ended June 30, 2017.

Exercising of commitment to extend credit

On June 15, 2017, the Company completed the receipt of credit from financial institutions / banks in the total amount of NIS 900 million, based on undertakings given to it as described in the 2016 Periodic Report.

On June 1, 2016, the Company repaid the last principal payment for Series 8 debentures thus securing final redemption of the debentures.

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

| Loan term | Source of financing | Principal amount (NIS million) | Currency or linkage | Type of interest and change mechanism | Average interest rate | Effective interest rate | Interest range in 2017 |
|---|---|---|---|---|---|---|---|
| **Long-term loans** | Banks | 852 | Unlinked NIS | Variable, based on prime rate* | 1.74% | 1.75% | 1.27%-1.80% |
| | Banks | 2,243 | Unlinked NIS | Fixed | 4.39% | 4.44% | 2.40%-6.85% |
| | Non-bank sources | 734 | Unlinked NIS | Variable, based on annual STL rate** | 1.51% | 1.57% | 1.51%-1.57% |
| | Non-bank sources | 3,260 | Unlinked NIS | Fixed | 3.87% | 3.98% | 3.65%-6.65% |
| | Non-bank sources | 3,976 | CPI-linked NIS | Fixed | 2.30% | 2.35% | 2.20%-3.70% |

* Prime interest rate in July 2017 – 1.6%.

** YSTL yield per year (518) – 0.114% (average for the last 5 days of trading in May 2017) for the interest period commencing June 1, 2016.

### Section 2.13.6 - Credit rating

On April 24, 2017, Standard & Poor's Maalot Ltd. ("Maalot") affirmed a rating of ilAA/Stable for the Company and its debentures (Series 6-10) and for Pelephone and DBS, as detailed in the full rating report published in an Immediate Report issued by the Company on April 24, 2017, which is included here by way of reference.

Furthermore, for the purpose of issuing the Company debentures as part of an expansion of series and exchange of the DBS debentures as noted in the above update, the following ratings were approved:

1. Approval from Midroog Ltd. for a rating of Aa2.il, outlook stable, for Series 6-10 debentures of the Company and for debentures of the Company in the amount of up to NIS 1.1 billion par value by means of an expansion of existing series of debentures and/or as part of an exchange of DBS debentures with debentures to be issued by the Company. On this, see immediate reports

published by the Company on May 21, 2017 May 25, 2017, which are included in this report by way of reference.

2. Maalot approval for an ilAA/Stable rating for debentures in the amount of up to NIS 1.1 billion par value to be issued by the Company by means of an expansion of one or more of the Series 6-10 for a cash payment and/or against an exchange for DBS debentures. On this, see immediate reports published by the Company on May 22, 2017 May 25, 2017, which are included in this report by way of reference.

On this matter, 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 June 30, 2017.

## Section 2.16 – Restrictions and control of the Company's operations

### Section 2.16.1 - Control of Company tariffs

On June 27, 2017, the Company received a hearing letter from the Ministry of Communications. According to the hearing documents, the Ministry is considering two alternatives to the present tariff control mechanism for telephony services:

(1) To convert the existing supervisory method that sets fixed rates (FIX) to maximum rates; the main telephony services (telephone line - NIS 57.92 including VAT, and 1.87 agorot including VAT for calls) will be set in relation to the updated costs structure; for most of the additional services, the present tariff will become the maximum tariff and price control will be lifted for some of the services.

(2) To remove price control from the main telephony services - telephone line and calls, and from additional services that are currently supervised in the form of fixed tariffs, and to set a maximum price for a "supervised bundle" which will include a telephone line and call minutes which the Company will offer customers who wish to subscribe to this service, similar to the alternative payments package currently offered by the Company for which there is most demand.

Similarly, it is proposed that only existing subscribers of the alternative payments package for the "Kav Kal" (Light Line) service will be able to continue to receive it. The Ministry of Communications is also considering determining that price supervision will be lifted on PRI channels and the price control on their call components will be cancelled.

On August 13, 2017, the Company submitted its comments on the hearing letter, opposing the proposed tariffs. The Company believes that the change in the control mechanism being considered in the hearing, insofar as this change is implemented, will negatively affect its financial results. The Company believes that its retail tariffs will be affected in parallel also as a result of the setting of wholesale prices for telephony services (see Section 1.7.3).

On this, see also the Company's Immediate Report dated June 28, 2017, (to which the hearing letter is attached) included here by way of reference.

## Section 2.18 – Legal proceedings

Pending proceedings - Subsection (B) - on a claim and motion for its certification as a derivative claim concerning an agreement for the purchase all the holdings and shareholders loans of Eurocom D.B.S. Ltd. in DBS by the Company - pursuant to the court's decision on July 2, 2017, on July 17, 2017, the Israel Securities Authority submitted its position in connection with the possibility of continuing the purchase process in view of the ISA investigation (see update to Section 1.1). Based on the ISA's position, in view of the fact that the investigation is complex, convoluted and involves a large number of parties, and it is still in its early stages, the ISA's position is that the purchase process should be delayed at the present time. Subsequently, the court decided on a stay of proceedings in this case until November 2017, when the ISA is scheduled to submit an updated announcement.

Pending proceedings - Subsection (E) - on a claim and motion for its certification as a class action relating to a campaign by the Company to upgrade the internet surfing speed - on April 3, 2017, a ruling was handed down on this action certifying the plaintiff's application to abandon the motion to certify the claim as a class action and dismissing the plaintiff's personal claim, and this after, in its response, the Company drew attention to advertisements in which it had specified the exclusions to the campaign.

Pending proceedings - Subsection (H) - on two motions for the certification of class actions claiming that the Company charges a monthly payment, unlawfully and without consent, for support and/or liability services as part of using its internet infrastructure, and a court ruling from March 26, 2017 to strike out the later motion in view of the similarity between the two motions - on May 14, 2017, the Company received notice of an appeal (that was filed in the Supreme Court on May 4, 2017) by the applicant in the later motion asking to strike out the earlier motion and continue the hearing in the later motion.

Pending proceedings - Subsection (I) - on two motions for the certification of class actions in connection with the antivirus service - on July 4, 2017, the Central District Court resolved to strike out the later motion (the motion for the amount of NIS 11 million) in view of the similarity between the two motions.

Legal proceedings that ended in the Reporting Period or by the date of publication of the report - subsection (B) - regarding a Supreme Court ruling which dismissed two appeals on a ruling of the Tel Aviv District Court (Economic Department) which dismissed two (consolidated) motions to certify derivative actions concerning the distribution of dividends and loans of the Company - on April 6, 2017, the Company received a copy of a petition to hold another hearing on the case that was filed by one of the appellants.

New proceedings:

1. In April 2017, the Company received a class action certification motion which was filed in the Tel Aviv District Court against the Company and against its subsidiary, Walla! Communications Ltd., Yad2 and an advertising company owned by Walla (hereinafter collectively, the “Respondents”). The motion pertains to the Company’s B144 service, which enables businesses to advertise on the Internet (the “Service”). According to the petitioner, the Respondents charged subscribers to the Service unlawful charges The petitioner estimates the class action amount at NIS 1.11 billion (based on an estimate of 300,000 customers and compensation of NIS 3,700 per customer). Notably, in May 2017, the Company received another claim together with a class action certification motion (which was filed in the Tel Aviv District Court) the subject of which is similar to this claim and alleging that unlawful amounts had been charged for the Company’s B144 service. According to the information in the motion, the amount of the class action cannot be estimated. The Company filed a motion to abandon the first motion in limine. Furthermore, a motion was filed to consolidate the two proceedings in view of shared questions and partial identity of the groups in both proceedings.

2. On June 28, 2017, the Company learned of two motions for the certification of class actions that were filed in the Tel Aviv District Court (Economics Department) by shareholders of the Company. The subject of the motions is a transaction from 2015 in which the Company acquired from Eurocom D.B.S. Ltd (a company controlled by the Company's controlling shareholders) the balance of shares of the subsidiary D.B.S Satellite Services (1998) Ltd ("DBS") that it held ("the Transaction”):

   The first motion was filed against the Company, Chairman of the Company’s Board of Directors, members of the Company’s Board of Directors, CEO of the Company, the CEO and CFO of DBS and companies in the Eurocom Group (including companies that are controlling shareholders of the Company, whether directly or indirectly) in the name of all those who purchased Company shares between February 11, 2015, and June 19, 2017 (excluding the Respondents and/or those acting on their behalf and/or connected with them). In the motion it is argued that the report concerning the Transaction was misleading and/or deficient, and on account of which due to the opening of a public investigation into the Transaction by the ISA the public has become aware of details concerning the Transaction and its implementation, which led to a drop in the Company's share price in the days following the disclosure and analysis of the new information, such that the estimate of damage caused to the Company's shareholders as a result of the disclosure is approximately NIS 1.3 billion. The Petitioner argues that the Respondents acted contrary to the provisions of the Securities Law, 1969 and contrary to the provisions of additional laws, and caused holders of the Company's securities heavy financial losses, amounting to millions of shekels if not more.

   The second motion was filed against the Company, Chairman of the Company’s Board of Directors, members of the Company’s Board of Directors, and companies that are controlling shareholders of the Company, B Communications Ltd. and Internet Gold - Golden Lines Ltd. in the name of three sub-groups - anyone who acquired (1) shares of the Company, (2) shares of B Communications Ltd, and (3) shares of Internet Gold - Golden Lines Ltd. on the Tel Aviv Stock Exchange between May 21, 2015 and June 19, 2017. The Petitioner argues that the public that invested in the aforementioned shares was seriously misled, which was uncovered following the opening of a public investigation into the Transaction by the ISA on June 20, 2017, whereby the increase in the cash flow of DBS as reported in the Company's financial statements was artificially inflated, according to their claim, thereby misleading reasonable investors who based themselves on DBS cash flow data to estimate its worth, which led to over-valuation of the above companies. The Petitioner estimates the damage caused to the sub-group of Company shareholders at NIS 568 million. The Petitioner also claims additional damage caused to the groups of shareholders in B Communications and Internet Gold-Golden Lines Ltd.

On July 24, 2017, the decision of the District Court which heard the motions was received, whereby the date for filing the Company's response to the motions was extended until further notice.

3. In July 2017, the Company was served with a motion to certify a class action that was filed in the Tel Aviv District Court. The subject of the motion is a transaction for the purchase of DBS shares (in this section "DBS Transaction") as well as a transaction to continue the agreement between DBS and Spacecom (in this section the "Spacecom Transaction"). The motion was filed against the Company and members of the Company's Board of Directors in the name of a group of people who are or had been Company shareholders, whether directly or indirectly, by various public or institutional bodies, all in the period between June 20, 2017 and June 29, 2017, and for the period relating to the publication of the failure in connection with the Spacecom Transaction from July 11, 2017. In the motion it is argued that in the circumstances described in the motion, there are four causes of action: breach of duty of care, breach of fiduciary duty, discrimination against the minority and the transfer of misleading information. According to the Petitioners, the damage caused is expressed as a decline in the value of the Company's share at the stage when the ISA summoned for investigation those involved acting for the Company and as a result, the alleged failures relating to the DBS Transaction were reported. The Petitioners estimate that the damage caused to the class as a result of the decline in the value of the Company's share is NIS 2 billion (including the damage caused after the publication of the affair relating to the continued contract with Spacecom).

4. In June - August 2017, Company shareholders filed several motions in the Tel Aviv District Court against the Company and DBS (not including two motions that were filed only against the Company). The motions were to disclose documents prior to filing a motion for certification of a derivative claim under Section 198A of the Companies law, where the background to these motions is the public investigation being conducted by the ISA, which began on June 20, 2017 and was expanded, as announced by the Company, on July 11, 2017 also with respect to the DBS - Spacecom transaction, as defined below (see update to Section 1.1).

   In some of these motions, the court was moved to instruct the Company (and DBS, as applicable) to submit to the Petitioners documents and information in connection with the agreement for the Company's purchase of DBS, and specifically in connection with the Second Contingent Payment according to that agreement (payment of NIS 170 million which is contingent on DBS meeting free cash flow targets in the period 2015-2017). In this context, it is noted that in June 2017, another motion was received in the Company's offices to disclose documents prior to the filing of a derivative claim which was sent to the Company prior to applying to the court and includes a request to disclose various documents on the same subject.

   In some of the motions, the court was moved to instruct the Company (and DBS, as applicable) to submit to the Petitioners certain documents in connection with an interested party transaction between DBS and Spacecom from 2013, as amended early in 2017 (in this section: the "DBS - Spacecom Transaction").

   In an additional motion, the court was moved to instruct the Company and DBS to submit to the Petitioner documents and information also in connection with the agreement for the Company's purchase of DBS and in connection with the DBS - Spacecom Transaction. In this motion, the Petitioner wishes to explore the filing of a motion to certify a derivative claim against officers in the Company and DBS who were in breach of their fiduciary duty against the Company in these transactions, according to the Petitioner, where the relief requested is to return all the benefits they received for their positions in the Company or DBS (salary, bonuses, management fees, etc.).

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

## Section 3.1 - General information about the area of operations

Section 3.1.5.1 - on April 20, 2017, permission was received from the Ministry of Communications to operate the LTE Advanced technology (LTEA).

## Section 3.2 - Services and Products

Section 3.2.2 - in April 2017, the Finance Minister announced an economic plan that includes, *inter alia,* the elimination of import duties and purchase taxes. As part of this plan, the Finance Ministry decided to abolish purchase tax on imported cellular devices, which had been 15% of the value of the device.

## Section 3.7 - Property, plant and equipment

Section 3.7.1.1 - in April 2017, Pelephone received approval to close down the CDMA network on July 30, 2017, or earlier with the Ministry's approval. On June 28, 2017, Pelephone discontinued operation of the CDMA network, in accordance with the amendment to its license on this matter.

## Section 3.8 - Intangible assets

Pelephone returned to the national pool of frequencies two frequency bands, both on the 1 mega bandwidth, in the 850 Mhz spectrum and towards the end of April 2017 Pelephone received a temporary allocation of 5 mega bandwidth on the 1800 Mhz spectrum. This allocation is for limited use and for a limited period and it will expire at the end of 2019 or earlier, according to the conditions specified in the allocation.

## Section 3.9 – Human resources

Sections 3.9.2 and 3.9.5 - on April 27, 2017, a new collective labor agreement was signed by Pelephone and the New General Federation of Workers ("the Histadrut") and Pelephone's workers' committee, replacing the collective agreement that expired on December 31, 2016. The main points of this agreement are:

1. The agreement applies retroactively from January 1, 2017 and up to December 31, 2019. After this date, the agreement will be extended automatically for 18-month periods, unless one of the parties gives notice that it wishes to change it.
2. The inclusion of mechanisms which include the Committee in decisions concerning the termination of permanent employees, the implementation of disciplinary measures against them and restructuring of the organization, while allowing for administrative flexibility which would make it possible to operate in a competitive and dynamic market.
3. The determination of quotas for streamlining-related dismissals and annual salary increments, various financial benefits and annual bonuses based on Pelephone's business results to be given to employees during the term of the Agreement. The ongoing costs of the agreement are not materially different from the previous collective agreement.
4. The open labor dispute declarations are cancelled.

## Section 3.16 – Legal proceedings

Section 3.16.1(A) - On an appeal filed in the Supreme Court against a decision by the District Court to dismiss a claim and a motion for its certification as a class action that was filed against cellular operators, including Pelephone, for the collection of VAT from customers who use cellular services while they are outside Israel - on July 3, 2017, the Supreme Court issued a ruling accepting the Petitioners' appeal against the decision to dismiss the claim and the hearing will be returned to the District Court to rule on the question of whether monies were collected unlawfully for cellular services abroad. According to the Supreme Court ruling, if the District Court rules in favor of the issue and Pelephone is required to refund the collected VAT to its customers, a claim for indemnification against the Tax Authority will be possible for these amounts that it will be required to refund. Furthermore, it was determined that in the context of prepaid service bundles for use overseas, the VAT rate is zero. According to Pelephone's initial estimate, the implication of the Supreme Court ruling is that the results of the aforementioned process will have no significant repercussions for Pelephone.

Section 3.16.1(G) - On a claim and motion for its certification as a class action against Pelephone, in which it is argued that Pelephone is in breach of the portability plan / rules, so that when attempting to move to another operator (the receiving operator), the Plaintiff discovered that Pelephone (the deserted operator) had deliberately blocked her from moving to a competitor. When contacting Pelephone to clarify the matter, the unacceptable motive for the blockage, the attempt to retain her as a customer and prevent her moving to a competitor, were discovered. Furthermore, injunctions are sought to prevent such blocking. On March 28, 2017, the court approved abandonment of the motion, striking out of the motion for certification and dismissal of the Plaintiff's personal claim.

Section 3.16.1(H) - on a claim and class action certification motion against Pelephone which alleges that Pelephone opted customers to the Smart Call service (a service that blocks incoming calls from various call centers, including the call centers of Pelephone's competitors), without their consent or knowledge - on May 7, 2017, the court authorized the applicant to abandon the motion for certification of the class action against Pelephone and it dismissed his personal claim against Pelephone.

Section 3.16.1(I) - On a claim and motion for its certification as a class action against Pelephone alleging that Pelephone overcharges for calls made to Israel from abroad on the Travel track, and that it charges a higher tariff instead of a call on the savings plan, due to the fact that the calls were made using the prefix 972 - on June 4, 2017, a ruling was issued dismissing the motion for certification and the Plaintiff's personal claim without ordering costs.

## 4. Bezeq International – international communications, Internet and NEP services

There are no updates to this chapter.

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

### Section 5.1 - General information about the area of operations

Recently, competition has increased as new players are beginning to launch low-priced internet-based television services and existing players become more firmly established. In April 2017, Triple C Cloud Computing Ltd. launched an internet-based television service. In July 2017, Netflix launched a Hebrew interface and Partner also launched an internet-based television service. Likewise, in March 2017, HOT launched a new internet-based television service and in August 2017 it announced the launching of an additional television service commencing September 2017. Additionally, in August 2017, Rami Levy announced the launching of a new television service over the internet which will also begin in September 2017.

DBS believes that this intensification of the competition could have a significant adverse effect on its operations and results.

DBS's opinion in this instance is forward-looking information, as defined in the Securities Law, based in part on the announcements of the new players. This assessment may not materialize, or it may materialize differently than expected, depending, *inter alia* on the dependence, manner in which these television services develop and are established, the entry of additional players, as well as the question of the application of regulatory matters with respect to these television services.

Section 5.1.2.6 - at the date of this report, the Knesset is discussing a government bill to amend the Communications Law. Among other things, the bill addresses issues that are similar to the must-sell regulations in the area of sports content that were also discussed by the Filber Committee, including the granting of a license for broadcasting a sports channel or a significant sports operator by their producers. At the date of the report, DBS is unable to estimate whether the aforementioned bill will be implemented in legislation and in what format, and it is also unable to estimate what effect it will have on DBS's business.

### Section 5.2 – Products and services

In July 2017, DBS announced that in Q4 2017 it expects to launch a service called "StingTV", which will include linear television channels, VOD service and other content of DBS, including original Israeli productions, children's content, documentaries, imported series and other content. The service will be based on the Android TV operating system which allows content to be viewed by streaming, smart TV and other terminal devices such as tablets, smartphones and PCs.

Regarding the timing and format of the launching of this service, DBS's opinion is forward-looking information, as defined in the Securities Law, based in part on DBS's assessment of this service. This assessment may not materialize, or it may materialize in a manner that differs significantly from that foreseen, in part taking into account its agreements with various service providers in connection with the service, their performance and the relevant time frame.

**Section 5.6.1 - Competitors in the market**

On the entry of new competitors to the television market, see the update to Section 5.1.

**Section 5.13.2 - Institutional financing**

In July 2017, DBS repaid the balance of the Series 1 debentures, as a result of the liens registered in favor of Trustee A were lifted.

On the purchase of Series 2 debentures of DBS by the Company (while at the same time issuing debentures of the Company), see the update to Section 2.13.

**Section 5.15.1 - S&P Maalot ratings for DBS and its debentures**

On the affirmation of an ilAA/Stable rating by Standard & Poor's Maalot Ltd. for DBS (as part of the affirmation of the rating for the Company), see the update to Section 2.13.6.

**Section 5.16.1 - Space segment leasing agreement:**

In April 2017, the Company's general meeting and the general meeting of Spacecom approved the engagement in the 2017 Agreement (see the Company's Immediate Report dated April 3, 2017, which is included in this report by way of reference.

At the beginning of April 2017, the Amos 2 satellite reached the end of its commercial life and ceased providing services to DBS. At the date of this report, DBS uses the space segments on the Amos 3 and Amos 7 satellites.

## Section 5.17 – Legal proceedings

**New legal proceedings**

For information about a public investigation that was launched by the ISA in June 2017, in which context the CEO and CFO of DBS, among others, were questioned, see the update to Section 1.1.

For information about a motion to certify a class action that was filed, inter alia, against the CEO and CFO of DBS in connection with a transaction from 2015, in which the Company acquired from Eurocom D.B.S. Ltd (a company controlled by the Company's controlling shareholders) the balance of DBS shares that it held in connection with a transaction to acquire shares of the Company held by Eurocom, see the update to Section 2.18.

For information about motions filed in the Tel Aviv District Court (Economics Division) to disclose documents prior to filing a motion for certification of a derivative claim under Section 198A of the Companies Law, that were filed by Company shareholders against the Company and DBS, to submit documents and information in connection with an agreement to purchase DBS by the Company, and specifically in connection with the Second Contingent Payment under that agreement, see the update to Section 2.18.

For information about motions filed by Company shareholders in the Tel Aviv District Court (Economics Division) in July 2017, to disclose documents prior to filing a motion for certification of a derivative claim under Section 198A of the Companies Law, against the Company and DBS, to disclose certain documents in connection with an interest party transaction between DBS and Spacecom from 2013, as amended in 2017, see the update to Section 2.18.

For information about a motion to disclose documents prior to filing a motion for certification of a derivative action under Section 198A of the Companies Law, which was filed in July 2017 by a shareholder in the Company against the Company and DBS in the Tel Aviv District Court (Economics Division), in connection with benefits received by senior officers of the Company and DBS, in the context of a transaction to acquire shares of DBS held by the Company and a transaction with Spacecom, see the update to Section 2.18.

| | |
|---|---|
| August 23, 2017 | |
| Date | Bezeq The Israel Telecommunication Corporation Ltd. |

Names and titles of signatories:
David Granot, Interim Acting Chairman of the Board of Directors
Stella Handler, CEO

# Chapter B -

## Board of Directors' Report on the State of the Company's Affairs for the Period Ended June 30, 2017

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 six months ended June 30, 2017 ("the Six Month Period") and the three months then ended ("the Quarter").

The Board of Directors' report includes a condensed review of its subject-matter, and was prepared assuming the Board of Directors' report of December 31, 2016 is also available to the reader.

Concerning the public investigation by the Israel Securities Authority which started on June 20, 2017, of suspected offenses under the Securities Law and the Penal Law concerning transactions related to the controlling shareholder, see Note 1.2 to the financial statements. At this time, the Company is unable to estimate the outcomes, if any, of the Israel Securities Authority's investigation. The Company's auditors call attention to that fact in their opinion of the financial statements.

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

1. **Domestic Fixed-Line Communications**
2. **Cellular Communications**
3. **International Communications, Internet and NEP Services**
4. **Multi-Channel Television**

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

The Group's results were as follows:

| | 1-6.2017 | 1-6.2016 | Increase (decrease) | | 4-6.2017 | 4-6.2016 | Increase (decrease) | |
|---|---|---|---|---|---|---|---|---|
| | NIS millions | NIS millions | NIS millions | % | NIS millions | NIS millions | NIS millions | % |
| Profit | **708** | 665 | 43 | 6.5 | **358** | 377 | (19) | (5.0) |
| EBITDA (operating profit before depreciation and amortization) | **1,991** | 2,079 | (88) | (4.2) | **997** | 1,056 | (59) | (5.6) |

Year-on-year, profit was up during the Period, mainly due to a reduction in taxes on income, as compared to an increase in the same period last year. The reduction was due to the effects of lower corporate tax rates on deferred tax assets. In addition, operating profit was down in the Period and Quarter, due to a decrease in revenues 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

| | June 30, 2017 | June 30, 2016 | Increase (decrease) | | Explanation |
|---|---|---|---|---|---|
| | NIS millions | NIS millions | NIS millions | % | |
| Cash and current investments | **1,873** | 2,250 | (377) | (16.8) | The decrease was mainly attributable to the Domestic Fixed-Line Communications segment, following a decrease in current investments. |
| Eurocom D.B.S. Ltd. | **56** | 29 | 27 | 93.1 | The increase in the balance was due to a reduction in the estimate for the second contingent consideration from the acquisition of DBS, to the amount of NIS 84 million, which was partially offset by an update to the fair value estimate of the advances received by Eurocom D.B.S from the Company, to the amount of NIS 57 million. See Note 4.2.1 to the financial statements. |
| Inventory | **105** | 109 | (4) | (3.7) | |
| Current and non-current trade and other receivables | **2,845** | 2,881 | (36) | (1.2) | The decrease was mainly due to a reduction in trade receivables in the Cellular Communications segment, due to lower revenues from handset sales and services. The decrease was partially offset, mainly by an increase in overall receivables from real estate sales in the Domestic Fixed-Line Communications segment. |
| Broadcasting rights | **456** | 455 | 1 | 0.2 | |
| Property, plant and equipment | **6,868** | 6,872 | (4) | (0.1) | |
| Intangible assets | **2,943** | 3,195 | (252) | (7.9) | The decrease was mainly due to write-downs of excess acquisition costs attributed to intangible assets upon assuming control of DBS, and a decrease in investment (net of depreciation) in the Cellular Communications and Domestic Fixed-Line Communications segments. |
| Deferred tax assets | **1,015** | 1,099 | (84) | (7.6) | Tax assets were reduced, mainly due to the reduction in the corporate tax rate starting 2017. |
| Deferred costs and non-current investments | **457** | 397 | 60 | 15.1 | The increase was due to early adoption of IFRS 15 - Revenues from Contracts with Customers , whereby distributor fees are recognized as subscriber acquisition assets. See Note 3.2 to the financial statements. |
| Total assets | **16,618** | 17,287 | (669) | (3.9) | |

## 1.1. Financial Position (Contd.)

| | June 30, 2017 | June 30, 2016 | Increase (decrease) | | Explanation |
|---|---|---|---|---|---|
| | NIS millions | NIS millions | NIS millions | % | |
| Debt to financial institutions and debenture holders | **11,519** | 11,504 | 15 | 0.1 | Debenture issues and receipt of loans were offset by debenture and loan repayments. Overall, debt remained stable. |
| Trade and other payables | **1,608** | 1,576 | 32 | 2.0 | |
| Current and deferred tax liabilities | **211** | 703 | (492) | (70.0) | The Company paid a total of NIS 461 million in the third quarter of 2016, following an agreement between the Company and the tax authorities |
| Liabilities towards Eurocom D.B.S. Ltd. | **-** | 208 | (208) | (100) | Payments to Eurocom D.B.S Ltd. for the first contingent consideration on acquisition of DBS's loans and shares. |
| Employee benefits | **577** | 609 | (32) | (5.3) | |
| Other liabilities | **378** | 388 | (10) | (2.6) | |
| Total liabilities | **14,293** | 14,988 | (695) | (4.6) | |
| **Total equity** | **2,325** | 2,299 | 26 | 1.1 | Equity comprises 14% of the balance sheet total, as compared to 13.3% of the balance sheet total on June 30, 2016. |

## 1.2 Results of operations

### 1.2.1 Highlights

| | 1-6.2017 | 1-6.2016 | Increase (decrease) | | 4-6.2017 | 4-6.2016 | Increase (decrease) | | Explanation |
|---|---|---|---|---|---|---|---|---|---|
| | NIS millions | NIS millions | NIS millions | % | NIS millions | NIS millions | NIS millions | % | |
| Revenues | 4,916 | 5,070 | (154) | (3.0) | 2,463 | 2,511 | (48) | (1.9) | Revenues were down in the Domestic Fixed-Line Communications segment, the Cellular Communications segment, and the Multi-Channel Television segment. This decrease was partially offset by greater revenues in the International Communications, Internet and NEP services. |
| Depreciation and amortization | 852 | 889 | (37) | (4.2) | 424 | 440 | (16) | (3.6) | The decrease was mainly attributable to the Domestic Fixed-Line Communications and Multi-Channel Television segments. There was also a decrease in the write-down of excess acquisition costs created upon assuming control of DBS. |
| Salaries | 998 | 1,008 | (10) | (1.0) | 494 | 495 | (1) | (0.2) | |
| General and operating expenses | 1,932 | 1,990 | (58) | (2.9) | 973 | 972 | 1 | 0.1 | The change was mainly due to decreased expenses in the Cellular Communications segment, partially offset by increased expenses in the International Communications, Internet and NEP Services segment. The change in expenses was affected, among other things, by early adoption of IFRS 15 - Revenue from Contracts with Customers, whereby distributor fees are recognized as subscriber acquisition assets. See Note 3.2 to the financial statements. |
| Other operating income, net | 5 | 7 | (2) | (28.6) | 1 | 12 | (11) | (91.7) | |
| Operating profit | 1,139 | 1,190 | (51) | (4.3) | 573 | 616 | (43) | (7.0) | |
| Finance expenses, net | 203 | 207 | (4) | (1.9) | 102 | 105 | (3) | (2.9) | The decrease in net finance expenses was mainly due to a reduction in the estimate for the second contingent consideration from the acquisition of DBS, to the amount of NIS 84 million. This decrease was offset by an update to the fair value estimate of the surplus advances received by Eurocom D.B.S from the Company, to the amount of NIS 57 million (see Note 4.2.1 to the financial statements), an increase in net finance expenses in the Multi-Channel Television segment, and NIS 13 million in finance expenses recognized on the swap of DBS debentures for Company debentures, as detailed in Note 8.2.2 to the financial statements.. |
| Share in losses of investees | 4 | 2 | 2 | 100.0 | 2 | 1 | 1 | 100.0 | |
| Taxes on income | 224 | 316 | (92) | (29.1) | 111 | 133 | (22) | (16.5) | Taxes were down in the Period, mainly due to a reduction in the tax asset and recognition of NIS 64 million in deferred tax expenses in the last-year period, following a reduction in the corporate tax rate. Furthermore, the corporate tax rate was reduced from 25% to 24% starting 2017. |
| Profit for the period | 708 | 665 | 43 | 6.5 | 358 | 377 | (19) | (5.0) | |

### 1.2.2 Operating segments

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

| | 1-6.2017 | | 1-6.2016 | | 4-6.2017 | | 4-6.2016 | |
|---|---|---|---|---|---|---|---|---|
| | NIS millions | % of total revenues | NIS millions | % of total revenues | NIS millions | % of total revenues | NIS millions | % of total revenues |
| **Revenues by operating segment** | | | | | | | | |
| Domestic Fixed-Line Communications | **2,136** | **43.4** | 2,212 | 43.6 | **1,058** | **43.0** | 1,100 | 43.8 |
| Cellular Communications | **1,260** | **25.6** | 1,329 | 26.2 | **632** | **25.7** | 658 | 26.2 |
| International Communications, Internet and NEP Services | **791** | **16.1** | 772 | 15.2 | **407** | **16.5** | 377 | 15.0 |
| Multi-Channel Television | **840** | **17.1** | 873 | 17.2 | **416** | **16.9** | 434 | 17.3 |
| Other and offsets | **(111)** | **(2.3)** | (116) | (2.2) | **(50)** | **(2.0)** | (58) | (2.3) |
| **Total** | **4,916** | **100** | 5,070 | 100 | **2,463** | **100** | 2,511 | 100 |

| | 1-6.2017 | | 1-6.2016 | | 4-6.2017 | | 4-6.2016 | |
|---|---|---|---|---|---|---|---|---|
| | NIS millions | % of segment revenues | NIS millions | % of segment revenues | NIS millions | % of segment revenues | NIS millions | % of segment revenues |
| **Operating profit by segment** | | | | | | | | |
| Domestic Fixed-Line Communications | **1,009** | **47.2** | 1,076 | 48.6 | **496** | **46.9** | 540 | 49.1 |
| Cellular Communications | **35** | **2.8** | 9 | 0.7 | **30** | **4.7** | 8 | 1.2 |
| International Communications, Internet and NEP Services | **94** | **11.9** | 84 | 10.9 | **45** | **11.1** | 47 | 12.5 |
| Multi-Channel Television | **101** | **12.0** | 134 | 15.3 | **49** | **11.8** | 77 | 17.7 |
| Other and offsets | **(100)** | **-** | (113) | - | **(47)** | **-** | (56) | - |
| **Consolidated operating profit/ % of Group revenues** | **1,139** | **23.2** | **1,190** | **23.5** | **573** | **23.3** | **616** | **24.5** |

### 1.2.2. Operating segments

B. Domestic Fixed-Line Communications Segment

| | 1-6.2017 NIS millions | 1-6.2016 NIS millions | Increase (decrease) NIS millions | % | 4-6.2017 NIS millions | 4-6.2016 NIS millions | Increase (decrease) NIS millions | % | Explanation |
|---|---|---|---|---|---|---|---|---|---|
| Fixed-line telephony | **708** | 758 | (50) | (6.6) | **347** | 374 | (27) | (7.2) | The decrease was due to lower average revenues per phone line and a decrease in the number of lines. |
| Internet - infrastructure | **816** | 792 | 24 | 3.0 | **407** | 398 | 9 | 2.3 | The increase was mainly due to growth in the number of internet subscribers through the wholesale service, offset by a decline in the number of retail internet subscribers. |
| Transmission, data communications and others | **612** | 662 | (50) | (7.6) | **304** | 328 | (24) | (7.3) | The decrease was mainly due to lower transmission revenues from telecom operators. |
| Total revenues | **2,136** | 2,212 | (76) | (3.4) | **1,058** | 1,100 | (42) | (3.8) | |
| Depreciation and amortization | **357** | 368 | (11) | (3.0) | **177** | 185 | (8) | (4.3) | |
| Salaries | **444** | 447 | (3) | (0.7) | **220** | 217 | 3 | 1.4 | |
| General and operating expenses | **331** | 342 | (11) | (3.2) | **166** | 170 | (4) | (2.4) | The decrease was mainly due to a reduction in distributor fee costs, recognized as an asset following early adoption of IFRS 15, and a reduction in interconnect fees to telecom operators. |
| Other operating income, net | **5** | 21 | (16) | (76.2) | **1** | 12 | (11) | (91.7) | This decrease in net income was due to lower capital gains on real estate sales. |
| Operating profit | **1,009** | 1,076 | (67) | (6.2) | **496** | 540 | (44) | (8.1) | |
| Finance expenses, net | **174** | 206 | (32) | (15.5) | **82** | 105 | (23) | (21.9) | The decrease in net finance expenses was due to a reduction in the estimate for the second contingent consideration from the acquisition of DBS to the amount of NIS 84 million, which was partially offset by an update to the fair value estimate of the advances received by Eurocom D.B.S from the Company, to the amount of NIS 57 million (see Note 4.2.1 to the financial statements). |
| Taxes on income | **199** | 216 | (17) | (7.9) | **97** | 109 | (12) | (11.0) | The decrease was due to a reduction in taxable income, and a reduction in the corporate tax rate from 25% to 24% starting 2017. |
| Segment profit | **636** | 654 | (18) | (2.8) | **317** | 326 | (9) | (2.8) | |

### 1.2.2. Operating segments

C. Cellular Communications segment

| | 1-6.2017 | 1-6.2016 | Increase (decrease) | | 4-6.2017 | 4-6.2016 | Increase (decrease) | | |
|---|---|---|---|---|---|---|---|---|---|
| | NIS millions | NIS millions | NIS millions | % | NIS millions | NIS millions | NIS millions | % | Explanation |
| Services | **884** | 911 | (27) | (3.0) | **449** | 456 | (7) | (1.5) | The decrease was due to migration of existing customers to cheaper plans offering greater data volumes at current market prices. The decrease was partially offset by growth in the Company's customer base. |
| Equipment sales | **376** | 418 | (42) | (10.0) | **183** | 202 | (19) | (9.4) | The decrease was mainly due to the cancellation of purchase tax on imported cellular handsets which lowered prices. The decrease was further affected by lower sales volumes of cellular handsets. |
| Total revenues | **1,260** | 1,329 | (69) | (5.2) | **632** | 658 | (26) | (4.0) | |
| Depreciation and amortization | **193** | 199 | (6) | (3.0) | **99** | 95 | 4 | 4.2 | |
| Salaries | **193** | 191 | 2 | 1.0 | **94** | 94 | - | - | |
| General and operating expenses | **839** | 930 | (91) | (9.8) | **409** | 461 | (52) | (11.3) | The decrease was mainly due to a reduction in distributor fees, recognized as an asset following early adoption of IFRS 15, and a reduction in the cost of handset sales as aforesaid. Results were also affected by a decrease in engineering expenses and updates to site leasing estimates and continued cost-cutting efforts by the Company. |
| Operating profit | **35** | 9 | 26 | - | **30** | 8 | 22 | - | |
| Finance income, net | **28** | 23 | 5 | 21.7 | **14** | 11 | 3 | 27.3 | |
| Taxes on income | **13** | 6 | 7 | 116.7 | **10** | 6 | 4 | 66.7 | |
| Segment profit | **50** | 26 | 24 | 92.3 | **34** | 13 | 21 | 161.5 | |

### 1.2.2 Operating segments

D. International Communications, Internet and NEP Services

| | 1-6.2017 NIS millions | 1-6.2016 NIS millions | Increase (decrease) NIS millions | % | 4-6.2017 NIS millions | 4-6.2016 NIS millions | Increase (decrease) NIS millions | % | Explanation |
|---|---|---|---|---|---|---|---|---|---|
| Revenues | **791** | 772 | 19 | 2.5 | **407** | 377 | 30 | 8.0 | The increase was mainly due to growth in revenues from the sale of PBXs and equipment for telecom solutions for businesses, as well as increased internet service revenues. The increase was offset by a decrease in revenues from call transfers between global operators (hubbing) in the present Period, and lower revenues from international calls due to a decrease in call minutes driven by continued competition with cellular operators and increasing use of substitute software products. |
| Depreciation and amortization | **66** | 68 | (2) | (2.9) | **33** | 35 | (2) | (5.7) | |
| Salaries | **165** | 165 | - | - | **81** | 82 | (1) | (1.2) | |
| General and operating expenses | **465** | 441 | 24 | 5.4 | **247** | 213 | 34 | 16.0 | The increase was due to higher costs on the sale of PBXs and equipment for telecom solutions for businesses and internet service expenses, corresponding to revenues as aforesaid. The increase was partially offset by lower expenses from international calls and a reduction in the present Period in expenses from call transfers between global operators (hubbing), coupled with lower fee payments on subscriber recruitment which were recognized as an asset following the early adoption of IFRS 15. |
| Other expenses | **1** | 14 | (13) | (92.9) | **1** | - | 1 | - | Expenses in the last-year period were attributable to the collective labor agreement signed in the first quarter of 2016. |
| Operating profit | **94** | 84 | 10 | 11.9 | **45** | 47 | (2) | (4.3) | |
| Finance expenses, net | **3** | 5 | (2) | (40.0) | **1** | 3 | (2) | (66.7) | |
| Tax expenses | **22** | 20 | 2 | 10.0 | **11** | 11 | - | - | |
| Segment profit | **69** | 59 | 10 | 16.9 | **33** | 33 | - | - | |

### 1.2.2 Operating segments

#### E. Multi-Channel Television

| | 1-6.2017 NIS millions | 1-6.2016 NIS millions | Increase (decrease) NIS millions | Increase (decrease) % | 4-6.2017 NIS millions | 4-6.2016 NIS millions | Increase (decrease) NIS millions | Increase (decrease) % | Explanation |
|---|---|---|---|---|---|---|---|---|---|
| Revenues | **840** | 873 | (33) | (3.8) | **416** | 434 | (18) | (4.1) | The decrease was mainly due to a decrease in the average number of subscribers. |
| Depreciation and amortization | **141** | 150 | (9) | (6.0) | **71** | 74 | (3) | (4.1) | The decrease was mainly due to a reduction in investments. |
| Salaries | **118** | 122 | (4) | (3.3) | **59** | 60 | (1) | (1.7) | |
| General and operating expenses | **480** | 467 | 13 | 2.8 | **237** | 223 | 14 | 6.3 | The increase was mainly due to increased content expenses and advertising and marketing expenses. This increase was partially offset by a decrease in distribution fee costs, which were recognized as an asset following the early adoption of IFRS 15. |
| Operating profit | **101** | 134 | (33) | (24.6) | **49** | 77 | (28) | (36.4) | |
| Finance expenses, net | **59** | 31 | 28 | 90.3 | **32** | 12 | 20 | 166.7 | Net expenses were up, mainly due to a change in the fair value of financial assets. |
| Finance expenses for shareholder loans | **-** | 287 | (287) | (100) | **-** | 179 | (179) | (100) | No finance expenses were recognized in the present Period and Quarter, following conversion of the shareholder loans to equity in the third quarter of 2016. |
| Tax expenses | **174** | 1 | 173 | - | **168** | - | 168 | - | Tax expenses were up, mainly due to a write-down of the tax asset following changes in projected profits following a change in Management's assessments concerning the severity and scope of competition in television operations. |
| Segment loss | **(132)** | (185) | 53 | (28.6) | **(151)** | (114) | (37) | 32.5 | |

## 1.3 Cash flow

| | 1-6.2017 NIS millions | 1-6.2016 NIS millions | Increase (decrease) NIS millions | Increase (decrease) % | 4-6.2017 NIS millions | 4-6.2016 NIS millions | Increase (decrease) NIS millions | Increase (decrease) % | Explanation |
|---|---|---|---|---|---|---|---|---|---|
| Net cash from operating activities | **1,701** | 1,792 | (91) | (5.1) | **875** | 870 | 5 | 0.6 | The decrease in net cash from operating activities in the present Period was attributable to the Cellular Communications segment, following a more moderate decrease in working capital as compared to the last-year period. The decrease was further attributable to Multi-Channel Television operations following a decrease in cash profits.<br>In the Quarter, net cash was up mainly due to Multi-Channel Television operations, following changes in working capital.<br>The increase in the present Quarter was offset by lower cash flows from operating activities in the Domestic Fixed-Line Communications segment due to lower profits and changes in working capital. |
| Net cash from (used in) investing activities | **(199)** | (791) | 592 | (74.8) | **174** | (668) | 842 | - | The decrease in net cash used in investing activities was mainly due to proceeds from the sale of held-for-trade financial assets in the Domestic Fixed-Line Communications segment, as compared to net purchases in the same period and quarter last year. This decrease was partially offset, mainly by increased investment in the subscriber acquisition asset (see Note 3.2.5 to the financial statements). |
| Net cash from (used in) financing activities | **(296)** | (218) | (78) | 35.8 | **13** | (85) | 98 | - | The increase in net cash used in financing activities in the present Period (in the Quarter - a decrease), was due to a decrease in cash from debenture issues and receipt of loans, and in the Period an increase in debenture and loan repayments, offset by a decrease in total dividend payments as compared to the same period and quarter last year (in the Quarter – also offset by a decrease in loan and debenture repayments). |
| Net increase in cash | **1,206** | 783 | 423 | 54.0 | **1,062** | 117 | 945 | - | |

Average volume in the reported Quarter:

Long-term liabilities (including current maturities) to financial institutions and debenture holders: NIS 10,970 million.

Supplier credit: NIS 894 million.

Short-term credit to customers: NIS 1,986 million. Long-term credit to customers: NIS 430 million.

### 1.3. Cash Flows (contd.)

As of June 30, 2017, the Group had a working capital surplus of NIS 1,297 million, as compared to a working capital deficit of NIS 208 million on June 30, 2016.

According to its separate financial statements, the Company had a working capital surplus of NIS 776 million as of June 30, 2017, as compared to a working capital deficit of NIS 657 million on June 30, 2016.

The Group and Company's transition from a deficit to a surplus in working capital was mainly due to a decrease in the Company's current liabilities, including a decrease in liabilities to financial institutions and debenture-holders, tax liabilities, and liabilities to Eurocom D.B.S. Ltd.

## 2. Market Risk - Exposure and Management

Surplus liabilities exposed to changes in the nominal NIS-based interest rate were up NIS 0.8 billion, mainly following receipt of unlinked loans and expansion of Debentures (Series 9) (see Note 8 to the financial statements). This increase was partially offset by the repayment of Debentures (Series 8) and scheduled loan payments in the Domestic Fixed-Line Communications segment (see Section 4 below). Other than the above, fair value sensitivity analysis data in accordance with changes in market factors as of June 30, 2017 do not differ materially from sensitivity analysis data as of December 31, 2016.

## 3. Disclosure Concerning the Company's Financial Reporting

### 3.1 Disclosure on the early adoption of IFRS 15 - Revenues from Contracts with Customers

Following publication of IFRS 15 - Revenues from Contracts with Customers ("the Standard"), the Company reviewed the Standard's possible impact on its financial statements, including by consultation with its auditing accountants and additional consultants. This review was conducted across all Group companies. As a result, the Company decided on the early adoption of the Standard, starting from the Company's financial statements as of March 31, 2017.

For information concerning the Standard's guidelines, its application, and adjustments to the Group's financial statements following the Standard's first-time application, see Note 3.2 to the financial statements.

**Actions taken by the Group in preparation for adopting the Standard, and measures for reducing risk of errors in its financial statements:**

1. The Group studied the possible impact of the Standard on its financial statements. This process included a review of the Standard's provisions, a review of professional information issued by international accounting firms and by the International Accounting Standards Board (IASB), and internal discussions with Group companies. Meetings were also held with the auditing accountants and additional accounting consultants. These meetings included a thorough discussion of issues raised by the Standard's application, and a review of its impact on the Group's companies. Each company documented the relevant issues and their impact on the financial statements.
2. The Group studied the Israel Securities Authorities' response to a pre-ruling request on the early adoption of the Standard, and Accounting Staff Position 11-4 - Disclosure on the Effects of Applying IFRS 15.
3. The Group has reviewed the necessary adjustments to the Group's information systems supporting the Standard's application.
4. The Group has studied its internal controls and adaptations needed to achieve effective control over proper first-time application of the Standard, in particular concerning the plausibility of significant judgments and estimates made in such application.

### 3.2 Disclosure of material valuations

The following table discloses material valuations pursuant to Regulation 8B to the Securities Regulations (Periodic and Immediate Reports), 1970:

| | **Second contingent consideration for Eurocom D.B.S. Ltd.** | **DBS** |
|---|---|---|
| Subject of valuation | Valuation of the second contingent consideration on the acquisition of shares in D.B.S Satellite Services (1988) Ltd. | Value in use of DBS Satellite Services (1988) Ltd. to test for impairment of goodwill attributed for its operations in the Company's financial statements pursuant to IAS 36. |
| Date of valuation | June 30, 2017; Valuations signed on August 23, 2017. | |
| Value prior to the valuation | The value of the second contingent consideration was estimated at NIS 84.5 million, as of December 31, 2016. | NIS 1,514 million carrying amount of net operating assets of D.B.S. Satellite Services (1988) Ltd. (NIS 120 million - goodwill). |
| Value set in the valuation | The present value of the second contingent consideration was estimated at NIS 213 thousand. | NIS 1,947 million. The Company concluded that there is no impairment requiring a write-down of goodwill recognized in the Company's books. (*) |
| Assessor's identity and profile | Giza Singer Even Ltd. The work was done by a team headed by Mr. Nir Harush, CPA, a partner in Giza Singer Even, who holds a BA in Business Administration and Accounting and an MBA from the College of Management Academic Studies, and has extensive experience in economics and finance. The assessor has no dependence on the Company. | |
| Valuation model | Scenarios model based on Monte Carlo simulations. | Discounted Cash Flow method (DCF). |
| Assumptions used in the valuation | Probability of structural separation being cancelled by the end of 2017 – 0%.<br><br>Free cash flow forecast for 2017 – NIS 146 million.<br><br>Present value discounted using the risk-free rate (0.1%). | Discount rate - 8.5% (post-tax).<br><br>Permanent growth rate - 1%.<br><br>Scrap value of total value set in valuation - 80%. |

For more information, see Notes 4.2 and 7 to the financial statements.

(*) DBS was last valuated on December 31, 2016, to the amount of NIS 2,551 million.

**3.3** 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. <u>Details of debt certificate series</u>

### 4.1 Debentures (Series 8)

On June 1, 2017, a total of NIS 434,209,624 par value in bonds were repaid - final settlement.

### 4.2 Issuance of debentures

In May and June 2017, the Company completed the issue of a total of NIS 1.1 billion par value in debentures, as follows:

A. Public offering of NIS 384,467,000 par value in Debentures (Series 9) by was of expansion of the series, under the Company's shelf prospectus fo May 2014, as amended in the clerical error correction of June 2014 ("the Shelf Prospectus") and the shelf offering report of May 25, 2017 ("the Shelf Offering Report"), in consideration for NIS 408 million.

B. Issue of the Company's listed Debentures (Series 6 and 10) to holders of DBS's Debentures (Series B), traded on the TASE 'TACT Institutional' system ("DBS Debentures") in consideration for their holdings in DBS Debentures. The issue was made under the Shelf Prospectus and Shelf Offering Report, as follows:

NIS 125,000,000 par value in DBS Debentures were exchanged for NIS 125,750,000 par value in Debentures (Series 6), and NIS 436,307,797 par value in DBS Debentures were exchanged for NIS 481,683,808 par value in Debentures (Series 10). Following this issue, total liabilities for Debentures (Series 10) became material compared to the Company's overall liabilities balance.

C. Two private placements of the Company's Debentures (Series 9) were made to classified investors, at a total value of NIS 108,000,000 par value, and which are subject to the resale restrictions stipulated in Section 15C to the Securities Law and in the Securities Regulations (Information Concerning Sections 15A through 15C to the Law), 2000, in consideration for NIS 114 million.

For more information, see Note 8.2 to the financial statements.

### 4.3 Debenture ratings

On April 24, 2017, Standard and Poor's Maalot Ltd. ("Maalot") affirmed its ilAA/Stable rating for the Company and its Debentures (Series 6-10), as detailed in the full ratings report appearing in the Company's immediate report of April 24, 2017 (ref. no. 2017-01-034792), included herein by way of reference.

Furthermore, in effecting the Company's debenture issueby way of a series' expansion and a swap of DBS debentures, as detailed above, the followng ratings were approved:

a. Midroog Ltd.'s approval of its Aa2.il/Stable rating for the Company's Debentures (Series 6-10) and for up to NIS 1.1 billion par value in Company debentures issued as an expansion of existing debenture series and/or as a swap of DBS debentures for debentures to be issued by the Company. In this context, see the Company's immediate reports of May 21, 2017 (ref. no. 2017-01-042550) and May 25, 2017 (ref. no. 2017-01-043915), included herein by way of reference.

b. Maalot's approval of its ilAA/Stable rating for up to NIS 1.1 billion par value in debentures to be issued by the Company as an expansion of one or more of Series 6-10 in consideration for cash and/or against a swap of DBS debentures. In this context, see the Company's immediate reports of May 22, 2017 (ref. no. 2017-01-042862) and May 25, 2017 (ref. no. 2017-01-043918), included herein 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 June 30, 2017, see the Company's reporting form on the MAGNA system, dated August 24, 2017.

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

| David Granot | Stella Handler |
|---|---|
| Interim Acting Chairman of the Board of Directors | CEO |

Signed: August 23, 2017

# Part C:

# Condensed Consolidated Interim Financial Statements

# June 30, 2017 (Unaudited)

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|---|---|

Somekh Chaikin
KPMG Millennium Tower
17 Ha-Arbaa Street, PO Box 609
Tel Aviv 6100601, Israel
800068403

## 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 June 30, 2017 and the related condensed consolidated interim statements of income, comprehensive income, changes in equity and cash flows for the six and three-month periods then ended. The Board of Directors and Management are responsible for the preparation and presentation of this interim financial information 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 June 30 2017, and whose revenues constitute 1% of the total consolidated revenues for the six and three month periods 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.

Somekh Chaikin
KPMG Millennium Tower
17 Ha-Arbaa Street, PO Box 609
Tel Aviv 6100601, Israel
800068403

*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 Note 1.2 regarding an ongoing investigation being conducted by the Israel Securities Authority over suspicions that the Company's controlling shareholder committed violations of the securities law and the penal law. As stated in the above note, at this stage the Company is unable to assess the results of the investigation or its effect on the Group, if any at all.

In addition, 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 9.

Somekh Chaikin
Certified Public Accountants (Isr.)

August 23, 2017

## Condensed Consolidated Interim Statements of Financial Position

| | | June 30, 2017* | June 30, 2016 | December 31, 2016 |
|---|---|---|---|---|
| | | (Unaudited) | (Unaudited) | (Audited) |
| **Assets** | | NIS million | NIS million | NIS million |
| | | | | |
| Cash and cash equivalents | | **1,854** | 1,338 | 648 |
| Investments | | **19** | 912 | 586 |
| Trade receivables | | **1,991** | 2,029 | 2,000 |
| Other receivables | | **347** | 205 | 219 |
| Eurocom DBS Ltd., related party | 4.2.1 | **56** | 29 | - |
| Inventory | | **105** | 109 | 106 |
| **Total current assets** | | **4,372** | 4,622 | 3,559 |
| | | | | |
| Trade and other receivables | | **507** | 647 | 644 |
| Broadcasting rights, net of rights exercised | | **456** | 455 | 432 |
| Fixed assets | | **6,868** | 6,872 | 6,876 |
| Intangible assets | | **2,943** | 3,195 | 3,047 |
| Deferred tax assets | | **1,015** | 1,099 | 1,007 |
| Deferred expenses and non-current investments | | **457*** | 397 | 382 |
| **Total non-current assets** | | **12,246** | 12,665 | 12,388 |

| | | | | |
|---|---|---|---|---|
| **Total assets** | | **16,618** | 17,287 | 15,947 |

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

| | June 30, 2017* | June 30, 2016 | December 31, 2016 |
|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Audited) |
| **Liabilities and equity** | NIS million | NIS million | NIS million |
| Debentures, loans and borrowings | **958** | 1,958 | 1,825 |
| Trade and other payables | **1,608** | 1,576 | 1,610 |
| Current tax liabilities | **112** | 628 | 104 |
| Liability to Eurocom DBS Ltd, related party | **-** | 208 | 32 |
| Employee benefits | **318** | 370 | 315 |
| Provisions | **79** | 90 | 80 |
| **Total current liabilities** | **3,075** | 4,830 | 3,966 |
| Loans and debentures | **10,561** | 9,546 | 9,128 |
| Employee benefits | **259** | 239 | 258 |
| Derivatives and other liabilities | **251** | 252 | 244 |
| Deferred tax liabilities | **99** | 75 | 101 |
| Provisions | **48** | 46 | 47 |
| **Total non-current liabilities** | **11,218** | 10,158 | 9,778 |
| **Total liabilities** | **14,293** | 14,988 | 13,744 |
| **Total equity** | **2,325** | 2,299 | 2,203 |
| **Total liabilities and equity** | **16,618** | 17,287 | 15,947 |

**David Granot**
Interim Acting Chairman of the Board of Directors

**Stella Handler**
CEO

**Danny Oz**
Controller and Deputy CFO

Date of approval of the financial statements: August 23, 2017

* See Note 3.2 for information about early adoption of IFRS 15, Revenue from Contracts with Customers.

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

## Condensed Consolidated Interim Statements of Income

| | Six months ended June 30 | | Three months ended June 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2017* | 2016 | 2017* | 2016 | 2016 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS million | NIS million | NIS million | NIS million | NIS million |
| **Revenues (Note 11)** | **4,916** | 5,070 | **2,463** | 2,511 | 10,084 |
| Costs of activity | | | | | |
| General and operating expenses (Note 12) | **1,932** | 1,990 | **973** | 972 | 4,012 |
| Salaries | **998** | 1,008 | **494** | 495 | 2,012 |
| Depreciation and amortization | **852** | 889 | **424** | 440 | 1,739 |
| Other operating income, net | **(5)** | (7) | **(1)** | (12) | - |
| | **3,777** | 3,880 | **1,890** | 1,895 | 7,763 |
| **Operating income** | **1,139** | 1,190 | **573** | 616 | 2,321 |
| **Financing expenses (income)** | | | | | |
| Financing expenses | **246** | 241 | **120** | 123 | 508 |
| Financing income | **(43)** | (34) | **(18)** | (18) | (61) |
| Financing expenses, net | **203** | 207 | **102** | 105 | 447 |
| **Profit after financing expenses, net** | **936** | 983 | **471** | 511 | 1,874 |
| **Share in losses of equity-accounted investees** | **(4)** | (2) | **(2)** | (1) | (5) |
| **Profit before income tax** | **932** | 981 | **469** | 510 | 1,869 |
| **Income tax** | **224** | 316 | **111** | 133 | 625 |
| **Profit for the period** | **708** | 665 | **358** | 377 | 1,244 |
| **Earnings per share (NIS)** | | | | | |
| Basic and diluted earnings per share | **0.26** | 0.24 | **0.13** | 0.14 | 0.45 |

## Condensed Consolidated Interim Statements of Comprehensive Income

| | Six months ended June 30 | | Three months ended June 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2017* | 2016 | 2017* | 2016 | 2016 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS million | NIS million | NIS million | NIS million | NIS million |
| Profit for the period | **708** | 665 | **358** | 377 | 1,244 |
| Items of other comprehensive income (loss) (net of tax) | **(8)** | (5) | **(14)** | 5 | (15) |
| **Total comprehensive income for the period** | **700** | 660 | **344** | 382 | 1,229 |

* See Note 3.2 for information about early adoption of IFRS 15, Revenue from Contracts with Customers.

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 |
| **Six months ended June 30, 2017 (Unaudited)*** | | | | | | | |
| Balance as at January 1, 2017 | 3,878 | 384 | - | 390 | (88) | (2,361) | 2,203 |
| Profit for the period | **-** | **-** | **-** | **-** | **-** | **708** | **708** |
| Other comprehensive loss for the period, net of tax | **-** | **-** | **-** | **-** | **(8)** | **-** | **(8)** |
| Total comprehensive income for the period | **-** | **-** | **-** | **-** | **(8)** | **708** | **700** |
| **Transactions with shareholders recognized directly in equity** | | | | | | | |
| Dividends to Company shareholders (see Note 10) | **-** | **-** | **-** | **-** | **-** | **(578)** | **(578)** |
| Balance as at June 30, 2017 | **3,878** | **384** | **-** | **390** | **(96)** | **(2,231)** | **2,325** |
| **Six months ended June 30, 2016 (Unaudited)** | | | | | | | |
| Balance as at January 1, 2016 | 3,874 | 368 | 16 | 390 | (98) | (2,139) | 2,411 |
| Profit for the period | - | - | - | - | - | 665 | 665 |
| Other comprehensive loss for the period, net of tax | - | - | - | - | (5) | - | (5) |
| Total comprehensive income for the period | - | - | - | - | (5) | 665 | 660 |
| **Transactions with shareholders recognized directly in equity** | | | | | | | |
| Dividend to Company shareholders | - | - | - | - | - | (776) | (776) |
| Exercise of options for shares | 4 | 16 | (16) | - | - | - | 4 |
| Balance as at June 30, 2016 | 3,878 | 384 | - | 390 | (103) | (2,250) | 2,299 |

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

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

| | Share capital | Share premium | Capital reserve for employee options | Capital reserve for transactions between a corporation and a controlling shareholder | Other reserves | Deficit | Total |
|---|---|---|---|---|---|---|---|
| | NIS million | NIS million | NIS million | NIS million | NIS million | NIS million | NIS million |
| **Three months ended June 30, 2017 (Unaudited)*** | | | | | | | |
| Balance as at April 1, 2017 | 3,878 | 384 | - | 390 | (82) | (2,011) | 2,559 |
| Profit for the period | **-** | **-** | **-** | **-** | **-** | **358** | **358** |
| Other comprehensive loss for the period, net of tax | **-** | **-** | **-** | **-** | **(14)** | **-** | **(14)** |
| Total comprehensive income for the period | **-** | **-** | **-** | **-** | **(14)** | **358** | **344** |
| **Transactions with shareholders recognized directly in equity** | | | | | | | |
| Dividends to Company shareholders (see Note 10) | **-** | **-** | **-** | **-** | **-** | **(578)** | **(578)** |
| Balance as at June 30, 2017 | **3,878** | **384** | **-** | **390** | **(96)** | **(2,231)** | **2,325** |
| **Three months ended June 30, 2016 (Unaudited)** | | | | | | | |
| Balance as at April 1, 2016 | 3,878 | 384 | - | 390 | (108) | (1,851) | 2,693 |
| Profit for the period | - | - | - | - | - | 377 | 377 |
| Other comprehensive income for the period, net of tax | - | - | - | - | 5 | - | 5 |
| Total comprehensive income for the period | - | - | - | - | 5 | 377 | 382 |
| **Transactions with shareholders recognized directly in equity** | | | | | | | |
| Dividend to Company shareholders | - | - | - | - | - | (776) | (776) |
| Balance as at June 30, 2016 | 3,878 | 384 | - | 390 | (103) | (2,250) | 2,299 |
| **Year ended December 31, 2016 (Audited)** | | | | | | | |
| Balance as at January 1, 2016 | 3,874 | 368 | 16 | 390 | (98) | (2,139) | 2,411 |
| | | | | | | | |
| Income in 2016 | - | - | - | - | - | 1,244 | 1,244 |
| Other comprehensive income (loss) for the year, net of tax | - | - | - | - | 10 | (25) | (15) |
| Total comprehensive income for 2016 | - | - | - | - | 10 | 1,219 | 1,229 |
| Transactions with shareholders recognized directly in equity | | | | | | | |
| Dividend to Company shareholders | - | - | - | - | - | (1,441) | (1,441) |
| Exercise of options for shares | 4 | 16 | (16) | - | - | - | 4 |
| Balance as at December 31, 2016 | 3,878 | 384 | - | 390 | (88) | (2,361) | 2,203 |

* See Note 3.2 for information about early adoption of IFRS 15, Revenue from Contracts with Customers.

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

## Condensed Consolidated Interim Statements of Cash Flows

| | Six months ended June 30 | | Three months ended June 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2017* | 2016 | 2017* | 2016 | 2016 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS million | NIS million | NIS million | NIS million | NIS million |
| **Cash flows from operating activities** | | | | | |
| Profit for the period | **708** | 665 | **358** | 377 | 1,244 |
| Adjustments: | | | | | |
| Depreciation and amortization | **852** | 889 | **424** | 440 | 1,739 |
| Share in losses of equity-accounted investees | **4** | 2 | **2** | 1 | 5 |
| Financing expenses, net | **227** | 220 | **117** | 107 | 474 |
| Capital gain, net | **(19)** | (40) | **(13)** | (29) | (107) |
| Income tax expenses | **224** | 316 | **111** | 133 | 625 |
| | | | | | |
| Change in trade and other receivables | **16** | 63 | **23** | 75 | 106 |
| Change in inventory | **(12)** | 5 | **8** | 14 | (20) |
| Change in trade and other payables | **(39)** | (98) | **(15)** | (137) | (24) |
| Change in provisions | **(1)** | (9) | **(2)** | 3 | (19) |
| Change in employee benefits | **3** | (8) | **9** | (9) | (65) |
| Change in other liabilities | **(34)** | (8) | **(25)** | (5) | 23 |
| Net income tax paid | **(228)** | (205) | **(122)** | (100) | (455) |
| **Net cash from operating activities** | **1,701** | 1,792 | **875** | 870 | 3,526 |
| **Cash flow used for investing activities** | | | | | |
| Purchase of fixed assets | **(580)** | (611) | **(303)** | (317) | (1,193) |
| Investment in intangible assets and deferred expenses | **(206)** | (121) | **(103)** | (70) | (223) |
| Acquisition of financial assets held for trading and others | **-** | (867) | **-** | (867) | (917) |
| Proceeds from the sale of financial assets held for trading and others | **558** | 711 | **554** | 515 | 1,088 |
| Proceeds from the sale of fixed assets | **28** | 98 | **18** | 56 | 138 |
| Tax payment for shareholder's loans | **-** | - | **-** | - | (461) |
| Miscellaneous | **1** | (1) | **8** | 15 | 1 |
| **Net cash from (used in) investing activities** | **(199)** | (791) | **174** | (668) | (1,567) |

## Condensed Consolidated Interim Statements of Cash Flows

| | Six months ended June 30 | | Three months ended June 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | **2017*** | **2016** | **2017*** | **2016** | **2016** |
| | **(Unaudited)** | **(Unaudited)** | **(Unaudited)** | **(Unaudited)** | **(Audited)** |
| | **NIS million** | **NIS million** | **NIS million** | **NIS million** | **NIS million** |
| **Cash flows used in financing activities** | | | | | |
| Issue of debentures and receipt of loans (Note 8) | **1,418** | 1,661 | **1,418** | 1,661 | 2,161 |
| Repayment of debentures and loans | **(869)** | (806) | **(645)** | (756) | (1,841) |
| Dividend paid (Note 10) | **(578)** | (776) | **(578)** | (776) | (1,441) |
| Interest paid | **(199)** | (224) | **(177)** | (192) | (458) |
| Payment to Eurocom DBS for acquisition of DBS loans and shares (Note 4.2.1) | **(61)** | (58) | **-** | - | (256) |
| Miscellaneous | **(7)** | (15) | **(5)** | (22) | (31) |
| Net cash from (used for) financing activities | **(296)** | (218) | **13** | (85) | (1,866) |
| Increase in cash and cash equivalents, net | **1,206** | 783 | **1,062** | 117 | 93 |
| Cash and cash equivalents at beginning of period | **648** | 555 | **792** | 1,221 | 555 |
| Cash and cash equivalents at end of period | **1,854** | 1,338 | **1,854** | 1,338 | 648 |

* See Note 3.2 for information about early adoption of IFRS 15, Revenue from Contracts with Customers.

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

# 1. General

## 1.1 Reporting Entity

Bezeq –The Israel Telecommunication Corporation Limited ("the Company") is a company registered in Israel whose shares are traded on the Tel Aviv Stock Exchange. The consolidated financial statements of the Company include those of the Company and its subsidiaries (together referred to as "the Group"). The Group is a principal provider of communication services in Israel (see also Note 14 –Segment Reporting).

## 1.2 Investigation of the Israel Securities Authority

On June 20, 2017, the Israel Securities Authority began an open investigation ("the Investigation"), which included searches at the offices of the Company and of DBS and seizure of documents. The Israel Securities Authority informed the Company that the Investigation involves suspicions of offenses under the Israel Securities Law and the Penal Law connected to transactions related to the controlling shareholder. To the best of the Company's knowledge, the Investigation refers to the Company's acquisition of DBS shares from Eurocom DBS Ltd., a company controlled by the Company's controlling shareholder. The Investigation was later expanded to transactions for satellite communications services between DBS and Space Communications Ltd., a company owned by the Company's controlling shareholder, as well as the conduct of the Ministry of Communications with the Company.

At this stage, the Company is unable to assess the results of the Investigation by the ISA, if any.

# 2. Basis of Preparation

**2.1** The condensed consolidated interim 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, 2016 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 August 23, 2017.

## 2.4 Use of estimates and judgments

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 policy and the principal assumptions underlying assessments that involve uncertainty, are consistent with those used in the Annual Financial Statements, other than as set out in Note 3 regarding early application of IFRS 15.

# 3. Reporting Principles and Accounting Policy

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

## 3.2 Initial application of new standards

3.2.1 As from January 1, 2017, the Group has early adopted IFRS 15, Revenue from Contracts with Customers ("IFRS 15"), which sets out guidelines for recognition of revenue.

IFRS 15 replaces IAS 18, Revenue and presents a new model for recognition of revenue from contracts with customers. The model includes five steps for analyzing transactions so as to determine when to recognize revenue and at what amount:

A. Identifying the contract with the customer.

B. Identifying separate performance obligations in the contract.

C. Determining the transaction price.

D. Allocating the transaction price to separate performance obligations.

E. Recognizing revenue when the performance obligations are satisfied.

In accordance with the model, the Group recognizes revenue when the customer gains control over the goods or services. Revenue is based on the consideration that the Group expects to receive for the transfer of the goods or services promised to the customer. Revenue is recognized when it is expected that the economic benefits will flow to the Group and if the revenues and costs can be measured reliably.

Application of the model did not have a material effect on the measurement of the Group's revenue in the reporting period, compared to the provisions of the previous standard.

The main effect of the Group's application of IFRS 15 is the accounting treatment for the incremental costs of obtaining a contract with a customer ("Subscriber Acquisition"), which, in accordance with IFRS 15, are recognized as an asset when the costs are attributed directly to a contract that the Group can specifically identify, they produce or improve the Group's resources that will be used for its future performance obligation and it is probable that the Group will recover these costs, and not only where there is an obligation of the customer to acquire services from the Company for a defined period.

Accordingly, direct commissions paid to agents and sales employees of the Group for sales and upgrades under agreements that do not include an obligation period for the customer, are recognized as an asset for obtaining a contract instead of an expense in the statement of income, since the Group expects to recover these costs under the contracts.

An asset for obtaining a contract is amortized in accordance with the expected average churn rate of subscribers based on the type of subscriber and the service received (mainly over 3-4 years).

Contract acquisition costs that would arise regardless of whether the contract was obtained are recognized as an expense when incurred.

3.2.2 The Group applied IFRS 15 using the cumulative effect approach without a restatement of comparative figures.

As part of initial implementation of IFRS 15, the Group has chosen to apply the expedients in the transitional provisions, according to which the cumulative effect approach is applied only for contracts not yet complete at the transition date and the accounting treatment for the contracts completed at the transition date will not be amended.

The contracts that are renewed every month and that may be cancelled by the customer at any time, without any penalty, are contracts that ended at the date of initial application of IFRS 15. Therefore, Subscriber Acquisition costs incurred prior to January 1, 2017 and recognized in the statement of income as an expense were not accounted for retroactively.

3.2.3 Implementation of the accounting policy described above requires the Group companies to exercise their discretion to estimate the expected service period and the anticipated subscriber churn rate. Changes in such estimates may result in a change in depreciation and amortization expenses and changes in the Subscriber Acquisition asset.

3.2.4 Other than the accounting treatment of Subscriber Acquisition costs, implementation of IFRS 15 had no other material effects on the financial statements. In addition, implementation of IFRS 15 had no effect on retained earnings as at the transition date.

3.2.5 The tables below summarize the effects on the condensed consolidated interim statement of financial position as at June 30, 2017 and on the condensed consolidated interim statements of income and cash flows for the six and three months then ended, assuming that the Group's previous policy regarding Subscriber Acquisition costs continued during that period.

Effect on the condensed consolidated interim statement of financial position as at June 30, 2017

| | In accordance with the previous policy | Change | In accordance with IFRS 15 |
|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Unaudited) |
| | NIS million | NIS million | NIS million |
| Net subscriber acquisition asset (stated as deferred expenses and non-current investments) | 7 | 64 | **71** |
| Capital | 2,276 | 49 | **2,325** |

Effect on the consolidated interim statement of income for the six and three months ended June 30, 2017:

| | Six months ended June 30, 2017 | | | Three months ended June 30, 2017 | | |
|---|---|---|---|---|---|---|
| | In accordance with the previous policy | Change | In accordance with IFRS 15 | In accordance with the previous policy | Change | In accordance with IFRS 15 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) |
| | NIS million | NIS million | NIS million | NIS million | NIS million | NIS million |
| General and operating expenses | 1,996 | (64) | **1,932** | 1,004 | (31) | **973** |
| Salaries | 1,014 | (16) | **998** | 502 | (8) | **494** |
| Depreciation and amortization expenses | 836 | 16 | **852** | 413 | 11 | **424** |
| Operating income | 1,075 | 64 | **1,139** | 545 | 28 | **573** |
| Profit after financing expenses | 872 | 64 | **936** | 443 | 28 | **471** |
| Profit before income tax | 868 | 64 | **932** | 441 | 28 | **469** |
| Income tax | 209 | 15 | **224** | 105 | 6 | **111** |
| Profit for the period | 659 | 49 | **708** | 336 | 22 | **358** |

Effect on the consolidated interim statement of cash flow for the six and three months ended June 30, 2017:

| | Six months ended June 30, 2017 | | | Three months ended June 30, 2017 | | |
|---|---|---|---|---|---|---|
| | In accordance with the previous policy | Change | In accordance with IFRS 15 | In accordance with the previous policy | Change | In accordance with IFRS 15 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) |
| | NIS million | NIS million | NIS million | NIS million | NIS million | NIS million |
| Net cash from operating activities | 1,621 | 80 | **1,701** | 836 | 39 | **875** |
| Net cash from (used in) investing activities | (119) | (80) | **(199)** | 213 | (39) | **174** |

### 3.2 New standards and interpretations not yet adopted

A detailed description of the standards not yet adopted appears in Note 2.17 to the Annual Financial Statements. Following are details about the interpretations published since the publication of the Annual Financial Statements:

In June 2017, the IFRS Interpretations Committee issued IFRIC 23, Uncertainty over Income Tax Treatments ("IFRIC 23"). IFRIC 23 clarifies application of recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatments.

IFRIC 23 will be effective for annual periods beginning on January 1, 2019, with early application being permitted. The Group believes that application of IFRIC 23 will not have a material effect on the 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 Further to Note 11.2.1 to the Annual Financial Statements 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 2017 the Company paid the second advance payment of NIS 57 million (plus linkage differences) for the operating results of DBS in 2016. As of June 30, 2017, the cumulative advances paid to Eurocom DBS amounted to NIS 119 million (including interest).

As of June 30, 2017, the Company updated the estimated second contingent consideration in view of its assessment that it is highly unlikely that there will be a merger with DBS in 2017. Taking into consideration the revised free cash flow forecast of DBS for 2017, the Company eliminated the liability of NIS 84 million to DBS in its financial statements. Elimination of the liability is recognized in the statement of income under financing income/expenses.

As a result of the aforesaid, the advance payments received by Eurocom DBS from the Company as of June 30, 2017 amounts to NIS 113 million (after offsetting a liability of NIS 6 million for the first contingent consideration). In accordance with the agreement between the parties, if the final amount is less than the amount of advance payments, Eurocom DBS will return the difference to the Company immediately after the final settlement, which is expected to be shortly after the signing of the Company's financial statements for 2017 (or on the merger date, whichever is earlier). The repayment bears annual interest at a rate of 4%.

The Company estimated the fair value of the amount expected to be recovered from the excess of the advance payments, and taking into consideration the solvency of Eurocom DBS, the value of the debt was estimated at NIS 56 million (representing 50% of the balance). The revised value of NIS 57 million was included under financing expenses in the statement of income. Accordingly, a total of NIS 27 million was recognized as income under financing income/expenses in the statement of income for the total revised value of the second contingent consideration.

4.2.2 Further to Note 17.2 to the Annual Financial Statements regarding the agreement of DBS for space segment capacity, Space Communications Ltd. ("Space") notified DBS that the Amos 2 satellite had reached the end of its commercial life and is no longer fit to make television broadcasts for DBS. Accordingly, as from March 31, 2017, DBS no longer uses the Amos 2 satellite and is currently using the Amos 3 and Amos 7 satellites.

On April 3, 2017, the general meeting of the Company's shareholders approved the Company’s vote at the general meeting of DBS in favor of the agreement between DBS and Space, with an amendment/addition to the existing agreement between the parties dated November 4, 2013 for the lease of satellite segments in space satellites, as described in Note 17.2 to the Annual Financial Statements, including implementation of the agreement.

4.2.3 Following the conversion of the shareholders loans and the investment in the equity of DBS in 2016 by the Company, the equity of DBS as at June 30, 2017 and December 31, 2016 amounted to NIS 460 million and NIS 592 million, respectively. Notwithstanding the improved financial position of DBS, as at June 30, 2017, its working capital deficit amounts to NIS 474 million.

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 the operations of DBS for the coming year.

4.2.4 See Note 8 below regarding the exchange of Debentures (Series B) of DBS with Debentures (Series 6 and 10) issued by the Company.

4.2.5 Further to Note 12.4 to the Annual Financial Statements, in July 2017, DBS repaid the balance of Debentures (Series A), and as a result, the liens registered in favor of Trustee A of the debentures were lifted.

4.2.6 For information about the investigation by the Israel Securities Authority that began on June 20, 2017, which involves suspicions of offenses under the Israel Securities Law and the Penal Law, see Note 1.2 above.

## 5. Income tax

Further to Note 6.6.3 to the Annual Financial Statements, regarding the best-judgment assessment for 2011 received by the Company, the Company filed its objection against the position of the Tax Authority.

The Company is discussing assessments with the Tax Authority for 2012-2014, including discussions of the issues included in the 2011 assessment.

## 6. Fixed assets

Further to Note 8.5 to the Annual Financial Statements regarding the installation of a fiber optic network that will reach the customer's home, in the reporting period, the fiber deployment reached the state required for their operation when it is decided which technology will be used, and the Company began to amortize the network over 25 years.

## 7. Review of impairment in the multi-channel television sector

In view of the changes in the competition in the multi-channel television sector, the Company estimated the recoverable amount of the multi-channel television cash-generating unit as of June 30, 2017.

The value in use of a multi-channel television cash-generating unit for Bezeq Group was calculated by discounting future cash flows (DCF) based on a five year cash flow forecast as of the end of the current period with the addition of the salvage value. The cash flow forecast is based on DBS’s results in recent years, so that the future growth and market share are affected by trends in the multi-channel television market, such as competition, regulation and entry of new players. The forecasted income is based on assumptions regarding the number of subscribers and the average revenue per subscriber. A key assumption of the forecast is that competition in the market will continue in the mid-term, affecting the Company's operations by satellite TV subscriber churn and a decrease in the average per subscriber revenue. At the same time, the launch of Sting TV is expected to lead to an increase in the number of subscribers at a slightly higher rate than this satellite TV subscriber churn.

Operating, sales and marketing expenses, and the launching costs were adjusted to the volume of DBS operations. The nominal capital price taken into account was 8.5% (after tax). In addition, a permanent growth rate of 1% was assumed. The valuation was prepared by an external appraiser. Based on the foregoing valuation, the Group was not required to amortize the impairment of the multi-channel television cash-generating unit

## 8. Debentures, loans and borrowings

**8.1** Further to Note 12.6 to the Annual Financial Statements regarding the undertakings received from banks and institutions to provide credit for the Company for 2017, in June 2017, credit facilities amounting to NIS 900 million were made available for the Company, based on the undertakings by the banks and institutions. The credit terms are set out in Note 12.6 to the Annual Financial Statements.

**8.2** In May and June 2017, the Company completed offering of the Company's debentures for a total par value of NIS 1.1 billion, as follows:

8.2.1 A public offering of NIS 384,467,000 par value Debentures (Series 9) by way of expansion of the series, under the Company's shelf prospectus of May 2014, as amended for a typographical error in June 2014 ("the Shelf Prospectus") and the shelf offering memorandum of May 25, 2017 ("the Shelf Offering Memorandum"). The total consideration (gross) that was received for this offering amounted to NIS 408 million.

8.2.2 An offering of Debentures (Series 6 and 10) that are traded by the Company, to the holders of Debentures (Series B) of DBS, which are listed on the TACT-Institutional system of the TASE ("the DBS Debentures") in return for the DBS Debentures that they hold. The offering was carried out in accordance with the Shelf Prospectus and the Shelf Offering Memorandum as follows: NIS 125,000,000 par value DBS Debentures were exchanged for NIS 125,750,000 par value Debentures (Series 6), and NIS 436,307,797 par value DBS Debentures were exchanged for NIS 481,683,808 par value Debentures (Series 10).

An exchange of debentures having substantially different terms was accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability at fair value. Accordingly, the Group recognized financing expenses of NIS 13 million, for the difference between the amortized cost of the DBS Debentures and the fair value of Debentures (Series 6 and 10) issued by the Company.

In addition, in June 2017, the Company acquired NIS 17,401,997 par value DBS Debentures for NIS 20 million.

8.2.3 Two private offerings of Debentures (Series 9) of the Company to classified investors totaling NIS 108,000,000 par value, which are subject to the resale restrictions set out in Section 15C of the Israel Securities Law and in accordance with the Israel Securities Regulations (Details in the Matter of Sections 15A to 15C of the Law), 2000.

The total consideration that was received for the private offerings amounted to NIS 114 million.

8.2.4 For information about the terms of the Debentures (Series 6, 9 and 10), see Note 12 to the Annual Financial Statements.

## 9. Contingent liabilities

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

In the opinion of the managements of the Group companies, based, among other things, on legal opinions as to the likelihood of success of the Legal Claims, the financial statements include adequate provisions of NIS 73 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 June 30, 2017 for claims filed against Group companies on various matters and which are unlikely to be realized, amounted to NIS 6.1 billion. There is also additional exposure of NIS 3.4 billion for claims, the chances of which cannot yet be assessed.

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

This amount and all the amounts of the additional exposure in this note are linked to the CPI and are stated net of interest.

For updates subsequent to the reporting date, see section 9.3 below.

**9.1** Following is a detailed description of the Group's contingent liabilities as at June 30, 2017, 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 | | |
| 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. | **43** | **3,871** | **1,521(1)** |
| 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** | **2,005(2)** | **1,808 (3)** |
| Claims of employees and former employees of Group companies | Mainly collective and individual claims filed by employees and former employees of the Group in respect of various payments and recognition of various salary components as components for calculation of payments to Group employees, some of which have wide ramifications. | **7** | **94** | **2** |
| 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). | **5** | **32** | **-** |
| 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** | **109** | **1** |
| 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.<br>The additional amount of exposure for punitive damages does not include claims for which the insurance coverage is not disputed. | **4** | **21** | **2** |
| Total legal claims against the Company and subsidiaries | | **73** | **6,132** | **3,334** |

(1) The amount includes exposure in the amount of NIS 1.11 billion for a claim against the Company, as well as against the subsidiary Walla! Communications Ltd., Yad 2 and an advertising company owned by Walla, which addresses with the Company's 144B service.

(2) Total exposure of NIS 2 billion for a claim filed by a shareholder against the Company and officers in the Company, referring to alleged reporting omissions by the Company regarding the wholesale market and the reduction of interconnect fees, which the plaintiff estimates at NIS 1.1 billion or NIS 2 billion (depending on the method used to calculate the damage).

(3) Two motions for certification of a class action filed in June 2017 against the Company, officers in the Group and companies in the group of the Company's controlling shareholders regarding the transaction for the Company's acquisition of DBS shares from Eurocom DBS Ltd.

**9.2** From June through August 2017 shareholders of the Company filed several motions for discovery of documents against the Company and DBS (excluding two motions filed against the Company only), prior to the filing of a motion for certification of a derivative action under section 198A of the Companies Law. These motions were filed due to the public investigation by the Securities Authority concerning the transaction for the Company's acquisition of DBS shares from Eurocom DBS Ltd. and transactions for satellite communications services between DBS and Space Communications Ltd., as described in Note 1.2 above.

It should be noted that, in addition to these motions, there is a pending claim and motion for certification of the claim as a derivative action against the Company, its controlling shareholder and directors, with regard the transaction for the Company's acquisition of Eurocom DBS's entire holdings in DBS and shareholders' loans.

**9.3** Subsequent to the date of the financial statements, a motion for certification of a class action totaling NIS 2 billion was filed against the Company and members of the Company's Board of Directors, regarding the acquisition of DBS shares and the transaction to continue the agreement between DBS and Space Communications Ltd. In addition, claims were filed against Group companies totaling NIS 31 million. As at the approval date of the financial statements, the chances of the claims cannot yet be assessed. In addition, claims with exposure of NIS 14 million came to an end.

## 10. Equity

**10.1** On May 9, 2017, the general meeting of the Company's shareholders approved the recommendation of the Company's Board of Directors of March 29, 2017 to distribute a cash dividend of NIS 578 million (NIS 0.2090049 per share) to the Company's shareholders. The dividend was paid on May 29, 2017.

**10.2** On August 23, 2017, the Board of Directors of the Company resolved to recommend to the general meeting of the Company's shareholders the distribution of a cash dividend to the shareholders in the amount of NIS 708 million. As at the approval date of the financial statements, the dividend has not yet been approved by the general meeting.

## 11. Revenues

| | Six months ended June 30 | | Three months ended June 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | **2017** | **2016** | **2017** | **2016** | **2016** |
| | **(Unaudited)** | **(Unaudited)** | **(Unaudited)** | **(Unaudited)** | **(Audited)** |
| | **NIS million** | **NIS million** | **NIS million** | **NIS million** | **NIS million** |
| **Domestic fixed-line communication (Bezeq Fixed-Line)** | | | | | |
| Fixed-line telephony | **688** | 737 | **338** | 363 | 1,450 |
| Internet - infrastructure | **790** | 775 | **394** | 389 | 1,558 |
| Transmission and data communication | **398** | 422 | **196** | 210 | 843 |
| Other services | **109** | 115 | **54** | 56 | 213 |
| | **1,985** | 2,049 | **982** | 1,018 | 4,064 |
| **Cellular telephony - Pelephone** | | | | | |
| Cellular services and terminal equipment | **864** | 890 | **439** | 446 | 1,777 |
| Sale of terminal equipment | **372** | 418 | **181** | 202 | 811 |
| | **1,236** | 1,308 | **620** | 648 | 2,588 |
| **Multichannel television - DBS** | **840** | 873 | **416** | 434 | 1,745 |
| **International communications, ISP, and NEP services - Bezeq International** | **752** | 737 | **394** | 360 | 1,480 |
| **Other** | **103** | 103 | **51** | 51 | 207 |
| | **4,916** | 5,070 | **2,463** | 2,511 | 10,084 |

## 12. General and operating expenses

| | Six months ended June 30 | | Three months ended June 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 | 2016 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS million | NIS million | NIS million | NIS million | NIS million |
| Terminal equipment and materials | **432** | 417 | **230** | 201 | 831 |
| Interconnectivity and payments to domestic and international operators | **402** | 423 | **206** | 211 | 825 |
| Maintenance of buildings and sites | **285** | 299 | **138** | 145 | 605 |
| Marketing and general | **278*** | 345 | **134*** | 168 | 697 |
| Content services | **323** | 301 | **162** | 147 | 629 |
| Services and maintenance by sub-contractors | **131** | 124 | **64** | 61 | 261 |
| Vehicle maintenance | **81** | 81 | **39** | 39 | 164 |
| | **1,932** | 1,990 | **973** | 972 | 4,012 |

* See Note 3.2 for information about early implementation of IFRS 15, Revenue from Contracts with Customers.

## 13. Financial instruments

### 13.1 Fair value

13.1.1 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.

| | June 30, 2017 | | June 30, 2016 | | December 31, 2016 | |
|---|---|---|---|---|---|---|
| | Carrying amount (in cluding 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) | **3,648** | **3,826** | 2,774 | 2,928 | 2,947 | 3,089 |
| Debentures issued to the public (CPI-linked) | **4,127** | **4,297** | 3,487 | 3,733 | 3,473 | 3,656 |
| Debentures issued to the public (unlinked) | **1,668** | **1,687** | 1,595 | 1,648 | 1,592 | 1,602 |
| Debentures issued to financial institutions (CPI-linked) | **212** | **214** | 1,286 | 1,293 | 830 | 879 |
| Debentures issued to financial institutions (unlinked) | **353** | **383** | 403 | 450 | 403 | 440 |
| | **10,008** | **10,407** | 9,545 | 10,052 | 9,245 | 9,666 |

13.1.2 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.

| | June 30, 2017 (Unaudited) NIS million | June 30, 2016 (Unaudited) NIS million | December 31, 2016 (Audited) NIS million |
|---|---|---|---|
| Level 1: investment in exchange-traded funds and financial funds | **19** | 48 | 31 |
| Level 2: forward contracts | **(185)** | (182) | (170) |
| Level 3: contingent consideration for a business combination | **-** | (237) | (84) |

# 14. Segment Reporting

## 14.1 Operating segments

| | Six months ended June 30, 2017 (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 | 1,986 | 1,236 | 752 | 840 | 102 | - | 4,916 |
| Inter-segment revenues | 150 | 24 | 39 | - | 9 | (222) | - |
| Total revenues | 2,136 | 1,260 | 791 | 840 | 111 | (222) | 4,916 |
| | | | | | | | |
| Depreciation and amortization | 357 | 193 | 66 | 141 | 10 | 85 | 852 |
| | | | | | | | |
| Segment results –operating income (loss) | 1,009 | 35 | 94 | 101 | (14) | (86) | 1,139 |
| Financing expenses | 186 | - | 4 | 72 | 1 | (17) | 246 |
| Financing income | (12) | (28) | (1) | (13) | (6) | 17 | (43) |
| Total financing expenses (income), net | 174 | (28) | 3 | 59 | (5) | - | 203 |
| | | | | | | | |
| Segment profit (loss) after financing expenses, net | 835 | 63 | 91 | 42 | (9) | (86) | 936 |
| Share in losses of associates | - | - | - | - | (4) | - | (4) |
| Segment profit (loss) before income tax | 835 | 63 | 91 | 42 | (13) | (86) | 932 |
| Income tax | 199 | 13 | 22 | 174 | - | (184) | 224 |
| Segment results –net profit (loss) | 636 | 50 | 69 | (132) | (13) | 98 | 708 |

# 14. Segment Reporting (contd.)

## 14.1 Operating segments (contd.)

| | Six months ended June 30, 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 | 2,050 | 1,307 | 737 | 872 | 101 | - | 5,067 |
| Inter-segment revenues | 162 | 22 | 35 | 1 | 7 | (224) | 3 |
| Total revenues | 2,212 | 1,329 | 772 | 873 | 108 | (224) | 5,070 |
| | | | | | | | |
| Depreciation and amortization | 368 | 199 | 68 | 150 | 8 | 96 | 889 |
| | | | | | | | |
| Segment results –operating income (loss) | 1,076 | 9 | 84 | 134 | (17) | (96) | 1,190 |
| Financing expenses | 224 | 2 | 8 | 330 | 1 | (324) | 241 |
| Financing income | (18) | (25) | (3) | (12) | (5) | 29 | (34) |
| Total financing expenses (income), net | 206 | (23) | 5 | 318 | (4) | (295) | 207 |
| | | | | | | | |
| Segment profit (loss) after financing expenses, net | 870 | 32 | 79 | (184) | (13) | 199 | 983 |
| Share in losses of associates | - | - | - | - | (2) | - | (2) |
| Segment profit (loss) before income tax | 870 | 32 | 79 | (184) | (15) | 199 | 981 |
| Income tax | 216 | 6 | 20 | 1 | - | 73 | 316 |
| Segment results –net profit (loss) | 654 | 26 | 59 | (185) | (15) | 126 | 665 |

# 14. Segment Reporting (Contd.)

## 14.1 Operating Segments (contd.)

| | Three months ended June 30, 2017 (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 | 983 | 620 | 394 | 416 | 50 | - | 2,463 |
| Inter-segment revenues | 75 | 12 | 13 | - | 5 | (105) | - |
| Total revenues | 1,058 | 632 | 407 | 416 | 55 | (105) | 2,463 |
| | | | | | | | |
| Depreciation and amortization | 177 | 99 | 33 | 71 | 6 | 38 | 424 |
| | | | | | | | |
| Segment results –operating income (loss) | 496 | 30 | 45 | 49 | (8) | (39) | 573 |
| Financing expenses | 89 | - | 1 | 36 | 1 | (7) | 120 |
| Financing income | (7) | (14) | - | (4) | (6) | 13 | (18) |
| Total financing expenses (income), net | 82 | (14) | 1 | 32 | (5) | 6 | 102 |
| | | | | | | | |
| Segment profit (loss) after financing expenses, net | 414 | 44 | 44 | 17 | (3) | (45) | 471 |
| Share in losses of associates | - | - | - | - | (2) | - | (2) |
| Segment profit (loss) before income tax | 414 | 44 | 44 | 17 | (5) | (45) | 469 |
| Income tax | 97 | 10 | 11 | 168 | - | (175) | 111 |
| Segment results –net profit (loss) | 317 | 34 | 33 | (151) | (5) | 130 | 358 |

## 14. Segment Reporting (Contd.)

### 14.1 Operating Segments (contd.)

| | Three months ended June 30, 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 | 1,018 | 647 | 360 | 434 | 52 | - | 2,511 |
| Inter-segment revenues | 82 | 11 | 17 | - | 2 | (112) | - |
| Total revenues | 1,100 | 658 | 377 | 434 | 54 | (112) | 2,511 |
| | | | | | | | |
| Depreciation and amortization | 185 | 95 | 35 | 74 | 3 | 48 | 440 |
| | | | | | | | |
| Segment results – operating income (loss) | 540 | 8 | 47 | 77 | (8) | (48) | 616 |
| Financing expenses | 115 | 2 | 4 | 206 | - | (204) | 123 |
| Financing income | (10) | (13) | (1) | (15) | (1) | 22 | (18) |
| Total financing expenses (income), net | 105 | (11) | 3 | 191 | (1) | (182) | 105 |
| | | | | | | | |
| Segment profit (loss) after financing expenses, net | 435 | 19 | 44 | (114) | (7) | 134 | 511 |
| Share in losses of associates | - | - | - | - | (1) | - | (1) |
| Segment profit (loss) before income tax | 435 | 19 | 44 | (114) | (8) | 134 | 510 |
| Income tax | 109 | 6 | 11 | - | - | 7 | 133 |
| Segment results –net profit (loss) | 326 | 13 | 33 | (114) | (8) | 127 | 377 |

# 14. Segment Reporting (Contd.)

## 14.1 Operating Segments (contd.)

| | Year ended December 31, 2016 (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 | 4,063 | 2,587 | 1,478 | 1,745 | 198 | - | 10,071 |
| Inter-segment revenues | 320 | 43 | 70 | - | 20 | (440) | 13 |
| Total revenues | 4,383 | 2,630 | 1,548 | 1,745 | 218 | (440) | 10,084 |
| | | | | | | | |
| Depreciation and amortization | 717 | 380 | 137 | 296 | 16 | 193 | 1,739 |
| | | | | | | | |
| Segment results –operating income (loss) | 2,076 | 32 | 176 | 264 | (34) | (193) | 2,321 |
| Financing expenses | 475 | 6 | 15 | 539 | 2 | (529) | 508 |
| Financing income | (30) | (52) | (5) | (13) | (4) | 43 | (61) |
| Total financing expenses (income), net | 445 | (46) | 10 | 526 | (2) | (486) | 447 |
| | | | | | | | |
| Segment profit (loss) after financing expenses, net | 1,631 | 78 | 166 | (262) | (32) | 293 | 1,874 |
| Share in profits (losses) of associates | - | - | 1 | - | (5) | (1) | (5) |
| Segment profit (loss) before income tax | 1,631 | 78 | 167 | (262) | (37) | 292 | 1,869 |
| Income tax | 399 | 17 | 42 | (330) | - | 497 | 625 |
| Segment results –net profit (loss) | 1,232 | 61 | 125 | 68 | (37) | (205) | 1,244 |

## 14.2 Adjustment of profit or loss for reporting segments

| | Six months ended June 30 | | Three months ended June 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | **2017** | **2016** | **2017** | **2016** | **2016** |
| | **(Unaudited)** | **(Unaudited)** | **(Unaudited)** | **(Unaudited)** | **(Audited)** |
| | **NIS million** | **NIS million** | **NIS million** | **NIS million** | **NIS million** |
| Operating income for reporting segments | **1,239** | 1,303 | **620** | 672 | 2,548 |
| Financing expenses, net | **(203)** | (207) | **(102)** | (105) | (447) |
| Amortization of surplus cost for intangible assets | **(85)** | (93) | **(38)** | (47) | (193) |
| Share in losses of associates | **(4)** | (2) | **(2)** | (1) | (5) |
| Loss for operations classified in other categories and other adjustments | **(15)** | (20) | **(9)** | (9) | (34) |
| Income before income tax | **932** | 981 | **469** | 510 | 1,869 |

# 15. Condensed Financial Statements of Pelephone, Bezeq International, and DBS

## 15.1 Pelephone Communications Ltd.

Selected data from the statement of financial position

| | June 30, 2017 | June 30, 2016 | December 31, 2016 |
|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS million | NIS million | NIS million |
| Current assets | **1,225** | 1,224 | 1,275 |
| Non-current assets | **2,119** | 2,081 | 2,019 |
| Total assets | **3,344** | 3,305 | 3,294 |
| Current liabilities | **474** | 516 | 465 |
| Long-term liabilities | **95** | 73 | 104 |
| Total liabilities | **569** | 589 | 569 |
| Capital | **2,775** | 2,716 | 2,725 |
| Total liabilities and equity | **3,344** | 3,305 | 3,294 |

Selected data from the statement of income

| | Six months ended June 30 | | Three months ended June 30 | | Year ended |
|---|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 | December 31, 2016 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS million | NIS million | NIS million | NIS million | NIS million |
| Revenues from services | **884** | 911 | **449** | 456 | 1,818 |
| Revenues from sales of terminal equipment | **376** | 418 | **183** | 202 | 812 |
| Total revenues from services and sales | **1,260** | 1,329 | **632** | 658 | 2,630 |
| Cost of services and sales | **1,082** | 1,139 | **529** | 560 | 2,248 |
| Gross profit | **178** | 190 | **103** | 98 | 382 |
| Selling and marketing expenses | **100** | 134 | **51** | 68 | 260 |
| General and administrative expenses | **43** | 47 | **22** | 22 | 89 |
| Other operating expenses | **-** | - | **-** | - | 1 |
| | **143** | 181 | **73** | 90 | 350 |
| Operating income | **35** | 9 | **30** | 8 | 32 |
| Financing expenses | **-** | 2 | **-** | 2 | 6 |
| Financing income | **(28)** | (25) | **(14)** | (13) | (52) |
| Financing income, net | **(28)** | (23) | **(14)** | (11) | (46) |
| Profit before income tax | **63** | 32 | **44** | 19 | 78 |
| Income tax | **13** | 6 | **10** | 6 | 17 |
| Profit for the period | **50** | 26 | **34** | 13 | 61 |

## 15.2 Bezeq International Ltd.

Selected data from the statement of financial position

| | June 30, 2017 | June 30, 2016 | December 31, 2016 |
|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS million | NIS million | NIS million |
| Current assets | **523** | 485 | 497 |
| Non-current assets | **711** | 719 | 691 |
| Total assets | **1,234** | 1,204 | 1,188 |
| Current liabilities | **310** | 296 | 280 |
| Long-term liabilities | **112** | 105 | 100 |
| Total liabilities | **422** | 401 | 380 |
| Capital | **812** | 803 | 808 |
| Total liabilities and equity | **1,234** | 1,204 | 1,188 |

Selected data from the statement of income

| | Six months ended June 30 | | Three months ended June 30 | | Year ended |
|---|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 | December 31, 2016 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS million | NIS million | NIS million | NIS million | NIS million |
| Revenues from services | **791** | 772 | **407** | 377 | 1,548 |
| Operating expenses | **546** | 504 | **288** | 246 | 1,015 |
| Gross profit | **245** | 268 | **119** | 131 | 533 |
| Selling and marketing expenses | **94** | 113 | **46** | 56 | 221 |
| General and administrative expenses | **56** | 57 | **27** | 28 | 118 |
| Other expenses, net | **1** | 14 | **1** | - | 18 |
| | **151** | 184 | **74** | 84 | 357 |
| Operating income | **94** | 84 | **45** | 47 | 176 |
| Financing expenses | **4** | 8 | **1** | 4 | 15 |
| Financing income | **(1)** | (3) | **-** | (1) | (5) |
| Financing expenses, net | **3** | 5 | **1** | 3 | 10 |
| Share in the profits of equity-accounted investees | **-** | - | **-** | - | 1 |
| Profit before income tax | **91** | 79 | **44** | 44 | 167 |
| Income tax | **22** | 20 | **11** | 11 | 42 |
| Profit for the period | **69** | 59 | **33** | 33 | 125 |

## 15.3 DBS Satellite Services (1998) Ltd.

Selected data from the statement of financial position

| | June 30, 2017 | June 30, 2016 | December 31, 2016 |
|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Audited) |
| | NIS million | NIS million | NIS million |
| Current assets | **502** | 403 | 440 |
| Non-current assets | **1,408** | 1,312 | 1,586 |
| Total assets | **1,910** | 1,715 | 2,026 |
| Current liabilities | **976** | 873 | 950 |
| Long-term liabilities | **474** | 873 | 484 |
| Loans from shareholders | **-** | 5,172 | - |
| Total liabilities | **1,450** | 6,918 | 1,434 |
| Capital (capital deficit) | **460** | (5,203) | 592 |
| Total liabilities and capital deficit | **1,910** | 1,715 | 2,026 |

Selected data from the statement of income

| | Six months ended June 30 | | Three months ended June 30 | | Year ended |
|---|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 | December 31, 2016 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS million | NIS million | NIS million | NIS million | NIS million |
| Revenues from services | **840** | 873 | **416** | 434 | 1,745 |
| Operating expenses | **628** | 633 | **313** | 312 | 1,261 |
| Gross profit | **212** | 240 | **103** | 122 | 484 |
| Selling and marketing expenses | **64** | 62 | **29** | 24 | 128 |
| General and administrative expenses | **47** | 44 | **25** | 21 | 92 |
| | **111** | 106 | **54** | 45 | 220 |
| Operating income | **101** | 134 | **49** | 77 | 264 |
| Financing expenses | **72** | 43 | **36** | 27 | 71 |
| Financing expenses for shareholder loans, net | **-** | 287 | **-** | 179 | 468 |
| Financing income | **(13)** | (12) | **(4)** | (15) | (13) |
| Financing expenses, net | **59** | 318 | **32** | 191 | 526 |
| Profit (loss) before income tax | **42** | (184) | **17** | (114) | (262) |
| Income tax | **174*** | 1 | **168*** | - | (330) |
| Profit (loss) for the period | **(132)** | (185) | **(151)** | (114) | 68 |

* As a result of the developments in the multi-channel television sector (see Note 7), DBS revised its projections and reduced the deferred taxes for cumulative losses

# Condensed Separate Interim Financial Information as at June 30, 2017

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

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Somekh Chaikin
KPMG Millennium Tower
17 Ha-Arbaa Street, PO Box 609
Tel Aviv 6100601, Israel
800068403

**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 June 30, 2017 and for the six and three month periods then ended. The separate interim financial information is the responsibility of the Company's Board of Directors and of its Management. Our responsibility is to express a conclusion on the separate interim financial information based on our review.

We did not review the separate interim financial information of an investee company the investment in which amounted to NIS 104 million as of June 30, 2017, and the loss from this investee company amounted to NIS 11 million and NIS 1 million for the six and three month periods then ended, respectively. The financial statements of that company were reviewed by other auditors whose review report thereon was furnished to us, and our conclusion, insofar as it relates to amounts emanating from the financial statements of that company, is based solely on the said review report of the other auditors.

Scope of Review

We conducted our review in accordance with Standard on Review Engagements 1, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" of the Institute of Certified Public Accountants in Israel. A review of separate interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

A review is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards in Israel and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

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

Without qualifying our abovementioned conclusion, we draw attention to Note 6.1 regarding an ongoing investigation being conducted by the Israel Securities Authority over suspicions that the Company's controlling shareholder committed violations of the securities law and the penal law. As stated in the above

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note, at this stage the Company is unable to assess the results of the investigation or its effect on the Group, if any at all.

In addition, 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.)
August 23, 2017

## Condensed Separate Interim Information of Financial Position

| | June 30, 2017 * (Unaudited) NIS million | June 30, 2016 (Unaudited) NIS million | December 31, 2016 (Audited) NIS million |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | **1,284** | 845 | 182 |
| Investments | **-** | 859 | 549 |
| Trade receivables | **695** | 711 | 698 |
| Other receivables | **204** | 73 | 72 |
| Eurocom DBS Ltd, an affiliate | **56** | 29 | - |
| Loans granted to investees | **97** | 100 | 78 |
| Investment in DBS debentures | **203** | - | - |
| **Total current assets** | **2,539** | 2,617 | 1,579 |
| | | | |
| Trade and other receivables | **110** | 192 | 211 |
| Property, plant and equipment | **4,934** | 4,810 | 4,867 |
| Intangible assets | **220** | 242 | 229 |
| Investment in investees | **7,085** | 6,647 | 7,080 |
| Loans granted to investees | **138** | 450 | 120 |
| Investment in DBS debentures | **461** | - | - |
| Non-current and other investments | **128** | 104 | 105 |
| **Total non-current assets** | **13,076** | 12,445 | 12,612 |
| | | | |
| **Total assets** | **15,615** | 15,062 | 14,191 |

## Condensed Separate Interim Information of Financial Position (contd)

| | June 30, 2017 * (Unaudited) NIS million | June 30, 2016 (Unaudited) NIS million | December 31, 2016 (Audited) NIS million |
|---|---|---|---|
| **Liabilities** | | | |
| Debentures, loans and borrowings | **748** | 1,527 | 1,405 |
| Loan from an investee | **105** | - | - |
| Trade and other payables | **501** | 544 | 679 |
| Current tax liabilities | **104** | 627 | 96 |
| Employee benefits | **257** | 314 | 263 |
| Liability to Eurocom DBS Ltd, related party | **-** | 208 | 32 |
| Provisions (Note 4) | **48** | 54 | 48 |
| **Total current liabilities** | **1,763** | 3,274 | 2,523 |
| | | | |
| Debentures and loans | **10,524** | 8,654 | 8,630 |
| Loan from an investee | **475** | 325 | 325 |
| Employee benefits | **220** | 201 | 220 |
| Derivatives and other liabilities | **241** | 245 | 231 |
| Deferred tax liabilities | **67** | 64 | 59 |
| **Total non-current liabilities** | **11,527** | 9,489 | 9,465 |
| | | | |
| **Total liabilities** | **13,290** | 12,763 | 11,988 |
| | | | |
| Capital | | | |
| Share capital | **3,878** | 3,878 | 3,878 |
| Share premium | **384** | 384 | 384 |
| Reserves | **294** | 287 | 302 |
| Deficit | **(2,231)** | (2,250) | (2,361) |
| **Total equity attributable to equity holders of the Company** | **2,325** | 2,299 | 2,203 |
| | | | |
| **Total liabilities and equity** | **15,615** | 15,062 | 14,191 |

| | | |
|---|---|---|
| **David Granot** | **Stella Handler** | **Danny Oz** |
| Interim Acting Chairman of the Board of Directors | CEO | Controller and Deputy CFO |

Date of approval of the financial statements: August 23, 2017

* See Note 1.3 concerning early application of IFRS 15 - Revenue from Contracts with Customers

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

## Condensed Separate Interim Information of Profit or Loss

| | Six months ended June 30 | | Three months ended June 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2017* | 2016 | 2017* | 2016 | 2016 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS million | NIS million | NIS million | NIS million | NIS million |
| **Revenues (Note 2)** | **2,136** | 2,212 | **1,058** | 1,100 | 4,383 |
| **Costs of activity** | | | | | |
| Salaries | **444** | 447 | **220** | 217 | 898 |
| Depreciation and amortization | **357** | 368 | **177** | 185 | 717 |
| Operating and general expenses (Note 3) | **331** | 342 | **166** | 170 | 705 |
| Other operating expenses, net | **(5)** | (21) | **(1)** | (12) | (13) |
| **Cost of Activities** | **1,127** | 1,136 | **562** | 560 | 2,307 |
| **Operating profit** | **1,009** | 1,076 | **496** | 540 | 2,076 |
| Financing expenses (income) | | | | | |
| Financing expenses | **186** | 224 | **89** | 115 | 475 |
| Financing income | **(12)** | (18) | **(7)** | (10) | (30) |
| Financing expenses, net | **174** | 206 | **82** | 105 | 445 |
| **Profit after financing expenses, net** | **835** | 870 | **414** | 435 | 1,631 |
| **Share in earnings of investees, net** | **72** | 11 | **41** | 51 | 12 |
| **Profit before income tax** | **907** | 881 | **455** | 486 | 1,643 |
| **Income tax** | **199** | 216 | **97** | 109 | 399 |
| **Profit for the period attributable to the owners of the Company** | **708** | 665 | **358** | 377 | 1,244 |

## Condensed Separate Interim Information of Comprehensive Income

| | Six months ended June 30 | | Three months ended June 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 | 2016 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS million | NIS million | NIS million | NIS million | NIS million |
| Profit for the period | **708** | 665 | **358** | 377 | 1,244 |
| Items of other comprehensive income (loss) for the period including actuarial gains and hedging transactions, net of tax | **(8)** | (5) | **(14)** | 5 | (15) |
| **Total comprehensive income for the period attributable to equity holders of the Company** | **700** | 660 | **344** | 382 | 1,229 |

* See Note 1.3 concerning early application of IFRS 15 - Revenue from Contracts with Customers

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

## Condensed Separate Interim Information of Cash Flows

| | Six months ended June 30 | | Three months ended June 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2017* | 2016 | 2017* | 2016 | 2016 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS million | NIS million | NIS million | NIS million | NIS million |
| **Cash flows from operating activities** | | | | | |
| Profit for the period | **708** | 665 | **358** | 377 | 1,244 |
| Adjustments: | | | | | |
| Depreciation and amortization | **357** | 368 | **177** | 185 | 717 |
| Share in earnings of investees, net | **(72)** | (11) | **(41)** | (51) | (12) |
| Financing expenses, net | **165** | 204 | **78** | 101 | 445 |
| Capital gain, net | **(19)** | (40) | **(14)** | (29) | (107) |
| Income tax expenses | **199** | 216 | **97** | 109 | 399 |
| | | | | | |
| Change in trade and other receivables | **10** | (32) | **(5)** | 23 | (51) |
| Change in trade and other payables | **(62)** | (79) | **(95)** | (81) | (54) |
| Change in provisions | **-** | (6) | **(2)** | 3 | (12) |
| Change in employee benefits | **(6)** | (18) | **6** | (10) | (72) |
| Miscellaneous | **1** | (6) | **1** | (4) | (15) |
| Net cash (used in) from operating activities due to transactions with subsidiaries | **(33)** | (30) | **(7)** | (23) | 27 |
| | | | | | |
| Net income tax paid | **(183)** | (175) | **(88)** | (83) | (445) |
| **Net cash from operating activities** | **1,065** | 1,056 | **465** | 517 | 2,064 |
| **Cash flows from investment activities** | | | | | |
| Investment in intangible assets and other investments | **(51)** | (39) | **(25)** | (23) | (76) |
| Proceeds from the sale of property, plant and equipment | **26** | 95 | **16** | 54 | 132 |
| Acquisition of financial assets held for trading and others | **-** | (855) | **-** | (855) | (905) |
| Proceeds from the sale of financial assets held for trading and others | **546** | 644 | **546** | 506 | 1,003 |
| Tax payment for shareholder's loans | **-** | - | **-** | - | (461) |
| Purchase of property, plant and equipment | **(378)** | (383) | **(194)** | (204) | (758) |
| Miscellaneous | **(26)** | (1) | **(19)** | 15 | 2 |
| Net cash from investment activities due to transactions with subsidiaries | **(98)** | 85 | **8** | 149 | 148 |
| **Net cash flows from (used in) investment activities** | **19** | (454) | **332** | (358) | (915) |
| **Cash flow from finance activities** | | | | | |
| Issue of debentures and receipt of loans | **1,418** | 1,661 | **1,418** | 1,661 | 2,161 |
| Repayment of debentures and loans | **(842)** | (798) | **(618)** | (749) | (1,444) |
| Dividends paid | **(578)** | (776) | **(578)** | (776) | (1,441) |
| Payment to Eurocom DBS for acquisition of DBS shares and loans | **(61)** | (58) | **-** | - | (256) |
| Interest paid | **(174)** | (186) | **(159)** | (169) | (381) |
| Miscellaneous | **-** | (21) | **-** | (24) | (21) |
| Net cash from (used for) financing activities due to transactions with subsidiaries | **255** | 311 | **150** | 311 | 305 |
| **Net cash from (used for) financing operations** | **18** | 133 | **213** | 254 | (1,077) |
| **Net increase (decrease) in cash and cash equivalents** | **1,102** | 735 | **1,010** | 413 | 72 |
| Cash and cash equivalents at beginning of period | **182** | 110 | **274** | 432 | 110 |
| **Cash and cash equivalents at the end of the period** | **1,284** | 845 | **1,284** | 845 | 182 |

* See Note 1.3 concerning early application of IFRS 15 - Revenue from Contracts with Customers

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 2016.

## 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 information for the year ended December 31, 2016 and in conjunction with the condensed interim consolidated financial statements as at June 30, 2017 ("the Consolidated Financial Statements").

The accounting policies used in preparing this 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, 2016.

## 1.3 First-time Application of Accounting Standards

Commencing January 1, 2007, the Group applies early adoption of International Financial Reporting Standard - Revenues from Customer Contracts ("IFRS 15"), which sets out guidelines with respect to recognition of revenue. IFRS 15 replaces IAS 18 - Revenues and presents a new model for recognition of revenues from contracts with customers.

For further information concerning the first-time adoption of IFRS 15 see Note 3.2 to the Consolidated Financial Statements.

The tables below present a breakdown of the effects on the condensed consolidated interim statement of financial position as at June 30, 2017 and on the condensed consolidated statement of income and consolidated interim statement of cash flows for the six and three months then ended, assuming that the Company's previous policy regarding subscriber acquisition costs was continued in this period.

Effect on the condensed consolidated interim statement of financial position as at June 30, 2017:

| | Per the previous policies | Change | Per IFRS 15 |
|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Unaudited) |
| | NIS million | NIS million | NIS million |
| Subscriber acquisition asset, net (presented as part of non-current deferred expenses and investments) | 7 | 10 | **17** |
| Capital | 2,317 | 8 | **2,325** |

Effect on the consolidated interim statement of income for the six and three-month periods ended June 30, 2017:

| | Six months ended June 30, 2017 | | | Three months ended June 30, 2017 | | |
|---|---|---|---|---|---|---|
| | Per previous policies | Change | Per IFRS 15 | Per the previous policies | Change | Per IFRS 15 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) |
| | NIS million | NIS million | NIS million | NIS million | NIS million | NIS million |
| General and operating expenses | 337 | (6) | **331** | 169 | (3) | **166** |
| Salaries | 448 | (4) | **444** | 222 | (2) | **220** |
| Depreciation and amortization costs | 357 | - | **357** | 177 | - | **177** |
| Operating profit | 999 | 10 | **1,009** | 491 | 5 | **496** |
| Profit after financing expenses | 825 | 10 | **835** | 409 | 5 | **414** |
| Profit before income tax | 897 | 10 | **907** | 450 | 5 | **455** |
| Income tax | 197 | 2 | **199** | 96 | 1 | **97** |
| Profit for the period | 700 | 8 | **708** | 354 | 4 | **358** |

Effect on the consolidated interim statement of cash flows for the three months ended June 30, 2017:

| | Six months ended June 30, 2017 | | | Three months ended June 30, 2017 | | |
|---|---|---|---|---|---|---|
| | Per the previous policies | Change | Per IFRS 15 | Per the previous policies | Change | Per IFRS 15 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) |
| | NIS million | NIS million | NIS million | NIS million | NIS million | NIS million |
| Net cash from operating activities | 1,055 | 10 | **1,065** | 460 | 5 | **465** |
| Net cash from investment activities | 29 | (10) | **19** | 337 | (5) | **332** |

## 2. Revenues

| | Six months ended June 30 | | Three months ended June 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 | 2016 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS million | NIS million | NIS million | NIS million | NIS million |
| Fixed-line telephony | **708** | 758 | **347** | 374 | 1,490 |
| Internet - infrastructure | **816** | 792 | **407** | 398 | 1,597 |
| Transmission and data communication | **500** | 543 | **248** | 270 | 1,077 |
| Other services | **112** | 119 | **56** | 58 | 219 |
| | **2,136** | 2,212 | **1,058** | 1,100 | 4,383 |

## 3. Operating and general expenses

| | Six months ended June 30 | | Three months ended June 30 | | Year ended December 31 |
|---|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 | 2016 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| | NIS million | NIS million | NIS million | NIS million | NIS million |
| Maintenance of buildings and sites | **92** | 95 | **45** | 46 | 189 |
| Marketing and general | **86** | 87 | **44** | 44 | 195 |
| Interconnectivity and payments to communications operators | **60** | 67 | **29** | 33 | 130 |
| Services and maintenance by sub-contractors | **36** | 34 | **19** | 17 | 72 |
| Vehicle maintenance | **35** | 35 | **17** | 18 | 72 |
| Terminal equipment and materials | **22** | 24 | **12** | 12 | 47 |
| | **331** | 342 | **166** | 170 | 705 |

## 4. Contingent Liabilities

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

In the opinion of the Company's management, based, *inter alia*, on legal opinions as to the likelihood of success of these litigations, the financial statements include appropriate provisions in the amount of NIS 48 million, where provisions are required to cover the exposure arising from such litigation.

In Management's opinion, the additional exposure (exceeding the foregoing provisions), as of June 30, 2017 due to legal claims filed against the Company on various matters, which are unlikely to be realized, amounts to a total of NIS 3.3 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 3 billion* 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.

From June through August 2017 shareholders of the Company filed several motions for discovery of documents against the Company and DBS (excluding two motions filed against the Company only) prior to the filing of a motion for certification of a derivative action under section 198A of the Companies Law. These motions were filed due to the public investigation by the Securities Authority concerning the transaction for the Company’s acquisition of DBS shares from Eurocom DBS Ltd. and transactions for satellite communications services between DBS and Space Communications Ltd., as described in Note 1.2 to the Consolidated Financial Statements.

It should be noted that, in addition to these motions, there is a pending claim and motion for certification of the claim as a derivative action against the Company, its controlling shareholder and directors, with regard the transaction for the Company’s acquisition of Eurocom DBS’s entire holdings and shareholders' loans in DBS

Subsequent to the date of the financial statements, a motion for certification of a class action totaling NIS 2 billion was filed against the Company and members of the Company's Board of Directors, concerning the acquisition of DBS shares and the transaction for continuing the engagement between DBS and Space Communications Ltd. In addition, claims with exposure of NIS 14 million were concluded.

* This amount includes:

(1) Exposure of NIS 1.11 billion with respect to a claim filed against the Company and its subsidiary, Walla Communications Ltd., Yad 2 and an advertising company owned by Walla, concerning the Company's 144 service.

(2) Two motions for certification of class action suits filed in June 2017 against the Company, officers of the Group and companies of the group that is the controlling shareholder of the Company, concerning the transaction for the Company's acquisition of DBS shares from Eurocom DBS Ltd.

For further information concerning contingent liabilities see Note 9 to the Consolidated Financial Statements.

## 5. Dividends from investees

**5.1** In May 2017, Bezeq International Ltd. paid a cash dividend to the Company, which was announced in March 2017, in the amount of NIS 65 million.

**5.2** In July 2017, the board of directors of Pelephone decided to distribute a dividend to the Company in the amount of NIS 84 million in October 2017.

**5.3** In July 2017, the board of directors of Bezeq International decided to distribute a dividend to the Company in the amount of NIS 68 million in October 2017.

## 6. Events in the reporting period

**6.1** For further information concerning the Securities Authority investigation see Note 1.2 to the Consolidated Financial Statements.

**6.2** On May 10, 2017, the Company provided Bezeq International a loan in the amount of NIS 50 million to be repaid in three equal annual installments commencing from May 2018. The loan bears annual interest of 2.56%.

**6.3** On May 28, 2018, the Company received a loan from Pelephone in the amount of NIS 150 million. The loan bears annual interest of 3.41% and is repayable in four equal annual installments commencing from December 1, 2022.

**6.4** For further information regarding credit provided to the Company in 2017 by banks and institutional investors on June 15, 2017, see Note 7.1 to the Consolidated Financial Statements.

**6.5** For information concerning the issue of debentures Series 6 and 10 of the Company replacing Debenture (Series B) of DBS, see Note 7.2.2.

**6.6** For information concerning the Company's issue of debentures during the quarter, see Note 7 to the Consolidated Financial Statements.

**6.7** For further information regarding the second contingent consideration to be paid to Eurocom DBS based on the business results of DBS, see Note 4.2 to the Consolidated Financial Statements and the fair value assessment of the amount that is expected to be repaid from the surplus advance payments.