

SECURITIES AND EXCHANGE COMMISSION  
Washington D.C. 20549

FORM 20-F

☐ REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2015

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

☐ SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report \_\_\_\_\_

Commission file number: 0-30198



**INTERNET GOLD – GOLDEN LINES LTD.**

(Exact name of Registrant as specified in its charter  
and translation of Registrant's name into English)

**Israel**

(Jurisdiction of incorporation or organization)

**2 Dov Friedman Street, Ramat Gan 5250301, Israel**

(Address of principal executive offices)

**Doron Turgeman, CEO, +972-3-9240000 (phone), +972-3-9399832 (fax)**

**2 Dov Friedman Street, Ramat Gan 5250301, Israel**

(Name, Telephone, E-mail and/or Facsimile Number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class

**Ordinary Shares, NIS 0.01 Par Value**

Name of each exchange on which registered

**NASDAQ Global Select Market**

Securities registered or to be registered pursuant to Section 12(g) of the Act: **None**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

**Ordinary Shares, par value NIS 0.01 per share** 19,203,186  
(as of December 31, 2015)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☐ No ☒

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☒

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP ☐

International Financial Reporting Standards as  
issued by the International Accounting  
Standards Board ☒

Other ☐

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 ☐ Item 18 ☒

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

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## **INTRODUCTION**

We are a leading communications group in Israel. Our shares are listed on the NASDAQ Global Select Market and on the Tel Aviv Stock Exchange, or TASE. B Communications Ltd. (formerly known as 012 Smile Communications Ltd.) is our subsidiary.

On April 14, 2010, our principal subsidiary, B Communications, completed the acquisition of the controlling 30.44% interest in Bezeq (TASE:BZEQ), Israel's largest telecommunications provider, from Ap.Sb.Ar. Holdings Ltd. (a consortium of Apax Partners, Saban Capital Group and Arkin Communications) for an aggregate cash purchase price of approximately NIS 6.5 billion. In accordance with the terms of the transaction, effective as of the closing of the acquisition, B Communications designated seven directors to replace the Apax-Saban-Arkin Group's representatives on Bezeq's Board of Directors, which numbers 11 directors. We began consolidating Bezeq's financial results into our financial statements effective as of the closing of the acquisition. B Communications currently owns 26.34% of Bezeq's outstanding shares. B Communications' ordinary shares are listed on the NASDAQ Global Select Market (symbol: BCOM) and on the TASE. We currently own 64.78% of the ordinary shares of B Communications.

The Bezeq Group operates the most comprehensive telecommunications infrastructure in Israel, with a broad range of telecommunications services across all of its markets. Through its wholly-owned subsidiaries, the Bezeq Group is a leading provider in Israel of fixed-line telephony services and fixed-line broadband Internet infrastructure access services, cellular telephony services, Internet service provider, or ISP, services, international telephony, or ILD, services, international and domestic data transfer and network services and information and communication technology, or ICT, services, pay television services and other communications infrastructures and services. In each of these markets, the Bezeq Group holds a significant market share, as indicated in the chart below.

As used in this annual report, the terms "we," "us" and "our" mean Internet Gold - Golden Lines Ltd. and its subsidiaries, "B Communications" means B Communications Ltd., "SP1" means B Communications (SP1) Ltd., "SP2" means B Communications (SP2) Ltd., "Eurocom Communications" means Eurocom Communications Ltd., "Bezeq" means Bezeq - The Israel Telecommunications Corp., Ltd.; "Pelephone" means Pelephone Communications Ltd., "Bezeq International" means Bezeq International Ltd. and "YES" (the trade name for DBS) and DBS mean DBS Satellite Services (1998) Ltd. Bezeq, Pelephone, Bezeq International and DBS are sometimes referred to as the Bezeq Group in this annual report.

Our consolidated financial statements appearing in this annual report are prepared in New Israeli Shekels and are translated into U.S. dollars at the representative rate of exchange at December 31, 2015 (NIS 3.902= \$1.00). The dollar amounts so presented should not be construed as representing amounts receivable, payable or incurred in dollars or convertible into dollars. All references in this annual report to "dollars" or "\$" are to U.S. dollars and all references in this annual report to "NIS" are to New Israeli Shekels.

Statements made in this annual report concerning the contents of any contract, agreement or other document are summaries of such contracts, agreements or documents and are not complete descriptions of all of their terms. If we filed any of these documents as an exhibit to this annual report or to any registration statement or annual report that we previously filed, you may read the document itself for a complete description of its terms.

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### **Forward Looking Statements**

Except for the historical information contained in this annual report, the statements contained in this annual report are “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995, as amended, with respect to our business, financial condition and results of operations. Such forward-looking statements reflect our current view with respect to future events and financial results. We urge you to consider that statements which use the terms “anticipate,” “believe,” “do not believe,” “expect,” “plan,” “intend,” “estimate,” “anticipate” and similar expressions are intended to identify forward-looking statements. We remind readers that forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any future results, performance, levels of activity, or our achievements expressed or implied by such forward-looking statements. Such forward-looking statements are also included in Item 4 – “Information on the Company” and Item 5 – “Operating and Financial Review and Prospects.” Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Except as required by applicable law, including the securities laws of the United States, we undertake no obligation to publicly release any update or revision to any forward-looking statements to reflect new information, future events or circumstances, or otherwise after the date hereof. We have attempted to identify significant uncertainties and other factors affecting forward-looking statements in the Risk Factors section that appears in Item 3.D. “Key Information - Risk Factors.”

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# PART I

## ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

## ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

## ITEM 3. KEY INFORMATION

### A. Selected Financial Data

The tables below as of and for the five years ended December 31, 2015 set forth selected consolidated financial data, which is derived from our audited consolidated financial statements. The audited consolidated financial statements as of December 31, 2014 and 2015 and for the years ended December 31, 2013, 2014 and 2015 appear in this annual report.

#### Consolidated Statement of Income Data:

|   | Year Ended December 31,                            |        |       |        |       |   |
|---|--|--------|-------|--------|-------|---|
|   | 2011   | 2012   | 2013  | 2014   | 2015  | 2015  |
|   |  |        |       |        |       | (\$ in millions, except share and per share data) |
|   | (NIS in millions, except share and per share data) |        |       |        |       |   |
| Revenues  | 11,376   | 10,278 | 9,563 | 9,055  | 9,985 | 2,559   |
| Depreciation and amortization                         | 2,984  | 2,367  | 2,014 | 1,873  | 2,131 | 546   |
| Salaries  | 2,109  | 1,980  | 1,874 | 1,771  | 1,960 | 502   |
| General and operating expenses                        | 4,468  | 3,997  | 3,586 | 3,371  | 3,878 | 994   |
| Other operating expenses (income)                     | 323  | (1)    | 57    | (535)  | 3     | 1   |
|   | 9,884  | 8,343  | 7,531 | 6,480  | 7,972 | 2,043   |
| Operating income                                      | 1,492  | 1,935  | 2,032 | 2,575  | 2,013 | 516   |
| Finance expense                                       | 1,079  | 997    | 931   | 1,329  | 759   | 195   |
| Finance income  | (497)  | (582)  | (535) | (635)  | (164) | (42)  |
| Finance expense, net                                  | 582  | 415    | 396   | 694    | 595   | 152   |
| Income after financing expenses, net                  | 910  | 1,520  | 1,636 | 1,881  | 1,418 | 364   |
| Share of losses (profit) in equity-accounted investee | 216  | 245    | 252   | 170    | (12)  | (3)   |
| Income before income tax                              | 694  | 1,275  | 1,384 | 1,711  | 1,430 | 367   |
| Income tax  | 656  | 556    | 524   | 667    | 347   | 89  |
| Net income for the year                               | 38   | 719    | 860   | 1,044  | 1,083 | 278   |
| Income (loss) attributable to owners of the Company   | (264)  | (37)   | 26    | (103)  | 87    | 22  |
| Income attributable to non-controlling interest       | 302  | 756    | 834   | 1,147  | 996   | 256   |
| Net income for the year                               | 38   | 719    | 860   | 1,044  | 1,083 | 278   |
| Basic earnings (loss) per share                       | (13.46)  | (1.94) | 1.33  | (5.38) | 4.54  | 1.16  |
| Diluted earnings (loss) per share                     | (13.50)  | (1.97) | 1.26  | (5.50) | 4.47  | 1.15  |

#### Statements of Financial Position:

|                           | December 31, |        |                   |        |        |                  |
|---------------------------|--------------|--------|-------------------|--------|--------|------------------|
|                           | 2011         | 2012   | 2013              | 2014   | 2015   | 2015             |
|                           |              |        | (NIS in millions) |        |        | (\$ in millions) |
| Cash and cash equivalents | 1,447        | 764    | 867               | 732    | 619    | 158              |
| Restricted cash           | -            | -      | -                 | 65     | 155    | 40               |
| Total assets              | 25,262       | 22,806 | 21,410            | 21,558 | 22,410 | 5,743            |
| Total current liabilities | 4,780        | 4,899  | 4,104             | 3,974  | 5,352  | 1,371            |
| Non-current liabilities   | 16,249       | 14,427 | 14,153            | 14,818 | 14,457 | 3,705            |

## Exchange Rate Information

The following table sets forth, for the periods and dates indicated, certain information regarding the Bank of Israel representative rate of exchange for dollars, expressed in NIS per one dollar. The representative rate is the average between the buying rate and the selling rate of exchange. We do not use such rates in the preparation of our consolidated financial statements included elsewhere herein. See Note 2 to the consolidated financial statements included elsewhere in this Form 20-F.

| Period                       | Average |
|------------------------------|---------|
| Year ended December 31, 2011 | 3.578   |
| Year ended December 31, 2012 | 3.856   |
| Year ended December 31, 2013 | 3.611   |
| Year ended December 31, 2014 | 3.578   |
| Year ended December 31, 2015 | 3.887   |

| Period                        | High  | Low   |
|-------------------------------|-------|-------|
| November 2015                 | 3.921 | 3.868 |
| December 2015                 | 3.905 | 3.855 |
| January 2016                  | 3.983 | 3.913 |
| February 2016                 | 3.964 | 3.871 |
| March 2016                    | 3.912 | 3.766 |
| April 2016 (through April 18) | 3.819 | 3.765 |

On April 18, 2016, the representative rate of exchange was NIS 3.785 = \$1.00 as published by the Bank of Israel.

### B. Capitalization and Indebtedness

Not applicable.

### C. Reasons for the Offer and Use of Proceeds

Not applicable.

### D. Risk Factors

*Investing in our ordinary shares involves a high degree of risk and uncertainty. You should carefully consider the risks and uncertainties described below before investing in our ordinary shares. If any of the following risks actually occurs, our business, prospects, financial condition and results of operations could be harmed. In that case, the value of our ordinary shares could decline and you could lose all or part of your investment.*

#### Risks Relating to the Bezeq Group's Business

**Competition from other telecommunications providers and recent and potential changes in the competitive environment and communications technologies could adversely affect the Bezeq Group's business, results of operations and financial condition.**

The Bezeq Group faces significant competition from established and new competitors who provide cellular telephony, fixed-line telephony, fixed-line broadband Internet infrastructure access, ISP and pay television services. In addition to the entrance of new competitors, competition among the existing communications groups in Israel is intensifying. Four main groups, each consisting of companies under common or joint control, hold a significant share of the communications market in Israel today: the Bezeq Group, the Cellcom Group, the Partner Group and the HOT Group. The Bezeq Group's three principal competitors may in some cases be required to comply with fewer regulations because, among other reasons, they use different technologies to provide their services or do not own their own fixed-line network.

Competition in the cellular telephony industry has intensified since 2012. This has led to lower prices and higher customer churn rates, which in turn has affected the results of Pelephone and the Bezeq Group. Bezeq expects competition to continue to increase amid the changing legislation in Israel and consolidation in the telecommunications industry that permits certain service providers to market a combination of fixed-line telephony, fixed-line broadband Internet infrastructure access, ISP and pay television services, or a "bundle", for an aggregate price which is lower than the price of the individual products and services in the bundle. The Bezeq Group is currently subject to restrictions on marketing bundles, which are stricter than the restrictions applicable to its competitors. In addition, Bezeq expects additional competitive pressure will arise from the convergence of broadcasting and communication technologies, which may lead participants in the Israeli media and telecommunications industries to offer bundles of fixed-line telephony and cellular telephony, Internet and/or video broadcast services in competition with it. These competitive forces may create further downward pressure on prices, which may result in a decrease in the Bezeq Group's average revenue per user, or ARPU, and increase the Bezeq Group companies' churn rates. In addition, the Bezeq Group companies may bear higher costs if they introduce new products or services to maintain or improve their competitive positioning and reduce subscriber churn. Furthermore, technological developments and falling equipment prices could enable other operators to provide services similar to those provided by the Bezeq Group at much lower costs. In combination with difficult economic environments, these competitive pressures could adversely impact the Bezeq Group's ability to increase, or in certain cases maintain, its ARPUs, operating cash flows and liquidity.



In November 2014, the Minister of Communications, or the Minister, amended the licenses of Bezeq and Hot Telecommunications, the two infrastructure owners in Israel, to define the basket of services under the licenses (managed broadband access and wholesale telephony services). The applicable new regulations include the obligation to provide the services, including accompanying services, and the regulation of maximum rates (which require the Finance Minister's approval) for the provision of the wholesale services.

The ongoing implementation of the wholesale market regulation may have a significant negative impact on the Bezeq Group which cannot be quantified at this time. However, the Bezeq Group may in the future be granted a permit to provide non-divisible bundles of services and the structural separation may be cancelled.

*Domestic fixed-line telephony* is regulated and controlled by the Ministry of Communications, which regulation is based among other things, the issuance of licenses to entities operating in the segment.

*Fixed-line telephony* is characterized by an intense competitive dynamic. Bezeq's competitors are HOT Telecom (which, pursuant to a decision by the Minister in 2014, obtained an extension for its mandatory implementation of universal services in full deployment), VoB service providers that have operated for several years under licenses with no obligation to provide universal service, and without their own independent access infrastructure, and entities related to Internet ISPs and international communication services providers. Some of the competitors are part of the three other telecommunications groups, and Bezeq believes that cellular companies are also competitors in the telephony segment. Following the decision and implementation of the wholesale telephony service in a resale format, service providers with a unified license that were permitted to provide domestic carrier services without any infrastructure at all will compete with Bezeq by offering basic telephony services that are identical to Bezeq's services, to Bit Stream Access, or BSA, service subscribers.

Upon application of the wholesale market, ISPs and holders of a general special license will compete with Bezeq, among others, in the provision of service packages that include broadband services, using Bezeq's infrastructure at wholesale prices. Communication operators that compete with Bezeq may buy services from Bezeq at supervised prices, including infrastructure segments, and thus compete with Bezeq by selling complete service packages to their customers.

*Fixed-Line Broadband Internet Infrastructure Access.* Bezeq's principal competitor in the fixed-line broadband Internet infrastructure access service market is HOT, which is currently the only other fixed-line broadband Internet infrastructure access provider in Israel. Bezeq's fixed-line broadband Internet infrastructure access services business also faces competition from cellular telephony operators who are increasingly able to utilize a combination of technologically advanced and high bandwidth technologies, such as universal mobile telecommunications system, or UMTS, and long term evolution, or LTE, technologies. Under the Ministry of Communications' policy for the establishment of a wholesale market for fixed-line telephony and broadband Internet infrastructure access, Bezeq will be required to provide access to its fixed-line broadband Internet network infrastructure to other service providers on a wholesale basis, which may increase competition in the fixed-line broadband Internet infrastructure access market.

HOT has not provided wholesale services as yet because of the absence of the approval of a pricing structure by the Ministry of Communications. On January 14, 2016, the Ministry of Communications published guidelines to determine the maximum tariffs for wholesale services on HOT's network.

The Internet segment is characterized by high rates of penetration, as a result of the deployment of a national access infrastructure. Bezeq's main competitor in this area is HOT and Bezeq is also exposed to competition from the cellular companies. Upon implementation of a wholesale market, ISPs and unified general license holders will be able to compete with Bezeq, by providing packages of services, including broadband services, using Bezeq's infrastructures, at wholesale tariffs. In addition, following the decision regarding wholesale telephony services for resale, unified license holders authorized to provide domestic carrier services will also be able to include telephony services in their packages.

In the transmission and data-communications sector, Bezeq competes mainly with HOT Telecom, Cellcom and Partner, who operate as communication groups and provide full communications solutions to their customers.

Competition in the industry depends on a number of factors, such as regulatory decisions, possible changes in the terms of the licenses of Bezeq and its subsidiaries, and in the terms of the licenses of their competitors, mergers and joint ventures between companies that compete with the Bezeq Group, possible repercussions of the Concentration Law, further development of the wholesale market, the lack of symmetry between the Bezeq Group and its competitors' ability to provide a comprehensive service, the new services that Bezeq will be permitted to provide, the tariff policy, the extent of flexibility allowed to the Bezeq Group when offering service bundles and technological developments.

In addition to HOT's cable and optical fiber network and the optical fiber infrastructures of Cellcom and Partner, there are a number of infrastructures in Israel today that have the potential to serve as communications infrastructures based on optical fibers. These infrastructures are mostly owned by government companies and bodies, including the infrastructures of the Israel Electric Corporation, or IEC, Israel Railways, Mekorot Israel National Water Company, or Mekorot, Petroleum & Energy Infrastructure Ltd. and Cross Israel Highway Ltd. Some municipalities are also trying to create an alternative to communications license holders by deploying their own infrastructures.

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

At the same time, IBC received a special license for the provision of domestic fixed data-communication services, according to which it is entitled to provide IP/VPN services and broadband data-communication lines for a period of five years (with the option to request an extension). This special license does not necessitate the provision of universal services to all the residents in Israel.

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

*Cellular Telephony.* There are five operators with cellular licenses operating in the cellular communications market in Israel today (Pelephone, Cellcom, Partner, Golan Telecom and HOT Mobile) and a few MVNO operators with cellular licenses for hosting on another network, the principal MVNO is Rami Levy. The entry of new operators into the market since 2012 has led to fierce competition resulting in higher subscriber churn rates, significant price erosion and eroded margins.

In 2012, subsequent to the Ministry of Communications gaining the right to allocate new frequencies and operating licenses, Golan Telecom began operating as a new operator and HOT Mobile began operating a UMTS network. As a condition to the issuance of their licenses, the new operators undertook to establish independent nationwide networks (with temporary hosting on existing networks on a domestic roaming basis).

In January 2015, under the 4G frequency tender, Marathon 018 Ltd. was awarded a 5MHz bandwidth frequency, subject to compliance with the requirements under the tender. If Marathon 018 receives a cellular operator license, it will become the sixth non-MVNO operator.

In November 2015, Cellcom entered into an agreement with Golan Telecom to acquire 100% of Golan Telecom's subscribers. If approved, this agreement will reduce the number of infrastructure operators to four (or five if Marathon 018 is added). Golan Telecom has not yet complied with its commitment to establish a nationwide independent network. If this agreement is not approved, Golan Telecom will be required to operate on an infrastructure sharing basis.

In April 2015, the Minister approved a network sharing agreement between Partner and HOT Mobile to operate active radio segment infrastructures. Subsequent to gaining the approval, Partner and HOT Mobile established a joint company that received a special license to provide cellular radio infrastructure services to a MVNO operator. This license is valid for 10 years. In September 2014, Pelephone entered into a collaboration agreement with Cellcom for the maintenance of passive components at the cellular sites owned by the two companies, which is expected to reduce maintenance costs at these sites. The agreement provides for maintenance of the shared sites through a supplier that will be selected by Pelephone and Cellcom.

*International Telephony.* The ILD market in Israel is characterized by a high degree of competition. At the end of 2015, there were eight companies offering ILD services to private and business customers in Israel. Changes in licensing policies and the expanded use of VoIP technology have significantly reduced the barriers of entry into this market. In addition, cellular telephony operators now offer ILD services as part of the unlimited packages they offered. Further, a recent hearing published by the Ministry of Communications proposes the adoption of a new regulatory regime allowing domestic fixed-line operators and cellular telephony operators to provide ILD services as part of the service packages they offer to their subscribers. We expect competition in this market, including price competition, to increase in the future.

*Internet Service Providers.* Access to broadband Internet in Israel requires households to purchase Internet access services from a licensed ISP and broadband Internet infrastructure access services from a separate provider. While there are only two fixed-line broadband Internet infrastructure access service providers in Israel (Bezeq and HOT), many telecommunication companies hold ISP licenses in Israel, including Bezeq International, 013 Netvision (which merged with Cellcom), 012 Smile (which merged with Partner), HOT Net and numerous minor niche players. The Israeli ISP market is a saturated market and as competitors are typically unable to differentiate themselves based on price, they attempt to differentiate themselves primarily by strengthening customer loyalty; however, competition has led to increased churn rates and reduced income per customer.

*Pay Television.* The Israeli television market is characterized by a very high penetration rate and an increasing emphasis on new television technology, in particular digital, HD and interactive television services, such as Video on Demand, or VOD, requiring high-bandwidth and bi-directional distribution platforms. In the multi-channel pay television market, DBS and HOT are the only two companies in Israel licensed to provide multi-channel pay television broadcasts. Other factors impacting competition in the market include the availability of free-to-air digital terrestrial television, or DTT, channels and the increasing availability and quality of video content offered over the Internet and cellular networks, which is not currently regulated and does not require designated infrastructure. We believe that the implementation of certain regulatory changes, including the expansion in the number and variety of free-to-air DTT channels and the possible appointment of a private entity to operate the DTT system instead of the Second Authority, which is the public authority that supervises commercial broadcasting in Israel, may increase competition in the television market.

There can be no assurance that the measures taken by the Bezeq Group companies to streamline their operations and improve the services they provide to differentiate themselves from their competitors will be successful. If the Bezeq Group companies are unsuccessful in their efforts, the Bezeq Group's business, financial condition and results of operations could be adversely affected.

**The Bezeq Group operates in a highly regulated telecommunications market, which limits its flexibility in managing its business and may materially and adversely affect our results of operations.**

The Bezeq Group operates in a highly regulated industry in Israel, which limits its flexibility in managing its business efficiently, and may increase its administrative and operational expenses and limit its revenue. The Bezeq Group is subject to government supervision and regulation relating to, among other things:

- regulations requiring structural separation between the members of the Bezeq Group;
- regulations restricting the Bezeq Group's ability to market bundles;
- price regulation for certain services that the Bezeq Group provides;
- rules and regulations imposed on telecommunications service providers with significant market share;
- rules governing the interconnection between different telephone networks and the interconnection rates that the Bezeq Group can charge and pay;
- regulations governing the prohibition of exit-fees or cancellation charges;
- regulations requiring the Bezeq Group to grant other telecommunications operators access to its infrastructure;
- regulations governing roaming charges and other billing and customer service matters;
- rules for authorizations, licensing, acquisitions, renewals, pledging and transfers of licenses;
- requirements covering a variety of operational areas such as land use, health and safety and environmental protection, technical standards and subscriber service requirements rules and regulations relating to subscriber privacy;
- rules and regulations relating to universal service provision and requirements to extend the Bezeq Group's services to areas of Israel even where it is not economically profitable to do so; and
- regulations restricting the number of television channels DBS can own and specifying the minimum investment DBS is required to make in local content productions.

**Bezeq's tariffs for its fixed-line services are subject to government control, which harms its ability to compete and places downward pressure on its tariffs, which adversely affects its business.**

Bezeq's tariffs for its main services (including interconnect fees) are subject to government control and intervention. The Minister is authorized to intervene in existing tariffs and marketing offerings and impose directives on Bezeq. On average, Bezeq's controlled tariffs erode in real terms. Significant changes in controlled tariffs, if implemented, could have a materially adverse effect on Bezeq's business and financial results. Furthermore, the limitations applicable to Bezeq in marketing alternative tariff packages could create difficulties for Bezeq in offering an appropriate competitive response to changes in the market. In the context of the application of a wholesale market, the Ministry of Communications has the power to set the price for which Bezeq will sell its services to license holders. The low prices determined may adversely affect Bezeq's level of revenues and profits.

**The Bezeq Group is subject to restrictions on intercompany relations with its principal subsidiaries, which harms its ability to compete and adversely affects its business.**

Bezeq's general license for domestic fixed-line communication services obligates it to ensure that its relationships with its principal subsidiaries do not result in favoring them over their competitors. Bezeq is also subject to various limitations as a result of the State of Israel declaring it a monopoly in the fixed-line services business. In addition, Bezeq is subject to limitations set forth in merger approvals granted by the Israeli Antitrust Authority. As a result of such limitations, separation of Bezeq and its principal subsidiaries' management, financial and marketing systems, assets and employees is required, which results in high administrative overheads. Bezeq is also subject to limitations with respect to the offering of bundles with its principal subsidiaries, which adversely impacts its business, particularly in light of the entry into the market of communications companies competing directly with Bezeq in most of its areas of operation based on the provision of bundled services to the customer.

**Potential health risks related to cellular network sites and cellular telecommunication devices could have a material adverse effect on Pelephone's business, results of operations and financial condition.**

Several lawsuits have been filed against cellular telephony operators and other participants in the cellular industry alleging adverse health effects and other claims relating to radio frequency transmissions to and from sites, handsets and other cellular telecommunications devices, including lawsuits against Pelephone. Although these lawsuits were settled during 2013 with no material expenses incurred, there can be no guarantee that potential future lawsuits will have favorable outcomes. Any exposure to such liabilities could have a material adverse impact on our business, results of operations and financial condition.

Pelephone takes steps to ensure that the levels of radiation emitted by its transmission facilities, equipment and devices do not exceed the levels of radiation permitted in the directives of the Israeli Ministry of Environmental Protection which align with international standards. However, health risks may be found to exist and transmission sites or devices and equipment may emit more radiation than that allowed in radiation standards, causing a risk to health, which may have an adverse effect on Pelephone's business and could result in a reduction in the use of cellular telephony services, difficulty in renting sites, claims for physical and property damages in substantial amounts and attempts to exercise the deeds of indemnity that Pelephone deposited with the planning authorities pursuant to the Planning and Construction Law. Pelephone's third-party liability insurance policy does not currently cover electromagnetic radiation.

Under the Planning and Construction Law, local planning committees may be held liable for the depreciation of the value of nearby properties as a result of approving a building plan or permit. Under the Israeli Radiation Law, the National Council for Planning and Construction requires indemnification undertakings from cellular companies as a precondition to obtaining a building permit for new or existing cellular network sites. The National Council has decided that until the national building plan is amended to reflect a different indemnification amount, Pelephone, as well as other cellular telephony operators, will be required to indemnify it in full against all losses resulting from claims for reductions in property values as a result of granting a permit for a cellular site.

**The Bezeq Group may face difficulties in obtaining some of the building and environmental permits required for the establishment and operation of its network sites, which could have an adverse effect on the coverage, quality and capacity of its network.**

The Bezeq Group, mainly with respect to its Pelephone cellular telephony operations, is subject to the Israeli Radiation Law, which regulates the emission of electromagnetic radiation from broadcast facilities. The Israeli Radiation Law prohibits, among other things, the construction or operation of a source of radiation in contravention of any applicable permit and the construction or operation of a source of radiation without a permit. After receiving a written warning from the authorities, failure to remedy a violation will subject the permit holder, officers and directors to civil liability or criminal prosecution on a strict liability basis. While the Bezeq Group is constantly working to obtain or renew permits to set up and operate its various broadcasting installations, the policies maintained by the various regulators and amendments to applicable statutes and standards could adversely impact the infrastructure of such installations. Any such adverse impact could affect the services offered over Pelephone's infrastructure, the result of which could have a material adverse effect on the revenues of the Bezeq Group from such services. The establishment of a broadcasting site without obtaining a building permit constitutes, among other things, a breach of the Planning and Construction Law, and in some instances, this has resulted in demolition orders against sites, indictments or the initiation of civil proceedings against Pelephone and some of its officers. Pelephone has succeeded in most of these instances to avoid demolition or to delay the execution of demolition orders pursuant to arrangements it reached with the planning and building authorities to resolve the lack of licensing. These arrangements have not required any admission of guilt by officers of Pelephone or their conviction. However, it is not certain that this will continue in the future, or that there will be no further instances in which demolition orders are issued and indictments are filed in respect of building permits, including against officers.

The establishment and operation of communications facilities in Israel are also subject to building permits from various planning and building committees, a process that involves a number of approvals from Israeli state entities and regulatory bodies. Bezeq's and Pelephone's inability to obtain such approvals and permits in the future may impair the quality and capacity of their existing networks and the deployment of new networks.

The deployment and manner of set-up of communications facilities in Israel are regulated by the National Outline Plan for Communications 36, or NOP 36, and National Outline Plan for Communications 56 in the Palestinian Administered Territories, or NOP 56. These plans were designed to ensure coverage for transmitting and receiving radio, television and wireless communications, while avoiding radiation hazards, minimizing damage to the environment and simplifying and increasing the efficiency of the processes involved in setting up new facilities.

Difficulties in obtaining approvals for the construction and operation of cellular network sites and other cellular network infrastructure could have an adverse effect on the extent, coverage and capacity of our cellular network, thus impacting the quality of the Bezeq Group's voice and data services and ability to continue to market its products and services effectively.

Pelephone, like the other cellular telephony operators in Israel, provides repeaters, also known as bi-directional amplifiers, to subscribers seeking an interim solution to weak signal reception within specific indoor locations. Due to the lack of a clear policy of the local planning and building authorities, and in light of the practice of the other cellular telephone operators, Pelephone has not requested permits under the Planning and Construction Law for the repeaters. If the local planning and building authorities determine that permits under the Planning and Construction Law are also necessary for the installation of these devices, or any other receptors that Pelephone believes do not require a building permit, it could have a negative impact on its ability to obtain permits for its repeaters.

The construction and operation of a "Source of Radiation" and the provision of a radiation measurement service requires a permit. Bezeq obtained operating permits for the communication facilities and broadcasting sites it operates. Bezeq also took steps to obtain radiation permits for its high-voltage facilities, and permits were received for 27 such high-voltage facilities. Permits for two other facilities are pending. The law includes a punitive chapter under which the construction or operation of a source of radiation in violation of the provisions of the permit and the construction or operation of a source of radiation without a permit, after having been warned in writing, are strict liability offenses.

Approximately 20% of the Bezeq Group's cell sites are wireless access devices that operate in reliance on an exemption from the requirement to obtain a building permit. Bezeq Group's reliance on the exemption for wireless access devices have been challenged and is currently awaiting ruling by the Israeli Supreme Court. Under an interim order issued by the Supreme Court in September 2010, the Bezeq Group is unable to further construct wireless access devices in cellular networks in reliance on the exemption. Under a decision of the Supreme Court of February 2011, the order will not apply to the replacement of existing wireless access devices under certain conditions. In September 2011, the interim order was relaxed to allow two new UMTS operators, Hot Mobile and Golan Telecom, to construct wireless access devices in reliance on the exemption until July 31, 2012 and was thereafter extended several times.

Should the Israeli Supreme Court determine that all wireless access devices without building permits must be removed, it could have a negative impact on Pelephone and the Bezeq Group.

**The Bezeq Group's systems and operations are vulnerable to damage or interruption, which could expose it to material risk of loss or litigation.**

The Bezeq Group provides services using various infrastructure systems that include exchanges, transmission, data communication and access systems, cables and computerized systems. Any failure to manage the growth and complexity of the Bezeq Group's networks could lead to a degradation of service and network disruptions that could harm its reputation and result in a loss of subscribers.

Under its cellular license and the Wireless Telegraph Ordinance, Pelephone has rights of use of frequencies in the 850 MHz spectrum for operating its CDMA network, and in the 850 MHz and 2100 MHz spectrums to operate its UMTS/HSPA network, and in the 1800 MHz spectrum for operating its LTE technology network. The frequencies assigned to Pelephone are exposed to interruptions that could impair the service quality of the networks that it operates.

Although some of the Bezeq Group's systems have backup, damage to some or all of these systems, whether due to a technical fault or natural disaster, could cause extreme difficulties in providing services. If any part of the Bezeq Group's infrastructure, including its IT systems, cellular information systems, communications lines, antenna sites, equipment or technology becomes subject to a flood, fire, other natural disaster, terrorism, acts of war, a computer virus, a power loss, material bugs in software or other catastrophe or unauthorized access, its operations and customer relations could be materially adversely affected. In addition, disaster recovery, security and service continuity protection measures that the Bezeq Group companies have, or may in the future undertake, and their monitoring of network performance, may be insufficient to prevent losses.

Although no incidents have occurred in numbers that are statistically significant, the Bezeq Group's networks and other technical equipment have been, and may continue to be, subject to occasional malfunctions due to material bugs in software or technical shortcomings or imperfect interfaces with equipment in private homes, the networks of other operators or its own networks or with other surrounding equipment. The Bezeq Group might incur liabilities or reputational damages as a result of such malfunctions.

In addition, the Bezeq Group accumulates, stores and uses data in the ordinary course of its operations that is protected by data protection laws. Although the Bezeq Group takes precautions to protect subscriber and employee data in accordance with the applicable Israeli privacy requirements, it may fail to do so, and certain subscriber and employee data may be leaked or otherwise used inappropriately. Violation of data protection laws may result in fines, loss of reputation and subscriber churn and could have an adverse effect on the Bezeq Group's business, financial condition and results of operations.

**Bezeq Group companies are parties to legal proceedings, which could result in them being ordered to pay significant sums.**

The Bezeq Group companies are parties to legal proceedings, including class actions, which could result in them being ordered to pay significant sums, the amount of which cannot be estimated. Class action claims can relate to a small loss for a single customer and yet can become a material claim for the Bezeq Group, if certified as a class action applicable to all customers or a significant portion of them. In addition, since Bezeq provides communications infrastructure as well as billing services to other licensees, parties suing those licensees in other class actions may also try to involve Bezeq as a party to such proceedings.

**The markets in which the Bezeq Group operates are characterized by material capital investments in infrastructure, subscriber equipment and changing technology, which imposes a heavy financial burden on the Bezeq Group and consequently, its capital expenditures may not generate a positive return.**

The markets in which the Bezeq Group operates are characterized by material capital investments in infrastructure and subscriber equipment as a result of changing technology. The frequent technological changes in infrastructure and terminal equipment and the intense competition in various market segments impose a heavy financial burden on the companies operating in the telecommunications market, requiring them to update their infrastructure technology from time to time or to introduce new devices into the market at heavy cost. The development of new technologies can render existing technologies obsolete, resulting in the need for large monetary investments in order to retain a competitive position. The Bezeq Group's future success will depend on its ability to develop and introduce, on a timely and cost-effective basis, new infrastructure and subscriber equipment that keep pace with technological developments. If the Bezeq Group is unable to respond promptly and effectively to changing technology, it will be unable to compete effectively in the future and its business could be adversely affected. No assurance can be given that the Bezeq Group's recent or future capital expenditures will generate a positive return or that it will have adequate capital available to finance such future upgrades. If the Bezeq Group is unable to, or elects not to, pay for costs associated with expanding or upgrading its networks, or making other capital expenditures, its growth and competitive position could be materially adversely affected.

**The Bezeq Group requires licenses from the Ministry of Communications to operate its business and is subject to monitoring and enforcement by the regulator.**

The Bezeq Group conducts its operations pursuant to licenses granted by the Ministry of Communications for specified periods, which may be extended for additional periods upon request. There is no certainty that such licenses will be renewed or extended in the future and any cancellation or change in the terms of the Bezeq Group's licenses may materially affect its business and results of operations, including the immediate acceleration of some of its debt.

Although we believe that the Bezeq Group is currently in compliance with all material requirements of its licenses, the interpretation and application of the technical standards used to measure these requirements, including the minimum quality standards and other license provisions, disagreements may arise in the future between the Ministry of Communications and the Bezeq Group. In addition, following recent amendments to the Communications Law introducing administrative enforcement, the Bezeq Group may be subjected to administrative enforcement proceedings and monetary sanctions. The Bezeq Group has provided significant bank guarantees to the Ministry of Communications to guarantee its performance under its licenses. If the Bezeq Group is found to be in material breach of its licenses, the guarantees may be forfeited and the licenses may be revoked. In addition, the Ministry of Communications is authorized to levy significant fines for breaches of the Bezeq Group's licenses, which could have a material adverse effect on the Bezeq Group's financial condition or results of operations.

Under the Concentration Law, Bezeq and each corporation owned by Bezeq and by the Eurocom Group (a private telecommunications group in Israel that has investments in telecommunications, satellite services, media, consumer electronic products, real estate, financial services and additional fields) is deemed a "Concentrating Entity," within the meaning of the Concentration Law. In addition, DBS is deemed to be an influential entity in the broadcasting field and, as a result, it too is deemed a "Concentrating Entity." Accordingly, each award of rights (including the award of a license) by a governmental authority in an "Essential Infrastructure Field," within the meaning of the Concentration Law, and the extension of existing licenses held by any of the Bezeq Group companies, are subject to the procedures set out in the Concentration Law, including the consideration of control concentration factors and factors relating to the promotion of an industry's competitiveness, as well as consulting with the Committee for Reducing Concentration. The governmental authority and the Committee are obliged to consider, among other things, factors concerning the prevention of the expansion of the operations of the "Concentrating Entity." If, as a result of the implementation of the procedures under the Concentration Law, a license is not granted to a Bezeq Group company or an existing license is not extended, the Bezeq Group's business could be adversely impacted. Furthermore, some of the competitors of the Bezeq Group companies are not, and future competitors may not, be deemed a Concentrating Entity and therefore, are not subject to the foregoing restricting procedures which could give them a competitive advantage over the Bezeq Group companies.

**The Bezeq Group's brands are subject to reputational risks.**

The Bezeq Group's brands are well recognized in Israel. The Bezeq Group companies, including Bezeq, Pelephone, Bezeq International and DBS, have developed their brands through extensive marketing campaigns, website promotions, customer referrals, and the use of sales forces and dealer networks. The Bezeq Group's brands represent a material and valuable asset. Although the Bezeq Group companies try to manage their brands, we cannot guarantee that such brands will not be damaged by any inability to remain technologically competitive, by circumstances that are external their control or by third parties with a resulting negative impact on the Bezeq Group's activities.

**The Bezeq Group's results of operations are subject to market risks such as currency fluctuations, inflation in Israel and the general economic environment and financial condition of the capital markets in Israel and worldwide.**

The Bezeq Group's results of operations are subject to market risks such as currency fluctuations, the general economic conditions, inflation in Israel and the financial condition of the capital market in Israel and worldwide. The Bezeq Group measures exposure to changes in exchange rates and inflation by the surplus or deficit of assets against liabilities. In addition, Bezeq is exposed to inflationary changes in Israel as well as to market risks associated with changes to the interest rates relating to its borrowings. In addition, Bezeq's tariff updating mechanism, which is subject to government regulation, is reviewed once a year and is influenced by the Israeli Consumer Price Index, or CPI. As a result, the annual rate of inflation and its distribution during the year can have a material influence on the erosion of Bezeq's tariffs and its revenues and expenses during the year, which in turn could have a material adverse impact on its operating results.

From time to time, the Bezeq Group engages in currency hedging transactions to reduce the impact on its cash flows and results of operations of currency fluctuations. The Bezeq Group recognizes freestanding derivative financial instruments as either assets or liabilities in the statements of financial position and it measures those instruments at fair value. However, accounting for changes in the fair value of a derivative instrument, such as a currency hedging instrument, depends on the intended use of the derivative instrument and the resulting designation. For derivative instruments that are not designated as cash flow hedges, changes in fair value are recognized in our income statement without any reference to the change in value of the related budgeted expenditures. These differences could result in fluctuations in our quarterly results of operations.

Negative developments in, or the general weakness of, Israel's economy, in particular increasing levels of unemployment, may have a direct negative impact on the spending patterns of retail consumers, both in terms of the products they subscribe for and usage levels. Because a substantial portion of the Bezeq Group's revenue is derived from residential subscribers who may be impacted by these conditions, such conditions may make it more difficult for the Bezeq Group to attract new subscribers, more likely that certain of its subscribers will downgrade or disconnect their services and make it more difficult to maintain ARPU's at existing levels. In addition, there can be no assurance that deterioration in the Israeli economy would not lead to a higher number of customers defaulting on their contracts or increased levels of service disconnections. Therefore, a weak economy and negative economic developments may jeopardize the Bezeq Group's growth targets and may have a material adverse effect on the Bezeq Group's business, financial condition and results of operations.

**The Bezeq Group could be subject to labor disruptions that interfere with its operations and adversely affect the Bezeq Group's business, financial condition and results of operations.**

The Bezeq Group could be subject to labor disputes and adverse employee relations which could disrupt its operations and adversely affect its business, financial condition and results of operations. A significant portion of its employees is represented by labor unions, and it is possible that such employees, and our other employees, could attempt to take collective action against companies in the Bezeq Group if they are unhappy with their employment conditions. Existing employment agreements with the employees and labor union agreements may not prevent a strike or work stoppage in the future. There can be no assurance that the Bezeq Group will not experience labor disputes and/or adverse employee relations in the future.

**The Bezeq Group depends on hardware, software and other providers of outsourced services, who may discontinue their services or products, seek to charge prices that are not competitive or choose not to renew their contracts.**

The Bezeq Group has important relationships with several suppliers of hardware, software and related services that are used to operate its businesses. In certain cases, substantial investments have been made in the equipment or software of a particular supplier, making it difficult to quickly change supply and maintenance relationships in the event that the initial supplier refuses to offer favorable prices or ceases to produce equipment or provide the support that the Bezeq Group requires. Further, in the event that hardware or software products or related services are defective, it may be difficult or impossible to enforce recourse claims against suppliers, especially if warranties included in contracts with suppliers have expired or are exceeded by those in the Bezeq Group companies' contracts with their subscribers, in individual cases, or if the suppliers are insolvent, in whole or in part. In addition, there can be no assurances that the Bezeq Group will be able to obtain the hardware, software and services it needs for the operation of its business, in a timely manner, at competitive terms and in adequate amounts. The Bezeq Group's ability to renew its existing contracts with suppliers of products or services, or enter into new contractual relationships upon the expiration of such contracts, either on commercially attractive terms, or at all, depends on a range of commercial and operational factors and events, which may be beyond its control. The occurrence of any of these risks could create technical problems, damage the Bezeq Group's reputation, result in the loss of customer relationships and have a material adverse effect on its business, financial condition and results of operations.

**The Bezeq Group may be subject to claims of intellectual property infringement, which could have an adverse impact on its businesses or operating results.**

The Bezeq Group is subject to the risk of intellectual property rights claims against it. The Bezeq Group has in the past and may in the future be subject to claims of infringement or misappropriation of other parties' proprietary rights. In addition to claims relating to broadcasts on channels DBS owns, it may be subject to intellectual property infringement claims with respect to programs broadcast on foreign channels that it carries. Successful challenges to DBS's rights to intellectual property could require DBS to enter into royalty or licensing agreements on unfavorable terms, incur substantial monetary liability or be enjoined preliminarily or permanently from further use of the intellectual property in question. This could require a change in business practices and limit the ability to provide customers with the content that they expect. If DBS is required to take any of these actions, it could have an adverse impact on its businesses or operating results.

Even if the claims of intellectual property infringement are without merit, defending against the claims can be time-consuming and costly and divert management's attention and resources away from its businesses. Israeli law relating to intellectual property contains provisions allowing the owner of an intellectual property right to apply to Israeli courts to grant various enforcement measures and other remedies, such as temporary and permanent injunctive relief and a right to confiscate infringing goods and damages. If any of these claims succeed, the Bezeq Group may be forced to pay damages or may be required to obtain licenses for the infringing product or service and may incur liabilities or reputational damages as a result. If the Bezeq Group cannot obtain all necessary licenses on commercially reasonable terms, it may be forced to stop using or selling the products and services, which could adversely affect its ability to provide certain services and products.

**Barriers to entry in the Israeli domestic fixed-line communications segment have lessened considerably in recent years.**

Operating in the Israeli domestic fixed-line communications segment requires receipt of the appropriate domestic fixed-line licenses. Traditionally, the main barrier to entry in this segment arose from the need for heavy investment in technological infrastructure and in surrounding systems, which were necessary to achieve economies of scale, and from high costs involving the establishment of marketing, sales, collection and customer support systems and the building of a brand. In recent years, these traditional barriers to entry into the Bezeq Group's segments of operation have lessened considerably as a result of the following factors: technological improvements, lower infrastructure and equipment prices, easing of regulations applying to new competitors and the mandatory obligation to allow Bezeq's competitors to use the fixed-line infrastructures and services of Bezeq and HOT.



In August 2013, IBC, a telecommunications joint venture between the government-owned IEC and a consortium of non-government companies that was selected by the IEC in a tender procedure, was granted a general license for the provision of telecommunications infrastructure services (including data services, digital transmissions and VPN) via fiber optic networks to telecommunication services providers. According to the license, IBC will enter into an agreement with the IEC to use the IEC's fiber optic network in Israel to provide such wholesale products to telecommunication services providers. If IBC is successful, it would compete with Bezeq and HOT in the wholesale market, as well as providing such services directly to large business customers. IBC has begun operating in several cities. Unlike the other communications groups, Bezeq Group is at present, subject to the stricter limitations.

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

**If DBS is unable to obtain attractive programming on satisfactory terms for its pay television services, the demand for these services could be reduced, which could adversely affect its revenue and profitability.**

The success of DBS's services depends on access to an attractive selection of television programming from content providers. The ability to provide movie, sports, popular series and other programming, including VOD content, is a major factor that attracts subscribers to pay television services, especially premium services. If DBS was unable to obtain high-quality content, it could limit DBS's ability to incentivize customers to migrate from lower priced packages to higher tier programming, which would inhibit its ability to execute its business strategy. Furthermore, there can be no assurance that DBS will continue to be able to obtain an attractive selection of television programming, obtain exclusive rights to certain programming, or that the local content that DBS provides will continue to be successful. Any or all of these factors could result in reduced demand for, and lower revenue and profitability from, DBS's satellite broadcast services.

**Adverse decisions of tax authorities or changes in tax treaties, laws, rules or interpretations could have a material adverse effect on the Bezeq Group's results of operations and cash flow.**

The tax laws and regulations in Israel may be subject to change and there may be changes in interpretation and enforcement of tax law. As a result, we and the Bezeq Group may face increases in taxes payable if tax rates increase, or if tax laws and regulations are modified by the competent authorities in an adverse manner. We regularly assess the likelihood of such outcomes and have established tax provisions which represent management's best estimate of the potential assessments. The Israeli Tax Authority may challenge certain positions that we and the Bezeq Group have adopted in the past or that we and the Bezeq Group may adopt in the future. The resolution of any of these tax matters could differ from the amount we or Bezeq have reserved, which could have a material adverse effect on our cash flows, business, financial condition and results of operations.

**Our success depends on the continued service of certain key executives and personnel.**

The Bezeq Group's key executives and employees possess substantial knowledge of its business and operations. We cannot assure you that the Bezeq Group will be successful in retaining their services or that the Bezeq Group would be successful in hiring and training suitable replacements without undue costs or delays. As a result, the loss of any of these key executives and employees could cause significant disruptions in the Bezeq Group's business operations, which could materially adversely affect our results of operations.

#### **Risks Related to Our Company**

**We and B Communications have a substantial amount of existing debt, which could restrict our financing and operating flexibility and have other adverse consequences; our ability to repay our debt may be affected by Bezeq's dividend distribution policy and the amount of dividends paid by Bezeq.**

We and B Communications have a substantial amount of indebtedness. As of April 18, 2016, we and B Communications had approximately NIS 4.5 billion (approximately \$1.1 billion) of debt. This significant level of debt could have important consequences, including, but not limited to, the following:

- making it more difficult for us to service our debt obligations and liabilities;
- making us vulnerable to, and reducing our flexibility to respond to, general adverse economic and industry conditions;
- requiring that a substantial portion of our cash flows from operations be dedicated to servicing debt, thereby reducing the funds available to us to fund working capital, or other general corporate purposes;

- impeding our ability to obtain additional debt or equity financing and increasing the cost of any such borrowing, particularly due to the financial and other restrictive covenants contained in the agreements governing our debt; and
- adversely affecting public perception of us.

**The agreements and instruments governing our and B Communications' debt contain restrictions and limitations that could adversely affect our ability to operate our business.**

The terms of the indentures governing our and B Communications' debt contain, a number of significant covenants or other provisions that could adversely affect our and B Communications' ability to operate our businesses. These covenants restrict our and B Communications' ability to, among other things:

- incur or guarantee additional indebtedness and issue certain preferred stock;
- use the proceeds of any dividends received from the Bezeq Group and make certain restricted payments and investments;
- create or incur certain liens;
- impose restrictions on the ability of our subsidiaries to pay dividends or other payments to us; transfer or sell ownership interests in the Bezeq Group;
- merge or consolidate with other entities;
- impair the security interest for the benefit of holders of the Notes; and
- enter into transactions with affiliates.

All of these limitations will be subject to significant exceptions and qualifications, including the ability to pay dividends, make investments or to make significant prepayments of shareholder debt. However, these covenants could limit our ability to finance our future operations and our ability to pursue business opportunities and activities that may be in our interest. In addition, our ability to comply with these restrictions may be affected by events beyond our control. In addition to limiting our flexibility in operating our business, the breach of any covenants or obligations under the agreements and instruments governing our debt will result in a default under the applicable debt agreement or instrument and could trigger acceleration of the related debt, which in turn could trigger defaults under other agreements governing our debt. If we or B Communications are unable to repay those amounts, our creditors could proceed against any collateral granted to them to secure repayment of those amounts. As a result, a default under any of the agreements governing our and B Communications' debt could materially adversely affect our growth, financial condition and results of operations.

**Our operating results may be adversely affected by significant fluctuations in the exchange rate between the U.S. dollar and the NIS, fluctuations in the Israeli consumer price index and in interest rates.**

We report our financial results in NIS. Bezeq receives payments in NIS for most of its sales. As a result, fluctuations in rates of exchange between NIS and the U.S. dollar may affect our operating results and financial condition. As a result of B Communications' issuance of 7¼% Senior Secured Notes in February 2014, it incurred \$800 million of U.S. denominated debt that is subject to exchange rate fluctuations. Although we have entered into certain hedging arrangements to protect against certain foreign currency exchange rate risks associated with the Notes, such hedging activities may be ineffective or may not offset more than a portion of the adverse financial impact resulting from foreign currency variations. Gains or losses associated with hedging activities also may negatively impact operating results. In addition, if one (or more) of our counterparties falls into bankruptcy, claims we have under any such hedging arrangements may become worthless. In addition, in the event that we refinance our debt or otherwise terminate hedging agreements, we may be required to make termination payments, which would result in a loss.

**We, B Communications, and other members of the Eurocom Group are subject to the Control Permit for holding the controlling interest in Bezeq. Failure to comply with this permit or other regulatory provisions relating to the control of Bezeq may result in the revocation of the Control Permit and our rights with respect to our Bezeq interest would be adversely impacted, which would materially and adversely affect our business and financial position.**

Pursuant to the Communications Order, we were required to obtain the prior written consent of the Ministers in order to obtain a permit to acquire the controlling interest in Bezeq. Under the Communications Order, no person may hold, directly or indirectly, "significant influence" over Bezeq or 5% or more of any particular class of Means of Control in Bezeq, nor may any person, together with any other person, appoint, elect or dismiss the general manager of Bezeq or cause the election, appointment or dismissal of any director of Bezeq, without the prior written consent of the Ministers. Subject to certain exceptions, prior written approval of the Ministers is also required to increase the holdings or other rights in excess of those determined in the initial approval, including by means of an agreement (including a voting agreement). No person may transfer control, "significant influence" or Means of Control in Bezeq to another, if, as a result of the transfer, the holdings of the transferee would require approval pursuant to the Israeli Communications Law or Communications Order and the transferor is aware that the transferee is not in possession of the requisite approval. For the foregoing purposes, "significant influence" means the ability to significantly influence the activity of a corporation, whether alone or together with or through others, directly or indirectly, other than as a result of holding Means of Control in that corporation or in another corporation, and including the ability derived from the corporation's articles of association, a written, oral or other kind of agreement, or from any other source. In this context, the right to appoint an officer or holding 25% of our Means of Control is presumed to confer significant influence. "Means of Control" means the right to vote at a general meeting of the company, appoint a director or general manager of the company, or to participate in the profits of the company or a share of the remaining assets of the company after payment of its debts upon liquidation.

The Control Permit includes several conditions, including, among others, the requirement that SP2 be controlled exclusively by the other parties to the Control Permit and that the parties to the Control Permit hold not less than 30% of any type of Means of Control of Bezeq and SP2. In February 2011, the Ministers permitted such percentage to decrease to 29% for a period of six months commencing from the date such holdings fall below 30%, in the event of dilution resulting from the exercise of options by Bezeq employees.

Despite the 30% rule, according to Article 3(a3) of the Communications Order, which is included as part of the Control Permit, the parties may hold less than 30% under certain circumstances, including the requirement that the parties control Bezeq and maintain at least a 25% ownership interest in Bezeq.

In addition, the Control Permit requires that 19% of SP2 be held at all times by an "Israeli Party," as defined in the Communications Order. The Control Permit also includes certain notice requirements regarding changes in the composition of the board of directors and certain holdings in us and B Communications. If we, B Communications or any other member of the Eurocom Group subject to the Control Permit fails to comply with the terms of the Control Permit or with other regulatory provisions relating to the control of Bezeq, such permit could be revoked and our rights with respect to our Bezeq interest would be adversely impacted, which would have a material adverse effect on our business and financial position.

Any event in which a receiver is appointed with respect to B Communications' holdings in SP2 or SP2's holdings in Bezeq will constitute grounds for the cancellation of the Control Permit. In addition, in the event that the Ministers determine that a material change in the details included in the application for the Control Permit has occurred or the members to the Control Permit failed to provide requisite notifications in accordance with the Control Permit, and there is a real concern that the essential service provided by Bezeq will be harmed, the Ministers may cancel the Control Permit or set conditions for its continuation pursuant to the provisions of the Israeli Communications Law. In the event that the Control Permit is cancelled and an application to reissue another control permit is denied, our holdings in Bezeq must be liquidated within 15 to 60 days (depending on the cause for such cancellation) pursuant to the Communications Order.

**In accordance with the recently enacted Concentration Law, if either we or B Communications are unable to delist our ordinary shares from the TASE and redeem any publicly held debt or go private prior to December 10, 2019, B Communications will not be permitted to control Bezeq after such date.**

Under the recently enacted Concentration Law, a second-tier company (i.e., a company with publicly held debt or equity securities that is subject to reporting obligations under the Israeli Securities Law and controlled by a first-tier company), is prohibited from controlling another tier company. In the case of existing companies, a second-tier company is entitled to continue to control another tier company that it controlled on the publication date of the Concentration Law for a period of six years from the date of publication of the Concentration Law, i.e., until December 10, 2019. In the event that a second-tier company controls another tier company contrary to the provisions of the Concentration Law, a district court may appoint a trustee, who will be awarded the Means of Control in such tier company for the purpose of selling such Means of Control. The trustee shall act pursuant to the orders of such court with respect to the Means of Control. Such court may, instead of appointing a trustee and under certain circumstances, order that the Means of Control held by the controlling shareholder shall not provide any rights whatsoever. Until the appointment of a trustee by a district court, the Means of Control held by a tier company that illegally controls another tier company shall not grant any voting rights at the illegally held tier company's shareholder meetings. The Concentration Law sets forth certain mechanisms intended to enable a tier company to make various arrangements for the repurchase of its publicly-held shares and the early redemption of publicly-held debt in order to comply with the provisions of the law.

Under the Concentration Law, we are deemed to be a first-tier company, B Communications is deemed to be a second-tier company and Bezeq is deemed to be a third-tier company. Accordingly, if either B Communications or we are unable to redeem any publicly held debt and delist our ordinary shares from the TASE (which would require 90-days' prior notice to the TASE) or go private prior to December 10, 2019, B Communications will not be permitted to control Bezeq after such date and its holdings in Bezeq may be transferred to a trustee for the purpose of selling such holdings. Furthermore, if a trustee is appointed, he may motion a district court to order the cancellation of distributions made by Bezeq prior to his appointment if they are deemed to not be in Bezeq's interest.

**If we do not maintain control of Bezeq we may be deemed to be an “investment company” under the Investment Company Act of 1940, which could materially and adversely affect our business.**

Section 3(a)(1)(A) of the Investment Company Act of 1940, or the Investment Company Act, defines an investment company as any issuer that is, holds itself out as being, or proposes to be, primarily engaged in the business of investing, reinvesting or trading in securities and Section 3(a)(1)(C) of the Investment Company Act defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire “investment securities” (within the meaning of the Investment Company Act) having a value exceeding 40% of the value of the issuer’s total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis. However, an issuer will be deemed not to be an investment company if no more than 45% of the value of such issuer’s total assets (exclusive of government securities and cash items) consists of, and no more than 45% of such issuer’s net income after taxes (for the last four fiscal quarters combined) is derived from, securities other than, among other things, securities issued by companies which are controlled primarily by such issuer. Primary control is presumed if the issuer owns over 25% of the controlled company’s voting securities and the issuer has control greater than that of any other person. Accordingly, so long as we maintain control of Bezeq, we will not be deemed an investment company.

If we were to no longer maintain the control of Bezeq, we could, among other things, be required either (i) to change substantially the manner in which we conduct our operations to avoid being subject to the Investment Company Act or (ii) to register as an investment company. An investment company that is organized under the laws of a foreign country may not register as an investment company, or publicly offer its securities through interstate commerce in the United States, unless the company applies to the Securities and Exchange Commission (the “SEC”), for an order permitting the company to register under the Investment Company Act, and to make a public offering in the United States. The SEC may issue an order granting the application if it finds that, by reason of special circumstances or arrangements, it is both legally and practically feasible effectively to enforce the provisions of the Investment Company Act against the issuer, and further finds that granting the application is otherwise consistent with the public interest and the protection of investors.

If we were required to register as an investment company under the Investment Company Act, we would become subject to substantial regulation with respect to our capital structure (including our ability to use leverage), management, operations, transactions with certain affiliates, reporting, record keeping, voting, proxy and disclosure requirements, and meeting these requirements would be costly, if at all possible.

**We may fail to maintain effective internal control over our financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002, which could have an adverse effect on our financial results and the market price of our ordinary shares.**

Section 404 of the Sarbanes-Oxley Act requires any company subject to the reporting requirements of the U.S. securities laws to do a comprehensive evaluation of its and its combined subsidiaries’ internal control over financial reporting. To comply with this statute, we are required to document and test our internal control over financial reporting and our management is required to assess and issue a report concerning our internal control over financial reporting. The rules governing the standards that must be met for management to assess our internal control over financial reporting are relatively complex and require significant documentation, testing and possible remediation to meet the detailed standards under the rules.

Failure to maintain effective internal control over financial reporting could result in investigation or sanctions by regulatory authorities and could have a material adverse effect on our operating results, investor confidence in our reported financial information and the market price of our ordinary shares.

#### **Risks Related to Our Relationship with Eurocom Communications Ltd.**

**Because Eurocom Communications controls substantially all the voting power of our ordinary shares, investors will not be able to affect the outcome of all shareholder votes.**

Messrs. Shaul and Yossef Elovitch, directly and through their control of Eurocom Communications, beneficially owned 63.80% of our outstanding ordinary shares, as of April 18, 2016. For as long as Eurocom Communications has a controlling interest in our company, it, Mr. Shaul Elovitch, the chairman of our board of directors and the chairman of the board of directors of Eurocom Communications, and the controlling shareholder of Eurocom Communications will have the power to determine or significantly influence the outcome of matters submitted to a vote of our shareholders that require a simple majority, including the power to elect all of the members of our board of directors (except external directors, within the meaning of Israeli law) and will have the ability to exercise a controlling influence over our business and affairs, including any determinations with respect to potential mergers or other business combinations involving us, our acquisition or disposition of assets, our incurrence of indebtedness, our issuance of any additional ordinary shares or other equity securities, our repurchase or redemption of ordinary shares and our payment of dividends. Because the interests of Eurocom Communications and Mr. Elovitch may differ from the interests of our other shareholders, actions taken by Eurocom Communications with respect to us may not be favorable to our other shareholders.

**Conflicts of interest may arise between Eurocom Communications, B Communications, other companies within the Eurocom Group and us that could be resolved in a manner unfavorable to us and result in reduced revenues and income.**

Conflicts of interest may arise between Eurocom Communications, B Communications and us in a number of areas relating to our past and ongoing relationships. Areas in which conflicts of interest between Eurocom Communications, B Communications, and us could arise include, but are not limited to, the following:

- *Cross officerships, directorships and share ownership.* A few of our directors and officers also serve or are employed by Eurocom Communications and/or B Communications. The cross officerships and directorships as well as the ownership interests of our directors and officers in our ordinary shares could create, or appear to create, conflicts of interest when directors and executive officers are faced with decisions that could have different implications for the different companies; and
- *Intercompany transactions.* From time to time, Eurocom Communications, B Communications or other companies within the Eurocom Group may enter into transactions with us or our subsidiaries or other affiliates. Although the terms of any such transactions will be established based upon negotiations between employees of such companies and us and, when appropriate, subject to the approval of our independent directors or a committee of disinterested directors and in some instances a vote of shareholders, the terms of any such transactions may not be as favorable to us or our subsidiaries or affiliates as may otherwise be obtained in arm's-length negotiations with unaffiliated third parties.

#### **Risks Related to Our Ordinary Shares**

##### **Our share price has been volatile and may decrease in the future.**

The market price of our ordinary shares has been subject to significant price movements and could be subject to wide fluctuations in the future in response to factors such as the following, some of which are beyond our control:

- Quarterly variations in our operating results;
- Global economic conditions;
- Price movements in the market price of Bezeq's ordinary shares;
- Operating results that vary from the expectations of securities analysts and investors;
- Changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;
- Regulatory changes that impact pricing of services and competition in Bezeq's markets;
- Changes in market valuations of other communications companies;
- Announcements of technological innovations or new services by Bezeq or its competitors;
- Announcements by Bezeq or its competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;
- Changes in the status of Bezeq's intellectual property rights;
- Announcements by third parties of significant claims or proceedings against us or Bezeq;
- Additions or departures of key personnel;
- Future sales of our ordinary shares; and
- Stock market price and volume fluctuations.

Domestic and international stock markets often experience extreme price and volume fluctuations. Market fluctuations, as well as general political and economic conditions, such as a recession or interest rate or currency rate fluctuations or political events or hostilities in or surrounding Israel, could adversely affect the market price of our ordinary shares.

**We have never paid cash dividends to our shareholders and have not adopted a dividend distribution policy.**

We have never declared or paid cash dividends on our ordinary shares and have not adopted a dividend distribution policy. B Communications' indirect wholly-owned subsidiary, SP2, which directly holds Bezeq's shares and our principal source of revenues and income, is subject to limitations on the payment of dividends under the terms of the financing agreements entered into in connection with its acquisition of the controlling interest in Bezeq. You should not rely on an investment in our company if you require dividend income from your investments.

**There is a significant risk that we are a passive foreign investment company, which would subject our U.S. investors to adverse tax rules.**

For U.S. federal income tax purposes, we would be classified as a passive foreign investment company, or PFIC, for any taxable year in which either: (i) 75% or more of our gross income is passive income or (ii) at least 50% of the average quarterly value of our assets for the taxable year produce or are held for the production of passive income. Based on our current and projected income, assets and activities, there is a significant risk that we are currently a PFIC.

If we were classified as a PFIC for U.S. federal income tax purposes, complex rules would apply to U.S. investors owning our ordinary shares. Such investors could suffer adverse U.S. tax consequences. If eligible, a U.S. investor may avoid many of the negative consequences of the PFIC rules by making a "mark-to-market" election (as explained below) for each taxable year in which our company is a PFIC. For more information please see "Item 10. Additional Information – E. Taxation – United States Federal Income Taxation – Passive Foreign Investment Companies." You are urged to consult your tax advisors regarding the application of the PFIC rules to you.

**Risks Related to the Operations of Bezeq and Our Company in Israel**

**Political, economic and military instability in Israel may disrupt our operations and negatively affect our business condition, harm our results of operations and adversely affect our share price.**

We, B Communications and the Bezeq Group companies are organized and based in the State of Israel and Bezeq derives substantially all of its revenues from markets within the State of Israel. As a result, political, economic and military conditions affecting Israel directly influence us. Since its establishment in 1948, Israel has been involved in a number of armed conflicts with its Arab neighbors and a state of hostility, varying from time to time in intensity and degree, has continued into 2015. In recent years, there was an escalation in violence among Israel, Hamas, the Palestinian Authority and other groups. Also, since 2011, riots and uprisings in several countries in the Middle East and neighboring regions have led to severe political instability in several neighboring states and to a decrease in the regional security situation. Such instability may affect the local and global economy, could negatively affect business conditions and, therefore, could adversely affect our operations. In addition, Iran has threatened to attack Israel and is widely believed to be developing nuclear weapons. Iran is also believed to have a strong influence among extremist groups in areas that neighbor Israel, such as Hamas in Gaza and Hezbollah in Lebanon. Although these matters have not had any material effect on our business and results of operations to date, the regional security situation and worldwide perceptions of it are outside our control and there can be no assurance that these matters will not negatively affect us in the future. Any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in the economic or financial condition of Israel could have a material adverse effect on our business, financial condition and results of operations.

**Our results of operations may be negatively affected by the obligation of our personnel to perform military service.**

Many of the Bezeq Group's and our executive officers and employees in Israel are obligated to perform annual reserve duty in the Israeli Defense Forces and may be called for active duty under emergency circumstances at any time. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Bezeq's operations could be disrupted by the absence for a significant period of one or more of its executive officers or key employees or a significant number of other employees due to military service. Any disruption in Bezeq's operations could adversely affect its business.

**Bezeq may be restricted in the conduct of its operations during periods of national emergency, which could negatively affect its business operations.**

During periods of national emergency, the Minister of Communications and other governmental authorities may issue various instructions regarding the use of Bezeq's network, including the use of the network by the Israeli security forces. In addition, the Israeli Equipment Registration and IDF Mobilization Law, 1987 permits the registration, taking and use of engineering equipment and facilities by Israel's Defense Forces. These actions could adversely affect Bezeq's business operations.

**As a foreign private issuer whose shares are listed on the NASDAQ Global Select Market, we may follow certain home country corporate governance practices instead of certain NASDAQ requirements.**

As a foreign private issuer whose shares are listed on the NASDAQ Global Select Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Stock Market Rules. As a foreign private issuer listed on the NASDAQ Global Select Market, we may follow home country practice with regard to, among other things, the composition of the board of directors, compensation of officers, director nomination process and quorum at shareholders' meetings. In addition, we may follow home country practice instead of the NASDAQ requirement to obtain shareholder approval for certain dilutive events (such as for the establishment or amendment of certain equity-based compensation plans, an issuance that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company and certain acquisitions of the stock or assets of another company). A foreign private issuer that elects to follow a home country practice instead of NASDAQ requirements must submit to NASDAQ in advance a written statement from an independent counsel in such issuer's home country certifying that the issuer's practices are not prohibited by the home country's laws. In addition, a foreign private issuer must disclose in its annual reports filed with the SEC each such requirement that it does not follow and describe the home country practice followed by the issuer instead of any such requirement. Accordingly, our shareholders may not be afforded the same protection as provided under NASDAQ's corporate governance rules.

**Our shareholders may have difficulties enforcing a U.S. judgment against us, our executive officers and directors and some of the experts named in this annual report, or asserting U.S. securities law claims in Israel.**

We are incorporated in Israel and all of our executive officers and directors named in this annual report reside outside the United States. Service of process upon them may be difficult to effect within the United States. Furthermore, all of our assets and most of the assets of our executive officers and directors and some of the experts named in this annual report are located outside the United States. Therefore, a judgment obtained against us or any of them in the United States, including one based on the civil liability provisions of the U.S. federal securities laws, may not be collectible in the United States and may not be enforced by an Israeli court. It also may be difficult for you to assert U.S. securities law claims in original actions instituted in Israel.

**Provisions of Israeli law, the licenses of Bezeq and our articles of association may delay, prevent or make difficult an acquisition of our company, which could prevent a change of control and, therefore, depress the price of our shares.**

Following our acquisition of the controlling interest in Bezeq, we and our shareholders are required to comply with the Communications Law, the Communications Order and regulations promulgated by the Ministry of Communications.

Pursuant to the Communications Order, we were required to obtain the prior written consent of the Ministers in order to acquire the controlling interest in Bezeq. Under the Communications Order, no person may hold, directly or indirectly, "significant influence" over Bezeq or 5% or more of any particular class of means of control in Bezeq, nor may any person, together with any other person, appoint, elect or dismiss the general manager of Bezeq or cause the election, appointment or dismissal of any director of Bezeq, without the prior written consent of the Ministers. Subject to certain exceptions, prior written approval of the Ministers is also required to increase the holdings or other rights in excess of those determined in the initial approval, including by means of an agreement (including a voting agreement). Furthermore, under the Communications Order, no person may transfer control, "significant influence" or means of control in Bezeq to another, if, as a result of the transfer, the holdings of the transferee would require approval pursuant to the Communications Law or Communications Order and the transferee is not in possession of the requisite approval. For the foregoing purposes, "significant influence" means the ability to significantly influence the activity of a corporation, whether alone or together with or through others, directly or indirectly, other than as a result of holding "means of control" in that corporation or in another corporation, and including ability derived from the corporation's articles of association, a written, oral or other kind of agreement, or from any other source. In this context, the right to appoint an officer and holding 25% of our means of control is presumed to confer significant influence. "Means of control" means the right to vote at a general meeting of the company, to appoint a director or general manager of the company, to participate in the profits of the company or a share of the remaining assets of the company after payment of its debts upon liquidation.

Israeli corporate law regulates mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to these types of transactions. Furthermore, Israeli tax considerations may make potential transactions unappealing to us or to some of our shareholders, including Israeli shareholders and shareholders whose country of residence does not have a tax treaty with Israel exempting such shareholders from Israeli tax. For example, Israeli tax law does not recognize tax-free share exchanges to the same extent as U.S. tax law. With respect to mergers, Israeli tax law allows for tax deferral in certain circumstances but makes the deferral contingent on the fulfillment of numerous conditions, including a holding period of two years from the date of the transaction during which sales and dispositions of shares of the participating companies are limited. Moreover, with respect to certain listed share swap transactions, the tax deferral is limited in time, and when the time expires, tax then becomes payable even if no actual disposition of the shares has occurred. These provisions of Israeli law may delay, prevent or make difficult an acquisition of our company, which could prevent a change of control and therefore depress the price of our shares. For additional discussion about some anti-takeover effects of Israeli law, see Item 10B. "Additional Information - Memorandum and Articles of Association" and Item 10E. "Taxation -Israeli Tax Considerations."

**The rights and responsibilities of our shareholders are governed by Israeli law and differ in some respects from those under Delaware law.**

Because we are an Israeli company, the rights and responsibilities of our shareholders are governed by our articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in a Delaware corporation. In particular, a shareholder of an Israeli company has a duty to act in good faith towards the company and other shareholders and to refrain from abusing his, her or its power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli law provides that these duties are applicable to shareholder votes on, among other things, amendments to a company's articles of association, increases in a company's authorized share capital, mergers and interested party transactions requiring shareholder approval. In addition, a shareholder who knows that it possesses the power to determine the outcome of a shareholders' vote or to appoint or prevent the appointment of a director or executive officer of the company has a duty of fairness towards the company. However, Israeli law does not define the substance of this duty of fairness. There is little case law available to assist in understanding the implications of these provisions that govern shareholder behavior.

#### **ITEM 4. INFORMATION ON THE COMPANY**

##### **A. History and Development of the Company**

We were organized under the laws of the State of Israel in April 1992 under the name Euronet Golden Lines (1992) Ltd. In June 1999 we changed our name to Internet Gold - Golden Lines Ltd. We are a public limited liability company under the Israeli Companies Law 1999 and our shares are traded on the NASDAQ Global Select Market and TASE. Our registered offices and principal place of business are located at 2 Dov Friedman Street, Ramat Gan 5250301, Israel, and our telephone number is +972-72-924-0000. Our website address is [www.igld.com](http://www.igld.com). The information on our website is not incorporated by reference into this annual report on Form 20-F.

We are a leading communications group in Israel. Our principal subsidiary, B Communications, is the controlling shareholder of Bezeq (TASE: BZEQ), Israel's largest telecommunications provider. Since B Communications' initial public offering in October 2007, its ordinary shares have been listed on the NASDAQ Stock Market (symbol: BCOM) and the TASE, and since January 1, 2011 its ordinary shares are listed on the NASDAQ Global Select Market. We currently own 64.78% of the ordinary shares of B Communications. B Communications maintains a website at [www.bcommunications.co.il](http://www.bcommunications.co.il). The information on B Communications' website is not incorporated by reference into this annual report on Form 20-F.

We began providing Internet access services in 1996, and began offering broadband services in 2001 and traditional voice services in 2004. As part of our internal restructuring in 2006, we transferred our broadband and traditional voice services businesses, which we refer to in this annual report as the legacy communications business, to B Communications (formerly named 012 Smile. Communications), and our media operations to Goldmind Media Ltd. (formerly named 012 Smile.Media). During 2010 and 2011 we sold all of our media assets.

##### **Acquisition of the Controlling Interest in Bezeq**

On April 14, 2010, B Communications completed the acquisition of 30.44% of Bezeq's outstanding shares from Ap.Sb.Ar. Holdings Ltd. for a purchase price of approximately NIS 6.5 billion in cash and became the controlling shareholder of Bezeq. The Bezeq interest was directly acquired by an indirect wholly-owned subsidiary of B Communications. In accordance with the terms of the transaction, effective as of the closing of the acquisition, B Communications designated seven directors to replace the Apax-Saban-Arkin Group's representatives on Bezeq's Board of Directors. We began consolidating Bezeq's financial results into our financial statements effective as of the closing of the acquisition and began reporting the consolidated results in our 2010 second quarter earnings release.

In addition to our ownership of Bezeq shares through B Communications, a total of 1,000,000 ordinary shares of Bezeq are jointly held by Mr. Shaul Elovitch, our controlling shareholder, and his brother, Mr. Yossef Elovitch. Further, 72,360 ordinary shares of Bezeq are held by Ms. Iris Elovitch, the wife of Mr. Elovitch, and 11,556 ordinary shares of Bezeq are held by Ms. Orna Elovitch, the daughter-in-law of Mr. Elovitch.



## Permit to Control Bezeq Granted to Members of the Eurocom Group

As part of B Communications' acquisition of the controlling interest in Bezeq, we, SP2, SP1 and other members of the Eurocom Group applied for authorization to control Bezeq, pursuant to the Communications Law and Communications Order. On April 13, 2010, the control permit was granted subject to the condition that SP2 continues to be controlled exclusively by the other parties to the control permit, referred to as the Companies' Control Permit. Concurrently, a separate control permit was also granted to Messrs. Shaul Elovitch and Yossef Elovitch, our controlling shareholders, referred to as the Individuals' Control Permit.

According to the Companies' Control Permit, the parties (through SP2) must hold not less than 30% of any type of means of control of Bezeq. Such percentage is permitted to decrease to 29% for a period of six months commencing from the date such holdings fall below 30%, in the event of dilution resulting from the exercise of stock options by Bezeq employees. Despite the 30% rule, according to Article 3(a3) of the Communications Order, which is included as part of the Control Permit, the parties to the Control Permit may hold less than 30% under certain circumstances, including the requirement that the parties control Bezeq and maintain at least a 25% ownership interest in Bezeq.

In connection with B Communications' issuance of the 7½% Senior Secured Notes, the Security Agent for such notes was granted a pledge permit which enabled B Communications to pledge the pledged Bezeq Shares and pledged SP2 Shares as collateral for the notes and certain hedging obligations. However, pursuant to the Communications Order and the Pledge Permit, no person (individually and acting in concert with other persons) may directly or indirectly hold, acquire or control, at any given time, more than 10% of the outstanding principal amount of 7½% Senior Secured Notes without first obtaining a permit.

For additional discussion about the Control Permit, see Item 4B. "Information On The Company-Regulatory- *Permit to Control Bezeq Granted to Members of the Eurocom Group.*"

## B. Business Overview

Since April 14, 2010, we have been, through B Communications, the controlling shareholder of Bezeq (TASE: BZEQ), Israel's largest telecommunications provider. Bezeq is the principal provider of communications services in Israel, providing a broad range of telecommunications operations and services, including domestic fixed-line, cellular and international communication services, Internet services, multi-channel television, television and radio broadcasts, satellite broadcasts, customer call centers, maintenance and development of communications infrastructures, provision of communications services to other communications providers and the supply and maintenance of equipment on customer premises, which is referred to as network end point, or NEP services. Bezeq was founded as a government company in 1980 and became a public company in 1990 with its shares traded on the TASE and included in the TA-25 Index.

## Bezeq's Operations

Our principal asset is our controlling interest through B Communications in Bezeq, Israel's largest telecommunications provider based on revenue and subscribers. The Bezeq Group operates the most comprehensive telecommunications infrastructure in Israel, with a broad range of telecommunications services across all of its markets. Through its wholly-owned subsidiaries, the Bezeq Group is a leading provider in Israel of fixed-line telephony services and fixed-line broadband Internet infrastructure access services, cellular telephony services, ISP services, ILD services, international and domestic data transfer and network services and ICT, pay television services and other communications infrastructures and services. In each of these markets, the Bezeq Group holds a significant market share, as indicated in the chart below.

| Bezeq Group Segments | Service   | As of December 31, 2015 |                 |
|----------------------|---|-------------------------|-----------------|
|                      |   | Estimated Market Share  | Market Position |
| Bezeq                | Fixed-Line Telephony (private sector)               | 56.0%                   | 1 of 4          |
|                      | Fixed-Line Telephony (business sector)              | 74.0%                   | 1 of 2          |
|                      | Fixed-Line Broadband Internet Infrastructure Access | 68.0%                   | 1 of 2          |
| Pelephone            | Cellular Telephony                                  | 25.6%                   | 3 of 5          |
| Bezeq International  | ISP   | 44.0%                   | 1 of 4          |
|                      | ILD   | 21.0%                   | —               |
| DBS                  | Pay Television                                      | 44.0%                   | 2 of 2          |

The Bezeq Group had approximately 2.18 million active fixed telephone lines in its fixed-line telephony business, 1.48 million fixed-line broadband Internet infrastructure access services subscribers (retail and wholesale), 2.65 million cellular telephony services subscribers and 635,000 pay television services subscribers as of December 31, 2015. For the year ended December 31, 2015, the Bezeq Group had revenues of NIS 9.99 billion (approximately \$2.56 billion).

The Bezeq Group's diversified telecommunications services are based on highly advanced nationwide infrastructures and are provided by the following segments of the Bezeq Group:

*Domestic Fixed-Line Communications (Bezeq)*

Bezeq is the incumbent and largest provider of fixed-line telephony and fixed-line broadband Internet infrastructure access services in Israel. Its products and services include basic telephony services on domestic telephone lines and associated services and fixed-line broadband Internet infrastructure access services through its nationally deployed, high quality infrastructure network. Bezeq also offers, among other services, transmission and data communication services, services to other communications operators and broadcasting services. Bezeq's new high-speed next generation network, or NGN, is the most advanced fixed-line communications network in Israel. The NGN, which covers 100% of Israeli households, uses VDSL2 technology and enables Bezeq to provide bandwidth of up to 100 Mbps (download) speed, as well as innovative value-added services.

|  | As at and<br>for the<br>year ended<br>December 31,<br>2015<br>(in millions,<br>except<br>percentages)<br>NIS 4,407 |
|--|--|
| <b>Bezeq Domestic Fixed-Line Communications</b>            |  |
| Revenues   |  |
| <b>Fixed-line telephony</b>                                |  |
| Estimated market share <sup>(1)</sup>                      | 65%  |
| Active lines   | 2.181  |
| Churn rate   | 10.1%  |
| <b>Fixed-line broadband Internet infrastructure access</b> |  |
| Estimated market share                                     | 68%  |
| Subscribers  | 1,479  |

(1) As of December 31, 2015, Bezeq's market share in the business and private sectors of the fixed-line telephony market is estimated to be 74% and 56%, respectively.

*Cellular Telephony (Pelephone)*

Pelephone is among the leading cellular telephony services providers in Israel. Pelephone provides cellular telephony services, sells handsets and other end-user equipment, and provides repair services for handsets sold by Pelephone. Pelephone's nationwide 3.5G UMTS/HSPA+ network supports download speeds of up to 42 Mbps and upload speeds of up to 5.7 Mbps, making it one of the fastest, highest quality and most advanced networks in Israel. We believe these network features provide Pelephone with a strong platform to continue to offer a variety of advanced services and products to its customers and to capitalize on the continued increasing demand for smartphones and advanced data services.

The intensified competition in the cellular market has led to subscriber churn and a price war where the operators continuously lower prices to undercut the competition. This has led to substantial erosion of the average revenue per subscriber. This trend continued and even increased in 2015, as average revenue per subscriber decreased by 19% as compared with 2014.

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

The cellular market growth rate is lower due to penetration rate saturation. The penetration rate in Israel at December 31, 2015 was 124%.

|                        | As at and<br>for the<br>year ended<br>December 31,<br>2015 |
|------------------------|--|
| Telephone              | (in millions,<br>except<br>percentages)                    |
| Revenues               | NIS 2,890  |
| Estimated market share | 25.6%  |
| Active lines           | 2.65   |
| Churn rate             | 25.8%  |

*ISP, ILD, Data Services and ICT (Bezeq International)*

Bezeq International is the leading provider of ISP services in Israel and one of Israel's leading providers of ILD and international and domestic data transfer and network services. Bezeq International provides comprehensive communications solutions that include ISP and related value-added services, international and domestic telephony, PBX supply and support, ICT, cloud computing services, data communications and information security, website server hosting and related managed services. Bezeq International also owns the JONAH high-speed submarine optical fiber communications cable system connecting Israel and Europe, which provides increased bandwidth (capacity and speed) and has positioned Bezeq International as the sole ISP in Israel to own and operate an advanced international network.

|                        | As at and<br>for the<br>year ended<br>December 31,<br>2015 |
|------------------------|--|
| Bezeq International    | (in millions,<br>except<br>percentages)                    |
| Revenues               | NIS 1,578  |
| <b>ISP</b>             |  |
| Estimated market share | 44.0%  |
| Churn rate             | 17.3%  |
| <b>ILD</b>             |  |
| Estimated market share | 21.0%  |

*Multi-Channel Pay Television (DBS)*

DBS offers nationwide coverage through its DTH technology and is the only company in Israel licensed to provide multi-channel pay television broadcasts via satellite and is one of only two companies in Israel licensed to provide multi-channel television services, with nation-wide coverage and innovative and advanced technologies, including PVR, VOD and HD television. DBS focuses on creating clear differentiation from its main competitor, HOT, with respect to brand, content and service quality. In addition, DBS has a strong track record of innovative technology development and is a leading provider of value-added services; including hybrid IP and DTH based set-top boxes (including PVR and VOD).

Apart from DBS, the only other broadcasting licensee in the multi-channel television broadcasting sector is HOT which provides cable television services to subscribers, and has a pronounced monopoly under the Antitrust Law in the multi-channel television broadcasting sector. Cellcom Group's Cellcom also operates in the multi-channel television sector, providing television services via the Internet that customers access to view VOD content and a few linear channels (including the DTT content) by either using a special streamer or application.

|                            | As at and<br>for the<br>year ended<br>December 31,<br>2015<br>(in millions,<br>except<br>percentages) |
|----------------------------|---|
| <b>DBS</b>                 |   |
| Revenues                   | NIS 1,774   |
| Estimated market share     | 44.0%   |
| Subscribers (in thousands) | 635   |
| Churn rate                 | 13.9%   |

#### Competitive Strengths

We believe that the following competitive strengths will enable us to retain our customer base, capitalize on growth opportunities and maintain and expand our current market share positions, which we expect to contribute to positive cash flow generation.

***The Bezeq Group is a leading provider of telecommunications services and owner of telecommunications infrastructure in Israel and provides diversified telecommunications offerings across all Israeli telecom markets.***

The Bezeq Group is the largest and the incumbent telecommunications provider in Israel, offering a broad range of services through its advanced, comprehensive and nationwide telecommunications infrastructure. The Bezeq Group holds a leading position in each of the markets in which it operates, with estimated market shares as of December 31, 2015 of 65% in fixed-line telephony, 68% in fixed-line broadband Internet infrastructure access, 25.6% in cellular telephony, 44% in ISP, 21% in ILD and 44% in pay television, based on the numbers of active lines, subscribers or outgoing minutes, as applicable. As a leading provider in each of these markets, the Bezeq Group has been able to maintain its strong performance and benefit from economies of scale. In addition, such leading positions across a diverse range of telecommunications offerings reduce the Bezeq Group's exposure to market and regulatory conditions. For example, the Bezeq Group is able to partially mitigate the negative effects of certain market trends, such as fixed-to-mobile substitution, as a result of its presence in the cellular telephony services market and its ability to capture a share of the growing mobile subscriber base. In addition, the Bezeq Group was able to partially offset a decline in revenues in its cellular telephony segment resulting from regulatory changes instituted in January 2011, which led to a significant reduction in interconnect fee tariffs, as a result of the reduction of the Bezeq Group's expenses for interconnect fees in the fixed-line communications segment.

We believe that the Bezeq Group's ability to maintain a leading position in the Israeli telecommunications market in the face of competitive and regulatory pressures reflects, among other things, the underlying strength of its advanced nationwide network infrastructures, the strength of its brands and its extensive offering of high quality content.

***The Bezeq Group operates in an attractive macroeconomic environment with a developed telecommunications market.***

Israel is a developed, industrialized market characterized by strong macroeconomic fundamentals. Israel is a member of the Organisation for Economic Co-operation and Development, or OECD, and had GDP per capita of \$33,718 in 2014.

The Israeli telecommunications market is highly developed and benefits from favorable dynamics, including high penetration rates across all telecommunications services, high penetration of postpaid contracts in the cellular telephony market, rapid adoption rates of new technologies and significant expenditures on telecommunications services by consumers and businesses. In addition, Israel is expected to experience steady population, which should provide a natural expansion of the addressable market. In particular, Bezeq expects such population trends will lead to a steady demand for fixed-line telephony services in Israel, especially among certain sectors of the growing population in Israel where fixed-line telephony is in widespread use. Furthermore, a relatively young population contributes to the attractiveness of the market, as such consumers typically spend more on telecommunications products and services while also driving increased demand for new technologies. We believe that the potential future growth in the Israeli telecommunications market will be driven by continued strong demand for higher bandwidth, both on the broadband Internet and mobile platforms, and advanced value-added services and technologies across all telecommunications services.

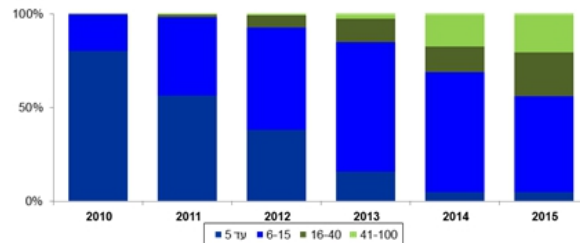
*The Bezeq Group owns advanced nationwide network infrastructures and is positioned at the forefront of technological innovation across all of the telecom markets in Israel.*

The Bezeq Group has historically made substantial investments in its fully owned infrastructure, which is one of the most technologically advanced in Israel and enables the Bezeq Group to reach customers nationwide.

Bezeq has a Next-Generation Network (NGN) based on a core IP network and deployment of an optical fiber network to street cabinets (a network topology known as Fiber to the Curb, or FTTC) and also based on an access network (a system that connects NEPs on the subscriber's premises to the network and engineering systems). Bezeq completed the deployment of the network at the end of 2015. The connection from the home, or the terminal equipment (equipment which is installed on the subscriber's premises, e.g., the actual telephone, private exchanges, fax machines, modems, routers, etc.) through which the subscriber receives the service, to the access network is based on copper cables and optical cables that connect the access systems to the backbone over optic cables (through special pipes or an above ground network) and to a limited degree through wireless systems.

Today, using VDSL2 technology, it is possible to provide a bandwidth of up to 100 Mbps downstream, as well as innovative added-value services. Other advantages of the new technology are simplification of the network structure and better management ability.

The following graph illustrates changes in the surfing speeds of Bezeq's Internet subscribers 2011-2015 (in Mbps at the end of each year):



Pelexphone currently operates communications networks using three main technologies:

- The 4G LTE technology is based on GSM standards. The advantages of this technology are larger data communication capacity and faster download rates than with the 3G technologies. All the terminal devices that support this technology also support the 3G technologies and the transition between the technologies is seamless.
- UMTS/HSPA, a digital technology based on the GSM standard. This technology is globally widespread and enables subscriber identification and services to be provided through a SIM card, which can be moved from one handset to another. The advantage of this technology, inter alia, is that it supports download speeds of up to 42 Mbps and upload speeds of up to 5.7 Mbps. This communication network is Pelexphone's primary network.
- CDMA digital technology. This technology is less prevalent worldwide than UMTS/HSPA and subscriber identification is via identification details burned onto the subscriber's terminal equipment rather than by means of a SIM card. To date, this network serves a limited number of subscribers who seldom use the network. Since the UMTS/HSPA network was launched, Pelexphone is working to transfer existing subscribers from CDMA to UMTS/HSPA, offering to upgrade their handsets to the new network. Pelexphone is not expanding its investment in this network beyond the needs of current maintenance.

In the ISP, ILD, data transfer, networks and ICT services segment, Bezeq International is currently the sole ISP in Israel to own and operate its own high-speed submarine optical fiber communications cable system. The JONAH cable, which was launched in January 2012, has a capacity of over 7.0 Tbps and provides Bezeq International with greater capacity for utilization than any other ISP in Israel. In addition, Bezeq International is able to obtain such capacity at an incremental cost, while other ISPs in Israel are required to purchase capacity and rely on one of the two other cable operators in Israel (MedNautilus and Tamares). The JONAH cable is fully redundant (i.e., utilizes two equipped fiber pairs), and in addition, Bezeq International has available capacity on two alternate submarine routes to Europe.

In the multi-channel pay television segment, DBS is the only licensed provider of multi-channel television broadcasts via satellite in Israel. While DBS relies on third party providers for the provision of satellite capacity, it owns the satellite dishes that carry the signals from such satellites to subscriber residences and set-top boxes. DBS differentiates itself from its main competitor, HOT, by offering a wide range of high quality content and by utilizing technology to be the first pay television services provider to offer new and innovative value-added services to subscribers. For instance, DBS was the first provider in Israel to offer a set-top box that combined PVR, VOD and HD capabilities in one device (branded as "yes MaxTotal"). DBS's PVR offering enables subscribers to download a movie or series to their yes MaxTotal set-top box over the Internet and watch recorded content immediately or at a later time. DBS is also the only provider in Israel that offers a multiroom service allowing subscribers to watch recorded content on multiple capable set-top boxes ("yes MultiRoom") and in 2014 DBS introduced its TV Everywhere service, branded as yesGo, which allows subscribers to watch content from mobile devices. In 2015, DBS began to offer a HDPVR converter known as yesQuattro that allows the recording of up to 4 channels simultaneously, in addition to the channel being viewed, has increased the number shows that may be recorded and allows the automatic recording of prime time content (6:00 PM to midnight) on two channels that the subscriber can select, for seven days (known as PrimeTime service).

DBS also operates its yesGo service, allowing subscribers to view the channels included under the service that they have purchased for home television viewing and VOD content, over a variety of terminal devices (smartphones, tablets and PCs).

At present, there are additional providers (other than Cellcom) that enable VOD viewing through the Internet, such as AppleTV and Netflix (which currently offer content that does not have Hebrew translations). Other entities are considering launching similar services.

***The Bezeq Group's brands are among the strongest and most widely recognized brands in Israel and are supported by its substantial investments in marketing, strong product and service offerings, extensive distribution network and leading customer service offerings.***

The Bezeq Group's brands are among the strongest and most widely recognized brands in Israel, including Bezeq, Pelephone, Bezeq International and DBS. The Bezeq Group's brands have been supported by its sustained and substantial investments in strong product and service offerings, marketing, extensive distribution network and leading customer service offerings. We believe the Bezeq Group's product and service offerings combined with its advanced technology and infrastructure are the key factors driving the association of the Bezeq, Pelephone, Bezeq International and YES brands with reliability, speed, excellent service and innovation throughout Israel. The Bezeq Group's marketing campaigns focus on and highlight various elements regarding each of its brands. For example, Bezeq focuses on the value-added services offered with its fixed-line broadband Internet infrastructure access service, Pelephone highlights the speed of its network, Bezeq International focuses on providing faster Internet speed than its competitors and its strong customer service, and DBS emphasizes its large selection of high quality international content and the subscriber viewing experience associated with it. Furthermore, the Bezeq Group also provides its customers with award winning customer service offerings in order to enhance customer loyalty.

***The Bezeq Group has an extensive offering of high quality content.***

Through its wholly-owned subsidiary, DBS, the Bezeq Group is able to complement its extensive telecommunications infrastructure with a wide array of high quality content. For instance, DBS, which benefits from strong content differentiation in the pay television market, provides a leading selection of television series and movies. With respect to television series, DBS broadcasts new television series at a minimal delay, in some cases within hours from the time the content is originally aired in the United States or worldwide. DBS also has an agreement with HBO pursuant to which DBS aired all of HBO's new English language television series and movies, the majority of which were only aired in Israel on DBS. The Bezeq Group's extensive offering of high quality content distinguishes it from competitors, and we believe that such distinction will likely enhance the Bezeq Group's competitive position if and when the Israeli wholesale market develops and the Bezeq Group's competitors that do not currently offer bundled packages with pay television begin doing so.

***The Bezeq Group's strong cash flow generation supports substantial and consistent dividends while providing for investment in the business and maintenance of a conservative level of leverage.***

The Bezeq Group is a highly cash generative business and has a proven track record of consistent operating cash flow generation. The Bezeq Group's stable, and in some segments, growing customer base and attractive offerings and services, together with its focus on profitability, provide it with strong revenues, Adjusted EBITDA margin and operating cash flow. While generating strong cash flow, the Bezeq Group has continued to invest in its business, technologies and infrastructure through major capital expenditure programs, several of which were completed in the last four years (including, the deployment of Bezeq's NGN, Pelephone's advanced 3.5G UMTS/HSPA+4G cellular network and the launch of Bezeq International's JONAH cable).

The following table sets forth the Bezeq Group's operating cash flow and ratio of capital expenditures to revenues for the years ended December 31, 2013, 2014 and 2015. The operations of DBS have been included for the last nine months in 2015.

|  | Year ended December 31,              |       |       |
|--|--------------------------------------|-------|-------|
|  | 2013                                 | 2014  | 2015  |
|  | (NIS in millions except percentages) |       |       |
| Operating cash flow                        | 4,152                                | 3,796 | 3,740 |
| Capital expenditure, net                   | 916                                  | 1,045 | 1,484 |
| Capital expenditure, net as a % of revenue | 9.6%                                 | 11.5% | 14.9% |

We believe the Bezeq Group has a conservative capital structure and that such conservative capital structure and strong cash flow generation have historically enabled Bezeq to make consistent dividend payments to its shareholders. Since 2006, Bezeq has distributed dividends in an amount equal to 100% of its net income after minority share in each year (and in addition, in each of 2007 and 2011, a special dividend was approved for distribution).

***The Bezeq Group has an experienced management team with a proven track record in the Israeli telecommunications industry.***

The Bezeq Group's management team has significant experience in the telecommunications industry, including with respect to the transformation of telecommunications companies and generating growth. The Bezeq Group's executive management has a proven track record in leading international and domestic technology and telecommunications companies and has successfully delivered efficient operating performance and strong returns for its shareholders despite increasing regulatory hurdles and competition in recent years. In recent years, the Bezeq Group's management has overseen significant investments in infrastructure to position the members of the Bezeq Group at the forefront of technology for the coming years.

***We control B Communications which is the sole controlling shareholder of Bezeq and have a management team with significant experience in developing and operating telecommunications companies.***

B Communications has sole control of Bezeq and, together with us and members of the Eurocom Group, are the only entities or persons that hold a permit to control and direct the activities of Bezeq. Since the acquisition of the controlling interest in Bezeq, B Communications has nominated all of the members of Bezeq's board of directors who were elected by shareholders, excluding employee representatives on the board whose nominations require the prior approval of our ultimate controlling shareholder, Mr. Shaul Elovitch, as chairman of Bezeq's board of directors, pursuant to Bezeq's collective bargaining agreement.

Our management team has long-standing experience in the communications sector. Our founder and Chairman, Mr. Shaul Elovitch, was also one of the founders of other Israeli leading telecommunications businesses (including, among others, DBS and Partner) and other major investment businesses, and has over 40 years of experience in the telecommunications market. Our Chief Executive Officer, Doron Turgeman, has over 19 years of experience in the telecommunications sector.

Our controlling shareholder, Eurocom Communications, is one of Israel's largest holding groups, with extensive experience in the telecommunications market and controlling stakes in other telecommunications companies, including Spacecom, Satcom, all of which operate in the field of satellite communications, Eurocom Cellular, a leading supplier in Israel of cellular devices, and Eurocom Digital, a leading supplier in Israel of communications products.

#### **Our Strategy**

We view our holding in Bezeq, through B Communications, as a strategic asset and currently expect to maintain a long-term controlling interest in Bezeq. The telecommunications market has historically served as a growth engine for the Eurocom Group and we intend to continue to focus our business on the telecommunications field. We intend to leverage our long-term experience and expertise in the telecommunications field to continue to contribute to Bezeq's management and operations, through ongoing involvement in its business and provision of extensive consulting and strategic services. Over the coming years we intend to gradually reduce our leverage level through the repayment of debt.

#### **Products and Services**

The Bezeq Group provides a wide range of telecommunications services for its business and private customers, including domestic fixed-line telephony and fixed-line broadband Internet infrastructure access services, cellular telephony services, ISP, ILD, data services, ICT solutions, multi-channel television broadcasts via satellite, customer call centers, maintenance and development of communications infrastructures, provision of communications services to other communications providers and the supply and maintenance of equipment on customer premises, also known as network end point (NEP) services.

Since May 2010, Bezeq has been permitted to offer joint service packages with its subsidiaries to private subscribers, and since July 2012, Bezeq has been permitted to offer joint service packages with its subsidiaries to business subscribers, in each case, subject to the approval of the joint service package by the Ministry of Communications and other conditions contained in Bezeq's license. The joint service packages must be capable of being "unbundled" such that each service included in a package must be offered separately and on the same terms, which effectively prevents the Bezeq Group from enhancing the attractiveness of the offer by offering a discount on the joint service packages. Joint service packages marketed by Bezeq's subsidiaries that include the services of Bezeq are also subject to similar limitations, including "unbundling" (except for a bundle offered by a subsidiary that only contains Bezeq's fixed-line broadband Internet infrastructure access service).

Bezeq currently offers packages that combine a subscription to Bezeq's fixed-line broadband Internet infrastructure access and to the accompanying ISP service, with the ability to choose from any ISP provider in Israel, including Bezeq International. The packages are "unbundled" and offered at the same price that the standalone services would cost if subscribed to separately. In addition, Bezeq offers packages to business customers that combine Bezeq's business data lines and the accompanying ISP service from Bezeq International. The packages are also "unbundled" and offered at the same price that the standalone services would cost if subscribed to separately. Business customers are also not required to use Bezeq International as their ISP provider and have the ability to choose any ISP provider in Israel.

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

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

#### ***Domestic Fixed-Line Communications (Bezeq)***

##### ***Fixed-Line Telephony Services***

Bezeq's fixed-line telephony services include basic telephony service on domestic telephone lines and associated value-added services, such as voice mail, caller ID, call waiting, call forwarding and conference calls. Bezeq also offers its business customers national toll free numbers which provide for full or partial payment for customer calls by the business customer.

As of December 31, 2015, Bezeq had 2.18 million active fixed telephone lines in Israel. Bezeq offers a variety of payment plans, ranging from a monthly subscription fee per fixed telephone line and charge per second of use, to various fixed-line telephony packages comprised of monthly amounts of minutes for a fixed monthly fee.

Most of Bezeq's fixed-line telephony services are subject to regulatory tariff control and the prices for such services are governed by such regulations. With respect to services that are not subject to tariff control, Bezeq is required under the Israeli Communications Law to set reasonable tariffs for such services. In addition, Bezeq is allowed to offer "alternative payment packages" for services that are subject to tariff control, with different pricing than the regulated tariff, subject to certain conditions.

##### ***Fixed-Line Broadband Internet Infrastructure Access Services***

Internet service in Israel is segregated into two separate elements comprised of infrastructure or network access services and ISP services. As such, a customer wishing to subscribe to fixed-line Internet services in Israel effectively needs to purchase infrastructure access services, which are provided exclusively by Bezeq and HOT, the only telecommunication operators in Israel that own national fixed-line network infrastructures, and ISP services, which can be provided by any licensed provider. The customer retains the choice with regards to providers for both services, i.e., it may choose to subscribe to the fixed-line broadband Internet infrastructure access facilities of Bezeq or HOT while using a separate ISP provider.

Bezeq provides fixed-line broadband Internet infrastructure access services to approximately 65% of the Israeli market based on the number of subscribers. There has been a growing demand for higher bandwidth speed from Bezeq's fixed-line broadband Internet infrastructure access services subscribers in recent years.



Bezeq offers its fixed-line broadband Internet infrastructure access services in a variety of packages, with prices varying according to bandwidth, and currently offers its subscribers packages with bandwidth speeds ranging from 5 Mbps up to 100 Mbps, depending, among other things, on the distance of the subscriber's premises from the street cabinet and the technology available at the subscriber's premises. Since April 2012, Bezeq has not been permitted to offer its fixed-line broadband Internet infrastructure access services at a reduced price when sold together with its fixed-line telephony services.

Bezeq offers add-on and value-added services to its fixed-line broadband Internet infrastructure access services subscribers, including Bezeq's recent offering of a shared national free WiFi network (a service allowing Bezeq's broadband subscribers to share a portion of their wireless bandwidth with other subscribers in return for the ability to browse outside of their homes using other subscribers' wireless bandwidth), free cloud services, anti-virus and parental controls. Bezeq charges its subscribers a monthly fee for certain of these add-on services. In addition, Bezeq offers the "Bhome" service - A "smart home" service that allows Bezeq's Internet subscribers to be updated on events at home in real time via their smartphones, cameras and sensors installed at home.

#### *Transmission and Data Communication Services*

Bezeq provides a wide variety of data and transmission services, both to its business customers and to other telecommunication operators. Bezeq's data service offerings include point to point, or point to multi point, network topology for business to business and multi-branch business customers, as well as connectivity, Internet access and remote access services. Bezeq provides these services on multiple platforms, from its legacy infrastructures to its newer and more advanced infrastructures, such as IPVPN and metro Ethernet.

Bezeq offers high-speed transmission services to a substantial number of the communications operators in Israel. Among other services, Bezeq provides backhaul services to cellular telephony operators and transmission connectivity services to wireline operators, ILD providers, ISPs and to the Palestinian Authority operators. Bezeq offers similar services to business customers, with a wide variety of bandwidths and interfaces.

#### *Other Services*

*Miscellaneous services to communications operators.* Bezeq provides various services to other communications operators, including rental of space and provision of services in its rented properties, hosting of cellular sites, billing and collection for ILD operators and special services for ISPs.

*Infrastructure services for HOT.* Bezeq installs and provides maintenance for the portion of HOT's cable network that runs through Bezeq's ducts and poles, which accounts for a substantial portion of HOT's cable network.

*Broadcast services.* Bezeq operates and maintains radio transmitters that are operated by radio stations and operators, including the Israel Broadcasting Corporation and the Israeli Defense Force Radio (Galei Zahal). Bezeq also operates DTT transmitters for the Second Authority. While Bezeq is responsible for the operation and maintenance of the transmitters, it is not responsible for the content of the broadcasts.

*Contract work.* Bezeq performs setup and operational work on networks and sub-networks for various customers such as the Israel Ministry of Defense, radio and television broadcasting companies, cellular and international communication operators, local authorities, municipalities and government agencies.

The following table shows the distribution of Bezeq's revenues by main products and services in its segments of operation from 2013 to 2015 (in NIS millions):

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

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

|                                 | 2015         | 2014         | 2013         |
|---------------------------------|--------------|--------------|--------------|
| Revenue from private customers  | 2,507        | 2,498        | 2,605        |
| Revenue from business customers | 1,900        | 1,819        | 1,873        |
| <b>Total revenue</b>            | <b>4,407</b> | <b>4,317</b> | <b>4,478</b> |

#### *Cellular Telephony (Pelephone)*

Pelephone offers its subscribers comprehensive voice, data and text messaging services and advanced multimedia services through its nationwide 3.5G UMTS/HSPA+4G network. Pelephone's basic cellular telephony (voice) services include basic call services, call completion services and auxiliary services such as call waiting, call forwarding, voice mail, voice conference call and caller ID. Pelephone's customers can also access Internet services by using their handsets or through a cellular modem, or netstick, with download speeds of up to 42 Mbps. Pelephone's value-added services include short text messages, or SMS, multimedia messages, or MMS, and content services. Pelephone also offers its customers handset repair services for a monthly payment.

Pelephone offers a variety of packages that combine the several services it makes available to subscribers. Such packages are primarily "unlimited" packages (where the subscriber pays a fixed usage fee and is entitled to make unlimited use of the services according to the terms of the purchased plan), however Pelephone also offers usage fee packages (where the subscriber pays a monthly fee for up to a limited usage and are charged according to their excess use beyond the limit). Since February 2011, Pelephone's contracts with private customers have not included any commitment period. Pelephone's arrangements with large business customers with over 100 subscribers include commitment periods of up to 36 months.

Pelephone also provides international roaming services, based on agreements it has with cellular telephony operators abroad. In addition, Pelephone provides inbound roaming services to the customers of foreign operators while they are in Israel.

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

In February 2016, Pelephone launched a private label terminal equipment brand (GINI), which initially included several 4G device models that will subsequently be augmented with additional models of phablets and tablets.

#### *Revenue from products and services*

The following table provides a breakdown of Pelephone's revenues from products and services (in NIS millions) in the last three years:

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

The following table provides a breakdown of revenue from customers (in NIS million) in the last three years:

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

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

As of December 31, 2015, Pelephone had 2.65 million subscribers. Pelephone also has 925,000 pre-paid subscribers (customers who pay for communications services in advance), but the revenues from these customers are not a significant portion of its total revenues. In addition to Pelephone's subscribers, who are end-customers that actually use Pelephone's network, Pelephone provides services under hosting agreements to other cellular operators that use Pelephone's network to provide services to their customers. Most of the hosting income in 2015 came from Rami Levy and Alon Cellular. Most of the income in 2014 came from HOT Mobile, whose hosting agreement with Pelephone ended in December 2014.

### ***ISP, ILD, Data Services and ICT (Bezeq International)***

#### ***ISP services***

Bezeq International provides a large variety of ISP services to private and business customers, including terminal equipment and support, with an emphasis on broadband Internet access services ranging from 5 Mbps to 200 Mbps based on Bezeq's ADSL infrastructure and local cable company infrastructure (HOT's UFI). Such access services are offered in various bandwidths and qualities of service based on available transmissions. Bezeq International also offers its customers a wide range of value-added services, including automatic online backup for personal computer files, antivirus, anti-spyware, anti-phishing, anti-spam, parental control over Internet use and premium technical support. Such value-added services are often provided as an integrated service package together with ISP services. In addition, Bezeq International offers packages of ISP services and fixed-line broadband Internet infrastructure access services of either Bezeq or HOT.

#### ***ILD services***

In the ILD services market, Bezeq International offers international direct dialing services to business and private customers, toll-free number services for business customers overseas, international call routing and termination services (i.e., hubbing, the transfer of international calls between foreign communication providers worldwide), telephone card services enabling prepaid and postpaid dialing from Israel, and domestic telephony services by means of VoB access (a service that allows users to make and receive telephone calls over the Internet through an Internet connection) through its wholly owned subsidiary B.I.P. Communications Solutions Limited Partnership.

#### ***Business Sector-Data Services and ICT***

Bezeq International specializes in providing IT and communications solutions for large local and international enterprises, offering a wide range of services and comprehensive solutions that combine its communications network and the customer's organizational computer infrastructures. Bezeq International offers a range of ICT services, including IT systems, computerized infrastructures, information security, networking and wireless and data back-up solutions, as well as maintenance for organizational computer networks, help desks and IT expert outsourcing services. Bezeq International also provides its business customers with international data networks, virtual private routed networks, or VPRN, and multiprotocol label switching, or MPLS, networks, and high-speed ISP services through a variety of broadband technologies, such as transmission, metro, ADSL, cables and WiFi.

Bezeq International offers its business customers services which allow for the upgrade and adjustment of such services to meet its customers' ever-changing requirements, which is referred to by Bezeq International as "IT as a Service" (such as IT Infrastructure as a Service, cloud computing and data backup, virtual servers and cloud call centers).

Bezeq International's customers also benefit from its advanced data centers, which supply website server hosting and co-location services as well as advanced disaster recovery solutions. Bezeq International operates large data centers and utilizes its international points-of-presence and global data network for the benefit of its international enterprise customers.

Bezeq International specializes in installing, maintaining and supporting internal organizational telephony exchanges, IP exchanges and call centers for some of the world's leading manufacturers. In traditional international communications, Bezeq International utilizes a "Soft Switch" switching system that provides Intelligent Network services for international calls enabling cost-effective advanced monitoring and customer use restrictions.

Bezeq International also provides data services to ISPs and international communications providers through its submarine optical fiber communications cable system.

## Multi-Channel Pay Television (DBS)

### Broadcasts

DBS currently offers a wide range of high quality content on 150 different channels, including 20 HD channels. Such channels include MTV, National Geographic, Discovery and Eurosport. DBS attempts to secure the best available programming across feature films, television series, documentary programming and original productions, while emphasizing both quality and ratings. DBS broadcasts new television series at a minimal delay in some cases, within hours from the time the content is originally aired in the United States or worldwide. DBS also has an agreement with HBO pursuant to which DBS broadcasts all of HBO's new English language television series, the majority of which were only broadcast in Israel by DBS. DBS also offers a variety of local content as well as VOD services, pay-per-view channels, radio channels, music channels and interactive services.

DBS's package offerings include a basic package, which each subscriber is required to purchase, as well as additional channels chosen by the subscriber, whether as a package or as single and PPV channels. For example, DBS currently offers, among others, a sports channels package, an entertainment and series package, a movies channels package, a business and news channels package, a science and nature channels package, a youth and music channels package, a Russian language channels package and an Arabic language channels package.

The following table provides a breakdown of DBS revenues (in NIS millions) during the last three years:

|  | 2015  | 2014  | 2013  |
|--|-------|-------|-------|
| Revenue from broadcasts and multi-channel television services to subscribers | 1,774 | 1,708 | 1,617 |

### Advanced services

DBS offers its subscribers a variety of value-added services, which are among the most advanced in the world, including:

- PVR set-top boxes which interface with DBS's electronic program guide and enable special services, including ordering recordings in advance, recording series and pausing live broadcasts;
- HD broadcasts through DBS's set-top boxes;
- VOD services via the Internet (accessed through the set-top boxes);
- smartphone and tablet applications that offer viewing content as well as the option to remotely record content on the subscriber's set-top box. At the beginning of 2010, DBS launched the option of viewing a variety of its content on iPhones and expanded the service to support iPads in March 2011. The iPad application incorporates viewing content at HD quality and connection to Facebook and both the iPad and iPhone applications offer the option to remotely record on the PVR;
- "yes streamer," a service that facilitates the viewing of video, pictures and music in diverse formats from the home computer on television (using DBS set-top boxes) in addition to access to certain Internet content, such as YouTube, Picasa, Flix and Flickr; and
- "yes MultiRoom," a service launched in June 2013 that allows subscribers to watch content that was recorded on one capable set-top box from other capable set-top boxes they have in other rooms using the home network.

These advanced services are available to subscribers through DBS's set-top boxes, depending on the type of advanced service, which include "yes Max" (PVR capabilities and, in some of them, VOD capabilities), "HDvod" (HD and VOD capabilities) and "yes MaxTotal" (PVR, HD, VOD, streaming capabilities and yes MultiRoom in the same set-top box). DBS also provides yesGo, a TV Everywhere feature that enables subscribers to watch a significant part of its content (both linear channels and VOD) via personal computers and mobile devices such as smartphones and tablets (available on iOS and Android).

## Marketing, Sales and Customer Service

Under the structural separation limitations, each of the Bezeq Group companies maintains independent marketing and sales operations.

### Domestic Fixed-Line Communications (Bezeq)

Bezeq has marketing, sales and service systems for its business and private customers, which include customer managers for the business sector, combined sales and service call centers around the country, technical support centers for private and business customers, Bezeq stores throughout Israel offering sales and services, as well as a virtual online shop.

Bezeq markets its services mainly through advertising in the mass media, telephone sales centers, customer managers and an array of independent dealers which are mainly ISPs, outsourced sales centers, and ISPs which, upon establishment of the wholesale market, mainly market end-to-end service packages based on the Bezeq's wholesale BSA services. Bezeq also has independent service and sales channels on its website (adapted to surfing from mobile phones), a dedicated application (Bezeq Sheli, My Bezeq), and also offers an Interactive Voice Response (IVR).

### *Cellular Telephony (Pelephone)*

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

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

### *ISP, ILD, Data Services and ICT (Bezeq International)*

Bezeq International's quality of service and the professional support provided to its customers are key drivers of its success. Bezeq International's customer services for its residential and business customers include designated call centers, its website, different social network interfaces (such as Facebook) and an advanced set of online web tools (such as chat, remote takeover software and advanced monitoring systems). Bezeq International's ICT and VoB customers are also provided with field technical support and installation services by trained technicians.

Bezeq International's marketing and advertising strategy highlights the importance of a smooth and fast Internet experience and emphasizes its unique value proposition as the best broadband Internet performance provider in Israel. For the private customer market, Bezeq International uses a broad range of distribution channels to sell its products throughout Israel, including call centers for ISP and ILD services and sales agents who make door-to-door sales. In addition, Bezeq International offers joint services packages. For the business customer market, Bezeq International's marketing channels include call centers, business service and solution centers, and customer managers according to customer type (SMB, SME customers designated for outsourcing transactions, etc.).

### *Multi-Channel Pay Television (DBS)*

DBS customer service operations are carried out mainly by in-house and outsourced call centers, as well as by self-service via interactive voice response, DBS's website and set-top boxes. Field technical support and installations are performed by DBS technicians and subcontractors.

DBS's sales operations are carried out via door-to-door sales personnel, call centers and third party dealers. DBS focuses its marketing strategy on media campaigns with high presence on television as well as other media such as radio, newspapers, Internet and billboard commercials, using well-known international actors and marketing special offers. DBS's campaigns highlight its role as a global technology pioneer with leading value-added services (VOD, PVR, HD, yes MultiRoom, streamer and mobile applications). DBS also highlights its relationships with other well-known, popular brands.

## **Networks**

### *Domestic Fixed-Line Communications (Bezeq)*

Bezeq offers private and business customers, as well as communication providers, a wide variety of services through a nationally deployed, fully-owned, advanced communication networks. Bezeq was the first fixed-line communications company in the world to provide a national NGN deployment. Over the past four years, Bezeq has deployed thousands of street cabinets, equipped with MSAG systems containing ADSL2+ and VDSL2 cards, through which Bezeq supplies its customers with telephone services, Internet access, data and value-added services, all on a unified IP network. The thousands of street cabinets are fiber optically linked through a metro Ethernet network, reaching dozens of aggregation sites leading to Bezeq's nationally distributed mega points of presence (POP) sites. The street cabinets are distributed in a manner by which the average distance from the customer does not exceed several hundred meters, enabling Bezeq to offer its customers, using VDSL2 technology, up to 100 Mbps bandwidth.

NGN network deployment and the transition to providing the array of services on a unified IP network has generated significant operational savings, by enabling Bezeq to gradually "shut down" the old PSTN network, as a result of which many structures that were formerly used to store the PSTN switches became redundant and are offered for sale upon removal of the PSTN switches (certain structures have already been sold) and following the removal of the copper cables in segments that were replaced by fiber optics.

Bezeq operates an extensive national network of optic fibers, providing relay and data communication services for business customers, government offices and security forces, as well as communication operators, while utilizing a wide variety of technologies, including SDH, metro Ethernet, IPVPN and more, with a wide variety of bandwidths. Bezeq recently began an initiative to extend the optical fiber network to be as close as possible to buildings and customer homes (FTTB/FTTH). This activity is expected to result in ultra-fast data transfer rates, significantly higher than the maximum rate provided on the current network (100 Mbps).

The data communication networks consist of thousands of switches and routers spread throughout hundreds of sites nationwide, as well as tens of thousands of kilometers of optical fiber, usually installed within duct infrastructures, enabling simple and rapid installation and maintenance. This array is deployed in a ring configuration, enhancing survivability.

#### *Cellular Telephony (Pelephone)*

Pelephone has a resilient and advanced network system in Israel, allowing it to offer its services with nationwide coverage and consistent high quality. Pelephone's cellular telephony license is valid until September 8, 2022. During the years ended December 31, 2013, 2014 and 2015, Pelephone had net capital expenditures of NIS 315 million, NIS 321 million and NIS 426 million (approximately \$109 million), respectively, for its network infrastructure.

Pelephone currently operates communications networks using the 4G LTE, UMTS/HSPA and CDMA technologies.

The 4G LTE technology is based on GSM standards. The advantages of this technology are greater data communication capacity and faster download rates than with the 3G technologies. All the terminal devices that support this technology also support the 3G technologies and the transition between the technologies is seamless.

UMTS/HSPA is a digital technology based on the GSM standard. This technology is globally widespread, and enables subscriber identification and services to be provided through a SIM card, which can be moved from one handset to another. The advantage of this technology, inter alia, is that it supports download speeds of up to 42 Mbps and upload speeds of up to 5.7 Mbps. This communication network is Pelephone's primary network.

CDMA digital technology is less prevalent worldwide than UMTS/HSPA and subscriber identification is via identification details burned onto the subscriber's terminal equipment rather than by means of a SIM card. To date, this network serves a limited number of subscribers who seldom use the network. Since the UMTS/HSPA network was launched, Pelephone is working to transfer existing subscribers from CDMA to UMTS/HSPA, offering to upgrade their handsets to the new network. Pelephone is not expanding its investment in this network beyond the needs of current maintenance.

At present, Pelephone's network infrastructure is based on two switch farms that are connected to more than 2,200 sites. Pelephone's network is interconnected with the networks of Bezeq and HOT in several locations across Israel. Pelephone's network is also connected to all of the cellular networks in Israel, the eight Israeli ILD operators, the fixed-line telephone network of Paltel and the cellular network of Wataniya, and indirectly to the cellular network of Jawwal in the Palestinian Authority.

Pelephone's transmission network is made up of leased lines (fiber optic) from Bezeq and Pelephone's own microwave links. Pelephone's UMTS base stations are connected using a hybrid connection (ATM for voice calls through Bezeq's SDH network and IP for data calls through Bezeq's metro Ethernet network).

Pelephone's networks cover substantially all of the population in Israel. Pelephone is continuing to expand and improve the coverage, capacity and quality of its 3.5G UMTS/HSPA+ network. Pelephone's network architecture is based on two mobile telephone switching offices (MTSOs), each one with an IP based core network that can support all the traffic in the network.

In April 2014, Pelephone signed an agreement with Ericsson to upgrade its network center to support LTE, purchase and install radio equipment and implement additional adjustments to the network to support LTE. The equipment to be supplied to Pelephone will also support Advanced 4.5G LTE technology.

In September 2014, Pelephone signed a three-year framework agreement under which Ericsson will be Pelephone's exclusive supplier for expanding the deployment of the 4G LTE radio network. The agreement is an extension of the agreement signed in April 2014 for deploying the first stage of the network.

The cost of establishing the network, including payments to Ericsson and additional costs linked to the deployment and adaptation of the network, is expected to amount to NIS 600 million through 2017, including NIS 96 million paid to acquire frequencies in a governmental auction. In addition, over the coming decade, Pelephone will be required to continue to establish new broadcasting sites, among other things, to comply with the terms of the cellular license.

Under its cellular license and the Wireless Telegraph Ordinance, Pelephone has rights of use of frequencies in the 850 MHz spectrum (CDMA network), the 850 MHz and 2100 MHz spectrums (UMTS/HSPA network), and in the 1800 MHz spectrum (LTE technology network).

#### *Ministry of Communications policy concerning infrastructure sharing*

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

The main points of the Policy Paper are:

- The Ministry of Communications encourages and will continue to encourage the active sharing of network sites and masts, as well as the active sharing of antennas, among all operators.
- In general, the Ministry of Communications believes that in order to streamline the frequency spectrum, the active sharing of antennas, frequencies and radio equipment (multi-operator core network (MOCN)) is preferable to active sharing of antennas and radio equipment without the sharing of frequencies (multi-operator radio access network (MORAN)). However, the Ministry did not rule out the possibility that under special circumstances it would consider it appropriate to approve a MORAN agreement, if requested.
- In general, the Ministry of Communications will allow the sharing of transmission from cellular sites to centralized radio-based stations in a bandwidth-sharing configuration, nonetheless, under exceptional conditions, and at the Ministry's discretion, it may allow sharing of transmission from the cellular sites to centralized radio-based stations as well.
- When reviewing individual network-sharing agreements, the Ministry of Communications will take into account the considerations specified in the Policy Paper with regard to four key aspects: (i) the existing level of competition and the potential for harm to the competition; (ii) the existing and expected inventory of frequencies and how efficiently they are being used; (iii) the survivability and redundancy of the networks from the national perspective; and (iv) ensuring the level of telecommunications services over time.
- Based on the foregoing, the Ministry outlined guidelines for examining each individual network-sharing agreement submitted for its approval, which provide, among other things, that MOCN-based sharing will not be allowed for two cellular operators with fully deployed 3G networks, but may be considered regarding a new operator with a partially deployed 3G network with an established operator with a fully deployed 3G network, and that the Ministry will allow MOCN-based sharing, provided that at least three independent wireless access networks are being operated in every region in Israel. Other conditions are also prescribed in the Policy Paper.
- The Ministry of Communications does not intend to permit any sharing of radio infrastructure, including shared transmission to radio base stations, between Bezeq Group and HOT Group, which are the only owners of fixed-line infrastructure in Israel.
- The Minister of Communications will consider revoking all or some of the network sharing approvals, depending on the circumstances, if it appears that the level of competition, coverage or customer service is harmed.

#### *Infrastructure sharing agreements and providing right of use of networks*

##### ***Partner - HOT Mobile***

In April 2015 Partner and HOT Mobile announced that the Minister of Communications had approved their agreement to establish a partnership for maintaining, developing and operating a single state-of-the-art cellular network for both companies, in which each company will hold an equal part. Subsequent to the foregoing approval, Partner and HOT Mobile set up a joint company that received a special license to provide cellular radio infrastructure services to a MVNO operator. This license is valid for 10 years.

### ***Cellcom - Golan Telecom***

In 2014, Cellcom announced that it had signed a 4G network active radio segment sharing agreement with Golan Telecom that had been hosted on Cellcom's network since its establishment. This agreement is in addition to the agreement to provide usage rights on Cellcom's 2G and 3G networks, which was entered into in December 2013. These agreements are subject to the approvals of the Ministry of Communications and the Antitrust Commissioner. Cellcom's announcement also noted that it is continuing its efforts to implement network sharing, including the sharing of the passive components at the cellular sites.

In March 2015 the Minister of Communications announced that the infrastructure sharing agreements between Cellcom and Golan Telecom require essential amendments before the Ministry of Communications would re-examine the agreements in detail.

In November 2015, Cellcom announced that it entered into an agreement to purchase 100% of the shares of Golan Telecom for NIS 1.17 billion. In March 2016, the Israeli Antitrust commissioner informed Cellcom that it is considering opposing the current terms of the proposed purchase of Golan Telecom.

### ***Pelephone - Cellcom***

In September 2014, Pelephone entered into a collaboration agreement with Cellcom for the maintenance of passive components at the cellular sites owned by the two companies, which is expected to reduce maintenance costs at these sites. The agreement provides for maintenance of the shared sites through a supplier that will be selected by Pelephone and Cellcom. The supplier, which will be chosen through a tender, will sign separate agreements with Pelephone and Cellcom for a period of at least 5 years.

In July 2015, the Antitrust Commissioner determined that the foregoing arrangement will be exempt from the conditions for approval of a restrictive agreement. Pelephone and Cellcom have not yet commenced their collaboration as yet. At present, Pelephone is reviewing a project that would lower the maintenance costs of the passive components by using its own employees.

The infrastructure sharing model provides potential for reducing the costs for establishing and ongoing operation of the network. Consequently, if Pelephone does not receive permission to operate under any network sharing model, the costs of Pelephone's network are likely to be higher than those of its main competitors.

#### ***MVNO - Mobile Virtual Network Operator***

Further to the government's decision to encourage competition in the cellular market, several MVNO licenses were granted to virtual operators. Only a few holders of MVNO licenses operate in the private market, which is dominated by Rami Levy. In October 2015, Pelephone completed the acquisition of a MVNO operator, Alon Cellular Ltd. Some of Alon Cellular's subscribers were hosted on Pelephone's network. As part of the acquisition, Pelephone gained approximately 70,000 new subscribers.

In June 2014, the Ministry of Communications announced that there will be hearing regarding the ruling that in hosting agreements drawn up between cellular operators and MVNOs, the cellular operators may not demand hosting tariffs that are higher than the lowest tariff given to business customers in cellular agreements. Pelephone submitted its objection to this ruling.

#### ***Amendments to Cellular Licenses (consumer related)***

In February 2016, the Ministry of Communications announced that it is proposing 41 amendments to the cellular companies' licenses, all related to consumer relations. Pelephone is reviewing the various issues arising from the proposed amendments and their ramifications.

#### ***Construction and Operation of Sites: Permits, Licenses***

Once a new coverage area has been identified, Pelephone's technical staff determines the optimal base station location and the required coverage characteristics. The area is then surveyed to identify network sites. In urban areas, typical sites are building rooftops. In rural areas, masts are usually constructed. Technical staffs also identify the best means of connecting the base station to the network. Once a preferred site has been identified and the exact equipment configuration for that site decided, Pelephone begins the process of obtaining necessary approvals.

The construction and changing of most of these network sites requires building permits from local or regional authorities, as well as a number of additional permits from governmental and regulatory authorities, such as construction and operating permits from the Ministry of Environmental Protection, permits from the Civil Aviation Authority, in certain cases, and permits from the Israeli Defense Forces.

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



In December 2011, Bezeq International completed the deployment of a new high-speed submarine optical fiber communications cable system connecting Israel and Europe, which was launched in January 2012 and has increased bandwidth (capacity and speed) at affordable rates and positioned Bezeq as the sole Internet service provider in Israel to own and operate such infrastructure. This high-speed optical fiber system named JONAH, covers 2,300 kilometers across the Mediterranean, is fully redundant (i.e., utilizes two equipped fiber pairs) and leverages Alcatel-Lucent's advanced submarine communications networking technology. The cable system can operate at 100 gigabits-per-second data transmissions to enable data capacity of over 7.0 Tbps between Tel Aviv and Bari, Italy. This ultimate data capacity could allow the simultaneous download of 100,000 MP3 files in one minute and the streaming of 15,000 HDTV channels. The system integrates Alcatel-Lucent OALC-5 cable, optimized with coherent submarine fiber (CSF), repeaters and the 1620 Light Manager submarine line terminal which is designed to accommodate 10G/40G/100G wavelengths in the same platform, enabling seamless capacity upgrades on a flexible grid for channel spacing without traffic interruption. This solution, which features advanced optical coherent technology, offers a pathway to multi-terabit capacity using 100G channels, far exceeding the maximum capacity achievable with 40G. This protects the investment from the risk of obsolescence or capacity limitations due to changes in transmission technology. Bezeq International's submarine optical fiber communications cable is extended from Bari terrestrially through Interoute's network to major European cities such as London, Frankfurt and Milan.

In parallel with the completion of the deployment of JONAH in the fourth quarter of 2011, Bezeq International invested in the purchase of a submarine fiber pair connecting Israel to Cyprus, known as the ARIEL cable, which extends to Marseilles, France via the ALEXANDROS submarine cable. In addition, Bezeq International holds multiple 10Gbps capacity indefeasible rights of use via the MedNautilus submarine cable system.

Bezeq International's capacity on the JONAH, ARIEL and MedNautilus submarine cables allows the delivery of faster connectivity to Israel and the Mediterranean region, fostering the delivery of innovative IP-based services for which capacity and speed are critical elements to meet end-users' demand. Bezeq International is the only telecom operator in Israel that provides three different routes of multiple 10Gbps to Europe.

In July 2014, Bezeq International launched the "Bigger" service for the business sector in which it offers an innovative digital platform for managing the marketing and advertising of small and medium size businesses.

#### PBX services

Bezeq International markets and maintains communication systems for the entire Israeli market, and PBX exchanges, telephony networks and IP communications, mainly for its business customers. As part of its service contracts, Bezeq International provides maintenance services for various PBX exchange manufacturers. These include services for gateways, PBX exchanges and network end points (NEP) for lines used as both internal and external lines.

The following table provides a breakdown of Bezeq International's revenue (in NIS millions) over the last three years:

|   | 2015         | 2014         | 2013         |
|---|--------------|--------------|--------------|
| Voice services  | 379          | 395          | 401          |
| % of total revenue  | 24.02%       | 26.26%       | 27.98%       |
| Revenue from business Internet and telecommunication services (ISP, PBX, ICT, data) | 1,199        | 1,109        | 1,032        |
| % of total revenue  | 75.98%       | 73.74%       | 72.02%       |
| Total revenue   | <u>1,578</u> | <u>1,504</u> | <u>1,433</u> |

The following table provides a breakdown of revenue to private and business customers (in NIS million) over the last three years:

| NIS million                     | 2015         | 2014         | 2013         |
|---------------------------------|--------------|--------------|--------------|
| Revenue from private customers  | 555          | 529          | 535          |
| Revenue from business customers | 1,023        | 975          | 898          |
| Total revenue                   | <u>1,578</u> | <u>1,504</u> | <u>1,433</u> |

#### *Multi-Channel Pay Television (DBS)*

DBS is the sole DTH provider in Israel. DBS uses space segments from the Amos 2 and Amos 3 satellites, operated by Spacecom. DBS is currently using 12 space segments (ten space segments on Amos 2 and two space segments on Amos 3). In November 2013, DBS entered into an agreement with Spacecom, extending the leases for space segments leased on the Amos 2, Amos 3 and Amos 6 satellites or another satellite to be agreed between the parties, until the end of 2028.

DBS operates a hybrid platform of satellite and IPTV OTT. DBS's IP platform, based on progressive download technology, enables DBS to provide its VOD service, which was launched in March 2010 using OTT technology, with a versatile and user friendly interface in HD quality incorporated into the electronic program guide.

As of December 31, 2015, DBS offers 150 television channels including 20 HD channels transmitted over 12 space segments (36 MHz each) on Amos 2 and 3. The main uplink site in Kfar Saba transmits content over eight carriers, while the secondary site of RRsat Global Communications Network Ltd., or RRsat, transmits content over four space segments. Up to six transport-streams can be transferred from the main site of DBS to its secondary site and be uplinked from RRsat. Ten transport-streams are transmitted using MPEG2 and DVB-S parameters and the two HD transport-streams are transmitted using MPEG4 and DVB-S2 standards.

DBS owns the satellite dishes and other endpoint devices that carry and receive the signals from such satellites to subscriber residences and set-top boxes. In addition, DBS leases some of the set-top boxes and cards that decode the coded signals received from the satellite to its subscribers, while other set-top boxes and cards are provided to subscribers for a deposit (an immaterial number of set-top boxes are sold to subscribers).

Additionally, DBS offers an extensive VOD library based on an OTT content solution, making it accessible to all households with an Internet connection with bandwidth of at least 2.5 Mbps. The VOD platform is comprised of transport-streams which reside in DBS's data center and components which reside in two points of presence ("POPs") of two ISPs.

#### ***Competition in the Israeli Telecommunications Market***

The telecommunications industry in Israel has developed rapidly in recent years, both the technology and regulations governing the industry, and is expected to continue to undergo significant changes. As a result of consolidation in recent years, competition has become concentrated among large telecommunication groups operating in most, if not all, of the segments of the telecommunications market. The Israeli telecommunications market is dominated by four main groups, the Bezeq Group, the Cellcom Group, the HOT Group and the Partner Group, each of which have interests in some or all of the main telecommunications segments in Israel.

**Cellcom Group.** The Cellcom Group provides communications services through Cellcom and its wholly-owned subsidiary, Netvision. These companies provide cellular telephony services (including cellular Internet), fixed-line telephony services (mainly to business customers) through Cellcom's own infrastructure and fixed-line telephony services using VoB technology, transmission and data communication services for business customers through Cellcom's own transmission network, ISP services and international telephony services. In December 2014, Cellcom launched an Internet-based television service which includes VOD services, Internet content and the integration of the Idan+ channels.

**HOT Group.** The HOT Group provides communications services through HOT and its wholly-owned subsidiaries HOT Mobile, HOT Net and HOT Telecom. The HOT Group owns a cable infrastructure deployed nationwide and provides multi-channel cable television services, as well as fixed-line telephony services, cellular telephony services, ISP services and transmission and data communications services.

HOT provides a range of communication services and interactive applications over its Internet infrastructure which is deployed throughout Israel. This network is the principal alternative to Bezeq's infrastructure in the private sector. The upgrading of the infrastructure and the service bundles marketed by the HOT Group, and the Ministry of Communication's decision regarding the cancellation of NDSL services, increased the level of competition. The HOT Group is subject to limitations of structural separation which are generally less stringent than those that apply to the Bezeq Group. While HOT was compelled to provide wholesale services, including BSA services, it does not yet actually provide them.

#### ***Competition from ISPs and Telecommunication Companies***

The operation of the wholesale market enables ISPs and telecommunication companies (holders of a single license) to offer customers service bundles that include also Internet infrastructure based on the infrastructures and services of Bezeq (in exchange for supervised tariffs that will be paid by the telecommunication providers to Bezeq).

### *Competition from the Partner Group*

The Partner Group provides communications services through Partner and its wholly-owned subsidiary, 012 Smile, which provide cellular telephony services (including cellular Internet), fixed-line telephony, transmission and data communications, ISP services, international call services and fixed-line telephony using VoB technology.

### *Internet*

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

Other operators in the market include Golan Telecom, MVNO cellular operators, international operators and ISPs, including service providers in the wholesale market.

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

Unlike the other communications groups, Bezeq Group is currently subject to the stricter restrictions described below.

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

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

In January 2015, Pelephone participated in a governmental tender for the allocation of 4G (LTE) frequencies. Under the tender, Pelephone received 15 MHz within the 1800 MHz spectrum. The frequency allocation was issued in August 2015. Pursuant to the provisions of the tender, receipt of a license for the frequencies is contingent upon an amendment to the existing license. Under the license amendment, the requirements regarding deployment and quality of service through the 4G network are more stringent as compared with the previous standards. Further deployment of the network is currently underway.

*New Fixed-Line Infrastructure Company.* In August 2013, IBC, a telecommunications joint venture between the government-owned IEC and a consortium of non-government companies that was selected by the IEC in a tender procedure, was granted a general license for the provision of telecommunications infrastructure services (including data services, digital transmissions and VPN) via fiber optic networks to telecommunication services providers. According to the license, IBC will enter into an agreement with the IEC to use the IEC's fiber optic network in Israel to provide such wholesale products to telecommunication services providers. If IBC is successful, it would compete with Bezeq and HOT in the wholesale market, as well as providing such services directly to large business customers. IBC has begun operating in several cities and announced its intention to begin operating in additional cities in 2015. The number of IBC subscribers is currently insubstantial.

#### *Fixed-Line Telephony Services Market*

The fixed-line telephony segment has been characterized by a decline in demand and in prices in recent years. The decline in demand is reflected in the decline in the number of existing fixed telephone lines and in a gradual erosion of the number of calls originating in fixed-line networks. Bezeq believes that this trend is primarily due to the rise in the number of cellular subscribers and the volume of use of cellular telephones in the comprehensive call-minute packages the cellular companies have marketed extensively over the last few years (Bezeq estimates that 80% of all calls originate in the cellular network), and from an increase in VoIP calls. In 2015, the number of Bezeq fixed lines declined by about 0.1% (compared with a decline of 0.5% in the number of lines in 2014). Likewise, the number of call minutes (incoming and outgoing) declined by 7% on Bezeq's fixed telephone lines compared with 2014. The average monthly revenue per phone line declined by approximately 5%.

HOT is Bezeq's main competitor in fixed-line telephony. In addition to Bezeq and HOT, fixed-line telephony services can also be purchased from providers of VoB services (a service that allows users to make and receive telephone calls over the Internet through an Internet connection).

The fixed-line telephony market in Israel is also characterized by:

- **Pricing Pressure:** The price erosion experienced in recent years has been partly driven by a reduction in termination rates and the increase in competition, including from cellular telephony operators that introduced unlimited packages in 2012, resulting in the decline of fixed-line telephony average revenue per line in Bezeq and HOT's networks.
- **Commoditization:** In recent years, fixed-line telephony services have been largely commoditized and uptake has become increasingly dependent on a quality broadband Internet offering by the same provider, or the overall attractiveness of the bundled offerings, which, mainly in the case of bundles offered by Bezeq's competitors, may combine fixed-line telephony with one or more of broadband Internet access, cellular telephony and pay television services. However, while usage of fixed-line telephony is declining, high penetration rates of fixed line telephony services are being maintained.
- **Growing Enterprise Data Services:** The enterprise segment has shown an increase in consumption of transmission and data communications services that have partially compensated for the overall decline in fixed-line telephony usage.
- **Technology Convergence between Communications Systems:** The transition to solutions based on IP protocol promotes technology convergence between the different communications systems and penetration of integrated products, facilitating various communications solutions on one handset (e.g. cellular and fixed-line telephony on one handset).

#### *Internet Access-Infrastructure and ISP Services*

Internet service in Israel is structured into two separate elements comprised of infrastructure, or network access services, and ISP services. Infrastructure access service relates to access to the physical network infrastructure within Israel that is required to connect the customer's device to the infrastructure access service provider. This service is provided exclusively by Bezeq and HOT, the only telecommunications operators in Israel that own a national fixed-line network infrastructure. ISP services, which can be provided by any licensed provider, consist of providing customers access to the local and global Internet network utilizing the infrastructure of Bezeq or HOT. ISPs generally also provide certain value-added services such as data protection services, security solutions, e-mail services and system administration services. Accordingly, a customer wishing to subscribe to Internet services in Israel effectively must purchase both fixed-line broadband Internet infrastructure access services and ISP services and retains the choice with regards to the provider of each service.

#### *Fixed-Line Broadband Internet Infrastructure Access Services Market*

The numbers of subscribers in the Internet segment has continued to grow in recent years. In 2015, there was a 4% increase in the number of fixed-line Internet subscribers in Israel. Furthermore, the Internet segment is characterized by an increase in surfing speeds and by the adoption of advanced services and value-added applications. In 2015, against the background of introduction of bitstream access, an increase of 8% was recorded in the number of Bezeq's subscribers (retail and wholesale) compared to 2014. At the end of 2015, there were 244,000 Internet subscribers on the wholesale platform, amounting to 17% of Bezeq's Internet subscribers). Average monthly revenue per Internet subscriber (retail) increased by 5% compared with 2014. In 2015, Bezeq began providing wholesale BSA services and as of December 31, 2015, Bezeq had 250,000 wholesale Internet lines in its network.

HOT provides broadband services through a hybrid fiber coaxial cable (a broadband network which combines optical fiber and coaxial cable).

**Wholesale Market Regulation.** Following hearings in January, August and November 2014, the Minister of Communications amended the licenses of Bezeq and Hot Telecommunications and delineated the basket of services under the licenses, i.e., managed broadband access and wholesale telephony services. The regulations attached to the Minister's decision contained the obligation to provide the services, including accompanying services and the regulation of maximum rates (which require the Finance Minister's approval) for the provision of the wholesale services. Bezeq expects that the implementation of the wholesale services regulation in the manner specified above could adversely affect its results of operations; however, the possible cancellation of the structural separation and supervision over Bezeq's fees as a result of the wholesale market regulation could positively impact Bezeq. In December 2014, Bezeq filed a petition with the Israeli High Court of Justice, or the High Court of Justice, to cancel the decision, and consequently to cancel the amendment of Bezeq's license, the regulations prescribing the obligation to provide the services and the regulation of the maximum rates for the wholesale services, and to schedule an urgent hearing on the petition.

In a hearing on the petition that took place in March 2015, the Court ordered the parties to return to the negotiation table to discuss various matters that arose in the petition and to notify the Court within 60 days of the outcome. In April 2015, Bezeq received a letter from the Ministry of Communications stating that the Ministry believes that the provision of wholesale telephony services can in fact be implemented with small adjustments, within a short period of time and at minimal cost to Bezeq. The Ministry also suggested possible technological solutions for providing the service. While the Ministry expected that Bezeq would prepare for the provision of the service by May 17, 2015, Bezeq rejected the statements in the letter and sent a detailed response to the Ministry. In its response to the Court, Bezeq rejected the statements of the Ministry of Communications and asserted that: the various solutions proposed by the Ministry for providing telephony services in the wholesale market were not technologically feasible and that the tariffs determined by the Ministry of Communications for the provision of such services were unreasonable. Another hearing took place in October 2015.

On December 10, 2015 the Ministry of Communications published a hearing in the matter of "The Provision of Telephony Services via Resale on the Bezeq Network." A draft amendment to Bezeq's general license was attached to the hearing document, addressing the addition of telephony service to the license, in a resale format. The service enables the holder of a general license that is authorized to provide domestic landline operating services, to purchase telephony services from the company, such that will facilitate the sending and receiving of phone calls and the provision of accompanying and value added services provided by the company, as much as possible, in such a manner that the service provider's subscriber will not discern that he is receiving service through Bezeq, other than with respect to technical support. In this framework the service provider may bundle packages that are marketed to its subscribers in any format whatsoever.

At the hearing the Ministry stated that is considering to allow Bezeq to offer the service as an interim solution for a limited period of one year from the date of the decision at the hearing, following which Bezeq will provide wholesale telephony service. It was further stated at the hearing that the service will be provided immediately after the determination of the operating arrangements with the providers, as the provision of services does not require preparations or changes to Bezeq's engineering systems, but rather only to the IT systems.

#### *ISP Market*

While only Bezeq and HOT provide broadband Internet infrastructure access services in Israel), many telecommunications companies hold ISP licenses, including Bezeq International, 013 Netvision (which merged with Cellcom), 012 Smile (which merged with Partner), HOT Net (a subsidiary of HOT) and numerous minor niche players. Bezeq International's estimated market share of the ISP market, based on the number of subscribers, was 44% as of December 31, 2015 compared to 42% as of December 31, 2014. The Israeli ISP market is a saturated market and as competitors are typically unable to differentiate themselves based on price, they attempt to differentiate themselves primarily by strengthening customer loyalty; however, competition has led to increased churn rates.

#### *Broadband infrastructure and ISP Services Markets Trends*

The Internet access market in Israel is characterized by:

- **Increasing Broadband Speeds:** Israeli Internet consumers continue to demand increased Internet bandwidth speeds.
- **Slow-Down in Market Growth Rates:** Despite the fact that the Israeli fixed-line broadband Internet infrastructure access services market is still growing in terms of the number of subscribers, the increase in penetration rate is slowing compared to previous years as a result of the high penetration levels in the market.
- **Increasing Adoption of Services and Value-Added Applications:** Advanced and value-added services, such as data protection services, e-mail, anti-virus and cloud services, are increasingly becoming differentiators in the market, and are believed to enhance customer loyalty and reduce churn rate.

The Israeli cellular telephony market is mature and highly competitive. Three cellular telephony operators, Cellcom, Partner and Pelephone, have historically led the Israeli cellular telephony market. The cellular market growth rate is lower due to “penetration rate” saturation. Penetration rate is the ratio between the number of subscribers in the market and the total population in Israel (excluding foreign workers and Palestinians, although they are included in the number of subscribers). The penetration rate at December 31, 2015 is 124%.

The Israeli cellular telephony market is characterized by a dominant post-paid market (i.e. purchased subscriptions rather than use of pre-paid cards).

In 2015, the trends that began in 2012 continued with increased competition in the Israeli cellular communications market. The entry of the new infrastructure operators, Golan and Hot Mobile, and to a lesser extent the activity of virtual cellular operators, resulted in the erosion of prices and the continued high level of mobility of customers between the companies.

Cellcom and Partner operate nationwide cellular networks based on GSM, UMTS/HSPA and 4G technologies. HOT Mobile and Golan Telecom are able to utilize the existing operators’ networks based on a national roaming model for a period of up to seven years from the launch of their operations (with an option to extend such period for another three years, subject to regulatory approval). HOT Mobile and Golan Telecom have yet to complete the rollout of their networks. HOT Mobile currently uses national roaming services provided by Partner, and prior to 2015, it used national roaming services provided by Pelephone. Golan Telecom uses the national roaming services provided by Cellcom.

In addition, following measures taken by the Israeli government to encourage competition in the cellular telephony market, 11 MVNO licenses were granted by the Israeli government. We believe that only four of the MVNO licensees currently provide services: Rami Levy (which signed hosting agreements with Pelephone), Alon Cellular (whose customers have subsequently been acquired by Pelephone), Azi Communications (which signed a hosting agreement with Pelephone and Partner) and Home Cellular (which signed a hosting agreement with Cellcom). A fifth MVNO, Cellact, signed a hosting agreement with Pelephone.

The main trends that characterize the cellular telephony market in Israel are:

- *Increasing Competition, Followed by Potential ARPU Stabilization.* The entry of the new operators as a result of regulatory changes, together with regulations banning exit fees and reducing interconnect fees, led to intensified competition in the cellular telephony market in Israel. Golan Telecom and HOT Mobile had a strong incentive to obtain market share, as depending on their market share after the grant of their license, they could have been required to pay a license fee of up to NIS 360 million and NIS 710 million, respectively. These developments resulted in higher churn rates among the existing operators and a significant decrease in tariffs. In November 2013, HOT Mobile was notified by the Ministry of Communications that as a result of meeting certain market share targets, the vast majority of its guarantee is reduced. We believe that Golan Telecom is expected to receive similar notification in the near future.
- *Changing Pricing Dynamics.* Partly as a result of intensified competition, during 2012 the manner of pricing services in the cellular telephony market changed significantly. Instead of charging subscribers for actual usage, the cellular telephony operators are primarily offering packages with unlimited usage. The increased competition and change in the format of the communication packages led to a significant decrease in ARPU and higher churn rates.
- *Increasing Demand for Data Transfer Services.* The penetration of smartphones has led to a rise in the supply of alternative applications and services, resulting in a higher level of consumption of data transfer services. The increasing demand for data transfer services has the potential to offset, in part, revenue shortfalls from traditional voice services. In addition, there has been an increase in the rate of use of smartphones that support LTE technology, a technology that allows better browsing. This increase has led to a further increase in consumption of 4G Data.
- *LTE Technology.* LTE technology, which is based on an Internet Protocol that can transfer data at higher speeds than the existing Generation 3.5 technology, is used by many operators around the world and is now supported by many smartphones in operation in the Israeli market. In March 2012, the Ministry of Communications published a work plan with respect to the introduction of LTE technology. The Ministry of Communications issued a tender for allocating LTE frequencies in 2014 and Pelephone was awarded 15 MHz on the 1800 frequency band. Pelephone also entered into network sharing arrangements for 4G networks with Cellcom and Golan Telecom, similarly to an agreement reached by Partner and HOT Mobile, both subject to governmental approvals, including the Israeli Antitrust Authority. Technological developments in the area of LTE, could have a significant effect on the market.

In January 2015, Pelephone participated in an online tender held by the State of Israel for the allocation of 4G LTE frequencies. Under the tender, Pelephone was awarded 15 MHz of bandwidth within the 1800 MHz spectrum, at a total cost of NIS 96 million. In August 2015, Pelephone was notified that its license was amended to include the 4G LTE frequencies and those frequencies were allocated.

- *Network Sharing Agreements.* In December 2013, Pelephone entered into a network sharing agreement for the construction and operation of a shared 4G network with Cellcom and Golan Telecom for a term of 15 years with an option to extend for an additional 15-year term, and an agreement with Cellcom for the sharing of passive components of cell sites on each company's existing networks for a term of 15 years. The agreements are expected to provide significant cost savings and reduced capital expenditure requirements with respect to the deployment and maintenance of an LTE network, as well as with respect to the maintenance of existing UMTS network. The network sharing arrangements are subject to approvals by the Israeli authorities, including the Israeli Antitrust Authority. The December 9, 2013 agreement followed the November 2013 announcement by Partner and HOT Mobile that they had entered into a 15-year network sharing agreement. On May 15, 2014, the Ministry of Communications published a paper on "policy for sharing the broadband access network of a holder of a general license for the provision of mobile radio-telephone services." From Pelephone's review of the Policy Paper, it emerges that the sharing agreement apparently does not comply with the threshold terms included therein.

In September 2014, Pelephone entered into a cooperation agreement with Cellcom for maintenance of the passive components at their cellular sites, including uniting passive components and reducing costs through a joint contractor. The agreement provides for maintenance of the shared sites through a supplier that will be selected by Pelephone and Cellcom. The supplier, which will be chosen through a tender, will sign separate agreements with Pelephone and Cellcom for a period of at least 5 years.

In July 2015, the Antitrust Commissioner resolved that the foregoing engagement will be exempt from the conditions for approval of a restrictive agreement. Pelephone and Cellcom have not yet, at this stage, executed the engagement in practice. At the same time, Pelephone is reviewing the implementation of a project to lower the maintenance costs of the passive components by using Pelephone's employees.

As part of the regulatory measures adopted by the Ministry of Communications since 2012 with the aim of increasing competition in the cellular telephony market, several additional cellular operators entered the market. The entry of the new operators led to substantial increase in competition among all the cellular operators. The increased competition led to an increase in subscriber churn among the existing operators and to a fierce price war that intensifies from year to year, leading to substantial erosion of prices and profit margins in the private customer market as well as in the business customer market. This trend continued and even intensified in 2015.

Pelephone expects this trend to continue in 2016, leading to further reduction in revenues and profitability. Pelephone is introducing streamlining measures and cost structure adjustments in an effort to reduce the impact on its profit margins.

The table below provides a breakdown of the number of subscribers of Pelephone and its competitors in 2014 and 2015 (thousands of subscribers, approximate).

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

(1) Golan Telecom and most of the other MVNOs are private companies that do not publish figures regarding the number of their subscribers and these figures are based on estimates.

(2) The number of subscribers as of September 30, 2015 and December 31, 2014, are based on the public reports issued by Cellcom, Partner and HOT Mobile.

As of December 31, 2015, there are eight competitors in the market, including 014 Bezeq International, 013 Netvision, 012 Smile, Golan Telecom and Hot Mobile International Communications. Bezeq International estimates that its market share for outgoing international calls as of December 31, 2015 was 21% compared with a market share of 23% as of December 31, 2014. A new competitor entered the international telephony market when the mobile app WhatsApp launched its call service in April 2015.

#### *Pay Television Services Market*

Israel's primary television platforms are dominated by pay television, with relatively limited penetration of free platforms such as terrestrial television or free DTH. Approximately 70% of the households in Israel subscribe for multi-channel pay television services from either DBS, which provides multi-channel satellite pay television services, or HOT, which provides multi-channel cable pay television services (Source: Informa Telecoms & Media). DBS, the only company licensed to provide multi-channel pay television broadcasts via satellite to subscribers in Israel, provides encoded and digital multi-channel broadcast services as well as other services. HOT, which provides cable pay television services, focuses its marketing strategy on offering bundles that include multi-channel pay television broadcast services together with other services such as ISP and fixed-line broadband Internet infrastructure access services (known as a "triple play").

Television viewers in Israel are also able to receive free television services through DTT, a terrestrial implementation of digital television technology using an aerial to broadcast to a conventional television antenna (or aerial) instead of a satellite dish or cable television connections. In August 2009, the Second Authority, the public authority that supervises commercial broadcasting in Israel, launched DTT broadcasts on a nationwide basis, enabling the free distribution to the public of five DTT channels free of charge upon purchasing a set top box. DTT currently offers access to only six channels, there is currently no access to premium or thematic content (such as sports, movies or children's programming) and it has no interactive functionalities (such as VOD). DTT has limited capacity to transfer a significant number of channels simultaneously and quality can be affected by the weather. However, pursuant to recent legislation, the DTT array may be expanded to include additional channels (including, among others, channels dedicated to specific themes and HD versions of any of the channels included in the DTT array) and the DTT system may be operated by a private entity instead of the Second Authority, and consequently, DTT could become more attractive in the future.

The transmission of video content over additional communication infrastructures has led to an increase in the amount and range of video content accessible to the public (whether with or without authorization from the holders of title to the content) and to a change in the format in which downloaded content is used for streaming. Viewing the content is by means of various items of terminal equipment, among them computers, televisions, tablets, and mobile phones. This trend allows diverse video content to be provided without the need for establishing specific network infrastructure (including by international entities) and at present, without regulatory supervision. In December 2014, Cellcom launched its Cellcom TV service, allowing VOD viewing through a special decoder, via the web, as well as DTT content. To the best of DBS's knowledge, other entities are considering launching similar services. The establishment and development of such services could substantially affect competition in the broadcast sector, which is currently based on designated infrastructures, and this effect could intensify if the provision of such content continues without regulatory supervision.

Historically, Bezeq was not allowed to control DBS or offer bundled services that include pay television services. On March 26, 2014, the Israeli Antitrust Authority issued a decision which provides that upon the fulfillment of certain terms, the restrictions imposed on the Eurocom Group with respect to its ownership interest in DBS would be removed and Bezeq's merger with DBS would be allowed. On June 23, 2015, the Ministry of Communications approved the transfer of the means of control in DBS to Bezeq allowing it to obtain 100% control of DBS. Bezeq paid Eurocom DBS NIS 680 million in consideration for the entire holdings of Eurocom DBS in DBS and acquired all the shareholder loans provided by Eurocom DBS to DBS on June 24, 2015. At such time, the director designee of Eurocom DBS to the board of DBS resigned.

In December 2014, Cellcom began providing its Cellcom TV services.

The penetration rates of DBS and HOT are estimated by DBS to be approximately 62% of households in Israel. DBS has indicated that it believes that its chances of penetrating an additional material segment are not high because most of the remaining households are not potential customers for DBS and HOT and have available alternative services to their services. Therefore, there has not been any significant change in the number of subscribers of DBS and HOT in recent years, mainly due to the increasing availability of alternative products. However, in 2015, there was a moderate increase in DBS's share of this market. An increase in the number of subscribers may be accomplished mainly by recruiting subscribers from the competition and recruiting new subscribers following the natural growth in the number of households. The broadcasting sector is characterized by fierce competition, which requires an investment of substantial resources to retain existing subscribers and recruit new ones. In addition to Cellcom entering the sector, in 2015, there was also an increased consumption of pirated broadcasts.



The following table provides a breakdown of DBS and HOT subscriber numbers and market shares to the best of its knowledge, at December 31, 2013, 2014 and 2015.

| 2015                       |              | 2014                       |              | 2013                       |              |
|----------------------------|--------------|----------------------------|--------------|----------------------------|--------------|
| Subscribers (in thousands) | Market share | Subscribers (in thousands) | Market share | Subscribers (in thousands) | Market share |
| 635                        | 44%          | 630                        | 42%          | 600                        | 40%          |

## Regulatory

### *Permit to Control Bezeq Granted to Members of the Eurocom Group*

The Israeli Communications Law and the Communications Order provide that the control over Bezeq requires a control permit from the Ministers.

As part of the acquisition of the controlling interest in Bezeq, we, B Communications, SP2, SP1, and other members of the Eurocom Group applied for authorization to control Bezeq, pursuant to the Israeli Communications Law and Communications Order. On April 13, 2010, the Control Permit was granted subject to the condition that SP2 is controlled exclusively by the other parties to the control permit. Concurrently, a separate control permit was also granted to Messrs. Shaul Elovitch and Yossef Elovitch, our controlling shareholders (the "Individuals' Control Permit"). According to the Communications Order, B Communications was not allowed to transfer the control or any Means of Control which will result in a decrease of its minimum holding requirement in Bezeq (30%) without the prior consent of the Ministers. The foregoing includes a transfer of the Bezeq interest in one transaction or a series of transactions, by one party or together with the other parties to the Control Permit or the parties to the Individuals' Control Permit. However, the parties may transfer the Means of Control of Bezeq among themselves, subject to compliance with certain conditions set forth in the Control Permit.

According to the Control Permit, the parties (through SP2) must hold not less than 30% of any type of Means of Control (as described below) of Bezeq. Such percentage is permitted to decrease below 30% to no less than 29% for a period of six months, in the event of dilution resulting from the exercise of stock options by Bezeq employees. However, the Communications Order prohibits issuance of shares which will result in a decrease of the minimum holding requirement in Bezeq (30%) or the ceasing to control Bezeq without the prior consent of the Ministers (certain permitted issuances do not require the Minister's prior consent). According to Article 3(a3) of the Communications Order, which is included as part of the Control Permit, the parties to the Control Permit may hold less than 30% under certain circumstances, including the requirement that the parties control Bezeq and maintain at least a 25% ownership interest in Bezeq. Accordingly, the parties are entitled to sell a portion of their Bezeq shareholdings to the extent they will retain at least 25% of the outstanding Bezeq shares, and no amendment to the Control Permit or the indenture governing our 7% Senior Secured Notes is necessary or required to sell Bezeq shares as long as the parties retain in excess of 25% the ownerships interest in Bezeq.

In accordance with the Control Permit, SP2, which holds the Bezeq shares is required to notify the Ministers of any changes in the composition of its board of directors every six months and if the change represents half or more of the members of the board of directors, within 30 days of the change. We and B Communications are also required to notify the Ministers of any "Exceptional Holdings" in Bezeq (as described below) immediately upon becoming aware of such event. We and B Communications are also required to notify the Ministers in the event a shareholder becomes a "principal shareholder" (namely, holds, directly or indirectly, over 5% of our issued and outstanding share capital) and regarding any 1% or more change in the holdings of a "principal shareholder" within 48 hours of becoming aware of such change. Our Articles of Association require our shareholders to notify us within a specified period of time after crossing any such threshold.

Under the Communications Order, no person may hold, directly or indirectly, "significant influence" over Bezeq or 5% or more of any particular class of Means of Control in Bezeq. The Communications Order defines "holding" as the holding, acquisition, transfer and encumbrance of the Means of Control in Bezeq, defines "significant influence" as the ability to substantially influence the activity of a company, either alone or together with others or using others, directly or indirectly, which arises by virtue of the possession of Means of Control therein or in another corporation, including where such ability is pursuant to the corporation's articles of association, or pursuant to an agreement (whether written or oral) with the controlling shareholder. "Means of Control" is defined under the Communications Order as the right to vote at a general meeting of the company, to appoint a director or general manager of the company, or to participate in the profits of the company or a share of the remaining assets of the company after payment of its debts upon liquidation. Additionally, no person, together with any other person, appoint, elect or dismiss the general manager of Bezeq or cause the election, appointment or dismissal of any director of Bezeq, without the prior written consent of the Ministers. A person shall be deemed to have "significant influence" if (i) he has the right to appoint a director or the chief executive officer; or (ii) if that person holds 25% or more of the Means of Control of a corporation. Additionally, no person, together with any other person, may appoint, elect or dismiss the general manager of Bezeq or cause the election, appointment or dismissal of any director of Bezeq, without the prior written consent of the Ministers.

Subject to certain exceptions, prior written approval of the Ministers is also required to increase the holdings or other rights in excess of those determined in the initial approval, including by means of an agreement (including a voting agreement). Furthermore, under the Communications Order, no person may transfer control, "significant influence" or Means of Control in Bezeq to another, if, as a result of the transfer, the holdings of the transferee would require approval pursuant to the Israeli Communications Law or Communications Order and the transferee is not in possession of the requisite approval. Any such unauthorized holding or acquisition is referred to as "Exceptional Holdings."

The Communications Order provides that in the event that a person holds "significant influence" or Means of Control in Bezeq, to a degree that requires the Ministers' prior approval, without receiving prior approval for such Exceptional Holdings (including as a result of the realization of a pledge over Means of Control), such person must report such Exceptional Holdings in writing to Bezeq and must submit an application to the Ministers for approval of such Exceptional Holdings all within 48 hours. Such application is required to be in the form of the questionnaire annexed to the Communications Order and must be accompanied by a power of attorney authorizing Bezeq's board of directors to sell the applicant's Exceptional Holdings (unless the Ministers have granted an exemption from providing a power of attorney). Following the submission of the application and all relevant documents, the Ministers have 60 days to inform the applicant and Bezeq as to their decision.

In addition to the possibility of obtaining a retroactive approval as described above, the Communications Order establishes the following procedure for the sale of Exceptional Holdings: (i) with respect to a person who has not applied for approval by the Ministers, as described above, such person must sell his Exceptional Holdings within seven days; (ii) with respect to a person whose permit has been revoked or has expired, and who has not submitted a new application, such person must sell his Exceptional Holdings within 14 days after the date of the revocation or expiration, as the case may be; and (iii) with respect to a person who has applied for approval by the Ministers, including a party whose permit has been revoked or has expired and who has submitted a new application, and whose application has been rejected, such person must sell his Exceptional Holdings within 60 days after the date on which the Ministers informed such person that his application has been rejected. If a person does not sell his Exceptional Holdings as detailed in sub-sections (i)-(iii) and Bezeq holds a power of attorney from such person as required by the Communications Order, Bezeq will sell the Exceptional Holdings within 60 days, on a stock exchange, in Israel or abroad, or through an off-exchange transaction. The proceeds of the sale will be delivered to the holder, less expenses involved in the sale.

In accordance with the Israeli Communications Law and Communications Order, and as set forth in our Articles of Association, a holder of Exceptional Holdings (including a holder that submitted an application for approval which was submitted to the Ministers, whether such application was rejected or has not yet been approved) will not be entitled to any rights in respect of its holdings in Bezeq, including with regard to the receipt of dividends, unless and to the extent permitted under the Communications Order. Accordingly, a holder of Exceptional Holdings will not have any voting rights at a general meeting of shareholders. Each shareholder participating in a general meeting of shareholders is required to certify to us prior to the vote or, if the shareholder is voting by a proxy or any similar instrument, as to whether or not his holdings in our company or his vote require the approval of the Ministers pursuant to the Israeli Communications Law and Communications Order. In addition, no director may be appointed, elected or removed from office by virtue of the vote of a holder of Exceptional Holdings. If a director is appointed, elected or removed from office by virtue of the vote of a holder of Exceptional Holdings, such appointment, election or removal from office shall have no effect.

The holding of control, "significant influence" or 5% or more of any particular class of Means of Control without the required approval or in violation of the terms of the approval constitutes a criminal offense and could subject the holder to criminal penalties as follows: (i) a person transferring control of Bezeq or acquiring and holding control over Bezeq without the required approval is subject to three years imprisonment or a fine currently in the amount of NIS 2.26 million as well as an additional fine for each day the offense continues (currently in the amount of NIS 14,000 per day); (ii) a person holding "significant influence" or more than 5% of the Means of Control of Bezeq without the required approval is subject to six months imprisonment or a fine currently in the amount of NIS 226,000 as well as an additional fine for each day the offense continues (currently in the amount of NIS 14,000 per day); and (iii) a person transferring "significant influence" or Means of Control of Bezeq, knowing that as a result of the transfer, the holdings of the transferee require approval pursuant to the Israeli Communications Law or the Communications Order, without being first shown the appropriate approval by the transferee, shall be subject to a fine currently in the amount of NIS 226,000.

According to the Control Permit, SP2 must at all times be held by an "Israeli Party," as defined in the Communications Order, to the following extent:

- At least 19% of each of the Means of Control of SP2 must be held by an Israeli Party at all times; or
- At least 19% of the rights to vote at the general meeting of shareholders of SP2 and the rights to appoint directors of SP2 must be held by an Israeli Party at all times; and
- The right to appoint at least one-fifth of the directors of Bezeq and Bezeq's subsidiaries and not less than one director of each such company will be held by an Israeli Party at all times, provided that the percentage of the Israeli Party's direct or indirect shareholdings in Bezeq is not less than 3% of any of the Means of Control of Bezeq. Indirect shareholdings will be calculated as the product of the Israeli Party's lowest rate of holdings in each of the Means of Control in SP2, multiplied by the percentage of the holdings of the parties to the Control Permit in each of the Means of Control in Bezeq.

The Ministers have determined that we and B Communications are deemed to be "Israeli Parties," so long as we and B Communications are controlled by a citizen and resident of Israel and that the ownership interest of Messrs. Shaul Elovitch and Yossef Elovitch in our company and B Communications does not fall below 50% at any time.

The parties to the Control Permit may not be controlled by any foreign country, foreign government company or a foreign company controlled by a foreign government company. The Control Permit will terminate if the foregoing condition ceases to exist with respect to any such party without the approval of the Ministers. The Ministers may authorize a foreign government company to hold an interest in any such party, provided that the foreign government company's aggregate direct or indirect holdings in Bezeq do not exceed 5% of any type of Means of Control of Bezeq and that it does not control such party.

According to the Communications Order a "principal shareholder" or a person with "significant influence" in Bezeq shall not be one of the following:

- a hostile state, a citizen or resident of a hostile state, a corporation registered or incorporated in a hostile state or a corporation controlled by a citizen or resident of a hostile state; or
- a government corporation, unless approved by the Ministers.

In the event the Ministers find that the information they were provided in the application for the control permit is incorrect, that there has been a material change in the details provided by the parties to the Control Permit which justifies its cancellation, or such parties failed to submit a required report, and the Ministers determine that there is probable cause to believe that the provision of the services that Bezeq is required to provide pursuant to its general license (including basic telephone, infrastructure, transmission and data transmission services and ancillary services) or the grounds for determining that any such service has been harmed, the Ministers may take action to cancel the Control Permit. Upon its cancellation, all the shareholdings purchased under the Control Permit will be deemed Exceptional Holdings as described above.

The Control Permit also authorizes an interested party in B Communications and our company that is not a party to the Control Permit or the Individuals' Control Permit to hold Means of Control in Bezeq, provided that such interested party does not hold more than 15% of any type of Means of Control of B Communications and our company. The foregoing authorization is subject to the condition (among others) that the percentage of holdings of the parties to the Control Permit in our company, of our company's holdings in B Communications and of Eurocom Communications' holdings in our company exceed 50% of the Means of Control in each of such companies at all times. We and B Communications are required to notify the Ministers of the share ownership of any such interested party.

If we, B Communications or any other member of the Eurocom Group subject to the Control Permit fails to comply with the terms of the Control Permit or with other regulatory provisions relating to the control of Bezeq, such permit could be revoked and our rights with respect to our Bezeq interest would be adversely affected.

Any event in which a receiver is appointed with respect to our holdings in SP2 or SP2's holdings in Bezeq will constitute grounds for the cancellation of the Control Permit. In the event that the Control Permit is cancelled and an application to reissue a Control Permit is denied, B Communications' holdings in Bezeq must be liquidated within 15 to 60 days (depending on the cause for such cancellation) pursuant to the Communications Order.

The provisions of the Control Permit are subject to the terms of the Communications Order and Israeli Communications Law, as they may be amended from time to time.

#### **Sale of an Ownership Interest in Bezeq**

As indicated above, according to Article 3(a3) of the Communications Order, which is included as part of the Control Permit, the parties to the Control Permit may hold less than 30% under certain circumstances, including the requirement that the parties control Bezeq and maintain at least a 25% ownership interest in Bezeq. Accordingly, the parties are entitled to sell a portion of their Bezeq shareholdings to the extent they will retain at least 25% of the outstanding Bezeq shares, and no amendment to the Control Permit or the indenture governing our 7% Senior Secured Notes is necessary or required to sell Bezeq shares as long as the parties retain in excess of 25% the ownerships interest in Bezeq.

On February 2, 2016, B Communications announced that its wholly-owned subsidiary, SP2, sold 115,500,000 Bezeq shares. As a result, B Communications received gross proceeds of NIS 8.50 per share, or NIS 982 million in the aggregate (approximately \$248 million). B Communications retained a 26.34% ownership interest in Bezeq following the closing of the transaction.

According to the terms of the indenture for B Communications' 7¼% Senior Secured Notes, the net proceeds from the sale of any Bezeq shares held by B Communications or its subsidiaries SP1 and SP2 must be deposited into our "Lockbox Account" and are subject to other customary conditions and covenants relating to asset sales and release of liens on sold assets. In addition, according to the terms of the indenture, B Communications must make an offer within 365 days to the holders of the notes to purchase notes with the proceeds deposited in the lockbox account at a cash offer price equal to 100% of the principal amount of the notes, plus accrued and unpaid interest to the date of purchase.

## **The Concentration Law**

In December 2013, the Knesset passed the Concentration Law, which regulates the following principal matters: (i) limitations on the control over companies with publicly held debt or equity securities through a pyramidal ownership structure by imposing a limitation on the number of public companies (tiers) in such pyramidal structure; (ii) authorizes financial regulators to set forth limitations on the amount of credit that financial institutions are permitted to provide to a corporation or a group of companies under the control of the same controlling shareholder; and (iii) limitations on the holdings by a significant non-finance company in a significant finance company or the holdings of both kinds of companies under common control; and (iv) requires governmental authorities responsible for the award of rights in public assets (including in the communications field) in certain events to consider control concentration factors and industry-specific competitive factors.

### ***Limitations on the control of public companies through a pyramidal ownership structure***

#### ***Prohibition on a second-tier company controlling another tier company***

The purpose of the Concentration Law is to limit the possibility to control a "tier company" (generally defined as a company with publicly held debt or equity securities that are subject to reporting obligations under the Israeli Securities Law) through a pyramidal structure of additional tier companies. Each of B Communications, our company and Bezeq is considered a "tier company" for the purposes of the Concentration Law. A "second-tier" company is a tier company that is directly controlled by a first-tier company, and accordingly, our company is deemed a "second-tier" company under the Concentration Law.

The Concentration Law prohibits a second-tier company from controlling another tier company. In the case of existing pyramidal structures, a second-tier company is entitled to continue to control another tier company that it controlled on the publication date of the Concentration Law for a period of six years from the date of publication of the Concentration Law (until December 10, 2019).

In the event that a second-tier company controls another tier company contrary to the provisions of the Concentration Law, a district court may appoint a trustee, who will be awarded the means of control (including voting rights and right to appoint directors) in such tier company for the purpose of selling such means of control. The trustee shall act pursuant to the orders of the district court with respect to such means of control and will be entitled to petition the district court to rule, among other things, that an appointment of directors in the tier company that was made prior to the trustee's appointment is void, to cancel transactions between the controlled tier company and its controlling shareholder or transactions in which the controlling shareholder had a personal interest if they have not yet been completed and to order the cancellation of a dividend distribution that was not in the tier company's interests which occurred prior to the trustee's appointment. The district court may, instead of appointing a trustee and under certain circumstances, order that the means of control held by the controlling shareholder shall not provide any rights whatsoever. Until the appointment of a trustee by the district court, the means of control held by a second-tier company that illegally controls another tier company shall not grant any voting rights at the illegally held tier company's shareholder meetings.

The Concentration Law sets forth certain mechanisms intended to enable a tier company, which is subject to the prohibition of controlling another tier company, to make various arrangements for the repurchase of its publicly-held shares and the early redemption of publicly-held debt in order to comply with the provisions of the law. These mechanisms enable the repurchase of publicly-held shares and the early redemption of publicly-held debt securities under a court-approved scheme of arrangement pursuant to the Israeli Companies Law, at fair value and in accordance with the conditions prescribed by the Concentration Law, while providing certain relief from shareholders or debenture holder majority requirements for the approval of the arrangement.

#### *Appointment of directors and the composition of the board of a “third-tier” company during the transition period*

Beginning six months after the publication of the Concentration Law and until the end of the six years’ transition period during which a “third-tier” company can no longer be controlled by a second-tier company, the board of directors of a company that is a “third-tier” company (such as Bezeq) must be comprised of a majority of “independent directors,” within the meaning of the Israeli Companies Law, and the number of “external directors” pursuant to the Israeli Companies Law shall be at least half the number of the company’s directors less one (rounded upwards) but not less than two. The election of such external directors will be by a majority vote of the shareholders and the controlling shareholder’s vote will not be counted for such purpose. The Israeli Minister of Justice is authorized to enact regulations setting forth a lower number of required external directors, provided that such number will not be lower than one-third of the board members.

In June 2014, the Regulations to Promote Competition and Reduce Concentration (Relief with Regard to the Number of External Directors), 2014, were published. Pursuant to these regulations, if a director of a company who is appointed according to the proposal of a representative labor union under a collective labor agreement serves in another tier company, the number of external directors in the tier company required under the Concentration Law who meet the provisions of the law may be reduced, provided that the external directors account for at least one-third of the board members. Bezeq complies with the provisions of the Concentration Law in this respect.

#### *Limitations on the provision of credit to corporations and issuer groups*

The Minister of Finance and the Governor of the Bank of Israel are authorized to enact regulations and directives limiting the amount of credit provided by financial institutions in Israel, cumulatively, to a corporation or a group of companies under the control of the same controlling shareholder. Such regulations have not yet been enacted.

### **The Bezeq Group**

The Bezeq Group is subject to various regulatory requirements and obligations including communications and broadcasting laws (including provisions applicable to providers of essential services), general antitrust law, securities and companies laws, consumer protection laws, planning and construction laws, environment, health and safety laws, as well as technical and other regulations. The communications and broadcasting industry in Israel is highly regulated and requires service providers to obtain licenses from, and comply with the terms of such licenses and the policy statements of, the Ministry of Communications or the Israeli Council for Cable and Satellite Broadcasting, or the Broadcasting Council, with respect to the various communications and broadcasting services, respectively, before offering such services to the public. Holding Means of Control in telecommunications services providers is also subject to regulation, including certain prohibitions on cross-holdings in communications companies. The ever-changing regulatory environment has had and will likely continue to have a material effect on the Bezeq Group’s activities. Certain key provisions of the regulations governing the Bezeq Group’s activities are set forth below. This description is not intended to be an exhaustive description of all regulations nor a review of specific obligations which have been imposed on the Bezeq Group.

As a general matter, the regulatory principles are set forth in the laws enacted by the Knesset, primarily the Israeli Communications Law. These laws are amended from time to time upon enactment by the Knesset. The laws authorize the Ministry of Communications (in some cases with the approval of the Economic Affairs Committee of the Knesset) to issue regulations which provide for specific requirements based upon the principles set forth in the applicable laws. In addition to the regulations, the Ministry of Communications issues policy statements after a public review and consultation process. These policy statements expand upon the Ministry of Communications’ policy with respect to certain basic issues in the relevant market. The Ministry of Communications grants licenses in accordance with the Israeli Communications Law and regulations. Bezeq was also declared a provider of essential services under the Communications Order and is subject to the provisions of such order.

### **General**

#### *Structural Separation*

Bezeq is subject to a duty to maintain structural separation between itself and its subsidiaries set forth in its domestic fixed-line license (including Telephone, Bezeq International and DBS). Separation is required between the managements of Bezeq and its principal subsidiaries, as well as separation between the financial and marketing systems, assets and employees.

The structural separation limitations result in high administrative overheads and place the Bezeq Group in an inferior competitive position compared with other Israeli communications groups that are subject to certain structural limitations, but not of the same scope.

In July 2013, the Knesset approved an amendment to the Israeli Communications Law, providing, among other things, that the authority of the Minister of Communications to mandate structural separation between two license holders for the purpose of providing certain services also includes separation between the provision of services to another license holder and the provision of services to a subscriber. According to the explanatory notes to the draft amendment, the existing form of structural separation in the Israeli communications market is expected to be gradually cancelled; however, structural separation between the provision of services to a subscriber and the provision of services to another license holder is expected to be required if a wholesale market does not develop or if its development encounters difficulties such as price discrimination and high barriers for entry.

In October 2013, the Ministry of Communications published a hearing for public comment regarding the implementation of new a regulatory regime in the ILD market. Under the proposed regime, domestic fixed-line operators and cellular telephony operators would be allowed to provide ILD services as part of the service packages they offer to their subscribers. The proposed regime would also allow domestic fixed-line operators and cellular telephony operators to provide international data transfer and transmission services. If such regulatory regime is approved, it could have a significant impact on Bezeq International's ILD operations.

#### *Limitations on Marketing of Bundles*

Historically, the structural separation limitations prevented Bezeq from marketing joint service bundles. Since May 2010, following the decrease of Bezeq's market share of the private fixed-line telephony services market to below 85%, Bezeq has been permitted to offer joint service packages with its subsidiaries to private subscribers, and since July 2012, Bezeq has been permitted to offer joint service packages with its subsidiaries to business subscribers, subject to approvals by the Ministry of Communications and other conditions contained in Bezeq's license, including the following:

- The joint service packages must be able to be "unbundled" so that each service included in a package must be offered separately and on the same terms; and
- At the time a request for approval of a joint service package is submitted, all of the services to be offered must be marketed as a package to private subscribers by a license-holder which is not a subsidiary of Bezeq, or a group that includes license holders that are not affiliated with Bezeq.
- When filing a request for marketing a bundle of services, which includes any of ISP service, international calls service or VoB service, Bezeq must allow any licensee that is capable of providing such services to offer its own services as part of Bezeq's bundle, alongside the bundle with the subsidiary (Bezeq International).

Joint service packages marketed by Bezeq's subsidiaries that include the services of Bezeq are also subject to similar limitations, including "unbundling" (except for a bundle offered by a subsidiary that only contains its ISP service with Bezeq's fixed-line broadband Internet infrastructure access service).

Despite the easing of the limitations on offering "unbundled" joint service packages, the Israeli Antitrust Authority informed DBS and Bezeq that the marketing of "unbundled" joint service packages by Bezeq and DBS constitute a restrictive arrangement which requires an exemption under the Israeli Antitrust Law and that the Commissioner does not intend to grant such exemption. Consequently, such packages were not offered. The recent merger between DBS and Bezeq ratified new limitations regarding possible bundling, including:

- Bezeq will sell and provide Internet infrastructure services and TV services under equal conditions for all of Bezeq's customers; and
- Bezeq and DBS will not have any exclusivity arrangements pertaining to TV productions that are not "original productions."

These limitations, and in particular the "unbundling" obligation, limit the Bezeq Group's ability to offer discounts on the components of a joint service package and effectively prevent the Bezeq Group from offering bundles, except for a bundle that contains fixed-line broadband Internet infrastructure access service and ISP service. Competing Israeli telecommunications groups are not subject to similar limitations in marketing joint service packages (other than a limitation on marketing bundles by HOT Net and other companies in the HOT Group).

#### *Additional Limitations on Cooperation between the Bezeq Group Companies—Antitrust Laws and the Provisions of Bezeq's Domestic Fixed-Line License*

Additional regulatory provisions impose limitations on cooperation between members of the Bezeq Group including provisions of Bezeq's domestic fixed-line license that obligate Bezeq to provide its services on an equal basis to all and to ensure that its relationships with its subsidiaries do not result in favoring them over their competitors. Bezeq is also subject to the Israeli Antitrust Law and regulatory orders issued by the Commissioner. Bezeq was declared a monopoly in its main fields of activity under the Israeli Antitrust Law, as discussed in the *Fair Competition and Antitrust Laws* section below.

In May 2012, the Ministry of Communications published the Wholesale Market Policy Document concerning expansion of the level of competition in the fixed-line communications market, primarily adopting the main recommendations of the Hayek Committee.

The key points of the Wholesale Market Policy Document are as follows:

- Owners of universal fixed-line access infrastructures that provide retail communications services, including Bezeq and HOT, will be obligated to sell wholesale services to other telecommunications services providers, including BSA, lease of access segments, dark fibers, duct access and transmission services, on an equal and non-discriminatory basis and with no discounts for size. In this regard, a procedure was established for negotiating an agreement for these services and as soon as such agreement is signed, the infrastructure providers are required to publish a “shelf offering” for the sale of the services based on the agreement and which also includes additional services as the Ministry of Communications may determine from time to time and such services’ prices. In this regard, the term “agreement” will apply to an agreement entered into by an infrastructure owner and a substantial service provider that is not an affiliate of the infrastructure owner. When the Minister of Communications believes that an agreed term or price is (i) unreasonable; (ii) might hinder competition; (iii) might harm the public’s interest, or (iv) might harm a services provider’s interest, the Minister has the power to establish conditions or prices for the services. The infrastructure providers must submit to the relevant telecommunications services providers the information relating to distribution of their existing infrastructures, with exceptions to be defined.
- If a license holder or a company affiliated with a license holder sets a tariff for a retail communications service in a manner that may hinder competition, the Minister of Communications will take measures to amend the wholesale tariff that is relevant for the provision of the retail service accordingly.
- The ancillary activities, services and arrangements relating to the wholesale services (rental of space, maintenance, etc.), and the arrangements for ordering, payment terms, provisioning and their tariffs, will also be negotiated by infrastructure owners and service providers, and the infrastructure owners will be allowed to demand reasonable and non-discriminatory prices. In the absence of agreement between the relevant license holders, the Minister of Communications will determine such terms.
- The Ministry of Communications will make use of a model for enforcement and supervision, which will help the Ministry of Communications to (i) ensure that the tariffs set in the shelf offering are in accordance with the conditions set out above, (ii) monitor the actual provision of the wholesale services in a reasonable and non-discriminatory manner, and (iii) track the level of implementation of the wholesale market.
- Infrastructure owners will provide, on an ongoing basis, information about ordering of wholesale services and the deployment of existing infrastructure to other license holders in accordance with the requirements of the Ministry of Communications, subject to exceptions that will be determined by the Ministry of Communications.
- The “shelf offering” will be published on the websites of both the infrastructure owners and the Ministry of Communications. Upon publication of such “shelf offering,” other entities (including affiliates of the infrastructure owner) may also purchase wholesale services on the same terms from the infrastructure owner, as long as such services shall be provided concurrently to any other entity, on a non-discriminatory basis. Under this procedure, Bezeq will be able to provide wholesale telephony services to its subsidiaries that are not supplied over a broadband network, provided that these services are also available to third parties without discrimination.
- Within nine months of publication of the “shelf offering,” the Minister of Communications was to eliminate the structural separation between the infrastructure provider who published the aforementioned offering and the ILD providers and ISPs that are affiliated with such infrastructure provider, replacing it with an accounting separation, unless the Minister believes that this will adversely affect competition or the public interest. As a result, Bezeq would be able, for example, to offer bundles that include local and ILD services, broadband Internet infrastructure access services and ISP services.
- The Ministry of Communications will determine indicators or conditions under which the Minister of Communications may conclude that the level of development of the wholesale market and the level of development of competition based on joint service packages which include fixed-line telephony and cellular telephony services in the private sector, permits the grant of relief from the structural separation between an infrastructure owner and an affiliated cellular telephony operator, or the elimination of the structural separation and its replacement with an accounting separation.

- If the Minister of Communications determines that the wholesale market has developed and the degree of competition based on joint service packages consisting of fixed-line services and cellular telephony services in the private sector permits, the Minister will consider eliminating the structural separation between an infrastructure provider and a cellular telephony operator who is affiliated with such provider.
- The Minister of Communications will examine the matter of the unbundling of broadcasting services included in the joint service packages which also include Bezeq services (fixed-line telephony or cellular telephony) or broadband access services. The structural separation between the infrastructure providers and multi-channel television services providers will be eliminated if there is a reasonable possibility in the Israeli market to provide a basic television service package over the Internet by service providers with no nationwide infrastructure.
- If a wholesale market does not develop in a satisfactory manner (based on parameters to be defined for this purpose) within 24 months of the publication of the Wholesale Market Policy Document, the Minister of Communications will take action to implement structural separation between the infrastructure and the services provided by general domestic fixed-line license holders.
- Within six months of publication of the “shelf offering,” the Minister of Communications is required to take action to change the method of control over Bezeq’s tariffs so that tariffs will be controlled by setting a maximum price.
- Within nine months of publication of the “shelf offering,” the Ministry of Communications is required to formulate a regulatory scheme aimed at increasing the investment in and upgrade of fixed-line communications infrastructures in Israel.

The Amendment to the Communications Law in the Economic Arrangements Law, July 2013 expands the powers of the Minister of Communications to oversee competition in the era of a wholesale market. The Minister of Communications was empowered (by the Minister of Finance) to determine payments for a license holder to use Bezeq installations operated by another license holder, to establish maximum or minimum tariffs for a license holder’s services, and this, in part, based on cost plus a reasonable profit or on a benchmark point derived from parameters prescribed in the law. The Minister may also request a report on the tariffs before services commence, he may instruct the tariff that a license holder may ask for a service, and may instruct the license holder to take action to prevent an immediate infringement of the competition. The amendment also prescribes provisions concerning a basic package of broadcasts, its content and payment for the package.

In accordance with the policy document on the expansion of competition, the structural separation which is currently in place will gradually be phased out. Nevertheless, the Minister’s power to impose structural separation also applies vertically (between services rendered to subscribers and services rendered to a license holder), and that the directive may be applied if a wholesale market does not develop at all, or problems emerge in the development of such a market, in part due to price discrimination, high entry barriers, etc.

The following actions were subsequently taken by the Ministry of Communications:

- In January 2014, the Ministry of Communications issued a list of the services that Bezeq will be obligated to offer as a wholesale service to the service providers. The list of services included: managed broadband access (Bitstream Access) (for a countrywide, regional or local connection); Sub Loop Unbundling (at this stage only on the Bezeq network); use and access to Bezeq’s physical infrastructure, and wholesale telephony service.
- In November 2014, the Minister of Communications issued a decision on the regulation of wholesale services and the format for the provision of wholesale services and the setting of rates for these services on Bezeq’s network.

The Minister of Communications adopted the recommendations of the Ministry’s professional echelon to amend the licenses of Bezeq and Hot Telecom and to detail the basket of services covered by the license - managed broadband access (including Multicast) and wholesale telephony service. These services must be provided within 3-6 months from the date of the decision. The regulations that were included in the Minister’s decision define the obligation to provide the services, including accompanying services and the maximum tariffs for these wholesale services to be provided by Bezeq (to date, no tariffs have been prescribed for HOT Telecom’s services).



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

|   | 2015   | 2016   | 2017  | 2018  | Unit                   |
|---|--------|--------|-------|-------|------------------------|
| Access service – excluding telephony                        | 32.56  | 32.70  | 32.87 | 33.21 | NIS per line per month |
| Access service – including telephony                        | 39.43  | 38.53  | 38.80 | 39.13 | NIS per line per month |
| Subloop unbundling service (or SLU)                         | 19.34  | 20.04  | 20.74 | 21.47 | NIS per line per month |
| Data transfer service on the network's core                 | 30.36  | 24.11  | 18.73 | 14.18 | NIS per MB per month   |
| Data transfer in multicast configuration <sup>1</sup>       | 15,517 | 12,267 | 9,456 | 7,236 | NIS per MB per month   |
| Creating a phone call                                       | 0.01   | 0.01   | 0.01  | 0.01  | NIS per minute         |
| Access service to the duct <sup>2</sup>                     | 398    | 398    | 400   | 400   | NIS per km per month   |
| First dark fiber on a line                                  | 484    | 484    | 487   | 485   | NIS per km per month   |
| Additional dark fiber on a line (up to a total of 4 fibers) | 2.18   | 2.14   | 2.11  | 1.99  | NIS per km per month   |
| Technician house call service                               | 158    | 158    | 158   | 158   | NIS per visit          |

1) The price for reaching customers connected to a maximum of 1,000 MSAG boxes. The prices for greater numbers of MSAG boxes are stated in the draft regulations.

2) Including access to pits, boxes and poles.

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

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

In the petition, Bezeq argued that the decision was unreasonable and impossible to implement. Bezeq also argued that the decision-making process was improper.

The Ministry of Communications held discussions with Bezeq and the relevant operators with respect to operating the service and in February 2015, issued various appendices to the BSA wholesale service file. Following their issuance, Bezeq began to provide wholesale services. Until May 2015, customers were transferred from retail subscribers to wholesale subscribers in a non-automated procedure (a manual procedure requiring involvement of Bezeq's staff). Thereafter, the transfer was automated and does not require human involvement.

In March 2015, the Supreme Court ruled that it would hold a round table discussion with Bezeq and the State of Israel to examine Bezeq's arguments (professional or technical in nature), in order to clarify topics, if possible, and make the necessary amendments, and that a notice from Bezeq and the State of Israel should be submitted within 60 days.

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

Thereafter, Bezeq submitted an update notice on its behalf where it rejected the State's update notice and noted that contrary to the State's conclusions: (1) the different solutions proposed by the Ministry for provision of telephony services in the wholesale market are not technologically possible; and (2) the tariffs prescribed by the Ministry of Communications for provision of the wholesale market services are unreasonable. Bezeq also argued that the Ministry of Communications had not completed the meetings to examine Bezeq's claims, as requested by the Supreme Court, and retained its decisions, so they remained unreasonable. An engineering opinion by an external expert and an economic opinion of an internal economist (together with an external comparative study indicating that the wholesale price in European countries on which the Ministry relied is more than double the price prescribed by the Ministry in Israel) were attached to Bezeq's update notice.

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

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

On December 10, 2015, the Ministry of Communications published a hearing regarding "the supply of telephony services for resale on Bezeq's network." A draft amendment to Bezeq's general license adding telephony services in a resale format was attached to the hearing document.

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

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

The following tariffs were presented at the hearing:

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

The above payments includes payments for interconnection for calls to Bezeq subscribers and in addition, the service provider will pay an interconnection fee for outgoing calls from its network for every subscriber of another operator other than Bezeq's subscribers. The service provider will also be eligible to payment for every incoming call.

Excess minute price - NIS 0.0923 per call minute.

Payment for additional services - the payment prescribed in bundles is decreased by 40%.

On January 10, 2016, Bezeq submitted its response to the hearing, according to which it is impossible to determine that after a certain period (or upon establishment of maximum tariffs or cancellation of the unbundling obligation) the service format anchored in the service file will apply automatically, since the format is impossible to implement and postponing it will not lead to a solution. The only way that enables Bezeq to provide the service in the service file format entails switch replacement and compelling Bezeq to perform a complex, disproportionate unauthorized and unjustified procedure. Moreover, a wholesale telephony service in the service file format is essentially unnecessary and unjustified (as testified by the various arguments for the service, each of which was concealed and another raised in its place) and all its aspects deviate from the global trend. With regard to the price of the service, it is clarified that it is inappropriate to reduce it by 40%, since it is a resale service with almost no costs to the telecommunication providers or saving for Bezeq and that the standard discount rate worldwide is between 10% and 20% maximum. It is further clarified that the "Kav Kal" (light line) is irrelevant and cannot be included in the resale arrangement and that interconnection fees will only be paid for outgoing services to another network and will be received for incoming calls from another network not belonging to Bezeq. It was further clarified that they are aimed at improving the cooperation between Bezeq and the service providers.

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

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

#### **Imposition of fines**

In the initial wholesale BSA service implementation period, the Ministry of Communications held supervisory proceedings against Bezeq claiming that Bezeq breached some of the provisions set out mainly in the service attachments issued as described above on the eve of the reform. On May 11, 2015, Bezeq received the Ministry of Communication's notice of its intention to impose fines regarding implementation of the broadband reform (the "Notice"), claiming that according to the supervision report attached to the notice, the Ministry discovered that Bezeq fails to comply with the provisions set out in the service file as required and that this conduct by Bezeq is a breach of an addendum to the Communications (Telecommunications and Broadcasts) Law, 1982. Therefore, the Ministry stated that it intends to impose a fine of NIS 11,343,800, which is the maximum amount possible under the law. Bezeq rejected the notice and submitted counterclaims, including its rejection of the groundless statements and declarations in the notice regarding the failings of the reform and the impairment to competition. Bezeq presented the Ministry's unreasonable behavior and the update of the service file without jurisdiction, ignoring the complexity of the non-automated procedures and the time allocated to them.

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

#### **Use of terminal equipment in the wholesale market**

On December 30, 2015, the Ministry published an administrative instruction regarding the use of wholesale terminal equipment and a draft agreed arrangement sent for a response on August 31, 2015), according to which until February 17, 2016, a service or infrastructure provider who lends or leases terminal equipment to a subscriber and that subscriber switches to another service provider under the BSA service file, will not prevent the abandoning subscriber from making regular and proper use of the terminal equipment, will under no circumstances limit and will allow the abandoning subscriber to make such use of the terminal equipment in its possession ("Transition Period") and as from February 18, 2016, will not prevent or limit and will allow such use for 21 business days from the switch notice. The payment will be made by the abandoning subscriber in the same way as previously made prior to switching service providers. In its decision, the Ministry also determined that the service or infrastructure provider may not restrict the use of terminal equipment previously sold to the former subscriber.

#### **Passive wholesale services (physical infrastructures and SLU):**

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

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

The Minister of Communications' decision of November 17, 2014 set out the passive service tariffs, while the volume and content of the services have yet to be determined. Bezeq petitioned the Supreme Court to cancel the tariffs.

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

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

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

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

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

With respect to the effect of implementation of the wholesale market, as at the end of 2015, there were 250,000 wholesale lines in Bezeq's network. Implementation of wholesale telephony services for resale according to the outline of the hearing may increase the churn rate of Bezeq's BSA service subscribers and implementation of the transition to using Bezeq's physical infrastructures may lead to increased competition in the data communication segment by launching of services that compete with those of Bezeq using these infrastructures. These lines also include lines which were not originally in Bezeq's network (new or from a competitor's network). Bezeq believes that 11% of the fixed-line subscribers in Israel are part of the wholesale BSA services.

#### **Cancellation of Structural Separation**

In Bezeq's opinion, the Ministry of Communication must retract the structural separation applicable to it for the following reasons: (i) the conditions set out in the competition expansion policy document were met; (ii) there exists an intense competition in the cellular service segment; and (iii) and there are companies providing television services over the Internet.

#### ***Merger with DBS***

Until March 25, 2015, Bezeq held 49.78% of the shares of DBS and it also owned stock options which entitled it to acquire 8.6% of the shares of DBS. In view of a decision of the Supreme Court in 2009 not to approve the merger of Bezeq and DBS, Bezeq ended its control in DBS and from August 21, 2009, it ceased to consolidate the operations of DBS in its financial statements and its investment in DBS was presented according to the equity method. The balance of DBS shares were held by Eurocom D.B.S. (A company controlled (indirectly) by Messrs. Shaul and Yossef Elovitch, controlling shareholders of Bezeq and our company).

On March 26, 2014, the Antitrust Authority issued a decision permitting the merger between Bezeq and DBS under certain conditions.

A sub-committee of the Board of Directors of Bezeq was appointed to deal with the topic, and the Audit Committee and Board of Directors as well as a General Meeting of the shareholders of Bezeq approved the transaction between Bezeq and Eurocom DBS to acquire all the holdings of Eurocom DBS in DBS, which represented 50.22% of the issued share capital of DBS (41.62% on a fully diluted basis) as well as all the shareholders' loans that Eurocom had provided to DBS (NIS 1,538 million as at December 31, 2014). It was also decided that prior to the purchase of the Eurocom interest, Bezeq and DBS would accept the merger conditions established by the Antitrust Authority and Bezeq would exercise its option to acquire 8.6% of the issued share capital of DBS for no consideration. On March 25, 2015, Bezeq exercised the option to acquire 8.6% of the issued share capital of DBS, resulting in its holding 58.4% of the issued share capital of DBS. Subsequently, Bezeq received notice from the Antitrust Authority of the cancellation of the limitations that were imposed on Eurocom Group with respect to its holdings in DBS.

On June 23, 2015, approval was received from the Minister of Communications to transfer the means of control in DBS in such manner that Bezeq will control DBS and will hold the entire issued and paid-up capital of DBS. On June 24, 2015, Bezeq acquired the shares of DBS held by Eurocom and Eurocom assigned to Bezeq its entire rights in the shareholders' loans that it had provided to DBS in consideration of NIS 680 million. Upon completion of the transaction, DBS became a wholly owned subsidiary (100%) of Bezeq.

In addition to the cash payment of NIS 680 million, Eurocom D.B.S. will be entitled to two additional contingent payments consisting of: one additional payment of up to NIS 200 million payable in accordance with the tax synergy that may be generated from the transaction and an additional payment of NIS 170 million that will be payable upon the business results of DBS reaching certain milestones in the next three years.

The Concentration Law establishes a procedure that governmental authorities are required to follow when granting rights (such as a license, franchise or an agreement with the State of Israel, or the State, for the operation of essential infrastructure) in "Essential Infrastructure Fields" to an entity that is a "Concentrating Entity." "Essential Infrastructure Fields" include activities for which certain telecommunication licenses are required (excluding a specialized domestic operator (such as a VoB operator) and radio and cellular phone operator), broadcast licenses, various types of licenses in the energy field, water production, natural resources and other areas.

A "Concentrating Entity" is an entity that will be included in the list of concentrating entities that will be promulgated under the Concentration Law, which will include, among others, a significant non-finance company - a corporation or group whose sales turnover exceeds NIS 6 billion, or NIS 2 billion in a monopoly market, or whose total credit exceeds NIS 6 billion, as well as an influential entity in the field of broadcasting or printed media (including, among others, newspapers and publishers, broadcasters, news producers, cable and satellite television broadcast licensees).

On December 11, 2014, the Antitrust Authority published the list of concentrated entities according to the law. Bezeq, the corporations it controls and that are controlled by its controlling shareholders, and DBS are all included on the list and are considered "concentrated entities."

The Concentration Law contains provisions according to which a governmental authority is entitled to not grant rights in an Essential Infrastructure Field to a "Concentrating Entity," after finding that not granting such rights is unlikely to cause significant harm to the relevant field and its regulation. A governmental authority may not award, and may not determine conditions for the award of rights, in Essential Infrastructure to a "Concentrating Entity," before considering control concentration factors and consulting the Committee for Reducing Concentration that will be established in accordance with the Concentration Law, which must, in turn, provide its opinion within a period of 60 days from the governmental authority's referral. The governmental authority and the Committee are obliged to consider, among other things, factors concerning the prevention of the expansion of the operations of the "Concentrating Entity."

The extension of existing licenses in an Essential Infrastructure Field for a cumulative period exceeding ten years will be considered an "award of rights" and will, therefore, be subject to the foregoing provisions. In addition, the procedure described above will also apply to the grant of approval for the transfer to a "Concentrating Entity" of means of control of companies held by the State or that were previously State-owned companies (such as Bezeq).

The foregoing provisions were effective in December 2014, except that the provisions concerning the extension of existing licenses will become effective December 2017.

In addition, a governmental entity must consider factors relating to the promotion of an industry's competitiveness when awarding certain types of rights, which include rights in "Essential Infrastructure" as well as licenses for fields of activity that are not considered as Essential Infrastructure if the number of workers in the industry subject to the award of rights is restricted. The Commissioner will publish a list of rights whose award may have a significant impact on competition and an entity will be required to consult with the Commissioner before awarding any of the listed rights.

#### *Consumer Protection*

Changes in consumer legislation regularly affect the operations of Bezeq and its subsidiaries. The Bezeq Group is subject, among other things, to the Israeli Consumer Protection Law and regulations promulgated thereunder. The Israeli Consumer Protection Law allows consumers to cancel transactions and to disconnect from on-going services and requires service providers to obtain the express consent of a customer to continue the service after the end of an initial term of the contract. The Israeli Consumer Protection Law also sets forth provisions concerning a refund of charges that were collected from subscribers not in accordance with the terms of the agreement with them, as well as a maximum waiting time for a human response in call centers. In addition, a number of pending legislative proposals provide for additional consumer protection and may affect the conduct of Bezeq and its subsidiaries with their subscribers.

#### *Limitation on the Exit Fees a License-Holder May Collect From a Subscriber*

Under the Israeli Communications Law, fixed-line telephony subscribers, ILD subscribers and pay television subscribers whose average monthly bill is less than NIS 5,000 and who entered into an agreement after August 8, 2011 cannot be charged exit fees, nor can the subscriber be denied a benefit that he or she would have received had he or she not terminated the agreement. Commencing November 8, 2011, the amendment also applies to subscribers who entered into agreements before the amendment became effective and subsequently cancelled their agreements. In addition, a telecommunications license-holder may not demand immediate payment of the balance owed for terminal equipment in the event of cancellation of the agreement.

Similar provisions applied to cellular telephony operators with respect to subscribers with a certain number of phone lines. In April 2012, an amendment to the Israeli Communications Law was published, eliminating exit fees for cellular telephony customers that hold up to 100 phone lines and who entered into agreements with the cellular telephony operator subsequent to November 1, 2011.

In October 2013, the Ministry of Communications delivered to Bezeq an initial inspection report stating that Bezeq prevents subscribers that terminate their agreement with Bezeq from receiving a refund for terminal equipment (routers), allegedly in violation of the provisions of the Israeli Communications Law. Bezeq submitted its response to the Ministry of Communications objecting to the initial determination reflected in the inspection reports. We believe that Bezeq acts lawfully.

#### *Interconnect Tariffs and Royalties*

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

#### *Change in interconnect tariffs*

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

In 2011, the tariff payable to cellular operators was decreased substantially and in 2012 the tariff payable to domestic carriers was reduced significantly. The changes in the interconnect tariffs have an offsetting effect at the Bezeq Group level, as a result of the decrease in the expenses of Bezeq and its subsidiaries.

#### *Restriction of the exit penalty a license-holder can collect from a subscriber*

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

Holders of domestic carrier licenses, ITS licenses and broadcast licenses (including Bezeq, Bezeq International, DBS and B.I.P.) may not collect disconnect fees from subscribers who cancel agreements if their average monthly bill is less than NIS 5,000. Additionally, license holders may not withhold a benefit from a subscriber that would have been given had the agreement not been terminated and they may not demand immediate repayment of any outstanding payments for terminal equipment if the agreement is canceled. Bezeq believes that these legislative amendments have led to an increase in the churn rate.

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

#### *No discrimination in the offering of benefits and special tariffs*

On October 31, 2010, the Director General of the Ministry of Communications sent a clarifying document to the cellular operators on the applicability of certain clauses in their licenses that address equality and discrimination, including the offense of discriminating against subscribers belonging to the same group of subscribers by offering special benefits and tariff plans.

In its position submitted to the Tel Aviv District Court in January 2014, as part of a number of class actions that were consolidated against several communications operators, the Ministry of Communications stated that the licenses of the ISPs do not permit them to offer their customers "individualized tariff plans" tailored to the needs of individual customers and their ability to "haggle", and that they must offer a standard price for each service package, subject to certain exceptions.

On April 30 2015, the Ministry of Communications clarified its opinion with respect to "individualized tariff plans", "packages" or "service bundles" marketed to new subscribers, indicating that a new subscriber is someone who at the time of the inquiry to the license holder did not have an agreement with the license holder. Therefore, license holders may not demand a "waiting period" from anyone wishing to contract with them again and they must allow anyone to join any plan under the terms offered to new subscribers. In addition, according to the clarification, all subscribers have the option of switching between the different plans offered at the time of the request, without discrimination, including plans marketed to new subscribers. However, this clarification does not lessen the license holders' right to determine switching terms.

#### *Administrative Enforcement*

During 2011, the Israeli Securities Law was amended, and during 2012, the Israeli Communications Law and the Israeli Antitrust Law were amended. All the amendments introduced administrative enforcement procedures and authorized the relevant regulators to impose monetary sanctions for violation of these laws, the regulations promulgated thereunder and regulatory orders issued thereunder. Administrative enforcement was also introduced to labor laws with the legislation of the Enforcement of Labor Laws Law, 2011.

#### *Copyright/Trademark Laws*

Israel grants copyright protection to original literary, dramatic, musical and artistic works, as well as sound recordings and computer programs under the Israeli Copyright Law. Copyright protection automatically exists with respect to works which comply with the terms set forth in the Israeli Copyright Law and generally runs from the date of creation until the end of the seventieth year after the year of the death of the author.

In Israel, trademarks are governed by the Trade Marks Ordinance (New Version), 1972. A trademark registration is valid for 10 years from the date of the trademark application and the registration may be renewed for further periods of 10 years after each renewal. The Bezeq Group has numerous registered trademarks and trademark applications, see “*Description of our Business—Intellectual Property*.”

#### *Hearing About Call Center Waiting Times*

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

#### *Amendment of Licenses Relative to Ensure Operational Continuity of Communication Companies in Emergencies*

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

#### **Bezeq**

##### *Communications Order*

Bezeq was declared a provider of essential telecommunications services under the Communications Order. By virtue of that declaration, Bezeq is required to provide certain types of services and may not interrupt its provision of such services or narrow them. Among these services are basic telephony services, infrastructure services, transmission services and data communication services including, interconnect, and other services listed in the schedule to the Communications Order. The main provisions of the Communications Order are:

- Limitations on the transfer and acquisition of Means of Control, which includes a prohibition on holding “significant influence” over Bezeq or 5% or more of Means of Control of a certain kind without the prior written approval of the Ministers. Transferring, holding or acquiring control in Bezeq requires the approval of the Ministers by means of a control permit. Any unauthorized holding or acquisition is referred to as “Exceptional Holdings.” Exceptional Holdings must be sold within the periods prescribed by the Communications Order. Nationality requirements were established for the controlling shareholder in Bezeq. For more information see “*Regulatory—Regulations of Control Over Bezeq—Permit to Control Bezeq Granted to Members of the Eurocom Group*.”

- A duty to report to the Ministers upon demand is imposed on Bezeq with respect to any information on matters relating to provision of an essential service.
- 75% of the members of the Board of Directors of Bezeq must be Israeli citizens and residents who have security clearance from the General Security Service.
- The Chairman of the Board of Directors of Bezeq, the external directors (within the meaning of the Israeli Companies Law), the chief executive officer, the deputy chief executive officer and other office-holders in Bezeq as listed in the Communications Order, must be Israeli citizens and residents and have a security clearance appropriate to their functions.
- The approval of the Ministers is required for the grant of rights in certain assets of Bezeq (switches, cable network, transmission network and data bases). In addition, the grant of rights in Means of Control in the subsidiaries of Bezeq, including allotment of more than 25% of the shares in a subsidiary, requires the approval of the Ministers.
- Provisions were established for the protection of computerized systems and the purchase of hardware and software.
- Certain actions of Bezeq require the approval of the Minister of Communications, including voluntary liquidation, a settlement or arrangement between Bezeq and its creditors, a change or reorganization of the structure of Bezeq and a merger or split of Bezeq.
- The ongoing management of Bezeq and the center of its business must be in Israel, and Bezeq's board and shareholder meetings must be held in Israel.

#### *Bezeq's Domestic Fixed-Line License*

Bezeq was granted a general domestic fixed-line license for an unlimited period. The principal provisions of the license include:

- *Scope of license*-Bezeq must provide its services to all on equal terms for each type of service, irrespective of the location or unique cost. The Minister of Communications may modify or cancel the license or make it contingent. The license and any part of it cannot be transferred, no charge can be imposed on it, nor can it be subject to attachment.
- *Structural separation*-Bezeq must operate under the principles of structural separation (see *—The Bezeq Group—General—Structural Separation—*).
- *Marketing joint service packages*—Bezeq may request permission to market joint service packages, subject to certain limitations (see *“—The Bezeq Group—General—Limitations on Marketing Bundles—*”).
- *Tariffs*-If Bezeq provides a service or package of services for which no tariff is set under the Israeli Communications Law, such service or services must be offered at a reasonable price to all, without discrimination and at a uniform tariff.
- *Operations of networks and service standards*-Bezeq is required to maintain and operate its network and provide its services at all times, including at times of emergency, in an orderly and proper manner commensurate with the technical requirements and the nature of the service, and to work towards improving its services on an ongoing basis. The license includes an appendix, “Service Standards for the Subscriber,” which is to be amended after Bezeq provides the Ministry of Communications with data. Bezeq submitted its proposal for an amendment to the appendix, adapting it to the current state of affairs and the licenses of other operators, but the amendment has not yet been adopted.
- *Duty to provide services*-Bezeq is required to provide interconnect services to other public switching networks and to allow other telecommunications license holders to use its network. Bezeq has a duty to provide infrastructure services to other telecommunications license holders on reasonable and equal terms and must refrain from providing preferable terms to its affiliates. Bezeq is also obliged to provide some of its telecommunications services to the entire public in Israel. According to the Ministry of Communications' interpretation of this provision and the provisions regarding the provision of infrastructure services to license-holders, Bezeq is also obliged to provide infrastructure and transmission services to competing communications operators for services which compete with those of Bezeq.
- *Security arrangements*-Bezeq's license includes provisions relating to the operation of its network in times of emergency. Bezeq is required to design and operate its network in a manner that will prevent its collapse in an emergency. Bezeq provides special services to the security forces and is required to provide telecommunications services and maintain terminal equipment infrastructure for the security forces in Israel and abroad, as provided in its agreements with the Israel Defense Forces. Bezeq is required to appoint a security officer and to comply fully with the security instructions contained with the applicable provisions in its license.



- *Supervision and reporting*-The license imposes on Bezeq extensive reporting requirements to the Ministry of Communications. In addition, the Director General has the authority to enter the facilities and offices used by Bezeq and to seize documents.
- *Revocation of the License*-Pursuant to the Israeli Communications Law and the provisions of Bezeq's license, the Minister of Communications may revoke the license in certain events, including, among others, in the event of a material breach of the license by Bezeq or an immaterial breach of the license that was not cured in accordance with the instructions of the Minister of Communications, in the event that certain insolvency or liquidation proceedings are initiated against Bezeq, failure to comply with certain instructions provided under the Israeli Communications Law or to perform the services in an adequate manner, or if the public interest requires the revocation of the license.
- *Miscellaneous*:
  - The license includes limitations on the acquisition, maintenance and transfer of Means of Control pursuant to the Communications Order, as well as on cross-ownership, which are mainly a prohibition on cross-holdings by entities with an interest in another material domestic fixed-line licensee, and limitations on cross-holdings by entities with domestic fixed-line licenses or general licenses in the same segment of operation.
  - Bezeq is required to prepare a draft of the standard agreement it plans to offer to subscribers and to submit them for the review by the Director General upon demand. The Director General has the authority to instruct that changes be made. Bezeq is in the process of preparing such an agreement.
  - Pursuant to the requirement of the license, Bezeq provided a \$10 million bank guarantee to secure its fulfillment of the terms of the license and to indemnify the State of Israel against any loss it may incur due to violations. The Minister of Communications may declare the guarantee or part of it forfeit based on the terms of the license.
  - The Director General has the power to impose a monetary sanction for violation of any of the terms of the license.
  - During a calendar year, Bezeq may invest up to 25% of its annual income in activities not connected with the provision of its services (the income of its subsidiaries is not considered income for this purpose). The Minister of Communications is authorized to grant a variance from that percentage.

#### *Fair Competition and Antitrust Laws*

Provisions prohibiting Bezeq from engaging in anti-competitive practices can be found in its domestic fixed-line license, in the various communications regulations and in the Israeli Antitrust Law.

Bezeq was declared a monopoly under the Israeli Antitrust Law in its main fields of activity, including basic fixed-line telephony services, provision of communications infrastructure services, transfer and transmission of broadcasting services to the public, provision of high-speed access services through its access network to subscribers and provision of high-speed access services for ISPs through a central public telecommunications network.

In October 2010, Bezeq began to provide infrastructure and transmission services to competing telecommunications operators following an examination carried out by the Ministry of Communications. In October 2011, the Israeli Antitrust Authority informed Bezeq that the Commissioner was considering issuing a ruling to the effect that Bezeq had violated the provisions of the Israeli Antitrust Law by, among other things, not providing fixed-line infrastructure and transmission services for telephony and Internet services to its competitors, Cellcom and Partner.

On October 16, 2013 and October 5, 2014, the Minister of Communications published a hearing document regarding new regulation in the international communication services market. According to the proposed regulation, any domestic fixed-line carrier or cellular operator will be able to provide international communication services as part of the service packages offered to subscribers. The proposed regulation also includes the provision of international data communication and transmission services by domestic fixed-line carriers and cellular operators. Bezeq sent its response to the hearing supporting the proposal under different terms. However, on February 1, 2015, the Ministry published a secondary hearing regarding special regulation for Bezeq Group and HOT Group for the interim period until cancellation of the structural separation obligation in these groups, according to which Bezeq and HOT will only be able to provide these services through other operators. Bezeq objected to the proposed change.

On November 16, 2014, Bezeq received the decision of the Deputy Commissioner of the Antitrust Authority finding that Bezeq had abused its position as a monopoly and determined unfair purchase and sale prices of a service in a monopoly, in contravention of the Antitrust Law, in that it determined prices for Internet and telephony services that were lower than the prices Internet for infrastructure only, in a campaign in which it had offered new subscribers a special introductory six month rate. The Commissioner claimed that given that the Internet access infrastructure service is a critical input for the supply of Internet-based telephony services, then the price set by Bezeq places competitors who wish to offer this service at a disadvantage, as the price of the critical input for supply of the service was higher than the price of the final service which Bezeq offered its customers.

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

Bezeq has adopted an internal compliance procedure containing guidelines and an internal reporting and control system in order to make sure that the activities of Bezeq and its employees are carried out in accordance with the provisions of the Israeli Antitrust Law.

#### *Control of Bezeq's Tariffs*

Bezeq's telephony tariffs and certain other tariffs are prescribed in regulations. As a result of a deliberate regulatory policy, the monthly usage tariff for a fixed-telephone line is set at a level that does not cover the costs involved in providing it (a situation known as "accessibility deficit"). This deficit has been reduced over the years, but still exists. The tariffs are updated according to a formula set forth in the regulations. Bezeq's controlled tariffs are reviewed by a public committee every few years, at which time Bezeq is exposed to material changes in its tariff structure and tariff levels. The mechanism for the update of the tariffs has resulted in the erosion of the tariffs over time.

Control of the tariffs creates or could create difficulties for Bezeq in providing an appropriate and competitive response to changes in the market and in offering competitive prices on short notice. In addition, the restrictions on granting discounts on tariffs limit Bezeq's ability to participate in certain tenders.

Under the Israeli Communications Law, Bezeq may apply to the Minister of Communications and the Minister of Finance, for an approval for an alternative payment package for a set of services for which tariffs are prescribed in the regulations, subject to certain conditions. Unless either the Minister of Communications or the Minister of Finance announces his objection within the period set forth in the Israeli Communications Law, Bezeq may offer the alternative payment package.

Under the Israeli Communications Law, a telecommunications license holder can demand reasonable payment for a telecommunications service for which the tariff is not set in the regulations. Bezeq sets the tariffs for these types of services.

#### *Deployment of Communications Facilities*

The deployment and manner of set-up of communication facilities in Israel are regulated by the NOP 36 and NOP 56. These plans were designed to ensure coverage for transmitting and receiving radio, television and wireless communications, while avoiding radiation hazards, minimizing damage to the environment and simplifying and increasing the efficiency of the processes involved in setting up new facilities.

Part A of NOP 36 deals with guidelines for erecting small and miniature broadcasting installations. Bezeq has obtained building permits for most of its small broadcasting installations in accordance with NOP 36A. From time to time, a need arises to add broadcasting installations which require that building permits be obtained in accordance with NOP 36A. Given the exemption granted under the orders of the Planning and Construction Law and of the Israeli Communications Law, we believe that Bezeq is not obliged to obtain building permits for miniature broadcasting installations, which are "wireless access facilities" under those laws. There are a number of initiatives to cancel this exemption, and its cancellation could have materially adverse implications, including making it difficult for Bezeq to provide universal service as required by the provisions of its license.

NOP 56 became effective in June 2008 and regulates the manner of construction and licensing of communications facilities in the Palestinian Administered Territories. NOP 56 has transition provisions for facilities erected with a permit for small installations. The guidelines also include a requirement for obtaining a communications license and the receipt of necessary consents from the Commissioner of Government Property at the Civil Administration. Bezeq has obtained licenses for 76 installations in the Palestinian Administered Territories and is in the process of obtaining licenses for an additional five installations in the Palestinian Administered Territories.

As a result of a process initiated by the State of Israel, IBC, a third fixed-line communications infrastructure company was established, 40% of which is held by the government-owned IEC and 60% of which is held by a consortium of non-government companies that was selected by the IEC in a tender procedure in June 2013. In August 2013, IBC was granted a general license for the provision of telecommunications infrastructure services (including data services, digital transmissions and VPN) via fiber optic networks. According to the license, IBC will enter into an agreement with the IEC to use the IEC's fiber optic network in Israel to provide wholesale products to telecommunication services providers. In addition, IBC was granted a five-year special license to provide wired domestic data communications services, according to which it is entitled to provide IPVPN services and broadband data communications services.

#### *Authority with respect to real estate*

Pursuant to the provisions of the Communications Law, the Minister of Communications granted Bezeq certain powers in connection with real estate. The law distinguishes between land owned by the State, the Development Authority, the Jewish National Fund, a local authority or a corporation lawfully established and owned by one of them, and a road ("Public Land"), and other land ("Private Land"). With regard to Public Land, Bezeq and any person authorized by it, can enter and perform work there, provided that approval for deployment of the network has been granted by the local Planning and Construction Committee. Under the provisions of the Telecommunications (Installation, operation and maintenance) Regulations, 1985, if Bezeq is of the opinion that providing a telecommunications service to an applicant requires the installation of a telecommunications device for transmission or switching on the applicant's premises (or in shared premises or common property), Bezeq is permitted to request that the applicant, as a prerequisite for providing the requested service, allocate a suitable place on the premises for installation of the device, for the sole use of Bezeq, and it may use the device to provide service to other applicants also.

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

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

#### *Exemption from a Permit to Add Antennas to Existing Lawful Broadcasting Facilities*

On August 1, 2014, the Planning and Building (Works and Buildings that are Exempt from a Permit) Regulations, 2014, entered into effect. These regulations provide that the addition of an antenna to an existing, lawful broadcasting facility is exempt from a permit, subject to meeting a combination of conditions and exclusions, including that it is consistent with the plans and applicable spatial instructions, to be determined by the local planning committees. Bezeq began to add antennas to its broadcasting facilities pursuant to the provisions of these regulations.

## ***Pelephone***

### *Cellular Telephony Licenses*

Pelephone has been granted a general license to establish and operate a cellular telephone network in Israel, which is valid until September 8, 2022. In addition, in April 2001, the Civil Administration for the Administered Territories granted Pelephone a general license for the provision of cellular telephony services in the Administered Territories that is valid until September 2022 and the provisions of the general license granted to Pelephone by the Ministry of Communications are also applicable to this license. The following are the principal provisions of Pelephone's general cellular telephony license:

- Under certain circumstances, the Minister of Communications is entitled to modify, restrict or suspend the terms of the license, and in certain instances to revoke it.
- The license is non-transferable, and it contains restrictions on the acquisition or transfer (including by means of a charge), directly or indirectly, of control or of 10% or more of any Means of Control in Pelephone, unless the Minister of Communications has given his consent beforehand. The license includes certain prohibitions on crossholdings in Pelephone and in other telecommunications operators.
- Pelephone is obliged to provide interconnect services under equal terms to all other operators and must refrain from any discrimination in the implementation thereof.
- Pelephone must refrain from giving a preference in providing its infrastructure services to a licensee with an interest (as defined in the license), such as a related party, over another licensee.
- Pelephone is generally not entitled to sell, lease or mortgage any of the assets used for the implementation of the license without the consent of the Minister of Communications, except as stipulated in the license.
- In periods of emergency, the relevant governmental authority may issue certain instructions to Pelephone with respect to its mode of operation and/or manner of provision of services.
- The license sets forth the types of payments that Pelephone may collect from its subscribers for cellular telephony services, mechanisms for setting tariffs, reports that Pelephone must submit to the Ministry of Communications and also the duty of serving notice to the Ministry of Communications prior to modifying its tariffs. The license also determines the Minister's power to intervene in setting tariffs in certain instances.

The license commits Pelephone to provide a minimal standard of service, including setting up of service call centers, the determination of a maximum period for repair of malfunctions, an accounts collection procedure and protection of the privacy of the recipient of the service.

- To secure Pelephone's undertakings and to compensate and indemnify the State of Israel for any damage that may be caused by acts committed by Pelephone, Pelephone is required to furnish bank guarantees to the Ministry of Communications. In May 2015, Pelephone deposited guarantees in the amount of NIS 80 million with the Ministry of Communications, which replaced the previous guarantees given in the amount of USD 10 million, as required under the 4G LTE frequency allocation tender.
- Pursuant to the Israeli Communications Law and the provisions of Pelephone's license, the Minister of Communications may revoke the license in certain events, including, among others, in the event of a material breach of the license by Pelephone or breach of certain obligations specified in the license, in the event that certain insolvency or liquidation proceedings are initiated against Pelephone, if officers of Pelephone are convicted of committing certain offenses, or if the public interest requires the revocation of the license.

### *Hearing in regard to the required coverage and quality*

In July 2014, the Ministry of Communications published a hearing directed to holders of a general license for providing cellular services, including Pelephone. The hearing discusses an amendment to the operators' licenses that will tighten the coverage and quality requirements for public telecommunications systems using 2G and 3G technology with nationwide deployment and in the Administered Territories. Pelephone submitted its comments and reservations to the hearing. If the coverage and quality requirements are amended as specified in the hearing, Pelephone and the other operators will likely face significant additional costs.

### *Allocation of Frequencies*

The Telegraph Ordinance regulates the use of the electromagnetic spectrum, and is applicable to Pelephone's use of radio frequencies as part of its infrastructure. Under the Telegraph Ordinance, the establishment and operation of a system using radio frequencies requires a license and the use of radio frequencies requires designation and allocation of a suitable frequency. The Telegraph Ordinance imposes license fees and fees for designation and allocation of frequencies.

For several years, there has been a shortage of radio frequencies for public use in Israel (due in part to the allocation of many frequencies for security uses), and the Israeli government has limited the number of licenses issued for the use of frequencies, while increasing fees payable in respect of the allocation of frequencies. The shortage of frequencies may also cause difficulties in implementing certain technologies (e.g. advanced technological infrastructures such as LTE).

LTE technology, which is based on an Internet Protocol that can transfer data at higher speeds than the existing Generation 3.5 technology, is used by many operators around the world and is now supported by many smartphones in use in the Israeli market. The Ministry of Communications issued a tender for allocating LTE frequencies in 2014 and Pelephone was awarded 15 MHz on the 1800 frequency band, at an aggregate cost of NIS 96 million. The adoption of the of LTE technology could have a significant effect on the market.

#### *Network Site Permits*

The set-up and operation of a wireless communication infrastructure, including cellular communications, are subject to the provisions of the Planning and Construction Law and the Israeli Radiation Law and permits from the Ministry for Protection of the Environment are required.

#### *Local Building Permits*

Pelephone's cellular telephony services are provided through cellular sites spread over Israel in accordance with engineering requirements. The constant need to upgrade and improve the quality of the cellular telephony services requires setting-up cellular sites and changes in configuration and existing antenna systems. Pelephone has deployed two main types of broadcasting sites: (i) macro sites that require a building permit from planning and building councils; and (ii) wireless access devices, which historically did not require a building permit. Under a temporary order of the Israeli Supreme Court initially issued in September 2010, Pelephone is currently not subject to certain limitations with respect to the construction of new wireless access devices absent a permit, as described below.

The licensing of cellular broadcasting sites is governed by the National Outline Plan for Communications 36, or NOP 36. The purpose of NOP 36, which came into effect in 2002, is to regulate the deployment and manner of setting-up broadcasting facilities, so that the entire country is covered for transmission and reception, with minimal damage to the environment and the landscape. Pelephone and its competitors have encountered difficulties in obtaining some of the required approvals and in particular, approvals from planning and building authorities. There is a pending proposal to amend NOP 36, which may result in more stringent regulations that could complicate and impede the process of obtaining building permits for cellular sites.

At the same time, criticism has been leveled at NOP 36 by various entities, including the contention that it is not applicable to 3G frequencies, which has led to a proposal to amend NOP 36. The amended NOP 36 is currently pending government approval.

As part of the "pergola reform," on August 1, 2014, Amendment 101 to the Planning and Building Law, 1965, the Planning and Building (Works and Buildings that are Exempt from a Permit) Regulations, 2014, entered into effect. Regulation 34 provides, among other things, that the addition of an antenna to an existing, lawful broadcasting facility is exempt from a permit, subject to compliance with a combination of conditions and exclusions, including consistency with the plans and the applicable spatial instructions, to be determined by the local planning committees.

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

On August 3, 2014 the State filed its response to the petition with the High Court of Justice asking that it be denied. Pelephone's response to the petition was filed on August 10, 2014, wherein Pelephone requested that the Court deny the petition.

On March 9, 2015 a hearing was held on the petition and the petitioners arguments were heard, claiming that the petition in question is related to another petition for which an order was granted and arguments were heard. The petitioners argued that the link between the petitions should not be severed and that the hearing be deferred until after a ruling is made with respect to the other petition. The High Court of Justice also stipulated that if a ruling is not made with respect to the other petition within six months, the petitioners may return and request that a hearing be held.

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

Pelephone's ability to maintain and preserve its cellular service quality as well as its coverage is partially dependent on its ability to set up cellular sites and install infrastructure equipment, including broadcasting sites. Any difficulties encountered by Pelephone in obtaining the required permits and approvals may adversely affect the performance of its existing network and the establishment of additional cellular sites required by the network. The inability to resolve these problems on a timely basis may prevent Pelephone from attaining the service quality goals specified in its license.

There are administrative or other delays in some planning and building councils regarding the issuance of building permits for sites. As a result, Pelephone operates a number of broadcasting sites that have not yet received permanent building permits. Pelephone has applied to the planning and building authorities for the building permits and these applications are at various stages of discussion and approval.

The establishment of a broadcasting site without obtaining a building permit constitutes, among other things, a breach of the Planning and Construction Law, and in some instances, this has resulted in demolition orders against sites, indictments or the initiation of civil proceedings against Pelephone and some of its officers. Pelephone has succeeded in most of these instances to avoid demolition or to delay the execution of demolition orders pursuant to arrangements it reached with the planning and building authorities to resolve the lack of licensing. These arrangements have not required any admission of guilt by officers of Pelephone or their conviction. However, it is not certain that this will continue in the future, or that there will be no further instances in which demolition orders are issued and indictments are filed in respect of building permits, including against officers.

Pelephone has also established broadcasting sites using wireless access devices, which require specific radiation permits according to the Israeli Radiation Law, but historically did not require a building permit if they were constructed pursuant to the conditions provided in an exemption provision pursuant to the Israeli Communications Law and the planning and construction law. Some local authorities disputed the applicability of the exemption provision to wireless access devices and to their use. Pelephone's position regarding the applicability of the exemption was accepted in a number of rulings and decisions by local courts and the use of such facilities and the supporting equipment were approved. One verdict provided an opposite ruling. Appeals have been filed for some of these rulings and decisions. Under a temporary order issued by the High Court of Justice on September 15, 2010, as amended on February 16, 2011 and July 17, 2012, and as extended on September 30, 2013, Pelephone, Cellcom and Partner are permitted under the exemption provision to exchange wireless access devices with another wireless access device for maintenance purposes, provided that the new device is in the exact same location as the replaced device and subject to other conditions in the temporary order, but are prohibited from erecting new wireless access devices under the exemption provision. HOT Mobile and Golan are temporarily permitted to deploy wireless access devices, under more lenient conditions.

On September 15, 2014 a hearing was held on petitions filed with the High Court of Justice and the arguments of all the parties were heard. In this context, the High Court of Justice recommended that the parties attempt to reach an arrangement that will balance the conflicting interests and move the process of promulgating the regulations forward in the spirit of the draft regulations from March 2010. The High Court of Justice further instructed the State to file an updated notice within 120 days which will include, among other things, the Minister of the Interior's current position, the current position of the Minister of Communications with respect to both the draft regulations and the existing regulations, the current position of the Antitrust Commissioner and an update of the Knesset Economic Affairs Committee discussions. The parties were also granted permission to respond to the State's position within 30 days of receipt. The High Court of Justice also instructed the parties to advise, no later than January 20, 2015 as to whether they had reached agreement and determined that after receiving notice from all the parties, the High Court of Justice will decide on how the cases will continue. In the State's update notice to the High Court of Justice dated January 19, 2015 the State explained, among other things, that the Minister of the Interior at that time, Gideon Saar, announced his decision to resign and consequently the terms of office of the relevant ministers changed. The State further stated that on December 8, 2014, the Knesset passed a bill to dissolve itself, ending the session and the Knesset went to pre-election recess. Under these circumstances, the State requested an extension to file its update notice until July 15, 2015, and on January 21, 2015 the High Court of Justice granted the requested extension.

Under this notice the State announced, among other things, that on May 14, 2015 a new government was formed in Israel and it was decided to transfer most of the authority of the Minister of the Interior under the Building and Planning Law to the Minister of Finance. The State further announced that on July 13, 2015 the Knesset approved the transfer of authorities from the Minister of Interior to the Minister of Finance. The State added that the Minister of Finance should be given reasonable time to address the issue of regulating regulations under the Building and Planning Law, and to formulate his opinion regarding the matter. Under the circumstances that were created and to enable the Minister of Finance as well as the Ministers of Communications and Environmental Protection to address the issues in the petition and to formulate their opinions, the State requested a further extension for filing its updated notice by December 15, 2015. On July 19, 2015 the High Court of Justice awarded the requested extension.

On December 24, 2015 an updated notice was filed with the High Court of Justice by the State according to which the State announced that it is reviewing the options recommended by the Minister of Finance, to whom the authority to regulate regulations of the Building and Planning Law was transferred. The State further announced that the Deputy Attorney General would hold a hearing on the matter in the near future. Under these circumstances the State requested additional time to review the options for regulating "balanced" regulations and to file, another notice on a date that will be fixed by the High Court of Justice.

On November 19, 2015, Partner Communications Ltd. and HOT Mobile Ltd. filed a petition to the High Court of Justice requesting that the temporary injunction of September 16, 2010 be limited. In the State's response, that was attached to the petition, the State made its consent to limiting the temporary injunction subject the companies dismantling and removing no less than 300 wireless access installations within one year. On January 5, 2016 Cellcom Israel Ltd. filed a petition on its behalf asking that the limit contained in the temporary injunction would also apply to it, but without application of the condition to dismantle access installations, based on the arguments set out in its petition. On January 12, 2016, Pelephone Communications Ltd. also filed a similar petition regarding limiting the applicability of the order, and Pelephone also requested that the obligation to dismantle access installations should also not apply to it.

In view of the foregoing, on January 27, 2016 the High Court of Justice issued a decision requiring the State to file its response to the petitions of Cellcom and Pelephone to limit the temporary injunction, with reference to their request not to dismantle part of the access installations that they hold, by February 3, 2016.

Pelephone believes that if the Access Installation Regulations are approved as proposed, the option of using the building permit exemption track in order to erect cellular access installations will be severely restricted. A restriction of this track, together with the proposed tightening of the terms for construction of base sites in the parallel Proposed New NOP 36A track is likely to lead to noticeable increase in the obstacles restricting the construction of new broadcasting sites and access installations, and would have an adverse effect on the quality of the cellular network. At present, Pelephone operates 461 wireless access installations.

Pelephone's ability to maintain and preserve the quality of its cellular services as well as its coverage is based partly on its ability to construct cellular sites and install information equipment, including broadcasting sites. The difficulties encountered by Pelephone in obtaining the permits and approvals required may have an adverse effect on the existing infrastructure, network performance and on the construction of the additional cellular sites required by the network. Any inability to resolve these issues in a timely manner will likely prevent Pelephone from achieving the service quality targets established in the cellular license.

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

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

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

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

#### *Permits of the Ministry of Environmental Protection*

The Minister for Environmental Protection has promulgated regulations pursuant to the Israeli Radiation Law that address issues such as fees for permits, the method of measuring radiation, etc.

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

In 2010, the Ministry of Environmental Protection notified Pelephone of a new condition for all of its network site operation permits, according to which it must install in its systems software (provided by the Ministry of Environmental Protection) that monitors and reports the level of power created in real time from the operation of its network sites.

#### *Additional Environmental Regulation*

Israeli Consumer Protection Regulations (Information regarding Non-Ionizing Radiation from a Cellular Telephone), 2002 specify the maximum permitted radiation level for a cellular telephone measured in units of Specific Absorption Rate ("SAR") and require Pelephone to notify its customers regarding the maximum permitted radiation level. As far as we are aware, all of the cellular telephones that Pelephone markets comply with the relevant SAR standards.

Pelephone conducts periodic radiation tests in order to ascertain its compliance with permitted operation standards and the standards of the International Radiation Protection Agency. These tests are outsourced and performed by companies authorized by the Ministry for Protection of the Environment. Pelephone has an internal enforcement procedure for supervision of implementation of the provisions of the Israeli Radiation Law, which is supervised by a senior manager. The purpose of the procedure is to incorporate the provisions of the Israeli Radiation Law into the procedures of Pelephone and limit the possibility of violations.

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

#### *Cellular Infrastructure Sharing*

In July 2011, the Ministry of Communications issued a press release listing the following main recommendations of the inter-ministerial committee on the sharing of infrastructures in the cellular market.

In May 2013, the Ministry of Communications, Ministry of Health and the Ministry of the Environment announced that a pre-condition to the deployment of fourth generation cellular infrastructure is the implementation of the inter-ministerial task force's recommendations regarding the sharing of cellular infrastructures.

#### *Separation between the Sale of Terminal Equipment and the Sale of Cellular Telephony Services*

In January 2013, an amendment to the Israeli Communications Law became effective, under which a cellular telephony operator may not make a subscriber's commitment to receive cellular telephony services dependent on that subscriber's agreement to purchase, rent, borrow or lease terminal equipment. In the past, Pelephone's principal sales method was to offer discounts on the price of cellular telephony services subject to the purchase of terminal equipment. This amendment has had a negative effect on the sale of terminal equipment.

#### *Ministry of Communications Hearing Concerning WiFi*

On August 6, 2014, the Ministry of Communications published a hearing report on the issue of amending Bezeq International's ISP license (corresponding with the bill discussed by the Economic Affairs Committee). The main points of the amendment are expansion of the existing obligation under the provisions of the Communications Law to inform customers and offer them an opportunity to protect themselves against offensive content by means of basic filtering software that is provided free of charge. As part of the hearing, the Ministry sought, among other things, to require Bezeq International to offer its customers more advanced filtering software free of charge, allowing them to choose between an applicative filter (which must be compatible for all devices) and the use of a network filter. Some of these solutions cannot be applied at the present time.

#### **Bezeq International**

On February 21, 2016, Bezeq International's license was amended by the General Director of the Ministry of Communications and was replaced by a unified general license to provide telecommunications services, or the Unified License.

The Unified License cancels and replaces the general license for providing international telecommunications services that was granted to Bezeq International on June 2, 1996, and the special general license for providing fixed-line domestic telecommunications services granted to B I P Telecom. Ltd. on February 8, 2009. In addition, the Unified License also cancels and replaces the special licenses for providing NEP and Internet services previously granted to Bezeq International. The Unified License, which is valid until May 2, 2025, covers all the services that Bezeq International was permitted to provide to date. Pursuant to Ministry of Communications requirements, Bezeq International provided a bank guarantee of NIS 5 million in compliance with the terms of the Unified License.

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



In August 2012, the Ministry of Communications amended the licenses of the ISPs, adding provisions to the licenses concerning filtering of offensive sites and content, as a supplementary measure to the existing provisions of the law with regard to this issue. The amendment stipulates that a license holder will be required among other things, to inform its subscribers about offensive websites and content which are not suitable for children and teenagers and to include details of methods for blocking access to such sites and content. Likewise, the license holder must offer its subscribers an effective service for filtering offensive sites and content, for no additional payment.

On August 6, 2014 the Ministry of Communications published a hearing on the issue of amending Bezeq International's ITS license (corresponding with the bill discussed by the Economic Affairs Committee). The main points of the amendment are expansion of the existing obligation to inform customers and offer them an opportunity to protect themselves against offensive Internet content and requiring Bezeq International to provide its customers, free of charge, with the most advanced filtering software; solutions that in part are not applicable at this time.

## **DBS**

The television broadcasting industry in Israel is highly regulated. Broadcasting is carried out pursuant to various broadcast licenses and is subject to the ongoing supervision of the Ministry of Communications and the Broadcasting Council. DBS's operations are regulated by and subject to an extensive system of laws that apply to the area of broadcasting, including the Israeli Communications Law and regulations thereunder and the Communications Rules, as well as administrative directives and Broadcasting Council decisions. Pursuant to the Communications Rules, various obligations and restrictions apply to DBS, including those relating to broadcast content and the amount and manner of investment in local productions. In addition, DBS may own up to 30% of the local channels broadcast by it.

Operations in the broadcasting sector are subject to extensive regulation under the Communications Law, with a strict licensing and monitoring regime and Ministry of Communications' policy decisions. Broadcasting operations are also under the ongoing supervision of the Council for Cable TV and Satellite Broadcasting, or the TV Council, which sets policy, makes rules and monitors many areas of the sector, including broadcasting content, compliance regarding original Israeli content, broadcasting ethics, consumer protection and approval of the channels broadcast and price controls. Non-licensed broadcasters providing multi-channel television services are currently not subject to the foregoing supervision.

In September 2014 the Prime Minister and Minister of Communications appointed an advisory committee, or the Filber Committee, to formulate recommendations regarding regulation of the broadcasting and content sector, including applicability to new players and formulating legislative amendments. On February 3, 2016 the Filber Committee submitted its interim recommendations which include, among other things, applicability of broad regulatory duties (including the duty to invest in and present original productions) and soft regulation (that includes the duty to mark and classify content and restrictions on marketing content) for major providers that are defined as audio-visual service providers whose market share exceeds 20% of the television provider market revenues (and so long as the market share is no less than 15%), and applicability of soft regulation only for non-major audio visual providers.

The Committee also intends to review the relief of regulation applicable to the broadcasting segment with regard to basic bundles and narrow bundles, regulating the launch and removal of channels, broadcasting dates and times and broadcasts in various languages, as well as the TV Council's rules relating to original productions, relief regarding the length of series, production adequacy and premier broadcasting duties.

The Committee further recommended that a gradual four year plan be drafted regarding investments in high-end original productions, according to which, among other things, such investment duty will apply to DBS and HOT in an amount that will not fall below 4% of its revenues in the first year of implementation of the recommendations and no less than 3% of revenues in the fourth year

### *The broadcasting license*

The broadcasting license provides provisions regarding the types of fees the licensee may collect from its subscribers for services provided under the license, and those fixed in DBS's price list. The vast majority of subscribers join special campaigns offering DBS services, including various content combination packages, related services, as well as the receipt and installation of terminal equipment at prices below the listed price.

The vast majority of subscribers join special offers, including different combinations of content packages, related services, as well as receiving and installation of terminal equipment at prices below the listed price for all components of the special offer and they appear in the DBS price list. The Council chairperson may intervene in campaigns or reductions offered by DBS if he/she finds that they are misleading to the public or discriminate among subscribers.

Under the Communications Law, the license may stipulate maximum prices that can be charged to subscribers. At present, no such prices have been set. Furthermore, under the Communications Law, the Minister may set the price for the basic package.

In December 2015, the TV Council issued a hearing document regarding setting a price policy and applicability of transparency provisions, addressing the multi-channel television market, including DBS. Prior to issuing the Hearing Document the Council chairperson decided not to permit DBS to raise the price for its VOD services. At the same time, the Council chairperson also decided not to approve the various price hikes announced by HOT. The Hearing Document stated, among other things, that based on the economic test conducted by the TV Council, the Council assumes that the current price structure in the multi-channel television market significantly harms competition and allegedly also raises concerns of discrimination and misrepresentation. Therefore, the Council initiated a hearing regarding its intention to prescribe comprehensive policies regarding prices in the multi-channel television market that will be based on various recommendations brought before the TV Council, including the recommendation to deny the option of raising the price of the current campaign within the period of the campaign; to provide that new campaigns will apply for subscribers for a limited period of 4 months only; to prohibit offering preferential prices to subscribers who threaten deserting or who are in the stages of disconnecting; to establish a prohibition on discrimination between campaigns and tracks offered at any given time; and to explore the option of canceling price gaps between existing customers unrelated to the date on which they joined and the track that they chose, as well as to define a standard uniform price for these subscribers.

The Hearing Document also stated that a recommendation was brought before the TV Council that if the reform and setting of a price policy will not be achieved within a reasonable period of time, the required objectives (as set out in the Hearing Document - significant improvement in transparency and simplifying the customers' ability to compare prices and the scope of the competitiveness), a more thorough investigation will examine applying price controls on the multi-channel television companies. The Hearing Document further stated that in view of the economic study presented before the Council, and with special attention to the significance of the principle of transparency, the Council decided that it should order the disclosure of all the price lists and campaigns of the companies in the multi-channel television market, by amending the licenses of the companies so that they will be required to publish on their websites all the campaigns offered to all of the customers of the companies. The TV Council also decided to temporarily freeze price hikes in the multi-channel television market and to not allow companies to offer new campaigns (this decision regarding a temporary freeze was canceled in February 2016, also due to HOT and DBS undertaking to publish new campaigns). In February 2016, DBS filed its response to the Hearing Document. The implementation of the proposal of the Council could have a substantial adverse effect on DBS's revenues and profitability.

#### *Obligation to invest in local productions*

Under the provisions of the broadcasting license and the TV Council's decisions, in 2015 DBS was required to invest an amount no less than 8% of its revenue from subscription fees in local productions, and according to the communications regulations and the decisions of the TV Council, DBS is required to invest different amounts of these investments in various genres of local productions. In 2015, DBS also supplemented investment shortfalls set by the Council for certain genres. The obligation to invest in local productions in 2016 remains at 8%, of revenues. In November 2015, the TV Council decided that the rate of investment in local production applicable for 2017 onwards will increase to 9% of revenues, so long as the TV Council does not order otherwise and so long as there is no decline in DBS's revenues or the number of its subscribers, in a manner that is to be prescribed in the decision.

#### *Requirement to transmit channels*

In accordance with the requirements under the law and license, DBS is required to allow the producers of channels set out in the law to use its infrastructures to transmit broadcasts to its subscribers in exchange for a payment to be determined in the agreement. Lacking agreement the payment will be determined by the Minister, after consulting with the TV Council.

Pursuant to the amendment to the Communications Law in 2010, niche channels are exempt from fees other than to HOT and DBS.

Content of the broadcasts and obligations with respect to subscription

The broadcasting license sets out provisions that relate to the content of DBS's broadcasts, including an obligation to obtain the Council's approval of the channels broadcast by DBS. The Communications Law forbids holders of broadcast licenses to broadcast commercials, other than a few exceptions. The broadcast license also includes provisions regarding the subscriber service terms, including discrimination prohibition.

#### *Ownership of broadcast channels*

Pursuant to the Communications Rules, DBS, including its affiliates as defined in the Communications Rules, may own up to 30% of the domestic channels it broadcasts (compared with the 20% applicable to HOT.) DBS is restricted under the Communications Law with respect to ownership of news broadcast productions, however under the Communications Law (Telecommunications and Broadcasts) (Amendment No. 59 and Temporary Order), 2014 and the Council's decision of March 2014, DBS has broadcast domestic news since April 2014. The Temporary Order was issued for two years as of April 2014.

#### *General provisions regarding the broadcasting license*

The Minister and the Council have parallel authority to amend the broadcast license. The Minister was authorized to cancel or postpone the broadcast license for causes set out in the Communications Law and the broadcast license. The Communications Law and broadcast license stipulate restrictions on the transfer, attachment and encumbrance of the broadcast license and any of the assets of the broadcast license. The broadcast license requires receipt of the approval of the Minister for specific changes in the holding of the means of control in DBS and imposes a reporting requirement regarding the holders of the means of control; harming competition by way of an agreement, arrangement or understanding with a third party in terms of provision of broadcasts and services is prohibited, unless approved in advance and in writing by the Council; the obligation to file reports to the Ministry of Communications was defined as well as conditions regarding the regulation of the activity of the licenses; an obligation was stipulated to provide bank guarantees that are currently NIS 40 million to the Ministry of Communications to guarantee DBS's undertakings under the license (in order to issue these guarantees, DBS shareholders provided securities to the issuing banks).

#### *Wiring in subscribers' homes*

In October 2012, the Ministry of Communications announced that it would cancel the administrative order applicable at that time, regulating subscriber churn between DBS and HOT, and reciprocal use of the infrastructure in subscribers' homes which in some cases is owned by the other provider. This announcement was further to the request by DBS and HOT to amend the administrative order, primarily to cancel the advance notice obligation for a subscriber connecting to another service provider. In 2013, DBS and HOT applied to the Ministry of Communications to amend this decision, so that the administrative instruction is not canceled but will be amended as they requested. The Ministry of Communications' position on this issue has not yet been received.

#### *Offering service bundles*

Under the broadcast license, DBS may offer joint service bundles that include service provided by Bezeq and service by DBS, subject to obtaining Ministry of Communications approval (and if no objections are raised within the period specified in the license, such approval will be deemed granted) and subject to conditions, the most important of which are the "unbundling" obligation, and the existence of a corresponding bundle marketed by a licensee that is unrelated to Bezeq. A joint service bundle that includes Bezeq's Internet infrastructure service only, does not require Ministry of Communications approval and the unbundling obligation does not apply.

DBS believes that in view of the development of competition between the communications groups and the growing importance of the supply of comprehensive communications services, if the restrictions with regard to Bezeq's collaboration with DBS remain in place, the adverse impact of such restrictions on DBS's results may increase.

On March 10, 2016, the TV Council laid out certain decisions, including, among else that each main special deal (a deal including the broad basic package, the narrow basic package or any other basic package that will be offered in the future) will be priced for a defined and fixed period of 4 to 18 months only during which no price increase will be permitted.

#### *Regulation of the transmission of video content via media infrastructures*

In July 2015, the committee that was appointed to examine regulation of the commercial broadcasts in 2014 submitted its final report. This report contains, among other things, the following recommendations: the establishment of a unified regulatory authority in the communications industry that will prescribe a list of issues that will be arranged through mutual regulation and a code of ethics, the duty to label and classify services, mandatory reporting dates for those entities that are required to report and measurable parameters for checking the level of competition in the communications sector.

The committee's decisions, if applied, may affect the developing trend of video content transmitted over the web.

DBS believes that the VOD services it provides over the web, are not subject to the regulations currently applicable to the multi-channel television broadcasts and as far as it is aware, the other services it provides via the Internet (such as yesGo) are also not subject to such regulation. Nonetheless, from the Council's various decisions it appears that the Council believes it is authorized to also regulate these services regarding DBS. In the event the foregoing regulations will be formulated or applied, they may affect the services provided by DBS.

## DTT

The Second Authority for Television and Radio, or the Second Authority, operates a digital terrestrial television and radio broadcasting system, or DTT, commercially known as Idan Plus, through which certain channels are broadcasted to the public, free of charge. It currently broadcasts the channels of the Broadcasting Authority (Channel 1 and Channel 33), the commercial channels (Channel 2 and Channel 10) and the Knesset Channel (Channel 99). The DTT operator may broadcast additional channels including radio channels, educational channels and special topic channels. These channels will generally carry broadcasting fees, but the Ministers of Communications and Finance may elect to subsidize the broadcasting fees for subject-based channels and niche channels. The subject-based channels may, under the law, finance their broadcasts by charging a subscription fee in addition to the alternative financing through commercials. The Ministers of Communications and Finance may appoint a private entity to operate the DTT system, in place of the Second Authority. At present, the DTT provides a limited alternative product to the multi-channel television broadcasts. DBS believes that an increase in the number or range of channels broadcast via DTT, as well as the possibility of a private entity operating the DTT system, could increase the scope of programs broadcasted and may therefore have a material detrimental effect on DBS's results.

### *Narrow Package Offering*

In accordance with a decision of the TV Council, beginning December 2012, DBS and HOT must allow subscribers to purchase, in addition to the basic package of channels that the licensees are obligated to offer to all their subscribers by law, a package of channels that includes certain basic channels and at least four channels produced in Israel, including a sports channel and a channel for pre-school children or a channel for children and teens based on the conditions defined in the Broadcasting Council's decision. According to the decision, DBS and HOT were required to offer these channels until May 31, 2013. In May 2013, the TV Council announced an extension of the period during which DBS and HOT may offer the limited group of channels until August 31, 2013.

In July 2013, the Knesset passed a second and third reading of provisions concerning the offering of a basic package in cable and satellite broadcasts as part of the Law for the Change of National Priorities (Legislative Amendments for Achieving Budget Targets for 2013-2014), 2013. According to such law, the Minister of Communications will stipulate the number of channels and price of the package and he will be authorized to stipulate the policy concerning the specifications of and types of channels in the package. The TV Council will issue instructions for implementation of the Minister of Communications' stipulations, including with respect to the specification, content, standard and scope of the channels. The Minister of Communications' stipulations will remain in force for a period of no more than three years, but the Minister of Communications' may, after consulting with the Broadcasting Council, instruct an extension for additional periods. Payment may not be collected from subscribers for the basic package for related services (including installation fees or the cost of installation and for terminal equipment) if subscribers are not charged for other packages, and in any event such payment will not exceed the payment requested from subscribers of other packages without permission from the TV Council.

In August 2013, the TV Council announced that it is considering amending the Communications (Broadcasting Licensee) Rules, 1987 and adopting a different model from the present model. According to the new model, DBS and HOT will be obligated to offer their subscribers a basic package of broadcasts which will include the mandatory channels as well as a number of additional channels which the subscriber will be able to choose from the broadcast channels offered by the license holder (except for a small number of channels), so that the basic package will include, together with the mandatory channels, between 17 and 24 channels.

### *Transmission of Video Content via Media Infrastructures*

In February 2014, the Minister of Communications appointed a committee to review the regulation of commercial broadcasts that will apply to all companies engaged in broadcasting of audio visual content. The committee was also required to make recommendations regarding the possible inclusion of commercials in HOT and DBS broadcasts. The committee was required to formulate its recommendations by August 2014. Further to a request from the committee, DBS submitted its position on the foregoing issues to the committee in April 2014.

In August 2014, the Committee submitted its recommendations to the Minister of Communications in an interim report. The committee recommended, among other things, that a license need not be required to provide audio-visual services over the Internet; that the regulations applicable to the new providers be imposed on a gradual basis, based on qualifying tests to be defined and the number of subscribers; and that a national communications authority be established to serve as a central regulator, which will incorporate the Ministry of Communications, the Second Authority and the Council. In September 2014, DBS submitted its response, in which it argued that licensing requirements should also apply to new suppliers, that the regulations should apply equally to holders of broadcast licenses and to new providers, and that if the regulations are applied gradually, the date on which the regulations become applicable should be limited (not only by quantitative measures). As of the date of this report, the committee has not submitted its final report. The committee's decisions, if applied, may affect the developing trend of video content transmitted over the web.

DBS believes that the VOD services it provides over the web are not subject to the regulations currently applicable to the multi-channel television broadcasts and as far as it is aware, this is the position of the Ministry of Communications. DBS also believes that the other services it provides via the Internet (such as yesGo) are also not subject to such regulation. Nonetheless, if other regulations will be formulated or applied, they may affect the foregoing services provided by DBS.

## Suppliers

The Bezeq Group has important relationships with several suppliers of hardware, software and related services that are used to operate its businesses. During 2015, no supplier accounted for more than 5% of the Bezeq Group's total annual purchases, nor did any supplier account for more than 10% of total purchases in a specific segment of operation.

### *Bezeq*

Most of the equipment purchased by Bezeq for data communication, switching, transmission and radio systems has been specially modified or developed for its use, and the ability to obtain support other than through the manufacturer is limited.

Bezeq relies on manufacturer support from a number of its key suppliers for certain of its systems, and may have difficulty replacing them. Bezeq's key suppliers include: (i) Alcatel Group (represented in Israel by Alcatel Telecom Israel Ltd.) in the areas of public switching and metro transmission, (ii) Dialogic Networks (Israel) Ltd. for migration exchanges for linking operators to Bezeq's switching network, (iii) Comverse, Inc. for switching exchanges for end customers on the NGN network, (iv) the NGN of Adtran Holdings Ltd., (v) Oracle in the area of databases, (vi) EMC for hardware solutions for back-up, recovery and archiving of systems and infrastructures, (vii) VMware for infrastructure for the entire virtualization of Bezeq's servers, and (viii) ECI Telecom for systems that connect Bezeq's network and business customers on its transmission network.

Agreements with the key suppliers are generally long-term and usually include a warranty period for a specified period, followed by another period of maintenance or support. Where necessary, Bezeq may enter into an agreement with a supplier for the supply of support and/or maintenance services for further periods. These agreements usually contain various forms of recourse for Bezeq should the supplier breach the agreement.

### *Pelephone*

Pelephone sells a wide range of cellular handsets and auxiliary accessories (such as batteries, hand-free kits, earphones, data cables and chargers). Pelephone also maintains spare parts to supply repair services to its customers and an inventory of used handsets.

Pelephone purchases handsets and accessories from a variety of suppliers and importers. Contractual engagements with most of the suppliers are based on framework agreements, which also set forth the technical support provided by the supplier for the equipment and spare parts and turnaround time for repairs. These agreements generally do not include a commitment of Pelephone to acquire a minimum quantity of devices and acquisitions are made by means of purchase orders. Generally, if an agreement with a particular supplier of equipment is cancelled, Pelephone can increase the quantity purchased from other suppliers or purchase equipment from a new supplier.

Pelephone has an agreement with Apple Distribution International for the purchase and distribution of iPhone handsets in Israel, which is in effect until May 2016. The agreement includes Pelephone's undertaking to purchase a minimum quantity of iPhone handsets. These handsets account for a substantial percentage of the handsets sold by Pelephone. If Pelephone fails to meet the minimum quantities it may be in breach of the agreement, which may involve payment of damages. Other than Apple Distribution International, Pelephone is not dependent on any supplier for the purchase of handsets.

Pelephone acquires the UMTS/HSPA+ network equipment from Ericsson and has a long-term agreement with Ericsson for the maintenance, support and upgrading of software for its UMTS/HSPA+ network. We believe that Pelephone could be deemed to be dependent on Ericsson for the support of its UMTS/HSPA+ network. The CDMA network equipment is acquired from Nortel and Motorola, and Pelephone maintains such equipment independently. In addition, the cellular networks use transmission facilities for which Bezeq is Pelephone's main supplier.

### *Bezeq International*

Bezeq International has cooperation agreements with approximately 200 foreign operators for approximately 240 destinations worldwide. Since fixed-line broadband Internet infrastructure access services are provided to its subscribers by Bezeq and HOT, Bezeq International is dependent upon Bezeq and, to a lesser degree, HOT for domestic capacity in the provision of its ISP services and for connecting the subscriber to the international exchange.

Under its agreement with MedNautilus, Bezeq International purchased indefeasible rights of use to an unparticular non-specific part of the communication capacity of the undersea cable system operated by MedNautilus between Israel and Europe for a period of up to 15 years from the date on which it started using this capacity (with an option to extend the period of use). The periods of use are at least until 2027, depending on the date of the start of use of the capacity. In consideration for such rights of use, Bezeq International paid a non-recurring payment around the date on which it started using the capacity. In addition, in October 2011, Bezeq International entered into an agreement with MedNautilus to expand and change the existing rights of use in the international optic network that it operates, so that such rights of use will serve as a backup for Bezeq International's JONAH submarine cable.

On January 18, 2010, Bezeq International signed a partnership agreement with British Telecom for the provision of global communications services to Israeli and multi-national companies operating in Israel. As part of the strategic agreement, Bezeq International operates as a BT Alliance partner in Israel and markets IT services and products from British Telecom's global range of services.

#### *DBS*

DBS purchases set-top boxes from three suppliers. Under a framework agreement entered into in August 2000, as amended from time to time, among DBS, Advanced Digital Broadcast S.A., or ADB and Eurocom Digital. DBS purchases set-top boxes (including the PVR set-top boxes) from Eurocom Digital, which imports them from ADB and provides the warranty for the set-top boxes. Eurocom Digital is controlled by Mr. Shaul Elovitch, who is a controlling shareholder of Bezeq. In addition, DBS purchases HD set-top box zappers from Pace Micro Technology PLC and HD set-top box zappers DSD 4145 STB from Altech Multimedia International (Pty) Ltd.

In 2015, DBS acquired from NDS Limited development, licensing, assimilation, maintenance and warranty services with regard to the operating systems of the broadcasting system and the decoders, and the hardware related to these services, including those connected to the encoding of DBS services, and viewing cards that allow the foregoing encoded content to be viewed.

Since January 2016, DBS purchases these services and products from Cisco Group companies, or Cisco, which is an affiliate of NDS, under an agreement signed between Cisco and DBS which has replaced the engagement with NDS. According to the agreement between Cisco and DBS, Cisco provides DBS with similar services to those provided by NDS, and provides products connected with the relevant systems and provides DBS with various licenses required for operating the systems and decoders. DBS is dependent upon the regular supply of these services and products, including integration of the various decoders that DBS uses for the operating system.

For these services and products DBS pays Cisco one-time payments and periodic payments part of which are in a fixed amount and part are based on the number of active decoders of each type, and the ratio of part of the payments is fixed in the agreement as minimum annual amounts. The term of the agreement with Cisco is until December 2020 (with an automatic extension mechanism, unless one of the parties decides to end the agreement, subject to prior notice as provided in the Cisco agreement. In 2015, DBS' payments to NDS amounted to NIS 27 million.

#### **Property**

##### *Bezeq*

According to a settlement agreement entered into in 2004 between Bezeq, the Israel Land Administration, or ILA and the State of Israel, which concerns most of the real estate that was transferred to Bezeq pursuant to the 1984 asset transfer agreement with the State of Israel, the assets remaining in Bezeq's possession have the status of a capitalized lease and are subject to the execution of individual lease contracts (contracts have been signed for approximately 110 of the 205 properties for which contracts are required). The settlement agreement allows Bezeq to enter into transactions and to improve the properties beyond the rights according to plans approved in the settlement agreement and it provides for a mechanism for payment to the ILA for such improvements, if undertaken, at the rate of 51% of the increase in value of the property following the enhancement (less part of the amounts paid for a betterment levy, if paid). The settlement agreement also provides that 17 properties must be returned to the ILA. Bezeq has returned 15 of those properties and the two remaining properties will be returned after Bezeq receives substitute properties, as provided in the settlement agreement.

The following is a list of Bezeq's real estate assets in accordance with the material rights in the asset. Bezeq also has interests (transition rights, etc.) in other real estate (such as for the construction of offices and for laying cables):

| Right   | Number of Assets                              | Area of the Plot (thousand sq. m.) | Built Area (thousand sq. m.) | Notes  |
|---|---|------------------------------------|------------------------------|--|
| Ownership, lease or right of lease                | 340   | 920                                | 170                          | Of this, 330 assets cover an area of 890 thousand sq. m., and 140 thousand sq. m. built up are assets for communication needs, and the remainder for administration needs.<br><br>30 are jointly owned with the Ministry of Communications and/or the Israel Postal Co. Ltd., with whom an agreement was signed for defining and regulating the rights of the parties in these properties. The parties operate as required by the orders of the agreement, and inter alia, to separate joint debits and systems. |
| Possession (authorized/possession rights by law)  | 40  | 2.5                                | 0.8                          | Assets in Israeli settlements in the Administrated Territories, all for communication needs. There is no written regulation of the contractual rights for these properties, but in Bezeq's opinion this does not create material exposure.   |
| Lease   | 330   | 30                                 | 70                           | 310 assets, out of which 11 thousand sq. m. built up are for communication needs and the remainder for administration needs. Out of which, approximately 4 sq.m. built up are sublet.  |
| Miscellaneous rights in 'residential rooms'       | 1,050   | 10                                 | 18                           | These are rooms for cables and installations for residential communications.<br><br>For most of the assets there is no arrangements for rights in writing (for example, the ILA, settlement entities, the entrepreneurs of the projects in which the properties are located, and house committees).  |
| Right to receive areas for warehouses and offices | An asset in Sakia (near the Mesubim junction) | 7 net                              | -                            | See below.   |

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

Following a new review by Bezeq's management concerning the sale of Bezeq's real estate assets, the Board of Directors approved further sales of assets which are not active and/or which can be relatively easily vacated without incurring significant expenses. The transition to the NGN allows Bezeq to increase the efficiency of the network and to sell some of the real estate assets that will be vacated as a result of the transition. During 2015, Bezeq sold 16 such properties, having a total area of 30,000 sq.m. of land and 36,000 sq.m. of built up structures, for approximately NIS 273 million.

According to Bezeq's estimates, the future sale of real estate assets that are not active or that can easily be vacated without incurring significant expenses and for which Bezeq has no use, may generate capital gains for Bezeq which may, in the aggregate over the coming years, reach significant amounts estimated at hundreds of millions of shekels (before tax). It should be emphasized that this estimate also relates to real estate assets where no concrete decision has yet been made to sell them, and there is no certainty regarding the timing of their sale. The estimate is based on appraisals prepared for some of the assets, some of which are not final or current, as well as to internal estimates prepared by Bezeq (including with respect to assets that were not appraised at all). Some of these assets may not be easily sold, including if there is no demand or there are local planning board limitations. At present, Bezeq is unable to foresee what, if any, consideration will be received upon the sale of these assets.

#### *Pelephone*

Pelephone does not own any of its sites and leases the premises that it uses for its operations from others, including Bezeq. Pelephone's radio and switching sites are spread out around the country and are leased for various periods (in many instances, for a period of five years and Pelephone has an option to extend the agreements for another five years).

Pelephone's headquarters are located in Givatayim, Israel and cover a total area of 17,800 square meters. The lease for these premises expires on December 31, 2020. Pelephone has an option to terminate the lease, under certain circumstances, commencing in 2017. Pelephone leases 31 service and sale centers throughout Israel and has additional lease agreements for warehouses, offices and telephone call centers that it uses for its operations.

Some of the radio sites leased by Pelephone are in areas owned by the ILA. Pelephone previously entered into an agreement with the ILA to use land in those areas for the construction and operation of communications sites for the period ended December 31, 2010. From 2010 negotiations were held with the ILA to conclude the terms for further use of the sites in the ILA areas. In June 2013, Pelephone entered into a framework agreement with the ILA for the use of land in the areas owned by the ILA for the construction and operation of communications sites for the period from January 1, 2011 until December 31, 2019, which agreement regulates, among other things, the fee for the use of the land.

#### *Bezeq International*

Bezeq International's property, plant and equipment include switching and Internet equipment, marine cable, PBX equipment, office equipment, computers, vehicles and leasehold improvements.

Bezeq International uses Veraz SoftSwitch switches to route its voice traffic. The value-added services, including dialing cards, are based on an intelligent network. Bezeq International's technological infrastructures, which support voice, data and Internet systems, are deployed at six sites, inside and outside Israel, in order to provide services with high survivability.

Bezeq International's intangible assets include licenses, software and discounted development costs. Bezeq International uses software and computer systems, some under purchased licenses and others which were developed by its IT department. Many of these licenses are limited in time, and are periodically renewed. The primary systems used by Bezeq International are an Oracle ERP system and an IBM customer billing system.

Bezeq International has long-term agreements for the lease of the two main buildings in which it is based. The lease period for one building ends in March 2024, with several exit options for Bezeq International during this period. The lease period of the other building is until December 2019 (with four equal extension options until 2027). Bezeq International has other lease agreements for warehouses (including a main logistics center) and for buildings where it operates the call centers that it uses for its operations.

#### *DBS*

DBS's central broadcasting center is located in Kfar Saba, Israel. DBS's secondary broadcasting center is operated by a third party in accordance with an agreement valid until the end of 2018 (with an extension option available to DBS). DBS's two broadcasting centers contain reception and transmission equipment, as well as computer and communication systems.

DBS leases a number of real estate assets which serve as its offices, customer service centers, broadcast centers, logistics centers and employee recruitment centers. DBS's principal offices and central broadcast center are located on leased land in Kfar Saba under an agreement that expires in 2019. The balance of the lease periods for the remaining properties leased by DBS vary from a few months to approximately six years (assuming that DBS exercises its options to extend such leases).

DBS recently entered into an agreement for a new logistics center in Modi'in, Israel, for a period of ten years, with an option to terminate the agreement after five years.



## Intellectual Property

### *Trademarks*

The Bezeq Group uses a variety of trade names and trademarks in its business. Bezeq has approximately 190 trademarks that are registered or are in the process of being registered in Israel, including its denominative trademark "Bezeq," the trademark "NGN Next Generation Network" and its logo "B." Pelephone owns a number of trademarks registered in Israel, including its denominative trademark "Pelephone." Bezeq International owns a number of trademarks registered in Israel, including its denominative trademark "Bezeq International" and the trademark "Private NGN." DBS owns a number of trademarks registered in Israel, including its denominative trademark "YES."

### *Broadcast Rights and Copyrights*

DBS licenses some of its television programming content for the DBS suite of channels from third-party content providers. DBS also enters into license agreements with producers of independent channels which it broadcasts over its network. In addition, DBS enters into agreements with third parties for the production of content and has the right to broadcast such content over its network (typically on an exclusive basis for an initial period of time) and in most cases, DBS is entitled to use other rights to the content and share the revenues stemming from additional use of the content. The broadcast and distribution of content by DBS on various media involves the payment of royalties to the owners of copyrights, including under the Israeli Copyright Law and the Broadcasters Rights Law. Royalty payments are made in accordance with blanket licenses with certain organizations in Israel that collect royalties on behalf of owners of intellectual property rights.

In October 2012, DBS entered into a settlement agreement and license agreement with the Association of Music Composers, Writers and Producers in Israel Ltd., or ACUM, an authors' right society in Israel, following a dispute regarding the amount of royalties to be paid by DBS in addition to the advance it had paid for the use of works whose rights are protected by ACUM for the period from 2003 to 2011. Under the agreements, DBS has a license to broadcast works whose rights are protected by ACUM until December 31, 2016, and it has agreed to settle all of ACUM's claims from 2003 until 2011 with respect to past royalties and has also agreed on royalty rates for 2012 to 2016.

## Employees

As of December 31, 2015, we have five employees. These employees also provide services to B Communications. Our five employees are all located in Israel and are not represented by any labor union. Since our inception, we have not experienced any labor-related work stoppages and believe that our relations with our employees are good. We have entered into an arrangement with B Communications according to which our employees provide services to both companies and each company will pay 50% of their compensation. We entered into a similar arrangement with B Communications and Eurocom Communications with respect to the management services supplied by Mr. Doron Turgeman to the three companies.

As of December 31, 2015, the Bezeq Group employed 12,615 persons, of whom 5,986 persons were employed by Bezeq, 2,679 persons were employed by Pelephone, 1,966 persons were employed by Bezeq International and 1,984 persons were employed by DBS.

### *Bezeq*

As of December 31, 2015, Bezeq employed 5,986 employees compared with 5,964 employees as of December 31, 2014. 90% of Bezeq's employees are employed under a collective agreement (out of which 58% are permanent employees and the remainder are nonpermanent employees). The remainder of Bezeq's employees (10%) are employed under personal agreements, not under collective agreements.

Bezeq's Board of Directors currently consists of 11 directors, including four external, two independent directors pursuant to the Israeli Companies Law and two employee representatives. Our Chairman, Mr. Shaul Elovitch, also serves as the Chairman of the Board of Directors of Bezeq and B Communications.

The members of senior management are employed under personal agreements, which include pension coverage, payment of bonuses based on targets, and additional retirement benefits. Bezeq also grants options to the members of senior management at its discretion.

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

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

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

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

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

On August 30, 2015, Bezeq's Board of Directors adopted another amendment to the collective agreement, extending the collective agreement and retirement arrangements until December 31, 2021, and their amendment. As part of the retirement arrangements, Bezeq will be entitled, at its discretion, to terminate the employment of 203 permanent employees (including new permanent employees) each year. The estimated cost of the agreement, including wage improvements and excluding employee retirement, which is subject to Bezeq's discretion, is NIS 280 million throughout the agreement period (of which NIS 30.0 million are contingent on Bezeq's expenses).

In 2015, the early retirement expenses of employees in a pension track, under the terms of the new collective agreement of December 2006 and its amendments, amounted to NIS 117 million. During 2015, 55 tenured employees retired from Bezeq, based on the early retirement plan. The Board also approved the termination of employment of additional employees in an increased severance pay track, in accordance with Bezeq's needs.

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

***Agreements with alternative entities that replaced the Makefet Fund in everything relating to early retirement arrangements of Bezeq employees***

As of 2005, the early retirement arrangements of Bezeq's employees are implemented through alternative entities in place of Makefet Fund. On April 24, 2014, Bezeq and Menorah Mivtachim Insurance Ltd. or Menorah, signed an agreement regulating pension payments for the early retirement of Bezeq employees, and payment of the remainder old-age and survivors' pensions to employees who retire from Bezeq under the special collective retirement agreement signed by Bezeq, the Union and the Histadrut on February 12, 2014. The agreement period is until the end of 2016.

***PeleePhone***

The table below provides data with respect to the number of PeleePhone employees at December 31, 2014 and December 31, 2015:

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

### *Remuneration plans for employees and managers*

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

### *Terms of employment*

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

### *Voluntary retirement*

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

### *Announcement of a labor dispute*

On August 3, 2015 Pelephone was informed by the New General Federation of Workers - Cellular, Internet and High-Tech Workers Union, that a labor dispute was announced pursuant to the Settlement of Labor Disputes Law, 1957 and that a strike would commence on August 17, 2015. According to the announcement, the issues under dispute were Pelephone's unilateral decisions regarding organizational / structural changes that impact working conditions and the expansion of the business segments and their scope that Pelephone outsources. The employees demanded negotiations regarding these issues.

Pelephone rejected the claims of the Workers Committee against it, and several meetings were held with the representatives of the Workers Committee under which Pelephone presented its detailed responses to the claims of the Workers Committee. Pelephone filed an application to the Regional Labor Court for interim relief to prevent continuing sanctions and labor disruptions. In September 2015, a hearing was held on the application, at the end of which the parties accepted the recommendation of the Court to continue intensive negotiations under the auspices of the Court and without either party taking actions. The parties requested another extension from the Court during which they agreed to report the outcome of the negotiations. The next hearing is set for the beginning of May 2016.

### *Bezeq International*

The following table provides data relating to the number of persons employed by Bezeq International, including outsourced employees, at December 31, 2014 and December 31, 2015:

| Department                        | Number of employees  |                      |
|-----------------------------------|----------------------|----------------------|
|                                   | December 31,<br>2015 | December 31,<br>2014 |
| Head office employees             | 1,157                | 1,173                |
| Sales and service representatives | 809                  | 759                  |
| <b>Total</b>                      | <b>1,966</b>         | <b>1,932</b>         |

Bezeq International has a number of employee groups whose wage structure includes a component of performance-linked commissions and incentives. These groups include sales employees, telephone sales representatives and telephone service and support representatives. Employees have arrangements for pension and health insurance that are fully subsidized by Bezeq. Bezeq International is not a party to any collective bargaining agreement.

Bezeq International perceives its employees as a substantial asset that it must retain and nurture. In 2015, Bezeq International invested in excess of 2000 hours on training employees to reinforce professionalism, authority and technical skills, sales management training, service expertise and more. In 2015, more than 1,000 of the company's employees participated in a range of personal development courses and professional and managerial reserves were developed of the organization's talents. Approximately 240 company managers developed their business managerial skills in the annual training program.

In March 2014, Bezeq International received notice from the Histadrut that more than one third of Bezeq International's employees had chosen to sign up as members and therefore it is the representative workers union of Bezeq International's employees. On January 12, 2016 Bezeq International signed a collective agreement with the New General Federation of Workers and the Bezeq International Workers Committee. The key terms of the agreement include:

- The agreement will apply to all Bezeq International employees, other than the executive management (VPs and those who report directly to them) and another group of employees and managers that the parties agreed upon.
- The period after which Bezeq International's employees will be considered as tenured is 36 months, with an option to extend the period for an additional six months with the Committee's agreement.
- The agreement prescribes mechanisms that include the Committee in decision making with regard to the termination of the employment of tenured employees, disciplinary measures imposed against them, and the execution of organizational changes.
- The agreement also provides for annual wage hikes and other financial benefits (such as subsidies, summer camp and welfare activities) to be provided by Bezeq International for its employees during the agreement period.
- The agreement is valid until December 31, 2018. Thereafter the agreement will automatically be renewed for additional 12 month periods, unless one of the parties gives notice of their intention to change the agreement.

#### DBS

The following table provides data with respect to the number of persons employed by DBS at December 31, 2014 and December 31, 2015:

| Division                        | Number of Employees |                 |
|---------------------------------|---------------------|-----------------|
|                                 | At Dec 31, 2015     | At Dec 31, 2014 |
| Marketing                       | 37                  | 36              |
| Customer Service                | 1,169               | 1,227           |
| Content Division                | 40                  | 64              |
| Engineering                     | 118                 | 106             |
| Finance and Operations          | 115                 | 106             |
| Human Resources                 | 60                  | 59              |
| Regulation and Legal Management | 11                  | 10              |
| Technologies and Information    | 141                 | 141             |
| Management and Spokesperson     | 7                   | 5               |
| Sales                           | 286                 | 291             |
| <b>Total</b>                    | <b>1,984</b>        | <b>2,042</b>    |

DBS employees are employed under personal employment agreements, on the basis of a monthly salary or an hourly wage, with some of the employees also entitled to performance-based compensation. The employment agreements are generally for an undefined period, and each party may terminate the agreement by prior notice in accordance with the agreement or applicable law. DBS employs personnel in some of its departments on the weekly day of rest and on days of rest prescribed by the State of Israel, and it has an appropriate permit for such employment.

On February 18, 2015, DBS received a notice from the Histadrut that more than one third of DBS's employees had joined the Histadrut and therefore it is the representative workers union of DBS employees. On February 24, 2015, after reviewing the enrollment forms that DBS received from the Histadrut, DBS confirmed the Histadrut's notice and recognized it as the representative workers union of DBS.

#### C. Organizational Structure

Mr. Shaul Elovitch, Mr. Yossef Elovitch, Eurocom Communications and Eurocom Holdings (1979) Ltd. are the beneficial owners of 12,250,701 ordinary shares of our company that are held by Eurocom Communications (925,000 of these shares are held directly by a joint account of Messrs. Shaul and Yossef Elovitch). Mr. Shaul Elovitch and his brother, Mr. Yossef Elovitch, own 80% and 20%, respectively, of Eurocom Holdings (Mr. Shaul Elovitch and Mr. Yossef Elovitch own 75% and 25%, respectively, of Eurocom Holdings' management shares). Eurocom Communications is 99.33% owned by Eurocom Holdings. The remaining 0.67% interest in Eurocom Communications is directly owned by Mr. Shaul Elovitch. Accordingly, Mr. Shaul Elovitch may be deemed to have the sole voting and dispositive power as to the ordinary shares of the Issuer held of record directly by Eurocom Communications. Mr. Shaul Elovitch may also deem to be the beneficial owner of 26,893 ordinary shares held of record by his wife, Mrs. Iris Elovitch. In addition, the above includes 8,300 shares that are held by other family members of Mr. Shaul Elovitch.

We operate through our 64.78% ownership interest in B Communications, which is the controlling shareholder of Bezeq, Israel's largest telecommunications provider. B Communications and its wholly-owned subsidiaries own 26.34% % of Bezeq's outstanding shares.

#### **D. Property, Plants and Equipment**

Our corporate headquarters are located in a 30 square meter facility in Ramat Gan, Israel, which we lease from Eurocom Communications at a token rent. The lease is for a three-year period, which may be extended each year for an additional one year period on the mutual consent of the parties.

#### **ITEM 4A. UNRESOLVED STAFF COMMENTS**

Not applicable.

#### **ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

##### **A. Operating Results**

*The following discussion of our results of operations should be read together with our audited consolidated financial statements and the related notes, which appear elsewhere in this annual report. The following discussion contains forward-looking statements that reflect our current plans, estimates and beliefs and involve risks and uncertainties. Our actual results may differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include those discussed below and elsewhere in this annual report.*

##### **Overview**

We are the controlling shareholder of B Communications which currently holds 26.34% of Bezeq's outstanding shares, and we consolidate Bezeq's financial results into our financial statements.

The Bezeq Group operates the most comprehensive telecommunications infrastructure in Israel, with a broad range of telecommunications services across all of its markets. Through its wholly-owned subsidiaries, the Bezeq Group is a leading provider in Israel of fixed-line telephony services and fixed-line broadband Internet infrastructure access services, cellular telephony services, ISP services, ILD services, international and domestic data transfer and network services and ICT, pay television services and other communications infrastructures and services. In each of these markets, the Bezeq Group holds a significant market share.

##### **Key Factors Affecting the Businesses of the Bezeq Group**

The operations of the Bezeq Group and the operating metrics discussed below have been, and will likely continue to be, affected by certain key factors as well as certain historical events and actions. The key factors affecting the business of the Bezeq Group and its results of operations include, among others, competition, government regulation, the build out of infrastructures, macro- economic and political risks, churn, seasonality, impact of currency fluctuations, effective corporate tax rate, conditions in Israel and trade relations. For further discussion of the factors affecting our results of operations, see "*Risk Factors*."

##### **Competition**

The Bezeq Group faces significant competition from established and new competitors who provide fixed-line telephony, fixed-line broadband Internet infrastructure access, cellular telephony, ISP and pay television services. In addition to the entrance of new competitors, competition among the existing communications groups in Israel is intensifying. Four main groups, each consisting of companies under common or joint control, hold a significant share of the communications market in Israel today: the Bezeq Group, the Cellcom Group, the Partner Group and the HOT Group. The Bezeq Group's three principal competitors may in some cases be required to comply with fewer regulations because, among other reasons, they use different technologies to provide their services or do not own their own fixed-line network.

Bezeq expects competition to continue to increase amid the changing legislation in Israel and consolidation in the telecommunications industry that permits certain service providers to market a combination of fixed-line telephony, fixed-line broadband Internet infrastructure access, ISP and pay television services (a "bundle") for an aggregate price which is lower than the price of the individual products and services in the bundle. The Bezeq Group is currently subject to restrictions on marketing bundles, which are stricter than the restrictions applicable to its competitors.

*Fixed-Line Telephony.* Competition in the fixed-line telephony market is intense. We believe that competition in this market will continue to increase due to the low barriers to entry and regulations permitting new service providers who receive a license to provide telephony services using voice over VoIP or VoB technology. While such services utilize the fixed-line broadband Internet infrastructure access network owned by either Bezeq or HOT, and therefore require end-users to purchase fixed-line broadband Internet infrastructure access services directly from Bezeq or HOT, such services have reduced demand for fixed-line telephony services.

*Fixed-Line Broadband Internet Infrastructure Access.* Bezeq's principal competitor in the fixed-line broadband Internet infrastructure access service market is HOT, which is currently the only other fixed-line broadband Internet infrastructure access provider in Israel. In addition, Bezeq's fixed-line broadband Internet infrastructure access services business faces competition from cellular telephony operators as they are increasingly able to utilize a combination of technologically advanced handsets and high bandwidth technologies, such as UMTS and LTE technology.

*Cellular Telephony.* The cellular telephony market in Israel is characterized by saturation and a very high penetration level in excess of 100%. In recent years, competition in the cellular telephony industry has intensified. This has led to lower prices and higher customer churn rates, which in turn has affected the Bezeq Group's results. Until 2012, three cellular telephony operators, Cellcom, Partner and Pelephone, led the Israeli cellular telephony market. During 2012, a number of other cellular telephony operators began to operate, including Golan Telecom and HOT Mobile, which has led to intensified competition, resulting in higher churn rates among the existing operators, a significant decrease in tariffs and, consequently, a decrease in profits. Pelephone's current principal competitors, Cellcom, Partner and HOT Mobile (since February 2012), also provide ISP services and fixed-line communications, and they market a variety of joint service packages. Pelephone also faces competition from MVNOs that provide cellular telephony services under their own brand using the network infrastructure of another service provider.

*International Telephony.* The ILD market in Israel is characterized by a high degree of competition. At the end of 2013, there were eight companies offering ILD services to private and business customers in Israel. Changes in licensing policies and the expanded use of VoIP technology have significantly reduced the barriers of entry into this market. In addition, during 2012, cellular telephony operators began to offer ILD services as part of the unlimited packages they offered.

*Internet Service Providers.* Access to broadband Internet in Israel requires households to purchase Internet access services from a licensed ISP and broadband Internet infrastructure access services from a separate provider. While there are only two fixed-line broadband Internet infrastructure access service providers in Israel many telecommunication companies hold ISP licenses in Israel. The Israeli ISP market is a saturated market and as competitors are typically unable to differentiate themselves based on price, they attempt to differentiate themselves primarily by strengthening customer loyalty; however, competition has led to increased churn rates and reduced income per customer.

*Pay Television.* The Israeli television market is characterized by a very high penetration rate and an increasing emphasis on new television technology, in particular digital, HD and interactive television services, such as VOD, requiring high-bandwidth and bi-directional distribution platforms. In the multi-channel pay television market, DBS and HOT are the only two companies in Israel licensed to provide multi-channel pay television broadcasts. Other factors impacting competition in the market include the availability of free-to-air television DTT channels and the increasing availability and quality of video content offered over the Internet and cellular networks, which is not currently regulated and does not require designated infrastructure.

#### **Government Regulation**

The Bezeq Group operates in a highly regulated industry in Israel, which limits its flexibility in managing its business efficiently, and may increase its administrative and operational expenses and limit its revenue. The Bezeq Group is subject to government supervision and regulation relating to, among other things:

- regulations requiring structural separation between the members of the Bezeq Group;
- regulations restricting the Bezeq Group's ability to market bundles;
- price regulation for certain services that the Bezeq Group provides;
- rules and regulations imposed on telecommunications service providers with significant market share;
- rules governing the interconnection between different telephone networks and the interconnection rates that the Bezeq Group can charge and pay;
- regulations governing the prohibition of exit-fees or cancellation charges;
- regulations requiring the Bezeq Group to grant other telecommunications operators access to its infrastructure;
- regulations governing roaming charges and other billing and customer service matters;

- rules for authorizations, licensing, acquisitions, renewals, pledging and transfers of licenses;
- requirements covering a variety of operational areas such as land use, health and safety and environmental protection, technical standards and subscriber service requirements rules and regulations relating to subscriber privacy;
- rules and regulations relating to payment of royalties (zero rate as of 2014);
- rules and regulations relating to universal service provision and requirements to extend the Bezeq Group's services to areas of Israel even where it is not economically profitable to do so; and
- regulations restricting the number of television channels DBS can own and specifying the minimum investment DBS is required to make in local content productions.

For additional information see "Regulatory."

### ***Build Out of Infrastructure***

The Bezeq Group has historically made substantial investments in its fully owned infrastructure, which is one of the most technologically advanced in Israel and enables the Bezeq Group to reach customers nationwide.

In the domestic fixed-line communications segment, Bezeq's NGN, which was completed in 2012, is the most advanced fixed-line communications network in Israel, offering broadband Internet bandwidth of up to 100 Mbps (download) speed, as well as innovative value-added services. In January 2013, Bezeq began laying optical FTTB and FTTH.

In the cellular telephony segment, Pelephone's nationwide 3.5G UMTS/HSPA. While Pelephone substantially completed the installation of its 3.5G UMTS/HSPA+ network in 2010, it has continued to invest in the network. We believe these network features provide Pelephone with a strong platform to continue to offer a variety of advanced services and products to its customers and to capitalize on the continued increasing demand for smartphones and advanced data services, which constitute the higher value segment of the cellular telephony market.

In the ISP, ILD, data transfer, networks and ICT services segment, Bezeq International is currently the sole ISP in Israel that owns and operates its own high-speed submarine optical fiber communications cable system. The JONAH cable, which was launched in January 2012 provides Bezeq International with greater capacity for utilization than any other ISP in Israel. In addition, Bezeq International is able to obtain such capacity at an incremental cost, while other ISPs in Israel are required to purchase capacity and rely on one of the two other cable operators in Israel (MedNautilus and Tamares).

In the multi-channel pay television segment, DBS is the only licensed provider of multi-channel television broadcasts via satellite in Israel and one of only two companies in the Israeli pay television services market. While DBS relies on third party providers for the provision of satellite capacity, it owns the satellite dishes that carry the signals from such satellites to subscriber residences and set-top boxes. Such equipment and infrastructure act as a significant barrier to entry against any potential competitor in the satellite pay television market.

During the years ended December 31, 2013, 2014 and 2015, the Bezeq Group companies invested NIS 1.2 billion, NIS 1.3 billion and NIS 1.6 billion (approximately \$414 million), respectively, in capital improvements, substantially all of which was invested in infrastructure and technology.

### ***Macro-Economic and Political Risks***

The Bezeq Group is subject to macro-economic and political risks that are outside of its control. For example, high levels of sovereign debt in the U.S., certain European countries and countries in the Middle East, combined with weak growth and high unemployment, could lead to fiscal reforms (including austerity measures), sovereign debt restructurings, currency instability, increased counterparty credit risk, high levels of volatility and, potentially, disruptions in the credit and equity markets, as well as other outcomes that might adversely impact the Bezeq Group. Moreover, as a business operating in Israel, we and the Bezeq Group are subject to the inherent risks associated with the political and military conditions in Israel and the potential for armed conflicts with Israel's neighbors. Further, while the majority of the Bezeq Group's revenues are in NIS, a portion of the Bezeq Group's operational expenses are in U.S. dollars. The exchange rate between U.S. dollars and NIS has been volatile in the past and may continue to be so in the future. Although we attempt to mitigate currency rate risk through hedging, sharp changes in the exchange rate could have a material effect on our results of operations.

## **Churn**

The fixed-line telephony, fixed-line broadband Internet infrastructure access, cellular telephony and multi-channel pay television industries typically exhibit churn as a result of high levels of competition. Churn levels may be affected by changes in our or our competitors' pricing, our level of customer satisfaction, disconnection of non-paying subscribers and changes in regulations. Increases in churn may lead to increased costs and reduced revenues. In recent years our churn rates increased, particularly in our cellular telephony segment as new competitors entered the market and advantageous billing plans were introduced. Similarly, competition has increased in recent years as a result of the prohibition on exit fees, long-term commitments and, as of January 2013, linkage of the price and terms of handsets sales to cellular telephony service prices and benefits.

## **Seasonality**

Bezeq's consolidated operating results are generally not characterized by a seasonal pattern. In general, Bezeq's revenues from its cellular phone services are slightly higher in the second and third quarters of the fiscal year than the first and fourth quarters due to different usage patterns prevailing in the summer months compared to the winter months and the holiday season in Israel. In general, Bezeq's revenues from international communications, Internet and NEP services are affected in a minor way by the seasons and holidays. For example, voice services for the business sector decrease in August and during the Passover holiday; voice services for the private sector increase in the summer months and towards the end of the calendar year; sales of Internet services and NEP equipment usually increase in the fourth quarter; and Internet services for the business sector decrease in the summer months due to the closure of educational institutions.

## **Impact of Currency Fluctuations**

Although the majority of our revenues and expenses are denominated in NIS, we are subject to risks caused by fluctuations in the exchange rate between the NIS and the U.S. dollar.

During 2015, the U.S. dollar strengthened against the NIS by 0.3%. A depreciation of the NIS in relation to the U.S. dollar has the effect of reducing the U.S. dollar value of any of our expenses or liabilities which are payable in NIS, unless those expenses or payables are denominated in or linked to the dollar. This depreciation also has the effect of decreasing the U.S. dollar value of any asset which consists of NIS or receivables payable in NIS, unless the receivables are denominated in or linked to the dollar.

From time to time we use derivative financial instruments, such as Cross Currency Swap contracts, to hedge certain of our risks associated with foreign currency fluctuations. These derivative financial instruments are carried at fair value.

Because exchange rates between the NIS and the U.S. dollar fluctuate continuously, exchange rate fluctuations, particularly larger periodic depreciations, may have an impact on our profitability and period-to-period comparisons of our results in U.S. dollars. We cannot assure you that in the future our results of operations may not be materially adversely affected by currency fluctuations. We recommend comparing our results between periods based on our NIS reports.

## **Effective Corporate Tax Rate**

Israeli companies are generally subject to income tax on their taxable income. The applicable Israeli company income tax rate was 25% in 2012 and 2013. In 2014 and 2015, our applicable income tax rate increased to 26.5% and commencing January 1, 2016, was set at 25%.

As of December 31, 2015, we had tax loss carryforwards in the amount of NIS 165 million (approximately \$42 million) and capital losses carry forward in the amount of NIS 325 million (approximately \$83 million). Under current Israeli tax laws, tax loss carryforwards do not expire and may be offset against future taxable income.

## **Conditions in Israel**

We are organized in, based in and derive substantially all of our revenues from markets within the State of Israel. See "*Risk Factors—Risks Relating to the Operations of the Bezeq Group and Our Company in Israel*" for a description of governmental, economic, fiscal, monetary or political policies or factors that have materially affected or could materially affect our operations.

## **Trade Relations**

Israel is a member of the United Nations, the International Monetary Fund, the International Bank for Reconstruction and Development, the International Finance Corporation and the World Trade Organization. In addition, Israel is a signatory to the General Agreement on Tariffs and Trade, which provides for reciprocal lowering of trade barriers among its member and has been granted preferences under the Generalized System of Preferences from the United States, Australia, Canada and Japan. These preferences allow Israel to export products covered by such programs either duty-free or at reduced tariffs.



Israel and the European Union Community concluded a Free Trade Agreement in July 1975, which confers certain advantages with respect to Israeli exports to most European countries and obligates Israel to lower its tariffs with respect to imports from these countries over a number of years. In 1985, Israel and the United States entered into an agreement to establish a Free Trade Area. The Free Trade Area has eliminated all tariff and specified non-tariff barriers on most trade between the two countries. On January 1, 1993, an agreement between Israel and the European Free Trade Association, known as EFTA, established a free-trade zone between Israel and the EFTA nations. In November 1995, Israel entered into a new agreement with the European Union, which included a refinement of rules of origin and other improvements, including providing for Israel to become a member of the research and technology programs of the European Union. In recent years, Israel has established commercial and trade relations with a number of other nations, including China, India, Russia, Turkey and other nations in Eastern Europe and Asia.

On May 10, 2010, the Organization for Economic Co-operation and Development, or OECD, invited Israel to become a member of the organization, whose mission is to promote co-operation between its members while keeping high international economic standards. On September 7, 2010, on signing the OECD Convention, Israel pledged its full dedication to achieving the Organization's fundamental aims. Israel was the 32nd country to join the organization, along with Estonia and Slovenia.

#### **Explanation of Key Income Statement Items**

**Revenue.** Revenue from Bezeq's domestic fixed-line communications segment is derived primarily from fees received for (i) fixed-line telephony services, primarily including the basic fixed-line telephony service on the domestic telephone line, plus associated services such as voice mail, caller ID, call waiting, call forwarding, speed dial, conference calls, public telephones and a unified telephone directory; (ii) fixed-line broadband Internet infrastructure access services in xDSL technology; (iii) data communication services, including network services for transferring data from point to point, transferring data between computers and between various communications networks, services connecting communications networks to the Internet and remote access services; and (iv) other services including, services to communications operators, broadcasting services, contract work, IP Centrex services (lines in a virtual private exchange in a public network), data center services, a search engine for locating phone numbers (including a classified search) and new services.

Revenue from the Telephone cellular telephony segment is derived primarily from fees received from its service offerings, including, voice transmission, transmission of text messages, roaming, data communications and advanced multimedia services. Telephone also sells cellular phones, laptops and other portable devices and offers attendant repair services.

Bezeq International's revenues are primarily derived from ISP services for private and business customers (including terminal equipment and support), voice services (including, ILD services to business and private customers and international call routing and termination services), hosting services, supply of international data communication solutions for business customers and ICT solutions for business customers and PBX services.

DBS's revenues are primarily derived from the sale of subscriptions for its multi-channel satellite pay television broadcast services. Revenue from subscriptions is recognized ratably over the contract period, which is generally one to twelve months. DBS does not provide revenues to Bezeq.

Bezeq also includes a category of "Other" in its consolidated financial statements, which mainly includes revenue from customer call center services through its Bezeq Online Ltd. subsidiary, investments in a venture capital fund and ownership of Walla!, a popular Israeli provider of Internet and portal services.

On May 20, 2014, Walla completed the sale of all the share capital of Coral-Tell Ltd. ("Coral-Tell"), a subsidiary which operates the Yad2 website, to Axel Springer Digital Classifieds Holding GmbH, a foreign media company incorporated in Germany, for NIS 805 million. Pursuant to the sale agreement, Walla and Bezeq agreed not to engage in the areas of operation of Coral-Tell for 24 months. Bezeq recorded a pre-tax profit of NIS 582 million with respect to the sale.

**Depreciation and Amortization.** Subsequent to our acquisition of the controlling interest in Bezeq, we adopted policies regarding the depreciation and amortization expenses related to Bezeq's communications business network equipment and capacity that were based on Bezeq's policies. Depreciation and amortization expenses primarily consist of depreciation on computer equipment, software, leasehold improvements, capitalized software development costs and amortization of purchased intangibles. In connection with our acquisition of the controlling interest in Bezeq, we assigned fair value to fixed assets acquired in the Bezeq acquisition. The difference between the book value and the fair value of those assets was recognized as an asset in our consolidated statement of financial position. The acquired assets are depreciated and amortized according to their expected useful life. Over time such assets are fully depreciated by Bezeq, and by us respectively. As a result, the excess fair value balance we assigned to the acquired assets decreases and our related future depreciation expenses will decrease as well.

**Salaries.** Salaries include salary costs, social, statutory and employment benefits, and commissions of all our employees. Bezeq's consolidated salary expenses primarily consist of operating and general and administrative salaries, benefits, stock-based compensation and incentive compensation.

**General and Operating Expenses.** Bezeq's consolidated general and operating expenses primarily consist of cellular telephone expenses, general expenses including outside consulting, legal and accounting services, materials and spare parts, building maintenance, services and maintenance by sub-contractors, international communication expenses, vehicle maintenance expenses, royalties paid to the State of Israel and collection fees.

**Other operating expenses.** Other operating expenses primarily include Bezeq's provision for severance pay on early retirement, capital gains from the sale of property, plant and equipment, provisions for contingent liabilities and income or losses from copper forward contracts.

**Finance Expenses.** Our finance expenses primarily include interest expenses, U.S. dollar exchange rate differences and CPI linkage expenses on our Senior Secured Notes, bank and institutional loans and debentures. In addition our finance expenses also include interest and exchange rate differences on other financial liabilities and changes in fair value of financial assets or liabilities measured at fair value through profit or loss. Bezeq's financing expenses primarily consist of interest expenses for its financial liabilities, linkage and exchange rate differences, changes in fair value of financial assets measured at fair value through profit or loss, financing expenses for employee benefits and other financing expenses.

**Income Tax.** Income tax expense is comprised of current and deferred tax. Bezeq recognizes current and deferred tax expense in profit or loss except to the extent that it relates to items recognized directly in equity or in other comprehensive income. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Our assessment considers that deferred tax is recognized using the statements of financial position method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Under our assessment, deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously. A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

The applicable Israeli company income tax rate was 25% in 2012 and 2013. In 2014 and 2015, our applicable income tax rate increased to 26.5% and commencing January 1, 2016 it was reduced to 25%.

## Results of Operations

The following table sets forth our results of operations in NIS in millions and as a percentage of revenues for the three years ended December 31, 2015:

|   | Year ended December 31, |      |        |      |       |      |
|---|-------------------------|------|--------|------|-------|------|
|   | 2013                    |      | 2014   |      | 2015  |      |
|   | NIS                     | %    | NIS    | %    | NIS   | %    |
| Revenues  | 9,563                   | 100% | 9,055  | 100% | 9,985 | 100% |
| Depreciation and amortization                         | 2,014                   | 21%  | 1,873  | 21%  | 2,131 | 21%  |
| Salaries  | 1,874                   | 20%  | 1,771  | 19%  | 1,960 | 20%  |
| General and operating expenses                        | 3,586                   | 37%  | 3,371  | 37%  | 3,878 | 39%  |
| Other operating expenses (income)                     | 57                      | 1%   | (535)  | (6)% | 3)    | -%   |
| Operating income                                      | 2,032                   | 21%  | 2,575  | 29%  | 2,013 | 20%  |
| Finance expense                                       | 931                     | 10%  | 1,329  | 15%  | 759   | 8%   |
| Finance income  | (535)                   | (6)% | (635)  | (7)% | (164) | (2)% |
| Income after financing expenses, net                  | 1,636                   | 17%  | 1,881  | 21%  | 1,418 | 14%  |
| Share of losses (profit) in equity-accounted investee | 252                     | 3%   | 170    | 2%   | (12)  | -%   |
| Income before income tax                              | 1,384                   | 14%  | 1,711  | 19%  | 1,430 | 14%  |
| Income tax  | 524                     | 5%   | 667    | 7%   | 347   | 3%   |
| Income for the year                                   | 860                     | 9%   | 1,044  | 12%  | 1,083 | 11%  |
| Income (loss) attributable to owners of the Company   | 26                      | 1%   | (103)  | (1)% | 87    | 1%   |
| Income attributable to non-controlling interest       | 834                     | 8%   | 1,147  | 13%  | 996   | 10%  |
| Income for the year                                   | 860                     | 9%   | 1,044  | 12%  | 1,083 | 11%  |
| Basic earnings (loss) per share                       | 1.33                    |      | (5.38) |      | 4.54  |      |
| Diluted earnings (loss) per share                     | 1.26                    |      | (5.50) |      | 4.47  |      |

As a result of the Bezeq acquisition, we assigned fair value to the assets acquired and liabilities assumed using the acquisition method. Adjustments to record the allocation of the consideration paid for assets acquired and liabilities assumed for Bezeq have not been reflected in the separate reporting of the segments because they are not being reviewed by our Chief Operating Decision Maker in order to make decisions about resources to be allocated to the segments and assess their performance. Accordingly, the purchase accounting adjustments are presented under the "adjustments" column.

The following three tables provide summary financial information regarding the operating results of the individual operating segments of the Bezeq Group and on a consolidated basis for the three years ended December 31, 2015.

**NIS in Millions**

|  | Year ended December 31, 2015             |                            |   |                                 |        |             | Consolidated<br>NIS |
|--|--|----------------------------|---|---------------------------------|--------|-------------|---------------------|
|  | Domestic<br>fixed-line<br>communications | Cellular<br>communications | International<br>communications<br>and Internet<br>services | Multi-<br>channel<br>television | Others | Adjustments |                     |
|  | NIS                                      | NIS                        | NIS   | NIS                             | NIS    | NIS         |                     |
| Revenue from external entities                                     | 4,122                                    | 2,831                      | 1,485   | 1,774                           | 197    | (440)       | 9,969               |
| Inter-segment revenues   | 285                                      | 59                         | 93  | -                               | 24     | (445)       | 16                  |
| Total revenue  | 4,407                                    | 2,890                      | 1,578   | 1,774                           | 221    | (885)       | 9,985               |
| Depreciation and amortization                                      | 725                                      | 419                        | 132   | 322                             | 13     | 520         | 2,131               |
| Segment results - operating income                                 | 2,148                                    | 157                        | 240   | 250                             | (15)   | (767)       | 2,013               |
| Finance income   | 30                                       | 53                         | 7   | 32                              | 17     | 25          | 164                 |
| Finance expenses   | (362)                                    | (4)                        | (15)  | (635)                           | (2)    | 259         | (759)               |
| Total finance income (expense), net                                | (332)                                    | 49                         | (8)   | (603)                           | 15     | 284         | (595)               |
| Segment profit (loss) after finance expenses, net                  | 1,816                                    | 206                        | 232   | (353)                           | -      | (483)       | 1,418               |
| Share in profit (loss) of equity-accounted investee                | -  | -                          | -   | -                               | (2)    | 14          | 12                  |
| Segment profit (loss) before income tax                            | 1,816                                    | 206                        | 232   | (353)                           | (2)    | (469)       | 1,430               |
| Income tax   | 492                                      | 55                         | 60  | 1                               | -      | (261)       | 347                 |
| Segment results - net profit (loss)                                | 1,324                                    | 151                        | 172   | (354)                           | (2)    | (208)       | 1,083               |
| <b>Additional information:</b>                                     |  |                            |   |                                 |        |             |                     |
| Segment assets   | 7,311                                    | 3,269                      | 1,160   | 1,667                           | 661    | 5,251       | 19,319              |
| Goodwill   | -  | -                          | 6   | -                               | 10     | 3,050       | 3,066               |
| Investment in equity-accounted investee                            | -  | -                          | 4   | -                               | 7      | 14          | 25                  |
| Segment liabilities  | 12,117                                   | 513                        | 343   | 6,685                           | 104    | 47          | 19,809              |
| Investments in property, plant and equipment and intangible assets | 837                                      | 419                        | 127   | 281                             | 33     | (80)        | 1,617               |

Year ended December 31, 2014

|  | Domestic<br>fixed-line<br>communications | Cellular<br>communications | International<br>communications<br>and Internet<br>services | Multi-channel<br>television | Others     | Adjustments    | Consolidated |
|--|--|----------------------------|---|-----------------------------|------------|----------------|--------------|
|  | NIS                                      | NIS                        | NIS   | NIS                         | NIS        | NIS            | NIS          |
| Revenue from external entities                                     | 4,045                                    | 3,361                      | 1,419   | 1,724                       | 209        | (1,724)        | 9,034        |
| Inter-segment revenues   | 272                                      | 58                         | 85  | -                           | 17         | (411)          | 21           |
| <b>Total revenue</b>   | <b>4,317</b>                             | <b>3,419</b>               | <b>1,504</b>  | <b>1,724</b>                | <b>226</b> | <b>(2,135)</b> | <b>9,055</b> |
| <b>Depreciation and amortization</b>                               | <b>688</b>                               | <b>430</b>                 | <b>130</b>  | <b>298</b>                  | <b>23</b>  | <b>304</b>     | <b>1,873</b> |
| Segment results - operating income                                 | 1,980                                    | 449                        | 232   | 273                         | 629        | (988)          | 2,575        |
| Finance income   | 285                                      | 77                         | 9   | 26                          | 11         | 227            | 635          |
| Finance expenses   | (472)                                    | (21)                       | (18)  | (619)                       | (2)        | (197)          | (1,329)      |
| Total finance income (expense), net                                | (187)                                    | 56                         | (9)   | (593)                       | 9          | 30             | (694)        |
| Segment profit (loss) after finance expenses, net                  | 1,793                                    | 505                        | 223   | (320)                       | 638        | (958)          | 1,881        |
| Share in profit (loss) of equity-accounted investee                | -  | -                          | 1   | -                           | (3)        | (168)          | (170)        |
| Segment profit (loss) before income tax                            | 1,793                                    | 505                        | 224   | (320)                       | 635        | (1,126)        | 1,711        |
| Income tax   | 478                                      | 132                        | 60  | 1                           | 147        | (151)          | 667          |
| <b>Segment results - net profit (loss)</b>                         | <b>1,315</b>                             | <b>373</b>                 | <b>164</b>  | <b>(321)</b>                | <b>488</b> | <b>(975)</b>   | <b>1,044</b> |
| <b>Additional information:</b>                                     |  |                            |   |                             |            |                |              |
| Segment assets   | 8,483                                    | 3,541                      | 1,206   | 1,820                       | 682        | 2,087          | 17,820       |
| Goodwill   | -  | -                          | 6   | -                           | 10         | 2,665          | 2,681        |
| Investment in equity-accounted investee                            | -  | -                          | 4   | -                           | 11         | 1,042          | 1,057        |
| Segment liabilities  | 12,369                                   | 696                        | 392   | 6,484                       | 107        | (1,256)        | 18,792       |
| Investments in property, plant and equipment and intangible assets | 835                                      | 339                        | 110   | 332                         | 17         | (332)          | 1,301        |

Year ended December 31, 2013

|  | Domestic<br>fixed-line<br>communications | Cellular<br>communications | International<br>communications<br>and Internet<br>services | Multi-<br>channel<br>television | Others      | Adjustments    | Consolidated |
|--|--|----------------------------|---|---------------------------------|-------------|----------------|--------------|
|  | NIS                                      | NIS                        | NIS   | NIS                             | NIS         | NIS            | NIS          |
| Revenue from external entities                                     | 4,198                                    | 3,741                      | 1,365   | 1,633                           | 241         | (1,633)        | 9,545        |
| Inter-segment revenues   | 280                                      | 68                         | 68  | 2                               | 21          | (421)          | 18           |
| <b>Total revenue</b>   | <b>4,478</b>                             | <b>3,809</b>               | <b>1,433</b>  | <b>1,635</b>                    | <b>262</b>  | <b>(2,054)</b> | <b>9,563</b> |
| <b>Depreciation and amortization</b>                               | <b>683</b>                               | <b>458</b>                 | <b>130</b>  | <b>263</b>                      | <b>31</b>   | <b>449</b>     | <b>2,014</b> |
| Segment results - operating income                                 | 1,991                                    | 608                        | 227   | 268                             | (4)         | (1,058)        | 2,032        |
| Finance income   | 314                                      | 137                        | 9   | 7                               | -           | 68             | 535          |
| Finance expenses   | (534)                                    | (46)                       | (23)  | (654)                           | (6)         | 332            | (931)        |
| Total finance income (expense), net                                | (220)                                    | 91                         | (14)  | (647)                           | (6)         | 400            | (396)        |
| Segment profit (loss) after finance expenses, net                  | 1,771                                    | 699                        | 213   | (379)                           | (10)        | (658)          | 1,636        |
| Share in losses of equity-accounted investee                       | -  | -                          | 1   | -                               | -           | (253)          | (252)        |
| Segment profit (loss) before income tax                            | 1,771                                    | 699                        | 214   | (379)                           | (10)        | (911)          | 1,384        |
| Income tax   | 408                                      | 178                        | 56  | 2                               | 5           | (125)          | 524          |
| <b>Segment results - net profit (loss)</b>                         | <b>1,363</b>                             | <b>521</b>                 | <b>158</b>  | <b>(381)</b>                    | <b>(15)</b> | <b>(786)</b>   | <b>860</b>   |
| Additional information:  |  |                            |   |                                 |             |                |              |
| Segment assets   | 7,767                                    | 4,126                      | 1,248   | 1,617                           | 232         | 2,580          | 17,570       |
| Goodwill   | -  | -                          | 6   | -                               | 87          | 2,732          | 2,825        |
| Investment in equity-accounted investee                            | -  | -                          | 3   | -                               | 14          | 998            | 1,015        |
| Segment liabilities  | 11,234                                   | 1,242                      | 440   | 5,960                           | 249         | (868)          | 18,257       |
| Investments in property, plant and equipment and intangible assets | 777                                      | 335                        | 106   | 327                             | 19          | (327)          | 1,237        |

## Year Ended December 31, 2015 Compared with Year Ended December 31, 2014

**Revenues.** Our revenues increased by 10.3% to NIS 10.0 billion (approximately \$2.59 billion) in the year ended December 31, 2015 from NIS 9.1 billion in the year ended December 31, 2014. For both periods, our consolidated revenues consisted entirely of Bezeq's consolidated revenues. The increase in revenues in 2015 was primarily due to the consolidation of DBS revenues in the amount of NIS 1.33 billion (approximately \$342 million) as of the second quarter of 2015. The increase in revenues is also attributable to the NIS 90 million (approximately \$23 million), or 1%, increase in revenues of the Domestic Fixed-Line segment and the NIS 74 million (approximately \$19 million), or 1%, increase in the revenues of the International Communications and Internet Services segment. The increase in revenues was partially offset by the NIS 529 million (approximately \$136 million), or 5%, decrease in revenues of the Cellular Communications segment, which resulted from the continuing intense competition in the cellular market in 2015.

Bezeq's revenues in the year ended December 31, 2015 increased to NIS 4.4 billion (approximately \$1.1 billion) from NIS 4.3 billion in the year ended December 31, 2014, an increase of 2.1%. The increase in the segment's revenues was primarily due to a NIS 148 million (approximately \$38 million), or 10.6%, increase in Internet services revenues as a result of an increase in the number of Internet subscribers (including wholesale service subscribers) and higher retail ARPU. The increase in revenues was partially offset by a NIS 82 million (approximately \$21 million), or 4.9%, decrease in telephony revenues as a result of a decrease in the average revenue per line, or ARPL, and the decrease in the number of access lines.

Telephone's revenues in the year ended December 31, 2015 decreased to NIS 2.9 billion (approximately \$741 million) from NIS 3.4 billion in the year ended December 31, 2014, a decrease of 15.5%. Revenues from services in the year ended December 31, 2015 decreased to NIS 2.0 billion (approximately \$512 million) from NIS 2.45 billion in the year ended December 31, 2014, a decrease of 18.5%. The decrease was due to a NIS 211 million (approximately \$54 million) reduction in hosting service revenues, following termination of Pelephone's contract with HOT Mobile in December 2014. Revenues were also impacted by lower rates resulting from increased market competition and the migration of existing customers to cheaper rate plans, both of which factors lowered ARPU. Revenues from repair services were also down in the year ended December 31, 2015. Revenues from the sale of terminal equipment in the year ended December 31, 2015 decreased to NIS 891 million (approximately \$228 million) from NIS 966 million in the year ended December 31, 2014, a decrease of 7.8%. The decrease is primarily attributable to a reduction in terminal equipment sales, partially offset by higher selling prices. Revenues from repair services were also down in the year ended December 31, 2015.

Bezeq International's revenues in the year ended December 31, 2015 increased to NIS 1.6 billion (approximately \$404 million) from NIS 1.5 billion in the year ended December 31, 2014, an increase of 4.9%. The increase in revenues is primarily attributable to higher revenues from enterprise communication solutions (ICT), higher Internet service revenues due to the growth in the number of subscribers and an increase in revenues from data communication services. The increase was partially offset by lower revenues from outgoing calls, following a decrease in the number of minutes caused by ongoing competition with cellular providers and increased use of substitute software products.

**Depreciation and Amortization.** We recorded depreciation and amortization expenses of NIS 2.1 billion (approximately \$546 million) in the year ended December 31, 2015 compared to NIS 1.9 billion in the year ended December 31, 2014, an increase of approximately 13.8%. The increase was primarily due to the consolidation of DBS's depreciation and amortization expenses of NIS 245 million (approximately \$63 million) as of the second quarter of 2015 along with amortization of purchase price allocation costs Bezeq incurred while acquiring control over DBS. The increase was partially offset by a decrease in depreciation and amortization expenses arising from the purchase price allocation relating to B Communications' purchase of the controlling interest in Bezeq to NIS 447 million (approximately \$115 million) during the year ended December 31, 2015 compared with NIS 593 million in the year ended December 31, 2014.

The Bezeq Group recorded consolidated depreciation and amortization expenses of NIS 1.7 billion (approximately \$432 million) in the year ended December 31, 2015 compared to NIS 1.3 billion in the year ended December 31, 2014, an increase of 31.5%. The increase was primarily attributable to the consolidation of the depreciation and amortization expenses of DBS beginning in the second quarter of 2015.

Bezeq's depreciation and amortization expenses amounted to NIS 725 million (approximately \$186 million) in the year ended December 31, 2015 compared with NIS 688 million in the year ended December 31, 2014, an increase of 5.4%.

Pelephone's depreciation and amortization expenses in the year ended December 31, 2015 amounted to NIS 419 million (approximately \$107 million) compared to NIS 430 million in the year ended December 31, 2014, a decrease of 2.6%.

Bezeq International's depreciation and amortization expenses in the year ended December 31, 2015 amounted to NIS 132 million (approximately \$34 million) compared to NIS 130 million in the year ended December 31, 2014, an increase of 1.5%.

*Salaries.* Salaries increased by 10.6% to NIS 2.0 billion (approximately \$502 million) in the year ended December 31, 2015 from NIS 1.8 billion in the year ended December 31, 2014, primarily due to the consolidation of DBS salaries as of the second quarter of 2015.

Bezeq's salary expenses increased by 1.9% to NIS 912 million (approximately \$234 million) in the year ended December 31, 2015 from NIS 895 million in the year ended December 31, 2014. The increase in salary expenses was primarily attributable to increased salaries and related costs, and was offset by employee retirements.

Pelephone's salary expenses decreased 8.6% to NIS 381 million (approximately \$98 million) in the year ended December 31, 2015 from NIS 417 million in the year ended December 31, 2014. The decrease in salary expenses is primarily attributable to a decrease in the number of employees.

Bezeq International's salary expenses increased 1.7% to NIS 303 million (approximately \$78 million) in the year ended December 31, 2015 from NIS 298 million in the year ended December 31, 2014. The increase in salary expenses was primarily attributable to an increase in the number of employees providing outsourcing services in ICT operations.

*General and Operating Expenses.* General and operating expenses increased 15.1% to NIS 3.9 billion (approximately \$994 million) in the year ended December 31, 2015 from NIS 3.4 billion in the year ended December 31, 2014. The increase was primarily attributable to the consolidation of DBS' general and operating expenses as of the second quarter of 2015.

Bezeq's general and operating expenses decreased by 7.2% to NIS 721 million (approximately \$185 million) in the year ended December 31, 2015, from NIS 777 million in the year ended December 31, 2014. The decrease is primarily attributable to a decrease in call completion fees to telecom operators, building maintenance costs, and consultancy costs.

Pelephone's general and operating expenses decreased by 8.4% to NIS 1.9 billion (approximately \$494 million) in the year ended December 31, 2015, from NIS 2.1 billion in the year ended December 31, 2014. The decrease was primarily attributable to: (i) reduction in sales of terminal equipment; (ii) a decrease in rental costs, content expenses, doubtful debt expenses and advertising expenses; and (iii) a decrease in repairs and extended warranties service costs following the decrease in the number of service subscribers and the number of repairs. The decrease was partially offset by an increase in frequency leasing fees following the acquisition of 4G LTE frequencies.

Bezeq International's general and operating expenses increased by 7.0% to NIS 903 million (approximately \$231 million) in the year ended December 31, 2015, from NIS 844 million in the year ended December 31, 2014. The increase is primarily attributable to an increase in ICT equipment costs, Internet services and data communications services, corresponding with the increase in revenues.

*Other Operating Expenses, net.* We had other operating expense, net of NIS 3 million (approximately \$1 million) in the year ended December 31, 2015 compared to other operating income, net of NIS 535 million in the year ended December 31, 2014. The decrease was primarily the result of the one-time capital gain of NIS 582 million (\$150 million) generated from the sale of Coral-Tell shares by Bezeq in 2014.

*Finance expenses, net.* Our consolidated finance expenses, net decreased by 14.3% to NIS 595 million (approximately \$152 million) in the year ended December 31, 2015 from NIS 694 million for the year ended December 31, 2014.

Our finance expenses, net for the year ended December 31, 2015 decreased by 28.6% to NIS 60 million (approximately \$15 million) from NIS 84 million in the year ended December 31, 2014. The decrease was primarily attributable to the 1.0% decrease in the Israeli CPI in 2015, which our three series of debentures are linked to.

B Communications' finance expenses, net in the year ended December 31, 2015 decreased 42.3% to NIS 293 million (approximately \$75 million) from NIS 508 million in the year ended December 31, 2014. The decrease was primarily attributable to the one-time expenses of NIS 183 million in 2014, relating to the early repayment by B Communications of the loans incurred to acquire its controlling interest in Bezeq, and the early redemption of all of its outstanding Series A Debentures.

The Bezeq Group's consolidated finance expenses, net increased by 102.3% to NIS 263 million (approximately \$67 million) in the year ended December 31, 2015 from NIS 130 million in the year ended December 31, 2014. The increase was primarily due to financing income from shareholder loans to DBS which were recorded in 2014 and were not included in the consolidated results as of April 1, 2015 due to the consolidation of DBS. Such increase was partially set off as a result of the cancellation of taxes' interest related provision owed by Bezeq for previous years. Such cancellation was executed further to the proposed agreement with the Tax Authorities. The consolidation of DBS financing expenses as of the second quarter of 2015 in the amount of NIS 91 million (\$23 million) was offset by the amortization of purchase price allocation costs attributed to the DBS debentures.

*Income Tax.* Income tax expenses decreased by 48.0% to NIS 347 million (approximately \$89 million) in the year ended December 31, 2015 from NIS 667 million in the year ended December 31, 2014. The decrease was primarily attributable to the decrease in the pre-tax profit of the Bezeq Group in 2015 and from the NIS 101 million (\$26 million) income tax benefit B Communications recorded as a result of the sale of its Bezeq shares in the first quarter of 2016. 2014 pre-tax profit included capital gain from Bezeq's sale of the Coral Tell shares.

Bezeq's consolidated income tax expenses in the year ended December 31, 2015 represented 25.8% of its pre-tax profit, compared to 27.9% in the year ended December 31, 2014.

*Income (Loss) Attributable to the Owners of Our Company.* Income attributable to the owners of our company amounted to NIS 87 million (approximately \$22 million) in the year ended December 31, 2015, compared to a loss of NIS 103 million in year ended December 31, 2014. The increase is primarily attributable to the decrease in B Communications' net finance expenses, along with the income tax benefit B Communications' recorded in 2015.

*Income Attributable to Our Non-Controlling Interests.* Income attributable to our non-controlling interests decreased to NIS 1.00 billion (approximately \$256 million) in the year ended December 31, 2015 from NIS 1.15 billion in the year ended December 31, 2014. The decrease is primarily attributable to the decrease in the Bezeq Group's net income in 2015 compared with 2014 as a result of the one-time capital gain arising from the sale of the Coral-Tell shares in 2014.

#### **Year Ended December 31, 2014 Compared with Year Ended December 31, 2013**

*Revenues.* Our revenues decreased by 5.3% to NIS 9.1 billion (approximately \$2.3 billion) for the year ended December 31, 2014 from NIS 9.6 billion for the year ended December 31, 2013. For both periods, our consolidated revenues consisted entirely of Bezeq's consolidated revenues. The decrease in revenues in 2014 was primarily due to a NIS 390 million (approximately \$100 million), or 10.2%, decrease in the revenues of the cellular communications segment, driven by continued increased competition in the cellular market in 2014. To a lesser extent, the decrease in revenues is also attributable to the NIS 161 million (approximately \$41 million), or 3.6%, decrease in the revenues of the fixed-line segment. The decrease was partially offset by a NIS 71 million (approximately \$18 million), or 5.0%, increase in the revenues of the international communications and Internet services segment.

Bezeq's revenues in the year ended December 31, 2014 decreased to NIS 4.3 billion (approximately \$1.1 billion) compared with NIS 4.5 billion in the year ended December 31, 2013, a decrease of 3.6%. The decrease in the segment's revenues was primarily due to a NIS 303 million (approximately \$78 million), or 15.4%, reduction in telephony revenues as a result of a decrease in the average revenue per line, or ARPL, and a decrease in the number of access lines. The decrease in revenues was partially offset by a NIS 107 million (approximately \$28 million), or 8.3%, increase in revenues from Internet services as a result of an increase in the number of Internet subscribers.

Telephone's revenues in the year ended December 31, 2014 decreased to NIS 3.4 billion (approximately \$879 million) compared with NIS 3.8 billion in the year ended December 31, 2013, a decrease of 10.2%. Revenues from services in the year ended December 31, 2014 decreased to NIS 2.45 billion (approximately \$631 million) compared to NIS 2.8 billion in the year ended December 31, 2013, a decrease of 12.6%. The decrease is primarily attributable to the reduction in tariffs that resulted from the continued intensified competition in the cellular market. The intensified competition led to a migration to unlimited usage plans which resulted in a decrease in ARPU, as well as to a decrease in the total number of subscribers. Revenues from the sale of terminal equipment in the year ended December 31, 2014 decreased to NIS 966 million (approximately \$248 million), compared to NIS 1 billion in the year ended December 31, 2013, a decrease of 3.5%. The decrease is primarily attributable to a decrease in handset sales and prices. The decrease was partially offset by increased revenues from the sale of accessories.

Bezeq International's revenues in the year ended December 31, 2014 increased to NIS 1.5 billion (approximately \$387 million) compared with NIS 1.4 billion in the year ended December 31, 2013, an increase of 5%. The increase in revenues is primarily attributable to an increase in revenues from call transfers between communication carriers worldwide, increased revenues from enterprise communication solutions (ICT) and increased revenues from Internet operations due to an increase in the number of subscribers. The increase was partially offset by a decrease in revenues from outgoing calls attributable to the transition in the cellular market to packages that include unlimited overseas calls.



*Depreciation and Amortization.* We recorded depreciation and amortization expenses of NIS 1.9 billion (approximately \$482 million) for the year ended December 31, 2014 compared to NIS 2.0 billion for the year ended December 31, 2013, a decrease of approximately 7%. The decrease was primarily due to a 15.6% decrease in depreciation and amortization arising from the purchase price allocation relating to B Communications' purchase of the controlling interest in Bezeq, to NIS 593 million (approximately \$152 million) during the year ended December 31, 2014 compared with NIS 703 million during the year ended December 31, 2013. To a lesser extent, the decrease in depreciation and amortization is also attributable to the NIS 30 million (approximately \$8 million), or 2.3%, decrease in the Bezeq Group depreciation and amortization that resulted from the end of depreciation of certain property, plant and equipment assets in the cellular communications and the Domestic Fixed-Line Communications segments during 2013.

The Bezeq Group recorded consolidated depreciation and amortization expenses of NIS 1.28 billion (approximately \$329 million) for the year ended December 31, 2014 compared to NIS 1.3 billion for the year ended December 31, 2013, a decrease of 2.3%. The decrease is primarily attributable to lower depreciation of certain property, plant and equipment assets and subscriber acquisition costs in the cellular communications segment.

Bezeq's depreciation and amortization expenses amounted to NIS 688 million (approximately \$177 million) in the year ended December 31, 2014 compared with NIS 683 million in the year ended December 31, 2013, an increase of 0.7%.

Pelephone's depreciation and amortization expenses in the year ended December 31, 2014 amounted to NIS 430 million (approximately \$111 million) compared to NIS 458 million in the year ended December 31, 2013, a decrease of 6.1%. The decrease is primarily attributable to the conclusion of the capitalization of subscriber acquisition costs and the depreciation of other property, plant and equipment.

Bezeq International's depreciation and amortization expenses in the year ended December 31, 2014 amounted to NIS 130 million (approximately \$33 million), the same as for the year ended December 31, 2013.

*Salaries.* Salaries decreased 5.5% to NIS 1.8 billion (approximately \$455 million) for the year ended December 31, 2014 from NIS 1.9 billion for the year ended December 31, 2013, primarily due to a decrease in the number of employees in the Cellular and Domestic Fixed-Line Communications segments.

Bezeq's salary expenses decreased 8.7% to NIS 895 million (approximately \$230 million) for the year ended December 31, 2014 from NIS 980 million for the year ended December 31, 2013. The decrease in salary expenses was primarily due to a decrease in the number of employees and in share-based compensation. The decrease was partially offset by higher employee wages during 2014.

Pelephone's salary expenses decreased 5% to NIS 417 million (approximately \$107 million) for the year ended December 31, 2014 from NIS 439 million in the year ended December 31, 2013. The decrease in salary expenses is primarily attributable to a decrease in the number of employees. The decrease was partially offset by higher employee wages during 2014.

Bezeq International's salary expenses increased 3.8% to NIS 298 million (approximately \$77 million) for the year ended December 31, 2014 from NIS 287 million in the year ended December 31, 2013. The increase in salary expenses was primarily attributable to an increase in the number of employees providing outsourcing services in ICT operations.

*General and Operating Expenses.* General and operating expenses decreased 6% to NIS 3.4 billion (approximately \$866 billion) for the year ended December 31, 2014 from NIS 3.6 billion for the year ended December 31, 2013. The decrease was primarily attributable to the Cellular Communications and the Domestic Fixed-Line Communications segments, as a result of lower terminal equipment costs and interconnect fees.

Bezeq's general and operating expenses decreased 13.2% to NIS 777 million (approximately \$200 million) in the year ended December 31, 2014, from NIS 895 million in the year ended December 31, 2013. The decrease is primarily attributable to a decrease in interconnect fees and a reduction in terminal equipment costs following a transition from selling home network routers to rental. The decrease was also attributable to a decrease in structure maintenance costs.

Pelephone's general and operating expenses decreased 6.2% to NIS 2.1 billion (approximately \$541 million) in the year ended December 31, 2014, from NIS 2.2 billion in the year ended December 31, 2013. The decrease was mainly attributable to: (i) changes in the sales mix; (ii) a decrease in repair costs and warranty services following a decrease in the number of service subscribers and the number of repair calls; (iii) a decrease in interconnect fees following a reduction in call termination rates to domestic fixed-line communication operators; and (iv) lower content expenses together with a reduction in content revenue. The decrease was partially offset by: (i) an increase in distribution fee costs, following an increase in the number of subscribers migrating to this segment; (ii) greater expenses for doubtful accounts; (iii) a one-time reduction in net collection costs recorded in the previous year; and (iv) an increase in site rental fees (following a one-time decrease of NIS 30 million recorded last year after adjusting a liability estimate).

Bezeq International's general and operating expenses increased 7% to NIS 844 million (approximately \$217 million) in the year ended December 31, 2014, from NIS 789 million in the year ended December 31, 2013. The increase is primarily attributable to an increase in the cost of call transfers between communications carriers worldwide and increased expenses from enterprise communications solutions. The increase was partially offset by a decrease in expenses for outgoing calls, consistent with the decline revenues.

*Other Operating Expenses, net.* We had other operating income, net of NIS 535 million (approximately \$138 million) in the year ended December 31, 2014 compared to other operating expenses, net of NIS 57 million in the year ended December 31, 2013. The increase was a result of the one-time pre-tax capital gain of NIS 582 million (\$150 million) from the sale of Coral-Tell shares.

*Finance expenses, net.* Our consolidated finance expenses, net increased by 75% to NIS 694 million (approximately \$178 million) for the year ended December 31, 2014 from NIS 396 million for the year ended December 31, 2013. The increase is primarily attributable to one-time expenses relating to the early repayment of the loans incurred to acquire B Communications' controlling interest in Bezeq and the early redemption of all of its outstanding Series A Debentures that were part of B Communications' refinancing process and to net finance expenses related to the revaluation of B Communications' Cross Currency Swap hedge transactions.

Our finance expenses, net for the year ended December 31, 2014 increased to NIS 591 million (approximately \$152 million) compared with NIS 287 million for the year ended December 31, 2013, an increase of 106%. The increase is primarily attributable to one-time expenses of NIS 183 million (approximately \$47 million) relating to the early repayment of the loans incurred to acquire B Communications' controlling interest in Bezeq and the early redemption of all of its outstanding Series A Debentures that were part of B Communications' refinancing process and to net finance expenses related to the revaluation of B Communications' Cross Currency Swap hedge transactions of NIS 85 million (approximately \$22 million).

The Bezeq Group's consolidated finance expenses, net decreased 10.3% to NIS 130 million (approximately \$33 million) in the year ended December 31, 2014 compared to NIS 145 million in the year ended December 31, 2013. The decrease is primarily attributable to a decrease in net finance expenses in the Domestic Fixed-Line Communications segment. The decrease was partially offset by decrease in net finance income in the cellular communications segment.

*Income Tax.* Income tax expenses increased by 27.3% to NIS 667 million (approximately \$172 million) for the year ended December 31, 2014 from NIS 524 million for the year ended December 31, 2013. The increase was mainly attributable to an increase in the pre-tax profit as a result of the sale of the Coral Tell shares.

Bezeq's consolidated income tax expenses in the year ended December 31, 2014 represented 27.9% of its pre-tax profit, compared to 26.9% in the year ended December 31, 2013.

*Income (Loss) Attributable to the Owners of Our Company.* Loss attributable to the owners of our company amounted to NIS 103 million (approximately \$26 million) for the year ended December 31, 2014, compared to an income of NIS 26 million for year ended December 31, 2013. The loss attributable to the owners of our company is primarily attributable to the one-time expenses of NIS 183 million (approximately \$47 million) that B Communications' incurred relating to the early repayment of the loans it incurred to acquire its controlling interest in Bezeq and the early redemption of all its outstanding Series A Debentures that were part of B Communications' refinancing process and to net finance expenses related to the revaluation of B Communications' Cross Currency Swap hedge transactions of NIS 85 million (approximately \$22 million).

*Income Attributable to Our Non-Controlling Interests.* Income attributable to our non-controlling interests increased to NIS 1.15 billion (approximately \$294 million) for the year ended December 31, 2014 compared to NIS 834 million for the year ended December 31, 2013. The increase in income attributable to our non-controlling interests is primarily attributable to the one time capital gain from the sale of Coral-Tell shares together with lower depreciation and amortization expenses with respect to the purchase price allocation relating to B Communications' purchase of the controlling interest in Bezeq.

## **B. Liquidity and Capital Resources**

Historically we funded our operations principally from cash flows from operations, short-term bank credit, revolving short-term bank loans and the proceeds of the initial public offering of our ordinary shares in August 1999.

In April 2005, we completed an offering of NIS 220 million of convertible debentures and warrants, in Israel, exclusively to Israeli residents. The debentures were to be repaid during the period April 2008 through April 2015, and were traded on the TASE. The interest rate of these debentures is 4%, and they are convertible into ordinary shares at a conversion price of NIS 50. Due to the significant increase in our share price, NIS 75.9 million of such convertible debentures were converted into 1,518,008 of our ordinary shares during 2010. In January 2008, our Board of Directors authorized the repurchase of up to NIS 112 million of the convertible debentures. In September 2011, we completed an early redemption of 242,561 par value Series A Debentures, together with CPI linkage differentials and accrued interest. As a result of the early redemption, our Series A Debentures were delisted from the TASE on September 26, 2011. As of December 31, 2015, the Series A debentures were fully repaid.

The warrants to purchase up to 2.5 million of our ordinary shares were exercised in full prior to October 15, 2007, their expiration date. The proceeds from the exercise of such warrants of NIS 104 million were used for general corporate purposes including working capital.

In September 2007, we completed an offering of Series B debentures that was made exclusively to Israeli residents. We raised a total of NIS 423 million. The interest rate for the debentures, which are traded on the TASE, is 5%. In November 2008, our Board of Directors authorized the repurchase of up to NIS 100 million of our Series B debentures. The purchases were made from time to time by us or one of our wholly-owned subsidiaries in the open market on the TASE. We repurchased NIS 5,714,370 of the Series B Debentures under the program at a total purchase price of NIS 4.4 million, or an average price of NIS 0.763 per bond.

In December 2009, we issued additional Series B debentures in two private placements to institutional investors in Israel for NIS 400 million. The terms of these additional Series B debentures issued in December 2009 are identical to those of the Series B debentures issued in September 2007. As of December 31, 2015, the Series B Debentures were fully repaid.

In 2009, we completed the repurchase of 5,481,859 of our ordinary shares for an aggregate of NIS 140 million, or an average price of NIS 25.30 per share, under two repurchase programs. In 2010, our Board of Directors authorized a third repurchase program, for the repurchase of up to an additional NIS 44 million of our ordinary shares in the open market from time to time at prevailing market prices. We repurchased 330,756 ordinary shares under the third program at a total purchase price of NIS 30 million (\$8 million), or an average price of NIS 90.7 (\$24.30) per share. No repurchases have been made since 2011.

In September 2010, we completed the public offering in Israel of NIS 170 million of our Series C Debentures. The Series C Debentures are payable in four equal annual installments on March 10 of each of the years 2016 through 2019 and pay interest at a fixed annual rate of 4.45%, which is payable semi-annually on March 10 and September 10 of each of the years 2011 through 2019 (the last interest payment is payable on March 10, 2019). The Series C Debentures are NIS denominated and are not linked to the Israeli CPI. The Series C Debentures contain standard terms and conditions and are unsecured, non-convertible and do not restrict our ability to issue any new series of debt instruments or distribute dividends in the future. The Series C Debentures are listed for trading on the TASE. Midroog Ltd. assigned an A3 stable rating to the newly issued Series C Debentures.

In December 2010, we issued NIS 148 million of our Series C Debentures in a private placement to certain institutional investors in exchange for NIS 125 million of our outstanding Series B Debentures, reflecting an exchange ratio of 1:1.188. In February 2011, we issued additional Series C Debentures in a private placement to a number of Israeli institutional investors. The offering price was NIS 1.0275 per debenture, which represented a yield of 4.2%. The aggregate proceeds were approximately NIS 133.6 million. In December 2011, January 2012, November 2013 and December, 2013 we completed private placements of NIS 65 million, NIS 14 million, NIS 60 million and NIS 65 million, respectively, of our Series C Debentures. The private placements were offered to a number of Israeli institutional investors pursuant to Regulation S under the Securities Act. The terms of all issued Series C Debentures are identical to the terms of the Series C Debentures issued in 2010, and they are listed on the TASE. In November 2013, Midroog confirmed a Baa1 rating for our Series C Debentures in connection with our NIS 60 million sale of Series C Debentures. As of December 31, 2015, NIS 518 million (approximately \$133 million) of Series C Debentures are outstanding.

In March 2014, we completed a public tender for an offering in Israel of Series D Debentures, with a fixed annual interest rate of 6%. In the tender, we accepted orders for 117,597 units of the non-convertible Series D Debentures for an aggregate principal amount of NIS 117.5 million (approximately \$33.7 million) at a price per unit of NIS 1,070. Midroog assigned a local Baa1 stable rating for the Series D Debentures Offering. The Series D Debentures are listed on the TASE.

We will repay the principal amount of the Series D Debentures in five installments as follows: (i) payments of 10% of the principal amount of the Series D Debentures will be made on each of September 15, 2018 and 2019; (ii) payments of 30% of the principal amount of the Series D Debentures will be made on each of September 15, 2020 and 2021; and (iii) a final payment of 20% of the principal amount of the Series D Debentures will be made on September 15, 2022. Interest on the outstanding principal of the Series D Debentures will be paid on March 15 and September 15 of each of the years 2014-2022, other than the first interest payment which was made on September 15, 2014. The principal and interest is linked to the Israeli consumer price index of January 2014.

On June 9 and 22, 2014 we completed a private placement of NIS 219,238,087 par value of Series D Debentures to certain institutional investors in Israel in exchange for NIS 106,938,290 par value of our outstanding Series B Debentures and NIS 95,324,216 par value of our outstanding Series C Debentures held by such institutional investors (or approximately 51% and 12% of the outstanding Series B Debentures and Series C Debentures, respectively). On October 22, 2014 we completed an additional private placement of NIS 106,813,717 par value of Series D Debentures to certain institutional investors in Israel in exchange for NIS 103,102,043 par value of our outstanding Series C Debentures held by such institutional investors (or approximately 15% of the outstanding Series C Debentures). On November 20 and 26, 2014 we completed an additional private placement of NIS 86,254,219 par value of Series D Debentures to certain institutional investors in Israel in exchange for NIS 84,979,526 par value of our outstanding Series C Debentures held by such institutional investors (or approximately 15% of the outstanding Series C Debentures). As of December 31, 2015, NIS 530 million (approximately \$136 million) of Series D Debentures are outstanding.

In January 2015, Midroog confirmed the Baa1 stable outlook rating with respect to our Series B, C and D Debentures and in February 2016, Midroog raised the rating for our Series C and D Debentures from Baa1.il to A3.il stable outlook.

As of December 31, 2014 and 2015, we had on an unconsolidated basis cash and cash equivalents as well as marketable securities of NIS 322 million and NIS 277 million (approximately \$71 million), respectively.

#### *Agreement with Norisha*

On June 27, 2013, we and Norisha Holdings Limited, or Norisha, entered into a share purchase agreement, or the SPA, pursuant to which we sold 3,571,741 ordinary shares, par value NIS 0.1 each, of B Communications to Norisha; and agreed, that upon certain terms, Norisha would be entitled to receive adjustment shares and to purchase option shares. On May 29, 2014, we and Norisha agreed to revise the terms of the SPA under the following basic terms: (1) Norisha would waive any of its current and future rights under the SPA, including any rights to receive any additional shares under the SPA; and (2) instead of the previous rights, we would transfer to Norisha 396,860 additional ordinary shares of B Communications without any further payment.

#### *Bezeq's Dividend Distributions*

On August 4, 2009, Bezeq's board of directors adopted a dividend distribution policy according to which Bezeq will distribute to its shareholders, semiannually, a dividend at a rate of 100% of its semiannual net income after minority share in accordance with Bezeq's consolidated financial statements. The implementation of the dividend policy is subject to the provisions of applicable law, including the dividend distribution tests set forth in the Israeli Companies Law, as well as the estimate of Bezeq's board of directors regarding Bezeq's ability to meet its existing and anticipated liabilities from time to time. Each dividend distribution is subject to the approval of Bezeq's shareholders, pursuant to Bezeq's articles of association.

On March 31, 2011, the Tel Aviv District Court approved a NIS 3 billion distribution by Bezeq to its shareholders in six equal, semi-annual payments during the period 2011 through 2013. The Court approval was required as the amount of the distribution exceeded Bezeq's accounting profits according to its financial statements. All of the six semi-annual payments of NIS 0.5 billion were distributed to Bezeq's shareholders.

Bezeq paid total cash dividends of NIS 2.8 billion, NIS 2.1 billion and NIS 1.8 billion (approximately \$455 million) in the three years ended December 31, 2015, out of which B Communications received NIS 876 million, NIS 638 million and NIS 545 million (approximately \$140 million), respectively.

#### *Debt Incurred by B Communications for the Acquisition of the Bezeq Shares*

On April 14, 2010, B Communications completed the acquisition of 30.44% of Bezeq's outstanding shares for approximately NIS 6.5 billion and became the controlling shareholder of Bezeq. The acquisition was funded with the proceeds that B Communications received from the sale of its legacy communications business and loans.

On the closing date of the acquisition of the Bezeq interest, B Communications' indirect fully owned subsidiary SP2, which holds the Bezeq interest acquired on that date, obtained loans of NIS 4.6 billion from certain banking and financial institutions. SP2 also created liens for the lenders as security for its obligations under the loan agreement and agreed to pay the lenders certain fees, expenses and cost increases. SP2 also issued phantom stock options to the banks. On November 5, 2013, SP2, entered into an amendment which provided for improved terms.

The proceeds of B Communications' February 2014 \$800 million senior secured note offering were used to repay all of the outstanding balances under the loans B Communications incurred to acquire its controlling interest in Bezeq.

*B Communications' \$800 Million Note Offering*

On February 19, 2014, B Communications completed a private offering to eligible purchasers of \$800 million of 7% Senior Secured Notes due 2021, or the Notes. The Notes were offered and sold in the United States to qualified institutional buyers pursuant to Rule 144A under the U.S. Securities Act of 1933, as amended (the "Securities Act"), and to certain qualifying investors in offshore transactions, including in Israel, in reliance on Regulation S under the Securities Act.

The Notes are senior obligations and are guaranteed by B Communications' two subsidiaries, SP1 and SP2 on a senior secured basis. The Notes and the guarantees are secured by first priority liens over all of the capital stock of SP2, the capital stock of Bezeq held by SP2, which constitute, as of the date of the issuance of the Notes, approximately 30% of the outstanding voting capital stock of Bezeq, and additional collateral.

The Notes and the guarantees are secured by security interests in the collateral described above, which collateral also secures the obligations under certain hedging obligations. In connection with the sale of the Notes, B Communications, SP1 and SP2 entered into an intercreditor agreement, or the Intercreditor Agreement, with, among others, the Security Agent (as hereinafter defined) under the indenture for the Note, or the Indenture, the Trustee under the Note, and the hedging counterparties with whom B Communications entered into hedging arrangements, or the Hedging Counterparties. Pursuant to the terms of the Intercreditor Agreement and subject to certain limitations as set forth below, any liabilities in respect of counterparties to certain hedging obligations that are permitted to be secured by Collateral will receive priority with respect to any proceeds received upon any enforcement action over, and certain distressed disposals of, any Collateral. The Intercreditor Agreement provides that a common security agent, who will also serve as the security agent for the creditors under B Communications' hedging obligations and any additional debt or other obligations secured by the collateral permitted to be incurred under the Indenture, or the Security Agent, will act as provided for in the Intercreditor Agreement, subject to the provisions of the Pledge Permit, the Israeli Communications Law and Communications Order. The Intercreditor Agreement regulates the ability of the Trustee or the holders of the Notes to instruct the Security Agent to take enforcement action.

Pursuant to the Communications Order issued by the Ministry of Communications in respect of Bezeq, there are legal limitations on the ability of any person (individually and together with others) directly or indirectly holding, acquiring or controlling 5% or more of the voting power or share of economic rights in Bezeq. In connection with the offering of the Notes, the Security Agent was granted a pledge permit from the Ministers, or the Pledge Permit, which enables B Communications to pledge the pledged Bezeq Shares and pledged SP2 Shares as collateral for the Notes and certain hedging obligations. However, pursuant to the Communications Order and the Pledge Permit, no person (individually and acting in concert with other persons) may directly or indirectly hold, acquire or control, at any given time, more than 10% of the outstanding principal amount of Notes without first obtaining a permit from the Ministers.

The indenture for the Notes, or the Indenture, among other things, restricts B Communications' ability to: (i) incur additional indebtedness; (ii) use a portion of the proceeds of any dividends received from the Bezeq Group and make certain payments and investments create certain liens; (iii) impose restrictions on the ability of B Communications' subsidiaries to pay dividends or other payments to B Communications; (iv) transfer or sell ownership interests in the Bezeq Group; (v) merge or consolidate with other entities; and enter into transactions with affiliates.

Prior to February 15, 2017, B Communications will be entitled to redeem all or a portion of the Notes at a redemption price equal to 100% of the principal amount of the Notes plus the applicable "make-whole" premium and accrued and unpaid interest and additional amounts, if any, to the redemption date. On or after February 15, 2017, B Communications will be entitled to redeem all or a portion of the Notes at certain redemption prices plus accrued and unpaid interest and additional amounts, if any, to the redemption date. Prior to February 15, 2017, B Communications will be entitled on one or more occasions to redeem the Notes in an aggregate principal amount not to exceed 40% of the aggregate principal amount of the Notes with the net cash proceeds from certain equity offerings at a redemption price equal to 107.375% of the principal amount outstanding in respect of the Notes, plus accrued and unpaid interest and additional amounts, if any, to the redemption date, so long as at least 60% of the aggregate principal amount of the Notes remains outstanding immediately after each such redemption and each such redemption occurs within 90 days after the date of the relevant equity offering.

In the event of certain developments affecting taxation (with respect to the Notes), B Communications may redeem all, but not less than all, of the Notes at 100% of the principal amount thereof, plus accrued and unpaid interest and additional amounts, if any, to the redemption date. In the event of certain developments affecting applicable regulations with respect to the ownership of the Bezeq Group, B Communications may redeem all, but not less than all, of the Notes at 101% of the principal amount thereof, plus accrued and unpaid interest to the date of redemption. Upon the occurrence of certain events constituting a "change of control," B Communications will be required to offer to repurchase all outstanding Notes at a purchase price in cash equal to 101% of the principal amount thereof on the date of purchase plus accrued and unpaid interest to the date of purchase.

Following the Note issuance B Communications entered into five Cross Currency Swap, or CCS, transactions in order to hedge its exposure to fluctuations in the U.S. dollar exchange rate. The CCS transaction hedged a total of \$725 million par value of the Notes.

On February 2, 2016, B Communications sold 115,500,000 Bezeq shares and received gross proceeds of NIS 982 million in the aggregate (approximately \$248 million). According to the terms of the Indenture for the Notes, the net proceeds from the sale of any Bezeq shares must be deposited into B Communications "Lockbox Account" and are subject to other customary conditions and covenants relating to asset sales and release of liens on sold assets. In addition, according to the terms of the Indenture, B Communications must make an offer within 365 days to the holders of the Notes to purchase Notes with the proceeds deposited in the lockbox account at a cash offer price equal to 100% of the principal amount of the Notes, plus accrued and unpaid interest to the date of purchase.

The sale took place in accordance with the provisions of Section 3(a3) of the Communications Order, by way of an agreement to sell the shares through a "distribution agent" (as this term is defined in the Communications Order), which entered into agreement with third parties to sell them the shares in off-the-floor transactions. In connection with this sale, the shares were released from a pledge that had been imposed on them in favor of debenture holders (USD Series 144A) that were issued by B Communications as well as various hedge funds with which we entered into agreements in connection with the aforementioned debentures. After completing the sale process, B Communications hold 26.34% of Bezeq's issued and paid-up share capital.

#### *Financing of Ongoing Operations*

We expect to have sufficient funds to meet our long term working capital needs, capital expenditures, debt service and other funding requirements, both on a consolidated level (including B Communications which consolidates Bezeq's results) and with respect to our own debt service (not including B Communications and Bezeq),

We expect to have sufficient funds to service our indebtedness (excluding Bezeq's and B Communications' indebtedness) from our cash, cash equivalents and short term investments, our ability to raise additional funds, including through the sale or pledge of a portion of our shareholdings in B Communications that are free from any encumbrances, and from future dividends from B Communications.

Following the execution of its refinancing agreement, B Communications declared its first dividend as a public company on November 7, 2013, a dividend of NIS 3.41 per share and NIS 102 million in the aggregate. The record date for the distribution of the dividend was November 18, 2013 and the payment date was December 3, 2013. We received NIS 69 million (approximately \$20 million) from the dividend distributed by B Communications.

On May 21, 2015, B Communications declared a dividend of NIS 2.24 per share (approximately \$0.58 cents) and approximately NIS 67 million (approximately \$17 million) in the aggregate. We received NIS 45 million (approximately \$12 million) from the dividend distributed by B Communications on June 16, 2015.

On August 31, 2015, B Communications declared a dividend of NIS 0.73 per share (approximately \$0.19) and approximately NIS 22 million (approximately \$6 million) in the aggregate. We received NIS 15 million (approximately \$4 million) from the dividend distributed by B Communications on September 29, 2015.

On November 19, 2015, B Communications declared a dividend of NIS 38 million (\$10 million), or NIS 1.27 (\$0.32) per share. We received NIS 25 million (approximately \$6 million) from the dividend distributed by B Communications on December 23, 2015.

Bezeq paid total cash dividends of NIS 1.8 billion (approximately \$455 million) in the year ended December 31, 2015, out of which B Communications received NIS 545 million (approximately \$140 million).

As of December 31, 2015, our cash, cash equivalents and short-term investments (not including B Communications and Bezeq) totaled NIS 277 million (approximately \$71 million).

In addition, as of December 31, 2015, we held 19.9 million unencumbered ordinary shares of B Communications having a value at December 31, 2015 of NIS 2.0 billion (66.71 % of B Communications' outstanding share capital). These shares can, if necessary, be used to support the refinance of existing debt or may be sold for cash (up to 5 million shares can be sold without endangering our controlling interest in B Communications).

In January, 2016, we sold 575,000 ordinary shares of B Communications, representing approximately 1.92% of its issued and outstanding shares, and received gross proceeds of NIS 56 million (approximately \$14 million) from the sale. As a result of the sale, our ownership interest in B Communications declined to 64.78% of its outstanding shares.

We believe that we have sufficient funds to service our debt service requirements through December 31, 2017 and we expect to have sufficient funds to serve our expected indebtedness beyond 2017.

#### ***Liquidity and Capital Resources of the Bezeq Group***

As of December 31, 2015, the Bezeq Group had cash and cash equivalents and current investments of NIS 1.3 billion (approximately \$338 million) compared to cash and cash equivalents and current investments of NIS 2.9 billion at December 31, 2014.

The Bezeq Group incurred consolidated capital expenditures of NIS 1.6 billion (approximately \$414 million) for the year ended December 31, 2015, compared with NIS 1.3 billion for the year ended December 31, 2014. The capital expenditures in 2015 were primarily for the development of communications infrastructure in the amount of NIS 1.1 billion (approximately \$278 million) and for investments in intangible assets and deferred expenses in the amount of NIS 194 million (approximately \$50 million) compared with investments of NIS 1.0 billion for the development of communications infrastructure and of NIS 186 million for intangible assets and deferred expenses in 2014.

In the year ended December 31, 2015, the Bezeq Group repaid debt and paid interest of NIS 1.7 billion (approximately \$444 million), compared with NIS 1.3 billion for year ended December 31, 2014. In addition, the Bezeq Group paid dividends of NIS 1.8 billion (approximately \$455 million) in 2015 compared to NIS 2.1 billion in 2014.

The Bezeq Group's average debt (including current maturities) to financial institutions and debenture holders for the year ended December 31, 2015 was NIS 10.9 billion (approximately \$2.8 billion). The average supplier credit for the year ended December 31, 2015 was NIS 903 million (approximately \$231 million), the average short-term customer credit for the year ended December 31, 2015 was NIS 2.2 billion (approximately \$564 million), and average long-term customer credit was NIS 516 million (approximately \$132 million).

The Bezeq Group's working capital deficit as of December 31, 2015 was NIS 1.1 billion (approximately \$294 million) compared with a surplus of NIS 1.7 billion on December 31, 2014. Bezeq (according to its separate financial statements) had a working capital deficit of NIS 2.1 billion (approximately \$548 million) as of December 31, 2015, compared with a working capital surplus of NIS 386 million as of December 31, 2014.

The Board of Directors of Bezeq reviewed the company's existing and projected resources and cash flows for the foreseeable future and its investment needs, as well as the sources of finance and the potential amounts that will be required by the Bezeq Group in the foreseeable future. On the basis of its review of all of these factors, Bezeq's Board of Directors concluded that the Bezeq Group can meet its existing cash needs and its needs for the foreseeable future from cash generated from its operations, by receipt of dividends from subsidiaries and by raising debt, from banking and non-banking sources, should it determine to do so.

#### ***Bezeq***

The table below describes the Bezeq Group long-term debt (including current maturities) as of December 31, 2015:

|                 | Source of financing | Amount (NIS millions) | Currency or linkage | Type of interest and change mechanism | Average interest rate | Effective interest rate | Interest range in 2015 |
|-----------------|---------------------|-----------------------|---------------------|---------------------------------------|-----------------------|-------------------------|------------------------|
|                 | Banks               | 1,331                 | Unlinked NIS        | Variable, based on prime rate         | 1.64%                 | 1.64%                   | 1.27%-1.95%            |
|                 | Banks               | 1,823                 | Unlinked NIS        | Fixed                                 | 5.21%                 | 5.27%                   | 2.40%-6.85%            |
| Long-term loans | Non-bank sources    | 734                   | Unlinked NIS        | Variable, based on annual STL rate    | 1.56%                 | 1.60%                   | 1.47%-1.61%            |
|                 | Non-bank sources    | 1,675                 | Unlinked NIS        | Fixed                                 | 5.53%                 | 5.61%                   | 3.65%-6.65%            |
|                 | Non-bank sources    | 3,661                 | CPI-linked NIS      | Fixed                                 | 2.63%                 | 2.68%                   | 2.20%-5.30%            |

## Restrictions on borrowings

### Restrictions included in Bezeq's loans

As of December 31, 2015 Bezeq was in compliance with all the restrictions applicable to it.

### Bank of Israel restrictions on a single borrower and group of borrowers

Directives of the Supervisor of Banks include restrictions on liability of a single borrower and of a group of borrowers towards the banks. Bezeq could be seen as part of one "group of borrowers" with B Communications Group and its controlling shareholders. The directives of the Supervisor of Banks could from time to time affect the ability of Israeli banks to grant further credit to Bezeq.

|  | Note   | December 31, 2015 |               | December 31, 2014 |               | Interest rate range      |
|--|--------|-------------------|---------------|-------------------|---------------|--------------------------|
|  |        | Carrying amount   | Nominal value | Carrying amount   | Nominal value |                          |
|  |        | NIS million       | NIS million   | NIS million       | NIS million   |                          |
| <b>Loans</b>   |        |                   |               |                   |               |                          |
| Total unlinked loans at variable interest                          | 12.3   | 1,331             | 1,331         | 1,656             | 1,656         | Prime -0.33% to +0.2%    |
| Total unlinked loans at fixed interest                             | 12.3   | 1,589             | 1,589         | 1,796             | 1,796         | 6.85% - 5%               |
| Total unlinked loans at fixed interest                             | 12.3   | 300               | 300           | 300               | 300           | 2.4%                     |
| CPI-linked loans at fixed interest                                 |        | -                 | -             | 22                | 18            | 4.45%-4.6%               |
| <b>Total loans</b>   |        | <b>3,220</b>      | <b>3,220</b>  | <b>3,774</b>      | <b>3,770</b>  |                          |
| <b>Debentures issued to the public</b>                             |        |                   |               |                   |               |                          |
| CPI-linked debentures at fixed interest - Series 5                 | 12.3.1 | 310               | 251           | 613               | 503           | 5.3%                     |
| CPI-linked debentures at fixed interest - Series 6                 | 12.3   | 3,087             | 2,874         | 3,165             | 2,874         | 3.7%                     |
| Unlinked debentures at variable interest - Series 7                | 12.3   | 734               | 734           | 734               | 734           | Makam for one year +1.4% |
| Unlinked debentures at fixed interest - Series 8                   | 12.3   | 886               | 886           | 1,329             | 1,329         | 5.7%                     |
| Unlinked debentures at fixed interest - Series 9                   | 12.3   | 388               | 388           | -                 | -             | 3.65%                    |
| CPI-linked debentures at fixed interest - Series 10                | 12.3   | 400               | 400           | -                 | -             | 2.2%                     |
| <b>Total debentures issued to the public</b>                       |        | <b>5,805</b>      | <b>5,533</b>  | <b>5,841</b>      | <b>5,440</b>  |                          |
| <b>Non-marketable debentures issued to financial institutions:</b> |        |                   |               |                   |               |                          |
| Unlinked debentures at fixed interest                              | 12.3   | 400               | 400           | 400               | 400           | 6.65%                    |
| CPI-linked debentures at fixed interest                            | 12.4   | 1,288             | 1,097         | -                 | -             | 5.35%-8.4%               |
| CPI-linked debentures at fixed interest                            |        | -                 | -             | 72                | 58            | 4.4%-4.6%                |
| <b>Total debentures issued to financial institutions</b>           |        | <b>1,688</b>      | <b>1,497</b>  | <b>472</b>        | <b>458</b>    |                          |
| <b>Total debentures</b>  |        | <b>7,493</b>      | <b>7,030</b>  | <b>6,313</b>      | <b>5,898</b>  |                          |
| <b>Total interest-bearing liabilities</b>                          |        | <b>10,713</b>     | <b>10,250</b> | <b>10,087</b>     | <b>9,668</b>  |                          |

For Debentures (Series 5), standard grounds were established for immediate repayment, including breach events, insolvency, dissolution procedures or receivership.

For Debentures (Series 6 to 10) and bank loans and for debentures issued to financial institutions in the amount of NIS 400 million, Bezeq has undertaken not to create additional liens on its assets unless liens are created at the same time in favor of the debenture holders and the lending banks (negative lien). The lien includes exceptions, including a lien on assets that will be purchased or expanded by Bezeq, if the undertakings underlying the lien are created for the purchase or expansion of those assets and for the matter of a token lien.

For Debentures (Series 6 to 8) and bank loans and for debentures issued to financial institutions in the amount of NIS 400 million, standard grounds were included for immediate repayment of the debentures and loans, including breach events, insolvency, dissolution procedures or receivership. In addition, a right was determined to call for immediate repayment if a third party lender calls for immediate repayment of Bezeq's debts in an amount exceeding the amount determined.



For Debentures (Series 6 to 10) and banks loans in the amount of NIS 2.03 billion as at December 31, 2015 (out of the total bank loans in the amount of NIS 3.2 billion), and for debentures issued to financial institutions in the amount of NIS 400 million, Bezeq has undertaken that if it makes an undertaking towards any entity in respect of compliance with financial covenants, it will also provide the same undertaking to the debenture holders and banks (subject to certain exceptions).

For Debentures (Series 6 to 10), Bezeq has undertaken to the debenture holders to take steps so that, to the extent under its control, the debentures will be rated by at least one rating agency, so long as there are debentures of the relevant series in circulation.

In addition, for Debentures (Series 9 and 10), standard grounds were included for immediate repayment of the debentures, including events of default, insolvency, liquidation proceedings, or receivership, as well as the right to call for immediate repayment if a third party lender calls for immediate repayment of Bezeq's debts (in an amount exceeding NIS 150 million, if another series of marketable debentures is called for immediate repayment - an unlimited amount), in the event of the sale of more than 50% of the Bezeq Group's assets (consolidated) such that communications will cease being the Bezeq Group's main activity, in the event of a change of control following which the current controlling shareholders in Bezeq will cease to be controlling shareholders (other than transfer of control to a transferee that received approval to control Bezeq in accordance with the provisions of the Communications Law or change in control under other circumstances that were established), in the event that a going concern qualification is recorded in Bezeq's financial statements for two consecutive quarters, in the event of a material deterioration in Bezeq's business compared with the situation at the time of the issue, and there is real concern that Bezeq will not be able to repay the debentures on time (as set out in section 351(1)(a)(1) in the Securities Law), all under the terms set out in the deed of trust of the debentures.

#### **Results of tender for the receipt of preliminary undertakings from classified investors for the purchase of Debentures (Series 9) ("Debentures")**

On April 18, 2016, a preliminary tender was held by Bezeq for the receipt of preliminary undertakings from classified investors, in preparation for a possible public offering of debentures to be issued, to the extent issued, as part of the expansion of an existing series in accordance with Bezeq's shelf prospectus, and the shelf offering report intended for publication in the coming days (the "Shelf Offering Report"). As part of the tender, units were offered which include debentures with a par value of NIS 1,000 each, through a uniform offering, by way of a tender for the unit price (the "Tender"). In total, orders aggregating to approximately NIS 1.2 billion have been received as part of the tender, of which Bezeq received preliminary undertakings from classified investors for the purchase of approximately NIS 713,572,000 in Debentures at a price of NIS 1.077 per unit with a unit par value of NIS 1,000. The price determined in the Tender will constitute the minimum price of a public tender in connection with the Debentures. It is clarified that the final price of the Debentures units will be determined in the framework of the public offering to be held by Bezeq, to the extent held, as part of the Shelf Offering Report, through a uniform offering, by way of tender for the unit price.

#### ***Credit received during the reporting period/commitments to extend credit***

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

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

In 2015, Bezeq entered into agreements with banks and financial institutions, whereby Bezeq received an undertaking from these institutions to provide credit to Bezeq in a total amount of NIS 1.4 billion to refinance its future debt in 2016 (with an average duration of between 4.6 to 4.9 years and a fixed NIS interest rate of 3.7% to 4.3 %), and an undertaking to provide credit of NIS 600 million in 2017 (with an average duration of 4.5 years and an average fixed NIS interest rate of 4.3%).

The terms of all the undertakings and the loans to be provided thereunder include terms that are similar to the terms provided for other loans taken by Bezeq, including the following: an undertaking to refrain from creating additional liens on Bezeq's assets (with certain restrictions); an undertaking that if Bezeq assumes an undertaking towards a party in respect of compliance with financial covenants, Bezeq will also assume the same undertaking for this credit (subject to certain exceptions); and standard terms for immediate repayment (such as default events, insolvency, liquidation or receivership), and cross default (with certain restrictions), which will also apply, with the required changes, to the periods of the undertaking to provide credit.

Subsequent to December 31, 2015, Bezeq signed another agreement to obtain a loan of NIS 300 million in 2017.

## **Bonds**

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

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

Bezeq also provided undertakings with respect to both bond series: (i) to not create any other charges on its assets (negative charge) without creating an identical charge in favor of the bond holders; (ii) should it make a commitment to any entity in connection with financial covenants, it will undertake the same commitment to the bond holders; and (iii) to do everything under its control for the bonds to continue to be rated until they are fully repaid.

The accepted grounds for recalling the bonds for immediate repayment were added, including violations, insolvency, liquidation procedures, receivership, etc.; the right to demand immediate repayment if a third party lender demanded immediate repayment of Bezeq's debt to it (for an amount that exceeds NIS 150 million, if another negotiable bond series is recalled for immediate repayment, the amount is unlimited); if more than 50% of the Group's assets (consolidated) are sold in a manner that the communication segment ceases to be the Group's central operation; in case of changes in control whereby the current controlling shareholder ceases to be its controlling shareholder (other than transfer of control to a recipient that obtained approval for control of Bezeq according to the provisions of the Communications Law or a change of control under other circumstances prescribed), if a "going concern" caveat is recorded in Bezeq's financial statements for a period of two consecutive quarters; material impairment of Bezeq's business compared to its situation on the issue date; and real concern that Bezeq will not be able to repay the bonds on time, all under the terms set out in the Deeds of Trust of the bonds.

### **Credit rating**

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

### **Assessment for raising financing and possible sources in 2016**

During 2016, Bezeq expects to repay approximately NIS 1,786 million of loan principal and interest (including bonds). Bezeq expects to exercise undertakings to obtain credits of NIS 1.4 billion from various banks and institutional entities.

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

### **Guarantee of DBS bonds**

In September 2015, Bezeq signed guarantee letters for compliance with DBS' undertakings to pay its full outstanding debt to the holders of bonds (Series B) and 2012 bonds of DBS (total of NIS 1.05 billion and NIS 307 million, respectively), against a decrease in the annual interest rate borne by the bonds (by 0.5% and 1%, respectively), and cancellation of collateral and certain provisions of the Deeds of Trust and the bonds (including the undertakings for compliance by DBS of certain financial covenants and restriction on distribution of a dividend by DBS), all according to the terms of the Deeds of Trust of the bonds. According to the terms of the bonds, decreasing the interest and canceling collateral and certain provisions in the bonds are subject to Bezeq's Maalot rating not falling below (-AA) or a corresponding rating ("the Minimum Rating"), terms that were complied with as at the date the collateral was provided, and if in future Bezeq's rating falls below the Minimum Rating, the interest reduction will be canceled, the canceled collateral will be provided again, the canceled provision will reapply and the guarantee will expire. On December 17, 2015, Bezeq provided DBS with a loan of NIS 325 million in order to allow DBS to early repay its 2012 bonds. The early repayment was made on December 20, 2015 and at that same time Bezeq's guarantee for the 2012 bonds expired.

### ***Pelephone***

Pelephone's operations are financed out of cash flow from operating activities. In 2015 Pelephone repaid the balance of its liabilities of NIS 93 million. As at December 31, 2015, Pelephone has no approved bank credit facilities.

Although Pelephone intends to make further investments in property, plant and equipment (mainly in the LTE network), it estimates that it will not need to obtain any financing in 2016 for its ongoing operations.

### ***Bezeq International***

Bezeq International has no outstanding debt other than to Bezeq.

### ***DBS***

In 2015, DBS was party to a financing agreement, or the Financing Agreement, with a consortium of banks, or the Banks, which was renewed in July 2012. According to the Financing Agreement, DBS received an on-going credit facility until the end of 2015 in the amount of NIS 170 million, and a hedge facility of USD 10 million. According to the Financing Agreement in each quarter DBS is required to comply with EBITDA/debt ratio and (E-C)/maximum debt ratio criteria as set out in the Financing Agreement. As of December 31, 2015 DBS was in compliance with these covenants. On December 31, 2015 the Banks approved the repayment of the entire unpaid balance of the borrowings provided by the Banks under the Financing Agreement and on December 31, 2015 the Financing Agreement was terminated as well as all of DBS's liabilities thereunder. Accordingly, all the liens charged in favor of the Banks were canceled. As of December 31, 2015 some of the Banks extended lines of credit and unsecured guarantees to DBS.

In December 2014, DBS entered into an unsecured loan agreement, or the Loan Agreement, with several banks in the amount of NIS 75 million, bearing fixed annual interest of 3.4%. The bank borrowings were extended for a period of five and a half years (until June 2020) and are being repaid (principal and interest) in 11 consecutive semi-annual installments commencing in June 2015. The Loan Agreement provides grounds for calling for immediate repayment, including various violations of the Loan Agreement, dissolution procedures and receivership against DBS, cancellation or suspension of the broadcasting license, unauthorized change of control, material violation of material agreements defined in the Loan Agreement and calling for immediate repayment of amount due from DBS to debenture holders, other banks or financial institutions. In December 2015 an amendment to the Loan Agreement was signed, under which certain provisions in the Loan Agreement were amended or rescinded, including the cancellation of DBS's obligation to comply with financial covenants and restrictions applicable to dividends and DBS's repayment of shareholders loans.

#### *Institutional financing*

DBS issued two debenture series to institutional investors that were listed on the TACT Institutional System of the TASE. A debenture series issued in 2007 under a deed of trust, or Deed of Trust A, between DBS and Hermetic Trust (1975) Ltd., or the Trustee, and its expansion in April 2014, or the Series A Debentures and a debenture series issued in 2010 under a deed of trust, or Deed of Trust B, between DBS and Hermetic Trust (1975) Ltd., or Trustee B, that was expanded in 2011, 2012, 2013, 2014 and in April and May 2015, or the Series B Debentures.

Under Deed of Trust A, DBS created a first degree floating charge, unlimited in amount, in favor of Trustee A on all of its assets (other than exceptions due to the provisions of the Communications Law), that contain a condition restricting the creation of additional charges (subject to exceptions set out in Deed of Trust A and the Deed of Pledge), and (subject to exceptions provided by the Communications Law) a first degree fixed charge, unlimited in amount, over the rights and assets of Bezeq, including its rights under material agreements to which it is party, its unissued registered capital, its goodwill, certain intellectual property rights and insurance rights to which it is entitled under an insurance policy. DBS may record, in favor of holders of other debentures that it may issue, first degree liens and/or add them to liens in favor of Trustee A, without requiring the consent of Trustee A.

Deed of Trust A and Deed of Trust B set out routine events (such as insolvency proceedings, violation, exercise of liens on most of Bezeq's assets and others) that, should they occur, following a warning period and under terms that were set in each Deed, establish the right to call for the immediate repayment of the debentures, subject to the provisions of the Deed of Trust, and the right to call for immediate repayment in the event of calling for immediate repayment of another DBS debenture series, if the outstanding balance exceeds the amount fixed in the Deed of Trust.

In September 2015, Bezeq signed a deed of guarantee to meet DBS's liabilities in favor of the holders of Series B Debentures, resulting in a reduction of the interest rate and cancellation of certain collateral (which were similar to those recorded in favor of Trustee A) and various provisions of Deed of Trust B.

On December 20, 2015 DBS redeemed the outstanding balance of debentures it issued in May 2012 with the proceeds of a NIS 323 million loan from Bezeq. The loan from Bezeq bears fixed annual interest of 3.6% (but not less than the minimum interest rate under section 3(J) of the Income Tax Ordinance).

*S&P Maalot ratings for DBS and its debentures*

In October 2015, S&P Maalot announced that it was upgrading DBS's rating by making it equivalent to the rating of Bezeq following Bezeq's acquisition of all of DBS's shares. As a result, DBS is rated ilAA (stable) (issuer rating) and the stable outlook is based on the rating outlook of Bezeq. The debentures issued by DBS are rated by S&P Maalot as ilAA.

*Credit facilities (in NIS millions)*

| Credit facility | Used as at Dec. 31, 2015 | Used as at Dec. 31, 2014 |
|-----------------|--------------------------|--------------------------|
| 0               | 0                        | 4                        |

*Estimate regarding the need to raise sources of financing in 2016*

According to the payment schedule for DBS's debentures in 2016, DBS expects to repay NIS 58 million on account of principal and interest of its loans. DBS finances its operations mainly from cash flows from ongoing operations and by raising debt.

The management of DBS believes that the financial resources available to it, including among other things receiving loans from Bezeq, will be sufficient for its operating needs in the coming year based on the projected cash flow approved by DBS's board of directors.

*Average interest rate on loans*

| Source of financing  | Amount at<br>December 31,<br>2015<br>(NIS millions) | Currency or<br>linkage | Average<br>interest rate | Effective<br>interest rate |
|----------------------|---|------------------------|--------------------------|----------------------------|
| Banking sources      | 64  | NIS                    | 3.45%                    | 3.48%                      |
| Long-term loans      |   |                        |                          |                            |
| Non-bank (1)         | 1,210   | CPI-linked NIS         | 6.2%                     | 6.93%                      |
| Shareholder loans(2) | 4,567   | CPI-linked NIS         | 6.1%                     | 6.2%                       |

(1) The non-banking credit, which is valid until December 31, 2015, is made up of debentures.

(2) Loans provided to DBS by its shareholders are linked to the CPI and are divided into three types: A. interest-free loans; B. loans bearing annual interest of 5.5%; C. loans bearing annual interest of 11%.

**Cash Flows of Our Company**

The following table summarizes our cash flows on a consolidated basis for the periods presented:

|  | Year ended December 31, |         |         |
|--|-------------------------|---------|---------|
|  | 2013                    | 2014    | 2015    |
|  | (NIS in millions)       |         |         |
| Net cash provided by operating activities            | 4,141                   | 3,782   | 3,644   |
| Net cash provided by (used in) investing activities  | (1,033)                 | (1,989) | 381     |
| Net cash used in financing activities                | (3,005)                 | (1,928) | (4,138) |
| Net increase (decrease) in cash and cash equivalents | 103                     | (135)   | (113)   |
| Cash and cash equivalents at beginning of year       | 764                     | 867     | 732     |
| Cash and cash equivalents at end of year             | 867                     | 732     | 619     |

### *Operating Activities*

Consolidated cash provided by operating activities in 2015 amounted to NIS 3.6 billion (approximately \$0.9 billion) compared to NIS 3.8 billion in 2014. The decrease in net cash provided from operating activities was primarily attributable to the Cellular Communications segment, due to a material decrease in net profits and a moderate decrease in trade receivables balances compared to 2014. This decrease was mainly offset by the consolidation of DBS cash flows, which generated NIS 356 million (approximately \$91 million) along with an increase in cash provided from the operating activities of the Domestic Fixed-Line Communications segment.

### *Investing Activities*

Consolidated cash provided by investing activities in the year ended December 31, 2015, was NIS 381 million (approximately \$98 million) compared to NIS 2.0 billion used in investing activities in the year ended December 31, 2014. The increase in net cash provided by investing activities was due to an increase in the net proceeds from the sale of short term investments in Bezeq along with a NIS 299 million (approximately \$77 million) of cash generated from the consolidation of DBS. The increase was partially offset by the consolidation of DBS cash used in investing activities as of the second quarter of 2015 in the amount of NIS 250 million (approximately \$64 million). In addition, cash flows used in investing activities in 2014 included NIS 596 million of proceeds from the sale of Coral-Tell shares by Bezeq.

### *Financing Activities*

Consolidated cash used in financing activities in the year ended December 31, 2015 was NIS 4.1 billion (approximately \$1.1 billion) compared to NIS 1.9 billion in the year ended December 31, 2014. The increase was primarily attributable to an increase in debenture repayments, a decrease in debenture issuances by Bezeq and the receipt of loans by the Domestic Fixed-Line Communications segment. The increase was also attributable to the payment of NIS 680 million (approximately \$174 million) to Eurocom D.B.S. for the acquisition of DBS shares and loans, and to the consolidation of DBS, which made debt repayments of NIS 633 million (approximately \$162 million).

### ***The Bezeq Group's Cash Flows***

The following table summarizes the Bezeq Group's consolidated cash flows for the periods presented:

|  | Year ended December 31, |                   |              |
|--|-------------------------|-------------------|--------------|
|  | 2013                    | 2014              | 2015         |
|  |                         | (NIS in millions) |              |
| Net cash provided by operating activities                    | 4,152                   | 3,796             | 3,740        |
| Net cash (used in) provided by investing activities          | (917)                   | (1,546)           | 283          |
| Net cash (used in) financing activities                      | (3,091)                 | (2,200)           | (4,128)      |
| <b>Net increase (decrease) in cash and equivalents</b>       | <b>144</b>              | <b>50</b>         | <b>(105)</b> |
| Cash and cash equivalents as at the beginning of the period  | 466                     | 610               | 660          |
| <b>Cash and cash equivalents as at the end of the period</b> | <b>610</b>              | <b>660</b>        | <b>555</b>   |

### *Operating Activities*

Consolidated cash provided by operating activities in the year ended December 31, 2015 amounted to NIS 3.7 billion (approximately \$958 million) compared to NIS 3.8 billion in the year ended December 31, 2014, a decrease of NIS 56 million (approximately \$14 million). The decrease in net cash provided from operating activities was primarily attributable to the Cellular Communications segment, due to a material decrease in net profits and a more moderate decrease in trade receivables balances as compared to 2014. This decrease was mostly offset by the consolidation of the operations of DBS for the first time, which generated NIS 356 million (approximately \$91 million) in cash from operations and an increase in cash from operating activities in the Domestic Fixed-Line Communications segment.

### *Investing Activities*

Net cash provided by investing activities in the year ended December 31, 2015 was NIS 0.3 billion (approximately \$73 million) compared to NIS 1.5 billion used in investing activities in the year ended December 31, 2014. The increase of NIS 1.8 billion in 2015 was due to an increase in the net proceeds from the sale of held-for-trade financial assets in the Domestic Fixed-Line Communications segment and was also due to NIS 299 million (approximately \$ 77 million) in cash added in the first quarter of 2015 after assuming control of DBS. The increase was partially offset by NIS 250 million (approximately \$64 million) in cash used in investing activities in DBS, the purchase of frequencies in the Cellular Communications segment and net proceeds received in 2014 from the sale of the Coral-Tell shares.

### *Financing Activities*

Net cash used in financing activities by the Bezeq Group in the year ended December 31, 2015 was NIS 4.1 billion (approximately \$1.1 billion) compared to NIS 2.2 billion in the year ended December 31, 2014. The increase of NIS 1.9 billion in cash used in financing activities was primarily attributable to an increase in debenture repayments, a decrease in debenture issuances and the receipt of loans by the Domestic Fixed-Line Communications segment. The increase was also attributable to the payment of NIS 680 million (approximately \$174 million) to Eurocom D.B.S. for the acquisition of DBS shares and loans and to the consolidation of the operations of DBS, which segment used NIS 633 million (approximately \$162 million) in financing activities (principally for debenture repayments). This increase was partially offset by a decrease in dividend payments.

### **Critical Accounting Policies**

We adopted the critical accounting policies of Bezeq after our acquisition of the controlling interest in Bezeq. The preparation of the consolidated financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the valuation of assets and expenses during the reporting period. There can be no assurance that actual results will not differ from these estimates.

### ***Consolidation of the financial statements and investments in associates***

***Business combinations.*** Business combinations are accounted for by applying the acquisition method. The acquisition date is the date on which the acquirer obtains control over the acquiree. Control exists when the Bezeq Group is exposed or has rights to variable returns from its involvement with the acquiree and it has the ability to affect those returns through its power over the acquiree. Substantive rights held by the Bezeq Group and others are taken into account when assessing control.

***Transactions eliminated on consolidation.*** Intra-group balances and income and expense arising from intra-group transactions are eliminated in the preparation of the consolidated financial statements.

***Non-controlling interests.*** Transactions with non-controlling interests, while retaining control, are accounted for as equity transactions. Any difference between the consideration paid or received for change in non-controlling interests is recognized in capital reserve for transactions with non-controlling interests. The Bezeq Group elected to present the difference under capital reserve for transactions with non-controlling interests.

***Associates (accounted for by the equity method).*** Associates are those entities in which the Bezeq Group has significant influence, but not control, over financial and operating policy. In respect of equity-accounted investments, goodwill is included in the carrying amount of the investment. When the Bezeq Group holds additional long-term interests in the associate (such as loans), which are a part of the Bezeq Group's net investment in the associate, and when the Bezeq Group's proportionate share in the additional interests is different from the Bezeq Group's share in the equity of the associate, the Bezeq Group recognizes its share in the additional losses of the associate at its proportionate share in the additional interests according to the percentage of the Bezeq Group's participation in all the levels of the additional interests and according to the order of priority of the additional levels of interests ("the Levels Method"). If, subsequently, the Bezeq Group recognizes its share in the profits of the associate, the Bezeq Group will recognize its share in the profits up to the amount of the cumulative losses previously recognized.

### ***Financial instruments***

***Non-derivative financial assets.*** Non-derivative financial assets include mainly investments in exchange traded notes, financial funds, ETFs, deposit certificates, debt instruments, shares, trade and other receivables, and cash and cash equivalents. The Bezeq Group initially recognizes loans and receivables when they are originated. All other financial assets are initially recognized at the date that the Bezeq Group becomes a party to contractual provisions of the instrument. Financial assets are derecognized when the contractual rights of the Bezeq Group to the cash flows from the asset expire, or the Bezeq Group transfers the rights to receive the contractual cash flows from the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Regular way sales of financial assets are recognized on the trade date, meaning on the date the Bezeq Group undertook to sell the asset.

*Cash and cash equivalents.* Cash comprises cash balances available for immediate use and call deposits. Cash equivalents comprise short-term highly liquid investments (with original maturities of three months or less) that are readily convertible into known amounts of cash and are exposed to insignificant risks of change in value.

*Financial assets at fair value through profit or loss.* A financial asset is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Upon initial recognition, attributable transaction costs are recognized in the statement of income as incurred. These financial assets are measured at fair value and changes therein are recognized in the statement of income.

*Available-for-sale financial assets.* The Bezeq Group's investments in shares (through a venture capital fund) are classified as available-for-sale financial assets. These investments are measured at fair value and changes therein, other than impairment losses, are recognized directly in other comprehensive income. At the date of derecognition of the investment, profits from realization of the investment and profits that were recognized in capital reserve, are recognized in profit or loss. The Bezeq Group elected to recognize profits or losses from disposal of available-for-sale financial assets under financing income or expenses.

*Loans and receivables.* Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method, net of impairment losses.

*Non-derivative financial liabilities.* Non-derivative financial liabilities include debentures issued by the Bezeq Group, loans and borrowings from banks and other credit providers, and trade and other payables. The Bezeq Group initially recognizes debt instruments as they are incurred. Financial liabilities are initially recognized at fair value plus any attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest method. Financial liabilities are derecognized when the obligation of the Bezeq Group, as specified in the agreement, expires or when it is discharged or canceled.

*CPI-linked assets and liabilities that are not measured at fair value.* The value of CPI-linked financial assets and liabilities, which are not measured at fair value, is revalued in each period according to the actual increase in the CPI.

*Offsetting financial instruments.* Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when we or the Bezeq Group currently have a legal right to offset the amounts and intend either to settle on a net basis or to realize the asset and settle the liability simultaneously.

*Change in terms of debt instruments.* An exchange of debt instruments having substantially different terms, between an existing borrower and lender is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability at fair value. Furthermore, a substantial modification of the terms of the existing financial liability or part of it is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

The terms are substantially different if the discounted present value of the cash flows according to the new terms, including any commissions paid, less any commissions received and discounted using the original effective interest rate, is different by at least ten percent from the discounted present value of the remaining cash flows of the original financial liability.

#### ***Derivative financial instruments***

*Hedge accounting.* The Bezeq Group holds derivative financial instruments to hedge cash flows for risks to future changes in the CPI and foreign currency exchange rate risks. Forward contracts are measured at fair value. Changes in the fair value of the derivative hedging instrument designated as a cash flow hedge are recognized through other comprehensive income, in a hedging reserve under equity, to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognized in profit or loss. The amount recognized in the hedging reserve is removed and included in profit or loss in the same period as the hedged cash flows affect profit or loss under the same line item in the statement of income as the hedged item.

*Economic Hedges.* The Bezeq Group holds other derivative financial instruments to economically hedge its exposure to foreign currency and changes in the CPI. Hedge accounting is not applied to derivative instruments that economically hedge financial assets and liabilities. Derivative instruments are recognized initially at fair value and attributable transaction costs are recognized in the statement of income as incurred. Subsequent to initial recognition, derivative financial instruments are measured at fair value and the changes in fair value are recognized in the statement of income as incurred.

### Property, plant and equipment

**Recognition and measurement.** Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to acquisition of the asset. The cost of self-constructed assets includes the cost of materials, direct labor and financing costs as well as any other cost directly attributable to bringing the asset to the condition for its use intended by the management, and the costs of dismantling and removing the items and restoring the site on which they are located in cases where the Bezeq Group has an obligation to vacate and restore the site. The cost of purchased software that is integral to the functionality of the related equipment is recognized as part of the cost of the equipment. Spare parts, servicing equipment and stand-by equipment are classified as property, plant and equipment when they meet the definition of property, plant and equipment in IAS 16, and are otherwise classified as inventory. When major parts of the property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of the property, plant and equipment. Gains or losses on disposal of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of the asset, and are recognized net under "other operating income" in the statement of income.

**Subsequent expenditure.** The cost of replacing part of an item of property, plant and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefit embodied in the replaced item will flow to the Bezeq Group and its cost can be measured reliably. The costs of day-to-day servicing are recognized in the statement of income as incurred.

**Depreciation.** Depreciation is recognized in the statement of income on a straight-line basis over the estimated useful life of each part of an item of property, plant and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets under finance lease agreements are depreciated over the shorter of the lease term and their useful lives. Depreciation of an asset starts when it is ready for use, meaning when it reaches the location and condition necessary for it to be capable of operating in the manner intended by management.

Leasehold improvements are depreciated over the shorter of the lease term, including the extension option held by the Bezeq Group and intended to be exercised) and the expected life of the improvement.

Assets are depreciated based on the following annual percentages:

|  | Years | Principal depreciation rate (%) |
|--|-------|---------------------------------|
| Fixed line and international network equipment (switches, transmission, power) | 4-12  | 12                              |
| Network  | 12-33 | 6                               |
| Subscriber equipment and installations   | 4-6   | 20                              |
| Equipment and infrastructure for multichannel television                       | 3-15  | 14                              |
| Vehicles   | 6-7   | 15                              |
| Office and general equipment   | 5-14  | 15                              |
| Electronic equipment, computers and internal communication systems             | 3-7   | 24                              |
| Cellular network   | 4-15  | 13                              |
| Buildings  | 25    | 4                               |
| Submarine communications cable   | 4-25  | 4                               |

Depreciation methods, useful lives and residual values are reviewed at least at each reporting year and adjusted as required.

### Non-current assets

Non-current assets are classified as held for sale if it is highly probable that they will be recovered primarily through a sale transaction rather than their ongoing use. These assets are presented at the lower of the carrying amount and fair value, less selling costs.



## **Intangible assets**

**Goodwill and brand name.** Goodwill and brand names that arise upon the acquisition of subsidiaries are included in intangible assets. Subsequent to initial recognition, goodwill and brand names are measured at cost less accumulated impairment losses. Goodwill and brand names are measured at least once a year to assess impairment.

**Software development costs.** Software development costs are recognized as an intangible asset only if the development costs can be measured reliably; the software is technically and commercially feasible; and the Bezeq Group has sufficient resources to complete the development and intends to use the software. The costs recognized as an intangible asset include the cost of the materials, direct labor and overhead expenses directly attributable to preparation of the asset for its intended use. Other development costs are recognized in the statement of income as incurred. Capitalized development costs are measured at cost less amortization and accumulated impairment losses.

**Software.** Software that is an integral part of the hardware, which cannot function without the programs installed on it, is classified as property, plant and equipment. However, licenses for stand-alone software, which adds functionality to the hardware, is classified (mainly) as intangible assets. Software depreciation is recognized in the statement of income using the straight-line method over the estimated useful life of the asset.

**Rights to frequencies.** Rights to frequencies refer to Pelephone's rights to cellular communication frequencies according to a Ministry of Communications tender. Depreciation of the asset is recognized in the statement of income using the straight line method over the license term, which is 13 years and 7 months starting from the use of the frequencies.

**Other intangible assets.** Other intangible assets acquired by the Bezeq Group, which have a definite useful life, are measured at cost less amortization and accumulated impairment losses.

**Subsequent expenditure.** Subsequent expenditure is recognized as an intangible asset only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditures, including expenditures relating to generated goodwill and brands, are recognized in the statement of income as incurred.

**Amortization.** Amortization, except for goodwill, brand name and customer relationships, is recognized in the statement of income on a straight-line basis over the estimated useful life of the intangible assets, from the date on which the assets are available for use. Goodwill and brand name are not systematically amortized but are tested for impairment at least once a year. Customer relationships are amortized according to the economic benefit expected from those customers each period, which results in accelerated amortization during the early years of the relationship.

Estimated useful lives for the current and comparative periods are as follows:

| Type of asset                            | Amortization period   |
|--|---|
| Frequency usage rights                   | Over the term of the license for 10 to 14 years starting from the use of the frequencies      |
| Computer programs and software licenses  | 3 - 10 years according to the term of the license or the estimated time of use of the program |
| Customer relationships                   | 5 - 7 years   |
| Brand acquired in a business combination | 12  |
| Other rights                             | 2 - 6 years according to the useful lives   |

## **Leased assets**

Leases, including leases of land from the ILA, where the Bezeq Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to the asset. Other leases are classified as operating leases and the leased assets are not recognized in the Bezeq Group's statement of financial position. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease.

Determining whether an arrangement contains a lease: At inception or upon reassessment of an arrangement, the Bezeq Group determines whether such an arrangement is or contains a lease. An arrangement is a lease or contains a lease if the following two criteria are met: (1) The fulfillment of the arrangement is dependent on the use of a specific asset or assets; and (2) The arrangement contains rights to use the asset. If, in accordance with these terms, the Bezeq Group determines that the agreement does not contain a lease, the agreement is accounted for as a service agreement and payments for the service are recognized in profit or loss on a straight line basis, over the service period.

### ***Right of use of capacities***

Transactions for acquiring an indefeasible right of use (IRU) of submarine communication cable capacities are mostly accounted for as service transactions. The prepaid expense is amortized on a straight-line basis as stated in the agreement, but for no longer than the expected estimated useful life of those capacities. Identifiable capacities which serve Bezeq exclusively meet the definition of a finance lease and are recognized in property, plant and equipment. The asset is depreciated on a straight-line basis as stated in the agreement, but for no longer than the expected estimated useful life of those capacities.

### ***Inventory***

Inventories are measured at the lower of cost and net realizable value. The cost of inventories is based on the moving average method. The inventories of a subsidiary include terminal equipment and accessories intended for sale and service, as well as spare parts used for repairs in the repair service it provides to its customers. Slow-moving inventory of terminal equipment, accessories and spare parts are stated net of the provision for impairment.

### ***Impairment***

*Non-derivative financial assets.* The Bezeq Group tests a financial asset for impairment when objective evidence indicates that one or more loss events have had a negative effect on the estimated future cash flows of that asset. Significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed for impairment collectively, in groups that share similar credit risk characteristics. The financial statements include specific provisions and Group provisions for doubtful debts, which properly reflect, in the estimation of the management, the loss inherent in debts for which collection is in doubt.

*Non-financial assets.* Timing of impairment testing: The carrying amounts of Bezeq Group's non-financial assets, other than inventory and deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the recoverable amount of the asset is estimated. The Bezeq Group assesses the recoverable amount of goodwill and brand name once a year, or more frequently if there are indications of impairment.

Measurement of recoverable amount: The recoverable amount of an asset or cash-generating unit is the greater of its value in use and fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash-generating unit, for which the estimated future cash flows from the asset or cash-generating unit were not adjusted.

Determining cash-generating units: For the purpose of impairment testing, the assets are grouped together into the smallest group of assets that generates cash from continuing use that are largely independent of other assets or groups of assets.

Allocation of goodwill to cash-generating units: For purposes of goodwill impairment testing, cash-generating units to which goodwill has been allocated are aggregated so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes, but in any event is not larger than an operating segment. Goodwill acquired in a business combination is allocated to cash-generating units that are expected to generate benefits from the synergies of the combination.

For purposes of goodwill impairment testing, when the non-controlling interests are initially measured according to their relative share of the acquiree's net identifiable assets, the carrying amount of the goodwill is adjusted according to the share which The Bezeq Group holds in the cash-generating unit to which the goodwill is allocated.

*Investments in equity-accounted investees.* An investment in an associate is tested for impairment when objective evidence indicates that there has been impairment. Goodwill that forms part of the carrying amount of an investment in an associate is not recognized separately, and therefore is not tested for impairment separately.

### ***Employee benefits***

*Post-employment benefits.* The Bezeq Group has a number of post-employment benefit plans. The plans are usually financed by deposits with insurance companies and they are classified as defined contribution plans and defined benefit plans.

Defined contribution plans: A defined contribution plan is a post-employment benefit plan under which the Bezeq Group pays fixed contributions into a separate entity and has no legal or constructive obligation to pay further amounts. The Bezeq Group's obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense in the statement of income in the periods during which services are rendered by employees.

**Defined benefit plans:** The Bezeq Group's net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods. That benefit is presented at its present value and the fair value of any plan assets is deducted. The discount rate is the yield at the reporting date on high quality corporate bonds denominated in NIS and linked to the CPI, that have maturity dates similar to the terms of the Bezeq Group's obligations. The calculation is performed annually by a qualified actuary. Net interest costs on a defined benefit plan are calculated by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability. The Bezeq Group elected to recognize the interest costs that were recognized in the statement of income under financing expenses. Re-measurement of the net defined benefit liability comprises actuarial gains and losses and the return on plan assets (excluding interest). Re-measurements are recognized immediately directly in retained earnings through other comprehensive income. When the benefits of a plan are improved or reduced, the portion of the increased benefit relating to past service by employees or the gain or loss from the reduction are recognized immediately in the statement of income when the plan improvement or reduction occurs.

**Other long-term employee benefits.** Bezeq Group's net obligation in respect of long-term employee benefits other than pension plans is the amount of future benefit that employees have earned in return for their service in the current and prior periods. The amount of these benefits is stated at its present value. The discount rate is the yield at the reporting date on high quality corporate bonds denominated in NIS and linked to the CPI, that have maturity dates similar to the terms of the Bezeq Group's obligations. The calculation is performed using the projected unit credit method. Any actuarial gains or losses are recognized in the statement of income in the period in which they arise.

**Benefits for early retirement and dismissal.** Employment termination benefits are recognized as an expense when the Bezeq Group is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to terminate employment before the normal retirement date. Termination benefits for voluntary redundancies are recognized as an expense if the Bezeq Group has made an offer of voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

**Short-term benefits.** Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognized for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Bezeq Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably. The employee benefits are classified, for measurement purposes, as short-term benefits or as other long-term benefits depending on the date when the benefits are expected to be to be wholly settled. In the statement of financial position the employee benefits are classified as current benefits or as non-current benefits according to the time the liability is due to be settled.

**Share-based payments.** The fair value on the grant date of options for Bezeq shares granted to employees is recognized as a salary expense with a corresponding increase in equity over the period during which the employee becomes entitled to the options. The amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest. The fair value of the amount payable to employees in respect of share-based payments, which are settled in cash, is recognized as an expense with a corresponding increase in liabilities, over the period that the employees become entitled to payment. The liability is re-measured at each reporting date until the settlement date. Any changes in the fair value of the liability are recognized in the statement of income. The Bezeq Group elected to recognize the changes in fair value of the liabilities under salary expenses.

### **Provisions**

A provision is recognized if, as a result of a past event, the Bezeq Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

**Legal claims.** Contingent liabilities are accounted for according to IAS 37 and its related provisions. Accordingly, the claims are classified by likelihood of realization of the exposure to risk, as follows:

- More likely than not-more than 50% probability;
- Possible-probability higher than unlikely and less than 50%; or
- Remote-probability of 10% or less.

For claims which the Bezeq Group has a legal or constructive obligation as a result of a past event, which are more likely than not to be realized, the financial statements include provisions which, in the opinion of the Bezeq Group, based, among other things, on the opinions of its legal advisers retained in respect of those claims, are appropriate to the circumstances of each case, despite the claims being denied by the Bezeq Group companies. There are also a few legal proceedings, received recently, for which the risks cannot be assessed at this stage, therefore no provisions have been made.

*Site dismantling and clearing costs.* A provision in respect of an obligation to dismantle and clear sites is recognized for those rental agreements where the Bezeq Group has an undertaking to restore the rental property to its original state at the end of the rental period, after dismantling and transferring the site, and restoring it as necessary. The provisions are determined by discounting the expected future cash flows. The carrying amount of the provision is adjusted each period to reflect the time that has passed and is recognized as a financing expense.

*Warranty.* A Bezeq Group subsidiary recognizes a provision for warranty in respect of first-year insurance for cellular handsets. The warranty is limited to technical malfunctions defined by the subsidiary, and does not include a warranty as a result of customer caused damage. However, an asset exists in respect of the manufacturer's warranty for those handsets, which is limited to technical malfunctions defined by the manufacturer.

### C. Research and Development, Patents and Licenses

We did not engage in any research and development during the last three fiscal years.

### D. Trend Information

From 2012 until 2014, Bezeq experienced a decline in revenues. Bezeq's revenues decreased from NIS 10.3 billion for the year ended December 31, 2012 to NIS 9.6 billion for the year ended December 31, 2013, decreased further to NIS 9.1 billion (approximately \$2.3 billion) for the year ended December 31, 2014. In 2015, Bezeq's revenues increased due to the first time consolidation of DBS to NIS 10.0 billion (approximately \$2.6 billion) for the year ended December 31, 2015.

The increase in revenues in 2015 was primarily due to the consolidation of DBS revenues as of the second quarter of 2015 in the amount of NIS 1.33 billion (\$342 million). The increase in revenues is also attributable to the NIS 90 million (approximately \$23 million), or 1%, increase in the revenues of the Domestic Fixed-Line Communications segment and increase in the revenues of the International Communications and Internet Services segment of a NIS 74 million (approximately \$19 million), or 1%. The increase in the revenues was partially offset by the revenues of the Cellular Communications segment which decreased in NIS 529 million (approximately \$136 million), or 5%, driven by continued increased competition in the cellular market in 2015.

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

- Net profit attributable to shareholders is expected to be approximately NIS 1.4 billion.
- EBITDA is expected to be approximately NIS 4.2 billion.
- The Bezeq Group's free cash flow is expected to be approximately NIS 2.0 billion.

Bezeq's forecasts are based on its estimates regarding the structure of competition in the telecommunications market and regulation in this sector, the economic situation and accordingly, the Bezeq Group's ability to implement its plans in 2016.

### E. Off-Balance Sheet Arrangements

We are not a party to any material off-balance sheet arrangements. In addition, we have no unconsolidated special purpose financing or partnership entities that are likely to create material contingent obligations.

### F. Tabular Disclosure of Contractual Obligations

The following table summarizes our (including B Communications' and Bezeq's) minimum contractual obligations and commercial commitments as of December 31, 2015 and the effect we expect them to have on our liquidity and cash flow in future periods:

| Contractual Obligations                         | Payments due by period<br>(NIS in millions) |                     |              |              |                      |
|---|---|---------------------|--------------|--------------|----------------------|
|   | Total                                       | less than<br>1 year | 1-3 years    | 3-5 years    | more than<br>5 years |
| Long-term debt obligations (including interest) | 17,897                                      | 2,885               | 5,309        | 3,984        | 5,718                |
| Operating lease obligations                     | 1,279                                       | 370                 | 567          | 238          | 104                  |
| Purchase obligations                            | 149   | 149                 | -            | -            | -                    |
| Other long term obligations                     | 85  | 78                  | 7            | -            | -                    |
| <b>Total</b>                                    | <b>19,409</b>                               | <b>3,482</b>        | <b>5,883</b> | <b>4,222</b> | <b>5,822</b>         |

## ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

### A. Directors and Senior Management

Set forth below are the name, age, principal position and a biographical description of each of our directors and executive officers:

| Name                                       | Age | Position                                       |
|--|-----|--|
| <b>Our Directors and Senior Management</b> |     |  |
| Shaul Elovitch <sup>(1)</sup>              | 68  | Chairman of the Board of Directors             |
| Felix Cohen                                | 62  | Director                                       |
| Yossef Elovitch                            | 65  | Director                                       |
| Dudi Ezra <sup>(2) (3)</sup>               | 47  | External Director                              |
| Shoshana Shidlo <sup>(2) (3)</sup>         | 51  | External Director                              |
| Anat Winner <sup>(2) (3)</sup>             | 56  | Director                                       |
| Doron Turgeman                             | 48  | Chief Executive Officer                        |
| Itzik Tadmor                               | 35  | Principal Financial Officer                    |
| <b>Bezeq Group's Executive Management</b>  |     |  |
| Stella Handler                             | 55  | Chief Executive Officer of Bezeq               |
| David Mizrahi                              | 46  | Chief Financial Officer of Bezeq               |
| Ran Guron                                  | 47  | Chief Executive Officer of Pelephone           |
| Moti Elmaliach                             | 56  | Chief Executive Officer of Bezeq International |
| Ron Eilon                                  | 51  | Chief Executive Officer of DBS                 |

(1) Director of B Communications.

(2) Member of our Audit Committee.

(3) Member of our Compensation Committee.

Mr. Shaul Elovitch, Mr. Felix Cohen, Ms. Anat Winner and Mr. Yossef Elovitch will serve as directors until our 2016 annual general meeting of shareholders. Mr. Dudi Ezra and Ms. Shoshana Shidlo each serve as an external director pursuant to the provisions of the Israeli Companies Law for a first three year term until August 2017 (see Item 6C. "Directors, Senior Management and Employees - Board Practices - External and Independent Directors - External Directors"). Mr. Shaul Elovitch and Mr. Yossef Elovitch are brothers. There are no other family relationships among our directors or executive officers. On May 3, 2015, we appointed Itzik Tadmor as our new Principal Financial Officer, replacing Ehud Yahalom, the prior CFO who was with the company for the previous four years. Gil Sharon, CEO of Pelephone, resigned in October 2015 after serving for 10 years, following his nomination as CEO of Discount Investment Corporation. He was replaced by Ran Guron, who previously served as Bezeq's deputy CEO. David Mizrahi, CFO of Bezeq, notified Bezeq on April 4, 2016 that he will be resigning to pursue other opportunities. A search to fill the CFO role is underway, and Mr. Mizrahi will continue as Bezeq's CFO until a successor is named.

#### *Our Directors*

**Shaul Elovitch** has served as the chairman of our board of directors since our inception in 1992. Mr. Elovitch is the controlling shareholder of Eurocom Communications and its affiliated companies, one of Israel's largest private communications groups. Mr. Elovitch has served as the chairman of the board of directors of Eurocom Holdings and Eurocom Communications, our parent company, since 1985. Mr. Elovitch serves as the chairman of the board of directors of Bezeq and as a director and chairman of various companies of the Bezeq Group and the Eurocom Group. Mr. Elovitch also serves as a member of the board of directors of Space Communications Ltd., Satcom Systems Ltd., Satlink Ltd., Eurocom cellular communications Ltd., Eurocom Digital Communications Ltd. and other various companies within the Eurocom Group. Mr. Elovitch has served as chairman of the board of directors of B Communications since 2000. Mr. Elovitch is the brother of Mr. Yossef Elovitch, a director.

**Felix Cohen** was elected to serve as a director by our Board of Directors in February 2010. Mr. Cohen has served as the Chief Financial Officer of the Eurocom Group since 1988, and also serves as a director and/or officer of various other companies within the Eurocom Group, including Enlight Renewable Energy Ltd., Space-Communications Ltd. and D.M Engineering (3000) Ltd. Mr. Cohen also serves as a director of Bezeq and other companies within the Bezeq Group.

**Yossef Elovitch** has served as a director since 1993. Mr. Elovitch has served as director of Eurocom Communications since 1985. Mr. Elovitch serves as a director of various other companies in the Eurocom Group. Mr. Elovitch is the brother of Mr. Shaul Elovitch.

**Dudi Ezra** has served as an external director since August 2014. He has served as a financial officer in multiple companies of the Ituran group, including Carnet On Line Ltd., Hotas Holdings Ltd., Gear Protection Ltd and Hapoel Ironi Kiryat Shmona Football Club since 1996. From 1998 to 2004, Mr. Ezra served as a director of Ituran Location and Control Ltd., which is dual-listed on NASDAQ and the TASE. Mr. Ezra holds a B.B.A. degree in Accounting and Business from Baruch College of the City University of New York and is a certified public accountant in Israel and in the United States.

**Shoshana Shidlo** has served as an external director since August 2014. She has provided internal audit services to various organizations since 1996. Ms. Shidlo holds a B.A. degree in Accounting and Economics from Tel-Aviv University. She is a certified public accountant in Israel and a certified internal auditor in the United States.

**Anat Winner** has served as a director of our company since August 2001 and is a member of our audit committee. She served as a director of B Communications between October 2007 and August 2013. Ms. Winner has been self employed as a business advisor since July 2003 and served as a director of Magal Security Systems Ltd., publicly traded on the NASDAQ Global Market and TASE from 2003 to 2010. From October 2001 to July 2003, Ms. Winner served as chief executive officer and chief financial officer of Israel News Ltd. From 1999 to October 2001, Ms. Winner served as chief financial officer of DBS. Ms. Winner holds a B.A. degree in Accounting and Economics from Haifa University and has been a certified public accountant (Israel) since 1986.

**Doron Turgeman** has served as our chief executive officer since October 2011 and previously had served as our deputy chief executive officer since October 2004 and as our chief financial officer since May 2001. Mr. Turgeman also serves as the chief executive officer of B Communications and as the chief financial officer of Eurocom Communications Ltd. Previously, Mr. Turgeman served as B Communications' chief financial officer and vice president of finance from February 2010 until October 2011 and served as a member of its board of directors from January 2008 to February 2010. Mr. Turgeman serves as a director of several other companies within the Eurocom group, including Phoenix Data Pte. Ltd., Barclay Associates Corporation, and Barclay Associates (S) Pte. Ltd. Mr. Turgeman also serves as a director of XTL Biopharmaceuticals Ltd. (NASDAQ: XTLB, TASE: XTL), Klein International Group Limited and MDG Real Estate Global Limited. Mr. Turgeman holds a B.A. degree in Economics and Accounting from the Hebrew University of Jerusalem and is a certified public accountant in Israel. During the last five years, Mr. Turgeman also served as an executive officer of several of our media and Internet companies, which have been sold. Mr. Turgeman holds a B.A. degree in Economics and Accounting from the Hebrew University of Jerusalem and is a certified public accountant in Israel.

**Itzik Tadmor** has served as our Principal Financial Officer since May 2015. Mr. Tadmor has been our company's controller for the past three years. Prior to joining our company, he worked at PriceWaterhouseCoopers (PwC) for five years. Mr. Tadmor received a Bachelor's Degree in Accounting and Economics and an M.B.A. degree from Tel-Aviv University. Mr. Tadmor is also a Certified Public Accountant in Israel.

#### ***Bezeq Group's Executive Management***

**Stella Handler** was appointed as the chief executive officer of Bezeq on April 14, 2013. Ms. Handler has held several senior positions in Israel's communications sector, among them as chairperson of HOT from May 2011 until January 2013 and chief executive officer of our company (then known as 012 Golden Lines) from 2003 until January 2010. Ms. Handler holds B.A. and M.A. degrees in Economics as well as an M.B.A. from the Hebrew University of Jerusalem.

**David Mizrahi** has served as Bezeq's deputy chief executive officer and chief financial officer since January 2013. Previously, from 2007 until December 2012, Mr. Mizrahi served as Vice President, Economics and Budgets of Bezeq. Mr. Mizrahi holds a B.A. degree in Economics from the Hebrew University of Jerusalem.

**Ran Guron** has served as the chief executive officer of Pelephone since November 2015. Previously, he served as the Deputy CEO and VP Marketing of Bezeq from March 2011 to October 2015. Before becoming Deputy CEO at Bezeq, he was VP Marketing – CMO at Bezeq for 5 years. From 2003 to 2005 Mr. Guron was VP Marketing at 013 Barak (currently 013 Netvision Ltd.) He serves as Mentor for Microsoft Ventures Accelerator Tel-Aviv program for startups. Mr. Guron is the founder of the Yair Guron Memorial Scholarship R&D Fund in the Arava region. Mr. Guron holds an M.B.A. degree and a B.A. degree in Economics and Business Administration from the Hebrew University of Jerusalem.

**Isaac Benbenisti** has served as the chief executive officer of Bezeq International since November 2007. He served as the deputy chief executive officer of Bezeq International from May 2007 to November 2007. Prior to that, from 2003 to 2006, he served as the director and general manager of the Personal System Group & Business Partners Division at Hewlett-Packard Israel. Mr. Benbenisti holds a B.A. degree in Economics and an M.B.A. from the Hebrew University of Jerusalem. On February 10, 2014, Mr. Benbenisti gave notice that he will be resigning from his position as chief executive officer of Bezeq International effective as of August 11, 2014.

**Ron Eilon** has served as the chief executive officer of DBS since August 2006. Mr. Eilon served as chief financial officer of Bezeq from 2003 to 2005, and as deputy chief executive officer of Bezeq from 2005 to 2006. From 1999 until 2002, he was the chief financial officer of Miro. Mr. Eilon holds a B.A. in Economics and an M.B.A. degree from the Hebrew University of Jerusalem.

## B. Compensation

We have two executive officers, Doron Turgeman, our chief executive officer and Itzik Tadmor, our principal financial officer, and six directors. Other than such officers, we have three additional employees who are engaged in management, financial and administrative activities. The aggregate direct compensation we paid to our directors and executive officers as a group (9 persons) for the year ended December 31, 2015 was NIS 1.2 million (approximately \$300,000). This amount includes directors compensation and expenses related to salaries, but does not include expenses such as business travel, professional and business association dues and expenses reimbursed to officers and other fringe benefits commonly reimbursed or paid by companies in Israel. As of December 31, 2015, no amount was reserved for pension, retirement, recreation payments and vacation or similar benefits for our directors and executive officers.

For so long as we qualify as a foreign private issuer, we are not required to comply with the proxy rules applicable to U.S. domestic companies, including the requirement to disclose information concerning the amount and type of compensation paid to our chief executive officer and principal financial officer, rather than on an aggregate basis. Nevertheless, a recent amendment to the regulations promulgated under the Israeli Companies Law requires us to disclose the annual compensation of our five most highly compensated officers (or all the named executive officers if there are less than five) on an individual basis, rather than on an aggregate basis, as was previously permitted for Israeli public companies listed overseas. Under the Companies Law regulations, this disclosure is required to be included in the notice of our annual meeting of shareholders each year or in a public document that accompanies such notice, which we furnish to the SEC under cover of a Report of Foreign Private Issuer on Form 6-K. The Companies Law regulations permit us to refer to a report filed pursuant to the laws of the country in which our shares are listed for trading that includes the required information in lieu of its inclusion in the notice of annual meeting. Because of that disclosure requirement under Israeli law, we are including such information in this annual report, pursuant to the disclosure requirements of Form 20-F.

The following table includes information for the year ended December 31, 2015 concerning compensation for our Named Executive Officers.

|   | Doron Turgeman<br>(Chief Executive Officer) <sup>1</sup>   | Itzik Tadmor<br>(Principal Financial Officer) <sup>2</sup> |
|---|--|--|
| Annual fixed salary   | NIS 536,160 plus VAT (linked to the Israeli consumer price index)  | NIS 165,000  |
| Retention Bonus (treated as salary costs in the company's financial statements).  | Up to NIS 1 million in the event that Mr. Turgeman stays with our company until the end of 2015. That bonus was paid to Mr. Turgeman at the beginning of 2016. |  |
| Annual Bonus (treated as salary costs in the company's financial statements).   | An annual bonus of up to NIS 89,360 <sup>3</sup> . For 2015, Mr. Turgeman received a bonus of NIS 8,936.   |  |
| Car Expenses, including lease costs, gas and maintenance, provided to the officers (treated as management and general costs in our company's financial statements). | NIS 58,400 plus VAT  | NIS 25,622 plus VAT  |

- (1) We have entered into an arrangement with Eurocom Communications and B Communications according to which Mr. Turgeman will provide management services to us, B Communications and Eurocom Communications. Each of Eurocom Communications, us and B Communications will pay 33% of Mr. Turgeman's management services costs.
- (2) Mr. Tadmor's compensation cost is divided equally between us and B Communications.

- (3) The variable portion of Mr. Turgeman's compensation is an annual bonus of up to two months' salary, according to a bonus plan with milestones which will be effective for three years ending December 31, 2015:
- (a) 50% of the bonus will be paid if the effective financing ratio (finance expenses divided by the total debt) will be 95% or lower than the expected financing ratio for that year according to the planned budget approved by our Board of Directors.
  - (b) 40% of the bonus will be paid if our company or one of its publicly traded debentures receives a higher rating from a recognized credit rating agency, compared to the rating given in the previous year by the rating agency. The credit rating is an acceptable and essential measurement of our company's financial strength and flexibility over the long term.
  - (c) 10% of the bonus will be paid if our company duly files its financial reports and its annual reports with the SEC within the time schedule set by the Board of Directors and in an appropriate manner.

During the year ended December 31, 2015, we paid to each of our external directors, as well as to our independent director, annual fees of NIS 68 thousands (approximately \$17 thousands) and a per meeting attendance fee of NIS 1,860 (approximately \$476). Such fees are paid based on the fees set forth in regulations promulgated under the Israeli Companies Law. Our other non-employee directors do not receive compensation for their services on our board of directors or any committee of our board of directors. All of our non-employee directors are reimbursed for their expenses for each meeting of the board of directors and audit committee attended.

In addition, our internal auditor, who is also deemed to be an "officer" in accordance with the Israeli Companies Law, received approximately NIS 28,800 for his services in 2015. Such costs are treated as management and general costs in our financial statements.

### **C. Board Practices**

#### **Introduction**

According to the Israeli Companies Law and our articles of association, the management of our business is vested in our board of directors. The board of directors may exercise all powers and may take all actions that are not specifically granted to our shareholders. Our executive officers are responsible for our day-to-day management. The executive officers have individual responsibilities established by our chief executive officer and board of directors. Executive officers are appointed by and serve at the discretion of the board of directors, subject to any applicable agreements.

#### **Election of Directors**

Our articles of association provide for a board of directors consisting of no less than six and no more than nine members or such other number as may be determined from time to time at a general meeting of shareholders. Our board of directors is currently composed of seven directors.

Pursuant to our articles of association, our board of directors is divided into three classes (other than external directors). Generally, at each annual meeting of shareholders one class of directors is elected for a term of three years by a vote of the holders of a majority of the voting power represented and voting at such meeting. All the members of our board of directors (except the external directors as detailed below) may be reelected upon completion of their term of office. Our board of directors may appoint additional directors to temporarily fill any vacancies in the board of directors, provided that the total number of directors will not exceed nine and that if the total number of directors decreases below six, the board of directors may only act in emergency situations, or to fill the minimum number of vacancies, or to call a general meeting of shareholders, so that following such meeting there will be at least six directors in office.

The board of directors of an Israeli public company is required to determine that at least one or more directors will have "accounting and financial expertise," as defined by regulations promulgated under the Israeli Companies Law. Our board of directors determined, accordingly, that at least two directors must have "accounting and financial expertise." Our Board of Directors has further determined that Mr. Shaul Elovitch, Mr. Dudi Ezra, Mr. Felix Cohen, Ms. Shoshana Shidlo and Ms. Anat Winner have the requisite "accounting and financial expertise."

As a controlled company within the meaning of the NASDAQ Stock Market Rules, we are exempt from the NASDAQ requirement regarding the nomination process of directors, and instead, follow Israeli law and practice, in accordance with which directors may be recommended by our board of directors for election by our shareholders. See Item 16G. "Corporate Governance - NASDAQ Exemptions for a Controlled Company."



## Potential Conflicts of Interest

Some of our directors also serve in various capacities for entities affiliated with Eurocom Communications and its affiliates. These relationships may give rise to conflicts of interest from time to time relating to (i) contracts, (ii) corporate opportunities, and (iii) use of directors' time and expertise. We have not adopted any formal plan or procedures to address such conflicts of interest and intend to review all related party transactions on a case-by-case basis. Under Israeli law, certain approvals are required for related party transactions (see below in this Item 6C. "Directors, Senior Management and Employees - Board Practices - Fiduciary Duties; Approval of Related Party Transactions under Israeli Law").

## External and Independent Directors

### *External Directors*

Under the Israeli Companies Law, companies incorporated under the laws of the State of Israel whose shares have been offered to the public are required to appoint at least two external directors. The external directors must meet certain statutory requirements of independence.

At least one of the external directors must have "accounting and financial expertise" and any other external director must have "accounting and financial expertise" or "professional qualification," as such terms are defined by regulations promulgated under the Israeli Companies Law.

The external directors are elected for their first term of office by shareholders at a general meeting, provided that either:

- The majority of shares voting on the matter (not including abstentions), including at least a majority of the shares of the non-controlling shareholders (and of shareholders who do not have a personal interest in the election of the external director as a result of their relationship with the controlling shareholder) voting on the matter, vote in favor of the external director; or
- The majority of shares voting on the matter (not including abstentions) vote in favor of the external director and the total number of ordinary shares held by non-controlling shareholders (and of shareholders who do not have a personal interest in the election of the external director as a result of their relationship with the controlling shareholder) that voted against the election of the external director does not exceed 2% of all of the voting rights in the company.

In general, external directors serve for a three-year term and may be reelected to two additional three-year terms if one of the following conditions is met:

- One or more shareholders holding at least 1% of the voting rights in the company nominated the external director for an additional term of office and the appointment was approved by a majority of the shares voting on the matter, not including votes of controlling shareholders or shareholders who have a personal interest in the election of the external director as a result of their relationship with the controlling shareholder; and provided that the total number of shares held by non-controlling persons and by persons who have no personal interest in the appointment of the external director as a result of their relationship with the controlling shareholder, who voted in favor of the election of the nominee, exceeds 2% of the voting rights in the company; or
- The board of directors proposed the nominee for an additional term of office, and the election was approved by the general meeting of shareholders by the majority required for the election of an external director for a first term of office, as described above.

External directors can be removed from office only by the same special percentage of shareholders as can elect them, or by a court, and then only if the external directors cease to meet the statutory qualifications with respect to their appointment or if they violate their duty of loyalty to the company. If an external directorship becomes vacant, the board of directors is required under the Israeli Companies Law to convene a shareholders meeting immediately to appoint a new external director.

Each committee of the board of directors that is authorized to exercise powers vested in the board of directors must include at least one external director, and the audit committee and compensation committee must include all the external directors. An external director is entitled to compensation as provided in regulations adopted under the Israeli Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with such service.

Mr. Dudi Ezra and Ms. Shoshana Shidlo each serve as an external director pursuant to the provisions of the Israeli Companies Law for a third three-year term until August 2017. Both have “accounting and financial expertise,” as such term is defined under the Israeli Companies Law.

#### *Independent Directors*

In general, NASDAQ Stock Market Rules require that a NASDAQ-listed company have a majority of independent directors on its board of directors and its audit committee must consist solely of independent directors, as defined under NASDAQ Stock Market Rules. Because Eurocom Communications own more than 50% of our ordinary shares, we are considered a “controlled company” within the meaning of NASDAQ Stock Market Rules. Accordingly, we are exempt from certain requirements under NASDAQ Stock Market Rules, such as the requirement to have a majority of independent directors on our board of directors. If the “controlled company” exemption would cease to be available to us under the NASDAQ Stock Market Rules, we may instead elect to follow Israeli law and would not be required to elect any additional independent directors.

Pursuant to the Israeli Companies Law, a director may be qualified as an independent director if such director is either (i) an external director; or (ii) a director who complies with the following requirements: (y) he or she is eligible for nomination as an external director and the audit committee has approved such eligibility; and (z) he or she has not acted as a director of the company for a period exceeding nine consecutive years.

Our board of directors has determined that each of Mr. Dudi Ezra and Ms. Shoshana Shidlo (both external directors under Israeli law) and Ms. Anat Winner qualifies as an independent director under the requirements of the SEC, NASDAQ and Israeli law.

#### **Audit Committee**

Under the Israeli Companies Law, the board of directors of any public company must establish an audit committee. The audit committee must consist of at least three directors, must include all of the external directors and must have a majority of independent directors, as such terms are defined in the Israeli Companies Law. The audit committee may not include the chairman of the board of directors, any director employed by the company or by the controlling shareholder of the company or by a company controlled by the controlling shareholder or any director who provides services on a regular basis to the company or the controlling shareholder or a company controlled by a controlling shareholder, or a director that is financially dependent on the controlling shareholder, or a controlling shareholder or any of the controlling shareholder’s relatives.

Our audit committee also serves, in compliance with the Israeli Companies Law and Israeli Companies Regulations (Provisions and Conditions regarding the Financial Statements’ Authorization Process), 2010 as the committee of our board of directors that is required to examine our financial statements.

In addition, the NASDAQ Stock Market Rules require us to establish an audit committee comprised of at least three members, all of whom must be independent directors, each of whom is financially literate and satisfies the respective “independence” requirements of the SEC and NASDAQ and one of whom has accounting or related financial management expertise at senior levels within a company.

Our audit committee assists our Board of Directors in overseeing the accounting and financial reporting processes of our company and audits of our financial statements, including the integrity of our financial statements, compliance with legal and regulatory requirements, our independent registered public accountants’ qualifications and independence, the performance of our internal audit function and independent registered public accountants, finding any defects in the business management of our company and proposing to our Board of Directors ways to correct such defects, approving related-party transactions as required by Israeli law, and such other duties as may be directed by our Board of Directors. The role of our audit committee also includes the determination of whether certain related party transactions are regarded as material, extraordinary, or insignificant, the review of the internal audit program and the operation of the internal auditor, as well as setting procedures for whistleblower protection.

Our audit committee consists of three members of our Board of Directors who satisfy the respective “independence” requirements of the SEC, NASDAQ and Israeli law for audit committee members. Our audit committee is currently composed of Mr. Ezra, Ms. Shidlo, and Ms. Winner. Our Board of Directors has determined that Ms. Winner qualifies as an audit committee financial expert. The audit committee meets at least once each quarter. Our audit committee charter is available on our website at [www.igld.com](http://www.igld.com).

## Compensation Committee

Our Board of Directors has established a Compensation Committee consisting of our three external directors (within the meaning of the Israeli Companies Law) who are also the members of our audit committee. The three members satisfy the “independence” requirements of the SEC, NASDAQ and Israeli law for audit committee members. Pursuant to a recent amendment to the Israeli Companies Law (the “Compensation Amendment”), which became effective on December 12, 2012, a compensation committee must be comprised of no fewer than three members and must include all of the external directors, whom must also constitute a majority of its members. All other members of the compensation committee must be directors who receive compensation that is in compliance with regulations promulgated under the Israeli Companies Law. In addition, the chairperson of the compensation committee must be an external director. Directors who are not qualified to serve on the audit committee may not serve on the compensation committee.

Under the Compensation Amendment, the compensation committee is responsible for: (i) making recommendations to the board of directors with respect to the approval of the compensation policy applicable to the company’s office holders and any extensions thereto. The compensation policy must be based on those considerations, must include those provisions and needs to reference those matters as are detailed in the Israeli Companies Law; (ii) providing the board of directors with recommendations with respect to any amendments or updates to the compensation policy and periodically reviewing the implementation thereof; (iii) reviewing and approving arrangements with respect to the terms of office and employment of office holders; and (iv) determining whether or not to exempt a transaction with a candidate for chief executive officer from shareholder approval.

Pursuant to the Compensation Amendment, our Compensation Committee adopted a compensation policy and will be required to approve our compensation policies at least once every three years. The compensation policy was approved by our board of directors, after considering the recommendations of our Compensation Committee, and by our shareholders by a special majority in accordance with the Compensation Amendment.

## Internal Auditor

Under the Israeli Companies Law, the board of directors of a public company must appoint an internal auditor nominated by the audit committee. The role of the internal auditor is, among other things, to examine whether a company’s actions comply with applicable law and orderly business procedure. The internal auditor must meet certain statutory requirements of independence. In determining the ownership or voting interest of a person, Israeli law is expansive and aggregates that person’s direct and indirect holdings, including the holdings of certain affiliates, relatives and associates. Mr. Ilan Chaikin currently serves as our internal auditor.

## Exculpation, Indemnification and Insurance of Directors and Officers

### *Indemnification of Office Holders*

Under the Israeli Companies Law and the Israeli Securities Law, 5738-1968, or the Israeli Securities Law, a company may, if permitted by its articles of association, indemnify an office holder for any of the following liabilities or expenses that they may incur due to an act performed or failure to act in his or her capacity as the company’s office holder, either pursuant to an undertaking given by the company in advance of the act or following the act:

- monetary liability imposed on the office holder in favor of a third party in a judgment, including a settlement or an arbitral award confirmed by a court. However, if a company undertakes to indemnify an office holder in advance of such a liability, the undertaking must be limited to foreseeable events based on the company’s activities when the company undertook such indemnification, and to amounts or standards that the board of directors has determined are reasonable under the circumstances;
- reasonable litigation expenses, including attorneys’ fees, expended by an office holder as a result of an investigation or proceeding instituted against the office holder by a competent authority, provided that such investigation or proceeding concludes without the filing of an indictment against the office holder and either: no financial liability was imposed on the office holder in lieu of criminal proceedings, or a financial liability was imposed on the office holder in lieu of criminal proceedings with respect to an alleged criminal offense that does not require proof of criminal intent;
- reasonable litigation expenses, including attorneys’ fees, expended by the office holder or for which the office holder is charged by a court:
  - o in an action brought against the office holder by the company, on behalf of the company or on behalf of a third party,
  - o in a criminal action from which the office holder is acquitted, or
  - o in a criminal action in which the office holder is convicted of a criminal offense which does not require proof of criminal intent.
- a payment that the office holder is obligated to make to an injured party pursuant to Section 52(54)(a)(1)(a) of the Israeli Securities Law, and expenses that the office holder incurred in connection with an administrative proceeding under the Israeli Securities Law, including reasonable litigation expenses and attorney fees.

#### *Insurance of Office Holders*

A company may, if permitted by its articles of association and subject to the conditions set forth in the Israeli Companies Law, obtain insurance for an office holder against liabilities incurred in his or her capacity as an office holder. These liabilities include a breach of duty of care to the company or a third-party, a breach of duty of loyalty and any monetary liability imposed on the office holder in favor of a third-party.

In addition, under the Israeli Securities Law, a company may, if permitted by its articles of association, obtain insurance for an office holder against liabilities incurred in his or her capacity as an office holder in connection with a payment that the office holder is obligated to make to an injured party pursuant to Section 52(54)(a)(1)(a) of the Israeli Securities Law, and expenses that the office holder incurred in connection with an administrative proceeding under the Israeli Securities Law, including reasonable litigation expenses and attorney fees.

#### *Exculpation of Office Holders*

Under the Israeli Companies Law, a company may, if permitted by its articles of association, also exculpate an office holder from a breach of duty of care in advance of that breach. A company may not exculpate an office holder from a breach of duty of loyalty towards the company or from a breach of duty of care concerning dividend distribution or a purchase of the company's shares by the company or other entities controlled by the company.

#### *Limitations on Exculpation, Insurance and Indemnification*

Under the Israeli Companies Law, a company may indemnify or insure an office holder against a breach of duty of loyalty only to the extent that the office holder acted in good faith and had reasonable grounds to assume that the action would not prejudice the company. In addition, a company may not indemnify, insure or exculpate an office holder against a breach of duty of care if committed intentionally or recklessly (excluding mere negligence), or committed with the intent to derive an unlawful personal gain, or for a fine or forfeit levied against the office holder in connection with a criminal offense. According to the Israeli Administrative Enforcement Law, a company cannot insure or indemnify an office holder for an administrative enforcement procedure, regarding payments to victims of the infringement or for expenses expended by the officer with respect to certain proceedings held concerning him or her, including reasonable litigation expenses and legal fees.

Pursuant to the Israeli Companies Law, exculpation of, procurement of insurance coverage for, and an undertaking to indemnify or indemnification of, our office holders must be approved by our Compensation Committee and our Board of Directors and, if the office holder is a director or the chief executive officer, also by our shareholders.

Our articles of association allow us to insure, indemnify and exempt our office holders to the fullest extent permitted by law, subject to the provisions of the Israeli Companies Law and Israeli Securities Law. We maintain a directors' and officers' liability insurance policy with liability coverage of up to \$10 million per claim and in the aggregate. We have undertaken to indemnify all of our directors and officers to the extent permitted by law, in an aggregate amount for all directors and officers not to exceed 25% of our equity (on a consolidated basis) in accordance with the our last financial statements published before the actual payment of the indemnity amount, to the extent that their liability is not covered under our directors' and officers' liability insurance policy. In November 2014, the Compensation Committee and Board of Directors approved the extension of the directors' and officers' liability insurance policy for the period from December 1, 2014 through April 30, 2016.

#### **D. Employees**

On December 31, 2015, we had five employees who also provided services to B Communications. Our direct employees are all located in Israel and are not represented by any labor union. Since our inception, we have not experienced any labor-related work stoppages and believe that our relations with our employees are good. We have entered into an arrangement with B Communications according to which our employees will provide services to both companies and each company will pay 50% of their compensation. We entered into a similar arrangement with B Communications and Eurocom Communications with respect to the management services supplied by Mr. Doron Turgeman to the three companies.

As of December 31, 2015, the Bezeq Group employed 12,615 persons, of whom 5,986 persons were employed by Bezeq, 2,679 persons were employed (or otherwise retained) by Pelephone, 1,966 persons were employed by Bezeq International and 1,984 persons were employed by DBS.

As of December 31, 2014, the Bezeq Group employed 12,939 persons, of whom 5,964 persons were employed by Bezeq, 3,001 persons were employed (or otherwise retained) by Pelephone, 1,932 persons were employed by Bezeq International and 2,042 persons were employed by DBS.

As of December 31, 2013, the Bezeq Group employed 13,763 persons, of whom 6,576 persons were employed by Bezeq, 2,952 persons were employed (or otherwise retained) by Pelephone, 1,989 persons were employed by Bezeq International and 2,246 persons were employed by DBS.

Israeli labor laws govern the length of the workday, minimum wages for employees, procedures for hiring and dismissing employees, determination of severance pay, annual leave, sick days and other conditions of employment. Israeli law generally requires severance pay upon the retirement or death of an employee or termination of employment by our company. For those of our employees who are entitled to a pension arrangement, we fund future severance pay obligations by contributing to managers' insurance or other pension arrangements. A provision in our financial statements covers severance pay to those employees who are not entitled to managers' insurance or other pension arrangements. Furthermore, we and our employees are required to make payments to the National Insurance Institute, which is similar to the U.S. Social Security Administration. Such amounts also include payments by the employee for health insurance.

Labor relations with Bezeq's employees involved in fixed-line communications are regulated by the collective agreements among Bezeq, the workers representatives and the Histadrut, as well as by personal contracts. Additionally, expansion orders to certain general collective agreements apply Bezeq's employees, such as cost-of-living increment agreements.

#### E. Share Ownership

As of April 18, 2016, none of our directors and executive officers beneficially owns any of our ordinary shares, other than Mr. Shaul Elovitch, the chairman of our board of directors. Mr. Shaul Elovitch, Mr. Yossef Elovitch, Eurocom Communications and Eurocom Holdings (1979) Ltd. are the beneficial owners of 12,413,307 ordinary shares of our company that are held by Eurocom Communications (925,000 of these shares are held directly by a joint account of Messrs. Shaul and Yossef Elovitch). Mr. Shaul Elovitch and his brother, Mr. Yossef Elovitch, own 80% and 20%, respectively, of Eurocom Holdings (Mr. Shaul Elovitch and Mr. Yossef Elovitch own 75% and 25%, respectively, of Eurocom Holdings' management shares). Eurocom Communications is 99.33% owned by Eurocom Holdings. The remaining 0.67% interest in Eurocom Communications is directly owned by Mr. Shaul Elovitch. Accordingly, Mr. Shaul Elovitch may be deemed to have the sole voting and dispositive power as to the ordinary shares of the Issuer held of record directly by Eurocom Communications. Mr. Shaul Elovitch may also deem to be the beneficial owner of 26,893 ordinary shares held of record by his wife, Mrs. Iris Elovitch. In addition, the above includes 8,300 shares that are held by other family members of Mr. Shaul Elovitch.

Mr. Shaul Elovitch also serves as the chairman of the board of directors of B Communications, Eurocom Communications and Eurocom Holdings. Accordingly, Mr. Shaul Elovitch may be deemed to have the sole voting and dispositive power over our ordinary shares beneficially owned by Eurocom Communications. See also Item 7A. "Major Shareholders and Related Party Transactions - Major Shareholders."

### ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

#### A. Major Shareholders

The following table sets forth certain information as of April 18, 2016, regarding the beneficial ownership by all shareholders known to us to own beneficially 5% or more of our ordinary shares:

| Name   | Number of Ordinary Shares Beneficially Owned <sup>(1)</sup> | Percentage of Ownership <sup>(2)</sup> |
|--|---|--|
| Eurocom Communications <sup>(3)</sup>            | 11,325,701  | 58.98%                                 |
| Messrs. Shaul and Yossef Elovitch <sup>(3)</sup> | 12,250,701  | 63.80%                                 |
| Yelin Lepidot <sup>(4)</sup>                     | 987,792   | 5.14%                                  |

- (1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Ordinary shares relating to options currently exercisable or exercisable within 60 days of the date of this table, are deemed outstanding for computing the percentage of the person holding such securities but are not deemed outstanding for computing the percentage of any other person. Except as indicated by footnote, and subject to community property laws where applicable, the persons named in the table above have sole voting and investment power with respect to all shares shown as beneficially owned by them.
- (2) The percentages shown are based on 19,203,186 ordinary shares issued and outstanding (which exclude 5,862,615 ordinary shares held as treasury shares) as of April 18, 2016.

- (3) Mr. Shaul Elovitch, Mr. Yossef Elovitch, Eurocom Communications and Eurocom Holdings (1979) Ltd. are the beneficial owners of 12,250,701 ordinary shares of our company that are held by Eurocom Communications (925,000 of these shares are held directly by a joint account of Messrs. Shaul and Yossef Elovitch). Mr. Shaul Elovitch and his brother, Mr. Yossef Elovitch, own 80% and 20%, respectively, of Eurocom Holdings (Mr. Shaul Elovitch and Mr. Yossef Elovitch own 75% and 25%, respectively, of Eurocom Holdings' management shares). Eurocom Communications is 99.33% owned by Eurocom Holdings. The remaining 0.67% interest in Eurocom Communications is directly owned by Mr. Shaul Elovitch. Accordingly, Mr. Shaul Elovitch may be deemed to have the sole voting and dispositive power as to the ordinary shares of the Issuer held of record directly by Eurocom Communications. Mr. Shaul Elovitch may also deem to be the beneficial owner of 26,893 ordinary shares held of record by his wife, Mrs. Iris Elovitch. In addition, the above includes 8,300 shares that are held by other family members of Mr. Shaul Elovitch.
- (4) Based on a Schedule 13G filed by Dov Yelin, Yair Lapidot and Yelin Lapidot Holdings Management Ltd. on January 6, 2016. Their address is 50 Dizengoff St., Dizengoff Center, Gate 3, Top Tower, 13th floor, Tel Aviv 64332, Israel.

#### **Significant Changes in the Ownership of Major Shareholders**

In 2014, Eurocom Communications sold 1,645,000 of our ordinary shares in private transactions, and also sold 925,000 of our ordinary shares to a joint account of Messrs. Shaul and Yossef Elovitch.

Eurocom reported sales of our ordinary shares in its Schedules 13D/A filed on December 4, 2015, and on January 15 and January 22, 2016. According to the reports, in 2015, Eurocom sold 573,000 of our ordinary shares and in 2016, Eurocom sold 533,622 of our ordinary shares in private transactions in Israel.

#### **Major Shareholders Voting Rights**

Our major shareholders do not have different voting rights.

#### **Record Holders**

Based on a review of the information provided to us by our transfer agent, as of April 18, 2016, there were 22 holders of record of our ordinary shares, of which 18 record holders holding approximately 35% of our ordinary shares had registered addresses in the United States. These numbers are not representative of the number of beneficial holders of our shares nor are they representative of where such beneficial holders reside since many of these ordinary shares were held of record by brokers or other nominees (including one U.S. nominee company, CEDE & Co., which held approximately 34.7% of our outstanding ordinary shares as of such date). According to the information available to us, we believe that we have approximately 968 beneficial holders in the United States.

#### **B. Related Party Transactions**

We receive and provide various services and products to and from related parties at market rates and in the ordinary course of business. Other than the transactions described below, none of our related party transactions are material to us or to our related parties. If a related party wishes to supply products or services to us, we generally obtain a bid from a third party to enable us to determine whether the related party's bid is on arm's-length terms. Any of such transaction is subject to the approval of our audit committee and our board of directors (and in some circumstances, our shareholders). In addition, generally we will not purchase a particular type of product or service solely from related parties, but will also have non-related vendors. Prices offered by non-related vendors are compared to those offered by related parties to ensure that the related parties are offering arm's length terms.

In the ordinary course of business, some of our subsidiaries and affiliates engage in business activities with each other. Such business activities are primarily among Bezeq, other Bezeq Group companies and other Eurocom Group companies, such as Eurocom Digital, Eurocom Cellular, Spacecom, Satcom, and to a lesser extent other affiliated companies. Such business activities primarily relate to the provision, purchase or sale of communications and digital services and products, including the provision of satellite or broadcasting services, cellular and electronic products and equipment, and Internet and telephony services. The transactions among these related parties are made at prices and on terms equivalent to those charged in transactions with unrelated parties under similar conditions.

#### **Relationship with Eurocom Communications and its affiliates**

Messrs. Shaul Elovitch, chairman of our board of directors, and his brother Yossef Elovitch, a director of our company, also serve as directors of Eurocom Communications and various of its affiliates, together indirectly hold a majority of the outstanding shares of Eurocom Communications. During the past three years, we have entered into transactions with Eurocom Communications and several of their affiliates, referred to as the Eurocom Group. We believe that the transactions with Eurocom Communications and its affiliates described below could have been entered into on comparable terms with unrelated parties and on an arm's length basis. Set forth below are summary descriptions of certain agreements, relationships and transactions between us and members of the Eurocom Group.

### ***Certain Related Party Transactions***

We and B Communications lease our principal offices from Eurocom Communications for an annual rent of NIS 59,000 (approximately \$15,000) for each company. In addition, Eurocom Real Estate Ltd. provides us and B Communications with parking spaces for NIS 8,000 (approximately \$2,000) a year for each company. Eurocom Digital provides us and B Communications with additional services, such as computing services for an annual fee of NIS 12,000 (approximately \$3,000) for each company.

In addition, Eurocom Communications Ltd. provides the Company and B Communications with legal services in an annual sum of NIS 96,000 for each company.

In addition, we receive and render various services and products to and from related parties at market rates and in the ordinary course of business. None of these transactions are material to us or to our related parties. If a related party wishes to supply products or services to us, we generally obtain a bid from a third party to enable us to determine whether the related party's bid is on arm's-length terms. Any of such transaction is subject to the approval of our Audit Committee and our board of directors (and our shareholders, if requires). In addition, generally we will not purchase a particular type of product or service solely from related parties, but will also have non-related vendors. Prices offered by non-related vendors are compared to those offered by related parties to ensure that the related parties are offering arm's length terms.

### ***Registration Rights Agreement with Eurocom Communications***

In July 1999, we entered into a registration rights agreement with Euronet Communications (which was subsequently assigned to Eurocom Communications) and our other than existing shareholders granting them the right to register their ordinary shares under the U.S. Securities Act. The registration rights include unlimited rights to request that their shares be included in any underwritten public offering of our ordinary shares (excluding any registration of employees' shares on Form S-8 or a similar form). Additionally, as of February 4, 2000, the holders of a majority of such shares are entitled to demand, up to three times in aggregate, that we register their shares. As of August 4, 2000, the holders of a majority of these shares are also entitled to request that we effect a registration of their shares on a shelf registration statement once in any 12-month period, up to three times in aggregate. All expenses incurred in connection with such registrations, other than underwriters' and brokers' discounts and commissions, will be payable by us.

### ***Execution Services Agreement with Eurocom Capital Finance Ltd.***

In November 2007, we entered into an execution services agreement with Eurocom Capital Finance Ltd., or Eurocom Capital, which is controlled by Mr. Shaul Elovitch, our controlling shareholder and the chairman of our Board of Directors, under which Eurocom Capital provides us with various financial services. Under the agreement, Eurocom Capital handles the execution of investments in our capital, pursuant to direct instructions from our chief executive officer. In consideration for these services, we agreed to pay Eurocom Capital fees which are customary for such agreements and on market terms. Eurocom Capital has agreed to act to preserve our financial resources according to a policy that will be set by our management and approved by the board of directors. We paid Eurocom Capital NIS 345,000, NIS 615,000 and NIS 433,000 (approximately \$111,000) for the years ended December 31, 2013, 2014 and 2015, respectively.

### ***Form F-3 Registration Statement***

Pursuant to the 1999 registration rights agreements with Eurocom Communications, on December 9, 2015 we filed on behalf of Eurocom Communications, a registration statement on Form F-3 and a prospectus relating to the resale, from time to time, by Eurocom Communications, as the selling securityholder, of up to 2,880,000 of our ordinary shares. The registration statement became effective on December 14, 2015.

### ***Agreements with B Communications***

#### ***Registration Rights Agreement with B Communications***

We and B Communications have entered into a registration rights agreement under which B Communications has granted us the right to register the ordinary shares of B Communications that we hold under the U.S. Securities Act. Under the registration rights agreement, we have "demand" registration rights that allow us, at any time after one year following the initial public offering in the United States of B Communications, to request to register under the U.S. Securities Act, some or all of the ordinary shares of B Communications that we own. We are entitled to an aggregate of five demand registrations. B Communications is not required to effect any demand registration unless such demand registration request is for a number of ordinary shares with a market value that is equal to at least \$7.5 million. B Communications is also not required to effect more than one demand registration during the first 12 months following its initial public offering in the United States or more than one demand registration during any 12-month period thereafter. B Communications is not obligated to grant a request for a demand registration within 90 days of any other demand registration. We also have "piggyback" registration rights that allow us to include the ordinary shares of B Communications that we own in any public offering of equity securities initiated by B Communications (other than public offerings pursuant to registration statements on Forms F-4, S-8 or any other successor forms). The "piggyback" registration rights are subject to proportional cutbacks based on the manner of the offering and the identity of the party initiating such offering. B Communications has also granted us the right to request a shelf registration on Form F-3, provided that it shall be eligible to utilize a registration statement on such form, providing for an offering to be made on a continuous basis, but for no longer than one year without the consent of the audit committee of B Communications.

Under the registration rights agreement, B Communications has agreed to indemnify us against any losses or damages resulting from any untrue statement or omission of material fact in any registration statement or prospectus pursuant to which we sell ordinary shares, unless such liability arose in reliance upon and in strict conformity with information that we furnished in writing. B Communications will pay all expenses incident to any demand registration, and we will pay our respective portions of all underwriting discounts, commissions and fees attributable to the sale of our ordinary shares it owns under the registration rights agreement.

#### *Chief Executive Officer Employment Agreement*

We have entered into an arrangement with Eurocom Communications, and B Communications according to which Mr. Turgeman provides management services to us, B Communications and Eurocom Communications. In consideration for such services, each of Eurocom Communications, B Communications and us will pay 33% of Mr. Turgeman's services costs.

#### *Recent Transactions in B Communications' Shares*

On June 17, 2014, we purchased 15,000 of B Communications' ordinary shares and on January 13, 2016, we sold 575,000 of B Communications' ordinary shares. We filed a Schedule 13D/A on January 14, 2016, to reflect these transactions that took place in Israel.

#### **Bezeq Group Interested Party Guidelines**

In March 2011, Bezeq's board of directors adopted guidelines and regulations to classify a transaction by Bezeq, any of its subsidiaries or affiliates of Bezeq with an interested party as an "insignificant transaction," which is not an "extraordinary transaction," as set out in the Israeli Securities Regulations (Annual Financial Statements), 2010. These guidelines and regulations are used to examine the scope of disclosure in periodic reports, prospectuses (including shelf offering reports) and immediate reports regarding a transaction of Bezeq, a company under its control and a subsidiary or affiliate of Bezeq with a controlling shareholder or in which the controlling shareholder has a personal interest.

From time to time, Bezeq and its subsidiaries or affiliates enter into "insignificant transactions," which are not extraordinary transactions, with an interested party in Bezeq or with related parties, including transactions for the sale or purchase of products and services, such as communication products and services, including fixed-line and cellular telephony handsets, software development products and services, maintenance services, voice-mail service agreements, rental transactions of real estate properties and advertising services.

In the absence of special, qualitative considerations under the specific circumstances, a transaction that is in Bezeq's regular course of business, is carried out in accordance with market conditions and has no material effect on the Bezeq Group, is deemed "insignificant" if all the following parameters exist:

- The amount of the transaction does not exceed NIS 10 million;
- Bezeq is not required to issue an immediate report for the transaction under applicable law; and
- The transaction does not involve employment terms (within the meaning of the Israeli Companies Law) of an interested party or any relative thereof.

According to the Israeli Companies Law, Bezeq's audit committee will review the parameters set out above and the need to update them on a yearly basis, prior to the publication of Bezeq's reports. Bezeq's board of directors may, from time to time and at its discretion, amend the parameters for an "insignificant transaction." In general, each transaction is tested separately for "insignificance." Nevertheless, separate transactions that are part of the same continuing transaction or very similar transactions that are carried out routinely and repeatedly, will be tested as one transaction on an annual basis for "insignificance," provided the scope of the transaction does not exceed NIS 10 million. In 2010, 2011 and 2012, the Bezeq Group entered into "insignificant transactions" with related parties of Bezeq Group or entities in which its controlling shareholder has a personal interest as described above.

In accordance with a recent amendment to the Israeli Companies Law, Bezeq's audit committee has determined that transactions of Bezeq or its subsidiaries (including DBS) with Bezeq's controlling shareholders or in which Bezeq's controlling shareholders have a personal interest, must be approved following a competitive process, which includes approaching three competitors that provide a similar service or product (subject to certain exceptions). The audit committee has determined standards for conducting such competitive process and certain types of transactions for which a different approval procedure shall apply.



## Bezeq Group Transactions Deemed to be Significant

| Approval date of Bezeq's shareholders unless otherwise indicated   | Nature of the transaction  | Amount of the transaction  |
|--|--|--|
| April 24, 2012   | Approval of Bezeq's vote in the general meeting of DBS in favor of the agreement between DBS and Eurocom and ADB to acquire three yesMax Total converters in accordance with an existing framework agreement until December 31, 2014.  | Total cost of \$10 million   |
| July 25, 2012  | Approval of Bezeq's vote at the general meeting of shareholders of DBS in favor of DBS' agreement with Eurocom and ADB for the acquisition of yesMaxTotal converters in accordance with the existing framework agreement until December 31, 2014.  | An additional cost of up to \$3 million, to the extent required by the market situation  |
| October 11, 2012   | Amendment to and extension of Pelephone's agreement with Eurocom Cellular Communications Ltd. Under the amendment, the agreement that was approved at the general meeting on June 10, 2010 will be expanded to include products manufactured by the Chinese electronics manufacturer ZTE. The agreement will be extended by three years until December 31, 2015. | Annual scope of up to NIS 300 million  |
| Approved by Bezeq's Board of Directors on April 25, 2013 in accordance with the Companies Regulations (Relief in Transactions with Interested Parties), 2000 ("the Relief Regulations for Transactions with Interested Parties") | Extension of the arrangements approved at Bezeq's general meeting on October 14, 2010, between Bezeq and DBS and between Bezeq International and DBS for reciprocal marketing of products and services until December 31, 2015.  | The fees to be paid by the parties to each other will be in accordance with the criteria approved by the general meeting as part of the original approval for the agreement  |
| May 8, 2013  | Approval of Bezeq's vote at the general meeting of DBS in favor of DBS' agreement with Space Communications Ltd. ("Space Communications") for leasing space segments, in which the original agreement will be amended and extended. The agreement is valid until the end of 2028.  | Total amount of up to \$227 million (net including discounts for satellite segments leased in the existing agreement)  |
| June 13, 2013  | The amendment to Bezeq's three-year agreement with Eurocom Communications Ltd. ("Eurocom Communications") for ongoing management and consultation services valid until May 31, 2016, unless one of the parties announces its intention to terminate the agreement with three months' notice.   | NIS 5.5 million per year   |
| Approved by Bezeq's Board of Directors on November 6, 2013 in accordance with the relief regulations for transactions with interested parties  | Amendment to and extension of DBS's agreement with Eurocom and ADB for acquisition of yesMaxTotal3 converters.   | The total cost will be \$10 million per year   |
| January 27, 2014   | Approval of Bezeq's vote at the general meeting of DBS in favor of DBS's agreement with Eurocom and ADB for the acquisition of an additional quantity of yesMaxTotal converters and power supplies for yesMax HD converters, until June 30, 2015.  | For converters: a total cost of \$14 million In addition, there is an additional 2.42% of the price for the cost of the hard drive only, if there are changes due to an increase in hard drive prices<br><br>For power supplies: a total cost of \$197,000 |

| Approval date of Bezeq's shareholders unless otherwise indicated   | Nature of the transaction   | Amount of the transaction   |
|--|---|---|
| Approved by Bezeq's Board of Directors on February 27, 2013 in accordance with the relief regulations for transactions with interested parties | Approval of the extension of supplier credit terms in accordance with the agreement between DBS and Space Communications for lease of space segments, up to December 31, 2014.  | NIS 920,000   |
| Approved by Bezeq's Board of Directors on November 27, 2014 in accordance with the relief regulations for transactions with interested parties | Approval of the extension of supplier credit terms in accordance with the agreement between DBS and Space Communications for lease of space segments, up to December 31, 2014.  | NIS 874,000.  |
| January 14, 2015   | Approval of Bezeq's vote at the general meeting of DBS in favor of DBS's agreement with Eurocom and ADB for the order of an additional quantity of yesMaxTotal converters, until December 31, 2015.   | A total cost of \$12 million and an additional price of up to 1.9% for the cost of the hard drive only, if there are changes due to an increase in hard drive prices  |
| March 23, 2015   | Acceptance of the terms established by the Commissioner in his approval of the merger on March 26, 2014, both by Bezeq and by DBS (in the context of Bezeq's vote in the general meeting of DBS) and announcement of the exercise, at no cost, of Bezeq's option for the allotment from DBS of 6,221 shares of DBS, representing 8.6% of the share capital of DBS. Bezeq's engagement in an acquisition agreement with Eurocom DBS was also approved, whereby Bezeq will acquire the entire holdings of Eurocom DBS in DBS shares and all the shareholder loans provided by Eurocom DBS to DBS. | The total cost is comprised of: a) total cash of NIS 680 million; b) total cash of up to NIS 200 million, subject to certain conditions; c) total cash of up to NIS 170 million, subject to certain conditions. |

### C. Interests of Experts and Counsel

Not applicable.

## ITEM 8. FINANCIAL INFORMATION

### A. Consolidated Statements and Other Financial Information

See the consolidated financial statements, including the notes thereto, beginning of page F-1 and the exhibits listed in Item 19 hereof and incorporated herein by this reference.

### Legal Proceedings

The Bezeq Group is involved in certain legal and regulatory actions, all of which have arisen in the ordinary course of business, except for the matters described in the following paragraphs. We believe that the ultimate resolution of such matters is unlikely to have a material adverse effect on the Bezeq Group's consolidated results of operations and/or financial condition, except as described below.

Bezeq makes provisions in its consolidated financial statements for certain of the legal proceedings to which it or other Bezeq Group companies is a party. These provisions are aggregated into groups based on the type of activity and claim. As of December 31, 2015, Bezeq has made an aggregate provision of NIS 146 million (see note 14) (approximately \$37 million) for its pending litigation and the additional exposure as at December 31, 2015 for claims filed against the Bezeq Group companies on various matters which are unlikely to be realized, which amounts to NIS 5.5 billion (approximately \$1.4 billion). There is also an additional exposure of NIS 4 billion (approximately \$1 billion) for claims, the outcomes of which cannot yet be assessed. All amounts are linked to the CPI and are stated net of interest. The foregoing amounts do not include additional potential exposure that Bezeq may have attributable to pending motions to certify lawsuits as class actions that do not state the amount claimed if the motion is approved. Since December 31, 2015, additional claims in the amount of NIS 93 million (approximately \$24 million) were filed against the Bezeq Group. In addition, claims in the amount of NIS 549 million (approximately \$141 million) against the Bezeq Group were dismissed.

Our reporting policy is based on Bezeq's reporting policy, which is based on considerations of quality and of amount. Bezeq has determined that the minimum reportable amount deemed to be material would be events affecting net profit by 5% or more of Bezeq's ongoing operations according to its latest annual consolidated financial statements. Accordingly, this section describes (i) pending legal proceedings involving NIS 120 million or more, which meet the 5% of pretax profit standard according to the Bezeq financial results for the year ended December 31, 2015, (ii) legal proceedings in which the amount claimed is not stated in the statement of claim (except for claims that on their face do not reach the above amount), or (iii) claims that Bezeq believes have other aspects and/or implications beyond their monetary amount. The claims described below are updated in accordance with the updates we receive from the Bezeq Group companies and the public filings of Bezeq with respect to such claims.

### Bezeq

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

Pending proceedings:

| Date                           | Parties*   | Instance                                       | Type of proceeding   | Description  | Original Amount of the Claim (NIS in millions) |
|--------------------------------|--|--|--|--|--|
| February 2012                  | Claim against Bezeq, Pelephone and two other additional cellular companies         | District Court (Jerusalem)                     | Action and request to approve it as a class action         | The plaintiffs alleged that the Respondents do not offer the handicapped members of the public accessible handsets and services in a fitting manner, and that they are therefore in breach of the law and the regulations.<br>In January 2014, a decision was made with the consent of the parties whereby the claim will be discussed together with another claim on the same matter, which was filed against other communication companies.<br>In December 2015, an application was filed with the Court for approval of a settlement arrangement in a case at minimal cost to Bezeq.  | 361  |
| July 2012                      | Two shareholders vs. Bezeq officers (including those that are no longer in office) | District Court (Tel Aviv, Economic Department) | Derivative claim and request to approve a derivative claim | It was argued that members of the Board of Directors were in breach of their duty of caution and fiduciary obligations towards Bezeq, by approving loans which were not used for Bezeq's benefit and were designated for the distribution of dividends, and were therefore in a conflict of interests. Alternatively, the Plaintiff alleges that the resolutions passed by the Board of Directors with respect to the aforementioned loans created a tax exposure for Bezeq due to the fact that the financing expenses are not recognized for tax purposes. Inter alia, declarative relief was requested for nullification of loans taken by Bezeq from the date of the change of control therein, and restitution of dividends by Bezeq's controlling shareholder.<br>On September 17, 2014, a decision was issued rejecting the two claims, since the court found that it was not proven that the respondents (officers) made their decisions in breach of their duty, or that they deviated from the confines of their prerogative, or that they damaged Bezeq.<br>Two plaintiffs submitted appeals to the Supreme Court against the ruling, which was heard in November 2015 and awaiting a ruling. | 900, one claim                                 |
| November 2012                  |  |  | Declarative reliefs  |  | 2,640 (net) in the other                       |
| (Two claims that were unified) |  |  |  |  |  |
| April 2013                     | Shareholder vs. Bezeq and Bezeq's Controlling Shareholder, B Communications Ltd.   | District Court (Tel Aviv, Economic Department) | Declarative relief claim                                   | The Court was requested to declare that the controlling shareholder of Bezeq has a personal interest in the distribution of dividends distributed in 2013 with the approval of the general meeting, and to instruct Bezeq to publish information and documents, and to summon economy experts whose opinions were published by Bezeq.  | **   |

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

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

| Date        | Parties*           | Instance                  | Type of proceeding                                 | Description  | Original Amount of the Claim (NIS in millions) |
|-------------|--------------------|---------------------------|--|--|--|
| August 2015 | Customer vs. Bezeq | District Court (Tel Aviv) | Action and request to approve it as a class action | <p>It was alleged that Bezeq abused its position as a monopoly to price its services in a manner that limits the ability of its competitors to offer fixed-line telephony services at competitive prices, among other things, by offering its customers fixed-line telephony services at the lowest price charged for infrastructure services only. In November 2014, the Antitrust Authority ruled that Bezeq abused its position as a monopoly and Bezeq filed an appeal with the Antitrust Tribunal against the ruling. The plaintiff argued that the damage to the public resulting from the above was estimated by reviewing the difference between the fixed-line telephony market price compared with the hypothetical price that would be charged in a market with weighted competition that would lead to reduced prices in the long term. According to the plaintiff's claims, the members of the represented group are all fixed-line telephony service subscribers, whether provided by Bezeq or its competitors, including through VoB technology, as of January 15, 2011 until the date of filing the application.</p> <p>In November 2015, Bezeq filed a motion for a stay of proceedings in the case for reasons of pending proceedings at the Antitrust Tribunal, which is deliberating the issues of the same nature as those at the center of the approval application.</p> | 244  |

| Date          | Parties*           | Instance               | Type of proceeding                                     | Description   | Original Amount of the Claim (NIS in millions) |
|---------------|--------------------|------------------------|--|---|--|
| November 2015 | Customer vs. Bezeq | Central District Court | Action and request for certification as a class action | It was alleged that Bezeq abused its position as a monopoly by "preventing and blocking competition in general and effective competition in the Israeli communication market) and thereby causing damage to the Israeli public and earning unreasonable profits as a result of abusing its power as a monopoly. According to the plaintiffs' allegations, the damage caused by Bezeq to the communication market in Israel is expressed by Bezeq's excessive and unreasonable profits and they claimed damages of NIS 800 million, which they allege is based on 10% of Bezeq's surplus operating income stemming from abuse of its monopolistic power. Accordingly, the plaintiffs set the amount of the claim at NIS 556 million, after the amount was reduced in another action (an application for certification of a class action dated August 2015, which is described above, for NIS 244 million for claimed abuse of monopolistic power and refers to the Antitrust Commissioner's decision). | 556  |

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

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

- \* Part of the proceedings were originally filed also against additional defendants that were removed later on from the proceedings. The parties indicated in the table are according to the current situation.
- \*\* The amount of the claim is not indicated, or the claim is not a financial claim.



## ***Pelephone***

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

| <b>Date</b>   | <b>Parties</b>  | <b>Court</b>         | <b>Type of Action</b>  | <b>Details</b>  | <b>Amount of Claim<br/>NIS million</b>  |
|---------------|---|----------------------|--|---|---|
| August 2010   | Customer v. Pelephone                                 | District (Central)   | A financial claim filed with a motion to certify it as a class action. | The claimant claims that Pelephone should refrain from collecting Value Added Tax from customers who use its services when they are outside Israel. The motion also contains relief for an order instructing Pelephone to cease charging its customers VAT for such services which they use outside Israel, and an order instructing that the moneys collected to date be refunded. In August 2014 the Court dismissed the application for recognition. As a class action. In October 2014 an appeal of the ruling was filed. | The amount of the claim is not stated, but the application is estimated in the tens of millions of shekels. |
| February 2012 | Customer v. Pelephone, the Bezeq, Cellcom and Partner | District (Jerusalem) | A financial claim filed with a motion to certify it as a class action. | The action relates to the alleged failure to comply with the provisions of the law with respect to people with disabilities when rendering Bezeq's services. In December 2015 a settlement was signed between the parties to drop the suit in return for implementing a series of accessibility adjustments and benefits for people with disabilities set out in the settlement. This arrangement was submitted to the court and is awaiting approval.  | Approximately 361 for all the defendants, without noting an amount for each of the defendants.              |

| Date          | Parties                                    | Court               | Type of Action   | Details   | Amount of Claim<br>NIS million  |
|---------------|--|---------------------|--|---|---|
| May 2012      | Customer v. Pelephone                      | District (Tel Aviv) | Civil class action   | The claimant alleges that Pelephone does not inform customers wishing to subscribe for its services using a handset that was not purchased from Pelephone, that if the handset does not support the 850 MHz frequency, they will only get partial reception over one frequency rather than two. In March 2014, the court certified the claim as a class action, which was subsequent to Pelephone announcing its agreement (for reasons of efficiency) to conduct the claim as a class action, while retaining its arguments.               | 124   |
| August 2012   | Customer v. Pelephone, Partner and Cellcom | District (Central)  | A financial claim filed with a motion to certify it as a class action. | The claimants allege that under the repair services provided by the defendants for a fee (payment per repair or a monthly fee for repair service), if a certain part in the handset must be replaced, the defendants do not provide the customer with the spare part in contravention of the law. The claimants also allege that the defendants reuse the replaced parts when providing repair services for other customers, thus ostensibly enriching themselves twice. The action also requests writs of mandamus and declaratory relief. | Approximately 120 for each of the defendants, in a total amount of 360. |
| November 2013 | Customer v. Pelephone                      | District (Tel Aviv) | A financial claim filed with a motion to certify it as a class action. | The claimants allege that Pelephone does not grant the same perks to all its customers, thereby distinguishing between those customers that they allege Pelephone considers to be highly valuable and others, which they claim is in breach of Pelephone's license and the law. They also request as remedy that Pelephone refrain from granting such perks. The case is in mediation proceedings between the parties.  | 300   |

| Date          | Parties   | Court               | Type of Action   | Details  | Amount of Claim<br>NIS million   |
|---------------|---|---------------------|--|--|--|
| May 2015      | Customer v. Pelephone                               | District (Tel Aviv) | A financial claim filed with a motion to certify it as a class action. | The claimants allege that Pelephone does not offer "Walla Mobile" tracks to all its existing customers and those who join are subscribers who want to transfer to a different track, and that this in violation of the provisions of the license that obligates equality, and thereby it misleads its customers.   | The amount of the claim is not stated, but the application is estimated to be in millions of shekels.                  |
| August 2015   | Customer v. Pelephone                               | District (Central)  | A financial claim filed with a motion to certify it as a class action. | The claimants allege that one of the communications companies made improper use of its database in violation of the Privacy Protection Law 1981, when it transferred or sold the customers' particulars to the other respondents, including Pelephone. The claim against Pelephone revolves mainly around the purchase or receipt of this information and its use for marketing purposes in a way that violates the provisions of the Communications Law regarding sending of spam. The applicant does not specifically mention the amount of the claim against Pelephone. | The amount of the claim is not stated, but the application is estimated in the tens of millions of shekels.            |
| November 2015 | Customer v. Pelephone and other cellular companies. | District (Central)  | A financial claim filed with a motion to certify it as a class action. | The claimants allege that the pre-paid prices of the companies are higher than the post-paid prices, which is due to cartelization of the three companies in this market.  | Approximately 2,800 with regard to Pelephone (and the total amount against the three companies is in excess of 13,000) |

| Date           | Parties               | Court               | Type of Action   | Details   | Amount of Claim<br>NIS million  |
|----------------|-----------------------|---------------------|--|---|---|
| December 2015. | Customer v. Pelephone | District (Lod)      | A financial claim filed with a motion to certify it as a class action. | The claimants allege that Pelephone violates the mobility plan / rules in that, when attempting to move to another operator (the receiving operator) the applicant found out that she was deliberately blocked by Pelephone (the deserted operator) from moving. When calling Pelephone to clarify the issue, she alleges that she found out that reason for blocking her was an attempt to retain her and prevent her from moving to a competitor. In addition, injunctions are sought to prevent such blocking. | The amount of the claim is not stated, but the application is estimated in Tens of millions.  |
| March 2016     | Customer v. Pelephone | District (Tel Aviv) | A financial claim filed with a motion to certify it as a class action. | Due to a widespread disruption of Pelephone's network on March 21, 2016, which originated from a fire in one of its facilities, Pelephone's customers were (fully or partially) denied the possibility of receiving services they were entitled to receive, including sending and receiving calls, messages and cellular Internet service.  | Reimbursement of the pro rata payment paid by each customer plus an additional NIS 10 per private customer and NIS 1,010 per business customer. |

#### Legal proceedings that ended during the Reporting Period

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

**Bezeq International**

| Date           | Parties   | Court              | Type of Action   | Details   | Amount of Claim<br>NIS million |
|----------------|---|--------------------|--|---|--------------------------------|
| 2008           | Customer v. Bezeq International and other international operators | District (Central) | A financial claim filed with a motion to certify it as a class action.                   | Four claims, which were consolidated to form one suit relating to the use of international phone cards for dialing to destinations in the Philippines, Thailand and Nepal. The plaintiffs, who are foreign workers, claimed that the phone cards provided an average of 50% of the time units indicated to the purchasers of the cards, and that Bezeq International also deducts call time for time unsuccessfully spent attempting to call someone, contrary to the declaration that it does not charge for units of round minutes, provides misleading information about the number of units on the card and formed a cartel with other international telecommunication companies regarding raising the prices for phone cards. The plaintiffs sought court recognition to file their claim as a class action on behalf of a group that includes anyone who purchased the relevant type of phone cards during the seven years prior to filing the claim and throughout the duration of the proceedings. The plaintiffs also petitioned the Court to order Bezeq International to cease its foregoing conduct. In November 2010, the Court recognized the motion to certify a class action on the grounds of deception. Nonetheless, the Court dismissed part of the causes of action and determined that the deception ended after the purchase of several phone cards. A request to appeal filed by Bezeq International was denied in September 2012 due to the settlement agreement signed between the other defendants in the proceedings and the plaintiffs. | 1,159                          |
| December 2011. | Customer v. Bezeq International                                   | District (Central) | A financial claim filed with a motion to certify it as a class action (certified since). | According to the plaintiffs, during October 2011, Bezeq International failed to provide its Internet customers with the browsing speed it had undertaken in the contract. The plaintiffs sought refund of the monthly fees and compensation for mental anguish.   | 120                            |

| Date           | Parties   | Court               | Type of Action   | Details  | Amount of Claim<br>NIS million   |
|----------------|---|---------------------|--|--|--|
| February 2012  | Customer v. Bezeq International and other international operators | District (Tel Aviv) | A financial claim filed with a motion to certify it as a class action. | Similar to the foregoing in line A above, the plaintiffs alleged that the defendants misled customers who purchased overseas dialing services by means of pre-paid international phone cards, with respect to the number of minutes on the card.   | 2,700  |
| January 2015   | Customer v. Bezeq International                                   | District (Central)  | A financial claim filed with a motion to certify it as a class action. | They claimed that the Moreshet content filtering services that Bezeq International provides for its religious and traditional sector customers, for a fee, do not protect users from offensive content and that their exposure to such content caused them harm. The claimants also demanded that Bezeq International compensate the customers who purchased content filtering services and who were not offered the basic filtering service which is provided free of charge. | Approximately 65, with the addition of NIS 1,000 for each member of the group, the size of which is unknown. |
| December 2015. | Customer v. Bezeq International                                   | District (Central)  | A financial claim filed with a motion to certify it as a class action. | The claimants alleged that Bezeq International charged the listed customers for an overseas dialing plan at "premium prices" that were higher than the agreed price fixed in the communications plan. The plaintiffs contend that Bezeq International exceeded the applicability of the plan, fixed line destinations overseas and defined them as "premium destinations", without basis and by misleading customers.  | Not noted.   |

| Date       | Parties         | Court              | Type of Action   | Details  | Amount of Claim  |
|------------|-----------------|--------------------|--|--|--|
| March 2013 | Customer v. DBS | District (Central) | A financial claim filed with a motion to certify it as a class action. | The applicant claims that DBS disconnected customers from channel 5+ and reconnected them only after the customers contacted Bezeq and requested reconnection but continued collecting fees for the channel from those customers who did not contact them and were, therefore, not reconnected. The parties conducted negotiations to end the proceedings by settlement. In May 2015 the parties filed a motion with the court to approve a settlement under which DBS will grant the members of the class action group a benefit and will pay compensation to the class action plaintiff and his legal fees ("the Settlement Agreement"). In September 2015, the Attorney General's position regarding the settlement agreement was received according to which the settlement agreement should not be approved because it does not provide real compensation for the group members. During the hearing before the Court in December 2015 on the motion to approve the settlement arrangement, the Court suggested that the parties amend the settlement so that part of the group members will be given a higher credit to purchase DBS products and another part will not be given the benefit. In February 2016, DBS filed an amended recommendation to the Court that it grant a credit to part of the group members only in a higher amount (with two alternatives) in the different credit format than that suggested by the Court. | The applicant estimates the damage to himself at NIS 1,065 of which NIS 1,000 is non-monetary damage, but did not include a total amount for the suit. |

| Date           | Parties   | Court               | Type of Action  | Details   | Amount of Claim  |
|----------------|---|---------------------|---|---|--|
| June 2014      | Customer and apartment building representatives vs. DBS | District (Tel Aviv) | A financial claim filed with a motion (consolidated) to certify it as a class action. | <p>The claimants allege that DBS unlawfully charged residents in apartment buildings (both subscribers and non-subscribers) for the electricity consumption for the satellite dishes and/or amplifiers and/or other devices that DBS uses that are located in these apartment buildings. The applicant also petitioned the Court to order DBS to refund the amount collected for electricity consumption as aforesaid.</p> <p>The second lawsuit (that was originally filed with the District Court in Haifa, and was moved for hearing before the District Court in Tel Aviv in September 2014) includes a claim that DBS installed equipment in apartment buildings that operate on electricity and according to their claim, DBS connected the outside equipment without approval and consent of the apartment buildings in which the equipment was connected to the communal electricity and also consumed electricity without paying for it.</p> <p>In October 2015, the Court consolidated the proceedings for certification and filing of consolidated statements.</p> | NIS 80 million is for monetary and non-monetary damages allegedly caused due to the electricity consumption for DBS systems and an injunction ordering DBS to install electricity meters for measuring the electricity consumption of DBS's systems. The costs were estimated in the motion to amount to NIS 44.6 million. |
| September 2014 | Customer v. DBS   | District (Tel Aviv) | A financial claim filed with a motion to certify it as a class action.                | <p>The claimants allege that electronic advertisements sent by DBS to its customers were in contravention of Section 30A of the Communications Law, in breach of DBS's license and breach of the agreement between DBS and its customers. The applicants petitioned the Court for relief for the inconvenience caused to the customers of DBS, harassment, loss of time, etc. and relief in an amount that will be determined at the Court's discretion, for the unlawful enrichment of DBS as a result of sending these messages.</p>  | NIS 402 million (with additional relief to be determined at the court's discretion).   |



| Date                        | Parties         | Court               | Type of Action   | Details  | Amount of Claim  |
|-----------------------------|-----------------|---------------------|--|--|--|
| July 2015<br>September 2015 | Customer v. DBS | District (Central)  | A financial claim filed with a motion to certify it as a class action. | The claimants allege discrimination against DBS customers who are not offered or given the best terms or the lowest price for the services they received from DBS; a claim of discrimination against new DBS customers over existing customers who are eligible for receiving a campaign or benefit for joining DBS; and a claim of discrimination of new members who are acquainted with the Bezeq's employees, over other new members. According to the allegations, these actions are contrary to DBS's obligations under its license and by law to refrain from discriminating with regard to the price for the services it provides. The applicant requested that DBS compensate members of the group for the monetary difference between the price that each of them actually paid to DBS for the services, and the lowest price they could have paid for those services. In addition, the applicant requests that the Court order DBS to offer and provide its services to everyone requesting its services at the same terms and to publish them in its various publications. In September 2015, following the filing of another motion to certify a class action against DBS, the Court held that the two actions will be defined as related cases and in November 2015 the Court ordered the consolidation of two motions. | The applicant does not specify the amount of the claim, but the extent of the damage is estimated to be tens of millions of shekel.<br><br>The amount of the second claim is estimated by the applicants to be NIS 13 million plus monetary damages as will be awarded by the Court, |
| December 2015               | Customer v. DBS | District (Central)  | A financial claim filed with a motion to certify it as a class action. | A claim that DBS and HOT operate illegally by providing their customers with premium content services, (as part of the VOD service of DBS and HOT), that is provided under transactions for fixed periods and automatically renewable, while charging their customers for the service unilaterally, without the clients' consent and in violation of the law. The claimant alleges that DBS and HOT charge their customers illegal amounts while enriching themselves unjustly.  | The applicants do not explicitly mention the amount of the claim, but believe that the conduct described provides DBS and HOT annual income of tens of millions of shekels.  |
| April 2016                  | Customer v. DBS | District (Tel Aviv) | A claim filed with a motion to certify it as a class action.           | A claim that DBS applied "freezing" a subscription for a limited time period and avoiding payment of subscription fees for such period, in a discriminatory and unreasonable term in a standard contract.  | NIS 736 million  |

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

|    | Date of filing of the action | Parties         | Court               | Type of Action   | Details  | Amount of Claim |
|----|------------------------------|-----------------|---------------------|--|--|-----------------|
| A. | February 2015                | Customer v. DBS | District (Tel Aviv) | A financial claim filed with a motion to certify it as a class action. | It was claimed that the way subtitles are inserted in DBS's television broadcasts detract from the enjoyment of its hearing impaired customers. Thus, it is claimed that DBS misleads its customers regarding the quality of the service it provides and unjust enrichment. The applicant sought compensation for the alleged damages caused to users due to DBS's alleged deception. In July 2015 a ruling was issued according to which the Court approved the motion for withdrawal filed by the applicant, with DBS's agreement. | NIS 126 million |

## Dividend Distribution Policy

We have never paid cash dividends to our shareholders and do not currently have a dividend distribution policy in place.

B Communications declared its first dividend as a public company on November 7, 2013, a dividend of NIS 3.41 per share and NIS 102 million in the aggregate. The record date for the distribution of the dividend was November 18, 2013 and the payment date was December 3, 2013. Dividend amounts paid in U.S. dollars were converted from NIS based upon the representative rate of exchange published by the Bank of Israel on November 18, 2013. Tax was withheld at a rate of up to 25%.

On May 21, 2015, B Communications declared a dividend of NIS 2.24 per share (approximately \$0.58 cents) and approximately NIS 67 million (approximately \$17 million) in the aggregate. Tax was withheld at a rate of 25%. Dividend amounts paid in U.S. dollars were converted from NIS based on the representative rate of exchange published by the Bank of Israel on June 1, 2015. The record date for the distribution of the dividend was June 2, 2015 and the payment date was June 16, 2015.

On August 31, 2015, B Communications declared a dividend of NIS 0.73 per share (approximately \$0.19) and approximately NIS 22 million (approximately \$6 million) in the aggregate. Dividend amounts paid in U.S. dollars were converted from NIS based upon the representative rate of exchange published by the Bank of Israel on September 16, 2015. The record date for the distribution of the dividend was September 16, 2015 and the payment date was September 29, 2015.

On November 19, 2015, B Communications declared a dividend of NIS 1.27 per share (approximately \$0.32) and approximately NIS 38 million (approximately \$10 million) in the aggregate. Dividend amounts paid in U.S. dollars were converted from NIS based upon the representative rate of exchange published by the Bank of Israel on December 10, 2015. The record date for the distribution of the dividend was December 10, 2015 and the payment date was December 23, 2015.

According to the Israeli Companies Law, a company may distribute dividends out of its profits (as such term is defined in the Israeli Companies Law), provided that there is no reasonable concern that payment of the dividend will prevent the company from satisfying all its current and foreseeable obligations, as they become due. Notwithstanding the foregoing, dividends may be paid with the approval of a court, at the company's request, provided that there is no reasonable concern that payment of the dividend will prevent the company from satisfying its current and foreseeable obligations, as they become due. In the event cash dividends are declared, such dividends will be paid in NIS.

## B. Significant Changes

Except as otherwise disclosed in this annual report, no significant change has occurred since December 31, 2015.

## ITEM 9. THE OFFER AND LISTING

### A. Offer and Listing Details

#### Annual Stock Information

The following table sets forth, for each of the years indicated, the high and low market prices of our ordinary shares on the NASDAQ and the TASE.

|      | NASDAQ   |          | TASE       |           |
|------|----------|----------|------------|-----------|
|      | High     | Low      | High       | Low       |
| 2011 | \$ 35.25 | \$ 10.42 | NIS 124.00 | NIS 38.41 |
| 2012 | \$ 11.71 | \$ 1.92  | NIS 45.07  | NIS 7.79  |
| 2013 | \$ 14.97 | \$ 2.65  | NIS 53.00  | NIS 9.91  |
| 2014 | \$ 11.24 | \$ 6.37  | NIS 39.33  | NIS 23.20 |
| 2015 | \$ 12.12 | \$ 4.01  | NIS 47.22  | NIS 15.68 |

#### Quarterly Stock Information

The following table sets forth, for each of the full financial quarters in the two most recent full financial years and any subsequent period, the high and low market prices of our ordinary shares on the NASDAQ Global Select Market and the TASE:

|                                   | NASDAQ   |          | TASE      |           |
|-----------------------------------|----------|----------|-----------|-----------|
|                                   | High     | Low      | High      | Low       |
| <b>2014</b>                       |          |          |           |           |
| First Quarter                     | \$ 10.14 | \$ 6.63  | NIS 35.51 | NIS 23.20 |
| Second Quarter                    | \$ 11.24 | \$ 9.00  | NIS 39.33 | NIS 31.12 |
| Third Quarter                     | \$ 10.50 | \$ 8.76  | NIS 35.46 | NIS 31.57 |
| Fourth Quarter                    | \$ 9.99  | \$ 6.37  | NIS 37.22 | NIS 24.45 |
| <b>2015</b>                       |          |          |           |           |
| First Quarter                     | \$ 6.52  | \$ 4.02  | NIS26.35  | NIS15.68  |
| Second Quarter                    | \$ 5.43  | \$ 4.01  | NIS21.68  | NIS15.83  |
| Third Quarter                     | \$ 8.36  | \$ 4.61  | NIS32.82  | NIS17.66  |
| Fourth Quarter                    | \$ 12.12 | \$ 7.97  | NIS47.22  | NIS31.17  |
| <b>2016</b>                       |          |          |           |           |
| First Quarter                     | \$ 17.82 | \$ 9.50  | NIS65.45  | NIS37.67  |
| Second Quarter (through April 18) | \$ 15.32 | \$ 13.32 | NIS57.90  | NIS49.10  |

## Monthly Stock Information

The following table sets forth, for the most recent six months, the high and low market prices of our ordinary shares on the NASDAQ Global Select Market and the TASE:

|                               | NASDAQ   |          | TASE     |          |
|-------------------------------|----------|----------|----------|----------|
|                               | High     | Low      | High     | Low      |
| November 2015                 | \$ 12.12 | \$ 10.25 | NIS47.22 | NIS40.05 |
| December 2015                 | \$ 11.81 | \$ 10.68 | NIS44.94 | NIS41.41 |
| January 2016                  | \$ 11.25 | \$ 9.5   | NIS42.67 | NIS37.67 |
| February 2016                 | \$ 14.19 | \$ 11.12 | NIS55.55 | NIS40.04 |
| March 2016                    | \$ 17.82 | \$ 13.62 | NIS65.45 | NIS50.70 |
| April 2016 (through April 18) | \$ 15.32 | \$ 13.32 | NIS57.90 | NIS49.10 |

### B. Plan of Distribution

Not applicable.

### C. Markets

Our ordinary shares were listed on the NASDAQ Global Market (symbol: IGLD) from our initial public offering in August, 1999 until July 21, 2001, at which date the listing of our ordinary shares was transferred to the NASDAQ Capital Market. From February 4, 2005 until December 31, 2010, our shares once again were listed on the NASDAQ Global Market and since January 1, 2011 our ordinary shares have been listed on the NASDAQ Global Select Market. Since March 1, 2005, our ordinary shares have also been traded on the TASE.

### D. Selling Shareholders

Not applicable.

### E. Dilution

Not applicable.

### F. Expense of the Issue

Not applicable.

## ITEM 10. ADDITIONAL INFORMATION

### A. Share Capital

Not applicable.

### B. Memorandum and Articles of Association

*Below is a description of certain provisions of our Articles of Association and of the Israeli Companies Law related to such provisions. This description is only a summary and does not purport to be complete and is qualified by reference to the full text of the Articles of Association, of our company which has been filed as an exhibit to this Annual Report and which is incorporated by reference, and to Israeli law.*

### Purposes and Objects of the Company

We are a public company registered under the Israel Companies Law as Internet Gold – Golden Lines Ltd., registration number 52-004426-4. Pursuant to our memorandum of association, we were formed for the purpose of providing various services in the telecommunication industry and performing various corporate activities permissible under Israeli law.

## The Powers of the Directors

Under the provisions of the Israeli Companies Law and our Articles of Association, a director cannot participate in a meeting nor vote on a proposal, arrangement or contract in which he or she is materially interested unless such proposal, arrangement or contract is in the ordinary course of business or the majority of directors are personally interested in such proposal, arrangement or contract. In the event the majority of the members of the board of directors have a personal interest in the proposed transaction, approval of our shareholders at a general meeting is required. In addition, our directors cannot vote compensation to themselves or any members of their body without the approval of our compensation committee and, unless exempted under the regulations promulgated under the Israeli Companies Law, our shareholders at a general meeting. If the compensation of our directors is inconsistent with our stated compensation policy, then the approval of our shareholders requires that either:

- at least a majority of the shares held by all shareholders who are not controlling shareholders and do not have a personal interest in such matter, present and voting at such meeting, are voted in favor of the compensation package, excluding abstentions; or
- the total number of shares of non-controlling shareholders and shareholders who do not have a personal interest in such matter voting against the compensation package does not exceed 2% of the aggregate voting rights in the company.

The authority of our directors to enter into borrowing arrangements on our behalf is not limited, except in the same manner as any other transaction by us.

Under our Articles of Association, retirement of directors from office is not subject to any age limitation and our directors are not required to own shares in our company in order to qualify to serve as directors.

## Rights Attached to Shares

Our authorized share capital consists of 50,000,000 ordinary shares of a nominal value of NIS 0.1 each. All of our issued and outstanding ordinary shares are duly authorized, validly issued, fully paid and non-assessable. Our ordinary shares are not redeemable and do not have preemptive rights.

**Dividend and Liquidation Rights.** The holders of the ordinary shares will be entitled to their proportionate share of any cash dividend, share dividend or dividend in kind declared with respect to our ordinary shares. Our board of directors may declare a dividend to be paid to the holders of ordinary shares in proportion to the paid up capital attributable to the shares that they hold. Dividends may only be paid out of our profits and other surplus funds, as defined in the Israeli Companies Law, as of the end of the most recent fiscal year or as accrued over a period of two years, whichever is higher, provided that there is no reasonable concern that a payment of a dividend will prevent us from satisfying our existing and foreseeable obligations as they become due. If we do not meet the profit requirement, we may seek the approval of the court to distribute a dividend. The court may approve our request if it is convinced that there is no reasonable risk that a distribution might prevent us from satisfying our existing and anticipated obligations as they become due.

Under the Israeli Companies Law, a dividend declaration must be approved by the board of directors and does not require the approval of the shareholders of a company unless the company's articles of association provide otherwise. Our articles of association do not require shareholder approval of a dividend distribution.

In the event of our liquidation, after satisfaction of liabilities to creditors, our assets will be distributed to the holders of ordinary shares in proportion to the paid up capital attributable to the shares that they hold. Dividend and liquidation rights may be affected by the grant of preferential dividend or distribution rights to the holders of a class of shares with preferential rights that may be authorized in the future.

**Exceptional Holdings; Principal Shareholders.** Under the Communications Order, no person may hold, directly or indirectly, “significant influence” over Bezeq or 5% or more of any particular class of means of control in Bezeq, nor may any person, together with any other person, appoint, elect or dismiss the general manager of Bezeq or cause the election, appointment or dismissal of any director of Bezeq, without the prior written consent of the Prime Minister of Israel and the Israeli Minister of Communications. Subject to certain exceptions, prior written approval of such Ministers is also required to increase the holdings or other rights in excess of those determined in the initial approval, including by means of an agreement (including a voting agreement). Furthermore, under the Communications Order, no person may transfer control, “significant influence” or means of control in Bezeq to another, if, as a result of the transfer, the holdings of the transferee would require approval pursuant to the Communications Law or Communications Order and the transferee is not in possession of the requisite approval. Any such unauthorized acquisition is referred to as “Exceptional Holdings.” For the foregoing purposes, “significant influence” means the ability to significantly influence the activity of a corporation, whether alone or together with or through others, directly or indirectly, other than as a result of holding “means of control” in that corporation or in another corporation, and including ability derived from the corporation’s articles of association, a written, oral or other kind of agreement, or from any other source. In this context, the right to appoint an officer and holding 25% of our “means of control” is presumed to confer significant influence. “Means of control” means the right to vote at a general meeting of the company, to appoint a director or general manager of the company, to participate in the profits of the company or a share of the remaining assets of the company after payment of its debts upon liquidation.

In compliance with the Communications Law and Communications Order following our acquisition of the controlling interest in Bezeq, our Articles of Association provide that Exceptional Holdings will not entitle the holder to any rights in respect of such holdings, unless and to the extent permitted under the Communications Order. Accordingly, Exceptional Holdings will not have any voting rights at a general meeting of shareholders. Each shareholder participating in a general meeting of shareholders will be required to certify to us prior to the vote or, if the shareholder is voting by a proxy or any similar instrument, on such proxy card or similar instrument, as to whether or not his or her holdings in our company or his or her vote require the approval of the Prime Minister of Israel and the Israeli Minister of Communications, pursuant to the Communications Law and Communications Order. In addition, no director may be appointed, elected or removed from office by virtue of the vote of a holder of Exceptional Holdings. If a director is appointed, elected or removed from office by virtue of the vote of a holder of Exceptional Holdings, such appointment, election or removal from office shall have no effect.

Under our Articles of Association, any person holding a number of our shares that requires approval under the Communications Order shall notify us, Bezeq, the Prime Minister of Israel and the Israeli Minister of Communications of such holdings in writing, no later than 48 hours from the date of acquiring such holdings.

Our Articles of Association include reporting requirements applicable to “Principal Shareholders,” meaning a holder, directly or indirectly, of 5% of our issued and outstanding share capital. Any person who, after acquiring, directly or indirectly, shares in our company becomes a “Principal Shareholder,” is required, no later than 48 hours after becoming a Principal Shareholder, to notify us in writing, specifying the number of our shares held by such shareholder and the date on which such shareholder became a Principal Shareholder. Any person who ceases to be a Principal Shareholder is required, no later than 14 days thereafter, to notify us in writing of the date on which such person ceased to be a Principal Shareholder. In addition, a Principal Shareholder is required to notify us in writing of any aggregate change in its holdings of our shares in an aggregate amount equal to 1% or more of our outstanding share capital compared to the last notice of holdings submitted by such Principal Shareholder, no later than 48 hours after such change. In the event a Principal Shareholder fails to provide any required notice, as discussed above, then until such Principal Shareholder provides us with the requisite notice, the Principal Shareholder will not be entitled to any rights in respect of such shares and the provisions of the Communications Order with respect to the exercise of rights underlying Exceptional Holdings will apply, and the undisclosed holdings shall also be deemed “dormant shares,” as defined under the Israeli Companies Law.

Under our Articles of Associations, we are required to notify the Prime Minister of Israel and the Israeli Minister of Communications of any Exceptional Holdings immediately upon becoming aware of such event. We are also required to notify such Ministers in the event a shareholder becomes a Principal Shareholder and regarding any change in the holdings of a Principal Shareholder within 48 hours of becoming aware of such change.

**Voting Rights.** Holders of ordinary shares have one vote for each ordinary share held on all matters submitted to a vote of shareholders, subject to the restrictions described above relating to Exceptional Holdings and Principal Shareholders. Such voting rights may be affected by the grant of any special voting rights to the holders of a class of shares with preferential rights that may be authorized in the future.

## **Election of Directors**

Our ordinary shares do not have cumulative rights for the election of directors. Rather, under our articles of association, our directors (other than the external directors) are elected by a vote of the holders of a majority of the voting power represented and voting at our annual general meetings of shareholders, and hold office until the next annual general meeting of shareholders and until their successors have been elected. See Item 6C. "Directors, Senior Management and Employees - Board Practices - Election of Directors." For information regarding the election of external directors, see Item 6C. "Directors, Senior Management and Employees - Board Practices - External Directors." All the members of our Board of Directors (except the external directors) may be reelected upon completion of their term of office.

Under our Articles of Association, provisions relating to the election and removal of directors who are not external directors, within the meaning of the Israeli Companies Law, may not be modified without the prior written consent of the Israeli Minister of Communications.

Regulations promulgated under the Communications Law require that our chief executive officer, any member of our board of directors holding an executive role, as well as a majority of the members of the board of directors, be citizens and residents of the State of Israel.

## **Annual and Extraordinary Meetings**

Under the Israeli Companies Law and our articles of association, our board of directors must convene an annual meeting of shareholders at least once every calendar year and within 15 months of the last annual meeting. Depending on the matter to be voted upon, and subject to the Israeli Companies Law and regulations thereunder, notice of at least 14 days or 21 days or 35 days prior to the date of the meeting is required. Our articles of association provide that notice of a general meeting of shareholders will be delivered to all eligible shareholders by publication in two daily Hebrew language newspapers in Israel that have a reasonably-sized readership. Our board of directors may, in its discretion, convene additional meetings as "special general meetings." In addition, the board must convene a special general meeting upon the demand of: (a) two of the directors or 25% of the directors in office, (b) one or more shareholders having at least 5% of the outstanding share capital and at least 1% of the voting power in the company, or (c) one or more shareholders having at least 5% of the voting power in the company. The chairman of the board of directors presides at each of our general meetings. The chairman of the board of directors is not entitled to a vote at a general meeting in his capacity as chairman.

## **Quorum**

The quorum required for any general meeting is the presence, in person or by proxy, of shareholders holding or representing, in the aggregate, at least one third of the voting rights. No business shall be considered or determined at a general meeting, unless the requisite quorum is present within half an hour from the time designated for the general meeting. If within half an hour from the time designated for the general meeting a quorum is not present, the general meeting shall stand adjourned to the same day in the following week, at the same time and place, or to such other time as designated in the notice of such adjourned meeting. If within half an hour from the time designated for the adjourned meeting a quorum is not present, any number of shareholders present will constitute a quorum. However, if the general meeting was convened on the demand of shareholders, the adjourned meeting shall take place only if there are present at least the number of shareholders required to convene a general meeting under our articles of association (as discussed above).

A general meeting in which a quorum is present may resolve to adjourn the meeting, the discussion or the vote on a matter included in the agenda to such other time and place as it may determine. Only matters that were on the agenda and in respect of which no resolution was passed shall be discussed at the adjourned meeting.

## **Resolutions**

An ordinary resolution requires approval by the holders of a simple majority of the voting rights represented at the meeting, in person, by proxy or by written ballot, and voting on the resolution.

Under the Israeli Companies Law, unless otherwise provided in the articles of association or applicable law, all resolutions of the shareholders require a simple majority. A resolution for the voluntary winding up of the company requires approval by holders of 75% of the voting rights represented at the meeting, in person, by proxy or by written ballot and voting on the resolution.

## Modification of Class Rights

Under the Israeli Companies Law and our articles of association, any amendment, conversion, cancellation, expansion, addition to or other change in the rights, preferences, privileges, restrictions or provisions attached to any particular class of shares issued to shareholders of our company, shall require the written consent of holders of all issued shares of such particular class, or authorization by an ordinary resolution adopted at an extraordinary meeting of such class.

## Limitations on the Rights to Own Ordinary Shares in Our Company

None of our memorandum of association, our articles of association or the laws of the State of Israel restrict in any way the ownership or voting of ordinary shares by non-residents, except that shares held by citizens of countries which are in a state of war with Israel will not confer any rights to their holders unless the Minister of Finance consents otherwise.

In addition, pursuant to the Communications Order, so long as we control Bezeq, any state, government corporation or a corporation controlled by a government corporation cannot control our company. Ownership of our shares, directly or indirectly, by a government corporation requires the prior written approval of the Israeli Prime Minister and Israeli Minister of Communications, provided that the government corporation's total direct and indirect holdings in Bezeq does not exceed more than 5% of any type of "means of control" (as such term is described above) of Bezeq. Ownership by a government corporation, directly or indirectly, of 5% or more of Bezeq's outstanding shares or a "significant influence" (as such term is described above) in Bezeq requires the approval of the Prime Minister of Israel and the Israeli Minister of Communications as well as the consent of the Israeli Minister of Defense. A "Hostile State," as such term is defined in the Communications Order, a citizen or resident of a Hostile State, a corporation incorporated in a Hostile State or controlled by a resident or citizen of a Hostile State is not allowed to hold, directly or indirectly, 5% or more or a "significant influence" (as described above) in Bezeq.

## Anti-Takeover Provisions; Mergers and Acquisitions

*Full Tender Offer.* A person wishing to acquire shares, or any class of shares, of a publicly traded Israeli company and who would as a result hold over 90% of the company's issued and outstanding share capital, or a class of shares which are listed, is required by the Israeli Companies Law to make a tender offer to all of the company's shareholders for the purchase of all of the remaining issued and outstanding shares of the company, or any class of shares, as the case may be. If (i) less than 5% of the outstanding shares are not tendered in the tender offer and the majority of the offerees who have no personal interest in the acceptance of the tender offer have accepted the offer; or (ii) less than 2% of the outstanding shares are not tendered in the tender offer, all of the shares that the acquirer offered to purchase will be transferred to the acquirer by operation of law. However, the shareholders may petition the court within six months after receipt of the offer to alter the consideration for the acquisition. The Israeli Companies Law allows an acquirer to determine in the terms of the offer that offerees who accepted the offer will not be entitled to appraisal rights. If the terms described above for the completion of a tender offer are not met, the acquirer may not acquire additional shares of the company from shareholders who accepted the tender offer if following such acquisition the acquirer would then own over 90% of the company's issued and outstanding share capital.

*Special Tender Offer.* The Israeli Companies Law provides that an acquisition of shares of a public company be made by means of a special tender offer if as a result of the acquisition the purchaser would hold 25% or more of the voting rights at the company's general meeting, unless one of the exemptions described in the Israeli Companies Law are met. This rule does not apply if there is already another shareholder who holds 25% or more of the voting rights at the company's general meeting. Similarly, the Israeli Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would hold more than 45% of the voting rights of the company, if there is no other shareholder of the company who holds more than 45% of the voting rights in the company. A tender offer is not required in the following circumstances: (i) the purchase was made in a private placement that was approved by the shareholders as a private placement and was meant to grant the purchaser 25% or more of the voting rights of a company in which no other shareholder holds 25% or more of the voting rights, or to grant the purchaser more than 45% of the voting rights of a company in which no other shareholder holds more than 45% of the voting rights, (ii) the purchaser would hold 25% or more of the voting rights after purchasing shares from a person that held 25% or more of the voting rights, or (iii) the purchaser would hold more than 45% of the voting rights after purchasing shares from a person that held more than 45% of the voting rights.



*Merger.* The Israeli Companies Law permits merger transactions if approved by each party's board of directors and, unless certain requirements described under the Israeli Companies Law are met, the majority of each party's shares voted on the proposed merger at a shareholders' meeting called on at least 35 days' prior notice. Under the Israeli Companies Law, if the approval of a general meeting of the shareholders is required, merger transactions may be approved by holders of a simple majority of the shares present, in person or by proxy, at a general meeting and voting on the transaction. In determining whether the required majority has approved the merger, if shares of the company are held by the other party to the merger, or by any person holding at least 25% of the outstanding voting shares or 25% of the means of appointing directors of the other party to the merger, then a vote against the merger by holders of the majority of the shares present and voting, excluding shares held by the other party or by such person, or anyone acting on behalf of either of them, is sufficient to reject the merger transaction. If the transaction would have been approved but for the exclusion of the votes of certain shareholders as provided above, a court may still approve the merger upon the request of holders of at least 25% of the voting rights of a company, if the court holds that the merger is fair and reasonable, taking into account the value of the parties to the merger and the consideration offered to the shareholders. Upon the request of a creditor of either party to the proposed merger, the court may delay or prevent the merger if it concludes that there exists a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy the obligations of any of the parties to the merger and the court may also provide instructions to assure the rights of creditors. In addition, a merger may not be completed unless at least 50 days have passed from the date that a proposal for approval of the merger was filed with the Israeli Registrar of Companies and 30 days from the date that shareholder approval of both merging companies was obtained.

Notwithstanding the foregoing, a merger is not subject to shareholders approval of (i) the target company, if it is a wholly-owned subsidiary of the acquiring company and (ii) the acquiring company, if no changes are required to its articles and memorandum of association and it is not issuing to the shareholders of the target company more than 20% of its voting rights and no person will become, as a result of the issuance, a controlling shareholder of the acquiring company, subject to certain limitations relating to the continuing of the votes, at a meeting of the shareholders of a company that is a party to the merger, of any entity or person that is either the other party to the merger or a control person thereof.

#### **C. Material Contracts**

None.

#### **D. Exchange Controls**

Israeli laws and regulations do not impose any material foreign exchange restrictions on non-Israeli holders of our ordinary shares. In May 1998, a new "general permit" was issued under the Israeli Currency Control Law, 1978, which removed most of the restrictions that previously existed under such law, and enabled Israeli citizens to freely invest outside of Israel and freely convert Israeli currency into non-Israeli currencies.

Non-residents of Israel who purchase our ordinary shares will be able to convert dividends, if any, thereon, and any amounts payable upon our dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of our ordinary shares to an Israeli resident, into freely repatriable dollars, at the exchange rate prevailing at the time of conversion, provided that the Israeli income tax has been withheld (or paid) with respect to such amounts or an exemption has been obtained.

#### **E. Taxation**

The following is a discussion of Israeli and United States tax consequences material to our shareholders. To the extent that the discussion is based on tax legislation which has not been subject to judicial or administrative interpretation, the views expressed in the discussion might not be accepted by the tax authorities in question or by court. The discussion is not intended, and should not be construed, as legal or professional tax advice and does not exhaust all possible tax considerations.

## ISRAELI TAX CONSIDERATIONS

The following summary describes the current tax structure applicable to companies in Israel, with special reference to its effect on us. The following discussion also summarizes the material Israeli income tax consequences applicable to the purchase, ownership and disposition of our ordinary shares. This discussion does not address all of the tax consequences that may be relevant to purchasers of our ordinary shares in light of their particular circumstances, or certain types of purchasers of our ordinary shares subject to special tax treatment. Examples of this kind of investor include residents of Israel and traders in securities who are subject to special tax regimes not covered in this discussion. Each individual/entity should consult its own tax or legal advisor as to the Israeli tax consequences of the purchase, ownership and disposition of our ordinary shares. To the extent that part of the discussion is based on new tax legislation, which has not been subject to judicial or administrative interpretation, we cannot assure that the tax authorities or the courts will accept the views expressed in this section.

### General Corporate Tax Structure

The applicable Israeli company income tax rate was 25% in 2012 and 2013. In 2014 and 2015, the applicable income tax rate increased to 26.5% and commencing on January 1, 2016, the tax rate was reduced to 25%.

### Tax on Capital Gains of Shareholders

Israeli law imposes a capital gains tax on the sale of capital assets by an Israeli resident and on the sale of capital assets located in Israel or the sale of direct or indirect rights to assets located in Israel, including on the sale of our Shares by some of our shareholders (see discussion below). The Israeli Income Tax Ordinance distinguishes between “Real Gain” and “Inflationary Surplus.” Real Gain is the excess of the total capital gain over Inflationary Surplus computed on the basis of the increase in the CPI between the date of purchase and the date of sale. In 2012, the Real Gain accrued on the sale of our Shares is generally taxed at a rate of 25% for corporations (24% in 2011) and a rate of 25% for individuals (20% in 2011). Additionally, if such individual shareholder is considered a “Significant Shareholder” at any time during the 12-month period preceding such sale (i.e. if such individual shareholder holds directly or indirectly, along with others, at least 10% of any means of control in the company), the tax rate will be 30% (25% in 2011). However, the foregoing tax rates will not apply to (i) dealers in securities; and (ii) shareholders who have acquired their shares prior to an initial public offering (that may be subject to a different tax arrangement). Inflationary surplus that accrued after December 31, 1993, is exempt from tax. Generally, a semi-annual detailed return, including a computation of the tax due should be submitted to the Israeli Tax Authorities and a tax advance amounting to the tax liability arising from the capital gain is payable. At the sale of traded securities, the aforementioned detailed return may not be submitted and the tax advance should not be paid, if all tax due was withheld at the source according to applicable provisions of the Israeli Tax Ordinance and regulations promulgated thereunder. Capital gains are also reportable on annual income tax returns.

#### *Individuals*

As of January 1, 2012, a shareholder will generally be subject to tax at 25% rate on realized real capital gain (if the shareholder is a Significant Shareholder, as defined above, the tax rate will be 30%). To the extent that the shareholder claims a deduction of financing expenses, the gain will be subject to tax at a rate of 30% (until otherwise stipulated in bylaws that may be published in the future).

### Taxation of Non-Israeli Shareholders

#### *Taxation of Non-Israeli Shareholders on Receipt of Dividends*

Non-residents of Israel are generally subject to Israeli income tax on the receipt of dividends paid on our ordinary shares at the rate of 25%, which tax will be withheld at source, unless a different rate is provided in a treaty between Israel and the shareholder's country of residence.

However, the tax rate on dividends paid to a “substantial shareholder” (a shareholder who alone, or together with another person, holds, directly or indirectly, at least 10% in one or all of any of the means of control in the corporation) is 30%.

Under the U.S.-Israel Tax Treaty, the maximum rate of tax withheld in Israel on dividends paid to a holder of our ordinary shares who is a U.S. resident (within the meaning of the U.S.-Israel Tax Treaty) is 25%. Furthermore, the maximum rate of withholding tax on dividends that are paid to a U.S. corporation holding 10% or more of our outstanding voting capital during the part of the tax year that precedes the date of the payment of the dividend and during the whole of its prior tax year, is 12.5%. This reduced rate will not apply if more than 25% of the Israeli company's gross income consists of interest or dividends, other than dividends or interest received from a subsidiary corporation 50% or more of the outstanding shares of the voting shares of which are owned by the company. Investors should consult their own tax advisors to determine if they are eligible for benefits under the U.S. Israel Tax Treaty.

A non-resident of Israel who receives dividends from which tax was fully paid is generally exempt from the duty to file returns in Israel in respect of such income, provided such income was not derived from a business conducted in Israel by the taxpayer, and the taxpayer has no other taxable sources of income in Israel.

Upon a distribution of dividend the following withholding tax rates will apply: (i) Israeli resident corporations - 0%, (ii) Israeli resident individuals - 25% and (iii) non-Israeli residents (whether an individual or a corporation) - 25%, subject to a reduced tax rate under the provisions of an applicable double tax treaty, provided that a certificate from the Israeli Tax Authorities allowing for a reduced withholding tax rate is obtained in advance.

#### *Capital Gains Taxes Applicable to Non-Israeli Shareholders*

Israeli law imposes a capital gains tax on the sale of capital assets. The law distinguishes between real gain and inflationary surplus. The inflationary surplus is the portion of the total capital gain that is equivalent to the increase of the relevant asset's purchase price (net of depreciation) which is attributable to the increase in the Israeli CPI between the date of purchase and the date of sale. Foreign residents who purchased an asset in foreign currency may request that the inflationary surplus be computed on the basis of the depreciation of the NIS against such foreign currency. The real gain is the excess of the total capital gain over the inflationary surplus. The inflationary surplus accumulated from and after December 31, 1993, is exempt from any capital gains tax in Israel while the real gain is taxed at the applicable rate discussed above.

Dealers in securities in Israel are taxed at regular tax rates applicable to business income.

Under the convention between the United States and Israel concerning taxes on income, Israeli capital gains tax will not apply to the sale, exchange or disposition of ordinary shares by a person:

- who qualifies as a resident of the United States within the meaning of the U.S.-Israel tax treaty; and
- who is entitled to claim the benefits available to the person by the U.S.-Israel tax treaty.

However, this exemption does not apply, among other cases, if the gain is attributable to a permanent establishment of such person in Israel, or if the holder is a resident of the United States within the meaning of the U.S.-Israeli tax treaty who holds, directly or indirectly, shares representing 10% or more of our voting power during any part of the 12-month period preceding the sale, exchange or disposition, subject to specified conditions. Under these circumstances, the sale, exchange or disposition would be subject to Israeli tax, to the extent applicable. However, under the U.S.-Israel tax treaty, a U.S. resident generally would be permitted to claim a credit for the Israeli taxes paid against the U.S. federal income tax imposed on the sale, exchange or disposition, subject to the limitations under U.S. law applicable to foreign tax credits. The U.S.-Israel tax treaty does not relate to U.S. state or local taxes.

Under Israeli law, the capital gain from the sale of shares by non-Israeli residents is tax exempt in Israel provided that, in general, both of the following conditions are met: (A) the capital gain is not attributed to the foreign resident's permanent establishment in Israel, (B) if the seller is a corporation, less than 25% of its means of control are held by Israeli residents.

The purchaser of the shares, the stockbrokers who effected the transaction or the financial institution holding the shares through which payment to the seller is made are obligated, subject to the above-referenced exemptions if certain conditions are met, to withhold tax on the Real Gain resulting from a sale of shares at the rate of 25%.

## UNITED STATES FEDERAL INCOME TAXATION

The following is a summary of certain material U.S. federal income tax consequences of the acquisition, ownership and disposition of our ordinary shares. This description addresses only the U.S. federal income tax considerations that are relevant to U.S. Holders (as defined below) who hold our ordinary shares as capital assets. This summary is based on the U.S. Internal Revenue Code of 1986, as amended, or the Code, Treasury regulations promulgated thereunder, judicial and administrative interpretations thereof, and the U.S.-Israel Tax Treaty, or the Treaty, all as in effect on the date hereof and all of which are subject to change either prospectively or retroactively. There can be no assurance that the U.S. Internal Revenue Service, or the IRS, will not take a different position concerning the tax consequences of the acquisition, ownership and disposition of our ordinary shares or that such a position would not be sustained. This description does not address all tax considerations that may be relevant with respect to an investment in our ordinary shares. This summary does not account for the specific circumstances of any particular investor, such as:

- dealers or traders in securities, commodities or currencies;
- real estate investment trusts, regulated investment companies or grantor trusts;
- financial institutions, and insurance companies;
- tax-exempt organizations;
- certain former citizens or residents of the United States;
- U.S. Holders (as defined below) whose functional currency is not the U.S. dollar;
- persons who hold the ordinary shares through partnerships or other pass-through entities;
- persons who acquire their ordinary shares through the exercise or cancellation of employee stock options or otherwise as compensation for services;
- investors that actually or constructively own 10% or more of our shares by vote or value, or
- investors holding ordinary shares as part of a straddle, an appreciated financial position, a hedging transaction or a conversion transaction.

Moreover, this description does not address the U.S. federal estate, gift, or alternative minimum tax consequences, or any U.S. state, local or non-U.S. tax consequences of the acquisition, ownership and disposition of our ordinary shares. Holders should consult their own tax advisers concerning the U.S. federal, state, local and foreign tax consequences of acquiring, owning and disposing of our ADSs and warrants in their particular circumstances.

If a partnership or an entity treated as a partnership for U.S. federal income tax purposes owns ordinary shares, the U.S. federal income tax treatment of a partner in such a partnership will generally depend upon the status of the partner and the activities of the partnership. A partnership that owns ordinary shares and the partners in such partnership should consult their tax advisors about the U.S. federal income tax consequences of holding and disposing of ordinary shares.

For purposes of this summary, a U.S. Holder is:

- an individual who is a citizen or, for U.S. federal income tax purposes, a resident of the United States;
- a corporation or other entity taxable as a corporation created or organized in or under the laws of the United States or any political subdivision thereof;
- an estate whose income is subject to U.S. federal income tax regardless of its source; or
- a trust that (a) is subject to the primary supervision of a court within the United States and the control of one or more U.S. persons or (b) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

A "Non-U.S. Holder" is a beneficial owner of our ordinary shares that is not a U.S. Holder.

## Taxation of Dividends and Other Distributions on Our Ordinary Shares

Subject to the discussion, below, under the heading “—Passive Foreign Investment Companies,” the gross amount of any distributions received with respect to our ordinary shares, including the amount of any Israeli taxes withheld therefrom, will constitute dividends for U.S. federal income tax purposes to the extent of our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. Dividends are included in gross income as ordinary income. Distributions in excess of our current and accumulated earnings and profits will be treated as a non-taxable return of capital to the extent of your tax basis in our ordinary shares and any amount in excess of your tax basis will be treated as capital gain from the sale of ordinary shares. See “—Disposition of Ordinary Shares” below for a discussion of the taxation of capital gains. Our dividends will not qualify for the dividends-received deduction generally available to corporations under section 243 of the Code.

Dividends that we pay in NIS, including the amount of any Israeli taxes withheld therefrom, will be included in your income in a U.S. dollar amount calculated by reference to the exchange rate in effect on the day such dividends are distributed, regardless of whether the payment is in fact converted into U.S. dollars. A U.S. Holder who receives payment in NIS and converts NIS into U.S. dollars at an exchange rate other than the rate in effect on such day may have a foreign currency exchange gain or loss that would generally be treated as U.S.-source ordinary income or loss. If dividends received in NIS are converted into U.S. dollars on the day they are received, a U.S. Holder generally should not be required to recognize foreign currency gain or loss in respect of the dividend.

U.S. Holders should consult their own tax advisors concerning the U.S. tax consequences of acquiring, holding and disposing of NIS and converting NIS into U.S. dollars.

Subject to complex limitations, some of which vary depending upon the U.S. Holder's circumstances, any Israeli withholding tax imposed on dividends paid with respect to our ordinary shares will be a foreign source income tax that is eligible for credit against a U.S. Holder's U.S. federal income tax liability (or, alternatively, for deduction against U.S. income tax in determining such tax liability). The limitation on foreign income taxes eligible for credit is calculated separately with respect to specific classes of income. Dividends generally are treated as foreign-source passive category income or, in the case of certain U.S. Holders, general category income for purposes of computing the U.S. foreign tax credit. Further, there are special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to a reduced tax rate (see discussion below). A U.S. Holder may be denied a foreign tax credit with respect to Israeli income tax withheld from dividends received on our ordinary shares to the extent such U.S. Holder has not held the ordinary shares for at least 16 days of the 31-day period beginning on the date which is 15 days before the ex-dividend date or to the extent such U.S. Holder is under an obligation to make related payments with respect to substantially similar or related property. Any days during which a U.S. Holder has substantially diminished its risk of loss on the ordinary shares are not counted toward meeting the 16-day holding period required by the statute. The U.S. rules relating to the foreign tax credit are complex, and you should consult with your own tax advisors to determine whether and to what extent you would be entitled to this credit.

Subject to certain limitations, “qualified dividend income” received by a non-corporate U.S. Holder will be subject to tax at the lower long-term capital gain rates (currently a maximum of 20%). Distributions taxable as dividends paid on our ordinary shares should qualify for a reduced rate provided that either: (i) we are entitled to benefits under the Treaty or (ii) our ordinary shares are readily tradable on an established securities market in the United States and certain other requirements are met. We believe that we are entitled to benefits under the Treaty and that our ordinary shares currently are readily tradable on an established securities market in the United States. However, no assurance can be given that our ordinary shares will remain readily tradable. The reduced rate does not apply unless certain holding period requirements are satisfied. With respect to the ordinary shares, the U.S. Holder must have held such shares for at least 61 days during the 121-day period beginning 60 days before the ex-dividend date. The reduced rate also does not apply to dividends received from a PFIC (see discussion below), in respect of certain hedged positions, or in certain other situations. The legislation enacting the reduced tax rate on qualified dividend income contains special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to the reduced tax rate. U.S. Holders of our ordinary shares should consult their own tax advisors regarding the effect of these rules in their particular circumstances.

## Sale or other Disposition of Ordinary Shares

If you sell or otherwise dispose of our ordinary shares, you will generally recognize gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the amount realized on the sale or other disposition and your adjusted tax basis in our ordinary shares. Subject to the discussion below under the heading “Passive Foreign Investment Companies,” such gain or loss will generally be capital gain or loss and will be long-term capital gain or loss if you have held the ordinary shares for more than one year at the time of the sale or other disposition. Long-term capital gain realized by a non-corporate U.S. Holder is generally eligible for a preferential tax rate (currently a maximum of 20%). In general, any gain that you recognize on the sale or other disposition of ordinary shares will be U.S.-source for purposes of the foreign tax credit limitation; losses will generally be allocated against U.S. source income. Deduction of capital losses is subject to certain limitations under the Code.

In the case of a cash basis U.S. Holder who receives NIS in connection with the sale or disposition of our ordinary shares, the amount realized will be based on the U.S. dollar value of the NIS received with respect to the ordinary shares as determined on the settlement date of such sale or other disposition. A cash basis U.S. Holder who receives payment in NIS and converts NIS into U.S. dollars at a conversion rate other than the rate in effect on the settlement date may have a foreign currency exchange gain or loss, which would generally be treated as ordinary income or loss. A foreign tax credit for foreign taxes imposed on capital gains may be denied if you do not satisfy certain minimum holding period requirements. The rules relating to the determination of the foreign tax credit are complex, and it is possible that the ability of a U.S. Holder to claim a foreign tax credit for any such Israeli tax will be limited. You should consult your tax advisor to determine whether, and to what extent, you will be entitled to this credit.

An accrual basis U.S. Holder may elect the same treatment required of cash basis taxpayers with respect to foreign currency gain or loss realized on a sale or disposition of our ordinary shares that are traded on an established securities market, provided that the election is applied consistently from year to year. Such election may not be changed without the consent of the IRS. In the event that an accrual basis U.S. Holder does not elect to be treated as a cash basis taxpayer for this purpose (pursuant to the Treasury regulations applicable to foreign currency transactions), such U.S. Holder may have a foreign currency gain or loss for U.S. federal income tax purposes because of differences between the U.S. dollar value of the currency received prevailing on the trade date and the settlement date. Any such foreign currency gain or loss would be treated as ordinary income or loss and would be in addition to the gain or loss, if any, recognized by such U.S. Holder on the sale or other disposition of our ordinary shares. Any foreign currency gain or loss a U.S. Holder realizes will generally be U.S. source ordinary income or loss.

The U.S. rules relating to foreign currency gains and losses are complex, and you should consult with your tax advisor to determine whether and to what extent you would have to recognize such foreign currency gains or losses.

#### **Passive Foreign Investment Companies**

If we were to be classified as a PFIC, in any taxable year, a U.S. Holder would be subject to special rules intended to reduce or eliminate any benefits from the deferral of U.S. federal income tax that a U.S. Holder could otherwise derive from investing in a non-U.S. company that does not distribute all of its earnings on a current basis. We will be treated as a PFIC for any taxable year in which either (i) 75% or more of our gross income is passive income, or (ii) at least 50% of the average value of all of our assets for the taxable year produce or are held for the production of passive income. For this purpose, passive income generally includes dividends, interest, royalties, rents, annuities and the excess of gains over losses from the disposition of assets that produce passive income. Included in the calculation of our income and assets for this purpose is our proportionate share of the income and assets of each corporation in which we own, directly or indirectly, at least a 25% interest, by value. If we were determined to be a PFIC for U.S. federal income tax purposes, unfavorable and highly complex rules would apply to you as a U.S. Holder of ordinary shares, whether you own your ordinary shares directly or indirectly. Accordingly, you are urged to consult your own tax advisors regarding the application of such rules.

Based on our current and projected income, assets and activities, we believe that we are not currently a PFIC, nor do we expect to become a PFIC in the foreseeable future. However, because the determination of whether we are a PFIC is based upon the composition of our income and assets from time to time, there can be no assurances that we will not become a PFIC in any future taxable year.

If we are treated as a PFIC for any taxable year, dividends on our ordinary shares would not qualify for the reduced tax rate on qualified dividend income, discussed above, and, unless you elect to “mark to market” your ordinary shares, as described below:

- you would be required to allocate income recognized upon receiving certain dividends or gain recognized upon the disposition of ordinary shares ratably over your holding period for such ordinary shares,

- the amount allocated to the current taxable year, and to any taxable years in your holding period prior to the first day in which we were treated as a PFIC will be treated as ordinary income in the current year, and
- the amount allocated to each prior taxable year during which we are considered a PFIC would be subject to tax at the highest individual or corporate tax rate, as the case may be, for that year and an interest charge would be imposed with respect to the resulting tax liability allocated to each such year.

If we are a PFIC and any of our non-U.S. subsidiaries is also a PFIC, you will generally be treated as owning a proportionate amount (by value) of the underlying shares of each such subsidiary PFIC. We do not intend to provide the information necessary for U.S. Holders to make qualified electing fund elections if we are classified as a PFIC.

A U.S. Holder may make a mark-to-market election only if our ordinary shares are “regularly traded” on a “qualified exchange.” In general, our ordinary shares will be treated as “regularly traded” for a given calendar year if more than a *de minimis* quantity of our ordinary shares is traded on a qualified exchange on at least 15 days during each calendar quarter of such calendar year. Our ordinary shares are listed on the Tel Aviv Stock Exchange and the NASDAQ. However, no assurance can be given that our ordinary shares will be regularly traded for purposes of the mark-to-market election. In addition, because a mark-to-market election cannot be made for a subsidiary PFIC, if you make a mark-to-market election you may continue to be subject to the PFIC rules with respect to your indirect interest in any PFICs we own.

If you elect to mark to market your ordinary shares, you will generally include in income, in each year in which we are considered a PFIC, any excess of the fair market value of your ordinary shares at the close of each tax year over your adjusted basis in the ordinary shares. If the fair market value of the ordinary shares has depreciated below your adjusted basis at the close of the tax year, you may generally deduct the excess of the adjusted basis of the ordinary shares over their fair market value at that time. However, such deductions would generally be limited to the net mark-to-market gains, if any, that you included in income with respect to such ordinary shares in prior years. Your adjusted tax basis in your ordinary shares would be increased by the amount of any income inclusion and decreased by the amount of any deductions under the mark-to-market rules. Income recognized and deductions allowed under the mark-to-market provisions, as well as any gain or loss on the disposition of ordinary shares with respect to which the mark-to-market election has been made, in a year in which we are classified as a PFIC, would be treated as ordinary income or loss (except that loss on a disposition of ordinary shares is treated as capital loss to the extent the loss exceeds the net mark-to-market gains, if any, that you included in income with respect to such ordinary shares in prior years). The source of such gain or loss would be U.S.-source for purposes of the foreign tax credit limitation. Gain or loss from the disposition of ordinary shares (as to which a mark-to-market election was made) in a year in which we are no longer classified as a PFIC, would be capital gain or loss.

If you own our ordinary shares during any year in which we are a PFIC, you may be required to file an IRS Form 8621 with respect to our company, typically with your federal income tax return for that year. U.S. Holders should consult their own tax advisors regarding whether we are a PFIC and the potential application of the PFIC rules to them, including the application of the mark-to-market election.

#### **Net Investment Income Tax**

In addition to the income taxes described above, U.S. Holders that are individuals, estates or trusts and whose income exceeds certain thresholds will be subject to a 3.8% Medicare contribution tax on net investment income, which includes dividends and capital gains.

#### **Certain Reporting Requirements with Respect to Payments of Offer Price**

U.S. Holders paying more than \$100,000 for our ordinary shares generally will be required to file IRS Form 926 reporting the payment of the Offer Price for our ordinary shares to us. Substantial penalties may be imposed upon a U.S. Holder that fails to comply. Each U.S. Holder should consult its own tax advisor as to the possible obligation to file IRS Form 926.

## Backup Withholding and Information Reporting

Payments in respect of our ordinary shares may be subject to information reporting to the IRS and to U.S. backup withholding tax at the rate (currently) of 28%. Backup withholding will not apply, however, if you (i) are a corporation or fall within certain exempt categories, and demonstrate the fact when so required, or (ii) furnish a correct taxpayer identification number and make any other required certification.

Backup withholding is not an additional tax. Amounts withheld under the backup withholding rules may be credited against your U.S. tax liability. You may obtain a refund of any excess amounts withheld under the backup withholding rules by filing the appropriate claim for refund with the IRS.

## Foreign Asset Reporting

U.S. citizens and individuals taxable as resident aliens of the United States that own “specified foreign financial assets” with an aggregate value in a taxable year in excess of certain thresholds (as determined under rules in Treasury regulations) and that are required to file a U.S. federal income tax return generally will be required to file an information report with respect to those assets with their tax returns. IRS Form 8938 has been issued for that purpose. “Specified foreign financial assets” include any financial accounts maintained by foreign financial institutions, foreign stocks held directly, and interests in foreign estates, foreign pension plans or foreign deferred compensation plans. Under those rules, our ordinary shares, whether owned directly or through a financial institution, estate or pension or deferred compensation plan, would be “specified foreign financial assets.” Under Treasury regulations, the reporting obligation applies to certain U.S. entities that hold, directly or indirectly, specified foreign financial assets. Penalties can apply if there is a failure to satisfy this reporting obligation. A U.S. Holder is urged to consult his tax adviser regarding its reporting obligation.

Any U.S. Holder who holds 10% or more in vote or value of our ordinary shares will be subject to certain additional U.S. information reporting requirements.

### F. Dividends and Paying Agents

Not applicable.

### G. Statement by Experts

Not applicable.

### H. Documents on Display

We are subject to certain of the reporting requirements of the Securities and Exchange Act of 1934, as amended, or the Exchange Act, as applicable to “foreign private issuers” as defined in Rule 3b-4 under the Exchange Act. As a foreign private issuer, we are exempt from certain provisions of the Exchange Act. Accordingly, our proxy solicitations are not subject to the disclosure and procedural requirements of Regulation 14A under the Exchange Act, and transactions in our equity securities by our officers and directors are exempt from reporting and the “short-swing” profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file periodic reports and financial statements as frequently or as promptly as U.S. companies whose securities are registered under the Exchange Act. However, we file with the SEC an annual report on Form 20-F containing financial statements audited by an independent accounting firm. We also submit to the SEC reports on Form 6-K containing (among other things) press releases and unaudited financial information. We post our annual report on Form 20-F on our website ([www.igld.com](http://www.igld.com)) promptly following the filing of our annual report with the SEC. The information on our website is not incorporated by reference into this annual report.

This annual report and the exhibits thereto and any other document we file pursuant to the Exchange Act may be inspected without charge and copied at prescribed rates at the SEC public reference room at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the SEC’s public reference room in Washington, D.C. by calling the SEC at 1-800-SEC-0330. The Exchange Act file number for our SEC filings is 000-30198.



The SEC maintains a website at [www.sec.gov](http://www.sec.gov) that contains reports, proxy and information statements, and other information regarding registrants that make electronic filings with the SEC using its EDGAR (Electronic Data Gathering, Analysis, and Retrieval) system.

The documents concerning our company referred to in this annual report may also be inspected at our offices located at 2 Dov Friedman Street, Ramat Gan 5250301, Israel. We will provide a copy of this annual report containing our financial statements upon shareholders' request.

#### **I. Subsidiary Information**

Not applicable.

#### **ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISKS**

We are exposed to a variety of risks, including foreign currency fluctuations and changes in interest rates. We regularly assess currency and interest rate risks to minimize any adverse effects on our business as a result of those factors.

##### **Effects of Currency Fluctuations**

B Communications' net exposure to changes in foreign currency exchange rates (primarily the U.S. dollar) was NIS 277 million (approximately \$71 million) at December 31, 2015. The exposure primarily consists of the outstanding balance of \$773.1 million par value Senior Secured notes. As at December 31, 2015, B Communications held 5 Cross Currency Swap hedge transaction in the amount of \$725 million that partially hedged its exposure with regards to its Senior Secured Notes and NIS 464 million (approximately \$119 million) of marketable securities denominated in foreign currencies (primarily the U.S. dollar). Each increase or decrease of 1% in the NIS-US\$ exchange rate will result in an increase or decrease in its yearly financial income of NIS 3 million (\$1 million).

The Bezeq Group is exposed to foreign currency risks mainly due to payments for purchases of terminal equipment and property, plant and equipment which are in or linked to the U.S. dollar or the Euro. In addition, the Bezeq Group provides services for customers and receives services from suppliers worldwide for which it is paid and it pays in foreign currency, mainly the U.S. dollar. The Bezeq Group has surplus liabilities over assets in foreign currency. To hedge its exposure, the Bezeq Group makes forward transactions against the U.S. dollar.

Bezeq Group holds derivative financial instruments to hedge its exposure to foreign currency. Hedge accounting is not applied to these derivative instruments that economically hedge financial assets and liabilities. Derivative instruments are recognized initially at fair value; attributable transaction costs are recognized in the statement of income as incurred. Subsequent to initial recognition, derivative financial instruments are measured at fair value and the changes in fair value are recognized in the statement of income as incurred.

Bezeq's total net exposure to changes in foreign currency exchange rates was NIS 995 million (approximately \$255 million) at December 31, 2015. Each increase or decrease of 1% in the NIS-US\$ exchange rate will result in an increase or decrease in Bezeq's yearly financial income of NIS 10 million (\$3 million).

##### **Effects of Changes in Interest Rates and the Israeli Consumer Price Index**

Our total net exposure to changes in the Israeli CPI was NIS 672 million (approximately \$172 million) at December 31, 2015. The exposure relates to NIS 1.1 billion (approximately \$275 million) of our outstanding debentures that are partially hedged by forward contracts on the Israeli CPI in the amount of NIS 380 million (approximately \$97 million) and our investment of NIS 27 million (approximately \$7 million) of CPI linked marketable securities. Each increase or decrease of 1% in the Israeli CPI will result in an increase or decrease in our yearly financial expense of NIS 7 million (approximately \$2 million).

B Communications' total net exposure to changes in the Israeli CPI was 56 million (approximately \$14 million) at December 31, 2015. The exposure primarily consists of a tax liability in the amount of NIS 79 million (approximately \$20 million). As of December 31, 2015, B Communications also holds forward contracts based on the Israeli CPI in the amount of NIS 70 million (approximately \$18 million) and NIS 65 million (approximately \$17 million) of CPI linked marketable securities. Each increase or decrease of 1% in the Israeli CPI will result in an increase or decrease in B Communications' yearly financial income of NIS 1 million.

The Bezeq Group's total exposure to changes in the Israeli CPI was NIS 7 billion (approximately \$1.8 billion) at December 31, 2015. The exposure primarily consists of Bezeq's debentures which are linked to the CPI. As of December 31, 2015, Bezeq holds forward contracts on the Israeli CPI in the amount of NIS 2 billion (approximately \$518 million). Each increase or decrease of 1% in the Israeli CPI will result in an increase or decrease in the Bezeq Group's yearly financial expense of NIS 50 million (\$7 million).

#### **Cash Investments, Marketable Securities and Interest Rate Risk Management**

Our cash investment policy seeks to preserve principal and maintain adequate liquidity while maximizing the income we receive from our investments without significantly increasing the risk of loss. To minimize investment risk, we maintain a diversified portfolio across various maturities, types of investments and issuers, which may include, from time to time, money market funds, U.S. government bonds, state debt, bank deposits and certificates of deposit, and investment grade corporate debt. As of December 31, 2015, we had NIS 38 million (approximately \$10 million) in cash and cash equivalents and NIS 239 million (approximately \$61 million) in marketable securities (not including the amounts of B Communications or Bezeq).

The performance of the capital markets affects the values of the funds we hold in marketable securities. These assets are subject to market fluctuations. In such case, the fair value of our investments may decline. We periodically monitor our investments for adverse material holdings related to the underlying financial solvency of the issuers of the marketable securities in our portfolio.

Our exposure to market risk for changes in interest rates relates primarily to our investment in marketable securities. Investments in both fixed rate and floating rate interest bearing securities carry a degree of interest rate risk. The fair market value of fixed rate securities may be adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than predicted if interest rates fall. Due in part to these factors, our future financial results may be negatively affected in the event that interest rates fluctuate.

#### **Bezeq's Exposure to Market Risks**

Bezeq is exposed to market risks, mainly as a result of changes in interest rates, exchange rates, inflation, the prices of raw materials and equipment, and the prices of securities. Bezeq seeks to hedge against such risks in accordance with a financial exposure management policy adopted by its Board of Directors. Pursuant to that policy, Bezeq takes partial hedging actions depending on the circumstances and its own judgment, primarily for reducing its exposure to changes in the Israeli CPI and foreign currency exchange rates. Bezeq monitors and reviews the Bezeq Group's exposure management every month, including, when necessary, making recommendations for change, if required, in the exposure management.

Bezeq has a significant surplus of liabilities for CPI linked assets, and the bulk of its financial exposure from the risk of a rise in inflation. The rate of inflation also affects Bezeq's operating income and operating expenses in the course of the year. In addition, Bezeq's tariff updating mechanism, which is subject to government regulation, is reviewed once a year and is influenced by the CPI. As a result, the annual rate of inflation and its distribution during the year can have a material influence on the erosion of Bezeq's tariffs and its revenues and expenses during the year.

Bezeq's exposure to change in the interest rate largely depends on the character of its financial liabilities and assets as well as future financing needs. Most of Bezeq's debt bears fixed interest, and therefore a change in the interest rate will affect its fair value rather than its carrying value.

Bezeq has investments in negotiable bonds that are stated in its books at their market value. This market value is influenced by changes in the interest rates in the economy. In addition, a change in the NIS exchange rate constitutes economic exposure that can affect Bezeq's future profit and cash flows, mainly the repayment of currency-linked liabilities and payments for currency-linked purchases of equipment and raw materials.

The cash flow generated by Bezeq's operations is used partially for investment in equipment. The prices of the equipment are affected by the indices to which they are linked, including industry price indices, exchange rates and global prices. Bezeq does not hedge against this exposure. Bezeq is also exposed to changes in copper prices that result in a change in the residual value of its copper cable infrastructure. In deploying its NGN, Bezeq removes copper cables previously used to provide its services and sells the copper from such cables, and the prices received are subject to the volatility of the copper market.

**ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

Not applicable.

**PART II****ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

None.

**ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS****Material Modifications to the Rights of Security Holders**

None.

**Use of Proceeds**

Not applicable.

**ITEM 15. CONTROLS AND PROCEDURES****Disclosure Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our chief executive officer and principal financial officer to allow timely decisions regarding required disclosure. Our management, including our chief executive officer and principal financial officer, conducted an evaluation of our disclosure controls and procedures, as defined under Exchange Act Rule 13a-15(e), as of the end of the period covered by this annual report on Form 20-F. Based upon that evaluation, our chief executive officer and principal financial officer have concluded that, as of such date, our disclosure controls and procedures were effective.

**Management's Annual Report on Internal Control Over Financial Reporting**

Our management, including our chief executive officer and principal financial officer, is responsible for establishing and maintaining adequate internal control over financial reporting, as defined under Exchange Act Rules 13a-15(f) and 15d-15(f). Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States. Internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets, (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with appropriate authorizations; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2015. In conducting its assessment of internal control over financial reporting, management based its evaluation on the framework in "Internal Control – Integrated Framework" (2013) issued by the Committee of Sponsoring Organizations, or the COSO, of the Treadway Commission. Based on that assessment, our management has concluded that our internal control over financial reporting was effective as of December 31, 2015.

## Changes in Internal Control over Financial Reporting

The acquisition of all the outstanding shares of DBS represents a material change in internal controls over financial reporting since the previous assessment of the effectiveness of internal controls over financial reporting made by the Company's management. In light of the complexity and scope of DBS activities, the use of separate accounting systems and internal control procedures by DBS, as well as in order to ensure our ability to evaluate the internal controls over the financial reporting of DBS in the best possible manner, our management decided to adopt the concession granted in accordance with the directives of the SEC, so that the first-time implementation of the assessment of the effectiveness of internal controls and procedures of DBS will begin on December 31, 2016. With the exception of the DBS acquisition, there were no changes in our internal control over financial reporting during the period covered by the Report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### ITEM 16. [RESERVED]

#### ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Ms. Anat Winner, an independent director and Mr. Dudi Ezra and Ms. Shoshana Shidlo, External Directors, meet the definition of an audit committee financial expert, as defined by rules of the SEC. For a brief listing of their relevant experience, see Item 6.A. "Directors, Senior Management and Employees - Directors and Senior Management."

#### ITEM 16B. CODE OF ETHICS

We have adopted a code of ethics that applies to our chief executive officer and all senior financial officers of our company, including the principal financial officer, chief accounting officer or controller, or persons performing similar functions. Our code of ethics is available for viewing on our website at [www.igld.co.il](http://www.igld.co.il). Written copies are available upon request. If we make any substantive amendment to the code of ethics or grant any waivers, including any implicit waiver, from a provision of the codes of ethics, we will disclose the nature of such amendment or waiver on our website.

#### ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

##### Fees Billed by Independent Public Accountants

The following table sets forth, for each of the years indicated, the aggregate fees billed to us, Bezeq, B Communications, Pelephone and Bezeq International by the independent registered public accounting firm that prepares their financial statements. All of such fees were pre-approved by the relevant committee for the examination of the financial statements.

| Services Rendered                        | Year Ended<br>December 31, |                      |
|--|----------------------------|----------------------|
|  | 2014                       | 2015                 |
| Audit fees and audit-related fees (1)(2) | NIS 5,565,000              | NIS 6,662,000        |
| Tax fees and all other fees (3)          | NIS 1,751,000              | NIS 1,277,000        |
| Total                                    | <u>NIS 7,316,000</u>       | <u>NIS 7,939,000</u> |

- (1) Audit fees are for audit services for each of the years shown in the table, including fees associated with the annual audit and audit services provided in connection with other statutory and regulatory filings.
- (2) Audit related fees are the aggregate fees billed for assurance and related services that are not reported under audit fees.
- (3) Tax fees are the aggregate fees billed for professional services rendered for tax compliance and tax advice.

## **Pre-Approval Policies and Procedures**

Our audit committee has adopted a policy and procedures for the pre-approval of audit and non-audit services rendered by our independent registered public accounting firm, Somekh Chaikin, a member firm of KPMG International. Somekh Chaikin also acts as Bezeq's independent registered public accounting firm. Pre-approval of an audit or non-audit service may be given as a general pre-approval, as part of the audit committee's approval of the scope of the engagement of our independent auditor, or on an individual basis. Any proposed services exceeding general pre-approved levels also require specific pre-approval by our audit committee. The policy prohibits retention of the independent registered public accountants to perform the prohibited non-audit functions defined in Section 201 of the Sarbanes-Oxley Act or the rules of the SEC, and also requires the audit committee to consider whether proposed services are compatible with the independence of the registered public accounting firm.

### **ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES**

Not applicable.

### **ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS**

No ordinary shares of our company were purchased by us or on our behalf or by any affiliated purchaser during 2015.

### **ITEM 16F. CHANGES IN REGISTRANT'S CERTIFYING ACCOUNTANT**

Not applicable.

### **ITEM 16G. CORPORATE GOVERNANCE**

#### **NASDAQ Exemptions for a Controlled Company**

We are a controlled company within the meaning of NASDAQ Stock Market Rule 5615(c)(1), since Eurocom Communications holds more than 50% of our voting power. Under NASDAQ Stock Market Rule 5615(c)(2), a controlled company is exempt from the following requirements of NASDAQ Stock Market Rule 5605:

- The requirement that the majority of the company's board of directors qualify as independent directors, as defined under NASDAQ Stock Market Rules. Instead, we follow Israeli law and practice which requires that we appoint at least two external directors, within the meaning of the Israeli Companies Law, to our board of directors. In addition, we have the mandated three independent directors, within the meaning of the rules of the SEC and NASDAQ, on our audit committee. See Item 6C. "Directors, Senior Management and Employees - Board Practices - External and Independent Directors."
- The requirement that the compensation of the chief executive officer and all other executive officers be determined, or recommended to the board of directors for determination, either by (i) a majority of the independent directors or (ii) a compensation committee comprised solely of independent directors. Under the Israeli Companies Law, any compensation arrangement with an office holder (including an exemption from liability and the insurance and indemnification of an office holder), require the approval of the compensation committee, the board of directors and in certain circumstances, shareholders.
- The requirement that director nominees either be selected or recommended for the board of directors' selection, either by (a) a majority of independent directors or (b) a nominations committee comprised solely of independent directors. Instead, we follow Israeli law and practice, in accordance with which directors may be recommended by our board of directors for election by our shareholders.

If the "controlled company" exemptions cease to be available to us under NASDAQ Stock Market Rules, we may instead elect to follow Israeli law instead of the foregoing NASDAQ requirements, as described below.

## NASDAQ Stock Market Rules and Home Country Practice

Under NASDAQ Stock Market Rule 5615(a)(3), foreign private issuers, such as our company, are permitted to follow certain home country corporate governance practices instead of certain provisions of the NASDAQ Stock Market Rules. As a foreign private issuer listed on the NASDAQ Global Select Market, we may follow home country practice with regard to, among other things, the composition of the board of directors, compensation of officers, director nomination process and quorum at shareholders' meetings. In addition, we may follow home country practice instead of the NASDAQ requirement to obtain shareholder approval for certain dilutive events (such as for the establishment or amendment of certain equity-based compensation plans, an issuance that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company and certain acquisitions of the stock or assets of another company). A foreign private issuer that elects to follow a home country practice instead of NASDAQ requirements must submit to NASDAQ in advance a written statement from an independent counsel in such issuer's home country certifying that the issuer's practices are not prohibited by the home country's laws. In addition, a foreign private issuer must disclose in its annual reports filed with the SEC each such requirement that it does not follow and describe the home country practice followed by the issuer instead of any such requirement. Accordingly, our shareholders may not be afforded the same protection as provided under NASDAQ's corporate governance rules.

### ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

## PART III

### ITEM 17. FINANCIAL STATEMENTS

We have elected to furnish financial statements and related information specified in Item 18.

### ITEM 18. FINANCIAL STATEMENTS

#### Consolidated Financial Statements of Internet Gold-Golden Lines Ltd.

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## ITEM 19. EXHIBITS

### Index to Exhibits

| Exhibit | Description   |
|---------|---|
| 1.1     | Memorandum of Association of the Registrant <sup>(1)</sup>  |
| 1.2     | Amended and Restated Articles of Association of the Registrant <sup>(2)</sup>   |
| 2.1     | Specimen of Share Certificate <sup>(1)</sup>  |
| 2.2     | Terms of Convertible Debentures Traded on Tel Aviv Stock Exchange <sup>(3)</sup>  |
| 2.3     | Form of B Communications Ltd. Series A Debenture Certificate for Notes issued in March 2007 and May 2007 <sup>(4)</sup>   |
| 4.1     | Registration Rights Agreement, dated July 30, 1999, among the Registrant, Euronet Communications Ltd., Shaul Elovitch and Eli Holtzman <sup>(1)</sup>   |
| 4.2     | English Translation of the Terms of the Bezeq – DBS Merger Agreement. <sup>(5)</sup>  |
| 4.3     | Share Purchase Agreement between the Registrant and Norisha Holdings Limited dated June 27, 2013. <sup>(6)</sup>  |
| 4.4     | Amendment No. 1 to the Share Purchase between the Registrant and Norisha Holdings Limited dated May 29, 2014. <sup>(7)</sup>  |
| 4.5     | Form of Indenture dated February 19, 2014 between B Communications and Mishmeret Trust Company <sup>(8)</sup>   |
| 4.6     | Intercreditor Agreement dated February 19, 2014, between B Communications and Mishmeret Trust Company <sup>(9)</sup>  |
| 4.7     | Form of Indenture entered into on February 23, 2013, between the Registrant and Reznik Paz Nevo Trusts Ltd. <sup>(10)</sup>   |
| 4.8     | English translation of Bezeq Control Permit issued by the Prime Minister of Israel and Israeli Minister of Communications to members of the Eurocom Group on April 13, 2010 <sup>(11)</sup>   |
| 4.9     | English translation of Credit Agreement dated February 11, 2010 between B Communications (SP2) Ltd. and Bank Hapoalim Ltd. (as Lender, Facility Agent and Security Trustee), Bank Leumi le-Israel BM, Amitim (Senior Pension Funds), Israel Discount Bank Ltd., Mizrahi Tefahot Bank Ltd., HSBC Bank PLC, First International Bank of Israel Ltd. and Union Bank of Israel (as Lenders) <sup>(11)</sup>   |
| 4.10    | English translation of Loan Agreement dated February 18, 2010, between B Communications (SP1) Ltd. and entities within the Migdal Insurance and Financial Holdings Ltd. group <sup>(11)</sup>   |
| 4.11    | English translation of Addendum and Amendment No. 1 the Credit Agreement dated February 11, 2010, dated April 14, 2010, between B Communications (SP2) Ltd. and Bank Hapoalim Ltd. (as Lender, Facility Agent and Security Trustee), Bank Leumi le-Israel BM, Israel Discount Bank Ltd., Mizrahi Tefahot Bank Ltd., HSBC Bank PLC, First International Bank of Israel Ltd., Union Bank of Israel, Central Benefits Fund of Histadrut Employees Ltd. (under special management), Makefet Fund Pension and Provident Center - AS Ltd. Pension Fund, Makefet Fund Pension and Provident Center - AS Ltd. (under special management) – Other-Purpose Funds, Mivtachim The Workers Social Insurance Fund Ltd. (under special management) - Pension Fund, Mivtachim The Workers Social Insurance Fund Ltd. (under special management) Illness and Accident Provident Fund, Hadassah Employees Pension Fund Ltd. (under special management), “Egged” Members Pension Fund Ltd. (under special management) – Pension Track and “Egged” Members Pension Fund Ltd. (under special management) – Full Pension Track (as Lenders) <sup>(11)</sup> |
| 4.12    | English translation of Addendum and Amendment No. 2 the Credit Agreement dated February 11, 2010, dated June 26, 2011, between B Communications (SP2) Ltd. and Bank Hapoalim Ltd. (as Lender, Facility Agent and Security Trustee) and the other Lenders <sup>(12)</sup>  |
| 4.13    | English translation of Addendum and Amendment No. 1 the Loan Agreement dated February 18, 2010, dated April 14, 2010, between B Communications (SP1) Ltd. and entities within the Migdal Insurance and Financial Holdings Ltd. Group <sup>(11)</sup>  |
| 4.14    | English translation of Deed of Trust dated August 31, 2010 between the Registrant and Reznik, Paz, Nevo Trustees Ltd. <sup>(12)</sup>   |

| Exhibit | Description   |
|---------|---|
| 4.15    | English translation of Addendum to the Deed of Trust of August 31, 2010 dated September 26, 2010 between the Registrant and Reznik, Paz, Nevo Trustees Ltd. <sup>(12)</sup> |
| 4.16    | Officers' Compensation Policy <sup>(13)</sup>   |
| 8       | List of Subsidiaries of the Registrant  |
| 12.1    | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended  |
| 12.2    | Certification of Principal Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended  |
| 13.1    | Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                                   |
| 13.2    | Certification of Principal Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                               |
| 15.1    | Consent of Somekh Chaikin, a member firm of KPMG International.   |

- 
- (1) Previously filed as an exhibit to the Registrant's Registration Statement on Form F-1 (Registration No. 333-10576), and incorporated herein by reference.
- (2) Previously filed as an exhibit to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2012, and incorporated herein by reference.
- (3) Previously filed as an exhibit to the Registrant's Report on Form 6-K for the month of April 2005 submitted to Securities and Exchange Commission on April 11, 2005, and incorporated herein by reference.
- (4) Previously filed as an exhibit to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2006, and incorporated herein by reference.
- (5) Previously filed as Exhibit 99.1 to the Registrant's Report on Form 6-K for the month of March 2015, submitted to Securities and Exchange Commission on March 18, 2015, and incorporated herein by reference.
- (6) Previously filed as Exhibit 99.1 to the Registrant's Schedule 13D/A filed with respect to holdings in B Communications on June 27, 2013, and incorporated herein by reference.
- (7) Previously filed as Exhibit 99.1 to the Registrant's Report on Form 6-K for the month of May 2014, submitted to Securities and Exchange Commission on May 29, 2014, and incorporated herein by reference.
- (8) Previously filed as Exhibit 99.2 to the Registrant's Report on Form 6-K for the month of February 2014 submitted to Securities and Exchange Commission on February 19, 2014, and incorporated herein by reference.
- (9) Previously filed as Exhibit 99.3 to the Registrant's Report on Form 6-K for the month of February 2014 submitted to Securities and Exchange Commission on February 19, 2014, and incorporated herein by reference.
- (10) Previously filed as Exhibit 99.1 to the Registrant's Report on Form 6-K for the month of March 2014 submitted to Securities and Exchange Commission on March 21, 2014, and incorporated herein by reference.
- (11) Previously filed as an exhibit to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2009, and incorporated herein by reference.
- (12) Previously filed as an exhibit to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2010, and incorporated herein by reference.
- (13) Previously filed as Exhibit 99.2 to the Registrant's Report on Form 6-K for the month of September 2013 submitted to Securities and Exchange Commission on September 30, 2013, and incorporated herein by reference.



**Consolidated Financial Statements**

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## **Report of Independent Registered Public Accounting Firm**

### **To the Board of Directors and Shareholders of Internet Gold – Golden Lines Ltd.**

We have audited the accompanying consolidated statements of financial position of Internet Gold- Golden Lines Ltd. (hereinafter - "the Company") and its subsidiaries as of December 31, 2014 and 2015 and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for each of the years in the three-year period ended December 31, 2015. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company and its subsidiaries as of December 31, 2014 and 2015 and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2015 in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

The accompanying consolidated financial statements as of and for the year ended December 31, 2015 have been translated into United States dollars ("dollars") solely for the convenience of the reader. We have audited the translation and, in our opinion, the consolidated financial statements expressed in New Israeli Shekels have been translated into dollars on the basis set forth in Note 2D to the consolidated financial statements.

/s/ Somekh Chaikin  
Somekh Chaikin

Certified Public Accountants (Isr.)  
Member Firm of KPMG International

Tel Aviv, Israel  
April 18, 2016

**Consolidated Statements of Financial Position as of**

(In millions)

|   | Note   | December 31   |               | Convenience<br>translation into<br>U.S. dollars<br>(Note 2D) |
|---|--------|---------------|---------------|--|
|   |        | 2014          | 2015          | 2015   |
|   |        | NIS           | NIS           | US\$   |
| <b>Assets</b>   |        |               |               |  |
| Cash and cash equivalents                               | 5      | 732           | 619           | 159  |
| Restricted cash   | 13B(1) | 65            | 155           | 40   |
| Investments including derivatives                       | 6      | 3,406         | 1,774         | 454  |
| Trade receivables, net                                  | 7      | 2,227         | 2,058         | 527  |
| Other receivables                                       | 7      | 242           | 270           | 69   |
| Inventory   |        | 96            | 115           | 30   |
| Assets classified as held-for-sale                      |        | 52            | 16            | 4  |
| <b>Total current assets</b>                             |        | <b>6,820</b>  | <b>5,007</b>  | <b>1,283</b>   |
| Long-term trade receivables                             | 7      | 566           | 674           | 173  |
| Property, plant and equipment                           | 8      | 6,572         | 7,197         | 1,844  |
| Intangible assets                                       | 9      | 5,908         | 7,118         | 1,824  |
| Deferred expenses and investments                       | 10     | 635           | 643           | 165  |
| Broadcast rights  | 11     | -             | 456           | 117  |
| Investments in equity-accounted investee (mainly loans) | 12     | 1,057         | 25            | 6  |
| Deferred tax assets                                     | 19     | -             | 1,290         | 331  |
| <b>Total non-current assets</b>                         |        | <b>14,738</b> | <b>17,403</b> | <b>4,460</b>   |
| <b>Total assets</b>                                     |        | <b>21,558</b> | <b>22,410</b> | <b>5,743</b>   |

The accompanying notes are an integral part of these consolidated financial statements.

**Consolidated Statements of Financial Position as of (cont'd)**

(In millions)

|  |             | December 31   |               | Convenience<br>translation into<br>U.S. dollars<br>(Note 2D) |
|--|-------------|---------------|---------------|--|
|  |             | 2014          | 2015          | 2015   |
|  |             | NIS           | NIS           | US\$   |
| <b>Liabilities</b>   | <b>Note</b> |               |               |  |
| Bank loans and credit and debentures                       | 13          | 1,561         | 2,219         | 568  |
| Trade and other payables                                   | 14          | 1,421         | 1,717         | 440  |
| Related party  | 12B         | -             | 233           | 60   |
| Current tax liabilities                                    | 19          | 671           | 705           | 180  |
| Provisions   | 15          | 62            | 100           | 26   |
| Employee benefits  | 18          | 259           | 378           | 97   |
| <b>Total current liabilities</b>                           |             | <b>3,974</b>  | <b>5,352</b>  | <b>1,371</b>   |
| Bank and institutional loans and debentures                | 13          | 13,419        | 13,215        | 3,387  |
| Employee benefits  | 18          | 233           | 240           | 61   |
| Other liabilities including derivatives                    |             | 262           | 227           | 58   |
| Provisions   | 15          | 69            | 46            | 12   |
| Deferred tax liabilities                                   | 19          | 835           | 729           | 187  |
| <b>Total non-current liabilities</b>                       |             | <b>14,818</b> | <b>14,457</b> | <b>3,705</b>   |
| <b>Total liabilities</b>                                   |             | <b>18,792</b> | <b>19,809</b> | <b>5,076</b>   |
| <b>Equity</b>  | 23          |               |               |  |
| Total equity attributable to equity holders of the Company |             | (183)         | (93)          | (24)   |
| Non-controlling interests                                  |             | 2,949         | 2,694         | 691  |
| <b>Total Equity</b>  |             | <b>2,766</b>  | <b>2,601</b>  | <b>667</b>   |
| <b>Total liabilities and equity</b>                        |             | <b>21,558</b> | <b>22,410</b> | <b>5,743</b>   |

Date of approval of the financial statements: April 18, 2016

/s/ Doron Turgeman

CEO

/s/ Itzik Tadmor

Principal Financial Officer

The accompanying notes are an integral part of these consolidated financial statements.

**Consolidated Statements of Income for The Year Ended December 31**

(In millions, except per share data)

|  |      |             |             |             | Convenience<br>translation into<br>U.S. dollars<br>(Note 2D) |
|--|------|-------------|-------------|-------------|--|
|  | Note | 2013<br>NIS | 2014<br>NIS | 2015<br>NIS | 2015<br>US\$   |
| <b>Revenues</b>  | 24   | 9,563       | 9,055       | 9,985       | 2,559  |
| <b>Cost and expenses</b>                               |      |             |             |             |  |
| Depreciation and amortization                          |      | 2,014       | 1,873       | 2,131       | 546  |
| Salaries   | 25   | 1,874       | 1,771       | 1,960       | 502  |
| General and operating expenses                         | 26   | 3,586       | 3,371       | 3,878       | 994  |
| Other operating expenses (income), net                 | 27   | 57          | (535)       | 3           | 1  |
|  |      | 7,531       | 6,480       | 7,972       | 2,043  |
| <b>Operating income</b>                                |      | 2,032       | 2,575       | 2,013       | 516  |
| <b>Financing (income) expenses</b>                     | 28   |             |             |             |  |
| Finance expenses                                       |      | 931         | 1,329       | 759         | 194  |
| Finance income   |      | (535)       | (635)       | (164)       | (42)   |
| <b>Financing expense, net</b>                          |      | 396         | 694         | 595         | 152  |
| <b>Income after financing expenses, net</b>            |      | 1,636       | 1,881       | 1,418       | 364  |
| Share of loss (income) in equity - accounted investees | 12   | 252         | 170         | (12)        | (3)  |
| <b>Income before income tax</b>                        |      | 1,384       | 1,711       | 1,430       | 367  |
| Income tax   | 19   | 524         | 667         | 347         | 89   |
| <b>Net income for the year</b>                         |      | 860         | 1,044       | 1,083       | 278  |
| <b>Income (loss) attributable to:</b>                  |      |             |             |             |  |
| Owners of the Company                                  |      | 26          | (103)       | 87          | 22   |
| Non-controlling interests                              |      | 834         | 1,147       | 996         | 256  |
| <b>Net income for the year</b>                         |      | 860         | 1,044       | 1,083       | 278  |
| <b>Earnings (loss) per share</b>                       | 30   |             |             |             |  |
| Basic income (loss) per share                          |      | 1.33        | (5.38)      | 4.54        | 1.16   |
| Diluted income (loss) per share                        |      | 1.26        | (5.50)      | 4.47        | 1.15   |

The accompanying notes are an integral part of these consolidated financial statements.

**Consolidated Statements of Comprehensive Income for the year ended December 31**

(In millions)

|  | 2013 | 2014  | 2015  | Convenience<br>translation into<br>U.S. dollars<br>(Note 2D) |
|--|------|-------|-------|--|
|  | NIS  | NIS   | NIS   | 2015<br>US\$   |
| <b>Net income for the year</b>                   | 860  | 1,044 | 1,083 | 278  |
| Items of comprehensive income (loss), net of tax | 6    | (36)  | 7     | 2  |
| <b>Total comprehensive income for the year</b>   | 866  | 1,008 | 1,090 | 280  |
| <b>Attributable to:</b>                          |      |       |       |  |
| Owners of the Company                            | 27   | (110) | 89    | 23   |
| Non-controlling interest                         | 839  | 1,118 | 1,001 | 257  |
| <b>Total comprehensive income for the year</b>   | 866  | 1,008 | 1,090 | 280  |

The accompanying notes are an integral part of these consolidated financial statements.

**Consolidated Statements of Changes in Equity (cont'd)**

(In millions except share data)

|  | Attributable to owners of the Company |        |               |                 |                               |                     |       | Non-controlling interest | Total equity |
|--|---------------------------------------|--------|---------------|-----------------|-------------------------------|---------------------|-------|--------------------------|--------------|
|  | Share capital                         |        | Share premium | Treasury shares | Other reserves <sup>(2)</sup> | Accumulated deficit | Total |                          |              |
|  | Number of Shares <sup>(1)</sup>       | Amount |               |                 |                               |                     |       |                          |              |
|  | NIS 0.01 par value                    | NIS    |               |                 |                               |                     |       |                          |              |
|  |                                       | NIS    | NIS           | NIS             | NIS                           | NIS                 | NIS   | NIS                      | NIS          |
| Balance as at January 1, 2013          | 19,203,186                            | *      | 658           | (169)           | (177)                         | (404)               | (92)  | 3,572                    | 3,480        |
| Changes during 2013:                   |                                       |        |               |                 |                               |                     |       |                          |              |
| Share-based compensation in subsidiary | —                                     | —      | —             | —               | —                             | —                   | —     | 29                       | 29           |
| Exercise of options in subsidiary      | —                                     | —      | —             | —               | (18)                          | —                   | (18)  | 130                      | 112          |
| Acquisitions non-controlling interest  | —                                     | —      | —             | —               | (3)                           | —                   | (3)   | (10)                     | (13)         |
| Dividends to non-controlling interests | —                                     | —      | —             | —               | —                             | —                   | —     | (1,321)                  | (1,321)      |
| Other comprehensive income             | —                                     | —      | —             | —               | (4)                           | 5                   | 1     | 5                        | 6            |
| Net income for the year                | —                                     | —      | —             | —               | —                             | 26                  | 26    | 834                      | 860          |
| Comprehensive income for the year      | —                                     | —      | —             | —               | (4)                           | 31                  | 27    | 839                      | 866          |
| Balance as at December 31, 2013        | 19,203,186                            | *      | 658           | (169)           | (202)                         | (373)               | (86)  | 3,239                    | 3,153        |

(\*) Represent an amount less than NIS 1.

(1) Net of treasury shares.

(2) Including reserve from transaction with non-controlling interests.

The accompanying notes are an integral part of these consolidated financial statements.

**Consolidated Statements of Changes in Equity (cont'd)**

(In millions except share data)

|  | Attributable to equity holders of the Company |          |               |                 |                               |                     |              |                          |
|--|---|----------|---------------|-----------------|-------------------------------|---------------------|--------------|--------------------------|
|  | Share capital                                 |          | Share premium | Treasury shares | Other reserves <sup>(2)</sup> | Accumulated deficit | Total        | Non-controlling interest |
|  | Number of Shares <sup>(1)</sup>               | Amount   |               |                 |                               |                     |              |                          |
|  | NIS 0.01 par value                            | NIS      | NIS           | NIS             | NIS                           | NIS                 | NIS          | Total equity<br>NIS      |
| <b>Balance as at January 1, 2014</b>       | 19,203,186                                    | *        | 658           | (169)           | (202)                         | (373)               | (86)         | 3,239                    |
| <b>Changes during 2014:</b>                |   |          |               |                 |                               |                     |              |                          |
| Share-based compensation in subsidiary     | —   | —        | —             | —               | —                             | —                   | —            | (1)                      |
| Exercise of options in subsidiary          | —   | —        | —             | —               | (1)                           | —                   | (1)          | 14                       |
| Transactions with non-controlling interest | —   | —        | —             | —               | 14                            | —                   | 14           | 10                       |
| Dividends to non-controlling interests     | —   | —        | —             | —               | —                             | —                   | —            | (1,431)                  |
| Other comprehensive income                 | —   | —        | —             | —               | (8)                           | 1                   | (7)          | (29)                     |
| Net income for the year                    | —   | —        | —             | —               | —                             | (103)               | (103)        | 1,147                    |
| Comprehensive income for the year          | —   | —        | —             | —               | (8)                           | (102)               | (110)        | 1,118                    |
| <b>Balance as at December 31, 2014</b>     | <u>19,203,186</u>                             | <u>*</u> | <u>658</u>    | <u>(169)</u>    | <u>(197)</u>                  | <u>(475)</u>        | <u>(183)</u> | <u>2,949</u>             |

(\*) Represent an amount less than NIS 1.

(1) Net of treasury shares.

(2) Including reserve from transaction with non-controlling interests.

The accompanying notes are an integral part of these consolidated financial statements.



**Consolidated Statements of Changes in Equity (cont'd)**

(In millions except share data)

|  | Attributable to equity holders of the Company |        |               |                 |                               |                     |       | Non-controlling interest | Total equity | Convenience translation into US\$ (Note 2D) |
|--|---|--------|---------------|-----------------|-------------------------------|---------------------|-------|--------------------------|--------------|---|
|  | Share capital                                 |        | Share premium | Treasury shares | Other reserves <sup>(2)</sup> | Accumulated deficit | Total |                          |              |   |
|  | Number of Shares <sup>(1)</sup>               | Amount |               |                 |                               |                     |       |                          |              |   |
|  | NIS 0.01 par value                            | NIS    |               |                 |                               |                     |       |                          |              |   |
|  |   |        |               |                 |                               |                     |       |                          |              |   |
|  |   | NIS    | NIS           | NIS             | NIS                           | NIS                 | NIS   | NIS                      | US\$         |   |
| Balance as at January 1, 2015          | 19,203,186                                    | *      | 658           | (169)           | (197)                         | (475)               | (183) | 2,949                    | 2,766        | 709   |
| Changes during 2015:                   |   |        |               |                 |                               |                     |       |                          |              |   |
| Exercise of options in subsidiary      | -   | -      | -             | -               | 1                             | -                   | 1     | 18                       | 19           | 5   |
| Dividends to non-controlling interests | -   | -      | -             | -               | -                             | -                   | -     | (1,274)                  | (1,274)      | (327)                                       |
| Other comprehensive income             | -   | -      | -             | -               | 2                             | -                   | 2     | 5                        | 7            | 2   |
| Net income for the year                | -   | -      | -             | -               | -                             | 87                  | 87    | 996                      | 1,083        | 278   |
| Comprehensive income for the year      | -   | -      | -             | -               | 2                             | 87                  | 89    | 1,001                    | 1,090        | 280   |
| Balance as at December 31, 2015        | 19,203,186                                    | *      | 658           | (169)           | (194)                         | (388)               | (93)  | 2,694                    | 2,601        | 667   |

(\*) Represent an amount less than NIS 1.

(1) Net of treasury shares.

(2) Including reserve from transaction with non-controlling interests.

The accompanying notes are an integral part of these consolidated financial statements.

**Consolidated Statements of Cash Flows for the Year Ended December 31**

(In millions)

|  | 2013           | 2014           | 2015         | Convenience<br>translation into<br>U.S. dollars<br>(Note 2D) |
|--|----------------|----------------|--------------|--|
|  | NIS            | NIS            | NIS          | 2015<br>US\$   |
| <b>Cash flows from operating activities</b>                |                |                |              |  |
| Net income for the year                                    | 860            | 1,044          | 1,083        | 278  |
| Adjustments:   |                |                |              |  |
| Depreciation and amortization                              | 2,014          | 1,873          | 2,131        | 546  |
| Profit from the sale of Coral Tell Ltd. shares             | -              | (582)          | -            | -  |
| Profit from consolidating an investee                      | -              | -              | (12)         | (3)  |
| Share of losses of equity accounted investees              | 252            | 170            | (12)         | (3)  |
| Finance expenses, net                                      | 523            | 791            | 626          | 160  |
| Capital gain, net  | (94)           | (124)          | (136)        | (35)   |
| Income tax expenses  | 524            | 667            | 347          | 89   |
| Others   | 7              | (8)            | (13)         | (3)  |
| Change in inventory  | 9              | 28             | (20)         | (5)  |
| Change in trade and other receivables                      | 653            | 547            | 323          | 83   |
| Change in trade and other payables                         | 24             | (41)           | (271)        | (69)   |
| Changes in provisions                                      | (19)           | (63)           | 18           | 5  |
| Changes in employee benefits                               | 2              | 3              | 110          | 28   |
| Change in other liabilities                                | 11             | 4              | 4            | 1  |
| Net income tax paid, net                                   | (625)          | (527)          | (534)        | (138)  |
| <b>Net cash provided by operating activities</b>           | <b>4,141</b>   | <b>3,782</b>   | <b>3,644</b> | <b>934</b>   |
| <b>Cash flows from investing activities</b>                |                |                |              |  |
| Investment in intangible assets and deferred expenses      | (186)          | (194)          | (311)        | (80)   |
| Proceeds from the sale of property, plant and equipment    | 312            | 230            | 151          | 39   |
| Change in investments, net                                 | (182)          | (1,485)        | 1,638        | 419  |
| Purchase of property, plant and equipment                  | (1,042)        | (1,081)        | (1,324)      | (339)  |
| Net proceeds from the sale of Coral Tell shares            | -              | 596            | -            | -  |
| Deposits to restricted cash, net                           | -              | (65)           | (90)         | (23)   |
| Proceeds from (acquisition of) non-current investments     | 9              | (19)           | -            | -  |
| Cash from gaining control over investee                    | -              | -              | 299          | 77   |
| Other  | 56             | 29             | 18           | 5  |
| <b>Net cash provided by (used in) investing activities</b> | <b>(1,033)</b> | <b>(1,989)</b> | <b>381</b>   | <b>98</b>  |

The accompanying notes are an integral part of these consolidated financial statements.

**Consolidated Statements of Cash Flows for the Year Ended December 31 (cont'd)**

(In millions)

|   |                |                |                | Convenience<br>translation into<br>U.S. dollars<br>(Note 2D) |
|---|----------------|----------------|----------------|--|
|   | 2013           | 2014           | 2015           | 2015   |
|   | NIS            | NIS            | NIS            | US\$   |
| <b>Cash flows from financing activities</b>                 |                |                |                |  |
| Proceeds from issuance of debentures and loans received     | 1,667          | 4,330          | 1,010          | 259  |
| Repayment of debentures and loans                           | (2,048)        | (4,054)        | (2,358)        | (604)  |
| Interest paid   | (710)          | (755)          | (826)          | (212)  |
| Dividends to non-controlling interests                      | (1,987)        | (1,431)        | (1,274)        | (327)  |
| Payments to Eurocom DBS                                     | -              | -              | (680)          | (174)  |
| Increase of holdings in a subsidiary                        | 75             | -              | -              | -  |
| Other   | (2)            | (18)           | (10)           | (3)  |
| <b>Net cash used in financing activities</b>                | <b>(3,005)</b> | <b>(1,928)</b> | <b>(4,138)</b> | <b>(1,061)</b>   |
| <b>Net increase (decrease) in cash and cash equivalents</b> | <b>103</b>     | <b>(135)</b>   | <b>(113)</b>   | <b>(29)</b>  |
| Cash and cash equivalents as at the beginning of the year   | 764            | 867            | 732            | 188  |
| <b>Cash and cash equivalents as at the end of the year</b>  | <b>867</b>     | <b>732</b>     | <b>619</b>     | <b>159</b>   |

The accompanying notes are an integral part of these consolidated financial statements.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 1 - Reporting Entity**

Internet Gold–Golden Lines Ltd. (“the Company”) is an Israeli resident company incorporated in Israel. The address of the Company’s registered office is: 2 Dov Friedman Street, Ramat-Gan, Israel. The consolidated financial statements of the Company as at and for the year ended December 31, 2015, comprise the Company and its subsidiaries (together referred to as the Group). The Company holds the majority of the outstanding shares of B Communications Ltd. (“B Communications”). The Company is a subsidiary of Eurocom Communications Ltd. (“Eurocom” or “the Parent Company”) and its ultimate parent is Eurocom Holdings (1979) Ltd.

On April 14, 2010, B Communications completed the acquisition of 30.44% of the outstanding shares of Bezeq - The Israel Telecommunications Corp. Limited. (“Bezeq”) and became the controlling shareholder of Bezeq. Bezeq’s ordinary shares are registered for trade on the Tel-Aviv stock exchange.

On February 1, 2016, after the balance sheet date, B Communications sold 115,500,000 shares of Bezeq for NIS 8.5 per share or NIS 982 (4.18% of the outstanding shares of Bezeq). B Communications retained a 26.34% ownership interest in Bezeq, following the closing of the transaction. For de facto control over Bezeq, see note 12F.

The ordinary shares of the Company are registered for trade on the NASDAQ Global Select Market and on the Tel Aviv Stock Exchange.

**Note 2 - Basis of Preparation****A. Statement of compliance**

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards, as issued by the International Accounting Standards Board.

The consolidated financial statements were authorized for to be issued by the Company’s Board of Directors on April 18, 2016.

**B. Definitions**

In these financial statements-

- (1) The Company: Internet Gold – Golden lines Ltd.
- (2) The Group: Internet Gold – Golden lines Ltd. and its subsidiaries, as listed in Note 12 - Investees.
- (3) B Communications: B Communications Ltd. and its subsidiaries, as listed in Note 12 - Investees.
- (4) Bezeq: Bezeq - The Israel Telecommunication Corp. Limited.
- (5) Bezeq Group: Bezeq The Israel Telecommunication Corp. Limited and its subsidiaries, as listed in Note 11 - Investees.
- (6) DBS: DBS Satellite Services (1998) Ltd.

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**Notes to the Consolidated Financial Statements**


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(All amounts are in millions except where otherwise stated)

**Note 2 - Basis of Preparation (cont'd)**
**B. Definitions (cont'd)**

- (7) Subsidiaries: Companies whose financial statements are fully consolidated, directly or indirectly, with the financial statements of the Company.
- (8) Associates: Companies in which the Group's investment is included, directly or indirectly, in the consolidated financial statements on the equity basis.
- (9) Investees: Subsidiaries or associates.
- (10) Related party: As defined in IAS 24 (2009), Related Party Disclosures.
- (11) Israeli CPI: The consumer price index as published by the Israeli Central Bureau of Statistics.

**C. Functional currency and presentation currency**

The consolidated financial statements are presented in NIS, which is the Group's functional currency, and have been rounded to the nearest million. The NIS is the currency that represents the principal economic environment in which the Group operates.

**D. Convenience translation into U.S. dollars ("dollars" or "\$")**

For the convenience of the reader, the reported NIS figures as at December 31, 2015, have been presented in dollars, translated at the representative rate of exchange as at December 31, 2015 (NIS 3.902 = US\$ 1.00). The dollar amounts presented in these financial statements are merely supplementary information and should not be construed as complying with IFRS translation method or as representing amounts that are receivable or payable in dollars or convertible into dollars, unless otherwise indicated.

**E. Basis of measurement**

The consolidated financial statements have been prepared on the historical cost basis except for the following items:

- \* Financial instruments, including financial derivative instruments, measured at fair value recognized through profit or loss.
- \* Inventories measured at the lower of cost and net realizable value.
- \* Financial assets classified as available-for-sale measured at fair value.
- \* Equity-accounted investments.
- \* Deferred tax assets and liabilities.
- \* Provisions.
- \* Liabilities for employee benefits.
- \* Liabilities for payment of contingent consideration in a business combination.

For further information regarding the measurement of these assets and liabilities see Note 3 regarding significant accounting policies. The methods used to measure fair value are specified in Note 17E.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 2 - Basis of Preparation (cont'd)****F. Use of estimates and judgments**Use of estimates and judgments

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

The preparation of accounting estimates used in the preparation of the Group's financial statements requires management to make assumptions regarding circumstances and events that involve considerable uncertainty. Management of the Company prepares the estimates on the basis of past experience. In exercising its judgment when making the estimates, management relies on past experience, various facts, external circumstances, and reasonable assumptions according to the pertinent circumstances of each estimate.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Significant estimates and judgments made when applying accounting policies and changes in these estimates and assumptions that could potentially have a material effect on the financial statements are as follows:

| <b>Subject</b>  | <b>Main assumptions</b>   | <b>Possible implications</b>  | <b>Reference</b>  |
|---|---|---|-------------------|
| Useful life of property, plant and equipment and intangible assets                        | Useful life of property, plant and equipment and intangible assets  | Change in the value of property, plant and equipment and intangible assets and in depreciation and amortization expenses            | Note 8 and Note 9 |
| Fair value measurement of the Company's investment in DBS prior to gaining control in DBS | Assumption of expected cash flows from the operations of DBS, discount rate and assumptions about the identity of the relevant market participant.                          | Change in profit/loss from gaining control  | Note 12           |
| Attribution of excess cost arising from acquisition of control in DBS                     | Assumption of expected cash flows from identifiable assets in the business combination, timing of recognition, and scope of the deferred tax asset for carry-forward losses | Change in the value of identifiable tangible and intangible assets in the business combination and changes in the value of goodwill | Note 12           |
| Fair value measurement of contingent consideration in a business combination              | Assumption of expected cash flows and assumption of DBS's losses for tax purposes.  | Change in the value of a liability for contingent consideration recognized in a business combination                                | Note 12           |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 2 - Basis of Preparation (cont'd)****F. Use of estimates and judgments (cont'd)**

| <b>Subject</b>  | <b>Main assumptions</b>   | <b>Possible implications</b>  | <b>Reference</b>    |
|---|---|---|---------------------|
| Deferred taxes  | Assumption of projected future realization of the tax asset in the future, including assumptions for the use of carry-forward losses in DBS.  | Recognition or reversal of deferred tax asset in profit or loss                                 | Note 19             |
| Uncertain tax positions   | The Group's uncertain tax positions and the risk of incurring any additional tax and interest expenses. This is based on an analysis of a number of matters including interpretations of tax laws and the Group's past experience | Recognition of additional or open income tax expenses   | Note 19             |
| Provisions and contingent liabilities   | Assessment of the likelihood of claims against Group companies and measuring potential liabilities attributable to claims   | Reversal or creation of a provision for a claim and recognition of income/expense, respectively | Note 15 and Note 20 |
| Measurement of recoverable amounts of cash-generating units that include goodwill | Assumption of expected cash flows from cash generating units  | Recognition of impairment loss  | Note 9              |
| Post-employment employee benefits   | Actuarial assumptions such as discount rate, future salary increases and turnover   | Increase or decrease in the post-employment defined benefit obligations                         | Note 18             |

**G. Determination of fair value**

When preparing the financial statements, the Group is required to determine the fair value of certain assets and liabilities. Further information about the assumptions made in determining fair values is disclosed in Note 17E regarding fair value.

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**Notes to the Consolidated Financial Statements**


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(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies**

The accounting policies set out below have been applied consistently by Group entities for all periods presented in these consolidated financial statements.

**A. Consolidation of the financial statements and investments in associates**
**(1) Business combinations**

In view of the consolidation of DBS as from March 23, 2015, as described in Note 12, below is a description of the accounting policy for the consolidation of DBS in these financial statements:

- A. The Group implemented the acquisition method for all business combinations. The acquisition date is the date on which the acquirer obtained control over the acquiree.
- B. The Group recognized goodwill at acquisition based on the fair value of the consideration transferred, and the fair value at the acquisition date of any pre-existing equity right of the Group in the acquiree, less the net amount of the identifiable assets acquired and the liabilities assumed.
- C. The consideration transferred includes the fair value of the assets transferred to the previous owners of the acquiree and the liabilities incurred by the acquirer to the previous owners of the acquiree, including the obligation to acquire the acquiree's equity instruments. In addition, the consideration transferred includes the fair value of any contingent consideration.
- D. In the step acquisitions, the difference between the fair value at the acquisition date of the Group's pre-existing equity rights in the acquiree and the carrying amount at that date is recognized in the statement of income under other operating income or expenses.
- E. Costs associated with the acquisition that were incurred by the Group in the business combination such as advisory, legal, valuation and other professional or consulting fees were recognized as expenses in the period the services are received.

**(2) Transactions eliminated on consolidation**

Intra-group balances and income and expense arising from intra-group transactions are eliminated in the preparation of the consolidated financial statements.

**B. Foreign currency transactions**

Transactions in foreign currency are translated into the functional currency of the Group at the exchange rate on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies on the reporting date are retranslated to the functional currency at the exchange rate at that date.



**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies****C. Financial instruments****(1) Non-derivative financial assets**

Non-derivative financial assets include mainly investments in exchange traded notes, financial funds, exchange traded funds ("ETFs"), deposit certificates, debt instruments, shares, trade and other receivables, and cash and cash equivalents.

The Group initially recognizes loan and receivables when they are originated. All other financial assets are initially recognized at the date that the Group becomes a party to contractual provisions of the instrument.

Financial assets are derecognized when the contractual rights of the Group to the cash flows from the asset expire, or the Group transfers the rights to receive the contractual cash flows from the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred.

Regular way sales of financial assets are recognized on the trade date, meaning on the date the Group undertook to sell the asset.

**(2) Classification of financial assets and the accounting treatment in each group**

The Group classifies its financial assets as follows:

**Cash and cash equivalents**

Cash comprises cash balances available for immediate use and call deposits. Cash equivalents comprise short-term highly liquid investments (with original maturities of three months or less) that are readily convertible into known amounts of cash and are exposed to insignificant risks of change in value.

**Financial assets at fair value through profit or loss**

A financial asset is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Upon initial recognition, attributable transaction costs are recognized in the statement of income as incurred. These financial assets are measured at fair value and changes therein are recognized in the statement of income.

**Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method, net of impairment losses.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)****C. Financial instruments (cont'd)****(3) Non-derivative financial liabilities**

Non-derivative financial liabilities include debentures issued by the Group, loans and borrowings from banks and other credit providers, and trade and other payables.

The Group initially recognizes debt instruments as they are incurred.

Financial liabilities are initially recognized at fair value plus any attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest method.

Financial liabilities are derecognized when the obligation of the Group, as specified in the agreement, expires or when it is discharged or canceled.

**(4) CPI-linked assets and liabilities that are not measured at fair value**

The value of CPI-linked financial assets and liabilities, which are not measured at fair value, is revaluated in each period according to the actual increase in the CPI.

**(5) Offsetting financial instruments**

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group currently has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

**(6) Change in terms of debt instruments**

An exchange of debt instruments having substantially different terms, between an existing borrower and lender is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability at fair value. Furthermore, a substantial modification of the terms of the existing financial liability or part of it is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

The terms are substantially different if the discounted present value of the cash flows according to the new terms, including any commissions paid, less any commissions received and discounted using the original effective interest rate, is different by at least ten percent from the discounted present value of the remaining cash flows of the original financial liability.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)****C. Financial instruments (cont'd)****(7) Derivative financial instruments including hedge accounting****a. Hedge accounting**

The Group holds derivative financial instruments to hedge cash flows for risks to future changes in the CPI and foreign currency exchange rate risks.

Forward contracts are measured at fair value. Changes in the fair value of the derivative hedging instrument designated as a cash flow hedge are recognized through other comprehensive income, in a hedging reserve under equity, to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognized in profit or loss. The amount recognized in the hedging reserve is reclassified to profit or loss in the same period as the hedged item affect profit or loss under the same line item in the statement of income as the hedged item.

**b. Economic hedges**

The Group holds other derivative financial instruments to economically hedge its exposure to foreign currency and the CPI. Hedge accounting is not applied to derivative instruments that economically hedge financial assets and liabilities. Derivative instruments are recognized initially at fair value and attributable transaction costs are recognized in the statement of income as incurred. Subsequent to initial recognition, derivative financial instruments are measured at fair value and the changes in fair value are recognized in the statement of income as incurred.

**(8) Share capital****a. Ordinary shares**

Incremental costs directly attributable to the issue of ordinary shares are recognized as a deduction from equity.

**b. Treasury shares**

When share capital recognized as equity is repurchased, the amount of the consideration paid, which includes directly attributable costs, net of any tax effects, is recognized as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity. When treasury shares are sold or reissued subsequently, the amount received is recognized as an increase in equity, and the resulting surplus or deficit on the transaction is carried to share premium.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)****D. Broadcast rights**

Broadcast rights are recognized at cost, net of rights exercised. The costs of rights to broadcast acquired content include the amounts paid to the rights provider, plus direct costs for preparing the rights to the broadcast. Broadcast rights are amortized in accordance with the actual broadcasts of the total number of expected broadcasts based on the management's estimate or broadcasts permitted under the agreement (the part that is unamortized at the end of the agreement term is amortized in full upon its termination), or on a straight line basis in accordance with the term of the rights agreement or the economic life, whichever is shorter. The net change of broadcast rights is presented in the cash flows statements as adjustments to net income in operating activities.

**E. Property, plant and equipment****(1) Recognition and measurement**

Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to acquisition of the asset. The cost of self-constructed assets includes the cost of materials, direct labor and financing costs as well as any other cost directly attributable to bringing the asset to the condition for its use intended by the management, and the costs of dismantling and removing the items and restoring the site on which they are located when the Group has an obligation to vacate and restore the site. The cost of purchased software that is integral to the functionality of the related equipment is recognized as part of the cost of the equipment.

Spare parts, servicing equipment and stand-by equipment are classified as property, plant and equipment when they meet the definition of property, plant and equipment under IAS 16, otherwise they are classified as inventory.

When major parts of the property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of the property, plant and equipment.

Gains or losses on disposal of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of the asset, and are recognized net under "other operating income" in the statement of income.

**(2) Subsequent expenditure**

The cost of replacing part of an item of property, plant and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefit embodied in the replaced item will flow to the Group and its cost can be measured reliably. The costs of day-to-day servicing are recognized in the statement of income as incurred.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)****E. Property, plant and equipment (cont'd)****(3) Depreciation**

Depreciation is recognized in the statement of income on a straight-line basis over the estimated useful life of each part of an item of property, plant and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets under finance lease agreements are depreciated over the shorter of the lease term and their useful lives. An asset is depreciated when it is ready for use, meaning when it reaches the location and condition necessary for it to be capable of operating in the manner intended by management.

Leasehold improvements are depreciated over the shorter of the lease term, including the extension option held by the Group and expected to be exercised and the expected life of the improvement.

The estimated useful lives for the current period are as follows:

|  | <b>Useful life</b> | <b>Principal depreciation rate (%)</b> |
|--|--------------------|--|
| Fixed line and international network equipment (switches, transmission, power) | 4-12               | 12                                     |
| Network  | 12-33              | 6                                      |
| Subscriber equipment and installations   | 4-6                | 20                                     |
| Equipment and infrastructure for multichannel television                       | 3-15               | 14                                     |
| Vehicles   | 6-7                | 15                                     |
| Office and general equipment   | 5-14               | 15                                     |
| Electronic equipment, computers and internal communication systems             | 3-7                | 24                                     |
| Cellular network   | 4-15               | 13                                     |
| Buildings  | 25                 | 4                                      |
| Submarine communications cable   | 4-25               | 4                                      |

Depreciation methods, useful lives and residual values are reviewed at least at each reporting year and adjusted as required.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)****F. Non-current assets held for sale**

Non-current assets are classified as held for sale if it is highly probable that they will be recovered primarily through a sale transaction rather than ongoing use. These assets are presented at the lower of the carrying amount and fair value, less selling costs.

**G. Intangible assets****(1) Goodwill and brand name**

Goodwill and brand names that arise upon the acquisition of subsidiaries are included in intangible assets. Subsequent to initial recognition, brand name (Bezeq CGU, Bezeq international CGU and Pelephone CGU) and goodwill are measured at cost less accumulated impairment losses. Goodwill and brand names are measured at least once a year to assess impairment.

**(2) Software development costs**

Software development costs are recognized as an intangible asset only if the development costs can be measured reliably; the software is technically and commercially feasible; and the Group has sufficient resources to complete the development and intends to use the software. The costs recognized as an intangible asset include the cost of the materials, direct labor and overhead expenses directly attributable to preparation of the asset for its intended use. Other development costs are recognized in the statement of income as incurred.

Capitalized development costs are measured at cost less amortization and accumulated impairment losses.

**(3) Software**

Software that is an integral part of the hardware, which cannot function without the programs installed on it, is classified as property, plant and equipment. However, licenses for stand-alone software, which adds functionality to the hardware, is classified (mainly) as intangible assets. Software depreciation is recognized in the statement of income using the straight-line method over the estimated useful life of the asset.

**(4) Frequency rights**

Rights to frequencies refer to frequencies assigned to Pelephone for cellular activities, after it won the dedicated tenders of the Ministry of Communications. Depreciation of the asset is recognized in the statement of income on the straight-line basis over the allocation of frequencies term, which started from the use of the frequencies. The 4G frequencies (LTE) are amortized over a period of 10 years. The 3.5G frequencies (UMTS / HSPA) are amortized over a period of 13 years and seven months.

**(5) Other intangible assets**

Other intangible assets acquired by the Group, which have a definite useful life, are measured at cost less amortization and accumulated impairment losses.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)****G. Intangible assets (cont'd)****(6) Subsequent expenditure**

Subsequent expenditure is recognized as an intangible asset only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditures, including expenditures relating to generated goodwill and brands, are recognized in the statement of income as incurred.

**(7) Amortization**

Amortization, except for goodwill, brand name (excluding brand acquired in DBS business combination) and customer relationships, is recognized in the statement of income on a straight-line basis over the estimated useful life of the intangible assets, from the date on which the assets are available for use. Goodwill and brand name are not systematically amortized but are tested for impairment at least once a year.

Customer relationships are amortized according to the economic benefit expected from those customers each period based on their expected churn rate, which results in accelerated amortization during the early years of the relationship.

Estimated useful lives for the current and comparative periods are as follows:

| Type of asset                            | Amortization period  |
|--|--|
| Frequency usage rights                   | Over the term of the license for 10 to 14 years starting from the first use of the frequencies |
| Computer programs and software licenses  | 3 - 10 years according to the term of the license or the estimated time of use of the program  |
| Customer relationships                   | 5 - 12 years   |
| Brand acquired in a business combination | 12   |
| Other rights                             | 2 - 6 years according to the useful lives  |

Amortization methods and useful lives are reviewed at least once a year and adjusted if appropriate.

**H. Leased assets**

Leases, including leases of land from the Israel Land Administration, where the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the assets are measured at cost less accumulated amortization and impairment losses.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)****H. Leased assets (cont'd)**

Other leases are classified as operating leases and the leased assets are not recognized in the Group's statement of financial position. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease.

At inception or upon reassessment of an arrangement, the Group determines whether such an arrangement is or contains a lease. An arrangement is a lease or contains a lease if the following two criteria are met:

A. The fulfillment of the arrangement is dependent on the use of a specific asset or assets.

B. The arrangement contains rights to use the asset.

If, in accordance with these terms, the Group determines that the agreement does not contain a lease, the agreement is accounted for as a service agreement and payments for the service are recognized in profit or loss on a straight-line basis, over the service period.

**I. Right of use of capacities**

Transactions for acquiring an indefeasible right of use of submarine communication cable capacities are mostly accounted for as service transactions. The prepaid expense is amortized on a straight-line basis as stated in the agreement, but for no longer than the expected estimated useful life of those capacities.

Identifiable capacities which serve Bezeq exclusively meet the definition of a finance lease and are recognized in property, plant and equipment. The asset is depreciated on a straight-line basis as stated in the agreement, but for no longer than the expected estimated useful life of those capacities.

**J. Inventory**

Inventories are measured at the lower of cost or net realizable value. The Group elected to recognize the cost of inventories according to the moving average method.

The inventories of a subsidiary include terminal equipment and accessories intended for sale and service, as well as spare parts used for repairs in the repair service it provides to its customers.

Slow-moving inventory of terminal equipment, accessories and spare parts are stated net of the provision for impairment.



**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)****K. Impairment****(1) Non-derivative financial assets**

The Group tests a financial asset for impairment when objective evidence indicates that one or more loss events have had a negative effect on the estimated future cash flows of that asset.

Significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed for impairment collectively, in groups that share similar credit risk characteristics. The financial statements include specific provisions and Group provisions for doubtful debts, which properly reflect, in the estimation of the management, the loss inherent in debts for which collection is in doubt.

**(2) Non-financial assets**Timing of impairment testing

The carrying amounts of the Group's non-financial assets, other than inventory and deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the recoverable amount of the asset is estimated.

The Group assesses the recoverable amount of goodwill and brand name once a year, or more frequently if there are indications of impairment.

Measurement of recoverable amount

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash-generating unit, for which the estimated future cash flows from the asset or cash-generating unit were not adjusted.

Determining cash-generating units

For the purpose of impairment testing, the assets are grouped together into the smallest group of assets that generates cash from continuing use that are largely independent of other assets or groups of assets ("cash-generating unit").

Allocation of goodwill to cash-generating units

For purposes of goodwill impairment testing, cash-generating units to which goodwill has been allocated are aggregated so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes, but in any event is not larger than an operating segment. Goodwill acquired in a business combination is allocated to cash-generating units that are expected to generate benefits from the synergies of the combination.

For purposes of goodwill impairment testing, when the non-controlling interests are initially measured according to their relative share of the acquiree's net identifiable assets, the carrying amount of the goodwill is adjusted according to the share which the Group holds in the cash-generating unit to which the goodwill is allocated.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)****K. Impairment (cont'd)****(2) Non-financial assets (cont'd)**Recognition of impairment loss

An impairment loss is recognized if the carrying amount of an asset or cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. As regards cash-generating units that include goodwill, an impairment loss is recognized when the carrying amount of the cash-generating unit, after including the balance of goodwill, exceeds its recoverable amount. Impairment losses recognized in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the cash-generating unit on a pro rata basis.

Allocation of impairment loss to non-controlling interests

If an impairment loss allocated to non-controlling interest relates to goodwill that was not recognized in the consolidated financial statements, the said impairment is not recognized as an impairment loss on goodwill. In such cases, only an impairment loss relating to goodwill that was allocated to the owners of the Company is recognized as an impairment loss on goodwill.

**L. Employee benefits****(1) Post-employment benefits**

The Group has a number of post-employment benefit plans. The plans are usually financed by deposits with insurance companies and they are classified as defined contribution plans and defined benefit plans.

**a. Defined contribution plans**

A defined contribution plan is a post-employment benefit plan under which the Group pays fixed contributions into a separate entity and has no legal or constructive obligation to pay further amounts.

The Group's obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense in the statement of income in the periods during which services are rendered by employees.

**b. Defined benefit plans**

The Group's net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods. That benefit is presented at its present value, and the fair value of any plan assets is deducted. The calculation is performed annually by a qualified actuary. The discount rate is the yield at the reporting date on high-quality linked corporate debentures denominated in NIS, with maturity dates approximating the terms of the Group's obligations.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)****L. Employee benefits (cont'd)****(1) Post-employment benefits (cont'd)**

Net interest costs on a defined benefit plan are calculated by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability.

The Group elected to recognize the interest costs that were recognized in profit or loss under financing expenses.

Remeasurement of the net defined benefit liability comprises actuarial gains and losses and the return on plan assets (excluding interest). Remeasurements are recognized immediately directly in retained earnings through other comprehensive income.

When the benefits of a plan are improved or curtailed, the portion of the increased benefit relating to past service by employees or the gain or loss on curtailment are recognized immediately in profit or loss when the plan improvement or curtailment occurs.

**(2) Other long-term employee benefits**

The Group's net obligation in respect of long-term employee benefits other than pension plans is the amount of future benefit that employees have earned in return for their service in the current and prior periods. The amount of these benefits is stated at its present value. The discount rate is the yield at the reporting date on high-quality linked corporate debentures denominated in NIS, with maturity dates approximating the terms of the Group's obligations. Any actuarial gains or losses are recognized in the statement of income in the period in which they arise.

**(3) Benefits for early retirement and dismissal**

Termination benefits are recognized as an expense when the Group is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to terminate employment before the normal retirement date. Termination benefits for voluntary redundancies are recognized as an expense if the Group has made an offer of voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

**(4) Short-term benefits**

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognized for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

The employee benefits are classified, for measurement purposes, as short-term benefits or as other long-term benefits depending on the date when the benefits are expected to be wholly settled.

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**Notes to the Consolidated Financial Statements**


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(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)**
**L. Employee benefits (cont'd)**
**(4) Short-term benefits (cont'd)**

In the statement of financial position the employee benefits are classified as current benefits or as non-current benefits according to the time the liability is due to be settled.

**M. Provisions**

A provision is recognized if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is more likely than not that an outflow of economic benefits will be required to settle the obligation.

**(1) Legal claims**

Contingent liabilities are accounted for according to IAS 37 and its related provisions. Accordingly, the claims are classified by likelihood of realization of the exposure to risk, as follows:

- a. More likely than not - more than 50% probability
- b. Possible - probability higher than unlikely and less than 50%
- c. Remote - probability of 10% or less

For claims which the Group has a legal or constructive obligation as a result of a past event, which are more likely than not to be realized, the financial statements include provisions which, in the opinion of the Group, based, among other things, on the opinions of its legal advisers retained in respect of those claims, are appropriate to the circumstances of each case, despite the claims being denied by the Group companies. There are also a few recently filed legal proceedings for which the risks cannot be assessed at this stage, therefore no provisions have been made.

Note 20 describe the amount of additional exposure due to contingent liabilities that are likely to be realized.

**(2) Site restoration and clearing costs**

A provision in respect of an obligation to restore and clear sites is recognized for those rental agreements where the Group has an undertaking to restore the rental property to its original state at the end of the rental period, after dismantling and transferring the site, and restoring it as necessary. The provisions are determined by discounting the expected future cash flows. The carrying amount of the provision is adjusted each period to reflect the time that has passed and is recognized as a financing expense.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)****M. Provisions (cont'd)****(3) Warranty**

A subsidiary recognizes a provision for warranty expenses in respect of first-year warranty for cellular handsets. The warranty is limited to technical malfunctions defined by the subsidiary, and does not include warranty as a result of customer damage. However, an asset is recognized in respect of the manufacturer's warranty for those handsets, which is limited to technical malfunctions defined by the manufacturer.

**N. Revenues**

Revenues are measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates.

**(1) Equipment sales**

Revenues from sales of terminal equipment are recognized in the statement of income when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably and the Group companies have no continuing involvement with the goods.

Revenues from the sale of terminal equipment to subscribers in long-term credit arrangements are recognized upon delivery to the customer at the present value of the future cash flow expected from them, at the appropriate interest rate for transactions of this kind (see Note 7). Financing income in respect of these transactions is recognized in the statement of income over the period of the installments using the effective interest method.

**(2) Revenues from services**

Revenues from services rendered are recognized in the statement of income proportionately over the term of the agreement or upon providing the service if the flow of the economic benefits associated with providing the service is probable. Revenues from calls, including revenues from prepaid call cards, are recognized when the call is made by the customer.

**(3) Reporting gross or net revenues**

When the Group acts as an agent or intermediary without bearing the risks and rewards deriving from the transaction, its revenues are recognized on a net basis (as profit or commission). The Group operates as an agent mainly for certain content services provided by other suppliers and payment is collected by the Group. However, when the Group acts as principal and bears the risks and rewards associated with the transaction, its revenues are recognized on a gross basis (such as interconnect fees).

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)****O. Financing income and expense**

Financing income comprises interest income from deposits, interest and CPI linkage income from loans to an associated company, interest income accrued using the effective interest method in respect of the sale of terminal equipment in installments, gains on the disposal of available-for-sale financial assets, and changes in the fair value of financial assets at fair value through the statement of income.

Financing expense comprises interest and linkage expense on borrowings, debentures issued, changes in the fair value of financial assets at fair value through the statement of income, impairment losses recognized on financial assets (except for a provision for doubtful debts, which is recognized under operating and general expenses), and financing expenses for provisions arising from legal claims.

In the statement of cash flows, interest received and dividends received are presented as part of cash flows from investing activities. The Group elected to present interest and linkage differences paid for loans and debentures under cash flows used for financing activities.

**P. Income tax expense**

Income tax expense comprises current and deferred tax and is recognized in the statement of income, or in other comprehensive income to the extent it relates to items recognized in other comprehensive income.

Current taxes

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date. Current taxes also include taxes in respect of prior years.

Uncertain tax positions

A provision for uncertain tax positions, including additional tax and interest expenses, is recognized when it is more likely than not that the Group will have to use its economic resources to pay the obligation.

Deferred taxes

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The Group does not recognize deferred taxes for the following temporary differences:

- Initial recognition of goodwill.
- Differences arising from investment in subsidiaries and associates, if it is probable that they will not reverse in the foreseeable future and if the Group controls the date of reversal.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)****P. Income tax expense (cont'd)**

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognized for carry-forward losses, tax benefits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Offsetting deferred tax assets and liabilities

The Group sets off deferred tax assets and liabilities if there is a legally enforceable right to offset deferred tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, but they intend to settle deferred tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

**Q. Earnings per share**

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the year. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise warrants and share options granted to employees.

**R. Dividend**

An obligation relating to a dividend proposed or declared after the reporting date is recognized only in the period in which the declaration was made (approved by the general shareholders' meeting). In the statement of cash flows, dividend paid is presented as part of cash flows used in financing activities.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 3 - Significant Accounting Policies (cont'd)****S. New standards and interpretations not yet adopted**

| <b>Standard</b>                                 | <b>Subject</b>   | <b>Implementation and transition provisions</b>  | <b>Expected effects</b>  |
|---|--|--|--|
| IFRS 9 (2014), Financial Instruments            | IFRS 9 (2014) replaces the requirements included in IAS 39 regarding classification and measurement of financial assets and financial liabilities, hedge accounting, and impairment of financial instruments.  | IFRS 9 (2014) will be effective for annual periods starting from January 1, 2018. Early application is permitted. IFRS 9 (2014) will be applied retrospectively, except for a number of exemptions.  | The Group is examining the effects of adopting IFRS 9 (2014) on the financial statements.                            |
| IFRS 15, Revenues from Contracts with Customers | IFRS 15 replaces current guidelines for revenue recognition and presents a new model for recognition of revenues from contracts with customers. The model includes five steps for analyzing transactions to determine the timing and amount of revenue recognition. IFRS 15 also establishes new and more extensive disclosure requirements.   | IFRS 15 (2014) will be effective for annual periods starting from January 1, 2018. Early application is permitted. IFRS 15 includes various alternatives for the transition guidelines, so that companies may choose one alternative upon initial application. | The Group is examining the effects of adopting IFRS 15.  |
| IFRS 16, Leases                                 | The standard replaces the previous instructions under IAS. For lessees, IFRS 16 eliminates the current classification of leases as either operating leases or finance leases and introduces a single lessee accounting model for all leases on a balance sheet (other than a number of exceptions), which are substantially similar to the accounting treatment for finance leases today. By contrast, the accounting treatment in the lessors' financial statements is expected to remain the same as the accounting treatment today. In addition, the standard establishes new and expanded disclosure requirements, both by lessors and by the lessees. | The standard will be effective for annual periods starting from January 1, 2019. Early application is possible, provided that the Company also applies IFRS 15, Revenue from Contracts with Customers.   | The Group will examine the effects of IFRS 16.   |
| Amendments to IAS 38 Intangible Assets          | The amendment to IAS 38 introduces a rebuttable presumption that a revenue-based amortization method for intangible assets is inappropriate. The purpose of the amendment is to restrict the use of revenue-based amortization, and therefore companies that want to continue amortizing an intangible asset using that method will have to show that the revenue and consumption of the economic benefits are highly correlated.  | The amendments are to be applied on a prospective basis for annual periods beginning on or after January 1, 2016 with earlier application being permitted.   | In the opinion of the Group, application of the amendments will have no material effect on the financial statements. |



**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 4 - Segment Reporting**

The Group operates in various segments in the communications sector and every company in the Group operates in one separate business segment. The primary reporting format, by business segments, is based on the Group's management and internal reporting structure.

Each company provides services in the segment in which it operates, using the property, plant and equipment and the infrastructure it owns. The infrastructure of each company is used only for providing its services. Each of the companies in the Group is exposed to different risks and yield expectations, mainly with respect to the technology and competition in the segment in which it operates. Accordingly, the separable components in the Group are each company in the Group.

The Group's investment in DBS was accounted for using the equity method up to March 23, 2015. As from this date, the financial statements of DBS are consolidated with the financial statements of the Group as described in Note 12B below. The Group reports on multichannel television as an operating segment without adjustment to ownership rates and excess cost in all reporting periods.

Based on the above, the business segments of the Group are as follows:

- Bezeq - The Israel Telecommunication Corp. Ltd.: fixed line domestic communications
- Pelephone Communications Ltd.: cellular communications
- Bezeq International Ltd.: international communications, internet services and network end point
- DBS Satellite Services (1998) Ltd.: multichannel television

The other companies in the Group are presented under the "Other" item. Other operations include call center services (Bezeq Online) and online shopping and classified ads, (through Walla). These operations are not reported as reporting segments as they do not fulfill the quantitative thresholds.

Inter-segment pricing is set at the price determined in a transaction between unrelated parties.

The results, assets and liabilities of a segment include items directly attributable to that segment, as well as those that can be allocated on a reasonable basis.

Segment capital expenditure is the total cost incurred during the period for acquisition of property, plant and equipment and intangible assets.

After DBS became a wholly-owned subsidiary of the Company on June 24, 2015, the Company updated the internal management reporting structure for financing income for the shareholders loans that were provided to DBS. Accordingly, the Company restated financing income under the separate interim financial information. As from 2015, the Company no longer recognizes financing income for the shareholders loans under the financing income of the fixed-line domestic communications segment. Financing expenses in the multichannel television segment include financing expenses for the loans without any change. The comparative figures were restated to reflect the change in the reporting structure: financing income in the amount of NIS 213 was eliminated in the fixed-line domestic communications segment for the year ended December 31, 2014, and NIS 226 in the year ended December 31, 2013.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 4 - Segment Reporting (cont'd)****A. Operating Segments**

|   | Year ended December 31, 2013                    |                                   |  |                                    |               |                    |                     |
|---|---|-----------------------------------|--|------------------------------------|---------------|--------------------|---------------------|
|   | Domestic<br>fixed-line<br>communications<br>NIS | Cellular<br>communications<br>NIS | International<br>communications<br>and internet<br>services<br>NIS | Multi-channel<br>television<br>NIS | Others<br>NIS | Adjustments<br>NIS | Consolidated<br>NIS |
| Revenue from external entities  | 4,198   | 3,741                             | 1,365  | 1,633                              | 241           | (1,633)            | 9,545               |
| Inter-segment revenues  | 280   | 68                                | 68   | 2                                  | 21            | (421)              | 18                  |
| Total revenue   | 4,478   | 3,809                             | 1,433  | 1,635                              | 262           | (2,054)            | 9,563               |
| Depreciation and amortization   | 683   | 458                               | 130  | 263                                | 31            | 449                | 2,014               |
| Segment results- operating income                                     | 1,991   | 608                               | 227  | 268                                | (4)           | (1,058)            | 2,032               |
| Finance income  | 314   | 137                               | 9  | 7                                  | -             | 68                 | 535                 |
| Finance expenses  | (534)   | (46)                              | (23)   | (654)                              | (6)           | 332                | (931)               |
| Total finance income (expense), net                                   | (220)   | 91                                | (14)   | (647)                              | (6)           | 400                | (396)               |
| Segment profit (loss) after finance<br>expenses, net                  | 1,771   | 699                               | 213  | (379)                              | (10)          | (658)              | 1,636               |
| Share in losses of equity-accounted<br>investee                       | -   | -                                 | 1  | -                                  | -             | (253)              | (252)               |
| Segment profit (loss) before income tax                               | 1,771   | 699                               | 214  | (379)                              | (10)          | (911)              | 1,384               |
| Income tax  | 408   | 178                               | 56   | 2                                  | 5             | (125)              | 524                 |
| Segment results - net profit (loss)                                   | 1,363   | 521                               | 158  | (381)                              | (15)          | (786)              | 860                 |
| Additional information:   |   |                                   |  |                                    |               |                    |                     |
| Segment assets  | 7,767   | 4,126                             | 1,248  | 1,617                              | 232           | 2,580              | 17,570              |
| Goodwill  | -   | -                                 | 6  | -                                  | 87            | 2,732              | 2,825               |
| Investment in equity-accounted investee                               | -   | -                                 | 3  | -                                  | 14            | 998                | 1,015               |
| Segment liabilities   | 11,234  | 1,242                             | 440  | 5,960                              | 249           | (868)              | 18,257              |
| Investments in property, plant and<br>equipment and intangible assets | 777   | 335                               | 106  | 327                                | 19            | (327)              | 1,237               |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 4 - Segment Reporting (cont'd)****A. Operating Segments (cont'd)**

|  | <b>Year ended December 31, 2014</b>                       |  |   |   |                       |                            |                             |
|--|---|--|---|---|-----------------------|----------------------------|-----------------------------|
|  | <b>Domestic<br/>fixed-line<br/>communications<br/>NIS</b> | <b>Cellular<br/>communications<br/>NIS</b> | <b>International<br/>communications<br/>and internet<br/>services<br/>NIS</b> | <b>Multi-channel<br/>television<br/>NIS</b> | <b>Others<br/>NIS</b> | <b>Adjustments<br/>NIS</b> | <b>Consolidated<br/>NIS</b> |
| Revenue from external entities                                     | 4,045   | 3,361                                      | 1,419   | 1,724                                       | 209                   | (1,724)                    | 9,034                       |
| Inter-segment revenues   | 272   | 58   | 85  | -   | 17                    | (411)                      | 21                          |
| <b>Total revenue</b>   | <b>4,317</b>  | <b>3,419</b>                               | <b>1,504</b>  | <b>1,724</b>                                | <b>226</b>            | <b>(2,135)</b>             | <b>9,055</b>                |
| <b>Depreciation and amortization</b>                               | <b>688</b>  | <b>430</b>                                 | <b>130</b>  | <b>298</b>                                  | <b>23</b>             | <b>304</b>                 | <b>1,873</b>                |
| Segment results- operating income                                  | 1,980   | 449  | 232   | 273   | 629                   | (988)                      | 2,575                       |
| Finance income   | 285   | 77   | 9   | 26  | 11                    | 227                        | 635                         |
| Finance expenses   | (472)   | (21)                                       | (18)  | (619)                                       | (2)                   | (197)                      | (1,329)                     |
| Total finance income (expense), net                                | (187)   | 56   | (9)   | (593)                                       | 9                     | 30                         | (694)                       |
| Segment profit (loss) after finance expenses, net                  | 1,793   | 505  | 223   | (320)                                       | 638                   | (958)                      | 1,881                       |
| Share in profit (loss) of equity-accounted investee                | -   | -  | 1   | -   | (3)                   | (168)                      | (170)                       |
| Segment profit (loss) before income tax                            | 1,793   | 505  | 224   | (320)                                       | 635                   | (1,126)                    | 1,711                       |
| Income tax   | 478   | 132  | 60  | 1   | 147                   | (151)                      | 667                         |
| <b>Segment results - net profit (loss)</b>                         | <b>1,315</b>  | <b>373</b>                                 | <b>164</b>  | <b>(321)</b>                                | <b>488</b>            | <b>(975)</b>               | <b>1,044</b>                |
| <b>Additional information:</b>                                     |   |  |   |   |                       |                            |                             |
| Segment assets   | 8,483   | 3,541                                      | 1,206   | 1,820                                       | 682                   | 2,087                      | 17,820                      |
| Goodwill   | -   | -  | 6   | -   | 10                    | 2,665                      | 2,681                       |
| Investment in equity-accounted investee                            | -   | -  | 4   | -   | 11                    | 1,042                      | 1,057                       |
| Segment liabilities  | 12,369  | 696  | 392   | 6,484                                       | 107                   | (1,256)                    | 18,792                      |
| Investments in property, plant and equipment and intangible assets | 835   | 339  | 110   | 332   | 17                    | (332)                      | 1,301                       |

## Notes to the Consolidated Financial Statements

(All amounts are in millions except where otherwise stated)

## Note 4 - Segment Reporting (cont'd)

## A. Operating Segments (cont'd)

|   | Year ended December 31, 2015                    |                                   |  |                                    |               |                    |                     |
|---|---|-----------------------------------|--|------------------------------------|---------------|--------------------|---------------------|
|   | Domestic<br>fixed-line<br>communications<br>NIS | Cellular<br>communications<br>NIS | International<br>communications<br>and internet<br>services<br>NIS | Multi-channel<br>television<br>NIS | Others<br>NIS | Adjustments<br>NIS | Consolidated<br>NIS |
| Revenue from external entities  | 4,122   | 2,831                             | 1,485  | 1,774                              | 197           | (440)              | 9,969               |
| Inter-segment revenues  | 285   | 59                                | 93   | -                                  | 24            | (445)              | 16                  |
| Total revenue   | 4,407   | 2,890                             | 1,578  | 1,774                              | 221           | (885)              | 9,985               |
| Depreciation and amortization   | 725   | 419                               | 132  | 322                                | 13            | 520                | 2,131               |
| Segment results- operating income                                     | 2,148   | 157                               | 240  | 250                                | (15)          | (767)              | 2,013               |
| Finance income  | 30  | 53                                | 7  | 32                                 | 17            | 25                 | 164                 |
| Finance expenses  | (362)   | (4)                               | (15)   | (635)                              | (2)           | 259                | (759)               |
| Total finance income (expense), net                                   | (332)   | 49                                | (8)  | (603)                              | 15            | 284                | (595)               |
| Segment profit (loss) after finance<br>expenses, net                  | 1,816   | 206                               | 232  | (353)                              | -             | (483)              | 1,418               |
| Share in profit (loss) of equity-accounted<br>investee                | -   | -                                 | -  | -                                  | (2)           | 14                 | 12                  |
| Segment profit (loss) before income tax                               | 1,816   | 206                               | 232  | (353)                              | (2)           | (469)              | 1,430               |
| Income tax  | 492   | 55                                | 60   | 1                                  | -             | (261)              | 347                 |
| Segment results - net profit (loss)                                   | 1,324   | 151                               | 172  | (354)                              | (2)           | (208)              | 1,083               |
| Additional information:   |   |                                   |  |                                    |               |                    |                     |
| Segment assets  | 7,311   | 3,269                             | 1,160  | 1,667                              | 661           | 5,251              | 19,319              |
| Goodwill  | -   | -                                 | 6  | -                                  | 10            | 3,050              | 3,066               |
| Investment in equity-accounted investee                               | -   | -                                 | 4  | -                                  | 7             | 14                 | 25                  |
| Segment liabilities   | 12,117  | 513                               | 343  | 6,685                              | 104           | 47                 | 19,809              |
| Investments in property, plant and<br>equipment and intangible assets | 837   | 419                               | 127  | 281                                | 33            | (80)               | 1,617               |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 4 - Segment Reporting (cont'd)****B. Adjustments for segment reporting of revenue, profit or loss, assets and liabilities**

|  | Year ended December 31, |              |              |
|--|-------------------------|--------------|--------------|
|  | 2013                    | 2014         | 2015         |
|  | NIS                     | NIS          | NIS          |
| <b>Revenue</b>   |                         |              |              |
| Revenue from reporting segments  | 11,355                  | 10,964       | 10,649       |
| Revenue from other segments  | 262                     | 226          | 221          |
| Elimination of revenue from inter-segment sales except for revenue from sales to an associate reporting as a segment | (421)                   | (411)        | (445)        |
| Elimination of revenue for a segment classified as an associate  | (1,633)                 | (1,724)      | (440)        |
| <b>Consolidated revenue</b>  | <b>9,563</b>            | <b>9,055</b> | <b>9,985</b> |
|  |                         |              |              |
|  | Year ended December 31, |              |              |
|  | 2013                    | 2014         | 2015         |
|  | NIS                     | NIS          | NIS          |
| <b>Profit or loss</b>  |                         |              |              |
| Operating income for reporting segments  | 3,094                   | 2,934        | 2,795        |
| Elimination of expenses from a segment classified as an associate  | (268)                   | (273)        | (59)         |
| Financing expenses, net  | (396)                   | (694)        | (595)        |
| Share in the losses (profit) of equity-accounted investees   | (252)                   | (170)        | 12           |
| Profit (loss) for operations classified in other Categories  | (4)                     | 629          | 44           |
| Depreciation and amortization of intangible assets resulting from the Bezeq PPA adjustments                          | (768)                   | (644)        | (545)        |
| Other adjustments  | (22)                    | (71)         | (222)        |
| <b>Consolidated profit before income tax</b>   | <b>1,384</b>            | <b>1,711</b> | <b>1,430</b> |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 4 - Segment Reporting (cont'd)**

B. Adjustments for segment reporting of revenue, profit or loss, assets and liabilities (cont'd)

|   | <b>December 31,</b> |               |
|---|---------------------|---------------|
|   | <b>2014</b>         | <b>2015</b>   |
|   | <b>NIS</b>          | <b>NIS</b>    |
| <b>Assets</b>   |                     |               |
| Assets from reporting segments  | 15,061              | 13,417        |
| Assets attributable to operations in other categories                           | 703                 | 676           |
| Goodwill not attributable to segment assets                                     | 2,665               | 3,050         |
| Investment in an equity-accounted investee (mainly loans) reported as a segment | 1,026               | 14            |
| Cancellation of assets for a segment classified as an associate                 | (1,820)             | -             |
| Inter-segment assets  | (681)               | 1,165         |
| Assets resulting from the Bezeq PPA, net  | 3,106               | 2,561         |
| Assets attributable to a non-reportable segment                                 | 1,498               | 1,527         |
| <b>Consolidated assets</b>  | <b>21,558</b>       | <b>22,410</b> |
|   |                     |               |
|   | <b>December 31,</b> |               |
|   | <b>2014</b>         | <b>2015</b>   |
|   | <b>NIS</b>          | <b>NIS</b>    |
| <b>Liabilities</b>  |                     |               |
| Liabilities from reporting segments   | 19,941              | 19,658        |
| Liabilities attributable to operations in other categories                      | 107                 | 104           |
| Cancellation of liabilities for a segment classified as an associate            | (6,484)             | -             |
| Inter-segment liabilities   | (692)               | (5,494)       |
| Liabilities resulted from the Bezeq PPA, net                                    | 837                 | 678           |
| Liabilities attributable to a non-reportable segment                            | 5,083               | 4,863         |
| <b>Consolidated liabilities</b>   | <b>18,792</b>       | <b>19,809</b> |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 5 - Cash and Cash Equivalents**

As of December 31, 2014 and December 31, 2015, cash and cash equivalents include mainly bank deposits with a maturity of up to 90 days.

**Note 6 - Investments including Derivatives**

|                                   | December 31, |              |
|-----------------------------------|--------------|--------------|
|                                   | 2014         | 2015         |
|                                   | NIS          | NIS          |
| <b>Current investments</b>        |              |              |
| Financial assets held for trading | 2,691        | 1,151        |
| Bank deposits                     | 710          | 556          |
| Monetary funds and others         | 5            | 67           |
|                                   | <u>3,406</u> | <u>1,774</u> |

Financial assets held for trading include investments in ETFs, and marketable securities. Investments in financial assets held for trading and monetary funds are designated for trading and are presented at fair value as at the reporting date. ETFs at Bezeq were exercised in January 2016, deposits at Bezeq are repayable until April 2016, and investments at Bezeq are exercisable in 2016.

**Note 7 - Trade and Other Receivables****A. Composition of trade and other receivables**

|   | December 31, |              |
|---|--------------|--------------|
|   | 2014         | 2015         |
|   | NIS          | NIS          |
| <b>Trade receivables, net</b>                             |              |              |
| Outstanding debts   | 986          | 841          |
| Credit cards and checks receivable                        | 343          | 434          |
| Unbilled receivables                                      | 250          | 240          |
| Current maturities of long-term receivables               | 632          | 534          |
| Related parties   | 16           | 9            |
| Total trade receivables                                   | <u>2,227</u> | <u>2,058</u> |
| <b>Other receivables and current tax assets</b>           |              |              |
| Prepaid expenses  | 103          | 135          |
| Other receivables   | 113          | 119          |
| Current tax assets  | 26           | 16           |
| Total other receivables                                   | <u>242</u>   | <u>270</u>   |
| <b>Long-term trade and other receivables</b>              |              |              |
| Trade receivables- open debts (1)                         | 531          | 509          |
| Long term receivables (from real estate sales) and others | 35           | 165          |
|   | <u>566</u>   | <u>674</u>   |
|   | <u>3,035</u> | <u>3,002</u> |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 7 - Trade and Other Receivables (cont'd)****A. Composition of trade and other receivables (cont'd)**

- (1) Discounted interest rates for long-term trade payables are based the estimated credit risk of trade payables. The discounted interest rates used by the Bezeq Group in 2015 are 3.4% - 4.6% (in 2014: 3.6% - 4.3%).

Long-term trade and other receivables are repayable until 2019.

**B. Change in provision for doubtful debts during the year**

|                          | <b>December 31</b> |             |
|--------------------------|--------------------|-------------|
|                          | <b>2014</b>        | <b>2015</b> |
|                          | <b>NIS</b>         | <b>NIS</b>  |
| Balance at January 1     | 38                 | 15          |
| Impaired loss recognized | 30                 | 34          |
| Lost debts               | (53)               | (32)        |
| Balance at December 31   | 15                 | 17          |

**C. Aging of trade receivables**

The aging of trade receivables at the reporting date was as follow:

|                              | <b>December 31, 2014</b> |                   | <b>December 31, 2015</b> |                   |
|------------------------------|--------------------------|-------------------|--------------------------|-------------------|
|                              | <b>Gross</b>             | <b>Impairment</b> | <b>Gross</b>             | <b>Impairment</b> |
|                              | <b>NIS</b>               | <b>NIS</b>        | <b>NIS</b>               | <b>NIS</b>        |
| Current                      | 2,596                    | (1)               | 2,367                    | (1)               |
| Past due up to one year      | 118                      | (5)               | 159                      | (5)               |
| Past due one to two years    | 31                       | (5)               | 29                       | (5)               |
| Past due more than two years | 28                       | (4)               | 29                       | (6)               |
|                              | <u>2,773</u>             | <u>(15)</u>       | <u>2,584</u>             | <u>(17)</u>       |



**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 8 - Property, Plant and Equipment**

|   | Land and<br>buildings | Switching<br>Transmission,<br>power,<br>Cellular,<br>And satellite<br>equipment | Network<br>equipment | Multi-<br>channel<br>equipment<br>and<br>infrastructure | Subscriber<br>equipment | Office<br>equipment,<br>computers<br>and<br>vehicles | Total  |
|---|-----------------------|---|----------------------|---|-------------------------|--|--------|
|   | NIS                   | NIS   | NIS                  | NIS   | NIS                     | NIS  | NIS    |
| <b>Cost</b>   |                       |   |                      |   |                         |  |        |
| Balance as at January 1, 2014                             | 1,004                 | 4,100   | 4,798                | -   | 792                     | 842  | 11,536 |
| Additions   | 43                    | 328   | 453                  | -   | 203                     | 82   | 1,109  |
| Disposals (including transfers to assets held for sale)   | 82                    | (3)   | -                    | -   | (17)                    | (42)   | 20     |
| Balance as at December 31, 2014                           | 1,129                 | 4,425   | 5,251                | -   | 978                     | 882  | 12,665 |
| Balance as at January 1, 2015                             | 1,129                 | 4,425   | 5,251                | -   | 978                     | 882  | 12,665 |
| Additions   | 41                    | 527   | 254                  | 164   | 225                     | 71   | 1,282  |
| Consolidation of subsidiary                               | 16                    | -   | -                    | 749   | -                       | 36   | 801    |
| Disposals (including transfers from assets held for sale) | (141)                 | -   | -                    | -   | -                       | -  | (141)  |
| Balance as at December 31, 2015                           | 1,045                 | 4,952   | 5,505                | 913   | 1,203                   | 989  | 14,607 |
| <b>Depreciation and impairment losses</b>                 |                       |   |                      |   |                         |  |        |
| Balance as at January 1, 2014                             | 241                   | 1,810   | 2,018                | -   | 429                     | 497  | 4,995  |
| Depreciation for the year                                 | 72                    | 567   | 246                  | -   | 158                     | 97   | 1,140  |
| Disposals (including transfers to assets held for sale)   | -                     | (2)   | -                    | -   | (14)                    | (26)   | (42)   |
| Balance as at December 31, 2014                           | 313                   | 2,375   | 2,264                | -   | 573                     | 568  | 6,093  |
| Balance as at January 1, 2015                             | 313                   | 2,375   | 2,264                | -   | 573                     | 568  | 6,093  |
| Depreciation for the year                                 | 76                    | 576   | 222                  | 189   | 197                     | 96   | 1,356  |
| Disposals (including transfers to assets held for sale)   | (39)                  | -   | -                    | -   | -                       | -  | (39)   |
| Balance as at December 31, 2015                           | 350                   | 2,951   | 2,486                | 189   | 770                     | 664  | 7,410  |
| <b>Carrying amounts</b>                                   |                       |   |                      |   |                         |  |        |
| As at January 1, 2014                                     | 763                   | 2,290   | 2,780                | -   | 363                     | 345  | 6,541  |
| As at December 31, 2014                                   | 816                   | 2,050   | 2,987                | -   | 405                     | 314  | 6,572  |
| As at December 31, 2015                                   | 695                   | 2,001   | 3,019                | 724   | 433                     | 325  | 7,197  |

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 8 - Property, Plant and Equipment (cont'd)**

- A.** The residual value of the Bezeq Group's copper cables is assessed at the end of each reporting period. The residual value is NIS 190 and NIS 140 as at December 31, 2014 and December 31, 2015, respectively. The change in the residual value resulted primarily from the price of copper.
- B.** Bezeq Group companies review the useful life of the property, plant and equipment through the depreciation committees, in order to determine the estimated useful life of their equipment. The change is not expected to have a material impact on the depreciation expenses of the Group. Following the findings of the committees, minor changes were made in the estimated useful life of certain assets.
- C.** Most of the real estate assets used by the Bezeq Group are leased under a capitalized finance lease from the Israel Lands Administration for 49 years beginning as of 1993, with an option for an extension of another 49 years. The lease rights are amortized over the term of the lease period.
- D.** In 2013, Bezeq started to install a national fiber-optic network that will reach as close as possible to customer homes. The investment in assets that are not yet operational amounts to NIS 294 as of December 31, 2015.
- E.** At the reporting date, there are commitments to purchase property, plant and equipment in the amount of NIS 75 (in 2014: NIS 88).
- F.** In accordance with the Telecommunications Order (Telecommunications and Broadcasts) (Determination of Essential Service Provided by Bezeq - The Israel Telecommunication Corp. Ltd.), 1997, approval from the Minister of Communications is required to confer rights in some of Bezeq's assets (switches, cable network, transmission network, and information and databases).
- G.** In accordance with its cellular license, Pelephone is not permitted to sell, lease or pledge any of its assets used for the implementation of the license, without the consent of the Minister of Communications, except for:
  - (1) A pledge on one of the license assets in favor of a bank operating lawfully in Israel, to receive bank credit, provided that it submitted notice to the Ministry of Communications regarding the pledge it intends to register, noting that the pledge agreement includes a clause ensuring that in any event, exercise of the rights by the bank will not impair, in any way, the services provided under the license.
  - (2) Sale of items of equipment when implementing an upgrade, including sale of equipment by the trade-in method.
- H.** For information about pledges for loans and borrowings, see Note 13.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 9 - Intangible Assets**

|  | <u>Goodwill</u> | <u>Customer relationships</u> | <u>Brand name</u> | <u>Computer software</u> | <u>Licenses</u> | <u>Subscribers acquisition costs and other</u> | <u>Total</u>  |
|--|-----------------|-------------------------------|-------------------|--------------------------|-----------------|--|---------------|
|  | <u>NIS</u>      | <u>NIS</u>                    | <u>NIS</u>        | <u>NIS</u>               | <u>NIS</u>      | <u>NIS</u>                                     | <u>NIS</u>    |
| <b>Cost</b>  |                 |                               |                   |                          |                 |  |               |
| Balance as at January 1, 2014                          | 2,825           | 5,163                         | 1,310             | 1,137                    | 350             | 223  | 11,008        |
| Acquisitions or additions from independent development | -               | -                             | -                 | 162                      | -               | 15   | 177           |
| Loss of control  | (132)           | -                             | (86)              | -                        | -               | -  | (218)         |
| Impairment   | (12)            | -                             | -                 | -                        | -               | -  | (12)          |
| Balance as at December 31, 2014                        | <u>2,681</u>    | <u>5,163</u>                  | <u>1,224</u>      | <u>1,299</u>             | <u>350</u>      | <u>238</u>                                     | <u>10,955</u> |
| Balance as at January 1, 2015                          | 2,681           | 5,163                         | 1,224             | 1,299                    | 350             | 238  | 10,955        |
| Acquisitions or additions from independent development | -               | -                             | -                 | 188                      | 96              | 28   | 312           |
| Business combination                                   | 385             | 790                           | 347               | 148                      | -               | -  | 1,670         |
| Disposals  | -               | -                             | -                 | -                        | -               | (51)   | (51)          |
| Balance as at December 31, 2015                        | <u>3,066</u>    | <u>5,953</u>                  | <u>1,571</u>      | <u>1,635</u>             | <u>446</u>      | <u>215</u>                                     | <u>12,886</u> |
| <b>Amortization and impairment losses</b>              |                 |                               |                   |                          |                 |  |               |
| Balance as at January 1, 2014                          | -               | 3,384                         | 42                | 641                      | 109             | 219  | 4,395         |
| Amortization for the year                              | -               | 471                           | 10                | 163                      | 28              | 16   | 688           |
| Loss of control  | -               | -                             | (36)              | -                        | -               | -  | (36)          |
| Balance as at December 31, 2014                        | <u>-</u>        | <u>3,855</u>                  | <u>16</u>         | <u>804</u>               | <u>137</u>      | <u>235</u>                                     | <u>5,047</u>  |
| Balance as at January 1, 2015                          | -               | 3,855                         | 16                | 804                      | 137             | 235  | 5,047         |
| Amortization for the year                              | -               | 447                           | 22                | 242                      | 31              | 20   | 762           |
| Disposals  | -               | -                             | -                 | -                        | -               | (41)   | (41)          |
| Balance as at December 31, 2015                        | <u>-</u>        | <u>4,302</u>                  | <u>38</u>         | <u>1,046</u>             | <u>168</u>      | <u>214</u>                                     | <u>5,768</u>  |
| <b>Carrying amounts</b>                                |                 |                               |                   |                          |                 |  |               |
| As at January 1, 2014                                  | 2,825           | 1,779                         | 1,268             | 496                      | 241             | 4  | 6,613         |
| As at December 31, 2014                                | <u>2,681</u>    | <u>1,308</u>                  | <u>1,208</u>      | <u>495</u>               | <u>213</u>      | <u>3</u>                                       | <u>5,908</u>  |
| As at December 31, 2015                                | <u>3,066</u>    | <u>1,651</u>                  | <u>1,533</u>      | <u>589</u>               | <u>278</u>      | <u>1</u>                                       | <u>7,118</u>  |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 9 - Intangible Assets (cont'd)**

Total value of goodwill attributable to each cash-generating unit:

|  | <b>December 31</b> |              |
|--|--------------------|--------------|
|  | <b>2014</b>        | <b>2015</b>  |
|  | <b>NIS</b>         | <b>NIS</b>   |
| Domestic fixed-line communications                 | 1,283              | 1,548        |
| Cellular telephone                                 | 1,205              | 1,205        |
| Multi-channel television (DBS)                     | -                  | 120          |
| International communications and internet services | 181                | 181          |
| others   | 12                 | 12           |
| <b>Total</b>                                       | <b>2,681</b>       | <b>3,066</b> |

**Goodwill impairment testing by B Communications**

For the purpose of impairment testing, goodwill is allocated to the Company's cash generating units ("CGU") which represent the lowest level within the Company at which the goodwill is monitored for internal management purposes. Several goodwill balances result from the requirement to recognize a deferred tax liability on business combination, calculated as the difference between the tax effect of the fair value of the acquired assets and liabilities, and their tax bases. For the purpose of testing this goodwill for impairment, any of the related deferred tax liabilities recognized on acquisition that remain at the balance sheet date are treated as part of the relevant CGU. The annual impairment test date is December 31.

The recoverable amount of each CGU was based on the Discounted Cash Flow method under the Income Approach. Value in use of the traditional voice and broadband CGUs was determined by discounting the future cash flows generated from the continuing use of the CGUs and was based on the following key assumptions:

**Domestic fixed line communications (Bezeq Fixed Line) -**

The value in use for the Group's domestic fixed line CGU was calculated using the future discounted cash flow method, based on the expected cash flow for the next five years. The expected cash flow is based on results of the domestic fixed-line communications segment in recent years, taking into account the effect of opening up the wholesale market in 2015. The revenue forecast is based on assumptions about the number of users and average revenue per user of internet infrastructure, the number of users and average revenue per user of telephony services, and revenue from transmission, data communication and other revenue. The main assumption underlying the forecast is that the wholesale market will function properly and will provide effective competition to the infrastructure owners. In addition, the effect of the elimination of the structural separation on the domestic fixed-line communication segment was not taken into account.

The operating, sales, marketing and investment expenses were adjusted for domestic-fixed line communication operations. The price of nominal capital used is 7.5% (after tax). In addition, it was assumed that the permanent growth will be 1%. The valuation was made by an independent appraiser. Based on this valuation, the Group was not required to record impairment of a fixed line domestic communications cash-generating unit.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 9 - Intangible Assets (cont'd)**

## Cellular telephone (Pelephone) -

The value in use for the Group's cellular CGU (Pelephone) was calculated using the future discounted cash flow method, based on the expected cash flow for the next five years. The expected cash flow is based on Pelephone's results in recent years, such that future growth and market shares are affected by directions in the cellular market, such as price competition, regulation and the scope of operations of the new cellular operators. The revenue forecast is based on assumptions regarding the number of users, average revenue per user, and sales of terminal equipment. The main assumption underlying the forecast is the recovery in Pelephone's business activity as from 2017, due to the expected stabilization of the market and the start of competitive balance. In addition, the valuation included synergies on the Group revenue level based on the high certainty of the structural separation in the long term.

The operating, sales, marketing and investment expenses were adjusted for Pelephone's volume of operations. The cost of nominal capital used is 10% (after tax). In addition, it was assumed that the permanent growth will be 2.5%. The valuation was made by an independent appraiser. Based on this valuation, the Group was not required to record impairment of a cellular communication cash-generating unit.

## Multi-channel television (DBS) -

The value in use for the Group's multichannel television CGU was calculated using the discounted cash flow method, based on the expected cash flow for the next five years. The expected cash flow is based on the results of DBS in recent years, such that future growth and market shares are affected by directions in the multichannel television market, such as competition, regulation, and the entry of new players. The revenue forecast is based on assumptions regarding the number of users and average revenue per user. The main assumption underlying the forecast is erosion in market share and a decrease in average revenue per user due to the expected increase in competition in the coming years.

The operating, sales, marketing and investment expenses were adjusted for the volume of operations of DBS. The price of nominal capital used is 8.5% (after tax). In addition, it was assumed that the permanent growth will be 1%. The valuation was made by an independent appraiser. Based on this valuation, the Group was not required to record impairment of a multichannel television cash-generating unit.

## International communications and Internet services (Bezeq International) -

The value in use for the Group's International communications and Internet services CGU was calculated using the discounted cash flow method, based on the expected cash flow for the next five years. The expected cash flow is based on the results of Bezeq International in recent years, such that future growth and market shares are affected by directions both in the International communications and Internet services markets, such as competition, regulation, and the wholesale market. The revenue forecast is based on assumptions regarding the number of users and average revenue per user. The main assumption underlying the forecast is erosion in market share and a decrease in average revenue per line ("APRL") due to the expected increase in competition in the coming years as a result of the wholesale market in the Internet services business line along with the decrease in the revenues of International communications business as a result of increased use of cellular phones and other communication solutions.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 9 - Intangible Assets (cont'd)**

The operating, sales, marketing and investment expenses were adjusted for the volume of operations of Bezeq International. The price of nominal capital used is 11% (after tax). In addition, it was assumed that the permanent growth will be 1%. The valuation was made by an independent appraiser. Based on this valuation, the Group was not required to record impairment of the International communications and Internet services cash-generating unit.

**Note 10 - Deferred Expenses and Non-Current Investments**

|                         | December 31 |      |
|-------------------------|-------------|------|
|                         | 2014        | 2015 |
|                         | NIS         | NIS  |
| Deferred expenses       | 364         | 358  |
| Non-current investments | 271         | 285  |
|                         | 635         | 643  |

- A. Deferred expenses include prepaid expense amounts for acquisition of an indefeasible right of use (IRU) of seabed cable capacities. The prepaid expense is amortized on a straight-line basis up to 2022 and 2027 according to the period set out in the agreements.
- B. Non-current investments include a bank deposit for loans to the Company's employees with a redemption date that has yet to be determined and a deposit for hedge transactions.

**Note 11 - Broadcast Rights, Net of Rights Exercised**

|                       | December 31 |       |
|-----------------------|-------------|-------|
|                       | 2014        | 2015  |
|                       | NIS         | NIS   |
| Cost                  | -           | 621   |
| Less rights exercised | -           | (165) |
| Total                 | -           | 456   |

As at December 31, 2015, DBS has agreements for the acquisition of broadcast rights. In 2015, acquisition of these broadcast rights amounted to NIS 189.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 12 - Investees****A. Material subsidiaries held directly and indirectly by the Company****1. General**

|  | <b>Principal<br/>location of the<br/>company's<br/>activity</b> | <b>Ownership<br/>interest</b> |
|--|---|-------------------------------|
| B Communications Ltd.  | Israel  | 66.71%                        |
| <u><b>Subsidiaries of B Communications Ltd.</b></u>                              |   |                               |
| B Communications (SP1) Ltd. and B Communications (SP2) Ltd. (1)                  | Israel  | 100%                          |
| Bezeq - The Israel Telecommunication Corp. Limited                               | Israel  | 30.56%                        |
| <u><b>Subsidiaries of Bezeq - The Israel Telecommunication Corp. Limited</b></u> |   |                               |
| Pelephone Communications Ltd.  | Israel  | 100%                          |
| Bezeq International Ltd.   | Israel  | 100%                          |
| DBS  | Israel  | 100%                          |
| Walla! Communications Ltd.   | Israel  | 100%                          |

(1) Held by B Communication (SP1) Ltd.

**2. Details of Group entities****a. B Communications Ltd.**

B Communications Ltd., is a majority-owned subsidiary of the Company. B Communications is the sole shareholder of B Communications (SP1) Ltd. which holds B Communications (SP2) Ltd. which directly holds the Bezeq controlling interest.

**b. Bezeq- The Israel Telecommunications Corp. Ltd.**

Bezeq is controlled by SP2 which holds 30.03% of Bezeq's outstanding shares. An additional 0.53% of Bezeq outstanding shares are held by B Communications. Bezeq is the largest communications group in Israel.

**c. B Communications (SP1) Ltd. and B Communications (SP2) Ltd.**

B Communications (SP1) Ltd. ("SP1"), founded in 2010, is a wholly-owned subsidiary of B Communications. SP1 is the sole shareholder of B Communications (SP2) Ltd. ("SP2") which directly holds the Bezeq controlling interest.

**d. Pelephone Communications Ltd.**

Pelephone Communications Ltd. ("Pelephone") is a wholly-owned subsidiary of Bezeq. Pelephone provides cellular communication services and value added services and markets terminal equipment.

**e. Bezeq International Ltd.**

Bezeq International Ltd. ("Bezeq International") is a wholly-owned subsidiary of Bezeq. Bezeq International provides internet access (ISP) services, international communications services and network end point (NEP) services.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 12 - Investees (cont'd)****A. Material subsidiaries held directly and indirectly by the Company (cont'd)**

## 2. Details of Group entities (cont'd)

**f. Walla! Communications Ltd.**

Walla! is wholly owned by Bezeq. Walla! provides internet, management and media services for a range of populations.

## 3. Dividend paid by Bezeq to non-controlling interests during 2015 was in the amount of NIS 1,232 (in 2014: NIS 1,431).

## 4. Bezeq's Dividend Distribution Policy

In August 2009, Bezeq's Board of Directors resolved to implement a dividend policy to distribute 100% of the semi-annual profit ("profit for the period attributable to the shareholders of Bezeq") in accordance with its consolidated financial statements as a dividend to its shareholders. Application of the policy to distribute a dividend is subject to the provisions of the law, including the distribution criteria prescribed in the Companies Law, and the estimation of the Board of Directors of Bezeq regarding its ability to meet its existing and anticipated liabilities, taking into consideration the projected cash flow, its operations and liabilities, the cash balance, its plans and position as will be from time to time and subject to the approval of the its general meeting of shareholders regarding any specific distribution, as set out in the articles of association of Bezeq. Since the date of the resolution, Bezeq's dividend policy has not changed.

Following Bezeq's Board of Director's resolution on February 10, 2015 regarding its engagement with Eurocom DBS for the acquisition of the full holdings of Eurocom DBS in DBS, Bezeq's Board of Directors determined that the revaluation gains, which were expected to arise in accordance with accounting principles, will be excluded from the dividend policy and will not be distributed as a dividend. These gains amounted to NIS 12.

In 2014 and 2015, Bezeq declared and paid the following dividends in cash:

|  | <u>2014</u>  | <u>2015</u>  |
|--|--------------|--------------|
|  | <u>NIS</u>   | <u>NIS</u>   |
| <b>Distribution of a regular dividend (see section B4 above)</b> |              |              |
| 2015 (NIS 0.65 per share)  | -            | 1,777        |
| 2014 (NIS 0.76 per share)  | 2,069        | -            |
|  | <u>2,069</u> | <u>1,777</u> |

**B. Business combination with DBS Satellite Services (1998) Ltd. ("DBS") that occurred in the period**

1. As at December 31, 2014, Bezeq held 49.78% of the share capital of DBS and options that conferred the right to 8.6% of DBS's shares, which Bezeq was unable to exercise. Accordingly, Bezeq accounted for its investment in DBS in accordance with the equity method.



**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 12 - Investees (cont'd)****B. Business combination with DBS Satellite Services (1998) Ltd. ("DBS") that occurred in the period (cont'd)**

On March 26, 2014, Bezeq received the decision of the Antitrust Authority, according to which, under the terms set out in the decision, the merger between Bezeq and DBS ("the Merger") would be permitted.

On February 10, 2015, a subcommittee of Bezeq's Board of Directors' that was established for this matter, Bezeq's audit committee and Bezeq's Board of Directors approved Bezeq's entry into a transaction with Eurocom DBS. In the transaction, Bezeq agreed to acquire the entire holdings of Eurocom DBS in DBS ("the Acquisition Transaction"), which represented 50.22% of the issued share capital of DBS (41.62% fully diluted) and all the shareholder loans provided by Eurocom to DBS. It was further decided that prior to the Acquisition Transaction, Bezeq would exercise the option granted, at no cost, for the allotment of 8.6% of the issued capital of DBS.

Under the terms of the Acquisition Transaction, Bezeq was required to pay Eurocom DBS NIS 680 in cash on the closing date, against acquisition of the shares and shareholder loans held by Eurocom DBS. Under the terms of the Acquisition Transaction Eurocom DBS will also be entitled to two contingent payments, as follows: a contingent payment of up to NIS 200 will be paid in accordance with the amount of the carryforward losses of DBS used for tax purposes and a second contingent payment of up to NIS 170 will be paid in accordance with the business results of DBS in three years following the closing.

On March 23, 2015, the general meeting of Bezeq's shareholders approved the merger terms and the exercise the option, and Bezeq's entry into the Acquisition Transaction, as described above. Subsequently, Bezeq and DBS announced the acceptance of the merger terms, and on March 25, 2015, Bezeq exercised the option to acquire 8.6% of the issued capital of resulting in Bezeq holding 58.4% of the issued capital of DBS. Accordingly, Bezeq has consolidated the financial statements of DBS as of March 23, 2015 (the date that the general meeting of Bezeq approved the exercise of the option to acquire DBS shares). In view of the Bezeq's holding of 49.78% of DBS shares prior to gaining control, the acquisition transaction was accounted for in the financial statements as a step acquisition.

Bezeq's agreement with Eurocom DBS for the acquisition of the entire holdings of Eurocom DBS in DBS was subject to the approval of the Ministry of Communications. This approval was received unconditionally on June 23, 2015, and on June 24, 2015, the transaction was completed. On the completion date, Bezeq transferred the cash consideration of NIS 680 to Eurocom DBS and Eurocom DBS transferred its DBS shares to Bezeq and assigned to Bezeq its entire rights in the shareholders loans of DBS. On completion of the transaction, DBS became a wholly owned subsidiary (100%) of Bezeq.

As at December 31, 2015, Bezeq has a liability to Eurocom DBS for the first contingent payment of NIS 204 (including accrued interest) and NIS 29 for the second contingent payment.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 12- Investees (cont'd)****B. Business combination with DBS Satellite Services (1998) Ltd. ("DBS") that occurred in the period (cont'd)**

2. Prior to the acquisition of control, Bezeq presented its investment in shares, share options and loans to DBS, according to their fair value based on a valuation by an independent assessor. In accordance with the valuation, the value of Bezeq's investments prior to acquisition of control was estimated at NIS 1.076 billion. Accordingly, Bezeq recognized a profit of NIS 12 from the gaining control under other operating income in the income statement.

The valuation was based on the income approach, whereby the discounted cash flow method was applied on the basis of the forecasted cash flow for 2015 through to 2019. The cash flow forecast was based on DBS' results for 2011-2014 and the three months ended March 31, 2015. In the valuation, it was assumed that the market share of DBS was expected to remain stable and would be 42%-43% throughout the years of the forecast. It was also assumed that gradual erosion in the Average Revenue Per User ("ARPU") of DBS was expected between 2015 and 2018, while in 2019 and thereafter, it was expected that a fixed nominal ARPU would be maintained. The revenue forecast was based on the forecast of the number of subscribers, average income and competition in the market.

Assumed cost of capital: 8.5% (net of tax). In addition, it was assumed that the permanent growth would be 1%.

The valuation was based on assumptions regarding the identity of the relevant market participant that might acquire Bezeq's holdings in DBS and does not take into account the specific operational and tax synergies between the companies.

3. Identifiable acquired assets and liabilities

|   | <b>March 23, 2015</b> |
|---|-----------------------|
|   | <b>NIS</b>            |
| Cash and cash equivalents   | 299                   |
| Trade and other receivables   | 182                   |
| Broadcast rights  | 449                   |
| Property, plant and equipment   | 801                   |
| Deferred tax asset, net of deferred tax liabilities (for attributed excess cost)                        | 1,170                 |
| Intangible assets (including excess cost attributed to customer relations and brand as described below) | 1,284                 |
| Debentures, loans, and borrowings (including excess cost attributed to debentures as described below)   | (1,946)               |
| Trade payables and other liabilities  | (632)                 |
| Contingent liabilities (including excess cost attributed to contingent liabilities as described below)  | (19)                  |
| Identifiable assets, net  | <u>1,588</u>          |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 12 - Investees (cont'd)****B. Business combination with DBS Satellite Services (1998) Ltd. ("DBS") that occurred in the period (cont'd)**

4. Bezeq attributed the acquisition cost in relation to the fair value of the assets and liabilities that were acquired in the business combination. The attribution was based on the valuation performed by an independent assessor whose opinion is attached to these financial statements.

Excess cost was attributed as follows:

|   | <b>March 23, 2015</b> |
|---|-----------------------|
|   | <b>NIS</b>            |
| Customer relations (see section a below)                          | 790                   |
| Brand (see section b below)                                       | 347                   |
| Goodwill (see section c below)                                    | 385                   |
| Deferred tax asset, net of deferred tax liabilities (see d below) | 1,170                 |
| Debentures (see section e below)                                  | (160)                 |
| Contingent liabilities (see section f below)                      | (10)                  |
| <b>Total excess cost</b>  | <b>2,522</b>          |

- a. **Customer relations:** The valuation was based on the income approach, using the multi-period excess earning method. Under this approach, the value of the asset is derived from the present value of the cash flows that are expected to arise from it over the remaining economic life of the asset. Amortization will be based on the existing customer churn rate.
- b. **Brand value:** The valuation was prepared in accordance with the relief from royalty method. In accordance with this method, the value of the asset is estimated as the present value of the appropriate royalty that the entity would have to pay a third party for the use of the asset, if the company did not own it. The useful life of the brand assumed in the model is 12 years.
- c. **Goodwill:** Following the acquisition of control, goodwill was recognized as follows:

|  | <b>March 23, 2015</b> |
|--|-----------------------|
|  | <b>NIS</b>            |
| Consideration value  | 897                   |
| Fair value of the investment in DBS prior to the acquisition | 1,076                 |
| Less the fair value of net identifiable assets               | (1,588)               |
| <b>Goodwill</b>  | <b>385</b>            |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 12 - Investees (cont'd)****B. Business combination with DBS Satellite Services (1998) Ltd. ("DBS") that occurred in the period (cont'd)**

To assess impairment, goodwill of NIS 265 was allocated to the domestic-fixed line communications segment, and goodwill of NIS 120 was allocated to the multichannel television segment. Goodwill is allocated on the basis of the valuation of an external assessor and the Company's estimates regarding the cash-generating units that are expected to benefit from the synergy of the business combination.

- d. **Deferred tax asset:** Following completion of the acquisition transaction on June 24, 2015, as described in Note 19G, Bezeq believes that will be able to take advantage of the tax asset for the accrued losses from future profits of DBS and due to the possible merger between the companies.

Bezeq accounted for completion of the acquisition transaction after gaining control as new information obtained in the measurement period for the facts and circumstances that existed at the acquisition date and, therefore, as at December 31, 2015, Bezeq recognized a deferred tax asset at the date control was acquired and updated the liability for the first contingent consideration accordingly (retrospectively).

Composition of the tax asset:

|  | <u>March 23, 2015</u> |
|--|-----------------------|
|  | <u>NIS</u>            |
| Tax asset for cumulative losses of DBS | <u>1,426</u>          |
| Tax reserve for attributed excess cost | <u>(256)</u>          |
| <b>Deferred tax asset, net</b>         | <b><u>1,170</u></b>   |

- e. **Debentures:** The excess cost reflects the fair value of the debentures at the acquisition date based on a capitalization rate of 1.9%-2.3%.
- f. **Contingent liabilities:** Amounts that represents a present obligation arising from a class action filed by DBS customers.
5. The contribution of DBS to Group revenue in 2015 amounted to NIS 1,333 and its contribution to profit as from the date of the business combination amounted to NIS 49 (this amount includes amortization of surplus cost amounting to NIS 43).
6. Bezeq's management estimates that had the business combination taken place on January 1, 2015, the revenue in the consolidated statement of income would have increased by NIS 434 and there would have been no significant change in the consolidated profit for the period. When determining the amounts, Bezeq's management assumed that the fair value adjustments at the date of the business combination are the same as the adjustments that would have been received had the business combination taken place on January 1, 2015.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 12 - Investees (cont'd)****B. Business combination with DBS Satellite Services (1998) Ltd. ("DBS") that occurred in the period (cont'd)**

7. Bezeq provided shareholder loans to DBS between 1999 and 2005. In addition, at the acquisition date of the rights of Eurocom in DBS in June 2015, as described above, Bezeq acquired the shareholders loan provided by Eurocom to DBS. The total amount of the shareholder loans in accordance with the contractual terms and fair value as at December 31, 2015 (including interest and linkage differences) is NIS 5.1 billion and NIS 1.4 billion, respectively.
8. For the purpose of rating the Debentures (Series A) issued by DBS, with a balance of NIS 368 million as at December 31, 2015 (as described in Note 12B below), in 2007, DBS undertook to S&P Maalot that it would not make any repayment on account of the shareholder loans provided to from the date of the undertaking, until the end of the term of the Debentures in July 2017.

On December 2015, Bezeq provided another shareholder loan to DBS, amounting to NIS 323, as described in Note 13C below.

9. Since the beginning of its operations, DBS has accumulated considerable losses. The losses of DBS in 2015 and 2014 amounted to NIS 354 and NIS 322, respectively. As a result of these losses, as at December 31, 2015, DBS had a shareholder's equity deficit and a working capital deficit of NIS 5,018 and NIS 584, respectively.

The management of DBS believes that the financial resources at its disposal, which receipt of loans from Bezeq, will be sufficient for its operations for the coming year, based on the cash flow forecast approved by DBS's board of directors.

**C. Bezeq distributable earnings**

On March 16, 2016 the Board of Directors of Bezeq resolved to recommend to the general meeting of shareholders the distribution of a cash dividend in the amount of NIS 776. As at the approval date of the financial statements, the dividend has not yet been approved by the general meeting. Subsequent to this distribution Bezeq will have a negative retained earnings balance and under the Companies Law its future distributions will be based on its future earnings. For Bezeq's dividend distribution Policy see note 12A4 above, for covenants and liens, see note 13.

## Notes to the Consolidated Financial Statements

(All amounts are in millions except where otherwise stated)

## Note 12 - Investees (cont'd)

## D. Non-controlling interests in subsidiaries

The table hereunder presents summary information of the Group's subsidiaries including fair value adjustments that were made on the date of acquisition, other than goodwill, in which there are non-controlling interests that are material to the Group.

|            | December 31,   |                |                    |                     |                         | Year ended December 31, |  |          |        |                            |                            |   |  |                                     |                                     |   |  |  |  |
|------------|--|----------------|--------------------|---------------------|-------------------------|-------------------------|--|----------|--------|----------------------------|----------------------------|---|--|-------------------------------------|-------------------------------------|---|--|--|--|
|            | Rate of direct ownership interests held by non-controlling interests % | Current assets | Non-current assets | Current liabilities | Non-current liabilities | Total net assets        | Carrying amount of non-controlling interests | Revenues | Profit | Other comprehensive income | Total comprehensive income | Profit (loss) attributable to non-controlling interests | Total comprehensive income attributable to non-controlling interests | Cash flow from operating activities | Cash flow from investing activities | Cash flow from financing activities without dividend to non-controlling interests | Dividend paid to non-controlling interests | Total increase (decrease) in cash and cash equivalents |  |
|            |  |                |                    |                     |                         |                         |  |          |        |                            |                            |   |  |                                     |                                     |   |  |  |  |
|            |  |                |                    |                     |                         |                         |  |          |        |                            |                            |   |  |                                     |                                     |   |  |  |  |
|            |  |                |                    |                     |                         |                         |  |          |        |                            |                            |   |  |                                     |                                     |   |  |  |  |
| NIS        |  |                |                    |                     |                         |                         |  |          |        |                            |                            |   |  |                                     |                                     |   |  |  |  |
| 2015       |  |                |                    |                     |                         |                         |  |          |        |                            |                            |   |  |                                     |                                     |   |  |  |  |
| Bcom Group | 33.29  | 4,730          | 17,392             | 5,199               | 13,532                  | 3,391                   | 2,694  | 9,985    | 1,136  | 7                          | 1,143                      | 996   | 1,001  | 3,652                               | 310                                 | (2,820)   | (1,274)                                    | (132)  |  |
| 2014       |  |                |                    |                     |                         |                         |  |          |        |                            |                            |   |  |                                     |                                     |   |  |  |  |
| Bcom Group | 33.29  | 6,498          | 14,738             | 3,898               | 13,750                  | 3,588                   | 2,949  | 9,055    | 1,132  | (36)                       | 1,096                      | 1,147   | 1,118  | 3,789                               | (1,897)                             | (487)   | (1,431)                                    | (26)   |  |
| 2013       |  |                |                    |                     |                         |                         |  |          |        |                            |                            |   |  |                                     |                                     |   |  |  |  |
| Bcom Group | 32.01  | 5,740          | 15,343             | 3,949               | 13,221                  | 3,913                   | 3,239  | 9,563    | 959    | 6                          | 965                        | 834   | 839  | 4,145                               | (1,014)                             | (1,162)   | (1,987)                                    | (18)   |  |

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 12 - Investees (cont'd)****E. Increasing Competition and Reducing Concentration, 2013 law**

In December 2013, the Knesset passed the Israeli Law for Increasing Competition and Reducing Concentration, 2013 ("Concentration Law"), which: (i) imposes limitations on the control over companies with publicly held debt or equity securities through a pyramidal ownership structure by imposing a limitation on the number of public companies (tiers) in such pyramidal structure; (ii) authorizes financial regulators to set forth limitations on the amount of credit that financial institutions are permitted to provide to a corporation or a group of companies under the control of the same controlling shareholder; (iii) imposes limitations on the holdings by a significant non-finance company in a significant finance company or the holdings of both kinds of companies under common control; and (iv) requires governmental authorities responsible for the award of rights in public assets (including in the communications field) in certain cases to consider control concentration factors and industry-specific competitive factors.

Internet Gold is deemed to be a "first tier" company, the Company is deemed to be a "second tier" company and Bezeq is deemed to be a "third-tier" company under the Concentration Law. Accordingly, if either Internet Gold or the Company are unable to redeem any of their publicly held debt and delist their ordinary shares from the TASE (which would require 90-days' prior notice to the TASE) or go private prior to December 10, 2019, the Company will not be permitted to control Bezeq after such date and its holdings in Bezeq may be transferred to a trustee for the purpose of selling such holdings.

The Concentration Law sets forth certain mechanisms intended to enable a tier company, which is subject to the prohibition of controlling another tier company, to make various arrangements for the repurchase of its publicly-held shares and the early redemption of publicly-held debt in order to comply with the provisions of the law. These mechanisms enable the repurchase of publicly-held shares and the early redemption of publicly-held debt securities under a Court-approved scheme of arrangement pursuant to the Israeli Companies Law, at fair value and in accordance with the conditions prescribed by the Concentration Law, while providing certain relief from shareholders or debenture holder majority requirements for the approval of the arrangement. Furthermore, if a trustee is appointed, he may seek a district court to order the cancellation of distributions made by Bezeq prior to his appointment if they are deemed not be in Bezeq's interest. In addition, beginning six months after the publication of the Concentration Law and during a six years transition period, the board of directors of a company that is a "third-tier" company (such as Bezeq) must be comprised of a majority of "independent directors," within the meaning of the Israeli Companies Law, and the number of "external directors" pursuant to the Israeli Companies Law shall be at least half the number of the company's directors less one (rounded upwards) but not less than two. The election of such external directors will be by a majority vote of the shareholders and the controlling shareholder's vote will not be counted for such purpose. The Israeli Minister of Justice is authorized to enact regulations setting forth a lower number of required external directors, provided that such number will not be lower than one-third of the board members.

The Company estimates that the application of the Concentration Law will not affect its controlling shareholder's vote position in Bezeq.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 12 - Investees (cont'd)****F. B Communications' de facto control over Bezeq**

B Communications has de facto control over Bezeq based on the facts that it holds significantly more voting rights than any other shareholder. Bezeq's other shareholders are widely dispersed and are not allowed to increase their holdings, appoint a director or the chief executive officer of Bezeq nor have any influence on Bezeq's day-to-day operational decision making policies. In addition the Israeli law and regulations were formulated in order to ensure that no individual or entity will interfere with the control of Bezeq by the holder of the Control Permit. These regulations enable B Communications to de facto nominate the majority of the board of directors of Bezeq.

**G. Transactions with non-controlling interests**

- (1) On June 27, 2013 the Company sold 3,571,741 ordinary shares of B Communications in an aggregate purchase price of NIS 125 to Norisha Holdings Limited ("NHL"). The shares sold represent approximately 11.95% of B Communications issued and outstanding shares. NHL is a holdings company incorporated under the laws of The British Virgin Islands. According to the Share Purchase Agreement, NHL may be entitled to receive up to 892,935 ordinary shares from the Company without additional consideration pursuant to a price adjustment mechanism ("the Adjustment Shares"). According to the Share Purchase Agreement if the number of Adjustment Shares transferred will be lower than 892,935, NHL will have the option to purchase the remainder of the 892,935 shares from the Company according to a price mechanism detailed in the Share Purchase Agreement. On May 29, 2014 the Share Purchase Agreement was amended in order to permit NHL to pay the Exercise Price through a "cashless exercise". Following the amendment to the Share Purchase Agreement the Company transferred to NHL 396,860 additional B Communications ordinary shares.
- (2) On January 14, 2016, the Company sold 575,000 ordinary shares of B Communications, representing approximately 1.92% of its issued and outstanding shares. The total proceeds from the sale amounted to approximately NIS 56. As a result of the sale, the Company's ownership interest in B Communications declined to 64.78% of its outstanding shares.



**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Loans and Borrowings, including Obligations to Banks, Institutions and Others****A. Composition**

|                                  | <b>December 31</b> |               |
|----------------------------------|--------------------|---------------|
|                                  | <b>2014</b>        | <b>2015</b>   |
|                                  | <b>NIS</b>         | <b>NIS</b>    |
| <b>Current liabilities</b>       |                    |               |
| Current maturities of debentures | 942                | 1,508         |
| Current maturities of bank loans | 619                | 711           |
|                                  | <u>1,561</u>       | <u>2,219</u>  |
| <b>Non-current liabilities</b>   |                    |               |
| Debentures                       | 10,264             | 10,707        |
| Bank loans                       | 3,155              | 2,508         |
|                                  | <u>13,419</u>      | <u>13,215</u> |
|                                  | <u>14,980</u>      | <u>15,434</u> |

**B. Terms and debt repayment schedule**

|  | <b>December 31, 2014</b> |                        | <b>December 31, 2015</b> |                        | <b>Currency</b> | <b>Nominal interest rate</b> |
|--|--------------------------|------------------------|--------------------------|------------------------|-----------------|------------------------------|
|  | <b>Par value</b>         | <b>Carrying amount</b> | <b>Par value</b>         | <b>Carrying amount</b> |                 |                              |
|  | <b>NIS</b>               | <b>NIS</b>             | <b>NIS</b>               | <b>NIS</b>             |                 |                              |
| <b>Loans from banks and others:</b>        |                          |                        |                          |                        |                 |                              |
| Linked to the Israeli CPI - Fixed interest | 18                       | 22                     | -                        | -                      | NIS             |                              |
| Unlinked - Variable interest               | 1,656                    | 1,656                  | 1,331                    | 1,331                  | NIS             | P-0.33 to P+0.2              |
| Unlinked - Fixed interest                  | 2,096                    | 2,096                  | 1,889                    | 1,889                  | NIS             | 2.20 to 6.85                 |
|  | <u>3,770</u>             | <u>3,774</u>           | <u>3,220</u>             | <u>3,220</u>           |                 |                              |
| <b>Debentures:</b>                         |                          |                        |                          |                        |                 |                              |
| Linked to the Israeli CPI - fixed interest | 4,508                    | 4,992                  | 5,643                    | 6,140                  | NIS             | 3.70 to 8.40                 |
| Linked to the US\$ - fixed interest        | 3,111                    | 3,053                  | 3,017                    | 2,966                  | US\$            | 7.375                        |
|  |                          |                        |                          |                        |                 | One year Makam + 1.4         |
| Unlinked - variable interest               | 734                      | 734                    | 734                      | 734                    | NIS             |                              |
| Unlinked - fixed interest                  | 2,435                    | 2,427                  | 2,380                    | 2,374                  | NIS             | 2.20 to 6.65                 |
|  | <u>10,788</u>            | <u>11,206</u>          | <u>11,774</u>            | <u>12,214</u>          |                 |                              |
| <b>Total interest-bearing liabilities</b>  | <u>14,558</u>            | <u>14,980</u>          | <u>14,994</u>            | <u>15,434</u>          |                 |                              |

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Loans and Borrowings, including Obligations to Banks, Institutions and Others (cont'd)****B. Debt terms and repayment schedule (cont'd)****Loans from banks and others and debentures**

- (1) On February 19, 2014, the B communications issued \$800 of Senior Secured Notes ("the Notes") due 2021 that bear 7 $\frac{3}{4}$ % annual interest paid semi-annually.

The Notes were offered and sold in the United States to qualified institutional buyers pursuant to Rule 144A under the U.S. Securities Act of 1933, as amended (the "Securities Act") and to certain qualifying investors in offshore transactions, including in Israel, in reliance on Regulation S under the Securities Act. The Notes are senior obligations of B Communications and are guaranteed by its two wholly-owned subsidiaries, SP1 and SP2, on a senior secured basis ("the Guarantees"). The Notes and the Guarantees are secured by first priority pledges over all of the capital stock of SP2, the capital stock of Bezeq held by SP2, and additional collateral. The Notes have been admitted for trading on the system of the Tel Aviv Stock Exchange for trading by institutional investors, known as TACT Institutional.

B Communications used the net proceeds from the offering to repay all amounts outstanding under the loans received by SP2 and SP1 from Bank Hapoalim Ltd. ("Bank Hapoalim"), and Migdal Insurance and Financial Holdings Ltd. Group ("Migdal") respectively and to deposit funds into a debt service account.

Under the terms of the indenture for the Notes ("The Indenture") funds maintained by SP2 must be deposited in one or more accounts designated as a lockbox account and pledged as collateral to the security agent for the benefit of the holders of the Notes. As of December 31, 2015 cash and cash equivalents and short term investments held in the lockbox account totalled NIS 535.

On August 10, 2014 B Communications' Board of Directors approved the buyback of up to \$50 million of the Notes. On January 20, 2016, after the balance sheet date, B Communications completed its \$50 million repurchase program and its Board of Directors approved to extend and increase the program by an additional \$50 million. During 2015, B Communications purchased \$27 million par value of the Notes. From January 1, 2016 through April 18, 2016, B Communications purchased an additional \$38 million par value of the Notes.

Following the sale of 115,500,000 shares of Bezeq shares in February 2016, under the terms of the Indenture for the Notes, the NIS 982 of, net proceeds of the sale were deposited in the "Lockbox Account". Under the terms of the Indenture, the Company must make an offer to the holders of the Notes within 365 days of receipt of the proceeds to purchase the maximum principal amount of Notes that may be purchased with such proceeds at a cash offer price equal to at least 100% of the principal amount of the Notes, plus accrued and unpaid interest to the date of purchase.

As at December 31, 2015 the outstanding par value of the Notes was NIS 3,017.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Loans and Borrowings, including Obligations to Banks, Institutions and Others (cont'd)****B. Debt terms and repayment schedule (cont'd)****Loans from banks and others and debentures (cont'd)**

- (2) On April 14, 2010, SP2 received loans from certain banking and financial institutions led by Bank Hapoalim in the total principal amount of NIS 4.6 billion for the acquisition of the Bezeq shares.

Under the terms of the loan agreement covenants between SP2 and the Bank Hapoalim consortium, Bezeq was required to maintain certain minimum shareholders' equity and minimum ratio of shareholders' equity to the balance sheet and was required to exceed certain thresholds relating to the ratio of financial debt to EBITDA. In addition, a minimum ratio of debt to EBITDA in SP2 and debt service coverage ratio of SP2 was required to be maintained.

The Bezeq shares held by SP2 and all of SP2's other rights and assets were pledged to the lenders as security of SP2's obligations under the loan agreements with Bank Hapoalim. In addition, SP1 pledged to the lenders the entire equity it holds in SP2 and the debt owed to it by SP2.

SP2 undertook to maintain a minimum cash deposit of NIS 150 in an account held with Bank Hapoalim from the cash Bezeq pays and/or distributes to SP2.

On February 19, 2014, following the issuance of B Communications Notes, the loan was repaid in full.

- (3) On February 18, 2010, SP1 entered into a loan agreement with certain entities associated with Migdal. According to the Migdal loan agreement, on April 14, 2010, SP1 received a NIS 500 loan for the acquisition of the Bezeq shares. The loan provided for annual interest at a rate of 6.81% and was linked to Israeli CPI.

The Migdal loan to SP1 was secured by a first ranking pledge on SP1's rights in the bank account into which all payments from SP2 were made, except for certain defined expenses. SP1 undertook to maintain minimum funds of NIS 22.5 (linked to the Israeli CPI) in the pledged bank account. The Migdal facility agreement included limitations on distributions and payments from the pledged bank account (including conditions as to total debt to EBITDA ratios that relate to SP1).

On February 19, 2014, following the issuance of B Communications Notes, the loan was repaid in full.

- (4) Issuance of series B debentures

On September 30, 2007, the Company issued Series B debentures. The debentures were repaid in six equal annual installments on November 1 of each of the years 2010 to 2015. The principal of the debentures and the interest accruing thereon was indexed to the Israeli CPI.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Loans and Borrowings, including Obligations to Banks, Institutions and Others (cont'd)****B. Debt terms and repayment schedule (cont'd)****Loans from banks and others and debentures (cont'd)**

The outstanding balance of the debentures bear interest of 5% per year, payable once every 12 months, on November 1 of each of the years 2008 to 2015. The debentures were listed for trading on the Tel Aviv Stock Exchange Ltd ("TASE") on October 2007. As of December 31, 2015 the Series B Debentures was repaid in full.

**(5) Issuance of series C debentures**

On September 28, 2010, the Company completed, following the filing of a supplemental prospectus dated September 26, 2010, and pursuant to its shelf prospectus filed on September 1, 2010, the public offering in Israel of its Series C Debentures.

In November and December of 2013, the Company completed private placements of additional Series C Debentures in the amount of NIS 60 and NIS 65 par value, respectively, to certain of Israeli institutional investors. As of December 31, 2015 the outstanding par value of Series C Debentures was NIS 491.

The Series C Debentures are payable in four equal annual installments on March 10 of each of the years 2016 through 2019 and pay interest at a fixed annual rate of 4.45% which is payable semi-annually on March 10 and September 10 of each of the years 2011 through 2019 (the first interest payment was made on March 10, 2011, and the last interest payment is payable on March 10, 2019). The Series C Debentures are NIS denominated and are linked to the Israeli CPI.

The Series C Debentures contain standard terms and conditions and are unsecured, non-convertible and do not restrict the Company's ability to issue any new series of debt instruments or distribute dividends in the future. The Series C Debentures are listed for trading on the TASE.

**(6) Issuance of series D debentures and replacement of debentures**

On March 3, 2014 the Company issued Series D Debentures at a par value of NIS 117.5 for a total consideration of NIS 126. Series D Debentures were listed on the TASE.

Series D Debentures are repayable in five installments as follows: (i) 10% of the principal amount on September 15, 2018 and 2019; (ii) 30% of the principal amount on September 15, 2020 and 2021; and (iii) the final 20% of the principal amount on September 15, 2022. Series D Debentures bear an annual interest of 6% payable on March 15 and September 15 of each of the years 2014-2022, other than the first interest payment which was made on September 15, 2014. Both principal and interest are linked to the Israeli CPI as of January 2014.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Loans and Borrowings, including Obligations to Banks, Institutions and Others (cont'd)****B. Debt terms and repayment schedule (cont'd)****Loans from banks and others and debentures (cont'd)**

The Series D Debentures contain standard terms and conditions and are unsecured, non-convertible and do not restrict the Company's ability to issue any new series of debt instruments or distribute dividends in the future. The Series D Debentures contain certain limitation on distribution of dividends by the Company.

**(6) Issuance of series D debentures and replacement of debentures**

On June 9 and 22, 2014 the Company completed a private placement of NIS 219 principal amount of Series D Debentures to certain institutional investors in Israel in exchange for approximately NIS 107 principal amount of the Company's outstanding Series B Debentures and NIS 95 principal amount of the Company's outstanding Series C Debentures held by such institutional investors (or approximately 51% and 12% of the outstanding Series B Debentures and Series C Debentures, respectively), reflecting an exchange ratio of 1:1.132 and 1:1.03 (NIS 1.132 principal amount of Series D Debentures for NIS 1 principal amount of Series B Debentures and NIS 1.03 principal amount of Series D Debentures for NIS 1 principal amount of Series C Debentures, respectively).

On October 22, 2014 the Company completed an additional private placement of NIS 107 principal amount of Series D Debentures to certain institutional investors in Israel in exchange for approximately NIS 103 principal amount of the Company's outstanding Series C Debentures held by such institutional investors (or approximately 15% of the outstanding Series C Debentures), reflecting an exchange ratio of 1:1.036 (NIS 1.036 principal amount of Series D Debentures for NIS 1 principal amount of Series C Debentures).

On November 20 and 26, 2014 the Company completed an additional private placement of NIS 86 principal amount of Series D Debentures to certain institutional investors in Israel in exchange for approximately NIS 85 principal amount of the Company's outstanding Series C Debentures held by such institutional investors (or approximately 15% of the outstanding Series C Debentures), reflecting an exchange ratio of 1:1.015 (NIS 1.015 principal amount of Series D Debentures for NIS 1 principal amount of Series C Debentures).

As of December 31, 2015 the outstanding par value of Series D Debentures was NIS 530.

**(7) B Communications Debentures**

A. During the period from March 2007 to May 2007, B Communications issued a total of NIS 425 of Series A Debentures. The Series A Debentures were linked to the Israeli CPI and bore an annual interest rate of 4.75%. Series A Debentures principle was payable in eight equal instalments on March 15 of each year starting from March 15, 2009. Series A Debentures interest was payable on March 15 of each year starting from the date of issuance.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Loans and Borrowings, including Obligations to Banks, Institutions and Others (cont'd)****B. Debt terms and repayment schedule (cont'd)****Loans from banks and others and debentures (cont'd)**

On March 17, 2014 B Communications completed an early redemption all of its outstanding Series A Debentures having a par value of NIS 153 for total consideration of NIS 203. As of that date the Series A Debentures were delisted from the Tel Aviv Stock Exchange.

**(7) B Communications Debentures (cont'd)**

- B. On September 21, 2010, B Communications issued, at par value, NIS 400 Series B Debentures to the public in Israel. In January, 2012 and August 2013, B Communications completed private placements of additional Series B Debentures in the amount of NIS 126 and NIS 180 par value, respectively, to certain Israeli institutional investors.

On March 31, 2016, after the balance sheet date, B Communications completed private placement of NIS 148 par value of its Series B Debentures to Israeli institutional investors for an aggregate consideration of NIS 162.

As at December 31, 2015 the outstanding par value of Series B Debentures was NIS 706.

Series B Debentures are unlinked to the Israeli CPI, bear interest at a fixed annual rate of 6.5% which is payable semi-annually on March 31 and September 30 of each of the years 2011 through 2019 (the first interest payment was made on March 31, 2011 and the last interest payment is payable on March 31, 2019). Series B Debentures principle is payable in four equal instalments on March 31 of each year starting from 2016. Series B Debentures interest is payable on March 31 of each year starting from the date of issuance.

According to the financial covenants of the Series B Debentures B Communications is obligated to the following:

1. Not to issue any additional Series B Debentures if such increase will decrease the A2 rating of the Series B Debentures.
2. To maintain control of Bezeq.
3. The investors will have the right to require the immediate repayment of the Series B debentures if Eurocom will no longer hold the controlling interest in B Communications.

As at December 31, 2015, B Communications was in compliance with the financial covenants of the Series B debentures.

- (8) Below are details of the terms that Bezeq undertook for the loans that were received and the debentures that were issued:

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Loans and Borrowings, including Obligations to Banks, Institutions and Others (cont'd)****B. Debt terms and repayment schedule (cont'd)****Loans from banks and others and debentures (cont'd)**

- a. For Debentures (Series 5), standard grounds were established for immediate repayment, including breach events, insolvency, dissolution procedures or receivership.
- b. For Debentures (Series 6 to 10) and bank loans and for debentures issued to financial institutions in the amount of NIS 400, Bezeq has undertaken not to create additional pledges on its assets unless pledges are created at the same time in favor of the debenture holders and the lending banks (negative pledge). The pledge includes exceptions, including regarding a pledges on assets that will be purchased or expanded by Bezeq, if the undertakings underlying the pledge are created for the purchase or expansion of those assets and for the matter of a token lien.
- c. For Debentures (Series 6 to 8) and bank loans and for debentures issued to financial institutions in the amount of NIS 400, standard grounds were included for immediate repayment of the debentures and loans, including breach events, insolvency, dissolution procedures or receivership. In addition, a right was determined to call for immediate repayment if a third party lender calls for immediate repayment of Bezeq's debts in an amount exceeding the amount determined.
- d. For Debentures (Series 6 to 10) and banks loans in the amount of NIS 2.03 billion as at December 31, 2015 (out of the total bank loans in the amount of NIS 3.2 billion), and for debentures issued to financial institutions in the amount of NIS 400, Bezeq has undertaken that if it Bezeq makes an undertaking towards any entity in respect of compliance with financial covenants, Bezeq will also provide the same undertaking to these debenture holders and banks (subject to certain exceptions).
- e. For Debentures (Series 6 to 10), Bezeq has undertaken to the debenture holders to take steps so that, to the extent under its control, the debentures will be rated by at least one rating agency, so long as there are debentures of the relevant series in circulation.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Loans and Borrowings, including Obligations to Banks, Institutions and Others (cont'd)****B. Debt terms and repayment schedule (cont'd)****Loans from banks and others and debentures (cont'd)**

- f. In addition, for Debentures (Series 9 and 10), standard grounds were included for immediate repayment of the debentures, including events of default, insolvency, liquidation proceedings, or receivership, as well as the right to call for immediate repayment if a third party lender calls for immediate repayment of Bezeq's debts (in an amount exceeding NIS 150, if another series of marketable debentures is called for immediate repayment - an unlimited amount), in the event of the sale of more than 50% of the Bezeq Group's assets (consolidated) such that communications will cease being the Bezeq Group's main activity, in the event of a change of control following which the current controlling shareholders in Bezeq will cease being controlling shareholders (other than transfer of control to a transferee that received approval to control Bezeq in accordance with the provisions of the Communications Law or change in control under other circumstances that were established), in the event that a going concern qualification is recorded in Bezeq's financial statements for two consecutive quarters, in the event of a material deterioration in Bezeq's business compared with the situation at the time of the issue, and there is real concern that Bezeq will not be able to repay the debentures on time (as set out in section 35I(1)(a)(1) in the Securities Law), all under the terms set out in the deed of trust of the debentures.

As at December 31, 2015 and the approval date of the financial statements, Bezeq was in compliance with all its liabilities, there were no grounds to call for immediate repayment, and financial covenants were not set out as described above.

**C. Non-marketable debentures issued by DBS**

DBS has two series of debentures with a balance of NIS 1,288 as at December 31, 2015. The debentures were issued to institutional investors and were listed on the TACT - Institutional system of the TASE. Below are details of the terms that DBS undertook in respect of the debentures:

- a. Standard events were established (such as insolvency proceedings, default and exercise of pledges on most of the Company's assets), which, should they occur, after the warning periods that were established, will allow the right to call for immediate repayment of the debentures subject to the provisions in the deeds of trust, and the right to call for immediate payment if another debenture series issued by DBS is called for immediate repayment, if the balance for settlement exceeds the amount set out in the deed of trust (a right that was cancelled for Debentures (Series B), following a letter of guarantee provided by the Company as described in this section below).



**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Loans and Borrowings, including Obligations to Banks, Institutions and Others (cont'd)****C. Non-marketable debentures issued by DBS (cont'd)**

- b. In accordance with the deed of trust for Debentures (Series A) (with a par value of NIS 305 as at December 31, 2015), DBS created an unlimited floating first lien in favor of Trustee A on all of its assets (other than exemptions arising from the provisions of the Communications Law), including a stipulation that limits additional pledges (subject to the exceptions set out in Deed of Trust A and the mortgage deed), and (subject to exceptions in accordance with the Communications Law) unlimited fixed first pledges on the rights and assets of DBS, including its rights under material agreements to which it is a party, its unissued registered capital, goodwill, certain intellectual property rights and insurance rights under its insurance policies.

Under Deed of Trust A, DBS may register first pledges in favor of additional holders of debentures that it might issue and/or add them to pledges in favor of Trustee A, without the consent of Trustee A.

In September 2015, Bezeq signed a letter of guarantee for the undertakings of DBS to pay the entire balance of its debts of NIS 1.05 billion to holders of Debentures (Series B), (amounting to NIS 792 as at December 31, 2015) against a reduction of 0.5% in the annual interest rate for the debenture and cancellation of securities (which were similar to those registered in favor of Trustee A) and certain provisions of the deed of trust and the debenture (including the DBS's undertaking to comply with the financial covenants and restrictions on distribution of a dividend by DBS), all in accordance with the terms of the deed of trust of the debenture and the debenture. In accordance with the terms of the debenture, a reduction in the interest rate and cancellation of the collateral and certain provisions in the debentures are contingent on the rating of Bezeq not falling below a rating of AA- by Maalot or a corresponding rating ("the Minimum Rating"), a condition that was fulfilled as at the date of the guarantee. If, in the future, the rating of Bezeq falls below the Minimum Rating, then the reduction in the interest rate will be cancelled, the collateral that was cancelled will be provided again, the provisions that were cancelled must be applicable again, and the guarantee will expire.

Up to December 2015, DBS was a party to another debenture series that was issued to several institutions ("the 2012 Debentures"). On December 20, 2015, DBS paid in full the unpaid balance of the 2012 Debentures in advance of the repayment date plus an early repayment fee of NIS 323 through a loan provided by Bezeq at that date.

**D. Undertakings to provide credit for 2016-2017**

In 2015, Bezeq entered into agreements with banks and financial institutions, whereby Bezeq received an undertaking from these institutions to provide credit to Bezeq in a total amount of NIS 1.4 billion to refinance its future debt in 2016 (with an average duration of between 4.6 to 4.9 years and a fixed NIS interest rate of 3.7% to 4.3 %), and an undertaking to provide credit of NIS 600 in 2017 (with an average duration of 4.5 years and an average fixed NIS interest rate of 4.3%).

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 13 - Debentures, Loans and Borrowings, including Obligations to Banks, Institutions and Others (cont'd)****D. Undertakings to provide credit for 2016-2017 (cont'd)**

The terms of all the undertakings and the loans to be provided thereunder include terms that are similar to the terms provided for other loans taken by Bezeq, including the following: an undertaking to refrain from creating additional pledges on Bezeq's assets (with certain restrictions); an undertaking that if Bezeq assumes an undertaking towards a party in respect of compliance with financial covenants, Bezeq will also assume the same undertaking for

This credit (subject to certain exceptions) has standard terms for immediate repayment (such as default events, insolvency, liquidation or receivership), and cross default (with certain restrictions), which will also apply, with the required changes, to the periods of the undertaking to provide credit.

In addition, some of the undertakings to provide credit in 2017 also include terms that are similar to the terms that were established for Bezeq's Debentures (Series 9 and 10) as set out in Note 13B above.

Subsequent to the balance sheet date, Bezeq signed another agreement to obtain a loan of NIS 300 in 2017.

**Other Obligations**

On April 14, 2010, SP2 issued phantom stock options to banks and the financial institutions led by Bank Hapoalim, under which they received option units with respect to Bezeq shares. The "base price" for the Bezeq shares of each unit was NIS 8.62. The total amount payable by SP2 to the banks and the financial institutions was limited to NIS 125 (NIS 2.4289 per option unit) in the aggregate.

During the fourth quarter of 2010, the banks and the financial institutions exercised all the phantom stock options issued to them. Under the exercise terms, SP2 was obligated to pay the banks and the financial institutions a total of NIS 124 in five equal annual instalments beginning in May 2012 (the "option obligation").

On February 19, 2014, following the issuance of B Communications' Notes, the two "bullet" loans were repaid in full.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 14 - Trade and Other Payables**

|   | December 31 |            |
|---|-------------|------------|
|   | 2014        | 2015       |
|   | NIS         | NIS        |
| <b>Trade payables (open accounts)</b>                       | <b>664</b>  | <b>913</b> |
| Trade payables consisting of related parties                | 3           | 17         |
| <b>Other payables</b>                                       |             |            |
| Liabilities to employees and other liabilities for salaries | 324         | 369        |
| Institutions  | 127         | 79         |
| Accrued expenses  | 110         | 90         |
| Accrued interest  | 111         | 125        |
| Deferred income   | 50          | 85         |
| Options and derivatives                                     | 16          | 22         |
| Other payables  | 19          | 34         |
| <b>Total other payables</b>                                 | <b>757</b>  | <b>804</b> |

**Note 15 Provisions**

|  | Customer<br>claims | Additional<br>legal claims | Dismantling<br>and clearing<br>of cellular<br>and other<br>sites | Total      |
|--|--------------------|----------------------------|--|------------|
|  | NIS                | NIS                        | NIS  | NIS        |
| <b>Balance as at January 1, 2015</b>   | 24                 | 35                         | 72   | 131        |
| Provisions created in the period       | 18                 | 13                         | 1  | 32         |
| Provisions used in the period          | (4)                | (4)                        | (4)  | (12)       |
| Provisions cancelled in the period     | (3)                | (2)                        | (20)   | (25)       |
| Consolidation of DBS                   | 17                 | 3                          | -  | 20         |
| <b>Balance as at December 31, 2015</b> | <b>52</b>          | <b>45</b>                  | <b>49</b>  | <b>146</b> |
| Current                                | 52                 | 45                         | 3  | 100        |
| Non-current                            | -                  | -                          | 46   | 46         |

**Claims**

For details of legal claims, see Note 20.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 16 - Financial Risk Management****A. General**

The Group is exposed to the following risks, arising from the use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk (which includes currency, interest, inflation and other price risks)

This Note provides information about the Group's exposure to each of the above risks, an explanation as to how the risks are managed, and the measurement processes.

**B. Framework for risk management**

The Company's Board of Directors has overall responsibility for the Company's, B Communications', SP1's and SP2's risk management. Bezeq's Board of Directors has responsibility for the Bezeq Group's risk management. The purpose of risk management in the Group is to define and monitor those risks constantly, and to minimize their possible effects arising from the exposure on the basis of assessments and expectations for parameters that affect the risks. The Company's policy is to hedge, in part and where required according to policies determined by the board, exposure from fluctuations foreign currency rates and in the Israeli CPI rates. Bezeq's policy is to hedge, in part and where required according to policies determined by the board, exposure from fluctuations in foreign currencies and the Israeli CPI.

**C. Credit risk**

Management monitors the Group's exposure to credit risks on a regular basis. Cash and investments in deposits and securities are deposited in highly-rated banks.

**Trade and other receivables**

Bezeq's management regularly monitors customer debts, and the financial statements include provisions for doubtful debts which properly reflect, in the management's estimation, the loss inherent in doubtful debts. In addition, the balances of trade receivables are widely spread.

**Investments in financial assets**

The Company's investment policy, which was approved by its Audit Committee, and established by the Company's Board of Directors, seeks to preserve principal and maintain adequate liquidity while maximizing the income received from investments without significantly increasing the risk of loss. According to the Company's investment policy approximately 80% of the funds must be invested in investment-grade securities. The Company's securities consist of investment grade securities, corporate debts securities and equity investments (stocks). The Company's and B Communications investment policies impose limitations on invested amounts by investment ratings, duration, exposure to a single issuer, exposure to a group of issuers with the same ownership, industries, geographic spread and currency exposure, thereby reducing credit risk concentrations. Transactions involving derivatives are made with entities that have high credit ratings.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 16 - Financial Risk Management (cont'd)****C. Credit risk (cont'd)****Investments in financial assets (cont'd)**

Any investments made by Bezeq in securities are made in securities which are liquid, marketable and have low risk. Transactions involving derivatives are made with entities that have high credit ratings.

As of the reporting date there is no significant concentration of credit risk.

**D. Liquidity risk**

Liquidity risk is the risk that the Group will be unable to honor their financial obligations on time. The Group's policy for liquidity management is to ensure, as far as possible, that it will always have sufficient liquidity to honor those liabilities on time, without incurring undesirable losses. In addition, for debentures issued by the Company and its subsidiaries, see Note 13.

**E. Market risks**

The purpose of market risk management is to manage and oversee the exposure to market risks within accepted parameters to prevent significant exposures to market risks that will influence the Group's results, liabilities and cash flows.

During the normal course of its business, the Group takes full or partial hedging actions. The Group's takes into account the effects of the exposure in its considerations for determining the type of loans it takes and in the management of its investment portfolio.

**Israeli CPI risk**

Changes in the rate of Israeli inflation affect the Group's profitability and its future cash flows, mainly due to its Israeli CPI-linked liabilities. In applying a policy of minimizing the exposure the Company has invested in bonds that are linked to the Israeli CPI in order to partially hedge the exposure to changes in the Israeli CPI. In addition, the Group enters into forward transactions against the Israeli CPI. The duration of the forward transactions is the same as or shorter than the duration of the hedged exposures. Bezeq applies hedge accounting with regards to its forward CPI hedge transactions.

A considerable part of the Bezeq's cash balances are invested in deposits, monetary funds or ETF's which are exposed to changes in their real value as a result of changes in the Israeli CPI.

**Foreign currency risk**

B Communications is exposed to foreign currency risks associated with its Notes that are denominated in US\$. In order to hedge its exposure to fluctuations in the US\$ exchange rate resulting from the Note issuance B Communications entered into five Cross Currency Swap ("CCS") hedge transactions to hedge a total of \$725 principal and interest amount of the Notes.

Bezeq is exposed to foreign currency risks mainly due to payments for purchases of terminal equipment and property, plant and equipment which are in or linked to US\$ or Euro. In addition, the Group provides services for customers and receives services from suppliers worldwide for which it is paid and it pays in foreign currency, mainly the US\$.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 17 - Financial Instruments****A. Liquidity risk**

Below are the contractual repayment dates of financial liabilities, including estimated interest payments:

|   | December 31, 2015  |                          |              |              |              |
|---|--------------------|--------------------------|--------------|--------------|--------------|
|   | Carrying<br>amount | Contractual<br>cash flow | 2016         | 2017         | 2018-2020    |
|   | NIS                | NIS                      | NIS          | NIS          | NIS          |
| <b>Non-derivative financial liabilities</b>             |                    |                          |              |              |              |
| Trade and other payables                                | 1,677              | 1,677                    | 1,677        | -            | -            |
| Bank loans  | 3,219              | 3,528                    | 808          | 924          | 1,564        |
| Debentures  | 12,215             | 14,044                   | 1,945        | 1,750        | 4,998        |
| Liability to Eurocom DBS                                | 233                | 233                      | 233          | -            | -            |
| <b>Total</b>  | <b>17,344</b>      | <b>19,482</b>            | <b>4,663</b> | <b>2,674</b> | <b>6,562</b> |
| <b>Financial liabilities for derivative instruments</b> |                    |                          |              |              |              |
| Forward contracts on CPI                                | 180                | 180                      | 29           | 2            | 117          |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 17 - Financial Instruments (cont'd)****B. Linkage and foreign currency risks**

The Company's exposure to linkage and foreign currency risk was as follows based on notional amounts:

|  | December 31, 2014 |                              |  |
|--|-------------------|------------------------------|--|
|  | Unlinked<br>NIS   | Israeli<br>CPI-linked<br>NIS | Foreign<br>currency<br>linked (mainly<br>U.S. dollars) |
|  |                   |                              | NIS  |
| <b>Current assets</b>  |                   |                              |  |
| Cash and cash equivalents                                    | 708               | -                            | 24   |
| Restricted cash  | 64                | -                            | 1  |
| Trade receivables  | 2,187             | 16                           | 24   |
| Other receivables  | 4                 | 110                          | -  |
| Investments including derivatives                            | 2,603             | 141                          | 662  |
| <b>Total current assets</b>                                  | <b>5,566</b>      | <b>267</b>                   | <b>711</b>   |
| <b>Non-current assets</b>                                    |                   |                              |  |
| Trade and other receivables                                  | 509               | 57                           | -  |
| Investments including derivatives                            | 90                | -                            | 181  |
| Equity-accounted investment                                  | -                 | 2,181                        | -  |
| <b>Total non-current assets</b>                              | <b>599</b>        | <b>2,238</b>                 | <b>181</b>   |
| <b>Total assets</b>  | <b>6,165</b>      | <b>2,505</b>                 | <b>892</b>   |
| <b>Current liabilities</b>                                   |                   |                              |  |
| Debentures, loans and borrowings                             | 1,074             | 487                          | -  |
| Trade payables   | 532               | -                            | 132  |
| Other payables including derivatives                         | 627               | 62                           | 20   |
| <b>Total current liabilities</b>                             | <b>2,233</b>      | <b>549</b>                   | <b>152</b>   |
| <b>Non-current liabilities</b>                               |                   |                              |  |
| Debentures   | 2,855             | 4,355                        | 3,054  |
| Bank loans   | 3,155             | -                            | -  |
| Other liabilities including derivatives                      | -                 | 109                          | -  |
| <b>Total non-current liabilities</b>                         | <b>6,010</b>      | <b>4,464</b>                 | <b>3,054</b>   |
| <b>Total liabilities</b>                                     | <b>8,243</b>      | <b>5,013</b>                 | <b>3,206</b>   |
| <b>Total exposure in the statement of financial position</b> | <b>(2,078)</b>    | <b>(2,508)</b>               | <b>(2,314)</b>   |
| <b>Forward transactions</b>                                  | <b>(5,572)</b>    | <b>3,011</b>                 | <b>2,561</b>   |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 17 - Financial Instruments (cont'd)****B. Linkage and foreign currency risks (cont'd)**

|  | December 31, 2015 |                |                |
|--|-------------------|----------------|----------------|
|  | Unlinked          | Israeli        | Foreign        |
|  | NIS               | CPI-linked     | currency       |
|  |                   | NIS            | linked (mainly |
|  |                   |                | U.S. dollars)  |
|  |                   |                | NIS            |
| <b>Current assets</b>  |                   |                |                |
| Cash and cash equivalents                                    | 592               | -              | 27             |
| Restricted cash  | 154               | -              | 1              |
| Trade receivables  | 2,019             | 21             | 18             |
| Other receivables  | 19                | 111            | -              |
| Investments including derivatives                            | 1,108             | 92             | 574            |
| <b>Total current assets</b>                                  | <b>3,892</b>      | <b>224</b>     | <b>620</b>     |
| <b>Non-current assets</b>                                    |                   |                |                |
| Trade and other receivables                                  | 482               | 192            | -              |
| Investments including derivatives                            | 55                | -              | 230            |
| <b>Total non-current assets</b>                              | <b>537</b>        | <b>192</b>     | <b>230</b>     |
| <b>Total assets</b>  | <b>4,429</b>      | <b>416</b>     | <b>850</b>     |
| <b>Current liabilities</b>                                   |                   |                |                |
| Debentures, loans and borrowings                             | 1,396             | 823            | -              |
| Trade and other payables                                     | 1,324             | 82             | 225            |
| <b>Total current liabilities</b>                             | <b>2,720</b>      | <b>905</b>     | <b>225</b>     |
| <b>Non-current liabilities</b>                               |                   |                |                |
| Debentures and bank loans                                    | 5,141             | 5,106          | 2,968          |
| Other liabilities including derivatives                      | -                 | 160            | 5              |
| <b>Total non-current liabilities</b>                         | <b>5,141</b>      | <b>5,266</b>   | <b>2,973</b>   |
| <b>Total liabilities</b>                                     | <b>7,861</b>      | <b>6,171</b>   | <b>3,198</b>   |
| <b>Total exposure in the statement of financial position</b> | <b>(3,432)</b>    | <b>(5,755)</b> | <b>(2,348)</b> |
| <b>Forward transactions</b>                                  | <b>(5,448)</b>    | <b>2,471</b>   | <b>2,977</b>   |

DBS has forward transaction to reduce exposure to changes in the USD exchange rate. As at March 31, 2015, the net fair value of these transactions is NIS 11.



**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 17 - Financial Instruments (cont'd)****B. Linkage and foreign currency risks (cont'd)**

The Group has CPI forward transactions for the Israeli CPI:

|  | Currency/<br>linkage<br>receivable | Currency/<br>linkage<br>payable | Expiry date | Par value<br>(currency)<br>NIS | Fair value<br>NIS |
|--|------------------------------------|---------------------------------|-------------|--------------------------------|-------------------|
| <b>December 31, 2014</b>                         |                                    |                                 |             |                                |                   |
| Forward exchange contracts on foreign currencies | US\$                               | NIS                             | 2018        | 2,561                          | 174               |
| Israeli CPI forward contracts                    | Israeli CPI                        | NIS                             | 2015-2022   | 3,011                          | (125)             |
| <b>December 31, 2015</b>                         |                                    |                                 |             |                                |                   |
| Forward exchange contracts on foreign currencies | US\$                               | NIS                             | 2018        | 2,561                          | 180               |
| Israeli CPI forward contracts                    | Israeli CPI                        | NIS                             | 2015-2022   | 2,887                          | (180)             |

Information regarding the Israeli CPI and significant exchange rates:

|                       | Year ended December 31 |       |        | December 31              |        |        |
|-----------------------|------------------------|-------|--------|--------------------------|--------|--------|
|                       | 2013                   | 2014  | 2015   | 2013                     | 2014   | 2015   |
|                       | Rate of change         |       |        | Reporting date spot rate |        |        |
|                       | %                      | %     | %      | NIS                      | NIS    | NIS    |
| 1 US dollar           | (7.0)                  | 12.0  | 0.3    | 3.471                    | 3.889  | 3.902  |
| 1 euro                | (2.8)                  | (1.2) | (10.1) | 4.782                    | 4.725  | 4.2468 |
| Israeli CPI in points | 1.9                    | (0.3) | (0.9)  | 141.67                   | 141.28 | 140.01 |

**C. Interest rate risk****1. Profile**

At the reporting date the interest rate profile of the Group's interest-bearing financial instruments was:

|                                  | December 31 |          |
|----------------------------------|-------------|----------|
|                                  | 2014        | 2015     |
|                                  | NIS         | NIS      |
| <b>Fixed rate instruments</b>    |             |          |
| Financial assets                 | 3,530       | 3,016    |
| Financial liabilities            | (12,590)    | (13,371) |
|                                  | (9,060)     | (10,355) |
| <b>Variable rate instruments</b> |             |          |
| Financial assets                 | 186         | 226      |
| Financial liabilities            | (2,390)     | (2,065)  |
|                                  | (2,204)     | (1,839)  |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 17 - Financial Instruments (cont'd)****C. Interest rate risk (cont'd)****2. Fair value sensitivity analysis for fixed rate financial liabilities and derivatives**

The Group does not account for any fixed rate financial liabilities at fair value through profit or loss, and the Group does not designate derivatives (interest swap contracts) as hedging instruments under a fair value hedge accounting model. Therefore a change in interest rates at the reporting date would not affect profit or loss.

**3. Sensitivity analysis of cash flow for instruments at variable interest**

An increase of 100 basis points in the interest rates at the reporting date would have decreased shareholders' equity and profit or loss by NIS 14 (2014 - NIS 16).

**D. Cash flow hedge accounting**

Bezeq entered into several forward contracts, as described in the table below, in order to reduce its exposure to changes in the CPI for its CPI-linked debentures (Series 5 and Series 6). These transactions hedge specific cash flows of certain of the Bezeq debentures and are recognized as cash flow hedge accounting. The expiry date of these transactions complies with the repayment schedule of the relevant debentures. The fair value of the forward contracts is based on observable market-based data (level 2) in fair value hierarchy.

| Hedge item                | Repayment date                | Number of Transactions | Nominal Value<br>NIS | Fair value<br>NIS | Capital reserve<br>NIS |
|---------------------------|-------------------------------|------------------------|----------------------|-------------------|------------------------|
| <b>December 31, 2014:</b> |                               |                        |                      |                   |                        |
| Debentures (Series 5)     | June 2015 - June 2016         | 4                      | 662                  | (35)              | 16                     |
| Debentures (Series 6)     | December 2018 - December 2022 | 8                      | 1,699                | (75)              | 47                     |
|                           |                               |                        | <u>2,361</u>         | <u>(110)</u>      | <u>63</u>              |
| <b>December 31, 2015:</b> |                               |                        |                      |                   |                        |
| Debentures (Series 5)     | June 2016                     | 2                      | 322                  | (22)              | 3                      |
| Debentures (Series 6)     | December 2018 - December 2022 | 8                      | 1,699                | (146)             | 67                     |
|                           |                               |                        | <u>2,021</u>         | <u>(168)</u>      | <u>70</u>              |

Subsequent to the subsequent to the balance sheet date, Bezeq entered into a new transaction to hedge Debentures (Series 6). The scope of the transaction is NIS 295. The maturity date of this transaction is December 2018.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 17 - Financial Instruments (cont'd)****E. Fair value****(1) Financial instruments measured at fair value for disclosure purposes only**

The table below shows the difference between the carrying amount and the fair value of groups of financial instruments. The carrying amount of other financial assets and liabilities does not differ significantly from their fair value. The fair value of debentures issued to the public is based on their quoted closing price at the reporting date (Level 1). The fair value of loans and non-marketable debentures is based on the present value of future principal and interest cash flows, discounted at the market rate of interest suitable for similar liabilities plus the required adjustments for risk premium and non-marketability at the reporting date (Level 2).

|   | December 31, 2014  |               | December 31, 2015  |               | Fair value<br>weighted<br>average<br>discount<br>rate<br>% |
|---|--------------------|---------------|--------------------|---------------|--|
|   | Carrying<br>amount | Fair value    | Carrying<br>amount | Fair value    |  |
|   | NIS                | NIS           | NIS                | NIS           |  |
| <b>Secured loans from banks and others</b>      |                    |               |                    |               |  |
| Unlinked  | 2,112              | 2,292         | 1,904              | 2,044         | 2.05   |
| <b>Debentures</b>                               |                    |               |                    |               |  |
| Issued to the public (CPI-linked)               | 4,978              | 5,099         | 4,891              | 5,104         | 2.09   |
| Issued to the public (unlinked)                 | 2,044              | 2,214         | 2,986              | 3,258         | 5.55   |
| Issued to institutional investors (US\$ linked) | 3,073              | 3,309         | 1,991              | 2,119         | 1.24   |
| Issued to institutional investors (unlinked)    | -                  | -             | 1,310              | 1,314         | 1.50   |
| Issued to institutional investors (CPI-linked)  | 403                | 467           | 403                | 458           | 2.11   |
|   | <u>12,610</u>      | <u>13,381</u> | <u>13,485</u>      | <u>14,297</u> |  |

**(2) Financial instruments measured at fair value**

The table below analyses financial instruments carried at fair value, by valuation method.

|  | December 31, 2014 |           |          |              |
|--|-------------------|-----------|----------|--------------|
|  | Level 1           | Level 2   | Level 3  | Total        |
|  | NIS               | NIS       | NIS      | NIS          |
| <b>Financial assets held for trading</b>   |                   |           |          |              |
| Monetary funds and ETFs                    | 1,513             | -         | -        | 1,513        |
| Marketable securities                      | 1,183             | -         | -        | 1,183        |
| <b>Derivatives not used in hedging</b>     |                   |           |          |              |
| Forward contracts on foreign currencies    | -                 | 174       | -        | 174          |
| Forward contracts on CPI                   | -                 | (125)     | -        | (125)        |
| <b>Available-for-sale financial assets</b> |                   |           |          |              |
| Unmarketable shares                        | -                 | -         | 9        | 9            |
|  | <u>2,696</u>      | <u>49</u> | <u>9</u> | <u>2,754</u> |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 17 - Financial Instruments (cont'd)****E. Fair value (cont'd)****(2) Financial instruments measured at fair value (cont'd)**

|   | December 31, 2015 |           |              |            |
|---|-------------------|-----------|--------------|------------|
|   | Level 1           | Level 2   | Level 3      | Total      |
|   | NIS               | NIS       | NIS          | NIS        |
| <b>Financial assets held for trading</b>            |                   |           |              |            |
| Monetary funds and ETFs                             | 193               | -         | -            | 193        |
| Marketable securities                               | 1,011             | -         | -            | 1,011      |
| <b>Derivatives not used in hedging</b>              |                   |           |              |            |
| Forward contracts on foreign currencies             | -                 | 180       | -            | 180        |
| Forward contracts on CPI                            | -                 | (169)     | -            | (169)      |
| <b>Available-for-sale financial assets</b>          |                   |           |              |            |
| Unmarketable shares                                 | -                 | -         | 2            | 2          |
| Contingent consideration for a business combination | -                 | -         | (233)        | (233)      |
|   | <b>1,204</b>      | <b>11</b> | <b>(231)</b> | <b>984</b> |

- a. The fair value of investments in financial funds and ETFs is determined by reference to their average quoted selling price at the reporting date (level 1).
- b. The fair value of forward contracts on the CPI or foreign currency is based on discounting the difference between the price in the forward contract and the price of the present forward contract for the balance of the contract term until redemption, at an appropriate interest rate (level 2). The estimate is made under the assumption that a market participant takes into account the credit risks of the parties when pricing such contracts.
- c. Information about fair value measurement of contingent consideration in a business combination (Level 3)

Below is the fair value of the contingent consideration liability for a business combination, as described in Note 12B:

|  | December 31, 2015                                    |            |
|--|--|------------|
|  | Maximum additional consideration under the agreement | Fair value |
|  | NIS  | NIS        |
| Additional consideration for tax synergy (first additional consideration) (1)                  | 200  | 204        |
| Additional consideration for the business results of DBS (second additional consideration) (2) | 170  | 29         |
|  | <b>370</b>   | <b>233</b> |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 17 - Financial Instruments (cont'd)****E. Fair value (cont'd)****(2) Financial instruments measured at fair value (cont'd)****(1) First additional consideration**

The fair value of the additional first contingent consideration was calculated on the basis of the agreement in principle with the tax assessor for the scope of the carryforward losses of DBS as described in Note 12B above and it includes accrued interest.

**(2) Second additional consideration**

The fair value of the first additional consideration was estimated by the assessor, using the Monte Carlo simulation with risk neutral measure of the underlying asset which is the expected cash flow of DBS for 2016-2017.

**F. Offset of financial assets and liabilities**

The Group has agreements with various communication companies to supply and receive communication services. The table below presents the carrying amount of the balances as stated in the statement of financial position as at December 31, 2015:

|  | <b>December 31,</b> |             |
|--|---------------------|-------------|
|  | <b>2014</b>         | <b>2015</b> |
|  | <b>NIS</b>          | <b>NIS</b>  |
| Trade and other receivables, gross   | 151                 | 147         |
| Offset amounts   | (114)               | (115)       |
| Trade and other receivables presented in the statement of financial position | 37                  | 32          |
| Trade payables, gross  | 165                 | 157         |
| Offset amounts   | (114)               | (115)       |
| Trade and other payables presented in the statement of financial position    | 51                  | 42          |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 18 - Employee Benefits**

Employee benefits include post-employment benefits, other long-term benefits, termination benefits, short-term benefits and share-based payments. For details of share-based payments, see Note 28 below.

**A. Liabilities for employee benefits**

|  | December 31, |            |
|--|--------------|------------|
|  | 2014         | 2015       |
|  | NIS          | NIS        |
| <b>Current liabilities for:</b>                            |              |            |
| Holiday  | 86           | 104        |
| Sick leave   | 111          | 117        |
| Early retirement   | 55           | 150        |
| Current maturities of pensioner benefits                   | 7            | 7          |
| <b>Total current liability for employee benefits</b>       | <b>259</b>   | <b>378</b> |
| <b>Non-current liabilities for:</b>                        |              |            |
| Liability for pensioner benefits                           | 121          | 114        |
| Severance compensation (net) (see composition below)       | 48           | 55         |
| Early notice   | 20           | 16         |
| Pension  | 44           | 55         |
| <b>Total non-current liabilities for employee benefits</b> | <b>233</b>   | <b>240</b> |
| <b>Total liabilities for employee benefits</b>             | <b>492</b>   | <b>618</b> |
| <b>Composition of liabilities for severance pay:</b>       |              |            |
| Liabilities for severance pay                              | 215          | 221        |
| Fair value of plan assets                                  | (167)        | (166)      |
|  | 48           | 55         |

**B. Defined contribution plans**

- (1) Liabilities for employee benefits at retirement age in respect of the period of their service with Bezeq and its subsidiaries, and for employees to which Section 14 of the Severance Pay Law – 1963 applies, are covered in full by regular payments made by Bezeq and its subsidiaries to pension funds and insurance companies.

|   | Year ended December 31, |      |      |
|---|-------------------------|------|------|
|   | 2013                    | 2014 | 2015 |
|   | NIS                     | NIS  | NIS  |
| Amount recognized as an expense for a defined contribution plan | 182                     | 191  | 199  |

- (2) The pension rights of Bezeq's employees for the period of their employment in the civil service through January 31, 1985, are covered by a pension fund ("the Makefet Fund"), which assumed the obligations of State of Israel following an agreement between the Government of Israel, Bezeq, the General Federation of Laborers in Israel ("Histadrut") and the Makefet Fund.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 18 - Employee Benefits (cont'd)****B. Defined contribution plans (cont'd)**

- (3) Severance obligation to employees who will retire on terms entitling them to compensation is covered for the period from February 1, 1985 by on-going contributions to such pension funds and insurance companies (in accordance with Section 14 of the Severance Pay Law).

Severance pay for the period of employment in the civil service through January 31, 1985, is paid by Bezeq, and the sums accumulated in the Makefet Fund for that period are kept in a fund that will be used for the employees' rights.

- (4) For certain employees, Bezeq has an obligation to pay severance in excess of the amount accumulated on behalf such employees in the compensation fund. See section 18C(1) below.

**C. Defined benefit plans**

Obligations for defined benefit plans in the Group include the following:

- (1) Severance obligation for the balance of the obligation that is not covered by contributions and/or insurance policies in accordance with the existing labor agreements, the Severance Pay Law, and the salary components for which the management of the Bezeq Group believes entitle the employees to receive compensation. For this part of the obligation, there are deposits in the name of the Bezeq Group in pension funds and insurance companies. The deposits in pension funds and insurance companies include accrued linkage differences and interest. Withdrawal of the reserve sums is contingent upon fulfillment of the provisions in the Severance Pay Law.
- (2) An obligation in accordance with the collective agreement of 2006 for employees who were transferred from civil service to Bezeq and who are entitled following retirement to a supplement in pension payments for the difference between the Civil Service Law and the standard policy of Makefet. Bezeq also has an obligation to a number of senior employees who are entitled to early retirement terms (pension and retirement grants) which are not dependent on the existing retirement agreements for all employees.
- (3) An obligation in accordance with the employment agreements of some of the senior employees in the Bezeq Group for payment of a benefit for early termination notice.
- (4) Bezeq's retirees receive, in addition to pension payments, benefits which consist mainly of a holiday gift (linked to the dollar exchange rate), financing for the upkeep of retiree clubs and social activities. Bezeq's liability for these costs accumulates during the employment period. The Company's financial statements include the liabilities for expected costs in the post-employment period.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 18 - Employee Benefits (cont'd)****D. Other long-term employee benefits (Sick leave provision)**

The financial statements include a provision in respect of redemption and utilization of sick leave. The right to accumulate sick leave was taken into account for all employees in the Group. Only employees eligible under the terms of the employment agreement may redeem sick leave. The provision was computed on the basis of an actuarial calculation, including the assumption of positive accumulation of days by most of the employees and utilization of days in accordance with the last in first out (LIFO) method.

**E. Benefits for early retirement and termination in Bezeq**

According to the collective agreement of December 2006, between Bezeq and the employees union and the Histadrut, and according to the amendment to the agreement of December 2010, Bezeq may, at its discretion, terminate the employment of 163 permanent employees in each of the years 2010-2016 (Bezeq's right is cumulative for the period).

Bezeq recognizes expenses for early retirement when it is significantly committed, without any real possibility of withdrawal, to a defined plan to terminate employment before the defined date, according to a defined plan. The collective agreement allows Bezeq to dismiss employees, but does not create a significant commitment without any real possibility of withdrawal. Accordingly, Bezeq recognizes the expense for early retirement on the date the plan is approved by its Board of Directors, since only after the approval of its Board of Directors and publication of the decision, does Bezeq have a significant commitment without any real possibility of withdrawal.

In 2015, expenses of the early retirement plan amounted to NIS 117.

**F. Collective agreement at Pelephone**

Principal actuarial assumptions for defined benefit plans at the reporting date are as follows:

- (1) Mortality rates are based on the rates published in Insurance Circulars 2013-3-1 of the Ministry of Finance.
- (2) Churn rates were determined on the basis of the past experience of Bezeq and its subsidiaries, distinguishing between different employee populations and taking into account the number of years of employment. The churn rates include a distinction between severance with entitlement to full severance compensation and severance without entitlement to this right.
- (3) As of December 31, 2015, the real discount rate (nominal) is based on the yield of high quality corporate bonds linked to the Israeli CPI and with similar duration to that of the gross liability.

As of December 31, 2014, the real discount rate (nominal) is based on the yield of high quality corporate bonds linked to the Israeli CPI and with similar duration to that of the gross liability.



**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 18 - Employee Benefits (cont'd)****F. Collective agreement at Pelephone (cont'd)**

- (4) The main discount rates are as follows:

|                        | <b>December 31,<br/>2014</b>               | <b>December 31,<br/>2015</b>               |
|------------------------|--|--|
|                        | <b>Average<br/>capitalization<br/>rate</b> | <b>Average<br/>capitalization<br/>rate</b> |
|                        | <b>%</b>                                   | <b>%</b>                                   |
| Severance compensation | 3.7  | 4.1  |
| Retirement benefits    | 4.7  | 4.74                                       |

- (5) Assumptions regarding salary increments for calculation of the liabilities were made on the basis of the management's assessments, distinguishing between the groups of employees. The main assumptions (in nominal terms) regarding salary increases are as follows:

**Salary increase assumptions**

|                               |  |
|-------------------------------|--|
| Bezeq permanent employees     | Average update of 7% for young employees, decreasing gradually to 2.7% at the age of 66.   |
| New Bezeq permanent employees | Average update of 3.2% for young employees, decreasing gradually to 1.4% at the age of 66. |
| Bezeq non-permanent employees | 6.5% for young employees decreasing gradually to 0%, 3.5% for senior employees             |
| Pelephone employees           | An increase of 3.1% as from 2015, as set out in the collective agreement at Pelephone      |

Regarding Bezeq's employees, as well as the assumption of the age-dependent wage increase, an expected individual wage growth was assumed for 2016-2026, arising from the collective agreement that was signed in August 2015.

- (6) Sensitivity analysis for actuarial assumptions

Changes in the actuarial assumptions which are reasonably possible as at the reporting date are not expected to have a material effect on the liabilities for employee benefits.

- (7) Average weighted useful life of liabilities for the main severance benefits:

|                        | <b>Year ended December 31,</b> |              |
|------------------------|--------------------------------|--------------|
|                        | <b>2014</b>                    | <b>2015</b>  |
|                        | <b>Years</b>                   | <b>Years</b> |
| Severance compensation | 10.9                           | 10.2         |
| Retirement benefits    | 15.7                           | 14.4         |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 19 - Income Tax****A. Corporate tax rate**

The tax rate relevant to the Company was 25% in 2012 and 2013. As from January 1, 2014 until December 31, 2015, the rate of corporate tax was 26.5%.

As at December 31, 2015, deferred tax balances were calculated according to the tax rate expected to apply on the utilization date (26.5%).

On January 4, 2016, the Knesset plenum approved a bill to amend the Income Tax Ordinance, including a reduction in corporate tax by 1.5% from 26.5% to 25%, as from January 1, 2016. Consequently, in 2016, the Group expects to reduce the tax assets and liabilities for deferred taxes and recognize a net expense of NIS 32 for deferred taxes.

**B. Composition of income tax expenses (income)**

|                                  | Year ended December 31 |            |            |
|----------------------------------|------------------------|------------|------------|
|                                  | 2013                   | 2014       | 2015       |
|                                  | NIS                    | NIS        | NIS        |
| Current tax expense              | 576                    | 781        | 567        |
| Deferred tax income              | (55)                   | (126)      | (220)      |
| Adjustments for prior years, net | 3                      | 12         | -          |
| <b>Income tax expense</b>        | <b>524</b>             | <b>667</b> | <b>347</b> |

**C. Reconciliation between the theoretical tax on the pre-tax income and the tax expense**

|  | Year ended December 31 |            |            |
|--|------------------------|------------|------------|
|  | 2013                   | 2014       | 2015       |
|  | NIS                    | NIS        | NIS        |
| Income before income tax   | 1,384                  | 1,711      | 1,430      |
| Statutory tax rate   | 25%                    | 26.5%      | 26.5%      |
| Income tax at the statutory tax rate   | 346                    | 453        | 378        |
| Changes in tax rate and others   | 14                     | -          | -          |
| Expenses not recognized for tax purposes                                       | 23                     | (5)        | (13)       |
| Adjusted tax calculated for the Company's share in equity-accounted investees  | 63                     | 45         | (3)        |
| Recognition of deferred tax assets which were not recognized on prior periods  | -                      | -          | (112)      |
| Current year tax losses and benefits for which deferred taxes were not created | 75                     | 162        | 97         |
| Taxes in respect of previous years   | 3                      | 12         | -          |
| <b>Income tax expenses</b>   | <b>524</b>             | <b>667</b> | <b>347</b> |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 19 - Income Tax (cont'd)****D. Unrecognized deferred tax liabilities**

The calculation of deferred taxes does not take into account the taxes that would be applicable in the case of the sale of investments in subsidiaries and associates, since the Group intends to retain the investments. Deferred taxes in respect of a distribution of profit in subsidiaries and associates were also not taken into account since the dividends are not taxable.

**E. Unrecognized deferred tax assets and carry-forward tax loss**

As at December 31, 2015, the Company has tax loss carry-forwards in the amount of NIS 165 and capital loss carry forwards in the amount of NIS 325. In addition, the Company's subsidiaries have tax loss carry-forwards in the amount of NIS 299 and capital loss carry-forwards in the amount of NIS 33.

Deferred tax assets relating to carry-forward losses and tax benefits were not recognized because their utilization in the foreseeable future is not probable. The deductible temporary differences and tax losses do not expire under current tax legislation. Deferred tax assets have not been recognized in respect of these items since it is not probable that future taxable profit will be available against which the Group can utilize the benefits.

As a result, as at December 31, 2015, deferred taxes were not created on carry-forward tax losses and on carry-forward capital losses of the Company as detailed above.

On January 14, 2016, after the balance sheet date, The Company sold shares of B Communications (see note 12G2), as a result, The Company recognized deferred taxes due outside basis difference attributed to investment in B Communications in the amount of NIS 11.

On February 1, 2016, after the balance sheet date, B Communications sold shares of Bezeq (see note 1), as a result, B Communications recognized deferred taxes due outside basis difference attributed to its investment in Bezeq in the amount of NIS 101.

**F. Recognized deferred tax assets and liabilities**

Deferred tax assets and liabilities are attributable to the following items:

|   | Property,<br>plant<br>equipment,<br>and<br>intangible<br>assets | Employee<br>benefits<br>plan | Carry-<br>forward<br>losses for<br>DBS | Provisions | Carry-<br>forward tax<br>losses and<br>deferred<br>expenses<br>and other | Brand<br>Name and<br>Customers<br>relationship | Total |
|---|---|------------------------------|--|------------|--|--|-------|
|   | NIS   | NIS                          | NIS                                    | NIS        | NIS  | NIS  | NIS   |
| <b>Balance of deferred tax asset (liability) as at December 31, 2013</b>  | (466)   | 232                          | -                                      | 27         | 22   | (787)  | (972) |
| Recognized in profit or loss  | (8)   | (23)                         | -                                      | -          | 32   | 125  | 126   |
| Recognized in other comprehensive income                                  | -   | -                            | -                                      | -          | 11   | -  | 11    |
| <b>Balance of deferred tax assets (liability) as at December 31, 2014</b> | (474)   | 209                          | -                                      | 27         | 65   | (662)  | (835) |
| <b>Balance of deferred tax asset (liability) as at December 31, 2014</b>  | (474)   | 209                          | -                                      | 27         | 65   | (662)  | (835) |
| Recognized in profit or loss  | 52  | 1                            | (7)                                    | -          | 51   | 124  | 221   |
| Business combination  | -   | -                            | 1,426                                  | -          | 45   | (301)  | 1,170 |
| Recognized in other comprehensive income                                  | -   | -                            | -                                      | -          | 5  | -  | 5     |
| <b>Balance of deferred tax assets (liability) as at December 31, 2015</b> | (422)   | 210                          | 1,419                                  | 27         | 166  | (839)  | 561   |

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 19 - Income Tax (cont'd)****F. Recognized deferred tax assets and liabilities (cont'd)**

As at December 31, 2015 deferred taxes are presented in the statement of financial position as follows: under deferred tax assets 1,290 (December 31, 2014: nil) and under deferred tax liabilities NIS 729 (December 31, 2014: NIS 835).

**G. Final tax assessments**

- (1) The Company has final tax assessments up to and including 2012.
- (2) B Communications has final tax assessments up to and including 2009. On January 22, 2015, B Communications entered into a tax assessment agreement with the Israeli Tax Authority (the "Agreement"), with respect to final tax assessments with respect to: (i) tax years 2007-2009; and (ii) the sale of its legacy communications business that was completed on January 31, 2010. According to the Agreement, B Communications will pay the Israeli Tax Authority NIS 148, including interest and CPI linkage differences, in 24 monthly instalments starting in February 2015. The Agreement does not qualify as a final tax assessment for the tax year 2010 and any such final assessment will exclude the matters agreed upon in the Agreement. The financial statements include appropriate tax provisions to cover this resolution.
- (3) Bezeq has received final tax assessments up to and including 2005. In 2013, Bezeq signed an agreement with the tax assessor for 2006-2008, which includes undisputed income. In addition, a decision was received according to the best judgment of the tax assessor, whereby financing expenses accumulated on the shareholders' loans that Bezeq provided DBS should be added to Bezeq's undisputed income. Bezeq filed a reservation on this decision. The reservation was dismissed and on February 24, 2015, Bezeq received orders which it intends to appeal. For 2009-2010, a decision was reached according to the tax assessor's best judgment regarding the aforesaid, and regarding other matters, mainly non-recognition of financing expenses for various reasons. Bezeq filed a reservation on this decision. The reservation was dismissed and on March 30, 2016 Bezeq received orders from the tax authorities. This action will have no material effect on the financial statements. Subsequent to the date of the financial statements, Bezeq reached an agreement in principle with the assessor regarding payment of taxes in the amount of NIS 460 million on financing income that accrued up to December 31, 2015 on shareholders loans provided to DBS. In addition, it was agreed that the losses of DBS as at December 31, 2014, which will be recognized in a merger or offset from the income of DBS, will amount to NIS 5.4 billion and the balance of the shareholder loan will be considered as equity in the financial statements of DBS. The agreement in principle has not yet resulted in a signed agreement. The financial statements include an appropriate provision based on Bezeq estimates.
- (4) Pelephone has received final tax assessments up to and including 2012.
- (5) Bezeq International has received final tax assessments up to and including 2012.
- (6) DBS has received final tax assessments up to and including 2009.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 20 - Contingent Liabilities**

As at December 31, 2015, contingent liabilities only include contingent liabilities relating to the Bezeq Group.

In addition to pending claims, during the normal course of business, new legal claims were filed against Group companies (in this section: "Legal Claims").

In the opinion of the managements of the Bezeq Group companies, which is based, among other things, on legal opinions as to the likelihood of success of the claims, the financial statements (Note 15 above) include appropriate provisions, where provisions are required to cover the exposure resulting from such claims.

In the opinion of the management of each of the Bezeq Group companies, the additional exposure as at December 31, 2015, due to claims filed against the Group companies on various matters and which are unlikely to be realized, amounts to NIS 5.5 billion. There is also an additional exposure of NIS 4 billion for claims which the likelihood of realization 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.

These amounts 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 B below.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 20 - Contingent Liabilities (cont'd)**

A. Following is a detailed description of the Group's contingent liabilities at December 31, 2015, classified into groups with similar characteristics.

| <b>Claims group</b>   | <b>Nature of the claims</b>   | <b>Balance of provisions<br/>NIS</b> | <b>Amount of additional exposure<br/>NIS</b> | <b>Amount of exposure for claims for which the amount of exposure cannot be assessed<br/>NIS</b> |
|---|---|--------------------------------------|--|--|
| Claims of employees and former employees of Group companies | Mainly collective and individual claims filed by Bezeq employees and former Bezeq employees in respect of recognition of various salary components as components for calculation of payments to Bezeq employees, some of which have wide ramifications in Bezeq.  | 10                                   | 115  | -  |
| Customer claims   | Mainly motions for certification of class actions concerning contentions of unlawful collection of payment and impairment of the service provided by the Group companies.   | 52                                   | 3,112  | 4,083  |
| Supplier and communication provider claims                  | Claims for compensation for alleged damage as a result of the supply of the service and/or the product.   | 3                                    | 222  | 6  |
| Claims for punitive damages, real estate and infrastructure | Claims for alleged physical damage or damage to property caused by Bezeq Group companies and regarding real estate and infrastructure.<br><br>The additional amount of exposure for punitive damages does not include claims for which the insurance coverage is not disputed.  | 2                                    | 35   | -  |
| Claims by enterprises and companies                         | Claims alleging liability of the Bezeq Group companies in respect of their activities and/or the investments made in various projects.  | 11                                   | 2,047*                                       | -  |
| Claims by the State and authorities                         | Various claims by the State of Israel, government institutions and authorities ("the Authorities"). These are mainly procedures related to regulations relevant to the Bezeq Group companies and financial disputes concerning monies paid by the Group companies to the authorities (including property taxes) or by the authorities to the Group companies. | 19                                   | 15   | -  |
| <b>Total legal claims against Bezeq Group companies</b>     |   | <b>97</b>                            | <b>5,546</b>                                 | <b>4,089</b>   |

\* This sum includes a total exposure of NIS 2 billion for a claim filed by a shareholder against the Company and officers in the Company, which the plaintiff estimates at NIS 1.1 billion or NIS 2 billion (according to the method of calculating the damage to be determined).

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 20 - Contingent Liabilities (cont'd)****C. Subsequent customer claims**

Subsequent to the reporting date, a claim for NIS 839 was filed against Bezeq and officers of Bezeq. At the approval date of the financial statements, the exposure for these claims cannot yet be assessed. In addition, claims against Group companies with exposure of NIS 554.

**Note 21 - Agreements**

- A. The Group companies have operating lease agreements for land, property and vehicles used by them. The minimum future contractual rental payments during the next five years, calculated according to the rental fees in effect as at December 31, 2015, are as follows:

| <u>Year ended December 31</u> | <u>Real estate</u> | <u>Vehicles</u> | <u>Total</u> |
|-------------------------------|--------------------|-----------------|--------------|
|                               | <u>NIS</u>         | <u>NIS</u>      | <u>NIS</u>   |
| 2016                          | 238                | 132             | 370          |
| 2017                          | 227                | 104             | 331          |
| 2018                          | 174                | 62              | 236          |
| 2019                          | 139                | -               | 139          |
| 2020                          | 99                 | -               | 99           |
| 2021 onwards                  | 104                | -               | 104          |
|                               | <u>981</u>         | <u>298</u>      | <u>1,279</u> |

- B. In May 2013, Pelephone signed an agreement with Apple International ("Apple") for continued acquisition and distribution of iPhones in Israel. According to the agreement, under certain circumstances, Pelephone is required to purchase a minimum number of iPhones every year for an additional three years at the prices in effect on the actual purchase date. Pelephone believes that, similar to previous years, these quantities will constitute a substantial part of the quantities of iPhones that it expects to sell in the agreement period.
- C. Pelephone has obligations as of December 31, 2015 amounting to NIS 74 (as at December 31, 2014, NIS 95) to acquire terminal equipment.
- D. DBS has agreements for the acquisition of channels. In 2015, expenses for consumption of channels acquired by DBS amounted to NIS 287 million.
- E. For information about agreements for the acquisition of broadcast rights by DBS, see Note 11. For information about agreements for the purchase of property, plant and equipment, see Note 8 above.
- F. On October 26, 2015, the District Planning and Building Committee approved the validation of the outline plan for an area of 70 dunam (net) for warehouses and offices in Sagiya (near the Messubim junction). As at this date, Bezeq is entitled to receive this area in a capitalized lease contract for 49 years that commenced on March 22, 1993 with an option to extend for another 49 years, for no consideration. This right was granted to the Company under the settlement agreement of May 15, 2003 between Bezeq and the government of Israel and the Israel Lands Authority, which was given the force of a court ruling on March 10, 2004. Exercise of the right is subject to approval from the planning institutions for planning the complex, which was received on October 26, 2015.

As at the reporting date, the fair value of Bezeq's rights to the land is estimated at NIS 450.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 21 - Agreements (cont'd)**

- G. For information about agreements for undertakings to provide credit for 2016-2017, see Note 13D above.
- H. For information about agreements with related parties, including the agreement between DBS and Space Communications Ltd. for the lease of space segments, see Note 31.
- D. For agreements for the purchase of property, plant and equipment, see Note 8 above.

**Note 22 - Securities, Pledges and Guarantees**

- A. For securities, pledges and stipulations given by the Company and its subsidiaries in connection with loan covenants and borrowings see Note 13.
- B. The Bezeq Group companies have provided guarantees of NIS 190 in favor of the Ministry of Communications to secure the terms of their licenses (mostly linked to the US\$ exchange rate).
- C. The Bezeq Group companies have provided bank guarantees of NIS 92 in favor of third parties.
- D. For information about the conditions for loans and borrowings, see note 13.
- E. For information about the guarantee provided by Bezeq in respect of DBS's liability for Debentures (Series B) see Note 13C.

**Note 23 - Capital and Capital Reserves**

|   | <b>Authorized<br/>December 31<br/>2014 and 2015</b> | <b>Registered and<br/>paid up<br/>December 31<br/>2014 and 2015</b> |
|---|---|---|
|   | <b>Number of shares</b>                             |   |
| Ordinary shares of NIS 0.1 par value each | <b>501,000,000</b>                                  | <b>19,203,186</b>   |

As of December 31, 2015, 5,862,615 shares have been purchased according to a share buyback program which was authorized by the Company's Board of Directors.



**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 24 - Revenues**

|  | Year ended December 31 |       |       |
|--|------------------------|-------|-------|
|  | 2013                   | 2014  | 2015  |
|  | NIS                    | NIS   | NIS   |
| <b>Domestic fixed line communications</b>                      |                        |       |       |
| Fixed line telephony   | 1,908                  | 1,636 | 1,543 |
| Internet – infrastructure                                      | 1,283                  | 1,394 | 1,530 |
| Transmission and data communication                            | 794                    | 802   | 840   |
| Other services   | 220                    | 220   | 212   |
|  | 4,205                  | 4,052 | 4,125 |
| <b>Cellular</b>  |                        |       |       |
| Cellular services and terminal equipment                       | 2,744                  | 2,399 | 1,948 |
| Sale of terminal equipment                                     | 1,000                  | 966   | 884   |
|  | 3,744                  | 3,365 | 2,832 |
| <b>International communications, internet services and NEP</b> | 1,367                  | 1,425 | 1,487 |
| <b>Multi-channel television</b>                                | -                      | -     | 1,333 |
| <b>Others</b>  | 247                    | 213   | 208   |
|  | 9,563                  | 9,055 | 9,985 |

**Note 25 - Salaries**

|  | Year ended December 31 |       |       |
|--|------------------------|-------|-------|
|  | 2013                   | 2014  | 2015  |
|  | NIS                    | NIS   | NIS   |
| <b>Salaries and incidentals:</b>   |                        |       |       |
| Operating  | 1,741                  | 1,691 | 1,871 |
| General and administrative   | 591                    | 563   | 588   |
| Share-based payments   | 34                     | 1     | -     |
| <b>Total salaries and incidentals</b>  | 2,366                  | 2,255 | 2,459 |
| <b>Less – salaries recognized in investments in property, plant and equipment and in intangible assets</b> | 492                    | 484   | 499   |
|  | 1,874                  | 1,771 | 1,960 |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 26 - General and Operating Expenses\***

|  | Year ended December 31 |       |       |
|--|------------------------|-------|-------|
|  | 2013                   | 2014  | 2015  |
|  | NIS                    | NIS   | NIS   |
| Terminal equipment and materials                                       | 1,071                  | 928   | 880   |
| Interconnectivity and payments to domestic and international operators | 905                    | 847   | 909   |
| Maintenance of buildings and sites                                     | 607                    | 639   | 616   |
| Marketing and general expenses   | 624                    | 608   | 649   |
| Services and maintenance by sub-contractors                            | 162                    | 137   | 199   |
| Vehicle maintenance expenses   | 152                    | 154   | 167   |
| Content services expenses  | 65                     | 58    | 458   |
|  | 3,586                  | 3,371 | 3,878 |

\* Less expenses of NIS 63 recognized in 2015 for investments in property, plant and equipment and intangible assets (in 2014, NIS 63 and in 2013, NIS 64).

**Note 27 - Other operating Expenses (income), net**

|  | Year ended December 31 |       |       |
|--|------------------------|-------|-------|
|  | 2013                   | 2014  | 2015  |
|  | NIS                    | NIS   | NIS   |
| Provision for severance pay in early retirement        | 90                     | 176   | 117   |
| Profit from the sale of Coral Tell shares              | -                      | (582) | -     |
| Capital gain from sale of property plant and equipment | (102)                  | (124) | (136) |
| Others   | 69                     | (5)   | 22    |
|  | 57                     | (535) | 3     |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 28 - Financing Expenses (Income)**

|  | Year ended December 31 |              |              |
|--|------------------------|--------------|--------------|
|  | 2013                   | 2014         | 2015         |
|  | NIS                    | NIS          | NIS          |
| Interest and linkage differences from loans to an associate                            | (226)                  | (213)        | (28)         |
| Income on bank deposits, investments and others  | (52)                   | (40)         | (17)         |
| Change in fair value of financial assets measured at fair value through profit or loss | (63)                   | (247)        | (27)         |
| Income in respect of credit in sales, net of discount commission                       | (122)                  | (84)         | (52)         |
| Other financing income   | (72)                   | (51)         | (40)         |
| <b>Total financing income</b>  | <b>(535)</b>           | <b>(635)</b> | <b>(164)</b> |
| Interest expenses on financial liabilities   | 707                    | 896          | 695          |
| Linkage and exchange rate differences, net   | 112                    | 333          | 61           |
| Change in fair value of financial assets measured at fair value through profit or loss | 24                     | 27           | 13           |
| Financing expenses for employee benefits, net  | 15                     | 21           | 16           |
| Reduction of the provision for assessor interest expenses                              | -                      | -            | (76)         |
| Financing expenses for dividends payable   | 22                     | -            | -            |
| Other financing expenses   | 51                     | 52           | 50           |
| <b>Total financing expenses</b>  | <b>931</b>             | <b>1,329</b> | <b>759</b>   |
| <b>Financing expenses, net</b>   | <b>396</b>             | <b>694</b>   | <b>595</b>   |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 29 - Share-Based Payments****Bezeq's share-based payments**

As at December 31, 2015, Bezeq has one option plan settled in shares through a net exercise mechanism. All of the options that were granted are non-marketable and the exercise price is adjusted to changes in equity and distribution of dividends. Below are additional details.

| <b>Name of plan</b>          | <b>Number of options granted (before forfeitures and exercise)</b> | <b>Number of options in circulation as at December 31, 2015</b> | <b>Weighted average of exercise price as at December 31, 2015</b> | <b>Weighted average of remaining contractual life</b> |
|------------------------------|--|---|---|---|
|                              | <b>In thousands</b>  |   | <b>NIS*</b>   |   |
| Employee option plan of 2010 | 69,495   | 4,347   | 2.72  | One month   |

In 2015, 27 million options were exercised, for which Bezeq issued 19 million ordinary shares of NIS\* 1 par value each.

\* Represent single NIS.

**Note 30 - Earnings (Loss) per Share**

The calculation of basic and diluted earnings per share was based on income (loss) attributable to ordinary shareholders, and on a weighted average number of ordinary shares outstanding, calculated as follows:

|   | <b>Year ended December 31</b>     |                                   |                                   |
|---|-----------------------------------|-----------------------------------|-----------------------------------|
|   | <b>2013</b>                       | <b>2014</b>                       | <b>2015</b>                       |
|   | <b>NIS</b>                        | <b>NIS</b>                        | <b>NIS</b>                        |
| <b>Loss attributable to ordinary Shareholders</b>                             |                                   |                                   |                                   |
| Basic profit (loss) for the year  | 26                                | (103)                             | 87                                |
| Effect of diluted per share loss in a subsidiary                              | (1)                               | (3)                               | (1)                               |
| Diluted profit (loss) for the year  | 25                                | (106)                             | 86                                |
|   | <b>Year ended December 31</b>     |                                   |                                   |
|   | <b>2013</b>                       | <b>2014</b>                       | <b>2015</b>                       |
|   | <b>Thousands of shares of NIS</b> | <b>Thousands of shares of NIS</b> | <b>Thousands of Shares of NIS</b> |
|   | <b>0.1</b>                        | <b>0.1</b>                        | <b>0.1</b>                        |
|   | <b>par value</b>                  | <b>par value</b>                  | <b>par value</b>                  |
| Weighted average number of ordinary shares at December 31 (basic and diluted) | 19,203                            | 19,203                            | 19,203                            |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 31 - Transactions with Related Parties****A. Identity of related parties**

The Company's related parties are as defined in IAS 24 (2009)- Related Party Disclosures and include: parent company - Eurocom, and other Eurocom Group companies, related parties of Eurocom, directors and key management personnel in the Company, the Eurocom Group companies and persons who are close to a family member of any of these individuals.

In the ordinary course of business, some of the Company's subsidiaries and affiliates engage in business activities with each other. Such business activities are primarily between Bezeq, or Bezeq subsidiaries and between other Eurocom Group companies, such as Eurocom Digital Communications, Eurocom Cellular Communications, Space Communications, Gilat Satcom, Satlink Communications, and to a lesser extent other affiliated companies.

Such business activities primarily relate to the provision, purchase or sale of communications or digital services and products, including, the provision of related satellite or broadcasting services, cellular and electronic products and equipment, and Internet and telephony services.

The transactions among these related parties are made at prices and on terms equivalent to those charged in transactions with unrelated parties under similar conditions.

Ordinary course of business transactions are aggregated in this Note. This Note also includes detailed descriptions of material related party transactions.

**B. Balances with related parties**

|   | December 31, |       |
|---|--------------|-------|
|   | 2014         | 2015  |
|   | NIS          | NIS   |
| Receivables - associates, net                     | 15           | 9     |
| Loans to an associate, see section C below*       | 2,181        | -     |
| Liabilities to related parties, net **            | (41)         | (17)  |
| Liability to Eurocom for contingent consideration | -            | (233) |

(\*) Bezeq provided a shareholder loan to DBS between 1999 and 2005. As from the date of acquisition of control in DBS as described in Note 12B above and consolidation of the financial statements of DBS in the Group's consolidated financial statements, these loans are not shown in the statement of financial position.

(\*\*) The amounts are for parent company Eurocom, and their related parties.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 31 - Transactions with Related Parties (cont'd)****C. Transactions with related parties**

|  | <b>Year ended December 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2013</b>                    | <b>2014</b> | <b>2015</b> |
|  | <b>NIS</b>                     | <b>NIS</b>  | <b>NIS</b>  |
| <b>Revenues</b>  |                                |             |             |
| From associates (including interest income in respect of shareholders' loans)* | 246                            | 229         | <b>30</b>   |
| From related parties **  | 8                              | 9           | <b>10</b>   |
| <b>Expenses</b>  |                                |             |             |
| To related parties **  | 128                            | 121         | <b>129</b>  |
| To associates  | 7                              | 1           | <b>3</b>    |
| <b>Investments</b>   |                                |             |             |
| Related parties **   | 66                             | 76          | <b>76</b>   |
| Acquisition of DBS   | -                              | -           | <b>913</b>  |

\* Revenues from associates are include mainly finance income from shareholders loans to DBS, see note 12B.

\*\* The amounts are for parent company Eurocom and its related parties.

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 31 - Transactions with Related Parties (cont'd)****D. Transactions listed in section 270(4) of the Companies Law**

| <b>Approval date of the general meeting (after approval of Bezeq's audit committee and Board of Directors)</b>   | <b>Nature of the transaction</b>   | <b>Amount of the transaction</b>  |
|--|--|---|
| Approved by Bezeq's Board of Directors on April 25, 2013 in accordance with the Companies Regulations (Relief in Transactions with Interested Parties), 2000 ("the Relief Regulations for Transactions with Interested Parties") | Extension of the arrangements approved at Bezeq's general meeting on October 14, 2010, between Bezeq and DBS and between Bezeq International and DBS for reciprocal marketing of products and services until December 31, 2015.  | The fees to be paid by the parties to each other will be in accordance with the criteria approved by the general meeting as part of the original approval for the agreement.  |
| May 8, 2013  | Approval of Bezeq's vote at the general meeting of DBS in favor of DBS's agreement with Space Communications Ltd. ("Space Communications") for leasing space segments, in which the original agreement will be amended and extended. The agreement is valid until the end of 2028.           | Total amount of up to USD 227 (net including discounts for satellite segments leased in the existing agreement).  |
| June 13, 2013  | The amendment to Bezeq's three-year agreement with Eurocom Communications Ltd. ("Eurocom Communications") for ongoing management and consultation services valid until May 31, 2016, unless one of the parties announces its intention to terminate the agreement with three months' notice. | NIS 5.5 per year.   |
| Approved by Bezeq's Board of Directors on November 6, 2013 in accordance with the relief regulations for transactions with interested parties  | Amendment to and extension of DBS's agreement with Eurocom and ADB for acquisition of yesMaxTotal3 converters.   | The total cost will be USD 10 per year.   |
| January 27, 2014   | Approval of Bezeq's vote at the general meeting of DBS in favor of DBS's agreement with Eurocom and ADB for the acquisition of an additional quantity of yesMaxTotal converters and power supplies for yesMax HD converters, until June 30, 2015.  | For converters: at a total cost of USD 14; there is an additional 2.42% of additional cost for the hard drive only, if there are changes due to an increase in hard drive prices.<br><br>For power supplies: at a total cost of USD 197 thousand. |
| Approved by Bezeq's Board of Directors on February 27, 2014 in accordance with the relief regulations for transactions with interested parties   | Approval of the extension of supplier credit terms in accordance with the agreement between DBS and Space Communications Ltd. for lease of space segments, up to December 31, 2014.  | NIS 920 thousand.   |
| Approved by Bezeq's Board of Directors on November 27, 2014 in accordance with the relief regulations for transactions with interested parties   | Approval of the extension of supplier credit terms in accordance with the agreement between DBS and Space Communications for lease of space segments, up to December 31, 2015.   | NIS 874 thousand.   |

**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 31 - Transactions with Related Parties (cont'd)****D. Transactions listed in section 270(4) of the Companies Law (cont'd)**

| <b>Approval date of the general meeting (after approval of Bezeq's audit committee and Board of Directors)</b> | <b>Nature of the transaction</b>  | <b>Amount of the transaction</b>   |
|--|---|--|
| January 14, 2015   | Approval of Bezeq's vote at the general meeting of DBS in favor of DBS's agreement with Eurocom and ADB for the order of an additional quantity of yesMaxTotal converters, until December 31, 2015.   | A total cost of USD 12 and an additional price of up to 1.9% for the cost of the hard drive only, if there are changes due to an increase in hard drive prices.  |
| March 23, 2015   | Acceptance of the terms established by the Antitrust Commissioner in his approval of the merger on March 26, 2014, both by Bezeq and by DBS (in the context of Bezeq's vote in the general meeting of DBS) and announcement of the exercise, at no cost, of Bezeq's option for the allotment from DBS of 6,221 shares of DBS, representing 8.6% of the share capital of DBS. Bezeq's engagement in an acquisition agreement with Eurocom DBS was also approved, whereby Bezeq will acquire the entire holdings of Eurocom DBS in DBS shares and all the shareholder loans provided by Eurocom DBS to DBS. | The total cost is comprised of: a) total cash of NIS 680; b) total cash of up to NIS 200, subject to certain conditions; c) total cash of up to NIS 170, subject to certain conditions. For additional information about the conditions relating to b and c, see Note 12B above. |
| October 19, 2015   | Approval of Bezeq's vote at the general meeting of shareholders of DBS in favor of DBS's agreement with Eurocom and ADB for the order of yesMaxTotal3 converters, under the existing agreement, until December 31, 2017   | Total cost of USD 14 million   |
| December 8, 2015   | Amendment to the framework agreement between Pelephone and Eurocom Cellular Communications Ltd., so that it will be extended to other products and brands, including related services for all products and its extension until December 31, 2018 (or three years after the acquisition date of any additional products or brands, whichever is earlier).  | Annual scope of up to NIS 50 million (for all the products)  |



**Notes to the Consolidated Financial Statements**

(All amounts are in millions except where otherwise stated)

**Note 31 - Transactions with Related Parties (cont'd)****D. Transactions listed in section 270(4) of the Companies Law (cont'd)**

The financial value of the transactions described above, which were carried out in 2015 were as follows:

|                              | <b>Amounts<br/>included in the<br/>consolidated<br/>financial<br/>statements<br/>NIS</b> |
|------------------------------|--|
| Expenses                     | <b>105</b>   |
| Property plant and equipment | <b>46</b>  |
| Acquisition of DBS           | <b>913</b>   |

**E. Agreements with the Eurocom Group and B Communications****1. Registration rights agreement with B Communications**

B Communications entered into a registration rights agreement with the Company granting it the right to demand registration of the ordinary shares it owns under the Securities Act of 1933, as amended. Under the registration rights agreement, B Communications has granted to the Company “demand” registration rights that allow it to request that B Communications register under the Securities Act of 1933, as amended, some or all of its ordinary shares. The Company is entitled to an aggregate of five demand registrations. B Communications is not required to affect any demand registration unless such demand registration is for a number of ordinary shares with a market value that is equal to at least US\$ 7.5. B Communications is also not required to affect more than one demand registration during any 12-month period thereafter. B Communications is not obligated to grant a request for a demand registration within 90 days of any other demand registration.

The Company also has “piggyback” registration rights that allow it to include B Communications' ordinary shares it owns in any public offering of equity securities initiated by B Communications (other than those public offerings pursuant to registration statements on Forms F-4, S-8 or any other successor forms). B Communications have also granted the Company the right to request a shelf registration on Form F-3, provided that B Communications will be eligible to utilize a registration statement on such form, providing for an offering to be made on a continuous basis but for no longer than one year without the consent of our audit committee.

Under the registration rights agreement B Communications agreed to indemnify the Company against any losses or damages resulting from any untrue statement or omission of material fact in any registration statement or prospectus pursuant to which the Company sell ordinary shares, unless such liability arose in reliance upon and in strict conformity with information furnished in writing from the Company. B Communications will pay all expenses incident to any demand registration, and the Company will pay its respective portions of all underwriting discounts, commissions and fees attributable to the sale of its ordinary shares the Company owns under the registration rights agreement.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 31 - Transactions with Related Parties (cont'd)****E. Agreements with the Eurocom Group and B Communications (cont'd)****2. Ordinary Transactions with the Eurocom Group**

B Communications and the Company lease their principal offices from Eurocom Communications Ltd. for an annual rent of NIS 59 thousand for each company. In addition, Eurocom Communications Ltd. provides the Company and B Communications with legal services in an annual sum of NIS 96 thousand for each company. In addition, Eurocom Real Estate Ltd. provides B Communications and the Company with parking spaces for NIS 8 thousand a year for each company. Eurocom Digital Communications Ltd. provides B Communications and the Company with additional services, such as computing services and car maintenance for an annual sum of NIS 12 thousand for each company.

**3. Financial service agreement with Eurocom Capital Finance Ltd.**

In February 2008, the Company entered into an execution services agreement with Eurocom Capital Finance Ltd. which is controlled by Mr. Shaul Elovitch, its controlling shareholder and the chairman of the Board of Directors, under which Eurocom Capital Finance Ltd. provides the Company with various financial services. Under the agreement, Eurocom Capital Finance Ltd. handles the execution of the Company's financial investments pursuant to direct instructions from its Chief Executive Officer, which is based on a policy that was established by its management and approved by the Board of Directors. In consideration for these services, the Company agreed to pay Eurocom Capital Finance Ltd. fees which are customary for such agreements and on market terms. The Company paid Eurocom Capital Finance Ltd. aggregate fees of approximately NIS 345 thousand, NIS 615 thousand and NIS 433 thousand for its services in the years 2013, 2014 and 2015, respectively.

**4. Management services agreements**

B Communications entered into an arrangement with Eurocom Communications Ltd. and the Company, according to which the Company's Chief Executive Officer, Mr. Doron Turgeman will provide management services to B Communications, the Company and Eurocom Communications Ltd. In consideration for such services, each of Eurocom Communications, B Communications and the Company will bear 33% of Mr. Turgeman services costs.

**5. Other agreements**

In addition, the Company receives and renders various services and products to and from related parties at market rates and in the ordinary course of business. None of these transactions are material to the Company or to its related parties. If a related party wishes to supply products or services to the Company, the Company obtains a bid from a third party to enable it to determine whether the related party's bid is on arm's-length terms. Any of such transactions are subject to the approval of the Company's Audit Committee and its board of directors (and its shareholders, if required). In addition, the Company does not purchase a particular type of product or service solely from related parties, but through other non-related vendors as well. Prices offered by non-related vendors are compared to those offered by related parties to ensure that the related parties are offering arm's length terms.

**Notes to the Consolidated Financial Statements**

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(All amounts are in millions except where otherwise stated)

**Note 31 - Transactions with Related Parties (cont'd)****F. Key management personnel compensation (including directors)**

Key management personnel compensation comprised:

|                   | <b>Year ended December 31</b> |             |             |
|-------------------|-------------------------------|-------------|-------------|
|                   | <b>2013</b>                   | <b>2014</b> | <b>2015</b> |
|                   | <b>NIS</b>                    | <b>NIS</b>  | <b>NIS</b>  |
| Employee benefits | <u>2</u>                      | <u>2</u>    | <u>2</u>    |

## SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

INTERNET GOLD – GOLDEN LINES LTD.

By: /s/ Doron Turgeman  
Doron Turgeman  
Chief Executive Officer

By: /s/ Itzik Tadmor  
Itzik Tadmor  
Principal Financial Officer

Dated: April 18, 2016

## LIST OF SUBSIDIARIES

| Name  | Place of Incorporation | Percentage of Ownership |
|---|------------------------|-------------------------|
| B Communications Ltd.   | Israel                 | 64.78%                  |
| Subsidiaries of B Communications Ltd.                         |                        |                         |
| Bezeq - The Israel Telecommunications Corp. Ltd. (TASE: BZEQ) | Israel                 | 26.34%                  |
| B Communications (SP1) Ltd.                                   | Israel                 | 100%                    |
| B Communications (SP2) Ltd.                                   | Israel                 | 100%                    |

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER**  
**Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended**

I, Doron Turgeman, certify that:

1. I have reviewed this annual report on Form 20-F of Internet Gold-Golden Lines Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent function):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: April 18, 2016

/s/Doron Turgeman\*  
 Doron Turgeman  
 Chief Executive Officer

\* The originally executed copy of this Certification will be maintained at the Company's offices and will be made available for inspection upon request.

**CERTIFICATION OF CHIEF FINANCIAL OFFICER**  
**Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended**

I, Itzik Tadmor, certify that:

1. I have reviewed this annual report on Form 20-F of Internet Gold-Golden Lines Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent function):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: April 18, 2016

/s/Itzik Tadmor\*  
 Itzik Tadmor  
 Principal Financial Officer

\* The originally executed copy of this Certification will be maintained at the Company's offices and will be made available for inspection upon request.

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the annual report of Internet Gold-Golden Lines Ltd. (the "Company") on Form 20-F for the period ending December 31, 2015 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Doron Turgeman, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/Doron Turgeman\*  
Doron Turgeman  
Chief Executive Officer

April 18, 2016

\* The originally executed copy of this Certification will be maintained at the Company's offices and will be made available for inspection upon request.

This certification accompanies this Annual Report on Form 20-F pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Company specifically incorporates it by reference.



**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the annual report of Internet Gold-Golden Lines Ltd. (the "Company") on Form 20-F for the period ending December 31, 2015 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Itzik Tadmor, Principal Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Itzik Tadmor\*  
Itzik Tadmor  
Principal Financial Officer

April 18, 2016

\* The originally executed copy of this Certification will be maintained at the Company's offices and will be made available for inspection upon request.

This certification accompanies this Annual Report on Form 20-F pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Company specifically incorporates it by reference.

The Board of Directors  
Internet Gold Golden Lines Ltd.

We consent to the incorporation by reference in the registration statement (No. 333-208404) on Form F-3 of Internet Gold Golden Lines Ltd. of our report dated April 18, 2016, with respect to the consolidated statements of financial position of Internet Gold Golden Lines Ltd. as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for each of the years in the three-year period ended December 31, 2015, which report appears in the December 31, 2015 annual report on Form 20-F of Internet Gold Golden Lines Ltd.

/s/Somekh Chaikin  
Somekh Chaikin  
Certified Public Accountants (Israel)  
Member Firm of KPMG International

Tel Aviv, Israel  
April 18, 2016